2017 JAMES H. BOCKING MEMORIAL AWARD WINNER / LAURÉATE DU PRIX COMMÉMORATIF JAMES-H.-BOCKING 2017

LOYALTY DISCOUNTS AND REBATES: A COMMENTARY ON CANADA PIPE AND ABUSE OF DOMINANCE IN CANADA

Corinne Xu, Blake, Cassels & Graydon *LLP*

In this paper I will review the abuse of dominance provisions under the Competition Act[1] *(the "***Act***"), discuss the diverging approaches between the US and EU with respect to loyalty discounts and rebates, and critique the Federal Court of Appeal's decision in* Canada (Commissioner of Competition) v. Canada Pipe Corporation Ltd.[2] *I will argue that while the US rebuttable presumption of legality with respect to loyalty discounts and rebates is preferable to the EU approach of near* per se *illegality, a detailed economic analysis of the market and the specific incentive program at issue should be made on a case-by-case basis. I will also argue that the Federal Court of Appeal's framework in* Canada Pipe *for assessing whether the impugned practice is anti-competitive is problematic. By limiting paragraph 79(1)(b) solely to an assessment of intent, practices that substantially lessen competition yet lack a predatory, exclusionary, or disciplinary purpose against competitors will not be caught. In my view, paragraph 79(1)(b) should involve a threshold balancing of whether the anti-competitive effects of a practice might outweigh its efficiency benefits. I will conclude that while the impugned practice in Canada Pipe was likely anti-competitive under paragraph 79(1)(b), it arguably did not amount to a substantial lessening of competition under paragraph 79(1)(c).*

Dans cet article, je vais examiner les dispositions sur l'abus de position dominante telles qu'elles figurent dans la Loi sur la concurrence[3] *(la* **Loi***), discuter des approches divergentes adoptées par les États-Unis et l'Union européenne quant aux abattements de fidélité, et lire avec un regard critique l'arrêt rendu par la Cour d'appel fédérale dans l'affaire* Canada (Commissaire de la concurrence) c. Tuyauteries Canada Ltée[4]. *Je vais soutenir qu'alors que la présomption réfutable de légalité des ristournes et abattements de fidélité adoptée aux États-Unis est préférable à l'approche*

européenne d'illégalité pratiquement automatique, il faudrait effectuer une analyse économique détaillée au cas par cas du marché et du programme d'incitation particuliers qui sont en cause. Je soutiendrai aussi que le cadre utilisé par la Cour d'appel fédérale pour évaluer, dans l'affaire Tuyauteries Canada, *si la pratique dénoncée est anticoncurrentielle pose problème. En limitant l'alinéa 79(1)b) à la seule évaluation de l'intention, les pratiques qui réduisent sensiblement la concurrence tout en manquant, à l'égard des concurrents, d'intention abusive, ou ne visent pas une exclusion ou une mise au pas, ne seront pas sanctionnées. À mon avis, l'alinéa 79(1) b) devrait comporter un seuil d'équilibre entre les effets anticoncurrentiels d'une pratique et ses avantages du point de vue de l'efficience. Je conclurai que bien que la pratique contestée dans l'affaire* Tuyauteries Canada *ait probablement été anticoncurrentielle en vertu de l'alinéa 79(1)b), on peut alléguer qu'elle ne causait pas une diminution sensible de la concurrence conformément à l'alinéa 79(1)c).*

I. Abuse of Dominance in Canadian Competition Law

The abuse of dominance provisions in the Act establish the "bounds of competitive behavior" for dominant firms.[5] The Competition Tribunal ("**Tribunal**") is empowered to issue corrective orders if it determines that a firm's dominant position is being used abusively to substantially lessen competition in the relevant market. Subsection 79(1) of the Act requires three criteria to be met prior to the Tribunal's corrective order: (a) the organization must have market control; (b) the organization must be engaged in an anti-competitive practice; and (c) the practice must prevent or lessen competition substantially.[6]

While the Act does not define an "anti-competitive act", section 78 provides a non-exhaustive list of anti-competitive acts that *could* lead to an anti-competitive practice finding under paragraph 79(1)(b). The Tribunal held in *Canada (Director of Investigation & Research) v. NutraSweet Co*[7] that the unifying theme across the listed acts in section 78 is an "intended negative effect…that is predatory, exclusionary, or disciplinary".[8] To determine whether an act not listed in paragraph 78 is anti-competitive, a predatory, exclusionary, or disciplinary *intent* must be found. This intent is determined by the firm's subjective motive for engaging in the impugned practice as well as the reasonably foreseeable effects of the practice on competition.[9] However, a negative impact on competition is not necessary for a practice to be anti-competitive under paragraph 79(1)(b). Furthermore, the exclusionary, predatory

or disciplinary act need not be directed at the firm's own competitor. A subsection 79(1) order can be made against an organization who controls a market otherwise than as a competitor if the act is exclusionary, predatory or disciplinary vis-à-vis one or more competitors in that market.[10]

The last step of an abuse of dominance analysis is to determine whether the impugned practice substantially lessens or prevents competition.[11] It is important to undertake a detailed and contextual economic analysis of the relevant market before finding an abuse of dominance, as practices that have substantial anti-competitive effects in some circumstances may be more benign in others. Relevant considerations include market shares, barriers to entry, as well as possible efficiency rationales.[12] The standard for finding a "substantial" lessening of competition is variable: smaller anti-competitive impacts could indicate an abuse of dominance from firms with high degrees of market power, whereas larger impacts may be required in markets where barriers to entry are very low.[13]

II. Loyalty Discounts and Rebates

Loyalty discounts and rebates refer to incentive schemes granted by suppliers to consumers for purchases of specified products that exceed a certain volume threshold or individualized share target. Individualized share targets usually involve all or most of a customer's demand.[14]

The effects of loyalty discounts and rebates on market competition varies greatly depending on market factors, as well as the structure of the particular incentive scheme. In markets with high fixed costs, loyalty discounts and rebates may reduce a supplier's per-unit costs by increasing total sales, leading to the more efficient allocations of resources.[15] They can also offset double marginalization, as well as reduce hold-up and free riding distortions by aiding coordination in the production chain.[16] Finally, loyalty discounts and rebates can induce a dominant firm to compete more aggressively for contested sales, leading to lower prices and increased consumer welfare.[17]

Loyalty discounts and rebates may also have anti-competitive effects by raising switching costs for consumers and strengthening barriers to entry and expansion for competitors. This is particularly likely if the incentive scheme is structured to apply retroactively to entire purchases within a reference period.[18] Such incentive schemes have a "suctioning" effect: when a customer is close to the threshold amount, a small increase

in purchases will trigger a rebate for all the purchased units so far.[19] Switching within a reference period would increase the average price of all purchases, as the rebate would not be realized.

Loyalty discounts and rebates have given rise to divergent antitrust policies between the US and the EU. Courts in the EU have generally taken the position that loyalty discounts and rebates are nearly always *per se* illegal. The mere potential of an incentive scheme to induce loyalty is sufficient to find an abuse of dominance, regardless of their actual impact on competition or consumer welfare.[20] Purchasers must be able to "change supplier without suffering any appreciable disadvantage",[21] whereas loyalty discounts and rebates "tend to remove or restrict the buyer's freedom to choose his own sources of supply" which hinders a rival firm's access or expansion in the relevant market.[22] The underlying rationale for the EU presumption of near *per se* illegality is the "special responsibility" of dominant firms to not raise the barriers of entry in a given market.[23]

In contrast, jurisprudence in the US has generally presumed loyalty discounts and rebates to be pro-competitive. So long as the discounted price is above cost, the plaintiff must overcome "a strong presumption of legality by showing other factors indicating that the price charged is anti-competitive".[24] For example, the Court in *Concord Boat Corp v. Brunswick Corp*[25] held that the impugned price cuts represented "the very essence of competition".[26] This presumption of legality stems from a fear of chilling price competition that, in part, reflects the view that loyalty discount and rebate schemes are not well understood in economics literature.[27] The presumption is rebuttable if the plaintiff can show "tangible exclusionary effects to the detriment of consumers".[28]

The *British Airways*[29] case starkly juxtaposes the respective treatment of loyalty rebate and discount programs by jurisprudence in the US and EU. Virgin Atlantic brought action alleging that British Airways engaged in predatory business practices with respect to its incentive agreements with travel agencies and corporate clients, which impeded Virgin Atlantic's efforts to expand service from London's Heathrow Airport to several key markets in the US.[30] The legality of these incentive agreements was litigated on both sides of the Atlantic. The US Appeals Court held that British Airways' rebate scheme to be lawful as "rewarding customer loyalty promotes competition on the merits".[31] The Court of First Instance, in contrast, found against British Airways and held that the

discounts infringed EU competition law because they had, as their object and effect, "the reward of the loyalty of those agents to BA".[32]

III. Summary of *Canada Pipe*

Canada Pipe is a Federal Court of Appeal case that arose in the context of a loyalty-rebate program in Canada. It is significant due to its extensive discussion of the appropriate legal approach to finding an abuse of dominance.[33] However, the status of loyalty discounts and rebates in Canadian competition policy remains unclear due to the settlement agreement between Canada Pipe and the Competition Bureau prior to the Tribunal's re-determination proceedings.

A. Overview

Canada Pipe is a seller and manufacturer of cast iron drain, waste, and vent products ("**DWV**" products). At issue in this case was its loyalty-based rebate program, referred to as the Stocking Distributor Program (the "**SDP**"). The SDP provided significant point-of-purchase discounts as well as quarterly and annual rebates to distributors who purchased all of their cast iron DWV products from Canada Pipe. These distributors were free to stock non-cast iron DVW products from other companies, and could opt out of the SDP at any time without penalty.[34]

The Commissioner of Competition ("**Commissioner**") brought action alleging that the SDP contravened the exclusive dealing and abuse of dominance provisions in the Act. In particular, the Commissioner claimed that the SDP induced the vast majority of distributors of cast iron DWV products to deal exclusively with Canada Pipe, because the switching costs of withdrawing from the SDP was prohibitively high, and Canada Pipe's competitors were unfairly prejudiced from attracting distributors to deal with them.[35]

Canada Pipe argued that the SDP was pro-competitive because it encouraged wholesalers to stock cast iron, which helped cast iron compete against other materials. The SDP also leveled the playing field between smaller and larger distributors since, rather than requiring a volume-based threshold, distributors were only required to meet individualized targets to participate in the incentive program.[36] Canada Pipe also argued that the SDP did not lock in distributors because there was no long-term commitment required or penalties for withdrawing and prior point-of-sale purchases would not need to be repaid upon withdrawal.

The most significant discounts offered by the SDP were the point-of-sale discounts: participating distributors paid 55% of the list price, whereas non-participating distributors would pay 94% of the list price. In contrast, the quarterly discounts rebates were 7-15% and the annual rebates 1-4%. Therefore, switching to a new supplier merely indicates that the distributor found a better deal elsewhere.[37]

Finally, Canada Pipe argued that it had a valid business justification for implementing the SDP. The SDP's purpose was to protect Canada Pipe's investments in all of its product lines. Increasing the sales of its cast iron products enabled Canada Pipe to lower its cost of production. This allowed Canada Pipe to continue to maintain a full product line by manufacturing and selling less popular products.[38]

B. The Tribunal Decision

The Tribunal found that Canada Pipe was a dominant firm in the relevant market under paragraph 79(1)(a) of the Act. In determining whether the SDP was an anti-competitive practice under paragraph 79(1)(b), the Tribunal heard evidence from several distributors about what the switching cost to another supplier would have meant for them. Emco testified that switching out of the SDP was not worthwhile due to the relatively small and eroding market for cast iron DWV products. A larger market would encourage it to search elsewhere based on the returns they would get for the added expense.[39] Crane Supply stated that due to the SDP, it would not be advantageous to switch suppliers for a portion of their cast iron DWV demand—they would either move all of their business, or none.[40] However, Octo Group, one of two major buying groups in Canada, testified that Canada Pipe did not supply all of its members' demand for cast iron DWV products. Rather, members that did not participate in the SDP were supplied by members that did. As such, all members could benefit from the SDP discounts regardless of whether they purchased all of their cast iron DWV products from Canada Pipe. This secondary market offset the cost of switching suppliers for members within the buying group, and indicated that there was flexibility in the SDP's application.[41]

The Tribunal found that while the SDP may discourage small-scale entry, it would not prevent entry or expansion of larger competitors that could imitate the incentive scheme. Since a distributor that leaves the SDP would not reimburse Canada Pipe for any prior point-of-purchase discounts, competitors need only to offer a better deal. Switching costs

would be prohibitively high only if distributors switched a portion of their demand from Canada Pipe elsewhere. Because the entire SDP discount would be lost, competitors would have to offer much more than that discount on their portion of the sales to offset that cost.[42]

The Tribunal concluded that the SDP was not an anti-competitive practice, as the requisite "link between the practice and its alleged anti-competitive effect" had not been found.[43] The presence of new entrants, such as Vandem and Sierra, indicated that the program did not bar entry into the relevant markets. The fact that several distributors had in fact switched suppliers indicated that the switching costs were not prohibitively high. This distinguished the SDP from other contracts in abuse of dominance cases, in which "non-performance would lead to heavy penalties".[44] The decision to switch out from the SDP "boil[ed] down to a cost-benefit analysis," and the SDP did not prevent the analysis from being acted upon if a more competitive supplier was found.[45] Furthermore, the Tribunal accepted Canada Pipe's business justification that the SDP allowed it to maintain important but less profitable products in its inventory, which had consumer-enhancing effects.[46]

The Tribunal also found that the SDP did not substantially lessen competition under paragraph 79(1)(c) of the Act, as there was "significant evidence of competitive pricing, notwithstanding the SDP" in Western Canada and in Ontario, which represented 75% of Canada Pipe's cast iron DWV market.[47] Furthermore, the "steadily increasing" presence of imports, and the emergence of a new competing manufacturer "for the first time in thirty years" suggested that an increase in competition.[48] For Quebec and the Maritimes, which represented 25% of the market, prices did not appear to be constrained by competition. However, due to the lack of market data prior to the 1998 implementation of the SDP, there was "insufficient evidence" to conclude that the SDP was responsible for a substantial lessening or prevention of competition.[49]

C. The Federal Court of Appeal Decision

The Federal Court of Appeal found that the Tribunal had erred in law in its analysis of whether the SDP was anti-competitive under paragraph 79(1)(b) of the Act. Rather than requiring proof of a link between the SDP with an anti-competitive effect, the Tribunal should have solely evaluated the *intended* impact of the SDP on Canada Pipe's competitors under paragraph 79(1)(b).[50] In coming to this decision, the Federal Court of Appeal emphasized the Tribunal's judgement in *NutraSweet* that

an anti-competitive act must be identified by reference to its predatory, exclusionary, or *disciplinary intent*.[51] An anti-competitive practice need not actually decrease competition nor cause detriment to the consumers. The SDP's impact on consumers should only be considered in the last step of the abuse of dominance analysis—whether the practice led to a substantial lessening of competition.[52] Furthermore, while a valid business justification could counterbalance a practice's alleged anti-competitive effects, improved consumer welfare is not sufficient to establish a valid business justification on its own.[53] A business justification for an impugned practice must provide a pro-competitive rationale that is linked to the respondent and benefits the respondent in some way.[54] As such, Canada Pipe's submission that the purpose of the SDP was to benefit its customers as well as the end-consumers by allowing Canada Pipe to lower production costs and stock a full product line was insufficient to preclude a finding that the SDP was an anti-competitive practice. The Federal Court of Appeal concluded that the issue should be returned to the Tribunal for reconsideration "in light of the correct legal test".[55]

The Federal Court of Appeal also held that the Tribunal erred in its analysis of whether the SDP substantially lessened competition under paragraph 79(1)(c) of the Act. The Tribunal focused on barriers to entry and expansion and compared the current level of competition with the 1998 competition level prior to the SDP's implementation. Instead, the Tribunal ought to have conducted a relative assessment of whether the current level of competition would be even greater "but for" the SDP.[56] The Federal Court of Appeal cited the Tribunal's decision in *Laidlaw*[57] that a substantial lessening of competition "need not necessarily be proved by weighing the competitiveness of the market in the past with its competitiveness as present" because "[s]ubstantial lessening can also be assessed by reference to the competitiveness of the market in the presence of the anti-competitive acts and its likely competitiveness in their absence".[58] Factors to be considered for this relative assessment might include: i) whether the entry or expansion of competitors could be substantially faster but for the SDP; ii) whether switching would be more frequent; and iii) whether prices might be substantially lower.[59] Mere evidence of entry or expansion by competitors into the market "subsisting in the presence of the impugned practice" is insufficient for the purposes of paragraph 79(1)(c).[60] The Federal Court of Appeal noted that this "but for" analysis could potentially require "the construction of a hypothetical comparator model, a market identical to reality in all aspects except that the impugned practice is absent".[61]

IV. Analysis and Critique of Canada Pipe

A. An Anti-Competitive Practice under Paragraph 79(1)(b)

In my view, the Federal Court of Appeal's restriction of paragraph 79(1)(b) to an analysis of only the intended impacts of the impugned practice by the dominant firm is problematic. Since all three criteria under subsection 79(1) must be satisfied prior to a finding of an abuse of dominance, practices that significantly lessen competition could be excluded if they lack the requisite predatory, exclusionary, or disciplinary intent. This is particularly troublesome as a company might in good faith engage in practices that nonetheless have significant unanticipated anticompetitive effects due to, for example, new innovations or technological developments that rapidly change the conditions of a market. Furthermore, as discussed by Ralph A. Winter (2014), a dominant firm could raise prices in the market by softening competition to the benefit of all competitors without being caught under paragraph 79(1)(b), even though such practices significantly decrease market efficiency and lower consumer welfare.[62]

Parliamentary debate on the Act also indicates that paragraph 79(1)(b) should not be restricted to intention. Upon introduction, Bill C-91—which replaced the *Combines Investigations Act* (the "**CIA**") with the *Competition Act*—initially contained an explicit intention requirement in (what is now) paragraph 79(1)(b). The applicable provision stated: "that person or those persons have engaged in or are engaging in a practice of anti-competitive acts, and the object of the practice is to lessen competition".[63] This intention requirement was later removed by the House Select Committee in response to a number of witnesses who argued that this requirement was "in effect…an additional test and renders proof more difficult"[64] and, were it to remain, abuse of dominance "would be extremely difficult to establish".[65] Upon Bill C-91's enactment, the revised provision simply stated: "that person or those persons have engaged in or are engaging in a practice of anti-competitive acts".[66]

At minimum, Parliament's removal of the intent requirement indicates that paragraph 79(1)(b) should be broader in scope than just the intended effects of the impugned practice. Abuse of dominance was previously a criminal matter under the CIA. However, the standard of beyond a reasonable doubt had been very difficult to meet, as evidenced by the fact that only a single contested proceeding resulted in a conviction

for criminal abuse of dominance.[67] The move from a criminal to a civil regime under Bill C-91 was intended to strengthen the legislation. In this context, many considered that the intent requirement hindered the underlying purpose of the new legislation. As stated by the Canadian Federation of Independent Business at a Standing Senate Committee Proceeding:

> Our principal concern is with the concept of object or intent, which are principally criminal notions and we feel do not belong in the civil section of the act. The transfers of mergers and abuse of dominant position to civil jurisdiction has not been completed until the notion of object or intent has been removed; otherwise perhaps this section will remain unenforceable. It would be very difficult to get convictions. The idea of the move is to increase the ability to get convictions which has just not happened under the present [CIA].[68]

Furthermore, it is notable that Canada is in the small minority of countries globally that require proof of intent for abuse of dominance. In 2009, the Unilateral Conduct Working Group prepared a report for the International Competition Network with respect to abuse of dominance policies relating to loyalty discounts and rebate schemes.[69] Of the 34 countries surveyed, only 3—Canada, Croatia and Mexico—required proof of intent, whereas 17 countries reported that intention was a relevant factor in assessing the effects of the practice.[70]

At the heart of an abuse of dominance analysis lies a balancing between the pro-competitive and anti-competitive effects of an impugned practice. To address the gap created by the current judicial interpretation of paragraph 79(1)(b), I believe that a determination of whether a practice is anti-competitive should involve a threshold balancing analysis of whether there is a real possibility that its anti-competitive effects outweighs its pro-competitive or efficiency benefits. Both the intended effects of the impugned practice on consumers and on competitors of the relevant market should be considered. If such a possibility is found, the analysis would then move to paragraph 79(1)(c), in which a detailed contextual economic assessment would be made to determine whether the lessening of competition is substantial. While a dominant firm's predatory, exclusionary, or disciplinary intent towards competitors in the relevant market would be a factor in determining whether the overall character of a practice is more pro-competitive or anti-competitive under paragraph 79(1)(b), it should not be determinative.

I also disagree with the Federal Court of Appeal's decision that the impugned practice's effects on consumer welfare should be excluded from the paragraph 79(1)(b) analysis, and that a business justification must be linked to the respondent (i.e. obtained by the respondent itself). Ultimately, the purpose of the abuse of dominance provisions in the Act, and of competition law more generally, is to maintain and encourage competition in Canada for the purposes of promoting the efficiency and adaptability of the Canadian economy.[71] As stated by Michael Trebilcock (2007), the purpose of competition law is "not the protection of competitors (including less efficient competitors) or maximizing the number of competitors in a market, but rather protecting the competitive process so that the ultimate goal of competition policy—the efficient utilization of resources in a market economy—is maximized".[72] This view is reflected by Hon. Michael Coté (Minister of Consumer and Corporate Affairs and Canada Post)'s opening remarks at second reading during the House of Commons Debates for Bill C-91:

> The purpose of Bill C-91, as stated in the purpose clause in the Bill, is to maintain and encourage competition in Canada. However, the clause makes it abundantly clear that competition is not to be considered an end in itself. Rather, competition is sought for its effects on the Canadian economy.[73]

The effects of an impugned practice on both the competitors and consumers of a market are indicators of how the practice affects the Canadian economy. Unlike in the EU, where the protection of small competitors is a "special responsibility" of dominant firms,[74] there is no compelling reason that paragraph 79(1)(b) must be limited to the intended effects on competitors and that other indicators of market efficiency, such as consumer welfare could not also be considered.

B. A Substantial Lessening of Competition under Paragraph 79(1)(c)

The "but for" test proposed by the Federal Court of Appeal with respect to paragraph 79(1)(c) does not largely affect the traditional balancing analysis that lies at the heart of the abuse of dominance analysis. I agree with the Federal Court of Appeal that it is preferable to assess the change in the relative rather than absolute level of competition to determine whether an impugned practice substantially lessens competition in the relevant markets. It is entirely possible for market conditions to vary over time, from (for example) changes in government

regulation; innovations in a relevant field; technological advances; or socioeconomic developments. It is conceivable that the absolute level of competition after the implementation of an impugned practice is unreflective of the impugned practice's effects and that, were it not for the practice, the competition level would be even higher. However, I believe that such cases are rather rare. They would occur, for example, if recent technological innovation lowered the costs of market entry; if changing socioeconomic factors spiked demand; if there had been recent major changes in relevant government regulation; if the practice has been in place for such a long time that market conditions have most likely changed; and so forth. In contrast, with respect to practices that have been in place for short periods of time in markets with relatively stable conditions, evidence of an absolute comparison between the current competition level with the level prior to the practice's implementation would serve as circumstantial evidence for the "but for" assessment.

In my view, the Tribunal's substantial lessening of competition analysis mostly conformed with the Federal Court of Appeal's proposed test, and the results of the Tribunal's analysis will inform the conclusion of the latter. The SDP had only been implemented for 4 years (between 1998-2002) in a market that was small and eroding before the Commissioner brought action for abuse of dominance. There is little reason to believe that market conditions would have changed during those years such that a comparison to market competition levels prior to 1998 would be substantially divergent from a comparison to market competition levels "but for" the presence of the SDP.

In their article "The High Price of Loyalty: Abuse of Dominance after *Canada Pipe*", Nicholson and Ermak express outrage towards the requirement for a relative, "but for" assessment in determining whether a practice substantially lessens competition in the market.[75] Their main criticism of *Canada Pipe* is that the absence or presence of barriers to entry and expansion can no longer be a reliable indicator to dominant firms about whether their conduct is an abuse of dominance.[76] Nicholson and Ermak claim that firms may have to "undertake a costly economic analysis" to determine whether their conduct potentially violates section 79 of the Act as a result.[77] Furthermore, the "but for" test is inconsistent with other provisions of the Act that have a substantial lessening of competition requirement, including section 77 (exclusive dealing) and section 92 (mergers).[78] This may cause the potential complications as "a company whose merger was approved based on the effective remaining

competition in the relevant markets may find itself subject to an abuse of dominance complaint under the same market conditions".[79]

It should be noted, in response, that it is the Commissioner, rather than the defendant firm, that bears the burden of proving on a balance of probabilities that the market would have been substantially more competitive "but for" the impugned practice. In addition, while the Federal Court of Appeal suggested that a "hypothetical comparator model" could conceivably be involved in applying the "but for" test to assess the relative effect of the impugned practice on the competition level, in practice I believe that the actual economic analysis involved in finding a paragraph 79(1)(c) substantial lessening of competition will remain largely the same for the above reasons.[80]

C. Was the SDP an Abuse of Dominance?

Economic studies have indicated that the effects of loyalty discounts and rebates on competition vary widely depending on the relevant market as well as the specific structure of the incentive scheme.[81] For example, Adrian Majumdar and Greg Shaffer (2008) modeled the behavior of a dominant firm and a non-dominant firm that supplied substitute goods with a buyer with private information about demand. They assumed that the dominant firm had a monopoly over product A (in the uncontested market segment) whereas product B was competitively supplied in the contested market segment. Upon examining the effects on competition of a dominant firm's market-share contracts (differentiated prices with respect to individualized targets), Majumdar and Shaffer concluded that the welfare effects of market-share contracts in and of themselves are ambiguous.[82] If the ratios of buyers' contested to uncontested purchases are known, a dominant firm would not compete in a contested market against an equally efficient firm in a single price equilibrium with inelastic demand. Market share contracts can be pro-competitive as they induce the dominant firm to compete for product B sales, leading to lower prices and enhanced consumer welfare.[83] On the other hand, market share contracts may also have anti-competitive effects as firms with a large enough uncontested market may be able to exclude equally efficient but smaller competitors without engaging in predatory below-cost pricing by tying the discounts on its uncontested product to the purchase of its contested product, essentially "bribing" consumers to purchase its contested product at a premium.[84]

The complex effects of loyalty discounts and rebates on competition

support the more circumspect approach in the US rather than the EU presumption of illegality.[85] As discussed by Sean Durkin (2017), loyalty discounts and rebates will generally always reduce the profits of a capacity-constrained competitor in comparison to the single-price equilibrium.[86] The premium a buyer pays for a dominant firm's non-contested units will be higher if the buyer purchases contested units from the less-preferred firm. The competitor must lower its prices to win the contested sales. Nonetheless, the analysis of whether a particular discount scheme is an abuse of dominance should be determined within the context of the ultimate purpose of competition policy of market efficiency and maximizing total surplus. As such, a detailed assessment of the impact a particular incentive scheme has on market competition is needed to strike the balance between prohibition in cases of substantial exclusion, and noninterference in cases of effective competition.

For the paragraph 79(1)(b) threshold balancing analysis, it is important to consider whether an equally efficient firm may conceivably be constrained from gaining entry or expansion into the market, due to the impugned practice.[87] Previous commentators have noted that less-efficient entrants can nonetheless be pro-competitive by increasing output, which leads to decreased prices and increased consumer welfare.[88] However, the pro-competitive effects of such entrants are much less significant if the goal of competition policy is to maximize total surplus rather than consumer surplus, as is the case in Canada. As discussed by Roger Ware (2017), a potential price decrease triggered from a new entrant creates a large transfer from producer surplus to consumer surplus as well as a small reduction in deadweight loss. Both magnitudes are factored into the consumer surplus standard, whereas only the reduction in deadweight loss would be considered in the total surplus standard.[89] As such, the equally efficient competitor test remains important in Canadian competition policy, since there is a substantially smaller gain from the entry of additional competitors as compared to jurisdictions in which consumer surplus is the primary goal.

In my view, the SDP was likely an anti-competitive practice as it raised barriers to entry such that smaller entrants with limited capacity and narrower product lines could potentially be disadvantaged if they could not fulfill a buyer's entire demand. Switching costs were high if distributors switched a portion of their demand elsewhere, whereas such costs were low if distributors switched their entire demand, which was the more likely scenario.[90] As such, while larger competitors that were

able to imitate the SDP and offer a better deal would induce distributors to switch, smaller competitors unable to fulfill a buyer's entire demand could be significantly constrained. The SDP's potential for competitive harm arises not because it was predatory, but because it could potentially constrain or foreclose equally efficient competitors that were unable to reach their minimally efficient scale or cover their fixed costs.

With respect to paragraph 79(1)(c), a detailed contextual economic assessment should be made to determine whether the lessening of competition was substantial. It is arguable (although not conclusive), that paragraph 79(1)(c) was not met because Canada Pipe lacked an uncontested market segment upon which to tie the purchase of its contested items. A key feature of many economic models purporting to demonstrate the anti-competitive effects of loyalty discounts and rebates relies on the existence of an uncontested market segment.[91] As discussed above, an uncontested market segment allows a dominant firm to tie discounts on its uncontested product to the purchase of its contested product, essentially "bribing" a consumer to purchase the contested product at a premium and shutting out a smaller competitor. In *Canada Pipe*, the Tribunal identified the product market as cast iron pipes, fittings, and mechanical joint couplings.[92] Both Canada Pipe and its competitor, Vandem, produced cast iron pipes and fittings, whereas neither produced mechanical joint couplings.[93]

Furthermore, the parameters of Majumdar and Shaffer's above mentioned study with respect to market share contracts are similar to the facts in *Canada Pipe*, in that the SDP was also a market share contract (involving 100% of individual demand). As the effects of such contracts were found to be ambiguous on consumer welfare without additional information, it is at least *possible* that the SDP did not substantially lessen competition. Additionally, the parameters of Majumdar and Shaffer's economic model that differed from the facts in *Canada Pipe* indicate an increased likelihood that the SDP was not an abuse of dominance. In their paper, Majumdar and Shaffer assumed that the retailer would forfeit a large discount if it breached the contract and failed to purchase the required shares.[94] In *Canada Pipe*, however, the point-of-purchase discounts were only lost for future purchases, as there was no penalty for breach. This results in lower switching-costs of the SDP as compared to Majumdar and Shaffer's model and a higher likelihood that the practice was not anti-competitive.

Finally, the SDP had only been implemented for 4 years (between 1998-2002) in a market that was small and eroding before the Commissioner brought action for abuse of dominance. There is little reason to believe that market conditions would have changed during those years such that a comparison to market competition levels prior to 1998 would be substantially divergent from a comparison to market competition levels "but for" the presence of the SDP. As such, I believe that the Tribunal's paragraph 79(1)(c) analysis is informative. The entry of Vandem—a much smaller competitor with less than 10% market share—as well as evidence that some distributors had, in fact, switched suppliers, suggests that barriers to entry were not prohibitively high. Evidence of secondary markets within members of a buying group also indicated that the application of the SDP was flexible,[95] and Canada Pipe's business justification that the SDP allowed the company to maintain its important but less profitable products to the benefit consumers weighed against the SDP being an abuse of dominance.[96]

V. Conclusion

At the heart of an abuse of dominance analysis lies a balancing between the pro-competitive and anti-competitive effects of an impugned practice. I believe that the Federal Court of Appeal erred in *Canada Pipe* by restricting a paragraph 79(1)(b) analysis to the intended effects of the impugned practice on competitors in the relevant market. Rather than focusing on intent, paragraph 79(1)(b) of the Act should involve a threshold balancing analysis of whether there is a real possibility that the anti-competitive effects of a practice might outweigh its efficiency benefits. Whether an equally efficient firm could be constrained from gaining entry or expansion into the market due to the impugned practice should be considered at this stage of the analysis, as well as the effects of the practice on both consumers and on competitors of the relevant market. If such a possibility is found, the analysis would then move to paragraph 79(1)(c), in which a detailed economic assessment would be made to determine whether the lessening of competition is substantial.

With respect to the loyalty discounts and rebates, in my view, the US rebuttable presumption of legality is preferable to the EU's approach of near *per se* illegality. However, a detailed contextual analysis of the relevant market and the specific structure of the incentive program at issue should be made on a case-by-case basis prior to an abuse of dominance determination.

Endnotes

[1] *Competition Act*, RSC 1985, c C-34 [Competition Act].
[2] *Canada (Commissioner of Competition) v Canada Pipe Corporation Ltd*, 2006 FCA 233 [*Canada Pipe FCA*].
[3] *Loi sur la concurrence*, LRC 1985, c C-34 [*Loi sur la concurrence*].
[4] *Canada (Commissaire de la concurrence) c Tuyauteries Canada Ltée*, 2006 CAF 233 [*Tuyauteries Canada CAF*].
[5] Competition Bureau, "Enforcement Guidelines on the Abuse of Dominance Provisions" (20 September 2012), online: <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03497.html> , s 1.3.
[6] Competition Act, *supra* note 1, s 79(1).
[7] *Canada (Director of Investigation & Research) v NutraSweet Co* (1990), 32 CPR (3d) 1 (Comp Trib) [*NutraSweet*].
[8] *Ibid*, at para 34.
[9] *Commissioner of Competition v The Toronto Real Estate Board* (2017 FCA 236), at para 56.
[10] *Ibid*.
[11] Competition Act, *supra* note 1, s 79(1)(c).
[12] *Ibid*.
[13] *Canada (Director of Investigation and Research) v Tele-Direct (Publications) Inc Ltd* (1997), 73 CPR (3d) 1 (Comp Trib), at paras 247 and 248.
[14] Gianluca Faella, "Antitrust Assessment of Loyalty Discounts and Rebates" (2008) 4(2) J. Competition L. & Econ 375 at 375 [Faella].
[15] Faella, *supra* note 14 at 382.
[16] *Ibid* at 377.
[17] Sean Durkin, "The Competitive Effects of Loyalty Discounts in a Model of Competition Implied by the Discount Attribution Test" (2017) 81: 2 antitrust lj 475 [Sean Durkin].
[18] Frank P Maier-Rigaud, "Switching Costs in Retroactive Rebates: What's Time Got to Do with it", 26 Eur Competition L Rev 272 (2005).
[19] *Ibid*.
[20] See, for example, EC, *Commissioner Decision of 29 March 2006 relating to proceedings under Article 82 [EC] and Article 54 of the EEA Agreement (Case COMP/E-1/38.113- Prokent-Tomra)* [2006], OJ, C 734/07; Article 102 of the Treaty of the Functioning of the European Union [TFEU].
[21] Michelin II, 2003 ECR II-4071, at para 240.
[22] Faella, *supra* note 14 at 383 and 384.
[23] NV *Nederlandsche Banden Industrie Michelin v Commission of the European Communities*, 1983 C-322/81 [Michelin].
[24] *Concord Boat Corp v Brunswick Corp*, 207 F. 3d 1039, 1061 (8th Cir. 2000) [*Concord Boat*].
[25] *Ibid*.
[26] *Ibid* at 1061.

[27] Faella, *supra* note 14 at 375. See also the discussion of *Virgin Atlantic v British Airways* in Office of Fair Trading (2005), Annex B.
[28] *Ibid* at 383.
[29] *Virgin Atlantic*, 257 F3D [*Virgin Atlantic*]. Also see *BA/Virgin*, 2003 ECR II-5917 [*BA/Virgin*].
[30] *Virgin Atlantic, supra* note 29.
[31] *Ibid* at para 265.
[32] *BA/Virgin, supra* note 29.
[33] Note that the *Toronto Real Estate Board* provided the clarification that an intended exclusionary, predatory or disciplinary act need not be directed at the party's own competitor, so long as the act is exclusionary predatory or disciplinary vis-à-vis a competitor in that market.
[34] *Commissioner of Competition v Canada Pipe*, 2005 Comp Trib 3 [*Canada Pipe Tribunal*], at paras 44-47.
[35] *Ibid*.
[36] *Ibid* at para 167.
[37] *Ibid* at para 168.
[38] *Ibid* at para 170.
[39] *Ibid* at paras 230 and 231.
[40] *Ibid* at para 232.
[41] *Ibid* at para 233.
[42] *Ibid* at para 232.
[43] *Ibid* at para 261.
[44] *Ibid* at para 256.
[45] *Ibid* at para 260.
[46] *Ibid* at para 212.
[47] *Ibid* at para 265.
[48] *Ibid*.
[49] *Ibid* at para 260.
[50] *Canada Pipe* FCA, *supra* note 2 at paras 77-83.
[51] *NutraSweet, supra* note 7.
[52] *Ibid*.
[53] *Canada Pipe* FCA, *supra* note 2 at para 90.
[54] *Ibid*.
[55] *Ibid* at para 92.
[56] *Ibid* at paras 37 and 38.
[57] *Canada (Director of Investigation and Research) v Laidlaw Waste Systems Ltd* (1992), 40 CPR (3d) 289 (Comp Trib).
[58] *Ibid* at para 346.
[59] *Canada Pipe* FCA, *supra* note 2 at para 58.
[60] *Ibid*.
[61] *Ibid* at para 46.
[62] Ralph A Winter, "The Gap in Canadian Competition Law Following Canada Pipe" (2014) 27: 2 CCLR 293.

[63] Bill C-91, *An Act to establish the Competition Tribunal and to amend the Combines Investigation Act and the Bank Act and other Acts in consequence thereof*, 1st Sess, 33rd Parl, 1985 (first reading 17 December 1985) at s 51(1)(b), (emphasis mine).
[64] *House of Commons Debates*, 33rd Parl, 1st Sess, Vol 8 (8 April 1986) at 12011 (Sheila Finestone).
[65] House of Commons, *Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-91*, 33rd Parl, 1st Sess, No 11 (21 May 1986) at 1630 (André Ouellet). Witnesses in favor of removing the intention element from the abuse of dominant position in Bill C-91 included: the Canadian Federation of Independent Businesses, the Petroleum Marketers Association of Canada, the Consumers' Association of Canada, the Canadian Labour Congress, and a number of professors including Professor Stanbury and Professor Thompson.
[66] Competition Act, *supra* note 1 at s. 79(1)(b). Also see: Bill C-91, *An Act to establish the Competition Tribunal and to amend the Combines Investigation Act and the Bank Act and other Acts in consequence thereof*, 1st Sess, 33rd Parl, 1986 (assented to 17 June 1986), SC 1986, c 26 at s 79(1)(b).
[67] Library of Parliament, Research Branch, *Mergers and abuse of dominant position: legal aspects* 91-3E (Current Series Review), (1991, revised 1998).
[68] Senate, Standing Committee on Banking, Trade and Commerce, *Proceedings*, 33rd Parl, 1st Sess, No 46 (7 May 1986) at 6.
[69] The Unilateral Conduct Working Group, *Report on the Analysis of Loyalty Discounts and Rebates Under Unilateral Conduct Laws*, online: International Competition Network (June 2009), online: <http://www.internationalcompetitionnetwork.org/uploads/library/doc357.pdf>
[70] *Ibid.*
[71] Competition Act, *supra* note 1 at s 1.1.
[72] Michael Trebilcock, "Abuse of Dominance: A Critique of Canada Pipe" [2007] Canadian Competition Record 1 at 7.
[73] *House of Commons Debates*, 33rd Parl, 1st Sess, Vol 8 (7 April 1986) at 11927 (Hon Michael Coté).
[74] Michelin, *supra* note 23.
[75] Mark J. Nicholson & Yana Ermak, *The High Price of Loyalty: Abuse of Dominance after* Canada Pipe (March 2007), online: Cassels Brock & Blackwell LLP, <http://www.casselsbrock.com/files/file/docs/AbuseOfDominance_NicholsonErmak_March2007.pdf>.
[76] *Ibid* at 14.
[77] *Ibid.*
[78] *Ibid* at 15.
[79] *Ibid.*
[80] *Canada Pipe* FCA, *supra* note 2 at para 46.
[81] See, for example, Adrian Majumdar & Greg Shaffer, "Market-Share Contracts with Asymmetric Information" (2009) 18(2) J Econ Manag Strateg 393 [Majumdar & Shaffer].
[82] *Ibid.*

[83] Note: this would only be the case if the quantity of uncontested and contested goods were known.
[84] *Majumdar & Shaffer, supra* note 81.
[85] *Ibid* at 394.
[86] Sean Durkin, *supra* note 17.
[87] Roger Ware, "The Economics of Multiproduct Loyalty Programs" (2017) 30:1 CCLR 112 at 123 [Roger Ware].
[88] Thomas Ross, "Scholars Panel on Loyalty Programs: Introduction" (2017) 30:1 CCLR 40 at 43-44 [Thomas Ross].
[89] Roger Ware, *supra* note 87.
[90] *Canada Pipe* Tribunal, *supra* note 34 at para 215.
[91] Roger Ware, *supra* note 87 at 127. Also see Thomas Ross, *supra* note 88 at 41.
[92] *Canada Pipe* Tribunal, *supra* note 32 at para 54.
[93] *Ibid*, at para 33.
[94] *Ibid* at para 415.
[95] *Ibid* at para 261.
[96] *Ibid* at para 212.