



Australian  
Competition &  
Consumer  
Commission

# Draft Determination

Application for authorisation A91433

lodged by

Tooltechnic Systems (Aust) Pty Ltd

in respect of

resale price maintenance

Date: 21 October 2014

Authorisation number: A91433

Commissioners:

Sims  
Rickard  
Schaper  
Cifuentes  
Court  
Featherston  
Walker

# Summary

**The ACCC proposes, on balance, to grant conditional authorisation to Tooltechnic Systems (Aust) Pty Ltd to engage in resale price maintenance for three years to encourage its dealers to offer the full range of services it considers appropriate in marketing Festool products to customers.**

## **Next steps**

**The ACCC will seek further submissions in relation to this draft determination before making its final decision. The applicant and interested parties may also request the ACCC to hold a pre-decision conference to allow oral submissions to be made on the draft determination.**

On 20 June 2014, Tooltechnic Systems (Aust) Pty Ltd (Tooltechnic) lodged an application for authorisation to engage in resale price maintenance. Tooltechnic proposes to amend its agreements with its dealers to include a requirement that they not sell any Festool products below minimum prices nominated by Tooltechnic (Proposed Conduct).

Tooltechnic is the exclusive importer and wholesaler of Festool power tools and related products in Australia.

Under the *Competition and Consumer Act 2010* (CCA), resale price maintenance is prohibited per se. However, the ACCC can authorise resale price maintenance where it is satisfied that in all the circumstances the conduct is likely to result in public benefits which outweigh the public detriments likely to result from the conduct.

Resale price maintenance limits or prevents retailers from competing with one another on price because they cannot offer the product for sale below a specified level. It is likely to result in some customers paying more for a product. In certain circumstances, resale price maintenance can also reduce competition and potentially lead to higher prices by facilitating coordinated conduct between manufacturers or retailers in setting their prices.

In this case, the ACCC accepts that the Proposed Conduct will eliminate price competition between Festool dealers for Festool products. This will result in a clear public detriment as some customers will face a higher retail price for Festool products. However, the extent of this detriment is likely to be limited by:

- the wide range of alternative trade quality power tools available to customers
- the fact that Tooltechnic has little incentive to set minimum retail prices above competitive levels because doing so would likely reduce sales of Festool products overall.

Based on the information available, the ACCC considers that the Proposed Conduct is unlikely to facilitate coordinated conduct between suppliers of trade quality power tools given:

- the small market share of Festool products and the significant number of other larger suppliers of trade quality power tools
- the history of entry and expansion, especially by established international power tool manufacturers

- the highly differentiated nature of power tools—as a result, suppliers compete on a range of factors such as reliability, performance and service in addition to price
- innovation is a key feature of the power tool industry.

The ACCC recognises that resale price maintenance can, in certain circumstances, address failures in the market and thereby generate benefits to the public.

The ACCC considers that Festool products are complex products which are highly differentiated in terms of their attributes and quality, and the provision of services to customers is important in the sale of Festool products. These services include pre-sale explanations, demonstrations and ‘try-before-you-buy’ of Festool products and post-sales services such as repairs, loan tools and training in use of a product. Full service retailers are well placed to effectively and efficiently explain and demonstrate these attributes to potential customers, and to provide after-sales service to existing customers. However, customers can access retail services from one retailer but then purchase the product from another retailer (which may not provide retail services) at a discount. That is, some retailers can gain the benefit of, or free ride on, the services offered by other retailers.

In this case, the ACCC accepts that there is a market failure caused by free riding by some Festool retailers. That is, there is a material risk that full service retailers will not achieve a sufficient return on the sales of Festool products to continue to provide these pre- and post-sales services, or to provide a sufficient level of these services.

The ACCC considers that the Proposed Conduct is likely to limit free riding by eliminating discounting and so encouraging retailers to offer better services (rather than lower prices) to attract customers. The ACCC is of the view that improved pre- and post-sales services are likely to result in public benefits including:

- some customers making more informed decisions in purchasing trade quality power tools
- power tool customers continuing to be offered the choice of a premium trade quality power tool product which is accompanied by a high level of post-sales service.

Although it is inherently difficult to determine the precise extent to which the Proposed Conduct will encourage a greater provision of pre- and post-sales services by dealers, in the circumstances of this application, the ACCC considers that there is likely to be a benefit to some customers arising from the future with the Proposed Conduct as compared to the future without it.

The key issue here is the apparent incentives facing Tooltechnic. With only a small share of the market Tooltechnic needs to judge whether higher service levels will outweigh lower prices in attracting sales. If the expected increase in service and sales does not eventuate, the conduct is not likely to be profitable and hence in Tooltechnic’s continued interest. Should higher services outweigh lower prices, inter-brand competition is also likely to be promoted to some extent.

On balance, the ACCC considers that in these particular circumstances the public benefit resulting from the increase in retail services will likely outweigh the clear, but limited, detriment resulting from the fact that some customers will face a higher retail price for Festool products.

The ACCC notes that this is the first application for authorisation of resale price maintenance since the CCA (then the *Trade Practices Act 1974*) was amended in 1995 to allow the ACCC to authorise such conduct. In these circumstances, and given the ACCC's finely balanced assessment of the public benefits and detriments likely to arise from the Proposed Conduct, the ACCC proposes to grant authorisation for three years rather than the five years sought by Tooltechnic.

The ACCC's assessment of efficiency promoting RPM conduct will depend heavily on the circumstances of each case. In proposing to grant authorisation to Tooltechnic, the ACCC has had regard to the following factors:

- Tooltechnic has a very small market share in a highly competitive market.
- Trade quality power tools are highly differentiated products and Festool products are particularly complex.
- In selling Festool products, therefore, customers obtain significant benefit from investment by retailers in both pre- and post-sales services.
- Trade quality power tools are readily sold online or by discount retailers who have not made this significant investment in services but who may benefit from other retailers who have done so.

The CCA allows the ACCC to grant authorisation subject to conditions. Given that this is the first authorisation of resale price maintenance conduct, and that it is difficult to weigh the public benefits and detriments before the conduct is put in place, the ACCC is proposing to impose conditions on authorisation to require Tooltechnic to provide the ACCC with certain information on an annual basis. This will allow the ACCC to monitor the impacts of the resale price maintenance conduct over the period of authorisation and will inform consideration of any future application for reauthorisation by Tooltechnic.

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## The application for authorisation

1. On 20 June 2014, Tooltechnic Systems (Aust) Pty Ltd (Tooltechnic) lodged an application for authorisation<sup>1</sup> (A91433) with the ACCC under subsection 88(8A) of the *Competition and Consumer Act 2010* (the CCA). Tooltechnic is seeking authorisation to engage in resale price maintenance in relation to Festool products for five years.
2. The ACCC notes that this is the first application for authorisation of resale price maintenance since the CCA (then the *Trade Practices Act 1974*) was amended in 1995 to allow the ACCC to authorise such conduct.

## The conduct

3. Tooltechnic proposes to amend its agreements with its dealers to include a requirement that they not sell any Festool product below minimum prices nominated by Tooltechnic to incentivise its dealers to offer the full range of services it considers appropriate in marketing Festool products to customers (the Proposed Conduct).

## The applicant

### Tooltechnic Systems (Aust) Pty Ltd

4. Tooltechnic is an importer and wholesaler of power tools and related products. These include drills, sanders, saws and dust extractors. Tooltechnic is a privately owned Australian business, and is the exclusive importer of the Festool, Protool, TOX, Tyrolit and WALKO brands in Australia. The Proposed Conduct relates only to the Festool brand.

### Festool products

5. Tooltechnic markets the Festool brand as a premium product, and states that the products are primarily aimed at trade users, rather than do-it-yourself (DIY) customers. Tooltechnic states that it supplies products which are mainly used in the following industries:
  - building and construction
  - cabinet making and joinery
  - painting and decorating
  - automotive refinishing
  - marine building and repairs
  - manufacturing.

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<sup>1</sup> Authorisation is a transparent process where the ACCC may grant protection from legal action for conduct that might otherwise breach the Competition and Consumer Act 2010 (the CCA). Applicants seek authorisation where they wish to engage in conduct which is at risk of breaching the CCA but nonetheless consider there is an offsetting public benefit from the conduct. Detailed information about the authorisation process is available in the ACCC's Authorisation Guidelines at [www.accc.gov.au/publications/authorisation-guidelines-2013](http://www.accc.gov.au/publications/authorisation-guidelines-2013)

6. Festool products are complex in that they often have a high level of features and functions, and they form part of a system which also includes a wide array of complementary accessories and consumables.
7. Tooltechnic submits that Festool products offer quality, benefits and features which justify a premium price. In comparison to standard power tools, Tooltechnic states that Festool products emphasise:
  - reliability and lifespan (including the ability to repair products)
  - inclusion of non-standard features and regular innovation of new features
  - useability in terms of precision, flexibility, and integration with a large range of complementary products to further increase user productivity.

### **Dealership arrangements**

8. Tooltechnic supplies its products through more than 200 dealers which are located in each Australian State and Territory.
9. Distribution of the Festool range to dealers is done through contracts that are renewed annually (Dealer Contracts). Under the terms of the Dealer Contracts, Festool dealers are not limited to stocking the Festool range and virtually all Festool dealers stock a variety of power tools from different manufacturers. Tooltechnic has three categories of dealers, based on their commitment to the Festool range.
10. A relatively small number of Festool dealers are 'Premium dealers', a category of dealer introduced by Tooltechnic in order to encourage a higher level of customer service. Premium dealers are required to dedicate at least 55m<sup>2</sup> of floor space to Festool products and to maintain a Festool demonstration centre. Other obligations on Premium dealers include:
  - maintaining stock levels
  - extensive staff training
  - holding customer demonstration days and trade events, with accompanying advertising and marketing
  - attending relevant conferences and review meetings.
11. The characteristics of Premium dealers vary considerably.
  - Some stores are largely focused on trade buyers, others on the serious hobbyist, while others target a combination of the two.
  - Some Premium dealers have small stores which focus on niche products or a limited number of manufacturers. In these stores, the Festool range may constitute around 20% to 50% of the floor space of the store. Other Premium dealers have very large stores and sell a number of categories of tools from a variety of manufacturers and Festool forms a relatively smaller part of their selection.
  - One or two Premium dealers are heavy discounters, others have occasional storewide sales once or twice a year, and others do not run regular discount promotions but may price match or provide a discount for a large purchase.

12. As well as Premium dealers, Festool has a significant number of 'Partner dealers'. This category mainly consists of tool suppliers (as opposed to more generalist hardware stores) which market to trade buyers and serious hobbyists.
13. Partner dealers are required to have at least a one metre display module (which holds Festool products and the accessories and consumables for those products) and are encouraged via rebates from Tooltechnic to have a larger display. Partner dealers may also provide a test centre and a repair drop off point. Partner dealers are required to maintain specified stock levels and are offered the same staff training and sales support as Premium dealers but this not compulsory. Some Partner dealers advertise heavy and ongoing discounts however most Partner dealers advertise either minimal or no discounts.
14. The remainder of Tooltechnic's dealer network consists of industry specialist stores (for example: automotive refinishing, flooring installation and industrial paint suppliers), which provide access to a range of complementary specialist power tools for the convenience of trade customers. These 'Specialist dealers' are similar to Partner dealers in operation, but stock a limited selection of Tooltechnic products which are relevant to their industry.
15. All categories of dealers (Specialist, Partner and Premium) can and do sell Festool products on their websites.

### **Importance of pre- and post-sales services to Tooltechnic**

16. Tooltechnic has the selective distribution model described above for a number of reasons, including that it believes customer focused service by dealers to be integral to supporting "high brand loyalty" from Tooltechnic's end users. Tooltechnic is of the view that the sale of Festool products is enhanced by high levels of retail service. It describes its distribution model as based on the delivery of "excellence in brand experience for the customer".
17. Dealers provide services to customers both before and after the sale of a Festool product. The types of pre-sales services provided by retailers include:
  - having highly trained staff available to explain product characteristics to customers
  - product demonstrations, which may involve setting aside significant floor space and the cost of demonstration tools
  - 'try-before-you-buy' arrangements.
18. These pre-sales services may include information about the accessory systems which are available to complement the relevant product, and the Festool consumables (e.g. sanding disks) which may be matched with the tool in order to complete the customer's task.
19. The types of post-sales services provided by Festool dealers include:
  - providing follow up information and informal training for customers who have difficulties with fully utilising a tool's features
  - supporting quick repair times and resolution of warranty issues (for example, either through in-store repair facilities or quick transmission of faulty products to the repairer and the offer of 'loan' tools)

- convenient availability of the full range of consumables and accessories for customers who may urgently require these items (avoiding delivery delays requires significant investment by dealers in stock and floor space to carry a wide range of consumables and accessories, the less popular of which have a low stock turnover).
20. In order to assist its dealers in providing these services, Tooltechnic submits that it provides support with:
- regular training events (both national training modules as well as in store training)
  - marketing and promotions
  - timely assistance with warranty and repair services
  - a dedicated hotline for assistance
  - on-site customer demonstrations
  - trade shows and sales events.
21. Tooltechnic submits that without adequate training on Festool products, it is difficult for sales staff to justify the features and benefits of the Festool products against the price of the product. Tooltechnic also states that knowledgeable sales staff are critical to the provision of expert advice to provide correct solutions for customers.

### **Rationale for the Proposed Conduct**

22. Tooltechnic submits that its distribution model has been subject to, 'free riding' by a minority of dealers who under invest or do not invest at all in the supply of retail services necessary to support the sale of Festool products. Tooltechnic has utilised contractual arrangements in an effort to induce retailers to provide a high level of service to customers and submits that these contractual arrangements initially provided dealers with sufficient motivation to improve retail services. However, with the onset of aggressive discounting and internet sales, Tooltechnic submits its current contractual arrangements are no longer effective in preventing free riding.
23. Tooltechnic states that some dealers focus only on undercutting other dealers on price rather than providing retail services. According to Tooltechnic, this leads to a situation in which those dealers which spend time and effort in providing expertise, advice and customer demonstrations to end users often do not get the sales, as the end-users ultimately purchase products at discounted prices from other dealers. It notes that there has been a clear shift in volume away from high service retailers and towards discounters. It also submits that some high service retailers have stopped supplying Festool products due to the insufficient margins they are able to earn. Other high services retailers have refused to start stocking Festool products for the same reason.
24. Tooltechnic submits that there are two problems it is trying to address with the introduction of a minimum retail price. The first is to deal with the issue of free riding (as lower service discount dealers are able to rely on higher priced dealers to provide services to their customers) and the second is its concern about damage to its brand image.

25. As regards free riding, Tooltechnic submits that in purchasing premium products, customers place value on the services that are performed by retailers such as the provision of advice, training and product demonstrations. Tooltechnic states that from an economic perspective these services enhance the value of the product because they are valued by customers.
26. Tooltechnic notes that when it comes to products such as the Festool range which are complex and differentiated, and therefore sold on the basis of features and quality, there is a significant propensity for free riding.
27. In respect of brand damage, Tooltechnic submits that the prestige and quality associated with its brand increases the demand for its products and notes that price undercutting damages the image and status of the product. Tooltechnic submits that the trend for full services retailers to scale back their service to meet lower priced dealers is also damaging to its brand as service and product offering are core elements of the Festool brand.
28. Tooltechnic submits that the Proposed Conduct is the best way to address free riding and to limit damage to its brand image as the Proposed Conduct:
  - is efficient
  - does not eliminate or restrict competition (i.e. intra-brand competition is enhanced on non-price terms and inter-brand competition is enhanced)
  - benefits end user customers
  - is a less restrictive means to achieve benefits and to overcome the limitations in its current retail arrangements than its alternative strategy which is to implement exclusive territories and limit sales through online channels (see paragraphs 62-68 below).

## Consultation

29. The ACCC tests the claims made by an applicant in support of its application for authorisation through an open and transparent public consultation process.
30. The ACCC invited submissions from a range of potentially interested parties including major competitors and power tool retailers.<sup>2</sup> The ACCC received three submissions from Festool dealers, generally in support of the application.
31. The ACCC has also conducted market inquiries with a number of Festool dealers and competitors.
32. Those dealers wishing to continue discounting generally did not support the application (compared to the current situation) as resale price maintenance would end their ability to discount. However, many of these dealers sell on the internet, and considered that resale price maintenance would be better than the alternative suggested by Tooltechnic which would ban internet selling.
33. Bricks and mortar dealers which do not discount expressed support for the application, but also noted that Tooltechnic's suggested alternative of exclusive

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<sup>2</sup> A list of the parties consulted and the public submissions received is available from the ACCC's public register [www.accc.gov.au/authorisationsregister](http://www.accc.gov.au/authorisationsregister).

territories and a ban on internet selling would be preferred from a business perspective.

34. The submissions by the applicant and interested parties are considered as part of the ACCC's assessment of the application for authorisation.

## Legal test

35. Resale price maintenance is prohibited by section 48 of the CCA. There is no requirement under section 48 to show that the conduct in question has any effect on competition. Accordingly, resale price maintenance is said to be prohibited *per se*.
36. Although it is prohibited *per se*, resale price maintenance can be authorised by the ACCC (s 88(8A)). The ACCC cannot authorise resale price maintenance conduct unless it is satisfied, in all the circumstances, that the Proposed Conduct would result, or be likely to result, in such a benefit to the public that it should be allowed to take place (s 90(8)).
37. In broad terms, this test requires the ACCC to be satisfied that the Proposed Conduct is likely to result in a public benefit, and that public benefit will outweigh the likely detriment to the public, including those constituted by any lessening of competition.<sup>3</sup>

## Resale price maintenance and free riding

38. There is consensus in the economic literature that resale price maintenance can, in certain circumstances, remedy a free riding problem and thereby increase competition and enhance consumer welfare.<sup>4</sup> The effects of free riding and how resale price maintenance addresses these effects are described below.
39. Retailers provide a range of services that they do not directly charge customers for. Many retailers train their sales staff so they are knowledgeable about the products they sell. Many retailers allocate space to demonstration facilities and invest in arrangements allowing customers to try the product before they buy. These retail services can be costly. Retailers provide these services to attract customers. They recover the cost of providing these services through the sales margin they add to the wholesale price of the product.
40. The incentive for retailers to offer these services depends on the volume of sales they are likely to generate. The more customers who attend a retail establishment for advice and to 'try before they buy' or to seek post-sales services, but purchase the product from retailers who do not offer these services (such as from an online or discount retailer), the less incentive there is for retailers to offer these services.

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<sup>3</sup> This is consistent with the approach taken by the Australian Competition Tribunal. See *Re Australian Association of Pathology Practices Incorporated* (2004), ATPR 41-985 at [93]-[94] and *Re VFF Chicken Meat Growers' Boycott Authorisation* [2006], ACompT 9 at [67].

<sup>4</sup> *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, No. 06-480, Supreme Court of the United States, November 3 2006, On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit, Amicus Brief, Motion for leave to file brief and brief of amici curiae economists in support of petitioner, p.5.

Online or discount retailers who do not provide these services (and do not incur the cost of providing them) can undercut full-service retailers. Over time, persistent free riding by discount or low service online retailers may crowd full-service retailers out of the market (or force them to become low service retailers).

41. In the event discount or low service online retailers crowd-out full-service retailers (or force them to change their business model), customers may not be able to access the information necessary to make a fully informed decision about the products they are purchasing. As a consequence:
  - some customers may not purchase the product that best meets their needs (given prices)
  - competition between manufacturers may be distorted by rewarding manufacturers of possibly inferior (but better understood) products over superior (but more complex) products
  - existing customers will not receive the high level of post-sales service which they may expect as a consequence of purchasing a premium product. As a result, this is likely to discredit the reputation of the brand over time, making it more difficult for it to justify its premium position.
42. Resale price maintenance may in some circumstances reduce the likelihood that full-service retailers will lose sales to discount retailers. If resale price maintenance is in place, retailers who provide advice and service to a customer are more likely to gain sales. So long as the margin between the minimum retail price and the wholesale price is sufficient, more retailers are likely to become full-service retailers.
43. Resale price maintenance may lead to a range of public benefits as well as a range of public detriments.

## Relevant areas of competition and competitive dynamics

### Tooltechnic's submission

44. Tooltechnic submits that for the purposes of its application, it has adopted the markets considered in the ACCC's 2008 decision in N93330 and N93331– Techtronic Industries Australia Pty Ltd and Bunnings Group Limited (*Techtronic Industries*). This matter involved a notification of exclusive dealing in relation to power tools. In that case, the ACCC found that there is a national market for the wholesale supply of DIY power tools and local retail markets for the supply of power tools to end users (and implicitly, separate wholesale and retail markets for the supply of trade quality power tools).
45. Tooltechnic submits that market share figures are not readily available but it has provided an estimate of shares of sales which combine the wholesale markets for both trade quality power tools and DIY quality power tools. This estimate indicates that Makita has the largest share of overall sales, with Techtronic (owner of Ryobi, AEG and Milwaukee) closely following. Bosch is around half the size of Makita, followed by Hilti, Black & Decker and Hitachi. The combined share of sales of Metabo, Tooltechnic, Ramset, Panasonic and Fein are estimated to be around 10%.

## ACCC view

46. Consistent with *Techtronic Industries*, the ACCC considers that there are two broad categories of power tools based on the type of users—namely, trade users and DIY users.
47. Trade quality power tools are generally marketed to skilled tradesmen who rely on power tools for their livelihood and place a high value on the quality, reliability, durability, and specialised functionality of their tools. Typically, trade quality tools are more expensive than tools aimed at DIY customers. DIY customers are more likely to be satisfied with basic functionality and focused on obtaining the lowest price to achieve the task they have in mind.
48. The ACCC notes that there is some overlap between the DIY users and trade users as serious hobbyists seeking a trade quality result often buy trade quality power tools. Similarly, trade users seeking a more ‘throwaway’ tool requiring little capital investment for a basic short term application may buy lower quality DIY tools.

### Retail supply of trade quality power tools

49. Retailing of power tools tends to reflect the distinction between trade and DIY users. The nationwide hardware chains such as Bunnings, Masters, Mitre 10, Magnet Mart, and Home Hardware generally cater to DIY customers.<sup>5</sup> In catering to such customers, hardware stores seek to offer a broad range of tools and materials and act as a ‘one-stop shop’. Power tool specialists such as Just Tools and VEK Tools tend to target trade users and are significantly more specialised.

### Wholesale supply of trade quality power tools

50. At the wholesale level, the ACCC considers that power tool suppliers broadly target either trade users or DIY users, and that it can be difficult to switch from targeting one consumer segment to the other as the production techniques involved in trade quality tools are different than for DIY. The following characteristics illustrate the distinction between trade quality and DIY quality power tools:
  - Complexity, innovation, precision and the ability to repair products are often features of high price point trade quality brands. Each of these features requires investment in research and development.
  - More reliable tools require more expensive components and internal engineering. As a result, many products which are marketed at the lower price points in the DIY market specifically exclude warranty claims over tools used intensively or for trade use.
51. The nature of competition in the wholesale supply of trade quality power tools is discussed in detail in the following section.

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<sup>5</sup> Although these chains generally cater to DIY customers, many do offer products and services for trade customers.

## Competitive dynamics of wholesale supply of power tools

52. Market inquiries with Festool dealers suggest that customers perceive Festool as one brand among a number of trade quality tool manufacturers. Based on the information before it, the ACCC considers that Festool is a low volume, niche brand still trying to establish a reputation among Australian consumers. Market inquiries also indicate that competition between suppliers of trade quality power tools is strong in Australia.
53. Some Festool products are functionally similar to products supplied by other power tool manufacturers but include different features and/or higher quality components. Other Festool products are designed to integrate into various complementary Festool systems.
54. While no other manufacturer currently offers product combinations that perform all of the functions of Festool's combined systems, these product combinations could potentially be replicated using items from a variety of manufacturers. For example, there are a wide variety of portable shop vacuum or dust extraction units available which can be paired with a range of power tools either from that brand or other brands.
55. Other brands position themselves as premium trade quality power tool manufacturers, including Hilti and Fein, and have product ranges that offer a level of reliability, specialisation, complementary products, price and level of customer service comparable to Festool. However, the ACCC notes that at this highly differentiated end of the market each of the three main companies focus on different specialities—Hilti on construction equipment, Fein on metal working and Festool on wood working.
56. Further, the ACCC notes that some brands that are not generally associated with premium trade quality tools (or tools altogether) are specialists in particular tool categories. For example, Panasonic has a good reputation for drills, Nilfisk and Kärcher for dust extractors, Metabo for grinders and Bosch for jigsaws. In their particular categories, these manufacturers are likely to offer customers with a strong alternative to Festool products.
57. Market inquiries also indicate that the industrial models in the product ranges of more general 'mass market' brands such as Metabo, Makita, Bosch and Milwaukee compete with Festool. In particular, dealers indicated that these mass market brands are valued among trade users for the good reliability and robustness offered, at a lower price than premium brands, and by users who place less value on premium value added features and services. Reflecting their popularity and broad range, market inquiries indicate that Makita, Bosch and Milwaukee are the three largest suppliers of trade quality power tools in Australia. In the high growth category of cordless products, the Makita, Bosch, Milwaukee, DeWalt and Hitachi ranges are particularly competitive, with each manufacturer having different specialities according to voltage, advanced battery technology, quality of tools and/or breadth of range.
58. Below the mass market, mid-range manufacturers' customers also have available to them a number of highly price-focused trade quality power tool brands. Manufacturers of these brands specialise in producing a basic, trade quality tool at relatively low prices. In terms of quality, below the lower end of the trade quality power tools lies the mid to lower range of power tools marketed to DIY users.

59. The ACCC also considers that, given the differentiated nature of trade quality power tools, a manufacturer with the appropriate products could successfully enter and establish themselves in the Australian market. The Korean power tool company Keyang is an example of a recent entrant. The ACCC notes that a number of international trade quality power tools companies do not currently supply to Australia but may choose to do so in future.
60. Overall, the ACCC considers that Tooltechnic is competing to distribute Festool products among a broad range of suppliers of trade quality power tools. The ACCC considers that while Festool's products are highly differentiated and at the premium end of trade quality power tools, they are not unique and a customer considering purchasing any Festool product will also have a number of other manufacturers' offerings available to them as well.

## **Future with and without the Proposed Conduct**

61. To assist in its assessment of the Proposed Conduct against the authorisation test, the ACCC compares the likely future with the conduct for which authorisation is sought and the likely future without the conduct the subject of the authorisation. The ACCC will compare the public benefits and detriment likely to arise in the future where the conduct occurs against the future in which the conduct does not occur.

### **Tooltechnic's submission**

62. As discussed earlier, Tooltechnic submits that engaging in resale price maintenance will best address the problem of free riding and limit damage to its brand image.

### **Tooltechnic's current arrangements—quality standards in dealer contracts**

63. Tooltechnic currently utilises contractual arrangements in an effort to induce retailers to provide a high level of service to customers. Tooltechnic's dealer contracts include quality standards relating to dealer services, with compliance linked to the rebate levels that dealers receive from Tooltechnic.
64. Tooltechnic submits that these contractual arrangements initially provided dealers with sufficient motivation to improve retail services. However, with the onset of aggressive discounting, internet sales and smart phone technology, Tooltechnic submits its current contractual arrangements are no longer effective in preventing free riding.
65. Tooltechnic has provided information indicating that it is actively enforcing the quality service standards in its dealer contracts, with at least eight dealers penalised in 2014 for failing to meet such standards. However, Tooltechnic submits that in the current retail discounting environment, some dealers are prepared to forgo Tooltechnic's supplier rebates in order to avoid the costs associated with meeting quality standards, and thereby protect their margins when price matching against discounters.
66. Tooltechnic also submits that its dealer contracts can only set quality criteria that are easy to measure by Tooltechnic, and they are not an effective means for controlling day-to-day interactions with customers. Tooltechnic submits that the limitations of attempting to contract for high quality services mean 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, some dealers have been identified by Tooltechnic as providing lower quality retail services despite achieving high rebate levels as the dealers' poor services were not captured by the quality standards in the dealer contracts. However, Tooltechnic submits that it would have been difficult to include a standard designed to avoid these particular incidents of poor quality service into the dealer contract, or measure dealers' performance against such a standard.

### **Tooltechnic's likely arrangements without authorisation of the Proposed Conduct**

67. Tooltechnic submits that the limitations with its current dealer arrangements are such that it must change its commercial arrangements with dealers and resale price maintenance is the most appropriate option.
68. Tooltechnic submits that if it is not authorised to engage in resale price maintenance, it is likely to revise its partnership contracts with Festool dealers for 2015 and supply dealers on the basis of exclusive territories, as well as limit dealer sales through online channels. The only remaining online sales channel will be Tooltechnic's own corporate website. Tooltechnic considers that this is its only alternative in order to overcome the concerns it has identified. Tooltechnic submits that it may also consider reducing dealer numbers overall.

### **ACCC view**

69. The ACCC considers that, without authorisation of the Proposed Conduct, Festool dealers would continue to individually determine the retail price of Festool products.
70. The ACCC accepts that maintaining the current arrangements may result in a continued gradual decline of retail service provision over time.
71. In considering the likely future without the Proposed Conduct, the ACCC has taken into account common alternative means for dealing with free riding, including the use of contractual arrangements and non-price vertical restraints.
72. One option is for Tooltechnic to continue to impose, monitor, and enforce, retail service standards contained in its dealer contracts. However, the ACCC accepts that there may be inherent difficulties in contracting for a particular level of retail service. In particular, it is difficult to specify in a contract what constitutes a high level of service and also to monitor compliance with any such requirements. Retailers are also usually best placed to know what services are most valued by their customers.
73. In light of the information provided by Tooltechnic regarding the breakdown of its efforts to use contractual arrangements to address the identified free riding problem, the ACCC considers it is likely that Tooltechnic will look for other ways in which to address the problem.
74. Another option is for Tooltechnic to impose non-price vertical restraints on its dealers. Tooltechnic submits that, absent authorisation, it is likely to institute dealer territories and a corresponding ban on internet sales (except through Tooltechnic's corporate website), with a potential reduction in dealer numbers.

The ACCC considers that if exclusive territories are implemented by Tooltechnic, a reduction in dealer numbers is likely in areas where dealers are so close together that their territories would otherwise overlap. This will mean that customers have fewer locations from which they can choose to purchase Festool products.

75. The ACCC accepts that the use of such non-price vertical restraints may be an alternative means by which Tooltechnic could attempt to limit the free riding concerns it has identified. The ACCC therefore considers that in the absence of the Proposed Conduct, it is likely that Tooltechnic may, to the extent permitted by law, implement exclusive dealer territories and ban online retailing by dealers.
76. However, there is some uncertainty as to whether or not this strategy will ultimately be commercially viable for Tooltechnic. This is, in part, because the strategy will likely decrease the availability of Festool products which may ultimately decrease its overall sales. Accordingly, while the ACCC accepts that Tooltechnic is likely to use such a strategy, the extent to which it will maintain it in the medium to long term is uncertain.
77. In light of this uncertainty, the ACCC has taken a conservative approach in its assessment by comparing the future with the Proposed Conduct to the future in which Tooltechnic continues to operate as it does today. The ACCC accepts that the status quo represents a more competitive outcome than exclusive territories or a ban on internet selling, and therefore will result in a conservative assessment of the likely public benefits and detriments arising from the Proposed Conduct.
78. However, where appropriate, the ACCC's assessment also considers the extent to which its assessment would differ if the future without the Proposed Conduct involved Tooltechnic introducing exclusive dealer territories and banning online sales by dealers.

## Public detriment

79. The CCA does not define what constitutes a public detriment and the ACCC considers its meaning as essentially the opposite of public benefit. In this regard the Tribunal has defined it as:

...any impairment to the community generally, any harm or damage to the aims pursued by the society including as one of its principal elements the achievement of the goal of economic efficiency.<sup>6</sup>

## Tooltechnic's submission

80. Tooltechnic submits that the only identifiable public detriment resulting from the conduct is that customers are likely to pay more uniform retail prices for Festool products across Australia. Tooltechnic accepts that this may result in higher prices for some customers. However, Tooltechnic claims that the potential detriment will be minimal for the following reasons.
  - Tooltechnic will not set retail prices so high as to unprofitably reduce the volume of sales.

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<sup>6</sup> *Re 7-Eleven Stores* (1994) ATPR 41-357 at 42,683.

- Tooltechnic will not seek to inflate prices above competitive levels due to significant inter-brand competition.
  - Dealers generally acquire a range of power tool brands besides Festool and will remain free to decide whether to continue a partnership agreement with Tooltechnic.
81. Tooltechnic also acknowledges that a minimum retail price has the potential to facilitate coordination at the wholesale and/or retail level of a market, which could ultimately give rise to higher prices or other anticompetitive effects. However, Tooltechnic submits that neither the wholesale supply of power tools marketed to trade users nor the retail supply of such tools exhibit characteristics that would facilitate such behaviour.
82. In particular, Tooltechnic submits that coordination in the wholesale market is unlikely given the high number of market players, new entrants into the market (such as Keyang and Einhell) and low barriers to entry.
83. At the retail level Tooltechnic submits that coordination is unlikely for similar reasons—a high number of market participants, new entrants and low barriers to entry. In particular, Tooltechnic notes that the majority of its dealers have relatively small sales shares in their local retail areas.

## **ACCC view**

84. The ACCC considers that the primary detriment likely to result from the Proposed Conduct is that some customers will face a higher retail price for Festool products.<sup>7</sup>

### **Elimination of intra-brand price competition leading to some customers facing a higher retail price for Festool products**

85. The Proposed Conduct effectively removes dealers' ability to set their own retail prices, including to discount. While dealers can set prices above the minimum prices set by Tooltechnic, they are unlikely to do so without risking losing their customers to other dealers. This means that dealers are likely to sell Festool products at the minimum prices set by Tooltechnic and any price competition among them will be eliminated. As a result, some customers will face a higher retail price for Festool products.
86. The loss of price competition among Festool dealers (a loss of intra-brand price competition for Festool products) is likely to be particularly detrimental to customers who would otherwise purchase products at discounted prices. This includes both customers who use pre-sales services from another dealer (but then purchase from a discounter) and sophisticated repeat Festool users who value discounting, and are satisfied with a lower level of pre- and post-sales retail services provided they can buy at the discount. Information provided by Tooltechnic to the ACCC indicates that customer appetite for buying from discounting dealers (although potentially seeking services from other dealers) is

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<sup>7</sup> While not relevant to the facts of this application, resale price maintenance can also raise concerns in other circumstances. For example, where a manufacturer seeking authorisation for resale price maintenance has market power, it may be able to use resale price maintenance to prevent the entry or expansion of rival manufacturers by limiting the incentives of retailers to stock rival products. An inefficient retailer with market power may also be able to use resale price maintenance to frustrate competition from more efficient retailers.

increasing as there has been a significant increase in wholesale demand for Festool products from the discounting dealers. These customers will face a higher retail price as a result of the Proposed Conduct.

87. However, the extent of detriment to the public caused by the higher retail prices some customers face for Festool products (and particularly for those customers who currently buy from discounters) is likely to be limited by the competitive constraint from Tooltechnic's competitors and its customers—both Festool customers and dealers.
88. As noted earlier, there are a large number of participants in the market for the supply of trade quality power tools and Tooltechnic has a relatively small sales volume in comparison to some of its competitors. Given these factors, the ACCC considers that Tooltechnic has little incentive to set minimum retail prices above competitive levels because such conduct would reduce sales volumes overall, impacting on Tooltechnic's profit (assuming wholesale prices are constant). Further, if Tooltechnic could profitably increase wholesale prices, it could also likely do this in the future without the conduct.
89. Festool customers can purchase, and are likely to switch to, other brands if the prices for Festool products increase significantly above competitive levels. This is due to the availability of premium substitutes among Fein, Hilti and specialist tool manufacturers and the strong price competitiveness of industrial lines in mass market brands such as Makita, Bosch, Milwaukee and Metabo. As a result, even if Tooltechnic were to set minimum retail prices above competitive levels, the ACCC considers it unlikely that Tooltechnic would be able to profitably maintain those prices without losing customers to its competitors.
90. Tooltechnic is also likely to face pressure from its dealers if it sets the minimum resale price too high, because dealers will not be able to sell the product at that price. Although dealers will be guaranteed a margin on the product, it is unlikely to be attractive if the dealers are unable to sell the product. Market inquiries indicate that dealers stock a wide range of brands, of which Tooltechnic is one of the smaller suppliers whose brands are less commonly stocked, indicating that dealers have bargaining power to determine whether to stock Festool products. Market inquiries also suggest that dealers often prefer stocking mass market power tool brands such as Makita to stocking higher-priced, low volume brands. Should Tooltechnic raise the prices of Festool products to an extent which causes significant customer switching, dealers are likely to become more reluctant to stock Festool products.

### **Facilitation of coordinated conduct**

91. Another way in which resale price maintenance may result in public detriment is if it facilitates coordinated conduct, which could also result in higher prices. Coordinated conduct covers a range of conduct from explicit agreements such as cartels to implicit understandings such as tacit collusion. Coordinated conduct is harmful to consumers as it is likely to lead to reduced output, increased prices or diminished innovation.
92. It is only in some circumstances that a fixed minimum retail price has the potential to facilitate coordinated conduct among manufacturers or retailers.
93. At the wholesale level, a fixed minimum retail price enables wholesale suppliers to better reach and monitor compliance with an agreement. At the retail level, a fixed

minimum retail price can be used by retailers to limit competition among one another by removing the ability of other retailers to lower their prices below a particular level.

94. The prospect of a fixed minimum retail price facilitating coordinated conduct depends on whether the market is conducive to such conduct. Market characteristics that facilitate coordinated conduct include:
- a high degree of market concentration
  - high barriers to entry and expansion
  - homogeneous products
  - an absence of maverick firms.
95. Based on information obtained from Tooltechnic and market inquiries, the ACCC considers that the wholesale supply of trade quality power tools demonstrates characteristics which mean that the Proposed Conduct is unlikely to facilitate coordinated conduct.
- There is a low degree of market concentration and a large number of Australian wholesalers which supply power tools for trade use, at all points in the spectrum of price points and quality. Suppliers at the high quality/high price point end have relatively small sales volumes. Suppliers at the mid-range have very substantially larger sales volumes, presumably due to their supply of lower price mass market products which have faster stock turnover.
  - In relation to barriers to entry and expansion, there is a history of entry and expansion by established international power tool manufacturers. This is demonstrated by:
    - the recent entries of Einhell (a German power tool and garden tool brand) and Keyang (a Korean power tool brand) into the Australian power tool market in 2010 and 2013 respectively
    - the very large expansion of Milwaukee over the past four years at the mid-range of trade quality power tools. This has occurred despite fierce opposition by the dominant supplier, Makita, which already occupied a similar mid-range/high volume position
    - the expansion of Kincrome (a hand tools supplier) into electric power tools (by becoming the supplier for the Triton brand).
  - Power tools are highly differentiated and come in a diverse range of quality and price points, and in the premium range are accompanied by a range of services. Accordingly, different brands target different niches of customers.
  - Innovation drives the power tool industry with Festool being one of the leaders in this area. For example, Festool was the first brand in Australia to offer plunge cut saws which run on guard rails that are connected to dust extractors. Several dealers indicated during market inquiries that power tool customers are always looking for new models of tools or upgrades to existing tools.
96. At the retail level, the ACCC accepts that there is a large and diverse range of power tool retailers such that the Proposed Conduct is unlikely to facilitate coordinated conduct at the retail level.

97. In summary, the ACCC considers it unlikely that the Proposed Conduct will facilitate coordinated conduct among suppliers or retailers of trade quality power tools.

## **ACCC conclusion on public detriments**

98. The ACCC accepts that the Proposed Conduct will eliminate price competition between Festool dealers for Festool products. This will result in a clear public detriment as some customers will face a higher retail price for Festool products. However, the ACCC considers the extent of this public detriment is likely to be limited by:
- the wide range of alternative trade quality power tools available to customers
  - the fact that Tooltechnic has little incentive to set minimum retail prices above competitive levels because doing so would likely reduce sales of Festool products overall.
99. The ACCC considers that the Proposed Conduct is unlikely to facilitate coordinated conduct given the characteristics of the wholesale and retail supply of trade quality power tools.
100. The ACCC notes that the future without the Proposed Conduct submitted by Tooltechnic could be more detrimental to customers than the Proposed Conduct. This is because introduction of exclusive territories and/or a ban on internet sales is likely to lead to a significant reduction in intra-brand competition on both price and service. As a result, some customers will face a higher retail price for Festool products as well as potentially receive a lower level (of services compared to the Proposed Conduct.

## **Public benefit**

101. The CCA does not define what constitutes a public benefit and the ACCC adopts a broad approach. This is consistent with the Tribunal which has stated that the term should be given its widest possible meaning, and includes:

...anything of value to the community generally, any contribution to the aims pursued by society including as one of its principal elements ... the achievement of the economic goals of efficiency and progress.<sup>8</sup>

## **Tooltechnic's submission**

102. Tooltechnic submits that its ability to set a minimum retail price will result in the following public benefits:
- increased supply of retail services
  - more efficient pricing, that is, over time due to the competitive market in which it operates, Tooltechnic will set the minimum retail price at a level which allows Festool dealers to provide the level of service which maximises customer utility

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<sup>8</sup> *Queensland Co-operative Milling Association Ltd* (1976) ATPR 40-012 at 17,242, cited with approval in *Re 7-Eleven Stores* (1994) ATPR 41-357 at 42,677.

- increased consumer choice, as Tooltechnic considers that in the absence of the Conduct, in the long term its brand, and thus the success of its products and distribution network, will be undermined
- increased intra-brand non-price competition between Festool dealers
- increased inter-brand competition, as Tooltechnic's sales will not increase unless it takes sales from rival brands (and Tooltechnic will have no incentive to continue engaging in resale price maintenance in a competitive market except if it can do so to increase sales)
- the avoidance of more restrictive alternatives
- encouraging innovation in products and retail services.

## **ACCC view**

103. The ACCC recognises that resale price maintenance can, in certain circumstances, address market failures and thereby generate benefits to the public. This will depend heavily on the circumstances of each case.

104. To the extent that public benefits are likely to result from the Proposed Conduct, the ACCC considers that they will arise from an increase in the provision of pre- and post-sales retail services to Festool customers, both existing and potential. The increase in such retail services is likely to generate public benefits including:

- some customers making more informed decisions in purchasing trade quality power tools
- power tool customers continuing to be offered the choice of a premium trade quality power tool product which is accompanied by a high level of post-sales services.

105. In order to determine whether or not the Proposed Conduct is likely to increase these services and generate the benefits listed above, a number of factors are relevant as set out below.

### **Is the provision of retail services important in the sale of Festool products to customers?**

#### ***Pre-sales services***

106. Not all products or all premium products require a high degree of service in order to be sold to customers. In many circumstances, customers are able to assess the attributes of products for themselves without the need for any prolonged or significant interaction with sales staff. Tooltechnic has submitted, however, that the provision of retail services is essential to its distribution model. Tooltechnic is particularly concerned that a variety of pre-sales services are needed in order to communicate the unique features of the Festool range, in particular its specialised functionalities, high durability and complex integrated systems. Tooltechnic submits that these features are not obvious to customers.

107. The market inquiries conducted by the ACCC have supported Tooltechnic's submission that the Festool range of tools are complex and positioned as niche, high quality and high price point products. Many market participants suggest that Festool products benefit from services at the point of sale due to their complexity

and the lack of customer awareness regarding the potential uses and benefits of Festool's products.

108. Festool is not unique in attempting to set itself apart from other power tool manufacturers through the use of specialised features and benefits. However, the ACCC accepts that retail services are particularly important in order to help inform Festool customers of the features of Festool products that differentiate them from other brands' offerings. The ACCC notes that experienced repeat customers may not require pre-sales service to the same degree as new customers. However, such customers may still value the ability to try the 'feel' of a product when considering purchasing a new power tool.

### ***Post-sales services***

109. Tooltechnic submits that:

- Festool's presence in Australia benefits consumers as it provides access to product types which would not otherwise be available to Australian consumers (that is, premium products sold accompanied by a high level of retail services).
- The sustainable growth of its presence in the Australian market depends upon providing its dealers with the incentive to stock a large range of its products as well as provide the necessary supporting customer service.
- The Proposed Conduct will encourage its dealers to expand the services including post-sales services that they offer.

110. Based on market inquiries with dealers, the ACCC considers that some Festool customers value the ability to access a high level of post-sales services provided by Festool dealers. These post-sales services include fast repair times, post sales training in tool use and ready access to a wide range of consumables and accessories. Therefore, it is likely that provision of these post-sales services is important in the sale of Festool products to customers.

111. Tooltechnic submits that Festool products are enhanced by post-sales services and that customers expect that Festool products, as a premium product, will come with premium post-sales services (such as fast turnaround on repairs etc). This is supported by market inquiries with dealers and other power tool suppliers.

112. Full-service Festool dealers note that customers approach them for assistance with repairs and follow-up information about using their new products after unsuccessfully seeking these services from online or discount dealers. Festool dealers also indicate that customers respond negatively if unable to quickly access the consumables or accessories needed in order to complete a task.

### **Are retailers best placed to provide these services?**

113. As resale price maintenance is designed to incentivise retailers to provide higher service levels, it is relevant to consider whether in fact the retailer is best placed to provide those services (both pre- and post-sales services).

114. In the absence of pre-sales services provided by the retailer, customers are unlikely to be able to easily and effectively access information regarding Festool products before deciding which power tool to purchase. Market inquiries

conducted by the ACCC suggest that alternative mediums for communicating this information, such as the internet and other media, have limitations as many characteristics of Festool products are difficult to understand without experiencing the product first hand. For example, it is difficult to assess the ability of a dust extractor to capture fine particles by watching a video, or to assess the claims of minimal vibration in a sander without an in-person demonstration.

115. The ACCC accepts that given the nature of the Festool products, it will be difficult for at least some customers to assess the features of the products without a demonstration by the retailer. The ACCC notes that some other market participants, for example Hilti, have adopted an alternative strategy of direct selling to end users which involves on-site demonstrations at worksites. On the facts of this case, the ACCC accepts that this would be a significant departure from Tooltechnic's current business model and would require significant investment. It would also completely remove competition between Festool dealers.
116. As for post-sales services, there is a question as to whether the retailer is actually best placed to provide these services or whether they could be provided by Tooltechnic itself. The ACCC acknowledges that there are advantages to having dealers provide at least some of these services since they are located close to customers, which is important given the nature of the products, and have a pre-existing relationship with those customers.

#### **Is there a material risk of under-provision of these services?**

117. In order to be satisfied that benefits are likely to arise, the ACCC needs to consider whether or not there is a material risk that there will be an under-provision of these services in the future without the Proposed Conduct.
118. The ACCC has taken into account the situation in the market as it currently stands. The ACCC notes that the majority of Festool dealers do currently provide high levels of pre- and post-sales services with respect to the sale of Festool products. Tooltechnic submits, however, that some of its dealers focus solely on undercutting their competitors and not on the provision of service to customers. As these discounting dealers are not investing in services, they are able to sell at a discount as compared to those retailers which are providing a high level of service to customers.
119. The ACCC considers that it is difficult to assess the extent to which there may be an under-provision of pre-sales services, in particular as some customers (particularly repeat customers) may not want or need any service when purchasing a product.
120. Market inquires support Tooltechnic's submission that Festool products are being discounted regularly and significantly. While deep discounts on Festool products appear to be limited to a small number of dealers, the ability for customers to compare Festool prices online and demand price matching to the level of the deep discounters means that most retailers have to regularly sell Festool products below the recommended resale price in order to avoid losing sales. This price matching reduces the average margin on Festool products (especially for retailers that have invested in providing services) and also means that the margin on selling a Festool product is relatively unpredictable.

121. As discussed above, such conduct constitutes free riding by dealers and over time may discourage the provision of services. Information provided by Tooltechnic, generally supported by market inquiries, indicates that this free riding effect is already reducing service provision by Festool retailers. For example:

- Some potential new high service dealers have been discouraged from stocking Festool products as they consider that their retail model cannot compete on price with discounting dealers.
- Some existing large dealers have been decreasing the amount of space devoted to Festool products, although there has been no clear trend of decline in the numbers of Partner or Premium dealers. However, the reduction in space constitutes a direct reduction in services given that a feature of Festool's after-sales service is convenient access to its full range of consumables and accessories.
- Some existing Partner or Specialist dealers which had invested in repair and demonstration facilities have ceased offering these services
- By matching discounted internet prices, high service bricks and mortar dealers receive unpredictable and low average margins. In combination with the relatively low volumes of Festool products sold, the bricks and mortar dealers submit that:
  - They are discouraged from approaching customers and attempting to sell Festool products in favour of selling lower price point and mass market products such as Makita which have a higher margin and/or faster stock turnover.
  - They have made commercial decisions to stock only the bestselling and most profitable Festool products and not stock complementary products as they are often too low volume and low margin to justify the floor space required.
  - In the longer run they intend to reduce their investment in selling Festool products by decreasing repair facilities, staff training and demonstration areas.

122. The ACCC accepts that there is a degree of free riding taking place with respect to Festool products. The ACCC recognises that the increase in internet selling has increased free riding in recent years because it has allowed customers to seek retail services from one dealer and then purchase the product from an online or discount dealer at a cheaper price.

123. While it is difficult to exactly quantify the extent of the problem, the information available to the ACCC indicates that free riding is impacting many of Festool full service retailers. This relates to both pre- and post-sales services. Festool full service dealers report spending up to an hour with a customer, only to have the customer leave and purchase the product from an online discount dealer (or demand that the full service dealer match the price of the discounter). Full service dealers also report having to deal with customers who have already bought products from online discounters. Those customers may need assistance as they were not shown how to use the product, were not supplied the product with all of its accompanying parts, or have a warranty or repair issue. Some customers report being told by online retailers not to come to them with any concerns but to go and visit their local Festool dealer.

124. The ACCC is therefore satisfied that some Festool dealers are currently under-providing retail services. The ACCC considers that over time the presence of discounting dealers who under-provide retail services will reduce the incentive and ability of other retailers to offer a high level of service due to the effect of free riding. The ACCC considers that this is likely to result in an overall under-provision of retail services for Festool products.

### **Will the Proposed Conduct decrease the risk of under-provision of services?**

125. Tooltechnic submits that the Proposed Conduct will give dealers a greater ability and incentive to increase their supply of retail services. In essence, the Proposed Conduct is intended to give Festool dealers the necessary margin on tool sales to compensate them for providing an efficient level of services.

126. Resale price maintenance reduces the likelihood that full-service retailers will lose sales to discount retailers. Retailers who provide advice and service to a customer are more likely to make the sale. So long as the margin between the minimum retail price and the wholesale price is sufficient, full-service retailers are more likely to prosper. As a result, resale price maintenance may improve the range of products and services available to customers and improve customer choice.

127. As the Proposed Conduct eliminates price competition between dealers, customers will no longer have the ability to shop around based on prices and instead will be likely to shop around for services. As a result, dealers will be likely to compete on the provision of retail services in order to sell Festool products.

128. Further, resale price maintenance provides dealers with guaranteed margins which are likely to incentivise and give them the financial return to provide:

- the pre-sales services necessary to enable some customers to make informed choices as to the power tools they purchase (e.g. demonstration centres)
- the post-sales services which are intended by Tooltechnic to enhance the premium nature of its products to existing customers. (e.g. replacement loan tools when repairs are required).

129. In light of these incentives, the ACCC is of the view that (at least some) dealers will likely increase or improve the level of retail services they provide in relation to Festool products. The ACCC notes, however, that the precise extent to which these services will be increased or improved is uncertain.

### **What benefits flow from ensuring an adequate provision of services?**

130. As a result of the likely increase in pre-sales services, the ACCC expects that some customers will be better informed when making purchasing decisions about whether or not Festool products are suitable for their needs. For example, Festool dealers will have an incentive to send staff for higher levels of training, provide demonstration facilities and try-before-you-buy options, which increase the ability of their staff to inform customers. Given the complexities of Festool products, new customers are likely to benefit from this higher level of information by being better able to judge products and select those products which best meet their needs.

131. The ACCC also expects that due to the increased provision of both pre- and post-sales services, some customers will be better informed about the accessories and

consumables they will need in order to make the best use of the complex features of the Festool system for a particular application. Some customers require extensive pre-sales information and post-sales assistance to acquire the accessories and consumables they need in order to make the best use of the Festool products they acquire. By encouraging more Festool dealers to provide these services, more Festool customers will benefit from being able to obtain the best value for the product they have purchased.

132. In addition, the likely increase in post-sales services should provide a greater number of Festool customers with the benefits they expect from a premium brand (including quick turnaround on repair and warranty issues, loan tools where required, custom delivery of tools, and availability of consumables and accessories). Accordingly, to the extent that Festool customers and potential customers value a brand which delivers a high level of post-sales services to complement physical product purchases, the conduct is likely to maintain Tooltechnic's ability to deliver this public benefit.
133. The ACCC notes that not all Festool customers will benefit from the increase in services. In particular, experienced Festool users who do not require pre-sales services and would be satisfied with a low level of post-sales services are unlikely to benefit significantly from the increase in the services.
134. The ACCC notes that, as a small participant in a competitive market, Tooltechnic faces an incentive to try to maintain and increase its sales by providing its customers with services that they value (in conjunction with its products) more than the price of its products. There is a potential that any consequential shift of sales to Festool products may see other manufacturers of power tools improve their offer by increasing quality or lowering price (increased inter-brand competition). While this may be the case, it seems unlikely that any increase in inter-brand competition will be substantial (in the short-term) given the small market position Festool product currently occupies.

## **ACCC conclusion on public benefits**

135. The ACCC considers that the Proposed Conduct is likely to limit free riding in this case by eliminating discounting and encouraging retailers to offer better services (rather than lower prices) to attract customers. The ACCC is of the view that improved pre- and post-sales services are likely to result in public benefits.
136. It is inherently difficult to determine the extent to which the Proposed Conduct will encourage a greater provision of pre- and post-sales services by dealers and therefore give rise to these benefits (and the extent to which these services will be valued by customers).
137. Nevertheless, in the circumstances of this application, the ACCC considers that there will be a benefit to some customers arising from the future with the Proposed Conduct as compared to the future without it.
138. Further, when compared to the future without the Proposed Conduct submitted by Tooltechnic (exclusive territories and banning online sales by dealers), the future with the Proposed Conduct is likely to result in a greater benefit. The introduction of exclusive territories combined with a ban on online sales by dealers will not provide the same incentives for dealers to increase the provision of retail services.

## Balance of public benefit and detriment

139. The ACCC may grant authorisation if it is satisfied that, in all of the circumstances, the Proposed Conduct is likely to result in such a benefit to the public that it should be allowed to take place. In broad terms, this requires the ACCC to be satisfied that the likely benefit from the Proposed Conduct would outweigh the likely detriments to the public, including those constituted by any lessening of competition.
140. The Proposed Conduct constitutes resale price maintenance which is a per se infringement of the CCA. The ACCC is of the view there will be a detriment to the public as some customers will face a higher retail price for Festool products. However, the ACCC considers that the extent of this detriment is likely to be limited by:
- the wide range of alternative trade quality power tools available to customers
  - the fact that Tooltechnic has little incentive to set minimum retail prices above competitive levels because doing so would likely reduce sales of Festool products overall.
141. Accordingly, while the ACCC considers that the Proposed Conduct is likely to result in a clear detriment because some customers will face higher retail prices, the extent of that detriment is likely to be limited.
142. The ACCC also considers that the conduct is likely to give rise to some public benefits.
143. The ACCC accepts that there is a market failure in this case caused by free riding by some Festool retailers. The ACCC considers that the Proposed Conduct is likely to limit this free riding by eliminating discounting and encouraging retailers to offer better services (rather than lower prices) to attract customers. The ACCC is of the view that improved pre- and post-sales services are likely to result in public benefits including:
- some customers making more informed decisions in purchasing trade quality power tools
  - power tool customers continuing to be offered the choice of a premium trade quality power tool product which is accompanied by a high level of post-sales services.
144. Although it is inherently difficult to determine the precise extent to which the Proposed Conduct will encourage a greater provision of pre- and post-sales service by dealers, in the circumstances of this application, the ACCC considers that there is likely to be a benefit to some customers arising from the future with the Proposed Conduct as compared to the future without it.
145. The key issue here is the apparent incentives facing Tooltechnic. With only a small share of the market, Tooltechnic needs to judge whether higher service levels will outweigh lower prices in attracting sales. If the expected increase in service and sales does not eventuate, the conduct is not likely to be profitable and hence in Tooltechnic's continued interest.

146. On balance, the ACCC considers that in the circumstances of this case, the likely public benefit resulting from the increase in retail services will outweigh the clear, but limited, detriment resulting from the fact that some customers will face a higher retail price for Festool products.

## Length of authorisation

147. The CCA allows the ACCC to grant authorisation for a limited period of time.<sup>9</sup> This enables the ACCC to be in a position to be satisfied that the likely public benefits will outweigh the detriment for the period of authorisation. It also enables the ACCC to review the authorisation, and the public benefits and detriments that have resulted, after an appropriate period.

148. In this instance, Tooltechnic seeks authorisation for five years.

149. As noted earlier, this is the first application for authorisation of resale price maintenance since the CCA (then the *Trade Practices Act 1974*) was amended in 1995 to allow the ACCC to authorise such conduct.

150. In these circumstances, and given the ACCC's finely balanced assessment of the public benefits and detriments likely to arise from the Proposed Conduct, the ACCC proposes to grant authorisation for three years rather than the five years sought by Tooltechnic. Given the conditions discussed below the ACCC will be in a good position then to assess whether this behaviour should be reauthorised, should Tooltechnic seek reauthorisation.

## Conditions of authorisation

151. The CCA allows the ACCC to grant authorisation subject to conditions. The ACCC may impose a condition in circumstances where, although the relevant public benefit test is met, without the condition the ACCC would not be prepared to exercise its discretion in favour of authorisation.<sup>10</sup>

152. As this is the first application for authorisation of resale price maintenance,<sup>11</sup> and in light of the ACCC's assessment of the public benefits and detriments likely to arise from the Proposed Conduct, the ACCC proposes to impose conditions on the authorisation to allow it to monitor the impact of the Proposed Conduct over the period of authorisation.

153. In particular, the ACCC proposes to impose conditions on the authorisation that require Tooltechnic to provide the ACCC with the following information on an annual basis:

- the minimum retail prices set by Tooltechnic for particular Festool products
- the average wholesale prices charged by Tooltechnic for particular Festool products

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<sup>9</sup> Subsection 91(1)

<sup>10</sup> *Application by Medicines Australia Inc* (2007) ATPR 42-164 at paragraph 133.

<sup>11</sup> That is, since the CCA (the then *Trade Practices Act 1974*) was amended in 1995 to allow the ACCC to authorise such conduct.

- the overall value of sales made to Festool dealers
- changes in the number of Festool dealers, changes in the type of Festool dealers (e.g., a partner dealer becoming a premium dealer), and details of any dealers who cease or commence stocking Festool products
- details of any changes made to the standard dealer contracts
- details of any monitoring and enforcement action taken by Tooltechnic in relation to service obligations in its Dealer Contracts
- details of the changes in the floor space that Festool dealers dedicate to Festool products
- details of any complaints received by Tooltechnic from customers or dealers in relation to Festool products.

## **Draft determination**

### **The application**

154. Application A91433 was made using a Form EA, under subsection 88(8A) of the CCA. Authorisation is sought by Tooltechnic to allow it to engage in conduct that constitutes (or may constitute) the practice of resale price maintenance. Authorisation is sought as resale price maintenance is a per se breach of section 48 of the CCA.
155. Subsection 90A(1) of the CCA requires that before determining an application for authorisation the ACCC shall prepare a draft determination.

### **The net public benefit test**

156. For the reasons outlined in this draft determination the ACCC is satisfied, pursuant to section 90(8), that the Proposed Conduct for which authorisation is sought is likely to result in such a benefit to the public that the Proposed Conduct should be allowed to take place.

### **Conduct which the ACCC proposes to authorise**

157. The ACCC proposes to grant conditional authorisation A91433 to Tooltechnic to amend its agreements with its Festool dealers to include a requirement for resellers to not sell any Festool product below a price(s) nominated by Tooltechnic, for a period of three years.
158. The authorisation is proposed to be granted subject to the conditions that are set out in Attachment B.
159. This draft determination is made on 21 October 2014.

### **Next steps**

160. The ACCC now seeks submissions in response to this draft determination. In addition, consistent with section 90A of the CCA, the applicant or an interested party may request that the ACCC hold a conference to discuss the draft determination.

## Attachment A – Public benefit test in CCA

**Subsection 90(8)** states that the ACCC shall not:

- make a determination granting:
  - i. an authorisation under subsection 88(1) in respect of a provision of a proposed contract, arrangement or understanding that is or may be an exclusionary provision; or
  - ii. an authorisation under subsection 88(7) or (7A) in respect of proposed conduct; or
  - iii. an authorisation under subsection 88(8) in respect of proposed conduct to which subsection 47(6) or (7) applies; or
  - iv. an authorisation under subsection 88(8A) for proposed conduct to which section 48 applies;

unless it is satisfied in all the circumstances that the proposed provision or the proposed conduct would result, or be likely to result, in such a benefit to the public that the proposed contract or arrangement should be allowed to be made, the proposed understanding should be allowed to be arrived at, or the proposed conduct should be allowed to take place, as the case may be; or

- make a determination granting an authorisation under subsection 88(1) in respect of a provision of a contract, arrangement or understanding that is or may be an exclusionary provision unless it is satisfied in all the circumstances that the provision has resulted, or is likely to result, in such a benefit to the public that the contract, arrangement or understanding should be allowed to be given effect to.

# Attachment B – Conditions of Authorisation

## APPLICATION FOR AUTHORISATION A91433–CONDITIONS

### OBJECTIVE

The objective of these conditions is to allow the ACCC to monitor the impact of Tooltechnic setting minimum retail prices for Festool products in Australia. In particular, it allows the ACCC to monitor the level of Tooltechnic's minimum retail prices over time together with the impact of those changes on the Festool Dealer network.

### 1. REPORTING OBLIGATIONS

- (a) Within two months of the Commencement Date, Tooltechnic must provide to the ACCC a report (**Initial Report**) including the following information:
- (i) the recommended retail prices of each of the Core Products in the 12 months prior to the date of the Authorisation;
  - (ii) the average wholesale price of each the Core Products by Dealer Type in the 12 months prior to the date of the Authorisation;
  - (iii) the total value of sales made to each Dealer in the 12 months prior to the date of the Authorisation;
  - (iv) any minimum retail price that has been set by Tooltechnic for a Core Product as at the Commencement Date;
  - (v) at the Commencement date, the average wholesale price for each of the Core Products, by Dealer Type;
  - (vi) at the Commencement date, copies of the standard contracts in place with each Dealer Type; and
  - (vii) at the Commencement date, the total number of Dealers and their Dealer Type.
- (b) Within two months of the end of each Period during the term of the Authorisation, Tooltechnic must provide the following information to the ACCC:
- (i) if the minimum retail price for any Core Product has changed (or been set) during the Period, the new minimum retail price for those products and the date on which the price was changed;
  - (ii) the minimum retail price for any Additional Product;
  - (iii) the average wholesale price during the Period for each of the Core Products (and any Additional Products) for each Dealer Type;
  - (iv) the total value of sales made to each Dealer in the Period;
  - (v) any change in the number of Dealers in each Dealer Type in the Period;
  - (vi) details of any Dealers, including the Dealer Type, who in the Period:
    - a. changed their Dealer Type;

- b. ceased stocking Festool products, and the reason for ceasing to stock the products;
  - c. commenced stocking Festool products;
  - d. increased or decreased the amount of floor space dedicated to Festool products in their retail shop, including details of the total amount of Festool floor space in that shop, and the amount in square metres of any increase or decrease (to the extent known by Tooltechnic);
  - e. added or removed any demonstration for Festool products;
  - f. added or removed any repair facilities for Festool products.
- (vii) a description of any changes made to the standard contracts in place with each Dealer Type in the Period (or a copy of any revised standard contracts in place with each Dealer Type);
- (viii) details of any monitoring and enforcement action taken by Tooltechnic in relation to the price and non-price obligations contained in the Dealer Contracts in the Period;
- (ix) details of any complaints received by Tooltechnic:
- a. from actual or potential end customers in relation to Festool products or Festool Dealers; and
  - b. from Festool Dealers in relation to Festool products.
- (c) To the extent possible, the information in paragraphs (a) and (b) above must be provided to the ACCC in an accessible spread sheet format.

## **2. INFORMATION**

- (a) Tooltechnic must respond as soon as practicable to any queries or requests for information or documents made by the ACCC pursuant to or in relation to these Conditions.
- (b) The ACCC may require Tooltechnic to:
  - (i) furnish information, documents and materials to the ACCC in the time and in the form requested by the ACCC;
  - (ii) produce information, documents and materials to the ACCC within Tooltechnic's custody, power or control in the time and in the form requested by the ACCC; and/or
  - (iii) direct its personnel, including its directors, contractors, managers, officers, employees and agents, to attend the ACCC at a reasonable time and place appointed by the ACCC to answer any questions the ACCC (including its Commissioners, its staff or its agents) may have.
- (c) Information furnished, documents and material produced or information given in response to any request or direction from the ACCC under these

Conditions may be used by the ACCC for any purpose consistent with the exercise of its statutory duties and functions.

- (d) Nothing in these Conditions requires the provision of information or documents in respect of which Tooltechnic claims legal professional privilege or other privilege.

### 3. APPLICATIONS TO VARY THE CONDITIONS

- (a) Tooltechnic may apply in writing to the ACCC for a variation to the Conditions.
- (b) Any application by Tooltechnic to the ACCC for a variation to the Conditions must state the nature of the variation sought and the reasons for that variation, and must be accompanied by evidence supporting the application.
- (c) The ACCC may request from Tooltechnic any additional information required by the ACCC to assess the application for a variation of the Conditions.
- (d) After considering an application to vary the conditions, the ACCC may, in its absolute discretion, determine to vary the Conditions or dismiss the application for variation.
- (e) If the ACCC determines to vary the Conditions, the variation will be effective from the date determined by the ACCC.

### 4. DEFINITIONS AND INTERPRETATION

**ACCC:** means the Australian Competition and Consumer Commission.

**Additional Product:** means any Festool product which is not a Core Product but is one of the top twenty products by value sold by Tooltechnic to Dealers in the relevant Period.

**Authorisation:** means the final determination by the ACCC regarding applications for authorisation A91433.

**Commencement Date:** the date on which Tooltechnic first requires any of its Dealers not to sell any Festool product below a specified price.

**Conditions:** mean these conditions subject to which the Authorisation is granted.

**Core Products:** means the top twenty Festool products by value sold to Dealers in the 12 months prior to the Commencement Date.

**Dealer:** means a retailer of Festool products in Australia which acquires those products from Tooltechnic.

**Dealer Contract:** means a contract or agreement between Tooltechnic and a Dealer in relation to the supply of Festool products by Tooltechnic to that Dealer.

**Dealer Type:** means a category of Dealer as established by Tooltechnic from time-to-time (for example, premium Dealers, partner Dealers, specialist Dealers).

**Initial Report:** means the report provided to the ACCC by Tooltechnic in accordance with clause 1(a) of these Conditions.

**Period:** means each 12 month period ending 31 December each year, commencing with the period ending 31 December 2015.

**Tooltechnic:** means Tooltechnic Systems (Aust) Pty Ltd and any related bodies corporate of Tooltechnic as defined in the *Corporations Act 2001* (Cth).

- *Interpretation*

In the interpretation of these Conditions, the following apply unless the context otherwise requires:

- (a) headings are inserted for convenience only and do not affect the interpretation of these Conditions;
- (b) a word which denotes the singular also denotes the plural and vice versa; and
- (c) a reference to the words 'include' and 'including', and similar expressions is to be construed without limitation.