

12 September 2014

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COMMERCIAL-IN-CONFIDENCE

Darrell Channing
Director - Adjudication Branch
Australian Competition & Consumer Commission
GPO Box 3131
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Dear Mr Channing

Tooltechnic application for authorisation – Response to further request for information

We refer to our telephone discussion with Tanya Hobbs on 8 September 2014 in which it was requested that our client, Tooltechnic Systems (Aust) Pty Ltd (**Tooltechnic**) respond to three further questions in relation to its application for authorisation (A91433).

The responses below contain confidential commercial information of our client and confidential information about Tooltechnic's dealers. We therefore request that this letter remains confidential. We have provided you with a redacted version of this letter for publication on the Commission's public register.

1. ***Provide examples of when Tooltechnic attempted (unsuccessfully) to include terms in its agreements with dealers that required them to meet service quality standards.***
 - 1.1 The current partner and premium dealer agreements include terms which require dealers to meet certain service quality standards in order to be eligible for discounts on Festool products and accessories. Our client wishes to clarify that it has not encountered difficulty in negotiating such terms into the dealer agreements. Rather, it has experienced a steady decline in the effectiveness of the discount structure to incentivise dealers to provide quality retail services.
 - 1.2 When the discount structure was initially introduced, our client found that it provided sufficient motivation for dealers to improve retail services. This trend shifted with the onset of aggressive discounting, internet sales and smart phone technology that enabled customers to easily compare prices which in turn has reduced profit margins on Festool products. In the current environment, the threat of losing discounts for failing to meet quality standards is not sufficient for some dealers to counter the pressure they are facing to reduce costs due to low margins. This is discussed further in question 2.

2. *Provide examples of when Tooltechnic disciplined dealers for failing to meet service quality standards or volumes sales targets.*

2.1 Under Tooltechnic's partner and premium dealer agreements, dealers are eligible for certain discounts if they meet quality standards such as [REDACTED]. The dealer agreements were provided with the application for authorisation (see Schedules 3 and 4).

2.2 We have set out below eight examples of dealers who were eligible for reduced discounts in 2014 compared to 2013 due to poor performance in one or more of the quality standards referred to above.

<i>Dealer</i>	<i>Discount achieved in 2013 out of max of %</i>	<i>Discount achieved in 2014 out of max of %</i>
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]

2.3 The table illustrates that our client has been actively enforcing the discount structure in the dealer agreements. While our client considers that the discount structure provides some incentive for dealers to perform better, it is not sufficient on its own to quell the general decline in retail service provided by dealers as demonstrated in our letter responding the ACCC's first request for information dated 22 August 2014 (**First Response**).

2.4 In the current retail discounting environment, some dealers are prepared to forgo Tooltechnic's discounts in order to avoid the costs associated with meeting quality standards and thereby, protect their margins when price matching against the discounters.

2.5 Our First Response also showed that free-riding is rampant in this market due to the difference in retail service levels being offered by dealers. The discount structure in the dealer agreements is an ineffective tool for dealing with the free-rider problem.

2.6 Another limitation of the discount structure is that it can only set quality criteria that are easy to measure by Tooltechnic. It is not an effective means for controlling day-to-day interactions with customers and leads to the case examples provided in our First Response of poor performance where dealers failed to:

- (a) spend adequate time to educate customers;
 - (b) have sufficient product knowledge;
 - (c) have adequate stock levels of consumables;
 - (d) provide demonstrations of products; or
 - (e) provide fast and effective returns, warranty and repair services.
- 2.7 Even if the discount structure was amended to include the above quality standards, it would be very difficult, time-consuming and costly for Tooltechnic to evaluate performance against such criteria.
- 2.8 This limitation means that although some dealers may meet all or most of the quality standards in their dealer agreements, this does not necessarily translate into better quality retail service. For example, [REDACTED] was identified in our First Response as an active discounter who provides poor retail service. Nevertheless, [REDACTED] achieved the maximum discount possible in 2013 and a slightly reduced discount in 2014. The instance of poor performance highlighted in our First Response related to returns service (paragraph 2.12 of the First Response) which is not a quality standard under the current discount structure and would be difficult to measure in any case.
- 2.9 Another example is [REDACTED] who had refused to attend training on multiple occasions due to the costs involved. Recently, [REDACTED] reluctantly agreed to attend training due to the threat of reduced discounts from Tooltechnic. However, [REDACTED] was identified as one of the most active discounters in our First Response and was mentioned in an example of providing poor returns service.
- 2.10 In contrast, having a minimum retail price for Festool products would provide a much more effective and efficient mechanism for improving retail service and addressing the free-rider problem. Dealers would have an economic incentive to increase investment in retail services in order to distinguish themselves from competitors. This incentive would drive improvement in the quality standards set out in dealer agreements and in the less measurable criteria outlined above that affect the day-to-day operations of a dealer's business. A minimum retail price would also encourage innovation in a way that a contract cannot.
- 3. *If the ACCC granted the authorisation, provide examples of terms Tooltechnic would be able to negotiate into its dealer agreements to obtain better service as a result of its stronger bargaining power.***
- 3.1 If the ACCC granted Tooltechnic's application for authorisation, Tooltechnic would continue to implement the discount structure as it envisages that the economic incentive afforded by a minimum retail price would work in conjunction with the contractual incentives afforded by the discount structure.
- 3.2 Over time, our client expects to increase the quality standards expected of its partner dealers. As an example, our client would allow for transition in 2015 and in 2016, would consider improving the quality standards as set out in the table below and continue such improvements over time.

<i>Current Criteria</i>	<i>Current Discount</i>	<i>Proposed Criteria</i>	<i>Proposed Discount</i>
[Redacted]			
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]			
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]			
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]	[Redacted]

4.1 In relation to the premium dealer agreements, Tooltechnic anticipates that partner dealers will consider upgrading to premium dealer status. Guaranteed margins would incentive dealers to make the investment required to be a premium dealer. Our survey of partner

dealers indicated the interest in becoming a dealer with a Festool Shop-in-Shop concept if margins were guaranteed on Festool products (see paragraph 10.4 of the First Response).

5. Further, Tooltechnic is considering monitoring and measuring the Customer Service of all Premium Shops and Partner Dealers on a regular basis [REDACTED]. After an initial introduction phase, parts of rebates and discounts may be linked to the results and improvement in the level of Retail Service [REDACTED]

If you require any further information in respect of this matter, please contact Geoff Carter on 03 8608 2090.

Yours faithfully

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Partner

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