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21 November 2013

Dear Sir/Madam

Third line forcing notification N96512 lodged by Subway Systems Australia Pty Ltd

Thank you for your recent submission in relation to third line forcing notification lodged with the Australian Competition and Consumer Commission (the ACCC) on 24 December 2012 by Subway Systems Australia Pty Ltd (Subway Australia). For interest, I have also attached the ACCC's recently release guide to third line forcing conduct by franchisors (also available from <http://www.accc.gov.au/system/files/Competition%20issues%20in%20franchising%20supply%20arrangements.pdf>).

The conduct the subject of the notification involves Subway Australia requiring its franchisees to acquire goods and services from approved suppliers (in most cases from a list of pre-approved suppliers). The ACCC notes that the notification does not relate to any requirement that franchisees purchase products from Subway Australia or Doctor's Associates. The ACCC also notes that the products covered by the notification overlap with previous notifications in 2009 in relation to IT software which have been allowed to stand (N94253, N94197 and N94009).

As you may be aware, the competition provisions of the *Competition and Consumer Act 2010* (the Act) prohibit certain forms of anti-competitive conduct or arrangements. Subsections 47(6) and (7) of the Act prohibit exclusive dealing of the type known as third line forcing. Third line forcing occurs where a corporation supplies goods or services on condition the customer acquires other goods or services from another business or refuses to supply because the customer will not agree to that condition.

Businesses wishing to engage in third line forcing conduct can 'notify' the ACCC of the conduct. Notification provides immunity from legal action by the ACCC and any other party for potential breaches of the exclusive dealing provisions of the Act where the conduct is in the public interest.

Under the notification process immunity in relation to third line forcing conduct is obtained automatically 14 days after the date of lodgement, and continues unless the ACCC issues a notice revoking the immunity.

The ACCC may issue a notice revoking the immunity in respect of third line forcing conduct 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.

Summary of ACCC assessment

Having considered the notification and submissions from interested parties, the ACCC does not intend to take further action in this matter at this stage as, on the basis of the evidence currently available, it is satisfied that the likely benefit to the public from the notified conduct would outweigh the likely detriment to the public resulting from the conduct.

In reaching this position the ACCC considered that the notified arrangements would generate public benefits by increasing the Subway chain's and its franchisees' competitive response in various relevant markets by:

- a) better satisfying the expectations of customers, franchisees and governments as to the quality, consistency and safety of products produced by franchisees across Australia. This includes facilitation of monitoring of the performance of the chain and individual franchisees by Subway Australia;
- b) assisting Subway Australia to improve its marketing by helping it to formulate and promote special offers; and
- c) facilitating the capture of bulk purchasing efficiencies in relation to Approved Products.

In considering the issues raised by Subway franchisees, Subway Australia has provided evidence to the ACCC that:

- it permits some flexibility for franchisees to buy from distributors and suppliers who meet Subway Australia's standards but who have not otherwise been formally approved;
- its practice is to allow the Independent Purchasing Company (Australasia) Limited (IPCA) to negotiate the terms of supply of most goods and services. Currently this includes coordination of distribution and handling franchisee complaints regarding suppliers. IPCA is wholly owned by Subway franchisees and the notification will not alter the position of IPCA; and
- the requirement to use approved suppliers and the existence of possible rebates is disclosed in Subway Australia's franchising agreements and disclosure document as required under the Franchising Code of Conduct.

Based on the above factors, the ACCC considers that the claimed benefits are likely to be realised and that there is unlikely to be sufficient detriment flowing from the notified conduct to outweigh those benefits.

This assessment has been made on the basis that Subway Australia will disclose all relevant terms and conditions to current and prospective franchisees. In particular I note that Subway Australia is required to comply with the disclosure requirements of the Franchising Code of Conduct in relation to the notified arrangement. 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, the ACCC may act to remove the immunity afforded by the notification 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.

A copy of this letter has been placed on the ACCC's public register. To ensure that all Subway franchisees are aware of the outcome of this matter, the ACCC has requested that Subway Australia provide a copy of this letter to all franchisees.

If you wish to discuss any aspect of this matter, please do not hesitate to contact Tanya Hobbs on (02) 6243 1029 or by email at adjudication@acc.gov.au.

Yours sincerely



Baethan Mullen
Acting General Manager
Adjudication Branch