Submission on Bill C-235, *Competition Act* Amendments

NATIONAL COMPETITION LAW SECTION
CANADIAN BAR ASSOCIATION

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PREFACE

The Canadian Bar Association is a national association representing over 35,000 jurists, including lawyers, notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

This submission was prepared by the National Competition Law Section of the Canadian Bar Association, with assistance from the Legislation and Law Reform Directorate at National Office. The submission has been reviewed by the Legislation and Law Reform Committee and approved as a public statement of the National Competition Law Section of the Canadian Bar Association.

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I. INTRODUCTION

The National Competition Law Section of the Canadian Bar Association (the Section) welcomes the opportunity to make submissions with respect to Bill C-235, *An Act to amend the Competition Act*. Bill C-235 is a private members bill which seeks to compel vertically integrated suppliers to charge "fair" prices for wholesale products to customers with whom the suppliers compete at retail. The term "vertically integrated supplier" means a supplier which owns and controls various stages of the production process, including (for example) extraction, manufacture, transportation, marketing and retail.

The Section submits that the Bill is inconsistent with the purposes and with other sections of the *Competition Act* (the *Act*), is vague and uncertain, and will inhibit rather than enhance competition in the marketplace. Further, anti-competitive behaviour by vertically integrated suppliers is already dealt with in other sections of the *Act*. It would not be appropriate to amend the *Act* to create a statutory regime that would operate in contradiction to competitive market forces. Therefore, the Section urges that the Committee recommend that the Bill not be adopted.

II. SUMMARY OF THE PROPOSED AMENDMENTS

The Section understands that the private member sponsoring the Bill was concerned primarily with vertically integrated firms in the petroleum industry. However, the Bill applies to any vertically integrated supplier which has its own retail operations and which also supplies independent retailers competing with the supplier's own retail operations. Examples include: large computer manufacturers such as IBM or Compaq which supply independent retailers and also sell their products directly to the consumer either through their own retail outlets or through the Internet; Canadian telecommunications companies which provide a wide range of services (for example, long distance telephone service, Internet access and mobile wireless services) to both independent suppliers (at bulk rates) and to the consumer; and any number of manufacturers who sell their products (ranging from greeting cards to clothing) through the Internet and who also sell to independent retailers. Even if the Bill's application were limited to the petroleum or other specific industries, however, the Section believes it should not be adopted.

The Bill would add a new section 50.1 making it an indictable offence for a supplier to charge a competing retailer a price higher than either the price charged to the supplier's own affiliate or the supplier's direct retail price (less the supplier's own costs of marketing and the supplier's reasonable return on the retail sale). In essence, the new section attempts to prevent vertically integrated suppliers from lowering their retail prices unless they charge independent customers the same wholesale prices as they charge their own retail divisions or affiliates.

The Bill would also amend the definition of "*anti-competitive act*" in the abuse-of-dominance provisions of the *Competition Act* (sections 78 and 79), to include any attempt by a vertically integrated supplier "to coerce" a competing customer-retailer in relation to a customer's retail prices or pricing policy.

III. ANALYSIS

The Bill presents significant conceptual and drafting problems and should not be passed because:

a) it is inconsistent with the overall purpose of the *Competition Act*;
b) to the extent that vertically integrated suppliers may engage in anti-competitive pricing behaviour, sections 50(1)(c) and 78(a) of the *Act* already provide adequate remedies;
c) the Bill potentially conflicts with section 61 of the *Act*;
d) if passed into law, the Bill would interfere with market forces and potentially have negative impact on the economy; and
e) the Bill is vague and uncertain.

A. Inconsistency with the Objectives of the *Competition Act*

The purposes of the *Act* are set out in section 1.1. Generally speaking, the *Act* is intended to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy. Proposed sections 50.1 and 78(j) are inconsistent with these objectives. Further, the *Act* is intended to protect the economic benefits and efficiencies generated by competition and not to protect particular market competitors. Bill C-235, on the other hand, proposes to protect a specific category of competitors from market forces.

In a competitive, dynamic market, there are winners and losers. Firms that are more efficient and innovative tend to succeed, while others fail. The fact that a particular firm may fail does not mean that its competitors have engaged in anti-competitive behaviour. Some independent retailers may be more efficient than a vertically integrated supplier's retail division or affiliate while others may not. Those who are most efficient are more likely to survive and thrive.

Proposed sections 50.1 and 78(j) would discourage integrated suppliers from realizing or passing onto customers the efficiency gains achieved from vertical integration, and these provisions therefore run counter to the main objectives of the *Act*. In addition, the legislation will require vertically integrated suppliers to incur substantial extra costs to maintain compliance with these provisions. While it is fair to say that such suppliers already periodically monitor other retailers' prices in a particular market to ensure their own prices are competitive, the proposed Bill would require suppliers to constantly monitor retail prices at every customer/retailer's establishment. This is a substantially more onerous obligation, which will create inefficiencies, the costs of which will likely be borne by retailers and ultimately consumers.

Under Bill C-235, the courts, rather than the marketplace, would be required to establish "reasonable returns on retail sales" and wholesale prices that must be offered to retailers. Section 50.1 favors the interests of non-integrated retailers over the benefits derived by the public at large in having competitive prices determined by market forces. Further, it does so by creating a serious criminal offence without the requirement of showing anylessening of competition (as is required by, for example, sections 45 and 50(1)(b) and (c)).

The proposed amendments are also inconsistent with the provisions of section 50(1)(a) (price discrimination). That section recognizes that different prices can be charged by suppliers in respect of sales of products differing in quantity (for example, volume discounts). A vertically integrated supplier's affiliate may be purchasing larger volumes of products at volume discounts, resulting in lower wholesale and retail prices than would be available to non-integrated suppliers.

B. Sections 50(1)(c) and 78(a) Provide Adequate Remedies

The Section submits that the proposals in the Bill are unnecessary. Under the current provisions of the *Act*, the Director of Investigation and Research (the "Director") and the Competition Tribunal already have the ability to address anti-competitive conduct of the kind that is proposed to be dealt with by the Bill. In particular, sections 50(1)(c) and 78(a) of the *Act* apply when vertically integrated suppliers engage in anti-competitive pricing activity which has the objective or actual impact of impeding or preventing a competitor's entry into or expansion in a market. Suppliers who attempt to coerce retailers to increase, to maintain or not to discount their retail prices may be subject to criminal penalties under section 61 of the *Act*. These sections provide ample criminal and civil reviewable measures to address anti-competitive behaviour which may have a significant impact in the market.

C. Potential Conflict with Section 61

Section 61 prevents persons from entering into agreements to maintain the margin between the wholesale selling price and the resale price of a product. The proposed section 50.1 is inconsistent with section 61 because it may in fact invite vertically integrated manufacturers and retailers to agree on wholesale and retail prices. As retail prices change which frequently occurs in a competitive, dynamic market wholesale prices also have to shift. Section 50.1 would require vertically integrated suppliers to communicate with competing retailers on a regular basis to ensure that the supplier's direct retail prices remain above the wholesale prices paid by competing retailers calculated in accordance with the formula in section 50(a)(i) and (ii). These calculations will be difficult and could well result in agreements or arrangements between suppliers and competing retailers on retail prices. If such agreements or arrangements are attempted or are actually achieved, section 61 of the *Act* would be contravened.

In order to avoid criminal sanctions under section 50.1, suppliers and retailers would be encouraged to engage in the anti-competitive behaviour prohibited by another section of the *Act*. In effect, a vertically integrated supplier will be caught between two opposing forces: compete vigorously in the retail market and risk criminal sanctions under section 50.1; or work out "appropriate" margins with competing customers and risk breaching section 61.

D. Negative Economic Impact of Bill C-235

Bill C-235 may chill vigorous competition by vertically integrated companies. A vertically integrated supplier, rather than risk the threat of criminal sanctions or a civil review process, may charge higher retail prices, engage in fewer promotions and agree with competing retailers on "appropriate" retail margins. This would have the potential of leading to higher consumer prices.

Vertically integrated suppliers may conclude that it is in their best interest to discontinue supplying products to competing retailers. The costs of calculating, documenting and monitoring the marketplace in order to avoid conflict with these new provisions, when combined with the risks of criminal sanctions and associated legal costs, may be too high to warrant the continued supply of products to independent retailers. If not, such costs would likely be reflected in increased wholesale prices which would be passed on to the consumer.

The proposed legislation may also interfere with the normal operation of the marketplace insofar as it could create a two-tier wholesale and retail market where vertically integrated suppliers are hindered, by threat of criminal sanctions, from competing vigorously with non-integrated retailers. For example, non-integrated retailers may try to promote their businesses by engaging in price wars in other words, dropping their retail prices for a period of time. In these situations, vertically integrated suppliers may be prevented from responding if the suppliers' retail prices would be lower than the wholesale prices charged to the competing retailers.

As noted above, Section 50.1 in effect requires the vertically integrated supplier to perform a difficult task of constantly monitoring the prices at each and every customer/retailer establishment to arrive at maximum prices at which it could sell to independent customers. As such, it is very similar to price regulation for the purposes of protecting a special category of market participants. The courts and the Competition Tribunal would ultimately be asked to regulate the prices at which vertically integrated suppliers could sell their products (both articles and services) to non-affiliated retailers competing in the same market.

To illustrate the administrative difficulties created by the proposed section 50.1 one need only consider the following. A vertically integrated supplier, on every sale to an independent retailer, must know:

- the retail prices at which the supplier's retail division customarily sells the product in the market and the retail prices charged by each and every independent retailer to whom the supplier has sold the product in that market;
- the supplier's own costs of marketing at retail on a customer by customer basis; and
- the supplier's reasonable return on the retail sales.

A supplier will generally know its marketing costs over the course of a year or generally by product line over the life of the product or during certain promotional periods. However, the proposed Bill would require a supplier to establish the costs of marketing at retail on a customer-by-customer basis, which for a number of reasons is simply not feasible. For instance, marketing costs are often incurred on a product-wide, region-wide or country-wide basis and are therefore not easily allocable to individual customers. Marketing costs usually vary between customers, vary during the course of a year and vary during the life-span of a particular product. Such costs are also affected by a company's own promotional activity as well as the activities (promotional and otherwise) of suppliers of competing products.

The supplier must continually monitor the wholesale and retail prices in every market in which it operates. If litigation ensues, the courts may well be called upon to do their own calculations to determine the propriety of the prices charged by a supplier.

The words "the price charged to the affiliate" in section 50.1(2)(b) raise an important issue. The price at which a company sells a product to its affiliate may, for many reasons, not reflect the true market price because the transaction is not an arm's length transaction. It is not reasonable from either a *Competition Act* perspective or an economic standpoint to use the price of a non-arm's length transaction to determine the reasonableness of the price of an arm's length transaction. This is a fundamental conceptual problem with the Bill as a whole.

Proposed Section 50.1(3) provides a defence for a supplier based on the customer's actual return on the retail sale of the same product, whereby the supplier is not required to sell at a price that results in the supplier receiving a lower return than the competing retailer's return. This defence ignores market forces, however, because it does not recognize that retailers often adjust their prices downward to respond to reductions in prices from third parties offering competing products. A customer/retailer's low rate of return may therefore have nothing to do with the actions of the supplier. Further, a supplier may not be able to avail itself of the defence if it lowers its retail price in response to a reduction in price from a competitor whether the competitor is a retailer which purchased from the supplier or a third-party competitor. This is because the supplier may have sold the same product to another retailer at a higher price on the basis of a lower volume. Volume discounts are, of course, permitted under section 50 of the *Act*.

The following example illustrates this problem. Company A, a vertically integrated supplier, sells a product to retailers B, C, D and E at prices of $10, $11, $12 and $13 respectively. These prices are based on the respective volumes purchased by these

retailers, which all sell at retail for $14. Company A charges itself $9 and sells at retail for $11.50. Company X is a third-party selling a competing product and sells at retail for $8.

In the above scenario, Company A is already violating proposed Section 50.1(2) because its retail sales are below the wholesale costs to D and E. The defence in Section 50.1(3) would not apply even though A's wholesale price is competitive with that charged to B and C and even though the prices to D and E are based on the volume of product purchased. Company A is also effectively prohibited from lowering its retail price to compete with Company X even where any of B, C, D or E do so.

E. Uncertainty in Drafting

While the Section understands that this Bill was drafted to target vertically integrated petroleum companies, the language used in the Bill is vague. For example, it fails, among other things, to set out:

- whether the phrase "manufactures and sells a product" in proposed Section 50.1(2) includes suppliers which provide services, given that "products" is deemed to include "services" in section 1 of the *Act*;
- the relevant time frame during which a comparison of prices would have to be undertaken;
- the relevant geographic area in which a comparison would have to be undertaken;
- in what circumstances vertically integrated suppliers could sell for less than their wholesale price;
- which customer-retailers' price or prices would be the relevant subject of comparison to the vertically integrated supplier's wholesale price and whether comparison of prices would include promotional discounts;
- how "the supplier's own costs of marketing at retail" would be calculated; and
- what is a supplier's "reasonable rate of return on the retail sales".

In particular, the words "own cost of marketing at retail" in section 50(2)(a)(i) and the words "reasonable return on the retail sale" in section 50.1(2)(a)(ii) create substantive uncertainty. A vertically integrated supplier may incur different marketing costs which would be difficult to allocate between business functions. Tying those marketing costs to any given (and potentially arbitrary) market area would be very difficult, if not impossible. This language would turn the court effectively into a marketing board.

The words "or a similar product" in section 50.1(2) are also vague. The phrase presents similar problems to determining whether articles are of "like quality" under section 50(1)(a) (price discrimination). This poses a problem, particularly where manufacturers offer different product lines which, while similar in design and construction, are positioned differently in the market, with different prices. Proposed section 50.1(2) would add a significant additional dimension to the question of different product lines and could lead to fewer products being available to Canadian consumers. This would limit product choices, contrary to the purposes of the *Act* as specified in section 1.1.

As a result of this uncertainty, firms would have extreme difficulty determining whether they are acting within the law and would incur significant legal costs doing so.

IV. SPONSOR'S AMENDMENTS TO THE BILL

On March 24, 1999, the sponsor of Bill C-235 introduced two amendments. The amendments to the proposed section 50.1 would make it a criminal offence punishable on indictment for a vertically integrated supplier who sells a product at

retail either directly or through an affiliate to sell that product to an independent retailer at a price that exceeds:

a) the supplier's own retail price in the same market area; or

b) the price charged to the supplier's affiliate in the case of a sale through an affiliate.

The amendments also eliminate a defence that was contained in the original proposed section 50.1(3) of Bill C-235. The defence provided that the vertically integrated supplier was not required to sell a product to an independent retailer at a price that would result in a lower return on the retail sale of the product when sold by the supplier or its affiliate than the independent retailer's return on the retail sale of the same product in the same market area.

A. Effect of Sponsor's Amendments

The proposed amendments may remove some of the difficulty that integrated suppliers would have in complying with the legislation and some of the uncertainty of interpretation. However, section 50.1, as amended, would still impose an unfair and unnecessary burden on vertically integrated suppliers, who will in effect have a wholesale price ceiling imposed on them which is not based on market forces. A vertically integrated supplier that does not sell through a separate affiliated corporation would still be required to monitor retail prices in order to determine prices to independent customers. In a competitive environment, retail prices change in response to market conditions and may change several times throughout a day. Proposed section 50.1 still does not clarify the relevant time period to compare the supplier's retail price and the price charged to independent retailers.

The overall effect would probably still be higher prices for the consumer. This is because the integrated supplier, rather than responding to the competitive forces in setting prices, would also be required to consider prices charged to independent customers.

Generally, business organizations will choose methods of distribution that are the most efficient and that enhance their ability to compete. Bill C-235 would frustrate these efforts to become more competitive and efficient. Proposed section 50.1 would still impose non-market related restrictions on a vertically integrated supplier that would make it less attractive to sell through independent retailers. This could cause a supplier to discontinue the dual mode of distribution and ultimately harm the category of business that Bill C-235 appears to be intended to protect.

V. CONCLUSION

There has been no substantive study or public consultation of the need for these amendments, their potential impact on vertically integrated suppliers or on competition. While vertically integrated suppliers may engage in anti-competitive pricing behaviour, the *Competition Act* already has adequate provision to address these situations.

Although the sponsor's amendments to proposed section 50.1 address some of the concerns that the Section has raised concerning uncertainty in interpretation and the difficulty that vertically integrated suppliers would have in attempting to comply with proposed section 50.1, the amendments do not affect the Section's fundamental objections to Bill C-235 which are:

a) it is inconsistent with the overall purpose of the *Competition Act*;
b) to the extent that vertically integrated suppliers may engage in anti-competitive pricing behaviour, sections 50(1)(c) and 78(a) of the *Act* already provide adequate remedies;
c) the Bill potentially conflicts with section 61 of the *Act*;
d) if passed into law, the Bill would interfere with market forces and potentially have a negative impact on the efficiency of the economy; and
e) portions of the Bill are still vague and uncertain.

In *General Motors of Canada Ltd. v. City National Leasing,*[1] the late Chief Justice of Canada Brian Dickson described the *Competition Act* as "…a well-integrated scheme of regulation designed to discourage forms of commercial behaviour viewed as detrimental to Canada and the Canadian economy...". The *Act* is a complex and integrated whole and is an important part of the fundamental framework of the Canadian economy. As such, it does not lend itself to piecemeal amendments that are not subject to the degree of public study and consultation afforded by the process established by the Competition Bureau.

The single greatest concern with Bill C-235 is that it will expose people to a risk of serious criminal liability for engaging in conduct which in most cases is not anti-competitive.

The amendments do not affect the main thrust of the Section's submissions. The Section strongly believes that Bill C-235, in either its amended or unamended form, would still be inconsistent with the objects of the present *Competition Act* and with competition policy in general. It is still at cross- purposes with other provisions in the *Act*.

The Section strongly urges the Committee to recommend that Bill C-235 not be adopted because the proposed amendments would not be in the best interests of the public and have no place in the *Act*. If the Committee believes that the protection anticipated by these amendments is necessary we suggest that they be referred to the Competition Bureau for appropriate public consultation in the next round of amendments to the *Act*.

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1 [1989] 1 S.C.R. 641.