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EXCLUSIVE DEALING IN FRANCHISING

Exclusive dealing occurs when one business (i.e. a franchisor) puts restrictions on someone’s freedom (i.e. a franchisee) to decide with whom, in what or where they will deal. This conduct is very common in the franchising industry because most franchises operate around unique products or services. Exclusive dealing is strictly regulated.

Exclusive dealing is technically a breach of the *Competition and Consumer Act 2010* (the Act). However, a person can lodge a notification with the Australian Competition and Consumer Commission (the ACCC) to notify them that the person intends to engage in the conduct. If the ACCC believes that the conduct will not substantially lessen competition in the marketplace (or other matters mentioned below) then the notification will stand. It may be revoked at any time, for example when someone brings an objection which leads the ACCC to believe it will substantially lessen competition.

What is Third Line Forcing?

Third line forcing is a form of exclusive dealing, where a business will only supply goods or services, or give a particular price or discount, on the condition that a person buys the goods or services from a nominated third party. If the person does not comply with the condition, then the business will refuse to supply the goods or services. Third line forcing is a breach of the Act and a business must lodge a notification if they intend on engaging in this conduct without facing prosecution from the ACCC.

What is Full Line Forcing?

Full line forcing is another form of exclusive dealing, and occurs when a supplier refuses to supply goods or services unless the person agrees not to:

- Buy goods of a particular kind or description from a competitor of the supplier.
- Resupply goods of a particular kind or description obtained from a competitor.
- Resupply goods of a particular kind obtained to a particular place or classes of places (territory restrictions).

A notification for full line forcing is only required to be lodged with the ACCC if the conduct results in substantially lessening competition in the marketplace.

What is an ACCC Notification?

Exclusive dealing is regulated under section 47 of the Act.

The ACCC can allow a notification to stand for businesses who engage in exclusive dealing where competition in the marketplace has not been substantially lessened, and where the public benefit outweighs the detriment.

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The ACCC may undertake a full public consultation process before making any decision. Public benefits can include improving product quality, promoting competition and supporting business efficiency.

By allowing a notification to stand, the ACCC do not object to or take action against the third line forcing. If the exclusive dealing does substantially lessen competition in the future, then the ACCC will have options to take action, such as revoking the notification. If a notification is revoked but the exclusive dealing continues, then the ACCC can institute proceedings.

Exclusive dealing will be prohibited when the conduct has the effect of substantially lessening competition in the marketplace. This is assessed by considering such matters as:

- Whether there has been a real affect on the competition in the marketplace for the particular product.
- Whether the refusal to supply would substantially restrict availability to people.
- Whether people are severely restricted in their ability to buy a product because the business has placed territorial restrictions as a condition of the supply.
- What is the market for the product. Defining the market can be very difficult.

Application to Franchising

Both franchisors and franchisees have an objective to be in an economically beneficial relationship. Franchisors have an interest in maintaining quality control to protect their goodwill and brand. By nominating suppliers who meet certain quality standards, franchisors are restricting the ability of franchisees to purchase from third parties.

A notification for third line forcing may be allowed to stand for genuine commercial reasons if a franchisor can establish a variety of matters including:

- The restrictions are necessary to protect the quality and integrity of the franchise system;
- The conduct will not substantially lessen competition in the marketplace; and
- There is a public benefit.

The ACCC can consider a range of public benefits:

- Consistency across a franchise system can benefit customers and increase the value of the franchise system.
- Franchisees operating compatible equipment and purchasing the same goods creates a more efficient operation and management of the franchise system through for example increasing efficiency in training.
- Cost and time savings for franchisees creates improved contractual relations and more efficient and effective bargaining between franchisors and suppliers.

Franchisors are permitted to receive rebates/financial benefits from suppliers for referrals, as long as they provide full disclosure of this to franchisees in the disclosure document.

The ACCC will always decide each situation upon its merits, and if a notification for exclusive dealing is allowed to stand, the franchisor will be granted immunity from prosecution under the anti-competition laws while that notification is in place.

Decisions of the ACCC

Some recent decisions by the ACCC highlight the situations when franchisors have lodged a notification to engage in exclusive dealing.

A notification by Bridgestone Australia Pty Ltd has been allowed to stand. This notification involved the franchisor placing a supply condition on its franchisees that they only acquire tyre disposal services from recyclers who are members of the Australian Tyre Recycling Association (ATRA). There is a high rate of illegal tyre disposal in Australia. The public benefit was that the ATRA ensures that tyres are disposed of in an environmentally and legally appropriate way.

The Cheesecake Shop Pty Ltd lodged a notification to require their franchisees to enter an agreement with the Commonwealth Bank for a customer online payment facility. This essentially cut out the franchisor as the middle man in processing payments. According to the franchisor, the arrangement benefited the public because it saved individual franchisees the costs and delays in processing payments, and offered customers an efficient payment system.

The franchisor of Pizza Hut franchises, Yum! Restaurants Australia Pty Ltd, lodged a notification to require their franchisees to source products from approved suppliers. The franchisor stated this benefited the public because it provided customers with consistency of services and the taste of high quality products throughout the whole franchise system.

The ACCC can also revoke notifications. Under a notification by Seal-A-Fridge Pty Ltd, franchisees were required to source goods used in the manufacture of refrigerator seals from nominated suppliers. There was no foundation that this conduct would deliver cost savings to franchisees or an increase of quality for people.

Franchisors can withdraw a notification before the ACCC takes action for exclusive dealing. In 2002 Juice Station Franchising Pty Ltd was given approval to require franchisees to obtain products, namely bottles, from nominated suppliers. In 2005 the ACCC became aware that the bottles were no longer fit for purpose because they were improperly formed. Because the supply arrangement no longer benefited the public, the ACCC lodged an intention to revoke the notification, leading the franchisor to withdraw their notification.

Decisions of the Courts

As one of the issues in the 2013 case of *Pampered Paws Connection Pty Ltd v Pets Paradise Franchising (Qld) Pty Ltd*, the franchisor was found to have engaged in third line forcing as no notification was lodged. The franchisor required the franchisee to purchase certain stock from the franchisor's own specified supplier. The franchisee was essentially made a retailer of the supplier's stock.

In the 2010 case of *ACCC v Black and White Cabs Pty Ltd*, Black and White Cabs required their taxi drivers to only use an electronic payment service from a specified company. This requirement was third line forcing and there had been no notification lodged. Black and White Cabs was ordered to institute a competition compliance program, pay a pecuniary penalty of $110,000 and $10,000 towards the ACCC's costs.

What are the Consequences for Exclusive Dealing?

Failure to lodge a notification can incur penalties from the ACCC. Individuals can be fined up to $500,000. For companies, fines up to or greater of:

1. $10 million;
2. Three times the gain from the dealing; or
3. 10% of annual turnover if the gain cannot be assessed.

Consequences do not just end with penalties:

- Compensation may be payable to franchisees.
- There can be damage to a franchisor's reputation in the marketplace depending on the conduct.
- There will be consultant's costs, including legal fees, accountants and actuaries.
- There will be affects on management time because focus is taken off business and put onto defending the claim.

Full disclosure to the ACCC by franchisors is important. The ACCC regularly receives complaints about exclusive dealing, prompting regular investigations. To see the figures for these and other franchise related complaints, see the report Small Business in Focus.

What steps should Franchisors and Franchisees take?

Franchisors must be careful when restricting a franchisee's freedom to deal with suppliers, and should ensure that any supply agreement is up to date with legal requirements.

Franchisees should discuss any concerns that they have about supply arrangements with their franchisor. An exclusive dealing arrangement may be in place to benefit both the franchise system and the public.

It is strongly recommended that advice is obtained from a lawyer before entering into a franchise agreement. At Bywaters Timms we can carefully check whether terms in a franchise agreement have the effect of substantially lessening completion in the marketplace and advise on ways to protect both franchisors and franchisees.

We can lodge notifications with the ACCC to engage in a form of exclusive dealing where appropriate, or advise on alternative ways to structure arrangements which will not breach anti-competition laws.

WARNING – This article is only meant to give you general information and should not be relied on as legal advice. If you would like more information then talk to one of our solicitors.