6 April 2023

Merger Investigations Branch
Australian Competition & Consumer Commission
Your Ref: MA1000022
Attention: Alex Reed and Louisa Wilson

By email: Armaguard-Prosegur-Merger@accc.gov.au
mergersru@accc.gov.au

Dear Mr Reed and Ms Wilson,

Coles Group Limited (Coles): Armaguard/Prosegur – submission in relation to undertaking

Thank you for your letter dated 21 March 2023 regarding the proposed merger between Armaguard and Prosegur (**Proposed Transaction**) and for your invitation for Coles to comment on the Proposed Undertaking (**Proposed Undertaking**).

Please find attached Coles' submission on the issues it considers relevant to the Commission's consideration of the Proposed Undertaking.

Yours sincerely

Fiona Morse
Managing Counsel – Legal Regulatory

Submission in response to Proposed Undertaking

Defined terms below have the meaning given to those terms in the Proposed Undertaking.

Does the Proposed Undertaking provide appropriate price constraints for cash-in-transit (**CIT**) services that reflect efficient costs and reasonable returns over time?

Coles considers that the Proposed Undertaking does not provide appropriate price constraints on the post-merger entity (**MergeCo**) for CIT services that reflect efficient cost and reasonable returns over time. This is because:

- whilst it is proposed that there will be verification of the Pricing Process annually by an Independent Auditor, there is no independent review and assessment of the prudency of the costs incurred by MergeCo to provide CIT services. Accordingly, imprudent expenditure by MergeCo could result in significant annual increases in prices charged to its customers.

- a cost-plus, zero risk pricing model allows MergeCo to pass on all inflationary pressures and cost risk associated with cash use decline to its customers and the proposed Target Revenue model does not encourage efficiency and incentivise investment and/or innovation in the provision of CIT services. The cost of MergeCo not innovating to potentially unlock value that could be passed on to customers, and/or MergeCo incurring additional expenditure may increase the cost of CIT services and subsequent prices charged to MergeCo's customers.

- the limit on the extent to which prices can increase annually for customers (CPI + 5%) under the Proposed Undertaking does not encourage MergeCo to become more efficient than the prevailing economic conditions, particularly in a situation of largely inelastic demand.

- The Volume Change Adjustment Mechanism allows MergeCo to increase prices when volume (revenue)declines. This could mean that any optimisation in service resulting in reduced cost could be offset by a price increase with no part of the benefit being realised by the customer.

- the Proposed Undertaking does not clearly articulate the benefits of scale for larger customers such as Coles.

- Coles queries the ability of customers to negotiate with MergeCo to receive discounted rates for agreed service levels in multi-year contracts as there appears to be very little incentive for MergeCo to agree to an annual price adjustment less than the maximum annual Target Revenue set out in the Proposed Undertaking.

- Coles is not convinced that MergeCo's proposed 10% EBIT target and opportunity to increase EBIT through savings against targeted operating expenditure constitutes reasonable returns given MergeCo's limited risk exposure, captive customer base and the proposed price increase mechanism.

Is the Proposed Undertaking sufficient to prevent reductions in service quality or coverage that might arise from any loss of competition between the Applicants?

Coles' opinion is that the Proposed Undertaking is not sufficient to prevent reductions in service quality or coverage. Whilst the Proposed Undertaking addresses MergeCo continuing to supply CIT services to customers in accordance with the standard of service that those customers were supplied CIT Services in the period immediately preceding the Commencement Date, there is insufficient detail provided in the Proposed Undertaking as to how MergeCo will not only maintain, but improve, service levels in the future.

Coles has concerns that:

- Coles' store operations could be impacted by supply chain disruptions to MergeCo (e.g., strikes, servicing delays, etc.) and Coles would have no alternative CIT service provider with a national presence to engage.
- Whilst MergeCo will offer CIT services to customers on a national basis to all the cash point locations that it services as at the Commencement Date, there is no commitment from MergeCo to service new Coles stores which may be in less profitable areas for MergeCo after the Commencement Date.
- MergeCo's subcontractors' costs/service quality may deteriorate if they are only engaged by a single scale supplier of CIT Services.
- MergeCo will not have any incentive to continue to provide cost optimisation services for Coles, comparable with current contractual arrangements, without potentially impacting Coles' CIT costs.
- continuation of and/or improvements of service commitments and KPIs under current contractual arrangements will be at MergeCo's discretion to accept moving forward.

Does the Proposed Undertaking remove incentive or ability for the Merged Entity to foreclose on or discriminate against independent ATM providers?

Coles has no submissions in respect to this question other than it is not clear to Coles if the revenue from these services provided by MergeCo forms part of the Target Revenue.

Does the Proposed Undertaking provide for access to cash centres by third parties on reasonable commercial terms, conditions and for reasonable prices?

Coles has no submissions in respect to this question other than it is not clear to Coles if the revenue from these services provided by MergeCo forms part of the Target Revenue.

Does the Proposed Undertaking have the potential to distort the market over the life of the Proposed Undertaking?

Coles' view is that as MergeCo will have 90% market share for CIT services with the remainder of the market being highly fragmented and with significant barriers to entry for new entrants, MergeCo will have the potential to distort the market over the life of the Proposed Undertaking.

Coles believes that the increased costs to manage cash may lead to higher prices of goods/services for customers who prefer to transact with cash. Further, some retailers may be compelled to remove cash as a payment option due to the increased associated costs with this payment method when compared with other forms of payment.

Does the Proposed Undertaking allow for effective operation, oversight and enforcement of the Proposed Undertaking?

Coles does not consider that the Proposed Undertaking allows for effective operation, oversight and enforcement of the Proposed Undertaking.

Coles is of the view that any Proposed Undertaking should:

- require MergeCo to bear reasonable risks incurred in the ordinary course of business;
- include an independent review process that assesses the prudency of costs incurred by MergeCo in determining prices for CIT services; and
- give customers confidence that they will continue to have access to nationwide CIT Services, even in less profitable locations for MergeCo to provide CIT services.