



# WHAT YOU NEED TO KNOW ABOUT:

## Competition issues in franchising supplier arrangements

October 2013

Franchisors often require franchisees to purchase goods or services from particular suppliers. This guide helps franchisors and franchisees understand the ACCC's role in reviewing these arrangements.



### Franchise supplier arrangements and the Act

Franchising supplier arrangements that limit the suppliers from whom franchisees may purchase the goods and services required to operate their businesses may raise competition issues under the Competition and Consumer Act (the Act).

A franchisor that requires franchisees to purchase goods or services only from a particular supplier or a list of nominated suppliers may be engaging in **'third line forcing'**. Third line forcing will breach the Act even if the conduct will not harm competition.

#### What is third line forcing?

Third line forcing occurs where a supplier (e.g. a franchisor) supplies goods or services (e.g. franchising services or the right to become a franchisee) on condition that the customer also acquires goods or services from another person or business (unrelated to the supplier).

Some franchisors also:

- set objective quality standards and allow individual franchisees to source goods or services from any supplier that meets those standards, or
- require franchisees to purchase goods or services from the franchisor or a related company.

These arrangements will only raise concerns under the Act if they have the **purpose or likely effect of substantially lessening competition**. Generally, competition is unlikely to be substantially affected where the franchise's market and the suppliers' markets include a number of competing businesses.

### How can franchisors implement these supplier arrangements under the Act?

Control by franchisors over the way in which franchisees operate is often central to the operation and success of a franchise system.

A franchisor who wishes to engage in third line forcing conduct may lodge a **'notification'** with the ACCC which provides it with protection from legal action under the Act.

#### What is a notification?

A notification is a notice prepared by the business that wants to engage in particular types of conduct (e.g. third line forcing) that may raise concerns under the Act. The notice:

- describes the arrangements, and
- sets out the public benefits and public detriments that are likely to arise from the conduct.

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After a notice is validly lodged with the ACCC, statutory protection to engage in the third line forcing conduct will commence after 14 days unless the ACCC takes steps to prevent this.

The ACCC regularly receives third line forcing notifications lodged by franchisors who intend to require franchisees to purchase goods or services from nominated suppliers.

Businesses may also lodge notifications with the ACCC in relation to supplier arrangements that may have the purpose or likely effect of substantially lessening competition.

## How does the ACCC assess third line forcing notifications?

The ACCC's ability to remove the protection provided by a notification is limited.

The ACCC may only remove the protection from legal action provided by a notification if it is satisfied that the likely public benefits will not outweigh the likely public detriments from the conduct.

If the ACCC is satisfied that this threshold is met at any time, it may take steps to remove the statutory protection provided by a notification (this is known as 'revoking' the notification).

**In relation to third line forcing notifications for franchising supplier arrangements, it is rare for the ACCC to take action to revoke notification.**

Where the ACCC has previously taken action in relation to these types of notifications, there has been evidence that the conduct would cause significant public detriment to the broader community. For example, the ACCC would be concerned if a franchisor required franchisees to purchase products that didn't meet minimum safety thresholds.

## What are the likely public benefits and public detriments?

The public benefits and public detriments the ACCC must consider include the impact of the conduct on the entire community and not just the impact on individual franchisees.

The ACCC considers the following public benefits may arise where a franchisor requires franchisees to only acquire goods and services from particular suppliers:

- consistency across the franchise system, which may benefit customers and increase the value of the franchise system as a whole
- more efficient operation and management of the franchise system where all franchisees operate compatible equipment and purchase the same goods
- more efficient and effective bargaining between the franchise group and its suppliers which may result in:
  - improved non-price terms of the supply contract—for example, specific service levels or changes to the supplier's usual method of delivery (e.g. beyond the 'take-it-or-leave-it' contracts that large suppliers may offer individual franchisees), and
  - cost and time savings, as franchisees will not need to individually search for and negotiate the best deal with suppliers.

When considered across the entirety of the franchise system, these public benefits may be significant.

However, in some cases public detriments may also arise, including:

- supplier arrangements which do not benefit the franchise group as a whole and are less efficient than if franchisees were not subject to those restrictions, and
- less competition in a relevant market, such as the markets in which franchisees operate or the markets in which suppliers of goods or services to the franchisee compete.

## How are rebates relevant to the ACCC's assessment of public benefits and public detriments?

Some franchisors may enter into arrangements where a nominated supplier will provide the franchisor with a 'rebate' or some other kind of financial benefit when franchisees purchase goods or services from that supplier.

The mere receipt of rebates by a franchisor will not automatically constitute a public detriment in the ACCC's assessment of a notification. **There is no outright prohibition against rebate arrangements.**

The **Franchising Code of Conduct** requires franchisors to disclose:

- whether they will receive a rebate or financial benefit from the supply of goods or services to franchisees,
- the name of the business providing the rebate or financial benefit, and
- whether the rebate is shared directly or indirectly with franchisees.

There is no legal requirement for franchisors to disclose the value of the financial benefit or to distribute that benefit amongst franchisees.

The receipt of rebates by a franchisor can be a contentious issue in some franchise systems. Many franchisees object to rebates as they consider that:

- the franchisor may select a supplier due to the expected value it will receive through the rebates, rather than by having regard to whether the supplier will deliver the best value for franchisees, or
- rebates may increase the cost of goods or services that the franchisees are required to buy.

On the other hand, some franchisors consider that rebates are an essential part of their operating model as the rebate income stream may be used to:

- provide benefits to franchisees (e.g. to support national marketing campaigns), or
- reduce the fees that franchisees would otherwise need to pay to the franchisor.

The receipt of rebates by a franchisor from nominated suppliers is a complex issue, and it can be difficult to establish whether these arrangements provide net benefits or detriments to the franchise system or the general public.

The matter of rebates will not be considered in isolation but may be considered as a part of the broader assessment of public benefits and public detriments. However, it is not the ACCC's role to reach a conclusion regarding whether the proposed supplier arrangements offer the best value for franchisees.

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## Further information for franchisees

The ACCC often receives complaints from franchisees about notified franchise supplier arrangements. Many do not directly relate to the supplier arrangements covered by the notification but go to other concerns the franchisee has regarding the operation of the franchise system.

Franchisees sometimes question why they should be forced to buy goods or services from suppliers nominated by their franchisor when they may be able to buy those or some of the goods or services cheaper elsewhere.

The role of the ACCC is to assess the public benefits from the supplier arrangement as a whole.

The public benefits for the franchise system will often include the combined increased efficiencies for the franchisor, nominated suppliers and all franchisees. These benefits will often outweigh specific examples of potential detriment to an individual franchisee.

The ACCC encourages franchisees, including prospective franchisees, to speak with franchisors regarding any concerns they have about the supplier arrangements for their franchise system.

## Further information for franchisors

Often the ACCC receives complaints from franchisees about supplier arrangements where changes have been introduced without adequate consultation. Franchisors are encouraged to:

- consult with franchisees when putting in place supplier arrangements which restrict how franchisees purchase goods and services, or changing the way in which such a supplier arrangement works (e.g. by decreasing the number of nominated suppliers)
- consider the costs and benefits for the franchise group as a whole when selecting nominated suppliers including ensuring that selected suppliers (whether they provide rebates or not) deliver better value for the franchise system than alternative suppliers
- explain to franchisees the process that the franchisor has undertaken in selecting those suppliers and the reason for any changes, especially where popular suppliers are removed, and
- monitor nominated suppliers in order to ensure that the arrangements continue to deliver value, either through lower prices or increased quality, to the franchise group as a whole.

The ACCC encourages franchisors to ensure details of any supplier arrangements are made transparent to both prospective and existing franchisees, including disclosure beyond the minimum requirements set out in the Franchising Code of Conduct.

## ACCC resources

The ACCC's [website \(www.accc.gov.au\)](http://www.accc.gov.au) contains information about the notification process and the obligations of franchisors under the Franchising Code of Conduct and the Competition and Consumer Act.

The ACCC maintains a [register](#) of all notifications it receives which is also available on its website.

Franchisors and franchisees may contact the ACCC for further help in understanding the notification process. Contact us through our [website](#) or our small business helpline on 1300 302 021.

### Important notice

The information in this publication is for general guidance only. It does not constitute legal or other professional advice, and should not be relied on as a statement of the law in any jurisdiction. Because it is intended only as a general guide, it may contain generalisations. You should obtain professional advice if you have any specific concern.

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