



ACCC's authorisation of Linfox/Prosegur

A presentation for the Competition Law Discussion
Group

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21 September 2023

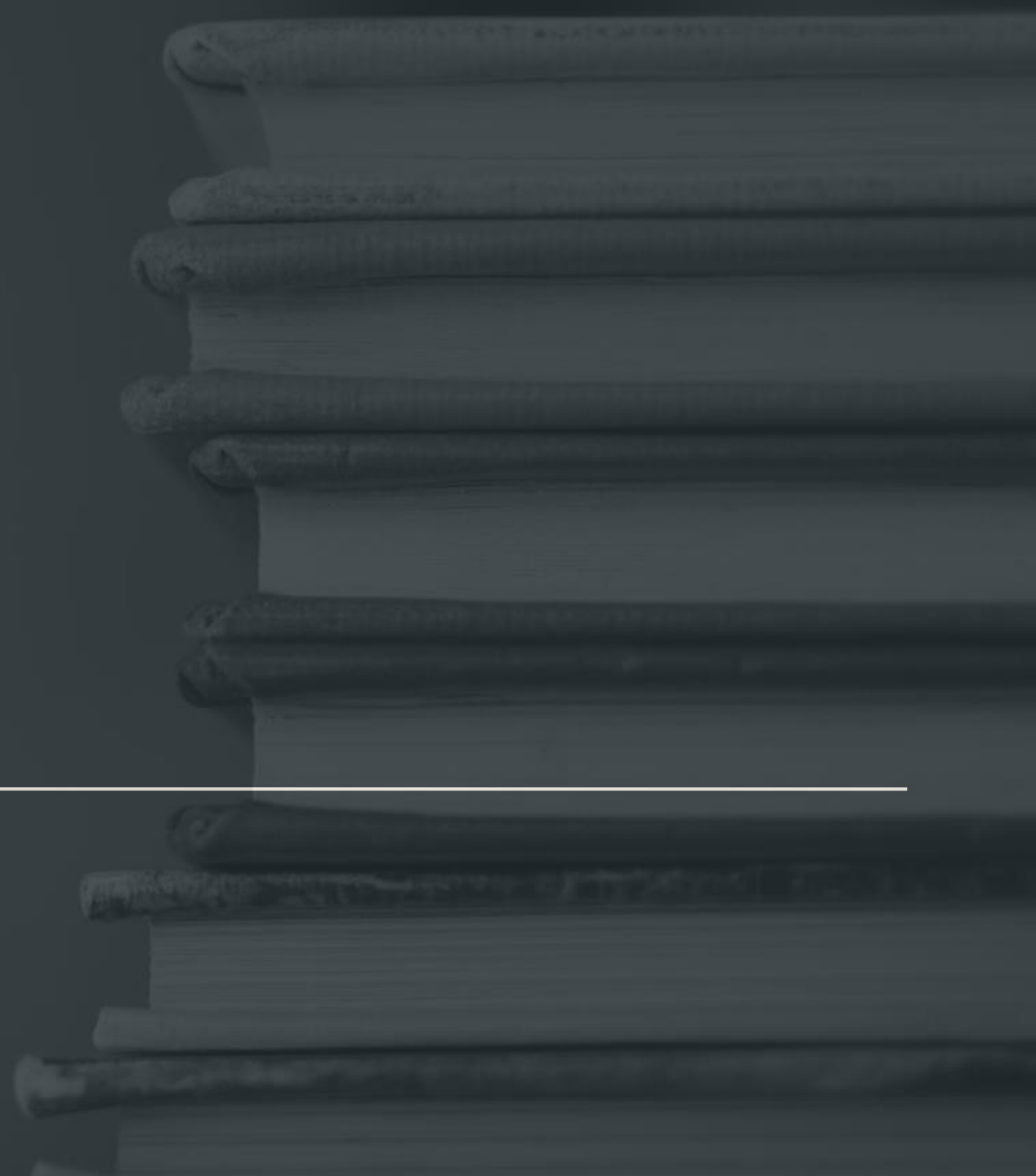
Noteworthy decision for several reasons

- ACCC accepted failing firm defence
- ACCC created 'failing firm offence'
- ACCC accepted behavioural undertaking on a merger (in part)
- First merger with SLC (ie, failed first part of authorisation test), but merger allowed on public benefits grounds

Outline

- Background facts
- Factual/counterfactual – failing firm defense
- Assessment of competition – failing firm offence
- Assessment of benefits
- Weighing up benefits and costs

Background facts



The applicants provide national cash-in-transit (CIT) services

- **Armaguard** is wholly owned by Linfox Group, an Australian logistics business
- **Prosegur** is wholly owned by Prosegur Group (a Spanish company), and entered Australia by acquiring Chubb Security Services in 2013



CIT services comprise a range of services



Cash collection and
delivery

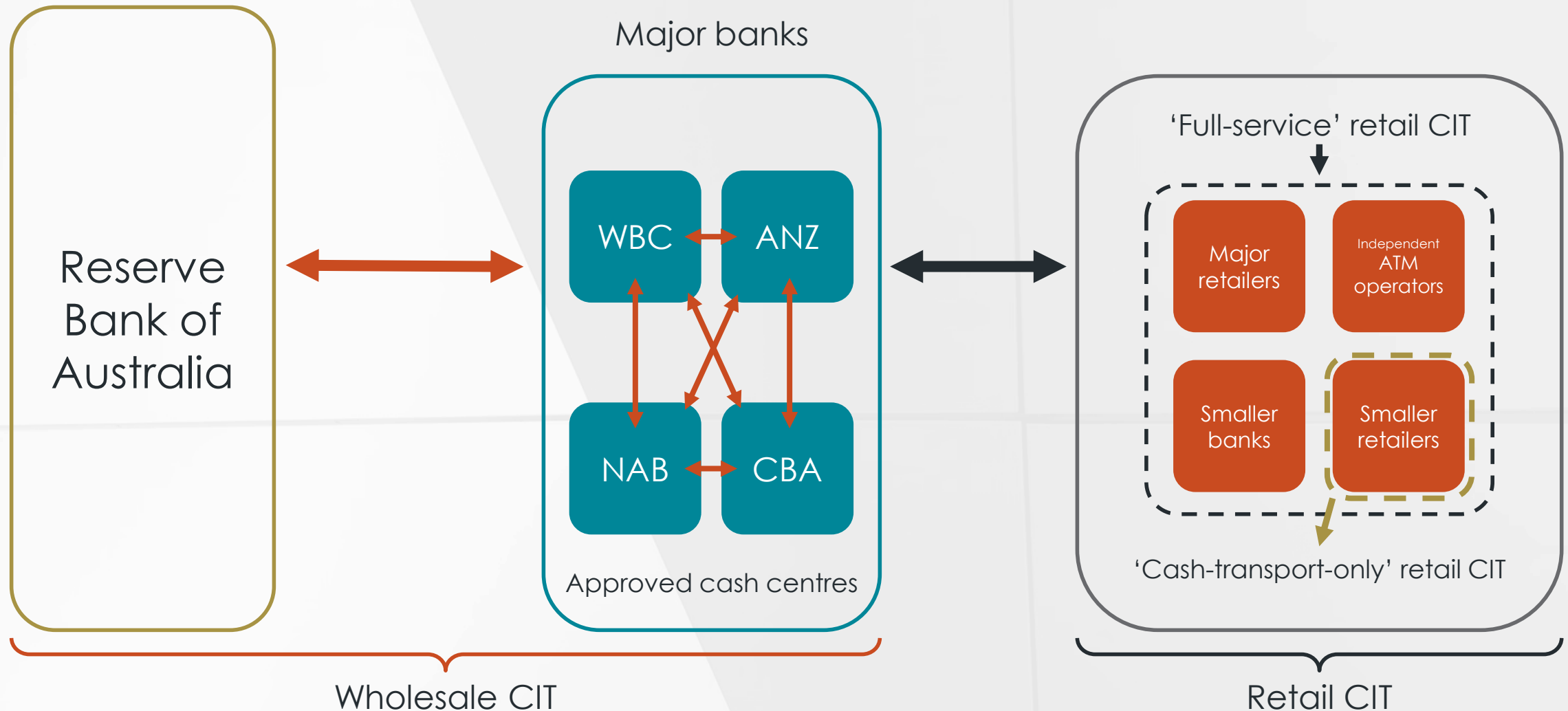


Cash processing



Cash administration

CIT services have wholesale and retail functions



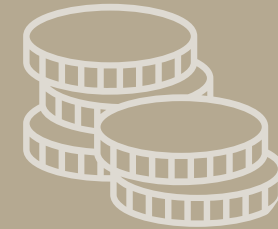
Armaguard and Prosegur supply 70-90 per cent of CIT services, and are the only national providers for major banks



National network of ACCs is required to service the needs of the major banks or ATM networks



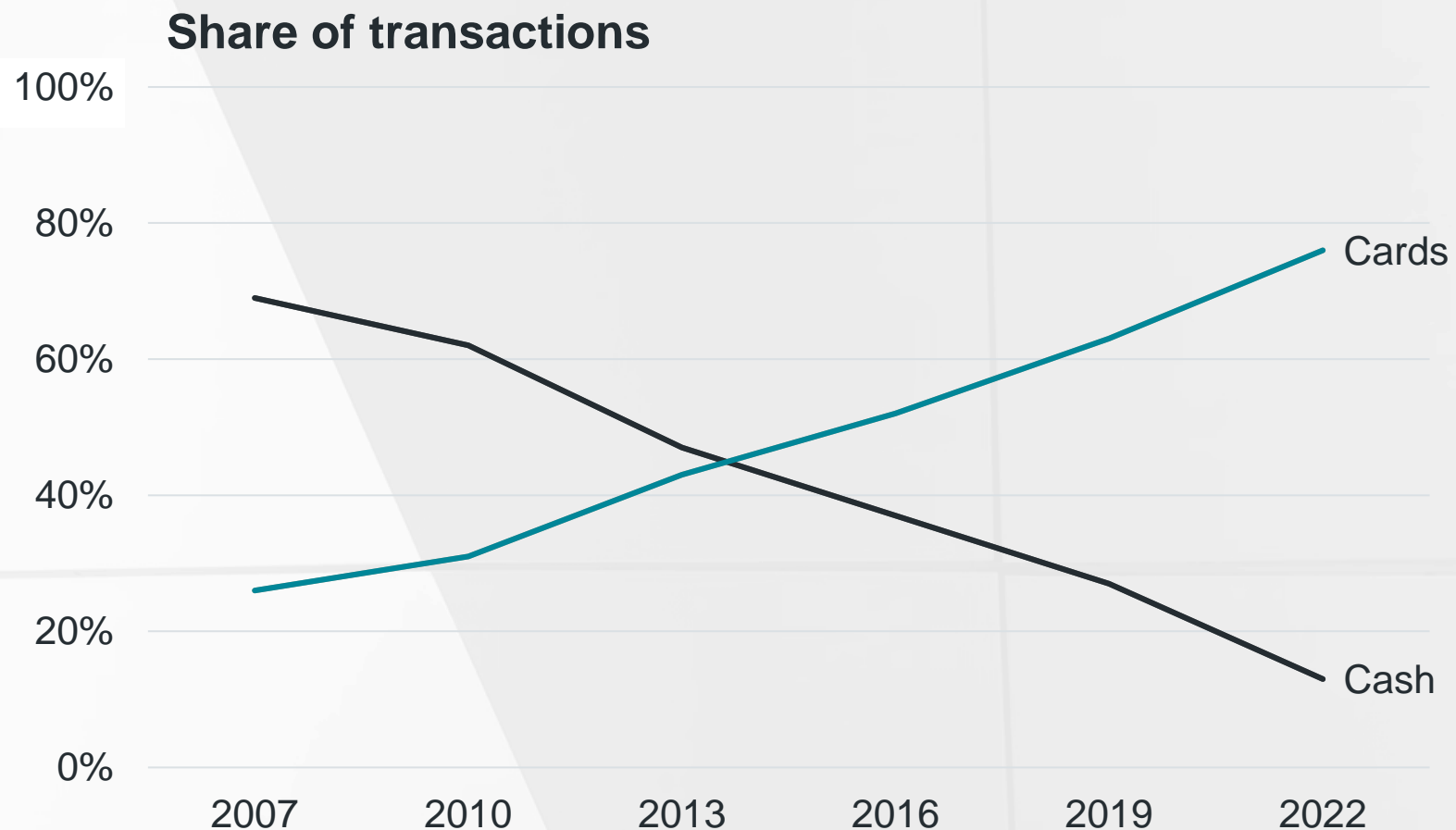
Some smaller providers operate nationally but are not accredited to provide services to the major banks



A range of smaller providers (~200) operate in Australia



CIT industry is in 'structural decline'



Source: Nguyen, T and Watson, B, *Consumer payment behaviour in Australia*, RBA Bulletin, June 2023, pp 21-29.

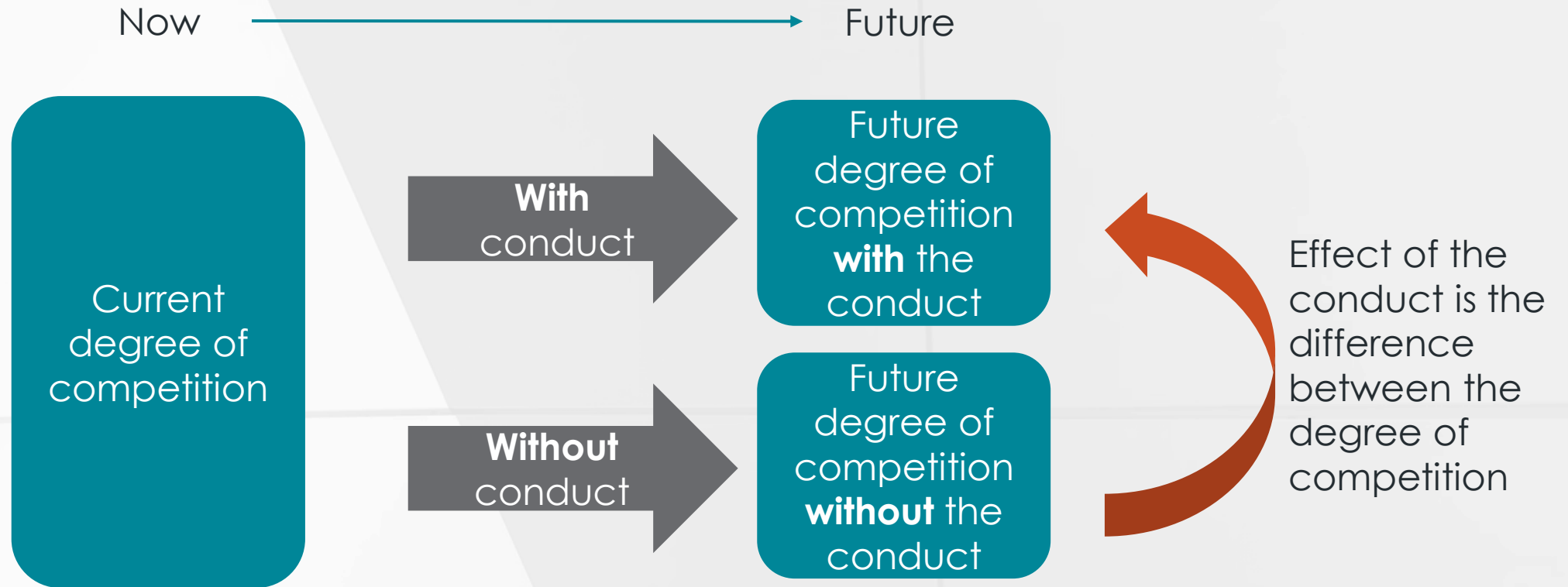
Statutory test – no SLC or net public benefits

- The Commission must not make a determination granting an authorisation under section 88 in relation to conduct unless
 - (a) the Commission is satisfied in all the circumstances that the conduct **would not have the effect, or would not be likely to have the effect, of substantially lessening competition**; or
 - (b) the Commission is satisfied in all the circumstances that:
 - (i) the conduct would result, or be likely to result, in a **benefit to the public**; and
 - (ii) the benefit would **outweigh the detriment to the public** that would result, or be likely to result, from the conduct

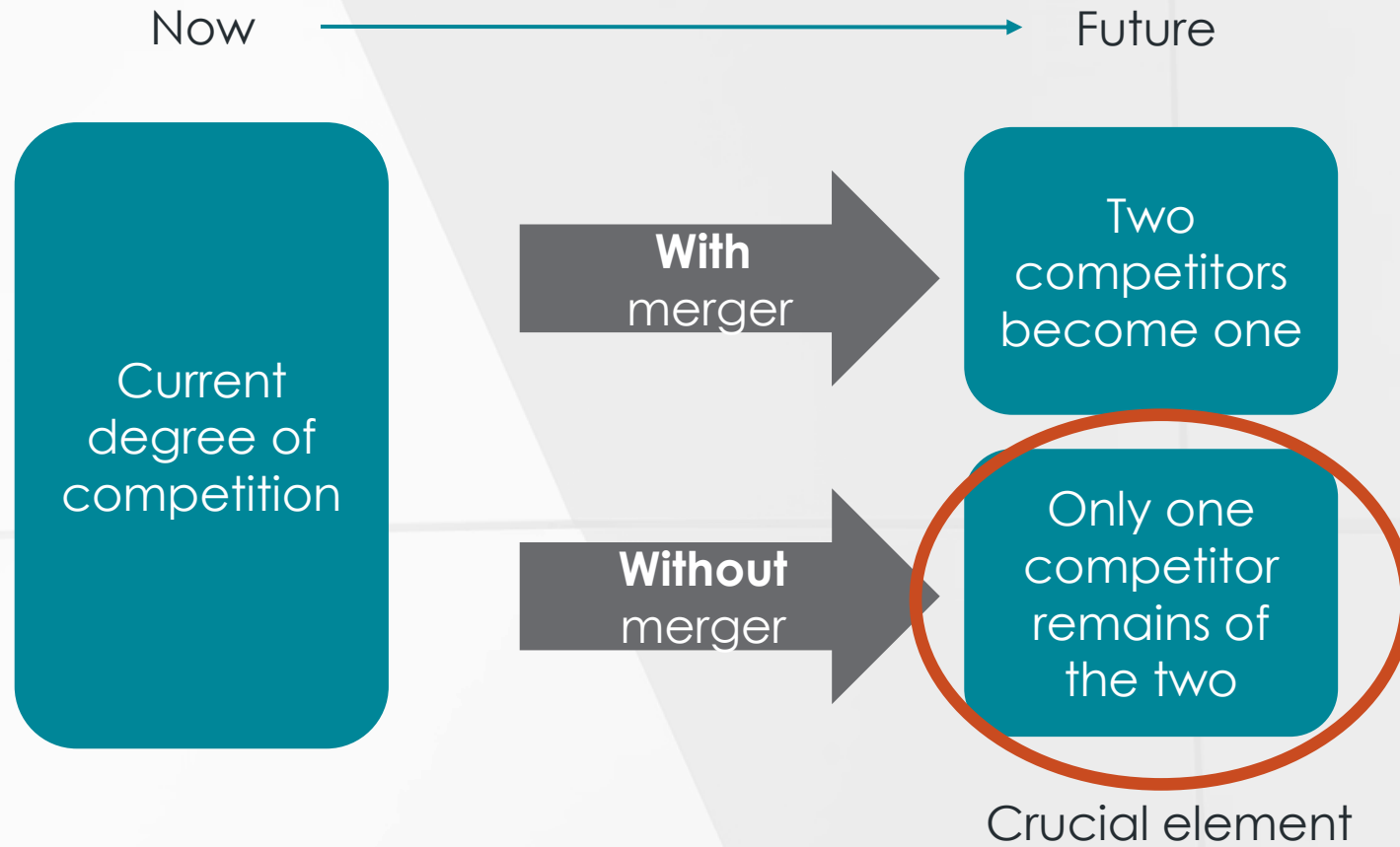
With and without test (factual/counterfactual)

The failing firm defense

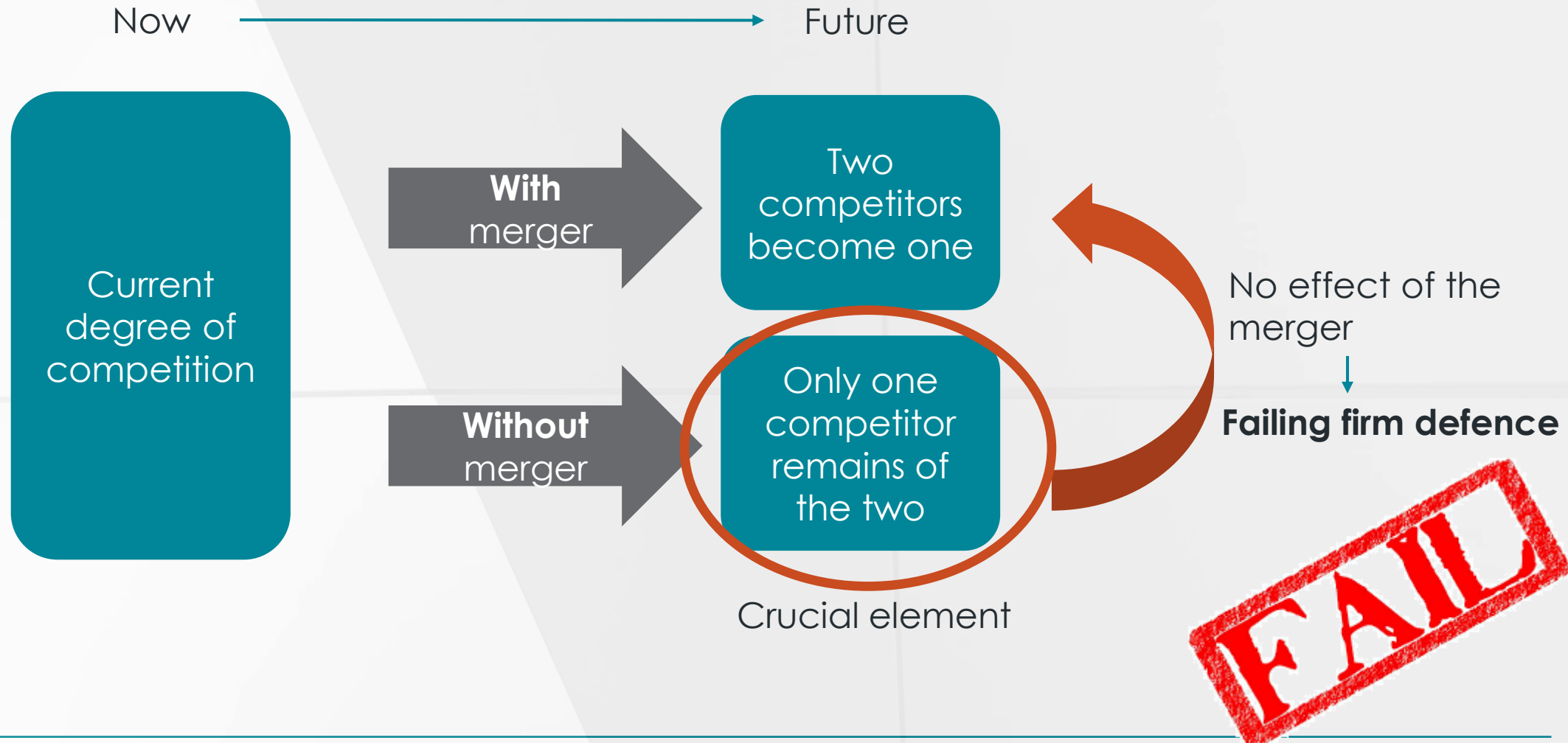
With and without test



Failing firm defense



Failing firm defense



Merger parties and experts said there would soon be one provider without the merger because...

- Merger parties are making unsustainable losses
 - › parties have high fixed costs and underutilisation of assets
 - › merger parties only able to continue due to continuous cash injections from parent companies
- No prospect of a turnaround
 - › declining cash use expected to continue
 - › no other arrangement short of a full merger would realise the cost savings needed
- No alternative purchaser would be interested in national network
 - › cash usage declining and continual losses



Interested parties and their experts had a different view

- Description of profits/losses in the evidence are not clear and often confidential
 - › many different ways to describe profits and losses
 - › hard to use accounting data for economic purposes
- Linfox/Prosegur will not shut down whilst recovering variable costs
 - › firm will continue to operate whilst it recovers its variable costs and can delay new fixed costs
 - › parties were recovering their variable costs
 - › no reason for substantial new investment/fixed cost in declining industry
- Alternatives to full merger
 - › shut down least profitable part of business
 - › joint venture in least profitable parts
 - › sale of some assets that are underutilised

ACCC: high probability that one of the Applicants would cease to supply CIT services in the short term

- ACCC analysed confidential financial records of the parties
 - › limited ability to see what ACCC relied upon
- Cash usage is declining
 - › led to strong competition between merger parties
- ACCC accepted that merger parties had tried alternatives
- Merger parties recorded significant trading losses

Both Applicants have recorded significant trading losses in recent years and are financially dependent on their parent companies to remain solvent

- Highly unlikely to be alternative purchaser for whole or major parts of merger parties

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- Cash

› led

- ACCC

- Merger

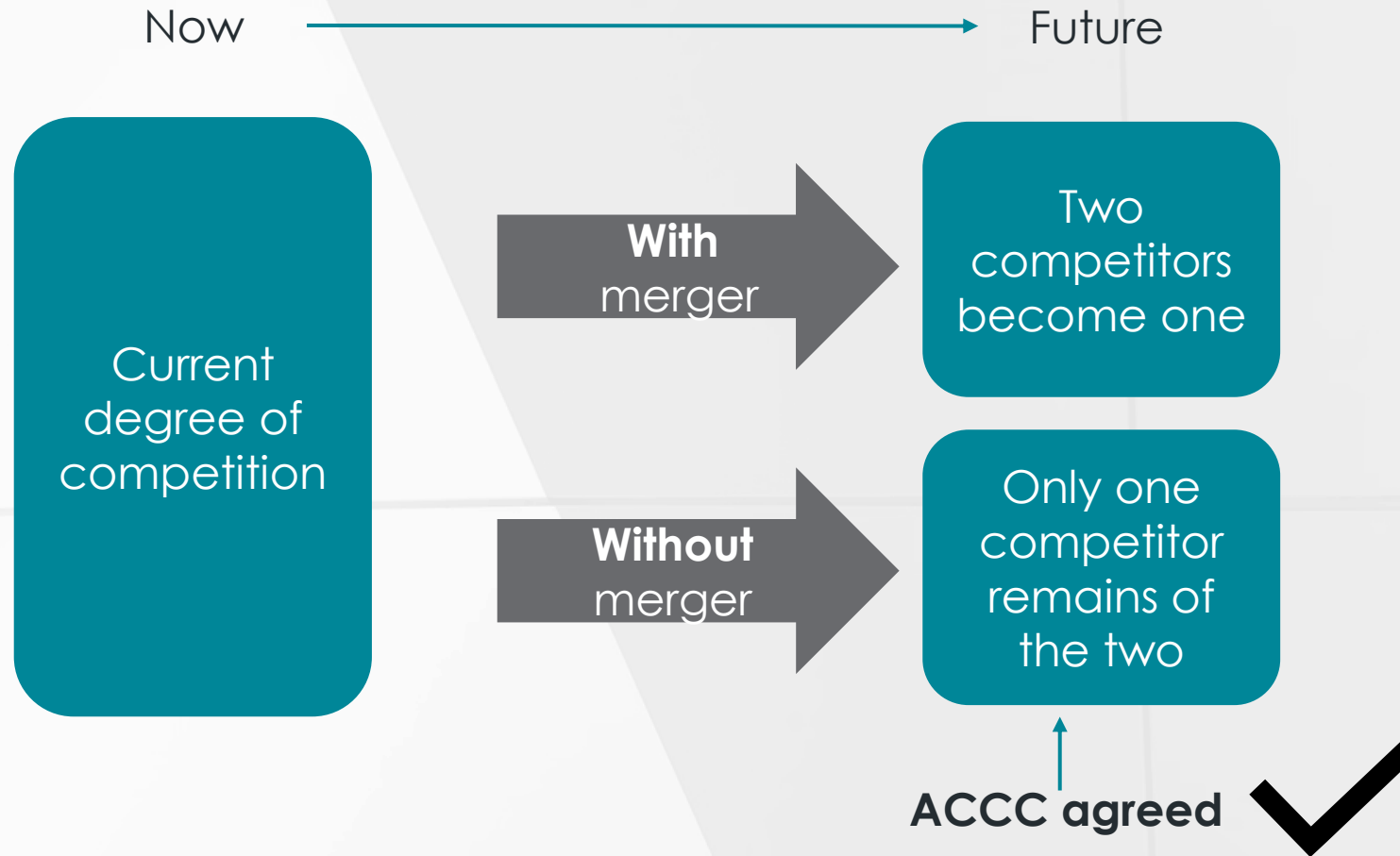
Both Applicants provided financial records

Lessons for putting failing firm cases to the ACCC

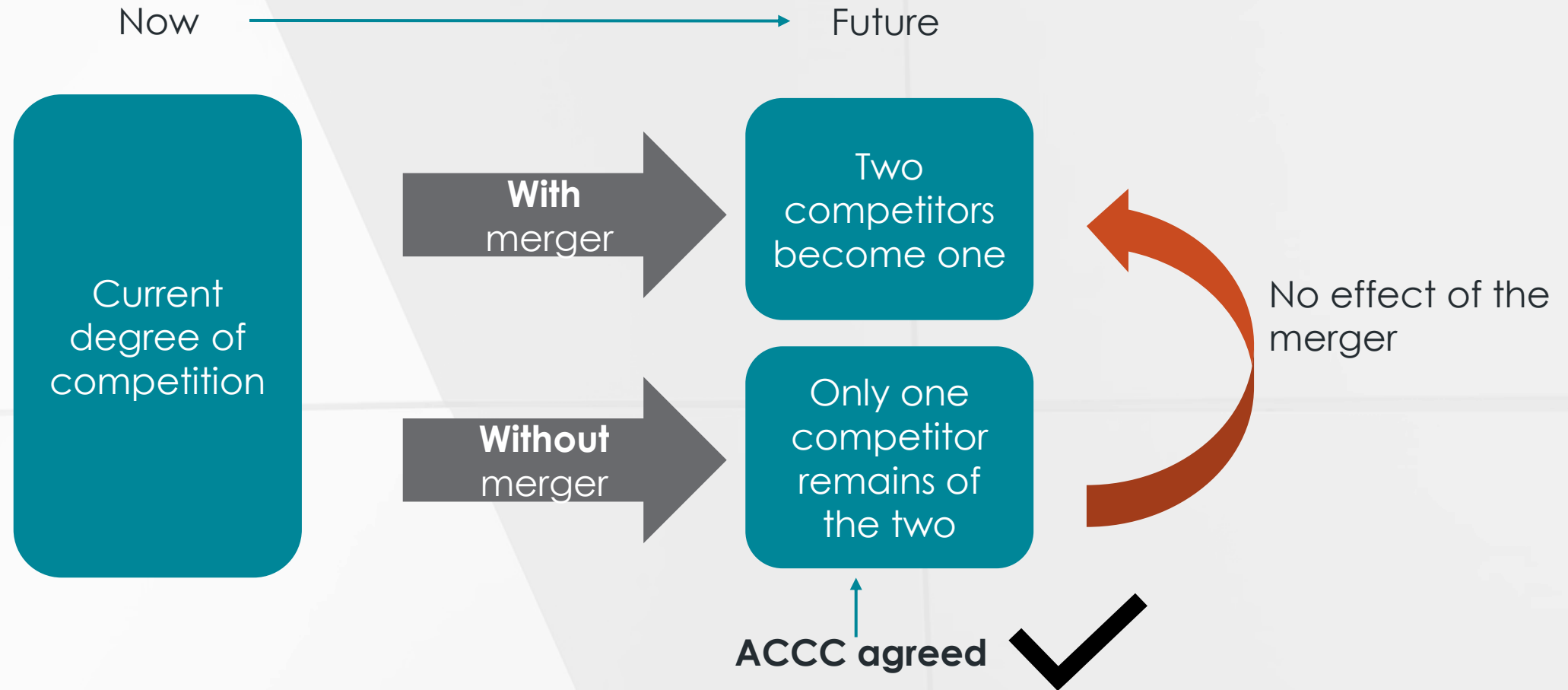
- Industry in decline
- Tried alternatives to merger & no other purchaser
- Extent of losses and how long they must continue for is unclear
 - Detailed financial record must be provided to the ACCC
- Key is to show one firm would otherwise shut down in the short term – timing is also somewhat unclear

- Highly unlikely to be alternative purchaser for whole or major parts of merger parties

Usually, a successfully failing firm defense immediately means there is no effect of the merger



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Assessment of competition

The failing firm offense

ACCC: Merger parties are each other's closest competitive constraint

- Merger parties – two largest suppliers of
 - › wholesale and retail CIT services nationally (>90% combined market share)
 - › full-service retail CIT services nationally (>85% combined market share)
- Merger parties
 - › only suppliers that offer national coverage of these services
 - › each other's strongest competitive constraint
- So ACCC focuses on the strength of the *next* closest constraint, ie, entry and expansion

Merged firm constrained by expansion and entry

- Merged firm constrained by
 - › expansion from existing full-service retail CIT suppliers, eg, Authentic Security
 - › entry from cash-transport-only CIT suppliers (over 200 firms)
 - not currently offering cash processing and administration services
- Barriers are low for full-service retail CIT because
 - › do not need Approved Cash Centre Operator accreditation
 - › involves lower cash volumes, and so less investment
 - › existing cash-transport-only CIT suppliers can leverage existing relationships

Entry not likely to provide strong competitive constraint

- Existing suppliers are much smaller and not national (<15% mkt share combined)
 - › ATM providers, banks and supermarkets strongly prefer a national supplier
 - › existing small suppliers not considered to be viable alternative by large customers
 - do not have adequate security and insurance measures
 - do not provide frequent services
- Cost of new entry and expansion is significant
 - › high fixed costs with obtaining infrastructure and scale
- How can entry of second firm be profitable and it not be profitable for there to be two competitors?
 - › why would a firm expand or enter if both firms make losses when there are two large operators?
 - › Authentic Security questioned why party would begin to supply services in current environment
 - › cost of entry and operation presumably more than the cost of continuing to operate, so less profitable to enter than to keep operating

Entry and/or expansion on a large, national scale appears extremely challenging, but less so on a small scale

- High barriers to entry/expansion for integrated wholesale/retail CIT services and full-service retail CIT services to large customers
 - › substantial sunk costs from entering (Approved Cash Centres, vehicles etc)
 - › stringent requirements of major banks
 - › declining cash usage and demand for CIT services
- But, barriers to entry/expansion on a small scale are less substantial
 - › localised supply requires lower up-front fixed costs
 - qu: lower fixed-cost, but lower profit too? How can costs be recovered?
 - › incumbent's advantage not as significant for localised supply
 - › note: ACCC does not provide any analysis of profitability

ACCC: Constraint from new entry/expansion without merger is materially greater than with merger

Factual – With the merger

- All customer contracts will continue to be serviced for their duration by the merger parties
- Assets kept by merger parties



No entry

Counterfactual – No merger and one firm exits in the short term

- Contracts held by exiting firm may become contestable
- Assets may become available for purchase



- Opportunities for a rival to expand because large number of contracts are contestable
- ACCC said it had evidence some firms were interested in some assets

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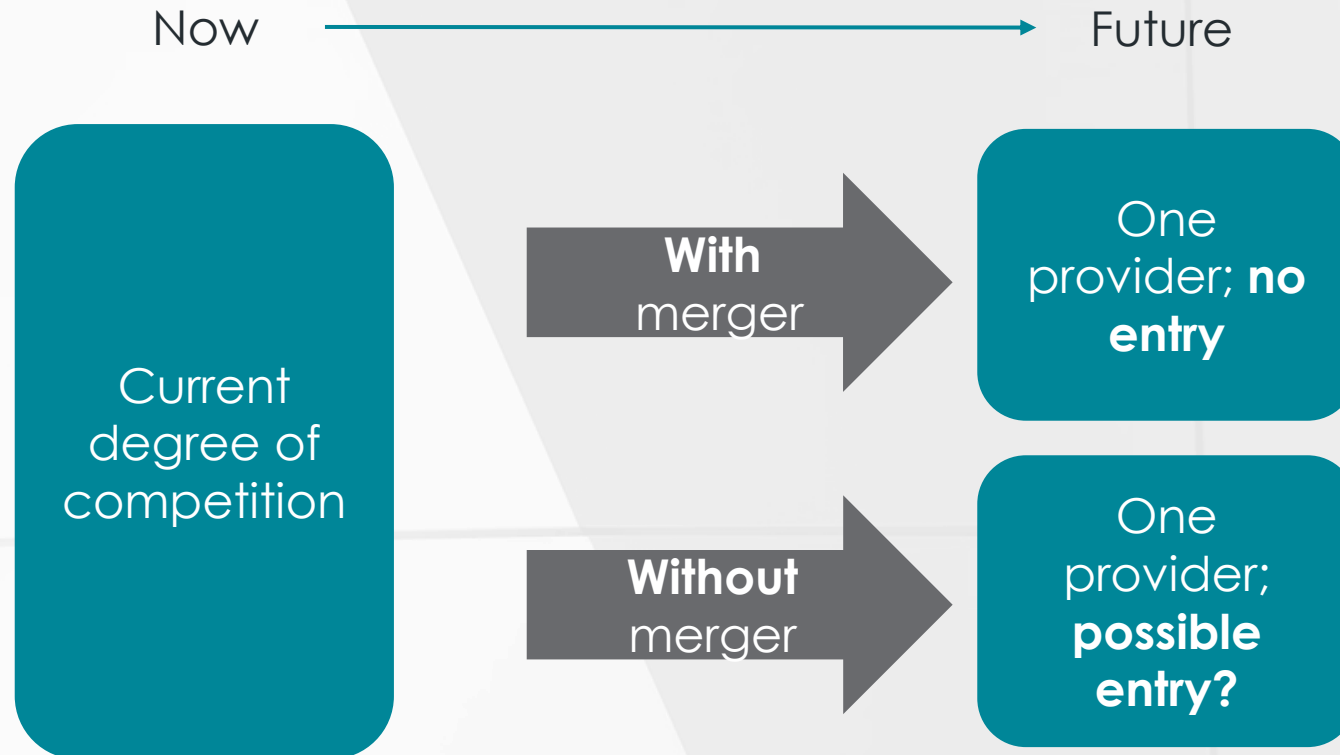
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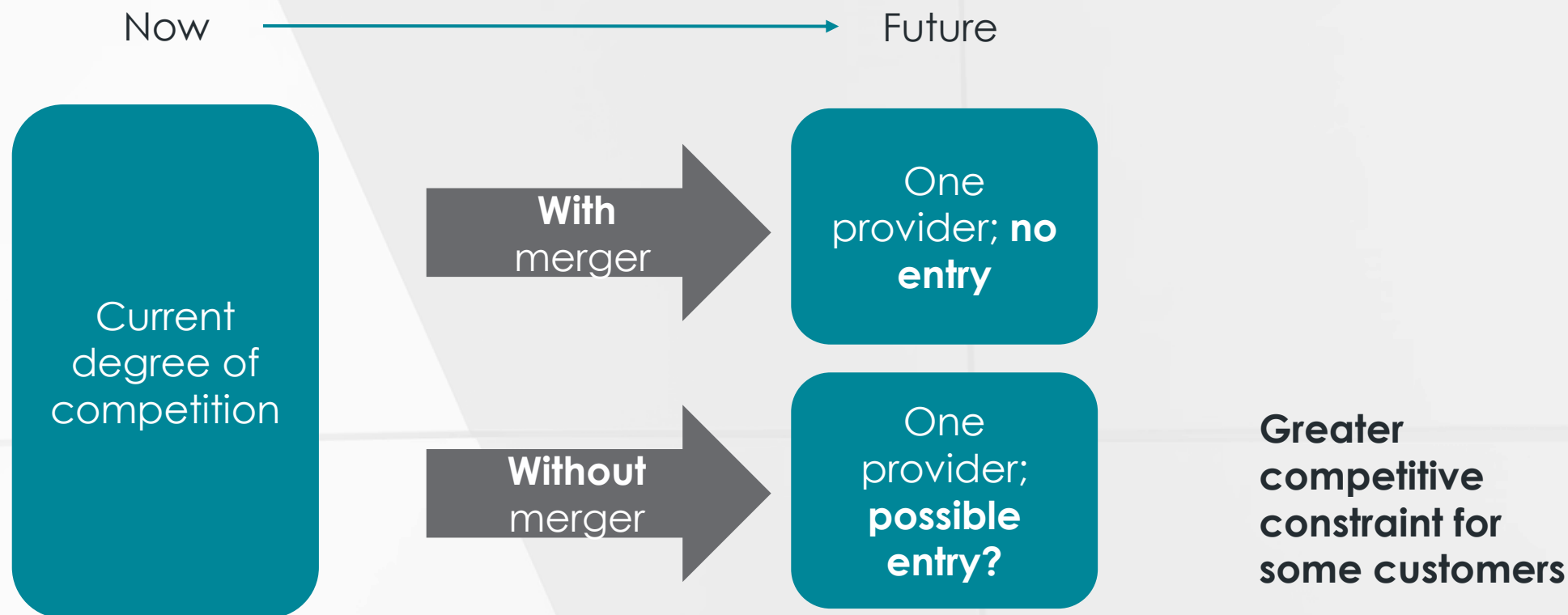
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Stronger competition with exit – the failing firm offense?

Failing firm offense



Failing firm offense



The ACCC acknowledges that the degree of competitive constraint that alternative suppliers could provide ... is uncertain. However, the ACCC considers that in respect of at least some classes of customers, this competitive constraint could be material.

Thread the needle

- It is **not** profitable for a firm to continue, but
- It **is** profitable for a firm to enter/expand



Thread the needle

- It is **not** profitable for a firm to continue, but
- It **is** profitable for a firm to enter/expand



Questions

- How would expanding firms expect to earn a return, yet merger parties are continually making losses?
- Why couldn't one of the merger parties continue in cut down form if other firms can profitably enter in that form?
- Similarity with/without the merger
 - Couldn't the continuing merger party buy up most/all of the assets and win most/all of the contracts without the merger?
 - Won't merger parties sell assets with the merger?

Undertaking reduces some of the competitive harm

- Undertaking
 - › register of Approved Cash Centres it intends to close
 - › register of personnel who used to be employed by merger parties
 - › register of surplus equipment
 - › commits to providing ATM services and not to foreclose rivals
- The ACCC considers the Undertaking reduces some competitive harm
 - › may improve ability of third parties to compete for CIT services, and limit foreclosure
 - › but opportunities to compete for customers and acquire assets not likely with merger, even with undertakings

the ACCC cannot be satisfied in all the circumstances that the Proposed Acquisition would not have the effect, or not be likely to have the effect, of substantially lessening competition

- So, benefits are needed to get the merger across the line

Assessment of benefits

Avoiding a disorderly exit

Merger parties and experts said the key benefit was the avoidance of 'dislocation costs'

- The benefits contended include:
 - › the exit of one of the merger parties (without the merger) would risk substantial dislocation costs
 - › using fewer assets (eg, trucks) to provide the service is a public benefit
 - › investment will be brought to 'sustainable' levels
 - › there would be a reduction in carbon emissions

Reasons for determination, paras 6.13-6.18, 6.44-6.46, 6.56-6.59, 6.70.

Avoided disorderly exit

- Armaguard said that if it exited it would cause ‘a collapse in the critical cash processing and secure transport function of the Australian economy’
 - › groups reliant on cash (elderly, remote) would be the most affected.
- Remaining provider(s) would need to rapidly scale up and negotiate contracts. During this ‘transition’ period
 - › there may be a cash shortage
 - › ATMs and businesses may be vulnerable to security threats
 - › consumers may be forced to adopt non-cash payments
 - › banks may have to temporarily or permanently cease cash services at branches
- ‘Disorderly’ exit unavoidable because
 - › withdrawal of support by parent company would result in voluntary administration
 - › it is not commercially realistic to gradually reduce scale

[Reasons for determination, paras 6.13-6.18, 6.44-6.46.](#)

Interested parties and their experts gave a different view

- Several parties agreed that there would be some disruption
- Some competitors said they could assist customers during a transition period
- All parties would benefit from an orderly, not disorderly exit, minimising the dislocation costs
 - › contractual obligations on Armaguard and Prosegur
 - › reputational risk/damage to large, multinational firms
 - › maximise resale value of assets (including for a voluntary administrator)
 - › non-exiting firm highly incentivised to start supplying customers of exiting firm immediately. Applicants submitted evidence that there is considerable spare capacity.
- Some transition costs would be incurred if the merger took place

Reasons for determination, paras 6.19-6.26.

ACCC view on disorderly exit

- ...ACCC has received credible evidence from the Applicants...there is also a **reasonable prospect that this [exit] would occur almost immediately** after a decision to exit as opposed to via a gradual wind down
- The ACCC considers that one of the Applicants ceasing to supply CIT services would likely **cause disorder and significant disruption** to the supply of CIT services...in the short term
- Even for large customers, who would likely be prioritised, this would probably mean **some disruption to the supply of services, or ongoing reduction in the quality of service**, during the transition period...Smaller customers may experience **significant periods of time without any service**, particularly as the remaining Applicant would likely prioritise transitioning larger customers.

Reasons for determination, paras 6.30-6.43.

ACCC view on disorderly exit

- *The ACCC considers that disruption...would significantly impact **both businesses...and consumers**. In particular, cash remains an important payment method for certain consumers. This includes consumers who are unable to use non-cash payment methods or have a greater preference for cash, such as those **living in regional or remote areas, the elderly**, and those without reliable access to the internet.*

Reasons for determination, paras 6.30-6.43.

ACCC view on disorderly exit

- *The ACCC considers that disruption...would significantly impact **both businesses...and consumers**. In particular, cash remains an important*

payment method for those who are unable to pay by credit card. The ACCC is concerned that the loss of cash, especially for those who rely on it for their daily needs, could have significant impacts on the community.

Lessons for benefits of avoided disorderly exit

- Link from exit in market to broader economy
- Would the exit be disorderly even if short?
- Assessment of distributional impacts

Reasons for determination, paras 6.30-6.43.

Improving productive efficiencies by reducing duplication of fixed costs

- Greater utilisation and reduced duplication of fixed costs would facilitate improved profitability
 - › *For example, Deloitte's analysis indicates that between 20-25 sites could be closed on the basis that each site is 150 kilometres or less from a site belonging to the other Applicant, which comprises 49% of the Applicants' total sites. In addition, the Applicants could dispose of vehicles equivalent to 8% of their combined fleet.*

Reasons for determination, paras 6.44-6.46.

Interested parties and their experts observed

- Some submissions agreed that there may be efficiency gains
 - › others suggested that they would be private, not public, benefits
- Assets need to be redeployed to actually generate a benefit (ie, not be destroyed or lay unused)



Reasons for determination, paras 6.47-6.50.

ACCC view on productive efficiencies

- *The ACCC also considers that the Proposed Acquisition is likely to result in **some limited benefits to the public in the form of productive efficiencies by removing duplicated fixed costs**...Reducing duplicated assets could free up resources, such as land and human resources, **for use in other parts of the economy**.*
- *However, the extent and magnitude of productive efficiencies attributable to the Proposed Acquisition is unclear.*
- *The ACCC considers that without the competitive pressure that the Applicants currently exert on each other, the extent to which any cost savings resulting from the Proposed Acquisition are likely to be **passed on to customers is lower**, and consequently, the ACCC has given **less weight to this public benefit**.*

Reasons for determination, paras 6.51-6.55.

ACCC view on productive efficiencies

- The ACCC also considers that the Proposed Acquisition is likely to result in **some limited benefits to the public in the form of productive efficiencies** by removing duplication of resources and freeing up resources for use in other parts of the economy.
- However, the ACCC is not able to quantify the benefits to the public from the Proposed Acquisition.
- The ACCC considers that, given the current competitive dynamics currently exert on each other, the extent to which any cost savings resulting from the Proposed Acquisition are likely to be **passed on to customers is lower**, and consequently, the ACCC has given **less weight to this public benefit**.

Lessons for deduplication of fixed costs

- Assets need to be freed up for use in other parts of the economy
- Reminder that private benefits do count (but not transfers), but may be given less weight by ACCC

Reasons for determination, paras 6.51-6.55.

The ACCC said that the undertaking would increase public benefits



...the **undertaking** increases this public benefit by further **reducing uncertainty** and the impacts on customers and competitors. Namely, uncertainty for customers **regarding pricing and service levels**, and uncertainty for competitors regarding third-party access to the facilities of MergeCo (the merged entity, as described in the Undertaking). Further, the commitments may avoid the need for government to consider an urgent response to assist in maintaining access to cash, allowing adequate time for consideration of any policy or broader regulatory response in the longer term.

[Reasons for determination, para 6.43.](#)

The ACCC said that the key public detriments were

- Competition effects
- Less resilience in wholesale cash distribution, relative to the potential entry
 - › having a single CIT supplier responsible for wholesale cash distribution could increase risks associated with disruptions such as natural disasters, employee strikes or IT services

Reasons for determination, paras 6.85-6.99.



Weighing up benefits and costs

Applying the authorisation test

Weighing up the benefits and detriments

- If both applicants would continue operating without the acquisition, the ACCC considers that the acquisition would result in a net public detriment – but this scenario is **not likely**
- The most significant public benefit is the avoidance of dislocation costs
 - › this will be larger if an exit occurs at short notice, which the **ACCC considers is the most likely scenario**
 - › the **undertaking increases the benefit**
- Reduction in competition is the most material public detriment
 - › the **undertaking reduces the detriment** ('may increase the opportunity for a third-party CIT supplier to provide a competitive constraint')
 - › the undertaking reduces the ability to foreclose independent ATM deployers

Reasons for determination, paras 6.124-6.135.

The ACCC concludes that the undertaking increases benefits (and reduces detriments) to satisfy the test

For the reasons set out above, the ACCC considers it appropriate to specify a condition in the authorisation that the Applicants must give, and comply, with the Undertaking. It is the ACCC's view that the **Undertaking increases the public benefit to a level sufficient** for the purposes of the statutory test in section 90(7)(b) of the Act. The ACCC further considers that the Undertaking will reduce some of the detriment arising from the competitive effects of the Proposed Acquisition. Therefore, the ACCC is satisfied in all the circumstances that, on the condition that the Applicants give, and comply with, the Undertaking, the Proposed Acquisition would result, or be likely to result, in a benefit to the public that would outweigh the detriment to the public that would result, or be likely to result from the Proposed Acquisition.

Takeaways

- Failing firm defence
- Failing firm 'offence' – threading the needle
- Link from effect in market to effect on economy and distributional effect
- Positioning undertakings to increase benefits and reduce detriments



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