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BY EMAIL: Armaguard-Prosegur-Merger@accg.gov.au

Bruce Mikkelsen
General Manager (A/g)
Merger Investigations
Australian Competition and Consumer
Commission



Dear Mr Mikkelsen

Armaguard/Prosegur – response to ACCC's market inquiries

We write in response to your letter of 6 October 2022 seeking views from interested parties in relation to the proposed transaction between Armaguard and Prosegur.

We act for an interested third party and have been instructed to assist with its response to the Commission's market inquiries letter dated 6 October 2022, seeking views from interested parties in relation to the proposed transaction between Linfox Armaguard Pty Ltd (**Armaguard**) and Prosegur Australia Holdings Pty Limited (**Prosegur**) (**Proposed Transaction**).

Our client is concerned that the Proposed Transaction will substantially lessen competition in one or more markets in Australia and that any public benefits arising from the transaction will be outweighed by the significant public detriments arising from allowing the only two national suppliers of cash-in-transit (**CIT**) services to combine.

Our client urges the Commission to not authorise the Proposed Transaction.

Our client's relationship with the merger parties

Our client operates a multi-store retail chain with sites located in multiple States and Territories across Australia. Our client's stores market and sell a range of consumer goods and services.

One of the merger parties in the Proposed Transaction supplies CIT services to our client under a services agreement. The merger party delivers coins and small denomination notes to, and picks up large denomination notes from, our client's stores.

In addition, our client also acquires ATM services and has an indirect relationship with one of the merger parties in relation to those services.

Concerns about the effect of the Proposed Transaction on competition in CIT services

Our client is very concerned that the Proposed Transaction will combine the only two national suppliers of CIT services and remove from the market the competition that would otherwise continue to exist in the absence of the transaction.

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A lack of competitive tension

Our client has previously sought bids for CIT services. Our client relied on the competitive tension between Armaguard and Prosegur to obtain a significant reduction in the price for CIT services from one of the merger parties compared to its previous contract for CIT services with one of the merger parties. In running this tender process, our client determined that Armaguard and Prosegur were the only suitable suppliers for this contract.

Although our client was aware of some smaller, niche suppliers of CIT suppliers, such suppliers were not considered suitable alternatives to Prosegur and Armaguard because, among other things, they would not have the capacity to service our client's network of stores.

If the Proposed Transaction proceeds, there is unlikely to be a viable alternative to the merged entity, particularly for customers that require integrated CIT services nationally. Our client expects that this will lead to higher prices, lower service levels, less innovation and increased security risks – not only on the next occasion our client tenders for CIT services but also for the remainder of the existing contract with one of the merger parties, in respect of which:

- (a) the merging party will have little or no incentive to improve pricing or performance; and
- (b) a long and expensive breach of contract claim by our client (even if it were to rise to that) would be unlikely to be a commercially rational response.

Little or no constraint from the threat of new entry or expansion

A combined Armaguard/Prosegur would be highly unlikely to be constrained by the threat of new entry or expansion.

On the one hand, the parties claim that the proposed transaction is necessary because a two player market is unsustainable and that an exit by one of the parties is inevitable. Yet, on the other hand, they claim that the threat of new entry would constrain the merged firm. It is not apparent how these two positions can be reconciled.

In any case, our client is not aware of new entry in the supply of CIT services in recent years and has no reason to expect that new entry or expansion by a supplier with the capability to service our client's network of stores will occur in a timely manner.

In-sourcing of cash delivery is commercially unrealistic

The merger parties also claim that customers could in-source cash delivery. Our client has never considered in-sourcing cash delivery between sites as an acceptable alternative. Our client does not possess the equipment, infrastructure or expertise to provide the services internally and in-sourcing would likely expose our client and its employees to significant safety and security risks.

Further, even if this was a realistic option for our client and other customers of the merger parties, such an outcome would undermine many of the merger parties' claims about the benefits of the transaction (avoidance of disruption, de-duplication, economic efficiency, reduction in carbon footprint etc) should customers need to individually obtain their own infrastructure, staff, processes and expertise to provide such services internally.

Lack of countervailing power

The merger parties claim that customers have countervailing power which will constrain the merged entity.

The presence of countervailing power relies on the party said to have that power having reasonable alternatives to by-pass the merged entity. Our client is a sizeable company in Australia but will have no reasonable alternatives to the merged entity if the Proposed Transaction proceeds and will be forced to accept whatever terms the merged entity offers for CIT services when its current contract with one of the merger parties expires (and, by and large, whatever level of performance or non-performance is delivered under its existing contract). Ceasing to provide customers with the option to conduct cash transactions in its stores would be damaging to our client's business and would adversely affect its customers.

'Threat' of RBA regulation is speculative

The merger parties also claim that the Reserve Bank of Australia (**RBA**) will competitively constrain the merged entity because it has certain regulatory powers to intervene to protect the cash system. Our client considers that the threat of regulatory intervention is speculative and our client doubts the RBA would intervene in respect of price rises and reductions in service levels that do not pose a threat to the cash system.

The claimed counterfactual ignores other viable options

The merger parties submit that the Proposed Transaction will avoid the consequences of a 'disorderly exit' from the market by one of the parties. Even if the exit of one of Prosegur or Armaguard is inevitable (in respect of which claim the Commission should be sceptical) the Proposed Transaction would:

- (a) appear to bring forward such an exit by a number of years, depriving customers of Prosegur and Armaguard of the benefits of competition during that period;
- (b) deprive potential future acquirers of the opportunity to acquire the business of an exiting Prosegur or Armaguard, to provide a viable competitive alternative to the remaining supplier of CIT services; and
- (c) be very likely to crystallise in the market for CIT services a structure that entrenches a monopoly supplier, increasing barriers to successful entry by any other potential supplier.

In our client's view, the appropriate response to difficult competitive conditions is for each of Armaguard and Prosegur to find ways to reduce costs, increase efficiency and innovate – not to seek to remove competition from the market. Our client considers that the more likely outcome than one of the parties ceasing to operate is that it will be acquired by a third party, potentially at a price that is much less favourable to the merger parties than the price negotiated between them for the current transaction. That third party would be keenly incentivised to 'right-size' the business.

Our client also notes that should either Prosegur or Armaguard, or their respective businesses, be on the verge of failure, or placed into administration, the other party will likely have the opportunity to engage with the ACCC on a potential acquisition of the business or assets of the other party at that time. Our client has seen no evidence that such failure is imminent for either party.

The merger parties claim that the rationale for the Proposed Transaction is to create a financially sustainable business with an efficient cost base which is able to invest in innovative, safe and efficient infrastructure and technology to support the availability of, and continued access to, cash in Australia on safe and secure terms.

But there is no explanation (or even attempt at an explanation) from the merger parties as to exactly why or how a merger to monopoly would create any incentive to do any of those things.

What will prevent a merged Armaguard/Prosegur from increasing pricing to the level just below that which might incentivise entry – but giving not a skerrick of improved service to its customers in return? A merger to monopoly almost always results in a less efficient, less motivated service provider that is able to 'charge more and give less' and the merger parties have not provided any compelling evidence that is not the case here. The removal of the only source of competitive constraint on the combined firm will likely see a *reduction* in investment in innovation, technology and infrastructure, not an *increase*.

Our client is also concerned that the Proposed Transaction will harm competition in the supply of non-CIT services, including because competition among large national providers deploying, servicing and maintaining ATMs will be substantially diminished.

The public detriments from the proposed acquisition will outweigh any minor public benefits

Our client considers that the majority of the public benefits listed in the merger parties' application for merger authorisation are unlikely to arise as a natural consequence of the Proposed Transaction.

Our client accepts that there is likely to be a small reduction in the carbon footprint of the merged entity if it reduces the number of vehicles used to provide CIT services, but such reduction is minor compared to the number of vehicles on the road and not sufficient to weigh materially in the balancing of public benefits and detriments.

The Proposed Transaction will, however, likely give rise to substantial public detriments including:

- (a) increases (and likely substantial increases) in prices for CIT and non-CIT services, in circumstances where such price rises are likely to be passed through to consumers in the form of higher retail prices;
- (b) lower levels of service and quality in the provision of CIT and non-CIT services. For example, the merged firm may reduce the frequency with which it is willing to collect and deliver cash or stop supplying services to rural and remote locations which are more costly to service;
- (c) lower levels of safety and security. For example, the merged firm might reduce the number of staff on duty or fail to upgrade equipment as frequently, putting at risk not only its own staff but the staff and customers of our client; and
- (d) less and/or slower innovation in the supply of CIT and non-CIT services.

The significant detriments arising from the Proposed Transaction will outweigh any benefits, which our client contends will be immaterial.

Conclusion

The Proposed Transaction is highly likely to substantially lessen competition in the supply of CIT services and non-CIT services in Australia. It is also highly likely to generate other, substantive public detriments, as a result of the loss of competition. On the other hand, the Proposed Transaction is unlikely to result in material public benefits – as claimed by the merger parties or otherwise.

Customers of the merger parties are rightly concerned about the Proposed Transaction. But it is Australian consumers who will ultimately bear the consequences of the reduction in competition when, inevitably, higher prices for CIT services are passed through to consumers in the form of higher prices for retail goods and services.

Our client submits that the Commission should not authorise the Proposed Transaction.

Our client is willing to assist the Commission should the Commission require any further information to facilitate its review of the Proposed Transaction. Please let us know in due course if it would be useful to discuss our client's concerns.

Yours sincerely



Ross Zaurini
Partner