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The Price is Right: How to Know? Loyalty Programs – The View from Canada

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I. Introduction

Abuse of dominance or monopolization[1] is, it is submitted, the most interesting and complex area of antitrust or competition law. It may not be the area with the greatest practical application, but it tends to give rise to the most difficult, challenging and interesting analytical issues. At least one of the reasons for it giving rise to such thorny issues is that there are a number of doctrines or tools which competition lawyers and economists bring to the task of analyzing loyalty discounts. In particular, does one approach then principally from a predatory pricing standpoint, or a broader consideration of exclusionary conduct? This challenge may be particularly complex in Canada, given that our *Competition Act*[2] is not written in general language. In the U.S., loyalty discounts are generally challenged under Section 2 of the Sherman Act.[3] In the EU, Article 102 of the Treaty on the Functioning of the European Union is available.[4] By contrast, the Canadian *Competition Act* contains very specific provisions dealing with different kinds of conduct. As a result, considering loyalty discounts in Canada requires consideration of (at least) four different laws, all found (or previously found) within the *Competition Act*: (i) abuse of dominant market position, (ii) predatory pricing, (iii) tied selling and (iv) exclusive dealing. This paper examines the current Canadian statutory and common law (or lack thereof) regime for loyalty programs.

II. Canadian Statutory Summary

Loyalty programs offered by dominant firms can raise issues under most antitrust regimes. In Canada, such programs can be challenged by the Commissioner of Competition (the "Commissioner") under the abuse of dominance, tied selling or exclusive dealing provisions of the *Competition Act*, and by parties who are directly and substantially affected under the exclusive dealing or tied selling provisions but not the abuse of dominance provision.[5]

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[1] Together with the related concepts of exclusive dealing, tied selling and predatory pricing.

[2] *Competition Act*, RSC 1985, c C-34 [*Act*].

[3] In the United States, loyalty rebate programs are subject to challenge under Section 2 of the Sherman Act as alleged monopolies. To establish a violation of Section 2, two elements must be shown: (i) the defendant possesses monopoly power in the relevant market and (ii) the defendant wilfully acquired or maintained that market power by anticompetitive conduct as opposed to gaining that power as a result "of a superior product, business acumen, or historical accident." See e.g., *United States v Grinnell Corp.*, 384 U.S. 563 (1966).

[4] In the EU, loyalty discounts are generally challenged under Article 102 of the Treaty on the Functioning of the European Union.

[5] Under Section 103.1 of the Act, private parties may make applications to the Tribunal, with leave, under Sections 75 and 77 of the Act, which includes exclusive dealing and tied selling.

Previously, depending on the prices offered, the conduct could have been challenged under Canada's criminal predatory pricing law, which was repealed in 2009. Set out below are the relevant provisions, with some brief commentary. Later, we will explore the (limited) case law.

A. Abuse of Dominance

The *Competition Act* provides regime with respect to abuse of dominant market position in Section 78 and 79 of the *Act*.

> **78 (1)** For the purposes of section 79, ***anti-competitive act***, without restricting the generality of the term, includes any of the following acts:
>
> **(a)** squeezing, by a vertically integrated supplier, of the margin available to an unintegrated customer who competes with the supplier, for the purpose of impeding or preventing the customer's entry into, or expansion in, a market;
>
> **(b)** acquisition by a supplier of a customer who would otherwise be available to a competitor of the supplier, or acquisition by a customer of a supplier who would otherwise be available to a competitor of the customer, for the purpose of impeding or preventing the competitor's entry into, or eliminating the competitor from, a market;
>
> **(c)** freight equalization on the plant of a competitor for the purpose of impeding or preventing the competitor's entry into, or eliminating the competitor from, a market;
>
> **(d)** use of fighting brands introduced selectively on a temporary basis to discipline or eliminate a competitor;
>
> **(e)** pre-emption of scarce facilities or resources required by a competitor for the operation of a business, with the object of withholding the facilities or resources from a market;
>
> **(f)** buying up of products to prevent the erosion of existing price levels;
>
> **(g)** adoption of product specifications that are incompatible with products produced by any other person and are designed to prevent his entry into, or to eliminate him from, a market;
>
> **(h)** requiring or inducing a supplier to sell only or primarily to certain customers, or to refrain from selling to a competitor, with the object of preventing a competitor's entry into, or expansion in, a market; and
>
> **(i)** selling articles at a price lower than the acquisition cost for the purpose of disciplining or eliminating a competitor.

79 (1) Where, on application by the Commissioner, the Tribunal finds that

(a) one or more persons substantially or completely control, throughout Canada or any area thereof, a class or species of business,

(b) that person or those persons have engaged in or are engaging in a practice of anti-competitive acts, and

(c) the practice has had, is having or is likely to have the effect of preventing or lessening competition substantially in a market,

the Tribunal may make an order prohibiting all or any of those persons from engaging in that practice.

(2) Where, on an application under subsection (1), the Tribunal finds that a practice of anti-competitive acts has had or is having the effect of preventing or lessening competition substantially in a market and that an order under subsection (1) is not likely to restore competition in that market, the Tribunal may, in addition to or in lieu of making an order under subsection (1), make an order directing any or all the persons against whom an order is sought to take such actions, including the divestiture of assets or shares, as are reasonable and as are necessary to overcome the effects of the practice in that market.

(3) In making an order under subsection (2), the Tribunal shall make the order in such terms as will in its opinion interfere with the rights of any person to whom the order is directed or any other person affected by it only to the extent necessary to achieve the purpose of the order.

(3.1) If the Tribunal makes an order against a person under subsection (1) or (2), it may also order them to pay, in any manner that the Tribunal specifies, an administrative monetary penalty in an amount not exceeding $10,000,000 and, for each subsequent order under either of those subsections, an amount not exceeding $15,000,000.

...

(4) In determining, for the purposes of subsection (1), whether a practice has had, is having or is likely to have the effect of preventing or lessening competition substantially in a market, the Tribunal shall consider whether the practice is a result of superior competitive performance.

(5) For the purpose of this section, an act engaged in pursuant only to the exercise of any right or enjoyment of any interest derived under the Copyright Act, Industrial Design Act, Integrated Circuit Topography Act, Patent Act, Trade-marks Act or any other Act of

> Parliament pertaining to intellectual or industrial property is not an anti-competitive act.
>
> ...

As may or may not be readily apparent from the above statutory excerpt, in order to establish abuse of dominance under section 79(1) of the *Competition Act* it must be shown that a person or persons: (i) substantially or completely control, throughout Canada or any area thereof, a class or species of business, (ii) has/have engaged in or is engaging in a practice of anti-competitive acts, and (iii) the practice has had, is having or is likely to have the effect of preventing or lessening competition substantially in a relevant market.[6] While section 78 of the Act provides a list of anti-competitive acts for the purposes of section 79, the list is not exhaustive and the Tribunal has held that conduct not specifically enumerated in the Act can constitute an anti-competitive act.[7] Further, exclusive dealing and tied selling, which have their own specific statutory provisions, can also constitute anti-competitive acts for the purpose of abuse of dominance. The Tribunal has also indicated that, given that all but one of the enumerated anti-competitive acts are acts directed at disciplining or excluding a competitor, to be an anti-competitive act the conduct must be one carried out with the purpose of negatively affecting a competitor in a predatory, exclusionary or disciplinary manner. However, in a more recent case[8] the Federal Court of Appeal has determined that the negative predatory, exclusionary or disciplinary conduct need not be directed at a competitor of the allegedly dominant firm – it can be aimed at a competitor in the market in which the dominant position is alleged to be abused.

To find that a loyalty program has contravened section 79(1), all of the above elements must be established. That is, the program must be offered by a dominant firm (or jointly dominant firms – but the peculiar concept of joint dominance is a Canadian diversion too far), be found to constitute a practice of anti-competitive acts, and have the requisite negative effect on a relevant market (i.e., prevent or lessen competition substantially).

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[6] The Tribunal has interpreted "class or species of business" to mean product market, "Canada or any area thereof" to mean geographic market, and "control" to mean market power. See *Canada (Director of Investigation and Research) v D&B Companies of Canada Ltd* (1995), 64 CPR (3d) 216 [*D&B Companies*]; *Canada (Director of Investigation and Research) v Laidlaw Waste Systems Ltd* (1992), 40 CPR (3d) 289 (Comp Trib) [*Laidlaw*]; *Canada (Director of Investigation & Research) v NutraSweet Co* (1990), 32 CPR (3d) (Comp Trib) at 83 [*NutraSweet*].

[7] See *NutraSweet*, *supra* note 6 at 34; *Laidlaw*, *supra* note 6 at 331-32; *D&B Companies*, *supra* note 6 at 257. Indeed, more often than not the findings of anti-competitive acts that have been made involve conduct not listed.

[8] *Commissioner of Competition v Toronto Real Estate Board*, 2016 Comp Trib 7; *Commissioner of Competition v Toronto Real Estate Board*, 2016 Comp Trib 8; *Commissioner of Competition v Toronto Real Estate Board*, 2017 FCA 236 [*Toronto Real Estate Board*].

In 2012, the Competition Bureau (the "Bureau") released the most recent iteration of its Abuse of Dominance Guidelines.[9] The 2012 Abuse of Dominance Guidelines are reasonably brief, and provide a general overview of abuse of dominance, but do not provide extensive commentary on loyalty programs in particular, although the predecessor guidelines[10] did not contain hypothetical examples. By way of general statements about exclusionary conduct, the 2012 Abuse of Dominance Guidelines simply state that various exclusionary strategies, including exclusive dealing, predation and tying and bundling, can in certain circumstances increase rivals' costs, making it more difficult to compete, and therefore constitute anti-competitive acts.[11]

B. Exclusive Dealing

The Canadian Competition Act contains, in addition to a general provision with respect to abuse of dominance, a specific provision addressing exclusive dealing.

> **77 (1)** For the purposes of this section,
>
> ***exclusive dealing*** means
>
> **(a)** any practice whereby a supplier of a product, as a condition of supplying the product to a customer, requires that customer to
>
> **(i)** deal only or primarily in products supplied by or designated by the supplier or the supplier's nominee, or
>
> **(ii)** refrain from dealing in a specified class or kind of product except as supplied by the supplier or the nominee, and
>
> **(b)** any practice whereby a supplier of a product induces a customer to meet a condition set out in subparagraph (a)(i) or (ii) by offering to supply the product to the customer on more favourable terms or conditions if the customer agrees to meet the condition set out in either of those subparagraphs; (*exclusivité*)
>
> ...
>
> **(2)** Where, on application by the Commissioner or a person granted leave under section 103.1, the Tribunal finds that exclusive dealing or tied selling, because it is engaged in by a major supplier of a product in a market or because it is widespread in a market, is likely to
>
> **(a)** impede entry into or expansion of a firm in a market,

[9] Canada, Competition Bureau, "Enforcement Guidelines – The Abuse of Dominance Provisions" (Gatineau: Industry Canada, 2012), online: < http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/cb-abuse-of-dominance-provisions-e.pdf/$FILE/cb-abuse-of-dominance-provisions-e.pdf> [*2012 Abuse of Dominance Guidelines*].

[10] Canada, Competition Bureau, "Enforcement Guidelines – The Abuse of Dominance Provisions" (Gatineau: Industry Canada, July 2001).

[11] *2012 Abuse of Dominance Guidelines*, *supra* note 9 at 11.

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> **(b)** impede introduction of a product into or expansion of sales of a product in a market, or
>
> **(c)** have any other exclusionary effect in a market,
>
> with the result that competition is or is likely to be lessened substantially, the Tribunal may make an order directed to all or any of the suppliers against whom an order is sought prohibiting them from continuing to engage in that exclusive dealing or tied selling and containing any other requirement that, in its opinion, is necessary to overcome the effects thereof in the market or to restore or stimulate competition in the market.
>
> ...
>
> **(4)** The Tribunal shall not make an order under this section where, in its opinion,
>
> **(a)** exclusive dealing or market restriction is or will be engaged in only for a reasonable period of time to facilitate entry of a new supplier of a product into a market or of a new product into a market,
>
> **...**
>
> and no order made under this section applies in respect of exclusive dealing, market restriction or tied selling between or among companies, partnerships and sole proprietorships that are affiliated.

For the Tribunal to make an order with respect to exclusive dealing under section 77(2) of the Act, it must be shown that a person has engaged in a practice of exclusive dealing (that is, conditioning supply on an agreement to buy exclusively, or inducing exclusivity by offering more favourable terms if one buys exclusively), the person must be a major supplier of a product in a relevant market (or the practice must be widespread in the market) and the exclusive dealing must be likely to create exclusionary effects with the result that competition is or is likely to be lessened substantially. The substantial lessening of competition test is the same as with respect to abuse of dominance, although, somewhat oddly, a substantial <u>prevention</u> of competition is not proscribed under the exclusive dealing provision, as it is under both the merger and abuse of dominance provisions. The other interesting divergence from the abuse of dominance provisions is that the conduct must be by either a dominant firm (here described as a "major supplier") or by

a number of firms if the conduct is “widespread” in the market. The abuse of dominance provision, on the other hand, requires that “one or more persons substantially or completely control...a class or species of business”.

C. Tied Selling

The *Competition Act* also contains a specific, parallel, provision with respect to tied selling.

> **77 (1)** For the purposes of this section,
>
> ***tied selling*** means
>
> **(a)** any practice whereby a supplier of a product, as a condition of supplying the product (the “tying” product) to a customer, requires that customer to
>
> **(i)** acquire any other product from the supplier or the supplier’s nominee, or
>
> **(ii)** refrain from using or distributing, in conjunction with the tying product, another product that is not of a brand or manufacture designated by the supplier or the nominee, and
>
> **(b)** any practice whereby a supplier of a product induces a customer to meet a condition set out in subparagraph (a)(i) or (ii) by offering to supply the tying product to the customer on more favourable terms or conditions if the customer agrees to meet the condition set out in either of those subparagraphs. (*ventes liées*)
>
> **(2)** Where, on application by the Commissioner or a person granted leave under section 103.1, the Tribunal finds that exclusive dealing or tied selling, because it is engaged in by a major supplier of a product in a market or because it is widespread in a market, is likely to
>
> **(a)** impede entry into or expansion of a firm in a market,
>
> **(b)** impede introduction of a product into or expansion of sales of a product in a market, or
>
> **(c)** have any other exclusionary effect in a market,
>
> with the result that competition is or is likely to be lessened substantially, the Tribunal may make an order directed to all or any of the suppliers against whom an order is sought prohibiting them from continuing to engage in that exclusive dealing or tied selling and containing any other requirement that, in its opinion, is necessary to overcome the effects thereof in the market or to restore or stimulate competition in the market.
>
> **...**

> **(4)** The Tribunal shall not make an order under this section where, in its opinion,
>
> **...**
>
> **(b)** tied selling that is engaged in is reasonable having regard to the technological relationship between or among the products to which it applies, or
>
> **(c)** tied selling that is engaged in by a person in the business of lending money is for the purpose of better securing loans made by that person and is reasonably necessary for that purpose,
>
> and no order made under this section applies in respect of exclusive dealing, market restriction or tied selling between or among companies, partnerships and sole proprietorships that are affiliated.

Tied selling is, as noted above, defined as both requiring the purchase of product A to obtain product B (or requiring that a product B not be used or distributed in conjunction with product A), and also as inducing the purchase (or non purchase) of product B by offering a better deal. This second definition is, as US antitrust practitioners will note, much wider than the standard concept of tied selling in US law. It is also, as anyone who has actually bought products will note, completely common in ordinary commerce – a bundled discount. Like exclusive dealing, to be prescribed tied selling must be engaged in being a major supplier or be widespread in the market, it must have exclusionary effects, and it must lead to a substantial lessening of competition.

D. Predatory Pricing

Finally, rounding out the quartet of statutory provisions, mercifully as the most succinct of them (but also the least relevant as it was repealed in 2009) is the predatory pricing criminal offence.

> **50 (1)** Every one engaged in a business who
>
> **...**
>
> **(c)** engages in a policy of selling products at prices unreasonably low, having the effect or tendency of substantially lessening competition or eliminating a competitor, or designed to have that effect,
>
> is guilty of an indictable offence and liable to imprisonment for a term not exceeding two years.

As noted in the introduction to this section, the repealed predatory pricing provision was a criminal offence. That alone is, presumably, sufficient to justify its repeal. When it was

repealed, the Bureau announced that predatory pricing concerns would in future be addressed under the Abuse of Dominance provisions. In 2008, shortly before it was repealed, the Bureau sought to provide guidance addressing the Bureau's approach to the provision.[12] The Bureau indicated that, from its perspective, predatory pricing involves deliberately setting prices to incur losses for a sufficiently long period of time such that it eliminates, disciplines or prevents entry by a competitor or competitors, with the expectation of recouping the firm's losses. Further, there has to be a substantial lessening or prevention of competition. As a result, driving some competitors out of the market is not relevant if the overall marketplace remains competitive. The Bureau also stated that prices have to be below an "appropriate" level of costs, without a reasonable business justification, such as selling off perishable product, or matching a competitor's price. As to the cost standard, the Bureau favours the use of average avoidable costs – which it believes to be a good proxy for marginal costs, since it captures opportunity costs.

As noted, the criminal predatory pricing provision has been repealed. However, at the time of its repeal the Bureau noted that, in future, predatory pricing allegations would be examined under the abuse of dominance provisions of the *Act*. Consequently, the Bureau's views of predatory pricing, including its views on recoupment, the relevant cost standard, and the relevance of a merely "meeting competition" defence continue to have resonance. The key aspects of the Predatory Pricing Guidelines were restated in the Bureau's 2012 Abuse of Dominance Guidelines.[13]

III. Cases – Overview

Despite an abundance of statutory provisions touching on loyalty programs there are relatively few cases interpreting them. The key case is now more than a decade old – the *Canada Pipe*[14] case. That case will be explored in greater detail in the next section. In this section, we seek to provide a brief summary of the (few) other significant loyalty program cases.

[12] Canada, Competition Bureau, "Predatory Pricing Enforcement Guidelines" (Ottawa: Industry Canada, July 2008), online: < http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/02713.html>.
[13] *2012 Abuse of Dominance Guidelines*, *supra* note 9, s. 3.2.2.

[14] *Canada (Commissioner of Competition) v Canada Pipe*, 2005 Comp Trib 3 [*Canada Pipe*].

A. Abuse of Dominance

Canada has had an abuse of dominant market position law since 1986. Only the Commissioner can bring abuse of dominance cases to the Competition Tribunal. Perhaps for that reason, or perhaps because true cases of abuse of dominance are relatively rare, there is not a great deal of case law with respect to abuse of dominance, and less still focused on loyalty program issues. The first ever Canadian abuse of dominance case was brought against the NutraSweet Company.[15] It did have a loyalty feature. NutraSweet supplied aspartame to manufacturers of soft drinks and other confectionary products. It employed contracts with various features, including:

- Exclusivity provisions in supply agreements;
- Discounts (of up to 40%) for displaying NutraSweet's logo on the customers' products; and
- Use of meet or release and most favoured nation clauses.

The Tribunal found that the NutraSweet Company had abused its dominant position, and prohibited it from enforcing the various exclusivity provisions and loyalty discounts.

The second Abuse of Dominance case in Canada dealt with Laidlaw's waste disposal business.[16] In this case, various conduct was challenged but only its long term exclusive contracts, which were prohibited, could be characterized as a loyalty program.

In *D&B Companies*,[17] AC Nielsen was found to have abused its dominant position in respect of scanner based check-out data, by entering into long term exclusive contracts with retailer suppliers of scanner data. It was prohibited from entering into exclusive contracts, as well as providing supply or other inducements to exclusivity. Nielson's "most favoured nation" clauses were also prohibited.[18]

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[15] *NutraSweet*, *supra* note 6.

[16] *Laidlaw*, *supra* note 6.

[17] *D&B Companies*, *supra* note 6.

[18] *Ibid* at para 201. Under the "most favoured nation" clause , the retailer agreed "not to provide its data to a third party on terms more favourable" than those it had granted to Nielsen.

Those are the only three abuse of dominance cases, with the exception of the *Canada Pipe* case, discussed below, which involved loyalty programs. As noted, they provide relatively limited guidance.

B. Exclusive Dealing

Like abuse of dominance, exclusive dealing is a reviewable practice under the *Competition Act*. Unlike abuse of dominance, breach of this provision does not attract administrative monetary penalties, but rather only subject to possible cease and desist orders from the Competition Tribunal. Not surprisingly, a number of abuse of dominance cases involving loyalty programs, including *NutraSweet*[19] and *Canada Pipe*[20] also involved finding of exclusive dealing. The exclusive dealing analysis in these cases did not, however, go beyond the analysis relevant to abuse of dominance.

C. Tied Selling

Like exclusive dealing, tied selling allegations are often combined with allegations of abuse of dominance. The *NutraSweet*[21] case involved an allegation of tied selling, tying the supply of aspartame to its trade mark or more specifically prohibiting the use of other suppliers' aspartame in conjunction with the NutraSweet trade mark, for which customers were paid a 40% allowance. That allegation was rejected by the Tribunal.

In an earlier case, BBM Bureau of Measurement was prohibited from tying the supply of television audience measurement services to the supply of radio audience measurement services. In particular, members that were provided the radio data got a significant discount if they also acquired television audience measurement services from BBM.[22]

Again, however, these cases provide relatively limited guidance.

D. Predatory Pricing

As noted above, predatory pricing constituted a criminal offence until 2009. That said few cases were prosecuted under the provision.[23] One of them, *Hoffman LaRoche*, which involved the

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[19] *NutraSweet*, *supra* note 6.

[20] *Canada Pipe*, *supra* note 14.

[21] *NutraSweet*, *supra* note 6.

[22] *Canada (Director of Investigation & Research) v BBM Bureau of Measurement* (1981), 60 CPR (2d) 26.

[23] *R v Producers Dairy Ltd* (1966), 50 CPR (2d) 265 (Ont CA); *R v Carnation Co* (1969), 4 DLR (3d) 133, 58 CPR 112; *R v Hoffman-La Roche Ltd* (1980), 109 DLR (3d) 5 (Ont HCJ) [*Hoffman LaRoche*].

provision of drugs free of charge to hospitals, in order to stimulate sale of those drugs to patients after their hospitalization, involved loyalty issues of a kind. None of the criminal cases, however, involved typical types of loyalty programs.

In the *NutraSweet* case,[24] the NutraSweet Company was alleged to have engaged in the anti-competitive practice of selling products below acquired cost. The Tribunal rejected the allegation, but found that in the right case predatory pricing could constitute an anti-competitive act and result in abuse of dominant market position.

IV. The *Canada Pipe* Case

A. Background

Canada Pipe is the leading Canadian loyalty program case – and is, in fact, the only true loyalty case that has been decided to date.[25]

The Commissioner alleged that Canada Pipe, a manufacturer of cast iron drain, waste and vent ("DWV") products, and supplier of mechanical joint couplings ("MJ couplings") had violated the abuse of dominance and exclusive dealing provisions of the Act through a loyalty program known as the stocking distributor program (the "Program").

The Program offered distributors quarterly and annual rebates and significant point-of-purchase discounts for agreeing to exclusively purchase all of their cast iron DWV products from Canada Pipe.[26] Any distributor could participate in the Program by making a minimum threshold purchase, after which the rebates and discounts remained the same regardless of the size of a distributor's purchase. There were no signed contracts under the Program, and distributors could join at any time to receive quarterly and yearly rebates for each completed quarter or calendar year. Therefore, purchasers could earn the discounts for one quarter but not for the next, or one year and not the next, as they chose.

[24] *NutraSweet*, *supra* note 6.

[25] *Canada Pipe*, *supra* note 14.

[26] Point-of-purchase discounts were up to 40%, quarterly rebates ranged between 7% and 15%, and annual rebates ranged between 1% and 4%.

B. Tribunal Decision

a. Market Definition

To establish an abuse of dominance, a necessary first step is to show that a person substantially or completely controls a class or species of business (i.e., possesses market power).[27]

The Commissioner argued that it was not necessary to begin by defining the product market because there was direct evidence of market power. In this regard, the Commissioner relied on her expert's analysis of "direct evidence", including Canada Pipe's high margins and prices and its ability to lower its prices in response to competition in certain regions.[28]

The Tribunal found, in accepting the Commissioner's position, that there were three relevant product markets (cast iron DWV pipe, fittings and MJ couplings) and that DWV products made from other materials were not included in these markets. The Tribunal's conclusion was based on an absence of evidence that the price of products made from other materials had a disciplinary effect on the price of cast iron DWV products and evidence of substitutability. In particular, the Tribunal found that though cast iron DWV products could be substituted with DWV products made from other materials for most uses, cast iron was favoured for some uses.

b. Market Power – Control

The Tribunal found that Canada Pipe possessed market power. In reaching this conclusion, the Tribunal again considered direct evidence including Canada Pipe's high margins (at least in some regions of Canada – in other regions the evidence was that Canada Pipe may have lost money); the variation of Canada Pipe's prices between regions; and its ability to lower its prices in the face of competition. While the Tribunal found that the evidence on barriers to entry (including sunk costs, incumbency advantages and the maturity of the market) was "not entirely conclusive", other indirect indicators of Canada Pipe's dominance included its large market shares (which the Tribunal found to be between 80 and 90%), stocking of a broad range of

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[27] In *NutraSweet*, *supra* note 6 at 28-29 the Tribunal held that several indicia are relevant to establishing market power including market share, production capacity and ease of entry. This conceptual approach was later accepted by the Tribunal in subsequent decisions. See e.g., *Laidlaw*, *supra* note 6 at 325, where the Tribunal held that "market power in the economic sense is the power to maintain prices above the competitive levels without losing so many sales that the higher price is not profitable. It is the ability to earn supra-normal profits by reducing output and charging more than the competitive price for a product."

[28] The Commissioner's expert argued that Canada Pipe's prices were supra-competitive in that they were 30-50% higher than the price of imported cast iron DWV products. See also *Canada (Director of Investigation and Research) v Tele-Direct (Publications) Inc* (1997), 73 CPR (3d) 1, [1997] CCTD No 8 [*Tele-Direct*], where the Tribunal noted that accounting profits of over 40% were an indicator of market power. See also, *US v. Dentsply International Inc.,* 399 F 3, 181 at 190 [*Dentsply*], where the U.S. Third Circuit Court of Appeals noted that "an increase in pricing is another factor used in evaluating existence of market power." See also, EC Discussion Paper, *supra* note 4 at 10, where the Commission states that "higher than normal profits may be an indication of a lack of competitive constraints on an undertaking."

products, lack of significant countervailing power, national presence and the limited penetration of competitors.[29]

It is submitted, however, that the Tribunal's reliance on Canada Pipe's "ability" to lower its prices in the face of competition appears inconsistent with, as opposed to supporting, the conclusion that Canada Pipe possessed market power (lowering its prices when confronted with competition would seem to indicate that Canada Pipe was unable to exercise market power). For example, in *Hoffman-La Roche & Co v EC Commission*, the European Court of Justice stated that "the fact that an undertaking is compelled by the pressure of its competitors' price reductions to lower its own prices is in general incompatible with that independent conduct which is the hallmark of a dominant position."[30]

c. *Practice of Anti-Competitive Acts*

The primary issue in *Canada Pipe* was the question of whether Canada Pipe had engaged in anti-competitive acts. The difficulty of distinguishing between anti-competitive and pro-competitive acts has been recognized by the Tribunal on a number of occasions.[31] The Commissioner has also noted the difficulty in drawing this distinction, stating that "clearly, there is a fine line between anti-competitive and pro-competitive behaviour and the effects-based analysis in our abuse of dominance provisions recognizes that reality."[32]

The Commissioner alleged that the Program constituted a practice of anti-competitive acts, tying distributors to Canada Pipe if they wanted to receive rebates, thereby foreclosing distribution channels to Canada Pipe's competitors. In particular, the Commissioner challenged the exclusivity and full-line forcing aspects of the Program.

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[29] *Canada Pipe*, *supra* note 14 at para 161. The Tribunal had held in *Laidlaw* and *D&B Companies*, *supra* note 6, that a large market share leads to a *prima facie* conclusion that a firm possesses market power. However, the Tribunal has also held that where barriers to entry are non-existent, even a very large market share will not support a finding of market power. See e.g., *Tele-Direct*, *supra* note 28.

[30] Case 85/76, *Hoffman-La Roche & Co v EC Commission*, [1979] ECR 461 at para 71 (Eur Ct Justice); See also *Dentsply*, *supra* note 28 at 191, where the Court commented on Dentsply's "high price umbrella" and the fact that Dentsply did not reduce its prices when competitors elected not to follow its price increases, concluding that it set its prices with "little concern for its competitors."

[31] For example, in *NutraSweet*, *supra* note 6 at para 90, the Tribunal held that the list of anti-competitive acts set out in section 78 is not exhaustive. In *Tele-Direct*, *supra* note 28, the Tribunal noted the difficulty of distinguishing between anti-competitive acts and hard competition on the merits. Tele-Direct proposed a bright line test (i.e., that conduct which a non-dominant firm would have undertaken in similar circumstances could not be an anti-competitive act). The Tribunal, however, rejected this argument. While it recognized the utility of attempting to distinguish in some clear way between anti-competitive acts and other conduct, the Tribunal noted that the range of possible conduct and circumstances was so broad that it could not lay down such an absolute test.

[32] Commissioner of Competition, "Abuse of Dominance Under the *Competition Act*", speech to the Federal Trade Commission/Department of Justice Hearings on Single-firm Conduct (Washington, D.C., September 12, 2006) at 9-10.

In reviewing the alleged anti-competitive aspects of the Program, the Tribunal considered the contractual aspect and binding effect of the Program, its business justification, its impact on Canada Pipe's competitors and switching costs.

The Tribunal noted that the terms of the Program were transparent and well known (allowing distributors to decide whether to take advantage of the discounts and competitors to match the discounts), and there was no contractual obligation for distributors to stay in the Program for any length of time.

With respect to switching, while non-performance by a distributor would result in lost rebates, the significant switching costs present in previous abuse of dominance cases (e.g., penalties or liquidated damages) were not present.[33] The Tribunal accepted the evidence of Canada Pipe's economic expert, that showed that the costs to distributors to leave the Program at the end of each year were zero, and that they were low throughout the rest of the year. In this regard, the Tribunal found that the decision for distributors as to whether to remain in the Program became a "straight cost-benefit analysis" based on their future interest and that the Program did not prevent that cost benefit analysis from being conducted or acted upon if a more competitive supplier was identified.[34]

This reasoning is consistent with the U.S. approach, at least in some cases. For example, in *Concord Boat*, the U.S. Eighth Circuit Court of Appeals held that a discount program offered by Brunswick Corporation did not violate Section 2 of the Sherman Act as the dealers receiving discounts were "free to walk away from Brunswick's discounts at any time" (and found that the evidence showed that they did in fact switch when Brunswick's competitors offered better discounts).[35] The ability of distributors to leave the Program can be contrasted to the *Dentsply* case, where *Dentsply* threatened dealers who carried and considered carrying competing products with non-supply.[36] The extensive argument on switching costs (and the Tribunal's reliance on

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[33] A lack of transparency has been an important factor for courts in the EU in finding discount systems to be abusive under Article 102 of the Treaty on the Functioning of the European Union. See e.g. Case T-203/01, *Michelin v EC Commission*, Sept 30, 2003 (Ct First Instance) [*Michelin II*] at para 141, where the Court of First Instance stated that "a discount system which is applied by an undertaking in a dominant position and which leaves that undertaking a considerable margin of discretion as to whether the dealer may obtain the discount must be considered unfair and constitutes an abuse by an undertaking of its dominant position on the market within the meaning of Article 82 EC [Article 102]." See also Case 322/81, *Michelin v EC Commission*, [1983] E.C.R. 3461 [*Michelin I*] at paras 83-85, where the European Court of Justice found that Michelin's discount system, in which discounts and sales targets were not communicated to dealers, limited the dealers' choice of suppliers and made access to the market more difficult for competitors.

[34] *Canada Pipe*, *supra* note 14 at para 206.

[35] *Concord Boat Corporation v Brunswick Corporation*, 207 F3d 1039 (8th Cir 2000) [*Concord Boat*].

[36] *Dentsply*, *supra* note 28.

switching as a factor) indicates the importance of showing that switching costs are low as an aspect of determining that a loyalty program is not exclusionary. Therefore, at least at one level, the Tribunal's decision can be argued to be simply a factual conclusion that, whether or not the Program was designed to be exclusionary, it simply was not so in practice. As such, there was no basis for an order.

The Tribunal also accepted Canada Pipe's business justification that it needed the Program to help it sell a certain volume of products to maintain a full product line (i.e., by selling high volumes of products, the margins earned on high volume items allowed it to maintain a supply of less frequently sold items, which benefited consumers).

The Tribunal's acceptance of Canada Pipe's business justification can be contrasted with *Dentsply*, where the Court found that *Dentsply*'s alleged business justification for its exclusivity policy with its dealers was expressly designed to exclude rivals from access to its dealers.[37]

Arguably, a different way for Canada Pipe to have articulated the same business justification would have been to argue that the Program was a pricing mechanism to cover the cost of supply of both the common and the rare parts. An alternate mechanism, which it also made available to those not in the Program, was to sell parts on a one-off basis. In that case, when customers chose to buy the relatively rare parts from it (because those parts were typically not stocked by Canada Pipe's competitors, so for those customers not participating in the Program, those were the parts which customers generally purchased from Canada Pipe), Canada Pipe charged a higher cost for stocking and supplying such relatively rare parts.

The Tribunal adopted the test set out in *NutraSweet* for an anti-competitive act, where it was held that an anti-competitive act is one whose purpose is an intended negative effect on a competitor that is predatory, exclusionary or disciplinary,[38] and found that the Commissioner had failed to establish that the Program was a practice of anti-competitive acts. The strongest factor for the Tribunal in making this determination was the fact that the Program had not prevented entry of competitors in certain regions, including the entry for the first time in thirty years of a new Canadian based manufacturer of cast iron DWV products. The Tribunal also held that to be anti-

[37] In finding that Dentsply had a clear plan to maintain its monopolistic power, the Court cited the testimony of two former Dentsply employees who testified that Dentsply's exclusivity policy was "designed to block competitive distribution points" and that the objective of the policy was not to allow "competition to tie up dealers" and "not to free up key players", *Ibid* at 189.

[38] *NutraSweet*, *supra* note 6 at 34.

competitive, a practice must have a negative effect on <u>*competition*</u> (emphasis added) and there must be a link between the practice and its alleged anti-competitive effect (which was not established).

d. Substantial Prevention or Lessening of Competition

While the Tribunal held that the Program did not constitute a practice of anti-competitive acts, it went on to consider whether the Program had resulted in a substantial prevention or lessening of competition under the third branch of the test (section 79(1)(c)).[39]

The Tribunal found that the Commissioner had failed to establish that there had been a substantial prevention or lessening of competition in any of the relevant markets. In making this determination, the Tribunal pointed to the fact that in Western Canada and Ontario (which represented about 75 percent of Canada Pipe's market) there was significant evidence of competitive pricing, notwithstanding the Program. The Tribunal also found that there had been effective entry, both by domestic suppliers and imports, evidenced by Canada Pipe lowering its prices in Ontario. With regard to Quebec and Maritimes, the Tribunal noted that prices appeared not to be constrained by competition, but that the Commissioner had failed to lead evidence to demonstrate that this was due to the Program. Since the Tribunal had no evidence of causation, it could not reach a conclusion that the Program was the cause of any substantial lessening of competition.

e. Exclusive Dealing

Under section 77, the Tribunal found that Canada Pipe's conduct could be characterized as a practice of exclusive dealing, as distributors participating in the Program were precluded from stocking other cast iron DWV products if they wanted to obtain rebates. The Tribunal also found that Canada Pipe was a major supplier, given its large market share. The Tribunal concluded, however, that for the same reasons as in its analysis under the second branch of the test for abuse of dominance (a practice of anti-competitive acts), the Commissioner had failed to establish that the Program impeded or was likely to impede entry of a new competitor or have any other exclusionary effect, and had failed to establish that it had substantially lessened competition.

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[39] In *NutraSweet*, *supra* note 6 at 47, the Tribunal held that in essence, the question to be decided is whether the anti-competitive acts "preserve or add to [the respondent's] market power".

C. The Federal Court of Appeal Decision

On appeal, the Federal Court of Appeal (the "FCA") held that the Tribunal had correctly articulated the legal test for an "anti-competitive act" as established by the Tribunal in previous abuse of dominance cases.[40] It found, however, that despite correctly articulating the test, the Tribunal erred by requiring a causal link between the anti-competitive act and a decrease in competition and detriment to the consumer as part of the test of whether there had been an anti-competitive act, rather than as part of the determination of whether there had been a substantial prevention or lessening of competition.

The FCA held that the second branch of the test for abuse of dominance, whether there is a practice of anti-competitive acts, is concerned with whether the act displays the requisite intended negative effect on *competitors* and is not directly concerned with the state of *competition* generally. It also held that "detriment to the consumer" is not a relevant factor for assessing exclusionary conduct, as this type of evidence does not directly relate to whether an act has an intended negative effect on a competitor.

In the FCA's view, the Tribunal's flawed analysis was partly based on a conflation of the legal test for establishing an anti-competitive act with that required to show a substantial prevention or lessening of competition. While the FCA acknowledged that in an abuse of dominance analysis the same evidence may be relied on in support of several different elements, it emphasized that each statutory element must give rise to a distinct legal test.

The FCA also addressed the issue of a legitimate business justification. It acknowledged that a valid business justification for impugned conduct can be relevant in determining whether the act was performed for an anti-competitive purpose. It held, however, that a business justification is not an absolute defence under the second branch of the test, but is meant to "counterbalance or neutralize" evidence of an anti-competitive purpose for the alleged anti-competitive acts.[41] In this regard, the FCA noted that the Tribunal "appears to have lost sight of the role of the valid business justification doctrine" granting it an "independent role."[42]

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[40] *Canada (Commissioner of Competition v Canada Pipe)*, 2006 FCA 233, [2007] 2 FCR 3 [*Canada Pipe FCA Appeal*].

[41] For a discussion of the balancing approach to the business justification doctrine, see *D&B Companies*, *supra* note 6 at 262 where the Tribunal noted that a business justification must be "weigh[ed]…in light of any anti-competitive effects to establish the overriding purpose" of the impugned act. The Tribunal further noted at 265 that the mere proof of some legitimate business purpose is "hardly sufficient to support a finding that there is no anti-competitive act" and that "all known factors must be taken into account in assessing the nature and purpose of the acts alleged to be anti-competitive."

[42] *Canada Pipe FCA Appeal*, *supra* note 40 at para 87.

The Tribunal had found that Canada Pipe's business justification was that the Program assisted it in marketing a full line of products, with benefits to consumers and customers. The FCA, nevertheless, held that consumer welfare benefits are insufficient on their own to establish a valid business justification for the purposes of section 79(1)(b), and that the Tribunal's reliance solely upon consumer welfare benefits to establish a business justification for the Program was at the core of the Tribunal's error.[43] According to the FCA, a valid business justification must provide a credible efficiency or pro-competitive explanation for why the conduct was engaged in unrelated to an anti-competitive purpose. The FCA concluded that the requisite efficiency-related link to the Program had not been established, leaving only self-interest as the justification for the Program.

While the Tribunal's decision, and therefore the FCA's reversal, did not turn on the business justification issue, it is submitted that it is difficult to understand precisely what the FCA had in mind with respect to this aspect of its decision. The Tribunal found the Program assisted Canada Pipe in ensuring that it had a full range of products available, and that this was a benefit to customers/consumers. That seems on its face to be both an explanation (perhaps not total, but at least in part) for the Program, and to be efficiency enhancing.

The other key aspect of the FCA's decision was its reversal of the Tribunal's conclusion on the issue of substantial lessening of competition. The FCA held that the Tribunal had failed to apply the correct test to determine whether the Program prevented or lessened competition in the relevant markets. The FCA accepted the Commissioner's argument that the correct approach is a "but for" test, which considers whether the relevant markets would have been substantially more competitive but for the impugned practice of anti-competitive acts. That is, the assessment is not merely an absolute evaluation of the level of competition in the relevant markets, but a comparison of the level of competitiveness in the presence and absence of the impugned practice to determine whether the prevention or lessening of competition, if any, is "substantial".

The FCA concluded that the Tribunal failed to consider whether, without the Program, the relevant markets would have been substantially more competitive than they were. It noted that the Tribunal had considered the effects of the Program against an absolute standard of "prevention of competition", rather than a more relative standard required by the term

[43] *Canada Pipe FCA Appeal*, *supra* note 40 at para 90.

"lessening" in section 79, and that the identification of entry (or evidence of competition subsisting in the presence of the impugned practice) was insufficient to meet this relative standard.

The FCA engaged in only a brief discussion of the elements of exclusive dealing, stating that there was a parallel structure and logic between the elements of exclusive dealing and abuse of dominance. It did note that there were some differences in wording between the two provisions that could yield different results in future cases. It concluded, however, that as the Tribunal had dismissed the Commissioner's exclusive dealing application on the basis of its abuse of dominance reasoning, to the extent the Tribunal erred with respect to its abuse of dominance analysis, the same errors of law applied with respect to exclusive dealing. The FCA also noted that, as with abuse of dominance, the statutory elements for exclusive dealing are distinct, and that each must be established before an order may be made under section 77.

In the result, the FCA sent the case back to the Tribunal for re-determination in accordance with its reasons, based on the existing record. The case ultimately settled before the re-determination. The Commissioner and Canada Pipe negotiated a 5-year consent agreement.[44]

V. Subsequent Developments

With respect to Canadian jurisprudence related to loyalty discounts subsequent to *Canada Pipe*, the simple answer is there is none. The law remains as articulated in *Canada Pipe*, which may not be that clear, but it is what it is. A subsequent abuse of dominance case involving the Toronto Real Estate Board adjusted the test for whether conduct could be seen as anti-competitive.[45] It found, unlike the court in *Canada Pipe*, that conduct aimed at excluding a competitor need not be aimed at a competitor of the alleged dominant firm, but rather could be directed against competitors in the marketplace in which the dominant position was abused,[46] even if those firms were not competitors of the allegedly dominant firm. Whether that leaves any meaningful content to the word "competitor" is beyond the scope of this paper, but the *Toronto Real Estate Board* case did not deal with the concept of loyalty discounts, nor has any litigated case in Canada subsequent to the *Canada Pipe* case.

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[44] *Canada (Commissioner of Competition) v Canada Pipe Co* (12 December, 2007), CT-2002-006, online: Competition Tribunal < http://www.ct-tc.gc.ca/CMFiles/CT-2002-006_130_45KOT-12202007-8411.pdf>.

[45] *Toronto Real Estate Board*, *supra* note 8.

[46] *Toronto Real Estate Board*, *supra* note 8.

In January of 2018, the Competition Tribunal registered a consent agreement reflecting a settlement between the Commissioner and Softvoyage, Inc.[47] *Softvoyage* was not a contested case, so the learning available is limited. Public statements made in relation to the consent agreement revealed that Softvoyage developed two types of computer software for use by packaged holiday tour operators: software which managed the various components of package holidays (flight, hotels, transfers, car rentals, etc.) ("Content Management Software"), and software which enabled tour operators to distribute the products ("Distribution Software"). Softvoyage allegedly held a greater than 90% share in each market. Softvoyage first developed significant market power in respect of Distribution Software. Most tour operators were using Softvoyage's Distribution Software, and over time moved to using its Content Management Software because those who used other software frequently faced technical barriers to the distribution of their vacation packages. Softvoyage also began to employ exclusivity clauses which required use of Softvoyage's Distribution Software by those using its Content Management Software.

The Bureau alleged that Softvoyage's conduct materially inhibited innovation. The consent agreement required that the exclusivity clause not be enforced, and that Softvoyage collaborate in assisting tour operators wishing to use other supplier's Distribution Software or Content Management Software.

Softvoyage is interesting in that it implicates abuse of dominance, tied selling and exclusive dealing. Because it is a settlement, however, it does not provide insight into a number of interesting issues; including what the consumer harm was thought to be, whether competitors outside of Canada could or did discipline the Canadian market, how significant the barriers to entry were, whether there were meaningful technological reasons for the tie between the two types of software, or whether there may be a basis in copyright law for Softvoyage's conduct. Such questions will have to wait for future cases.

By way of recent statutory changes, after the decision in *Canada Pipe*, administrative monetary penalties were introduced for conduct contrary to the abuse of dominant market position provisions of the *Competition Act*. These penalties can be up to $10 million for a first instance of abuse of dominance and $15 million for subsequent instances. While not criminal, a finding

[47] *The Commissioner of Competition v Softvoyage Inc* (17 January, 2007), CT-2002-006, online: Competition Tribunal < http://www.ct-tc.gc.ca/CMFiles/CT-2018-004_Registered%20Consent%20Agreement_3_67_1-17-2018_1878.pdf> [*Softvoyage*].

of abuse of dominance can now come not only with the threat of cease and desist orders or mandatory supply orders (and in extreme cases divestiture) but also significant fines, by whatever name. The tied selling and exclusive dealing provisions do not allow for administrative monetary penalties.

As mentioned, the Bureau introduced its most recent abuse of dominance guidelines[48] subsequent to the *Canada Pipe* case. However, they contain no specific guidance with respect to loyalty programs, adding very little to the debate.

VI. Conclusion

Canada has an embarrassment of riches in respect of statutory provisions relevant to loyalty programs, and a surprising lack of jurisprudence in seeking to understand the laws. The *Canada Pipe* decision is the only Canadian case to extensively consider loyalty programs.[49] In that case, the FCA introduced some potentially troubling concepts; including downplaying the relevance of detriment to consumers, at least in respect of the determination of whether conduct constitutes an anti-competitive act, as well as finding that conduct which is undertaken to provide benefits to consumers does not necessarily constitute a legitimate business justification. Whether these concepts will, in time, set Canada on a different path to that followed by the United States with respect to abuse of dominance generally, including the importance of consumer welfare, and in particular a divergence between Canada and the U.S. on issues related to loyalty programs, cannot yet be determined but it is a possibility. Since jurisprudence is slow to develop, we may have to wait some time to discover the answer.

[48] *2012 Abuse of Dominance Guidelines*, *supra* note 9.
[49] As noted, in *NutraSweet*, *supra* note 6, the Tribunal focused on loyalty programs to some degree.