



**Australian
Competition &
Consumer
Commission**

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20 April 2010

Mr Luke Dale
Partner
Kelly & Co Lawyers
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ADELAIDE SA 5001

Dear Mr Dale

**Exclusive dealing notifications N94070 – N94082 lodged by
Essential Beauty Franchisors and Master Franchisees**

I refer to the above mentioned exclusive dealing notifications lodged with the Australian Competition and Consumer Commission (the ACCC) by the five Essential Beauty franchisors and three Essential Beauty Master Franchisees (the Applicants) on 10 August 2009.

Broadly, the conduct the subject of the notifications involves the Applicants requiring franchisees to purchase goods and services approved by the Franchisors (Approved Goods and Services) from the Applicants (this conduct is referred to as exclusive dealing conduct other than third line forcing) or suppliers approved by the Franchisors (Approved Suppliers) (this conduct is referred to as third line forcing conduct). Following is a more detailed summary of each of the three series of notifications lodged by the Applicants.

Exclusive dealing other than third line forcing notifications

Notifications N94070 to N94074

- A. Essential Beauty Franchising Pty Ltd, Essential Beauty Franchising (NSW) Pty Ltd, Essential Beauty (Qld) Pty Ltd, Essential Beauty (Vic) Pty Ltd and Essential Beauty Franchising (WA) Pty Ltd (the Franchisors) have each lodged notifications in respect of requirements that:
- (i) Master Franchisees and franchisees agree to acquire Approved Goods and Services only from the Franchisors, under the standard Master Franchise and Franchise Agreements

- (ii) Master Franchisees only supply Approved Goods and Services, acquired from Approved Suppliers, to appointed franchisees, and
- (iii) Franchisees only supply Approved Goods and Services, acquired directly from Franchisors or Approved Suppliers, or from the Franchisors or Approved Suppliers via the Master Franchisees (as intermediary), to consumers.

Third line forcing notifications

Notifications N94075 to N94079

- B.** Each of the Franchisors propose to offer franchise agreements to Master Franchisees and franchisees on condition that Master Franchisees and franchisees acquire Goods and Services only from Approved Suppliers.

Notifications N94080 to N94082

- C.** Each of Essential Beauty Chermside Pty Ltd, Essential Beauty Victoria Pty Ltd and Pilton Holdings Pty Ltd (the Master Franchisees) propose to offer franchise agreements on condition that franchisees agree to only acquire Approved Goods and Services from the Franchisor responsible for the territory in which they operate, or Approved Suppliers.

Legal immunity conferred by the notifications commenced on 10 August 2009 for notifications N94070 – N94074 and 24 August 2009 for notifications N94075 – N94082.

Having considered the notifications and submissions from the Applicants and interested parties, the ACCC does not intend to take further action in this matter at this time.

Under the notification process immunity from the exclusive dealing provisions of the *Trade Practices Act 1947* (the Act) for third line forcing conduct is obtained automatically 14 days after the date of lodgement, and for exclusive dealing conduct other than third line forcing immunity commences on receipt of an application. For both types of conduct the immunity continues unless the ACCC issues a notice revoking the immunity.

For third line forcing conduct, the ACCC may issue a notice revoking the immunity only if it is satisfied that the likely benefit to the public from the notified conduct would not outweigh the likely detriment to the public resulting from the conduct. Provided it is so satisfied, the ACCC may act to remove the immunity afforded by a notification at any stage.

For exclusive dealing conduct other than third line forcing the ACCC may revoke the immunity only if it is satisfied the exclusive dealing conduct will substantially lessen competition and the public benefits would not outweigh the anti-competitive detriments resulting from the substantial lessening of competition.

Summary of ACCC considerations

Assessment of exclusive dealing conduct other than third line forcing (N94070 – N94074)

The Essential Beauty wholesale and retail businesses constitute a relatively small proportion (i.e. less than 2 per cent) of the entire wholesale and retail markets for the supply and acquisition of personal care, personal grooming and beauty products, equipment and services in Australia. On this basis, the ACCC considers that the proposed conduct is unlikely to substantially lessen competition within the retail and wholesale markets for the supply of these products.

Assessment of third line forcing notifications (N94075-N94082)

It is not uncommon for franchisors to require franchisees to acquire stock or equipment from nominated suppliers (including themselves). By their very nature, franchise agreements will impose some restrictions on franchisees' freedom to choose with whom, in what or where they deal.

Franchisors often argue, and the ACCC has previously accepted, as in this case, that a number of public benefits flow from exclusive dealing in franchise supply arrangements.

The ACCC accepts that there is a public benefit in arrangements that promote consistency in quality of products across franchise networks, and the reputation of the franchise network. The ACCC considers that this is likely to lead to greater choice for consumers and promote competition in the market more generally.

The ACCC considers that the notified arrangements may also create buyer power which could deliver cost savings to franchisees, result in more timely supply of goods and, as submitted by the Applicants, allow products to be packaged and supplied in a manner specifically tailored to the Essential Beauty brand. This may also improve the competitiveness of Essential Beauty retailers which would be likely to be reflected in greater choice in price and quality of personal grooming/beauty products for consumers.

The ACCC also had regard to the concerns raised by franchisees that some products are available more cheaply from alternative suppliers or the unavailability of some items. However, the ACCC considered that it is appropriate that the franchisor consider various criteria in approving suppliers, in addition to cost and product range.

Also relevant to the ACCC's assessment is the Applicants' statement that they intend to implement procedures to allow franchisees to nominate items for consideration as Approved Goods or Services. The nomination procedures will also allow franchisees to suggest suppliers for consideration and approval as an Approved Supplier.

Whether the third line forcing conduct is permitted under individual franchise agreements will depend on the clauses of those contracts and any breach is primarily a private contractual matter for franchisees. The ACCC notes that immunity from legal action conferred by the notifications does not extend to a breach of contract.

Other considerations

This assessment has been made on the basis that the Applicants will disclose all relevant terms and conditions to current and prospective franchisees. In particular I note that the Applicants are required to comply with the disclosure requirements of the Franchising Code of Conduct in relation to the notified arrangements. Among other things, these specify that a franchisor must provide information to franchisees in its disclosure document about:

- any restrictions on acquisition of goods or services by the franchisee from other sources
- whether the franchisor or an associate will receive a rebate or other financial benefit from the supply of goods or services to franchisees, including the name of the business providing the rebate or financial benefit and
- whether any such rebate or financial benefit is shared directly or indirectly with franchisees.

More generally I would note that the Franchising Code of Conduct also requires disclosure of:

- ownership by a franchisor or an associate of a franchisor of an interest in any supplier from which the franchisee may be required to acquire goods or services
- any restrictions by a franchisor on the goods or services that a franchisee may supply, and
- any restrictions on the persons to whom a franchisee may supply goods or services.

As with any notification, please note that the ACCC may act to remove the immunity afforded by the notifications at a later stage if it is satisfied that the likely benefit to the public from the conduct will not outweigh the likely detriment to the public from the conduct.

Other conduct sought to be notified

The third line forcing notifications lodged by the Applicants also described the following conduct:

Notifications N94075 – N94079

D. Each of the Franchisors proposing to offer franchise agreements to Master Franchisees and franchisees on condition that:

- (i) Master Franchisees only supply the Approved Goods and Services, acquired from Approved Suppliers, to appointed franchisees, and
- (ii) Franchisees only supply the Approved Goods and Services, acquired directly from Approved Suppliers, Franchisors or from the Franchisor or Approved Suppliers via the Master Franchisees (as intermediary), to consumers.

Notifications N94080 – N94082

- E. Each of Essential Beauty Chermside Pty Ltd, Essential Beauty Victoria Pty Ltd and Pilton Holdings Pty Ltd (the Master Franchisees) proposing to offer franchise agreements on condition that franchisees agree to only supply the Approved Goods and Services, acquired from Approved Suppliers or the Franchisor responsible for the territory in which they operate, directly, to consumers.

As discussed with Gina D’Ettorre on 17 August 2009, this conduct cannot be characterised as third line forcing conduct. That is, it does not involve the supply of goods or services on condition that the purchaser also acquires goods or services from a third party. Accordingly, the ACCC does not consider this conduct to be covered by notifications N94975 – N94079.

With respect to the conduct described at D. (i) and (ii) I note that the Applicants have notified identical conduct in the notifications concerning exclusive dealing other than third line forcing (referred to above at A (i) to (iii) above) and the ACCC considers that this conduct is covered by these notifications.

With respect to the conduct described at E above I note that Gina D’Ettorre of this office advised you that should protection be required for this conduct the Applicants will need to lodge a new notification for exclusive dealing other than third line forcing.

A copy of this letter has been placed on the ACCC’s public register. If you wish to discuss any aspect of this matter, please do not hesitate to contact Gina D’Ettorre on 03 9290 1483.

Yours sincerely

A handwritten signature in black ink, appearing to be 'R Chadwick', written over a light blue horizontal line.

Dr Richard Chadwick
General Manager
Adjudication Branch