

Competition Bureau

Interpretation Bulletin:

**The Abuse of Dominance Provisions (Sections 78 and 79 of the
Competition Act) as Applied to the Canadian Grocery Sector**

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1. Purpose and Scope of the Bulletin

This document is being published to provide the grocery industry with a better understanding of how the abuse of dominance provisions could be applied by the Bureau and to assist in deterring anti-competitive conduct in the grocery sector by encouraging compliance with the law.

The Canadian Grocery sector is one of the key sectors of the Canadian economy. Groceries are a necessity to all Canadians and as such the sector attracts considerable attention. In the face of consolidation and vertical integration, there has been growing concern by industry participants over the increased potential for abuse of market dominance. This concern has given rise to calls by stakeholders for grocery sector specific amendments to the abuse of dominance provisions of the *Competition Act* (the “Act”). The Competition Bureau’s (the “Bureau”) response has been two-fold. First, the Bureau continues to vigorously examine mergers and complaints of alleged anti-competitive conduct related to this important industry sector. Second, the Bureau has taken the position that no sector-specific amendments pertaining to the grocery sector are required.

The focus of this bulletin is to clarify how, from an enforcement policy perspective, the Bureau addresses allegations that a dominant firm or a group of firms, in the grocery sector is harming competition through abuse of market power. The Bureau’s approach to enforcement policy is based on the provisions set out in the Act, supplemented by jurisprudence, academic literature and practical enforcement experience. Nothing in this bulletin deviates from the enforcement approach outlined in the *Enforcement Guidelines on the Abuse of Dominance Provisions (sections 78 and 79 of the Competition Act)*, which were released in July 2001.

In addition to producing this bulletin, the Bureau has also commissioned three background economic papers related to this topic. Their titles are listed in Appendix 2 of the Bulletin, and copies can be obtained from the Bureau Web site at www.cb-bc.gc.ca.

2. The Canadian Grocery Sector

The Canadian grocery sector is comprised of the production and importation of grocery products, wholesaling and retail distribution. Currently, the retail distribution component of this sector accounts for more than a quarter of total retail trade in Canada or almost \$60 billion per year¹. Mergers in this sector have increased over the past decade, to the extent, the Bureau estimates, that the four largest supermarket chains now account for approximately 75% of total Canadian food store sales.

Within each segment of the sector, competitors operate at various levels, locally, regionally or nationally. Some firms specialize in one segment of the sector while others, such as large retailers, own chains of stores and have their own distribution and wholesale operations.

¹Jean-Francois Wen, *Market Power in Canadian Grocery Retailing: Assessing the Evidence for Canada*, p 1.

Some of the larger retail chains supplement nationally recognized brands with a range of exclusive products that are packaged and marketed under their own brand names which are commonly referred to as private label products. Alongside these large chains are smaller independent grocers who do not have the resources to develop their own private labels. A number of these retailers have joined larger buying groups that allow them to obtain discounts from manufacturers based on the combined purchase volume of the buying groups.²

Consequently, the Canadian grocery sector includes a broad spectrum of competitors ranging from independent firms with standard business relationships with their suppliers, to fully integrated firms with significant market presence in all areas of the sector. In some cases, integrated firms supply their independent competitors; for example, wholesalers owned by the retail chains may also be supplying independent retailers. As a result, the application of competition policy to the grocery sector must take into account the complex horizontal and vertical relationships amongst firms.

3. Abuse of Dominance

Briefly, abuse of dominance occurs when a dominant firm in a market, or a dominant group of firms, engages in conduct intended to eliminate or to discipline a competitor or group of competitors and to deter future entry by new competitors. The conduct must likely lessen or prevent competition substantially.

The abuse of dominance provisions are not intended to regulate prices, but rather to ensure the proper handling of anti-competitive conduct that, in this context, means efforts to maintain or enhance market power through activities directed towards competitors in an exclusionary, disciplinary or predatory manner.

It is recognized that firms at all levels of the grocery sector require an equitable opportunity to compete in the market. In cases of market dominance, one firm or group of firms, has sufficient market power to exercise significant control over the market. In these instances, careful scrutiny needs to be given to the impact of the activities of the dominant firm or group of firms, on smaller and medium-sized companies since in dominance situations, the latter usually constitutes the remaining effective competition in the market.

For example, dominant firms at the manufacturing level may be able to abuse their positions vis-à-vis distributors or retailers to the extent that smaller manufacturers become severely limited in their ability to enter or expand in the market. Dominant firms in similar circumstances at the retail level may prevent smaller retailers from obtaining the products they require to compete. Potential problems also arise

²Competition issues involving buying groups are generally reviewed by the Bureau under the price discrimination provision (paragraph 50(1)(a)) of the Act. For more information on the Bureau's position with respect to buying groups, please consult the Price Discrimination Enforcement Guidelines on our Web site at <http://strategis.ic.gc.ca/SSG/ct01140e.html>. In addition, competition issues involving buying groups could also be reviewed under the conspiracy provision (section 45) of the Act.

when the actions of a dominant firm at one level of the grocery sector may have a direct impact on competition at other levels of the sector.

Since market participants vary in terms of size and resources, it is important to note that the abuse of dominance provisions are not intended to provide protection from legitimate market competition, nor are they designed to ensure that all firms continue to prosper in the market. Rather, they are meant to make it possible for businesses of all sizes to have an equitable opportunity to participate in the market. In this way, the market can provide consumers with competitive prices and product choices.

The Bureau conducts its role on an impartial basis, pursuing those complaints that satisfy the elements of section 79 of the Act.

4. Institutional Framework for Enforcement

The Commissioner of Competition (the “Commissioner”) is responsible for inquiries under the Act, and is provided with significant powers with which to carry them out. The Competition Tribunal (the “Tribunal”) is responsible for adjudication of the civil provisions of the Act, including the abuse of dominance provisions.

Only the Commissioner can make an application to the Tribunal for a remedial order under section 79 of the Act. Similarly, the Tribunal can consider an issue under section 79 of the Act only when it has received an application from the Commissioner. When an application has been filed with the Tribunal, the burden of proof is on the Commissioner to satisfy the Tribunal that all of the elements of section 79 have been met (see Part 5 below) and that an order of the Tribunal should be granted. In other words, the Commissioner cannot directly compel changes in business behavior, but rather must take on the role of litigant before the Tribunal and produce evidence to support the grounds for making the order. In contested cases, the Commissioner may file an application with the Tribunal seeking adjudicative relief. In such a situation, the rules of the Tribunal provide for a public hearing process limited by certain rules of confidentiality to protect commercial sensitive information in which affected third parties can apply for intervener status. Proceedings are governed by the Competition Tribunal Rules, which include procedures for the appearance of witnesses as well as the production of documentary evidence where the matter is proceeding on a contested basis.

An alternative to litigation before the Tribunal is a consent agreement. An agreement may be registered with the Tribunal on a consent basis when the Commissioner concludes that grounds exist for an application to the Tribunal for a remedial order in situations where the respondent and the Commissioner have agreed on a remedy that is appropriate for the competition problem.³

³The consent agreement must be based on terms that could be the subject of a Tribunal order (subsection 105(2) of the Act).

5. The Elements of an Abuse of Dominance

Before it may grant an order, the Tribunal must be satisfied that the three essential elements for abuse of dominance pursuant to subsection 79(1) of the Act are met.⁴ The Tribunal must find 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 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 substantially preventing or lessening competition in a market.

These elements are discussed in turn in sections 5.1, 5.2 and 5.3 below.

5.1 Market Dominance

Paragraph 79(1)(a) of the Act addresses the issue of market dominance. Consistent with the jurisprudence established by the Tribunal, the Bureau considers market dominance to be synonymous with market power, that is, the ability to profitably maintain prices above competitive levels for a significant period of time, normally one year. Similarly, market dominance can arise in situations where one or more firms have buying (monopsony) power, that is, the ability to profitably maintain prices below competitive levels for a non-transitory period of time. Note, however, that the law does not imply that the mere existence of market power provides grounds for the issuance of a remedial order by the Tribunal, since charging prices above the competitive level is in itself insufficient for an application under section 79 of the Act.

5.1.1 Defining the Relevant Markets

Assessing whether market power first exists requires the proper identification of the relevant markets, including the existing competitors that are likely to constrain the ability of the firm, or firms, to profitably raise prices and/or to restrict competition. In doing so, the Bureau might face two different situations: one where there is only one product at issue and the other where there are a wide range of products involved.

The Bureau defines a "class or species of business" as one that is synonymous with a relevant product.⁵ It begins by examining the product market(s) within which the alleged abuse of dominance has occurred

⁴See Appendix 1

⁵*Canada (Director of Investigation and Research) v. NutraSweet Co.* [1990], 32 C.P.R. (3d) 1 (Comp. Trib.) [hereinafter *NutraSweet*]. In this case the Competition Tribunal concluded that delineating a class or species of business is equivalent to defining a relevant product market.

or is occurring. As in other areas of competition law, the Bureau then looks at whether competition from other product sources limits the ability of the firm(s) in question to exercise market power. It focuses on whether close substitutes exist for the product(s) in question, such that buyers would choose them if the product price was raised above competitive levels by a significant amount for a non-transitory period of time. In general, a five percent real price increase above competitive levels lasting one year is considered a significant and non-transitory amount.

An analysis of existing competitors and product substitutes also has a geographic dimension. The Bureau considers the specification “throughout Canada or any area thereof” to describe the relevant geographic market.⁶

Price increases are not the only indicator used to define relevant markets. The Bureau also considers many qualitative factors when determining the appropriate product and geographic market definitions. These include, but are not limited to, the views, strategies and behavior of consumers and competitors, suppliers and other market participants, the physical and technical characteristics of the product and costs that buyers would have to incur in order to switch their purchasing from one supplier to another.

Market definitions are very much dependent on the facts specific to a particular situation. For example, complaints involving the ability of a manufacturer to obtain proper shelf space in retail stores or distribution at the wholesale level generally allow for traditional methodologies for defining the product and geographic dimensions of the relevant market. Usually, it is quite clear which products are being affected, what are the close substitutes for the product and what are the geographic dimensions of the market.

The following outlines how the Bureau currently defines the relevant markets in multi-product businesses such as retailers in the grocery sector.

Multi-product retailers present a challenge as they may trade in thousands of products covering a complex range of goods and services. In such cases, the analysis used to define the relevant market as described in the *Enforcement Guidelines on the Abuse of Dominance Provisions (Sections 78 and 79 of the Competition Act)* for a single product firm becomes more complicated. The greatest complication being how to determine which multi-product grocery retailers are comparable to warrant their inclusion in the same relevant product market.

The current approach used by the Bureau for relevant market definition for multi-product retailers begins by focusing on two retailers in close geographic proximity to each other and then treating each retailer’s entire product offering as the potential relevant product. That is, each retailer will be treated as representing a single product differentiated by a range of characteristics such as product selection, location, service, etc. The Bureau then establishes the competitive effect that each retailer has on the

⁶In *NutraSweet*, the Tribunal stated that the relevant geographic market encompassed “an area [that] is sufficiently isolated from price pressures emanating from other areas so that its unique characteristics can result in prices differing significantly for any period of time from those in other areas.”

other through a statistical analysis of each retailer's profits, pricing service standards and other measurable competitive variables. Where a statistically significant relationship exists between the retailers they are included in the relevant product and geographic market. The Bureau will continue performing this analysis considering other retailers product offerings and locations until it is satisfied that all retailers selling competing product offerings are included in the relevant market.⁷

The Bureau's approach to market definition serves simply as a starting point for analytical purposes.⁸ It is a technique which can adapt to changing markets. As is the case with many sectors of the Canadian economy, market definitions may change as products evolve, new substitutes are introduced, consumer patterns shift and innovations are made.

5.1.2 Assessing Market Power

Once the Bureau has ascertained the existing competitors and other relevant factors, it must assess the extent to which they constrain any market power that the allegedly dominant firm(s) might otherwise possess. The Bureau considers control to be synonymous with market power where the latter is seen as the ability to profitably set prices above (or below in a monopsony case) competitive levels for a considerable period of time. Market power may also be defined in terms of the ability to maintain a material, specific reduction in other factors of competition, such as service, quality, variety, advertising and innovation. For ease of reference, market power is referred to here with respect to price increases, but it should be understood to also include non-price factors of competition.

As it is difficult to measure market power directly, the Bureau typically relies on a number of indicators, both qualitative and quantitative. These include, but are not necessarily limited to the following:

- # market share, including share stability and distribution;
- # barriers to entry, including the conduct allegedly engaged in by the dominant firm(s); and
- # other market characteristics, including extent of technological change, extent of excess capacity, and customer or supplier countervailing power.

As noted earlier, assessing market power at the retail level also involves an analysis of the unilateral competitive effects each store possesses in a market.

⁷ A similar methodology was used by the defendant in the attempted merger between Staples and Office Depot in 1997. The merger involved the two largest office superstore chains in the US. Since these stores tend to carry a large assortment of goods, a statistical study into market definition would be difficult as potential competitors, large and small, would be numerous. The defendant's empirical study was based on how each store's profit margin was affected after the entry of a competitor's store.

⁸ For multi-product firms, pre-defined relevant market definitions (e.g. based on store size, locational boundaries estimated by shopping patterns), are very useful for a quick initial analysis of cases involving numerous markets, such as a merger of grocery chains where there are many stores in multiple local markets.

5.1.3 Market Share

The Bureau's general approach with regard to market share is as follows:

- # A market share of a single firm that is less than 35 percent will generally not give rise to concerns of market power or dominance;
- # A market share of a single firm that is 35 percent or more will generally prompt further examination; and
- # In the case of a group of firms alleged to be jointly dominant, a combined market share of 60 percent or more will generally prompt further examination.

The Bureau prefers to use sales revenues to assess market shares in the retail grocery sector. However, when revenue data are not available, it will use market shares based on capacity, using both the size of a store's selling area and/or the entire store, as proxies. The Bureau accepts that capacity shares based on physical size have limitations in measuring market power, since stores can have different formats with differing marketing capacities. Since there is no definitive numeric market share to imply that a firm has market power, it has taken the view that market share levels exceeding the thresholds described above is normally a necessary, but not sufficient, condition to establish market power.⁹

With the focus on control by a single firm or group of firms, market power analysis measures the extent to which existing competitors (identified in the market definition exercise described above) and/or potential competitors (discussed in the following section on entry barriers) or any other relevant factors (such as countervailing customer power) are likely to constrain exercise of market power.

In the contested abuse of dominance cases heard to date by the Tribunal, the market shares of the dominant firms were 87% or higher. In these cases, the near monopoly shares suggest that consumers have few alternatives when the dominant firm increases prices above competitive levels.

5.1.4 Barriers to Entry

Many of the anti-competitive activities that concern the Bureau involve the creation or enhancement of barriers to entry. Some examples of barriers to entry include significant economies of scale and sunk costs (i.e. the costs of investments made that are not likely recoverable), contract clauses requiring or inducing exclusivity and high customer switching costs. Where barriers to entry are low, any attempt by a firm with a high market share to exercise market power is likely to be met with the entry of new firms or expansion of existing firms. In this process, the firm with the high market share loses customers to its rivals to the extent that it does not find it profitable to attempt to raise prices above competitive levels.

⁹The Bureau considers that a market share of less than 35% will normally not give rise to concerns that a firm has engaged, or is engaging in, a practice of anti-competitive acts that is preventing or lessening competition substantially in a market.

Where barriers to entry are high, in general, entry is likely to be prevented by the presence of absolute cost differences between the incumbent and the entrant, or by the entrant's need to make investments that are not likely to be recovered if entry is unsuccessful. Barriers to entry are a competitive concern when an entrant is unable to enter the market, or become a viable competitor.

5.2 Anti-Competitive Acts: Section 78

An essential element of the abuse of dominance provisions under paragraph 79(1)(b) of the Act is that there is or has been a "practice of anti-competitive acts". Examples of business practices constituting anti-competitive acts are listed in section 78. The list, although broad, is not exhaustive. Accordingly, the Tribunal has latitude to address anti-competitive acts not defined in section 78 and has done so in a number of cases. In order to help differentiate between legitimate competitive activity and that constituting abuse within the meaning of section 79, most acts listed in section 78 involve an element of purpose, object or design to undermine competition.

The Bureau's approach in assessing potentially anti-competitive acts in the grocery sector is to determine whether those acts are exclusionary, predatory or disciplinary with respect to other competitors in the relevant market.

More specifically, the Bureau focuses on determining whether the activities in question:

- (i) facilitate raising rivals' costs or reducing rivals' revenues;
- (ii) involve predatory conduct aimed at eliminating or disciplining competitors; and/or
- (iii) encourage interdependence or tacit collusion among firms.

The Canadian grocery sector contains a variety of allowances, fees and promotional arrangements between manufacturers, wholesalers, and retailers.

In responding to concerns about these types of arrangements, the Bureau assesses each situation by looking at the particular facts of the case to determine whether or not there have been anti-competitive effects. If the anti-competitive effects lead to substantial lessening or prevention of competition in the market, the Bureau will take the action necessary to remedy the situation.

Without knowing the particulars of a specific business arrangement, it is difficult to generalize about the competitive effects of any class or type of business arrangement. The Bureau examines business arrangements from the perspective of understanding the competitive impact they have on the market(s) affected. In a generic sense, the types of arrangements which raise particular concerns to the Bureau include "listing fees", "slotting allowances", "pay-to-stay fees", "volume allowances or earned cost reductions" and various other product promotion schemes.

5.2.1 Raising Rivals' Costs

The most straightforward strategy for raising rivals' costs in the grocery sector is for a dominant firm or group of firms to enter into agreements with manufacturers, distributors or retailers in the market that preclude competitors' access to facilities. From the perspective of a manufacturing entrant, this could involve pre-empting access to the distribution system or shelf space in retail stores. Alternatively, an approach toward a retailing entrant is to pre-empt access to important brands or suppliers through the use of exclusive agreements.

Where dominance in a market has been established and anti-competitive activities have been alleged, the Bureau will examine whether this market power is being maintained or enhanced through anti-competitive activities that raise rivals' costs. Examples include exclusive agreements, slotting allowances and other listing fees.

5.2.1(a) Exclusive Agreements

Retailers may ask to have the exclusive rights for selling a manufacturer's goods within their trading area. In these instances, other competitors may complain to the Bureau that this exclusive right puts them at a significant disadvantage. Initially, the Bureau would examine the nature of the exclusive agreement to determine whether it would confer market power on the retailer or enhance it, leading to a substantial lessening or prevention of competition.

Consider a hypothetical situation where a core product or group of products in the household bundle of groceries is supplied by only one manufacturer or distributor in a given market. If that manufacturer or distributor gives an exclusive right to retailing that good to one retailer or group of competitors in the market, it could have a significant anti-competitive impact on the ability of other retailers in that area to compete. In these situations, the Bureau would assess the availability of substitute products, the scope of the territory involved, the duration of the arrangement and any other relevant factors regarding the nature of the exclusive arrangement.

Manufacturers or distributors possessing market power through the control of significant brands may abuse this power by requiring retailers wishing to carry their brand (or bundles of branded products) to refuse to carry or to restrict the number of competitors' products listed in their stores. These sorts of exclusive arrangements raise rivals' costs and can result in a substantial lessening or prevention of competition.

An Illustrative Example

In 2000, the Bureau had concerns that certain exclusive practices carried on by a baby food manufacturer (the "manufacturer") with respect to the supply of baby food to retailers in Canada

contravened the abuse of dominance provisions of the Act. The Bureau concluded that this market was concentrated and subject to barriers to entry, including the imposition of anti-dumping duties against imports of baby food from the United States. The matter was raised with the manufacturer and learning of the Bureau's concerns, the manufacturer voluntarily entered into a binding undertaking designed to enhance the competitive climate for jarred baby food and infant cereal in Canada.

Based on the factors below, the Bureau concluded that a major and dominant supplier had engaged in activities which created a significant barrier to entry for competitors, substantially preventing or lessening competition in the marketplace and this led to the voluntary undertaking.

The principal anti-competitive acts of concern to the Bureau included:

- i) large lump sum, up front payments made to retailers not to stock non-manufacturer jarred baby food and infant cereal;
- ii) multi-year contracts for exclusive supply; and
- iii) discounts conditional upon exclusive supply.

In the undertaking, the manufacturer agreed for a period of up to 10 years not to:

- # enforce the exclusivity provisions of any existing supply agreements with retail and wholesale customers of jarred baby food and infant cereal;
- # enter into agreements requiring or providing more favourable treatment (including lump sum payments) in exchange for such exclusivity;
- # engage in tied selling of its jarred baby food and infant cereal products; and
- # provide volume discounts inducing exclusivity.

The manufacturer also agreed to:

- # limit the terms of its supply arrangements for jarred baby food and infant cereal to one year except when meeting competitive offers of a longer duration; and
- # advise all users of gravity feed racks that the racks can be used to display any brand of jarred baby food.

5.2.1(b) Slotting Allowances and Other Listing Fees

Retailers in the grocery sector are perpetually challenged by the competitive pressure of maximizing revenues generated in stores with finite space. To meet this challenge, they continually assess the profitability of the products on their shelves by determining which categories and brands of products are generating the most revenue. The decision to change products or to introduce new products brings with it inherent risks and opportunities. One of the common ways in which retailers seek to minimize risks in promoting products is to pass some of the costs back to the manufacturers or distributors in the form of

listing fees, slotting allowances and pay-to-stay fees. In all these instances the retailer is extracting some form of payment from the supplier in exchange for shelf space.

Retailers with market power may not be contravening the abuse provisions of the Act by soliciting rents in the form of fees or allowances. However, it is clear that, given the imposition of fees in exchange for shelf space and the fact that shelf space is limited, such schemes could have an exclusionary effect on some competitors or classes of competitors. Where a firm, or a group of firms, dominate a market for a product, the Bureau would be concerned if the payment of a slotting allowance is being used by the dominant firm(s) to acquire exclusivity or to tie up enough of the available shelf space to preclude other competitors from entering or expanding into the market.

The Bureau has investigated several exclusive dealing contracts between manufacturers and grocery retailers. In so doing, it determined whether the exclusionary effect of these contracts has the effect of increasing competitors' costs. If these effects also result in higher prices to purchasers, the Bureau concludes that there is a substantial lessening of competition in the relevant market.

Equally problematic in the Bureau's view are full exclusivity contracts, along with contracts between manufacturers and retailers that condition the amount of shelf space and the placement of the manufacturer's products in relation to its competitors. The Bureau examines these contracts with particular attention to clauses that:

- # tie up a specific percentage share of shelf space devoted to a specific product category;
- # limit competitors to a specific number of stock keeping units ("SKUs");
- # exclude specific competitor SKUs;
- # require some form of price parity with competitors;
- # specify when and how competitors can advertise; and
- # obtain information on the terms of competitors' contract offers.

The Bureau will only take action where these anti-competitive acts are being engaged in by a dominant firm resulting in a substantial lessening or prevention of competition in the relevant market.

5.2.2 Predatory Conduct

It is difficult to distinguish between predatory pricing and competitive pricing since both, at least initially, involve lower prices. As clarification, predatory pricing by a dominant firm normally involves a firm's ability to raise prices once rivals have been disciplined or have exited the market.

Predatory pricing is often described as selling at a price below some measure of cost in order to harm a competitor. The Bureau's position is that a predatory price is a price below avoidable cost and recognizes avoidable cost as being the relevant cost concept. Avoidable costs refer to all costs that could have been avoided by a firm had it chosen not to sell the product(s) in question. Avoidable costs

do not include sunk costs. Predatory pricing can be profitable to the dominant firm and hence harmful to competition, if that firm, through maintaining or enhancing market power, is potentially able to recoup the losses from its predatory strategy. It can do this by eliminating a rival in cases where entry barriers prohibit or discourage potential entrants from preventing price increases by the dominant firm following its predatory action. In the absence of such barriers, predation may also be profitable if it deters potential competitors from entering the market for fear of a repeated predatory episode. This reputation for predation may also deter entry into other markets in which the dominant firm operates, thus increasing that firm's incentive to engage in predation.

Dominant firms can also engage in predation in order to discipline competitors that have undertaken to challenge the market power of the dominant firm. The intent of disciplinary actions is to convince the target of the actions to cease a particular practice, rather than to eliminate or exclude it from the market. However, the effect on competition can be the same as elimination of a rival if the disciplining eliminates the competitive threat. Consider the example of a competitor seeking to obtain market share by lowering its prices. The dominant firm reacts by engaging in a predatory pricing strategy, aimed not at eliminating the competitor, but rather at compelling it to resume pricing at previous levels.

The Bureau has received a number of complaints regarding the pricing practices of some grocery retailers. In general, these complaints allege that a retailer is engaged in predatory conduct aimed at eliminating or disciplining competitors. This predatory conduct usually involves either low prices on frequently purchased items or low prices offered by a new retail grocery entrant (geographic price discrimination) on a broad selection of SKUs.¹⁰

Situations arise where there is intense competitive rivalry in a market between large retailers who can exploit lower cost structures associated with their size and buying power. Often such rivalry imposes significant pressure on smaller retailers who must also compete in the market. This pressure can result in a loss of market share or even the exiting of higher cost competitors from the market. This consequence, however, is not the basis for concluding that there has been an abuse of dominance as it has come about as a result of competition rather than as a result of a strategy by the larger competitors to discipline or eliminate smaller competitors.

The Bureau has also received complaints related to predatory pricing following a large scale entry by a supermarket in a geographic market. As well, suppliers have complained that the entrant was permitted a "new store discount" for a period of up to a year.

In cases of low prices offered by a new retail grocery entrant on a larger selection of SKUs, the Bureau focuses on prices in relation to costs, as well as on typical mark-ups for that particular retail format in other geographic markets in order to judge whether prices are predatory. The Bureau has done

¹⁰The Bureau has on several occasions established that a dominant retailer sold a number of SKUs at below cost. However, it concluded that the competitive impact in a retail grocery market of loss leaders with sales involving less than 50 SKUs, in a store stocking 17,000-23,000 SKUs, was too limited to meet the substantial lessening requirement of section 79 of the Act. This assessment is done on a case by case basis.

extensive price comparisons between areas to establish that the lower post-entry prices do not cross the predatory threshold.

While the Bureau generally accepts that most large scale retail grocery entrants incur losses in the first six months, it is also of the view that, subsequent to the first six months, significant deviations from normal mark-ups and pricing strategy to cover costs are direct evidence of predatory pricing.

Below cost pricing may also be permissible in other circumstances. The case law requires the Bureau to take business justifications for below cost pricing into consideration.¹¹ For example, it may be reasonable for a company to sell excess, obsolete or perishable goods, or products for which demand is shrinking at below-cost prices. In the case of temporary cost increases or demand decreases, a firm may use below-cost pricing to retain existing customers or to build inventory in anticipation of increased business in the future. Companies may use below-cost promotional pricing to induce customers to try a new product. In each case, the Bureau considers the particular competitive context of the pricing in question, with no single factor predominating.

The following outlines how the Bureau examines alleged predation on a preliminary basis under an avoidable cost test.

- # At the outset, where specific allegations of predation are made by a complainant, the Bureau generally reviews the matter under the predatory pricing criminal provision (paragraph 50(1)(c)) of the Act. However, a final decision on which provision under the Act the Bureau will proceed is not made before all the relevant facts have been gathered.¹²
- # After defining the relevant markets, and determining that the dominant firm(s) may possess market power, the Bureau considers whether the complainant is profitable enough to continue on as an on-going business. If the complainant remains profitable in spite of the alleged predation, the complainant is unlikely to exit from the market. Where profitability is declining the Bureau will require evidence from the complainant that the decline is attributed to the alleged predator. To assess the profitability issue relatively quickly, the Bureau uses information from a single store and analyzes the profits of various product bundle scenarios.
- # There are several key factors to consider in each product bundle scenario. Cost data at the store level is typically in the form of acquisition cost. From the acquisition cost data, the Bureau will add estimates of other avoidable costs (eg. variable portions of labour cost, rent and general expenses such as utility costs, grocery bags, etc.) and subtract estimates of certain revenues (eg. advertizing allowances, cash discounts, etc.) to arrive at an estimate of total

¹¹R. v. *Consumers Glass Co.* (1981), 33 O.R. (2d) 228. Also see *Boehringer Ingelheim (Canada) Inc. v. Bristol-Myers Squibb Canada Inc.*, Ontario Court of Justice (General Division), October 9, 1998, unreported, a private action brought under section 36 of the *Competition Act*.

¹²Whether the complaint is reviewed under the criminal predatory pricing provision or the civil abuse of dominance provisions the analysis is similar.

avoidable cost. These calculations provide an estimate of the profitability of the bundle (i.e. price above or below avoidable cost). Lastly, the Bureau will consider the product bundle scenarios for a range of time periods.

- # Unless the product bundle scenarios demonstrate that the complainant is profitable and is pricing most of its goods above cost, the Bureau repeats the same exercise with the alleged predator's cost information. In this case, if the alleged predator is pricing most of its goods below cost, then the Bureau will apply a full avoidable cost analysis.

5.2.3 Interdependence or Tacit Collusion Among Firms: Facilitating Practices

The abuse of dominance provisions recognize that firms who have legitimately obtained a dominant position in a market through superior competitive performance are free to exercise their market power, provided that they do not engage in abusive activities designed to eliminate or restrict competition. However, in markets where a small number of competitors account for a significant proportion of the market and barriers to entry make it difficult for other competitors to enter or expand in the market, there is increased concern that incumbent firms could create market dominance through co-ordinated activities. This could constitute an anti-competitive act through the creation of market power and could substantially lessen or prevent competition in the relevant markets.

Facilitating practices enhance the ability of firms to coordinate their behaviour in order to increase or maintain prices. Thus, a group of firms would employ facilitating practices to ensure cooperation of members in order to sustain the group's joint dominance in the relevant market(s). Typically, such practices assist firms in monitoring each other to ensure that no one "cheats" on an arrangement or allow firms to more effectively punish such deviations.

Examples of this behaviour include pre-announcing price increases, publicizing price lists, category management and engaging in delivered pricing. The latter can involve uniform delivered prices, whereby firms charge the same delivered price to all customers regardless of location. Alternatively, firms can adopt the same base points from which transportation costs are added. Both forms of delivered pricing simplify price lists and result in customers facing the same price from each firm, thus making pricing more transparent to other firms and facilitating coordinated behaviour. Unless a series of facilitating practices are present in the market, the Bureau will not likely pursue the case.

Contractual arrangements can also be used to enhance transparency and to allow for more effective punishments. "Meet-or-release" clauses can alert a firm to price cutting by other firms, thereby facilitating detection of deviations. These clauses also provide for punishment by allowing the firm to match the offer, thus preventing the price cutter from making the sale.

Similar practices incorporate stronger punishments, such as a firm promising to beat any rival's price by 10 percent. Most "favoured customer" clauses effectively commit a firm to punishing itself for offering a selective price cut to a particular customer, since that price cut would have to be offered to all customers

with similar clauses. Thus, these clauses can deter selective price cuts and stabilize interdependence among oligopolists.

There has been no evidence to date to suggest that this sort of co-ordinated behaviour is ongoing within the grocery sector. However, given the evolving nature of this sector, the Bureau has given priority to remaining apprised of any changes in the structure of the sector and of any emerging trends in the market that might facilitate greater co-ordination between competitors.

5.2.4 Other Matters

Similar to allegations of predatory pricing previously discussed, alleged anti-competitive acts by a dominant firm are frequently reviewed under other specific provisions of the Act. As a rule of thumb, where a specifically alleged anti-competitive act falls under a specific provision of the Act, the Bureau will generally examine the behaviour under that provision. However, the final decision on which provision under the Act the Bureau will proceed is not made before all the relevant facts have been gathered. Other specific provisions to review dominant firm(s) conduct include: alleged anti-competitive pricing practices under price discrimination, paragraph 50(1)(a), or under price maintenance, section 61, as well as the conspiracy provision under section 45.

5.3 Substantial Prevention or Lessening of Competition

Paragraph 79(1)(c) of the Act imposes a requirement of proof that the business conduct has had, is having, or is likely to have, an effect of "preventing or lessening competition substantially." The focus is placed squarely on competition rather than on individual competitors. In any given case, the final determination of whether competition has been substantially lessened or prevented will depend on the degree of dominance, the nature and severity of the anti-competitive acts and the degree of competition remaining in the market. In general, the Bureau will focus on a variety of indicators to determine the impact of anti-competitive activities on competition. These include level of choice or product variety, quality and innovation and the impact on consumer price levels.

In order to illustrate the approach taken by the Bureau in the investigation of Canadian grocery sector complaints, a series of hypothetical case studies has been included in Appendix III of the Bulletin.

6. Remedies

6.1 Alternative Case Resolutions

Where appropriate, the Commissioner will open discussions to try to obtain voluntary compliance with the law; this may be all the action required to correct the situation. A more formal solution would involve the registration of a consent agreement with the Tribunal where all parties agree to a solution that will restore competition in the marketplace. In most circumstances the Bureau's preference would be to have any proposed remedy agreed upon by the parties registered with the Tribunal pursuant to a consent agreement. However, resolution of these matters are dealt with on a case-by-case basis.

In instances where an alternative (to litigation) course of action has been adopted by the parties to resolve the competition issues, the Bureau will make the resolution public to ensure that the process remains transparent and that all interested parties have been informed of the fact that the matter has been resolved.

6.2 Interim Orders

Section 103.3 of the Act provides the Tribunal with the authority, on an *ex parte* application by the Commissioner, to issue an Interim Order or ‘temporary order’ to prevent irreparable harm to competition or to a competitor, while an inquiry by the Commissioner is still underway. Temporary orders are limited to a maximum of 80 days, unless the Tribunal is satisfied that the Commissioner has sought and not received information necessary for the Commissioner to complete his inquiry. The Bureau will use section 103.3 of the Act in a cautious manner in the course of its investigations.

An interim order pursuant to section 104 of the Act may also be available once an application for remedial order is filed with the Tribunal.

6.3 Remedial Orders

The Bureau will pursue contested proceedings in cases where the resolution of the issues on a consent basis is considered inappropriate.¹³ In such circumstances, the Bureau will file an application before the Tribunal for remedial orders. The Tribunal has a number of remedies at its disposal to overcome the effects of anti-competitive acts and restore competition. The most common remedy is an order that requires the termination of the anti-competitive conduct. If the Tribunal believes further remedial action is necessary, it may issue an order to take any actions, including the divestiture of assets or shares, which are reasonable and necessary to overcome the effects of the anti-competitive acts.¹⁴

6.4 Limitations and Exceptions

Subsection 79(3) of the Act places a limitation on the scope of an order under subsection 79(2) of the Act, in order to provide an additional safeguard protecting the rights of persons against whom an order is directed. The intent here is that an order should restore competition, but not exceed that objective.

Subsection 79(4) of the Act requires the Tribunal to consider whether the lessening of competition is attributable to the superior competitive performance of the dominant firm or firms. It does not call upon the Tribunal to balance superior competitive performance against the effects of anti-competitive acts. Superior competitive performance is only a factor to be considered in determining the cause of the lessening of competition rather than a justifiable reason for engaging in an anti-competitive act.

Exclusive rights provided by intellectual property law do not of themselves constitute abusive conduct by a dominant firm. Subsection 79(5) of the Act is intended to ensure that the legitimate use of intellectual

¹³ *Conformity Continuum Information Bulletin*, p. 10.

¹⁴ Subsection 79(2) of the Act.

property rights does not constitute an anti-competitive act. However, abuse of those rights could result in a violation of section 79 of the Act.

Subsection 79(6) of the Act clarifies the point that no action can be taken against an anti-competitive act by a dominant firm or group of firms three years after the practice has ceased.

Subsection 79(7) of the Act requires the Commissioner to choose between the conspiracy, the merger or the abuse of dominance provisions when electing to proceed with either a referral to the Attorney General of Canada (alleging criminal conspiracy) or an application before the Tribunal (under the civil provisions). The choice of which provision to pursue will depend on the facts of each case.

7. Competition Bureau Contact

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Appendix I

The Abuse of Dominance Provisions of the Competition Act (Sections 78 and 79)

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;
- (i) selling articles at a price lower than the acquisition cost for the purpose of disciplining or eliminating a competitor ;
- (j) acts or conduct of a person operating a domestic service, as defined in subsection 55(1) of the *Canada Transportation Act*, that are specific under paragraph (2)(a); and
- (k) the denial by a person operating a "domestic service", as defined in subsection 55(1) of the *Canada Transportation Act*, of access on reasonable commercial terms to facilities or services that are essential to the operation in a market of "an air service", as defined in that subsection, or refusal by such a person to supply such facilities or services on such terms.

(2) the Governor in Council may, on the recommendation of the Minister (of Industry) and the Minister of Transport, make regulations :

- (a) specifying acts or conduct for the purpose of paragraph 1(j); and

(b) specifying facilities or services that are essential to the operation of an air service for the purpose of paragraph (1)(k).

79. (1) Where, on application by the Director, 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) Where the Tribunal makes an order under subsection (1) or (2) against an entity who operates a domestic service, as defined in subsection 55(1) of the *Canada Transportation Act*, it may also order the entity to pay, in such manner as the Tribunal may specify, an administrative monetary penalty in an amount not greater than \$15 million.

(3.2) In determining the amount of an administrative monetary penalty, the Tribunal shall take into account the following:

- (a) the frequency and duration of the practice;
- (b) the vulnerability of the class of persons adversely affected by the practice;
- (c) injury to competition in the relevant market;
- (d) the history of compliance with this Act by the entity; and
- (e) any other relevant factor.

(3.3) The purpose of an order under subsection (3.1) is to promote practices that are in conformity with this section, not to punish.

(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*, *Patent Act*, *Trademarks Act* or any other Act of Parliament pertaining to intellectual or industrial property is not an anti-competitive act.

(6) No application may be made under this section in respect of a practice of anti-competitive acts more than three years after the practice has ceased.

(7) No application may be made under this section against a person
(a) against whom proceedings have been commenced under section 45, or
(b) against whom an order is sought under section 92 on the basis of the same or substantially the same facts as would be alleged in the proceedings under section 45 or 92, as the case may be.

79.1 The amount of an administrative monetary penalty imposed on an entity under subsection 79(3.1) is a debt due to Her Majesty in right of Canada and may be recovered as such from that entity in a court of competent jurisdiction.

Appendix II

List of Economic Papers Commissioned by The Competition Bureau*

1. Dr. Guofu Tan: *The Economic Theory of Vertical Restraints*
2. Dr. Jean-Francois Wen: *Market **Power in Canadian** Grocery Retailing: Assessing the Evidence for Canada*
3. Dr. J. Stephen Ferris: *Alternative Approaches to Vertical Constraints: Theoretical Models and Current Practices [in Grocery Retailing]*

* These papers are available on the Bureau's Web site at <http://strategis.ic.gc.ca/SSG/ct02318e.html#ij>

Appendix III

Hypothetical Case Studies

Hypotheticals Case Studies presented below are factually limited and the analysis that follows each one of them is a possible course of action which the Bureau may take.

EXAMPLE 1: SLOTING ALLOWANCES

Biggie Foods, a manufacturing and retailing conglomerate, is charging slotting allowances for carrying other manufacturer's goods in its retail stores. Superb Coffee, a coffee manufacturer, claims that the amount of money that Biggie Foods demands for slotting allowances for carrying Superb Coffee's products in its stores is excessive. Biggie Foods is also demanding a fixed annual allowance that is independent of Superb Coffee's sales in Biggie Foods' stores. Even if Superb Coffee sells only one package of its coffee through Biggie Foods, it still has to pay the same amount annually.

Biggie Foods produces goods sold mostly as house brands within its stores, including coffee. Over the past decade, the company has invested heavily on its information system in order to manage its inventory much more efficiently. For example, the company found that its slotting allowances were too low given the high cost of carrying new products. That is, if the product fails, the opportunity cost and any actual cost in carrying the products were much higher than previously calculated.

Superb Coffee finds that the higher slotting allowances are taking its toll on its margins. Eventually, Superb Coffee may have to retreat from the chain stores and focus on the smaller stores but there are relatively fewer independent retailers. Superb Coffee believes that the excessive slotting allowances are not fair but indicative of the collusive relationships between the chain stores and larger competitors of Superb Coffee. As a start, the company wants the Bureau to examine the anti-competitive effects of Biggie Foods' contracts and allowances.

ANALYSIS

Slotting allowances can generate potential benefits including (i) shifting some of the risk of product failure from retailers to manufacturers and (ii) providing a screening device for retailers to carry products with high quality. These allowances may also raise serious competition issues.

Slotting allowances contracts may be used as a strategic tool to reduce competition in the retail market. A dominant manufacturer may use slotting allowances to gain exclusive product listing from

retailers. By obtaining an exclusive product listing, the retailer enhances its market power vis-à-vis other retailers. In addition, depending on the size and scope of the market the retailer dominates, the allowances imposed by a dominant retailer may limit competition in the manufacturing market. Therefore, slotting allowances may raise rivals' costs and create, enhance or maintain market power, which can result in a substantial lessening or prevention of competition.

However, the fact that Biggie Foods is using fixed and unconditional allowances creates concerns that the allowances are not being used for simply risk sharing as the allowances should normally be expected to vary according to risk involved. Consequently, the Bureau would examine the conduct of Biggie Foods under the abuse of dominance provisions of the Act.

The analysis of the complaint requires a determination of whether Biggie Foods dominates the market for retailing coffee. Clearly, the market power of Biggie Foods has to be assessed at a number of levels. While Biggie Foods has a large national presence, it may not be as significant in certain geographic locations. Despite the fact, however, that Biggie Foods may not be dominant in some local markets, its overall market power may be sufficient to have a significant impact on the ability of Superb Coffee to sell its product and remain viable.

The impact of the allowances on Superb Coffee would also need to be assessed. Assuming Biggie Foods possesses market dominance, its ability to extract fees from manufacturers is not, by itself, contrary to the abuse of dominance provisions of the Act. Charging an allowance in addition to the risk associated with shelving the product would only be a cause for concern to the extent that action somehow lessens or prevents competition substantially.

If the allowances were such that they precluded Superb Coffee (and perhaps other manufacturers) from remaining competitive in the market, an assessment of the impact on competition of the removal of Superb Coffee (and any other manufacturers) would also be required to demonstrate that competition had been substantially lessened or prevented. Therefore, the Bureau would likely examine the conduct of Biggie Foods under the abuse of dominance provisions of the Act. It should be noted that if the slotting allowances are not fixed but are conditional, for example, based on sales performance, then the allowances are less likely to be anti-competitive. It may also be that there exists a number of coffee manufacturers who are more efficient than Superb Coffee and can absorb the conditional and not fixed slotting allowances while still remaining competitive.

EXAMPLE 2: LISTING FEES

Superb Coffee, a small coffee manufacturer, would like to enter a local market but finds that there is only one wholesaler, Smith Wholesale, serving the area. Through the use of long term exclusive contracts with its customers, Smith Wholesale has raised artificial barriers to entry. Superb Coffee

does not have sufficient sales volume to sell directly to retailers and thus requires Smith Wholesale to distribute its goods. However, Smith Wholesale is demanding listing fees for carrying Superb Coffee's products. More precisely, the fees have to be paid quarterly in order for Smith Wholesale to continue listing Superb Coffee's goods.

Wholesalers provide listing services that allow manufacturers and retailers to exchange information about product availability and prices. Listing fees are charged for this type of listing service. Superb Coffee finds the listing fee *demand* unfair as the fees are essentially payable forever. The company is willing to pay Smith Wholesale for any cost incurred if the retailers find Superb Coffee's goods not saleable. It is even willing to specify a time period for the success of its products and pay for any removable costs.

ANALYSIS

Listing fees can create potential benefits including (i) shifting some of the risk of product failure from wholesalers to manufacturers and (ii) providing a screening device for wholesalers to carry products with high quality. However, these listing fees may also raise serious competition issues similar to those identified previously under the slotting allowances case study.

Smith Wholesale, who is likely in a dominant position, is essentially asking for pay-to-stay fees in order to stock Superb Coffee's products. Similar to fixed and unconditional slotting allowances in the previous example, the listing fees in this case are likely anti-competitive since Smith Wholesale is excluding Superb Coffee from the wholesale market and may substantially lessen or prevent competition. Therefore, the Bureau would further examine the conduct of Smith Wholesale under the abuse of dominance provisions of the Act.

EXAMPLE 3: CATEGORY MANAGEMENT

Local Bubble, like all other gum manufacturers, sells its products through retailers. Since gum is typically bought on impulse, product visibility on store shelves is an important factor for any gum manufacturer to succeed. In recent years, Local Bubble has realized that its sales have been decreasing due to the actions of another gum manufacturer, Power Gum. Following the trend among retailers in using category managers, Power Gum has also started a similar category management program for retailers. In particular, Power Gum wants retailers to allocate their shelf space based on sales. For example, if Power Gum has 50% of the gum sales, then it would get 50% of the shelf space dedicated to gum.

Since Power Gum has an estimated 80% share of the gum product market at the national level, Local Bubble believes that this program is not fair because Power Gum tends to use aggregated

data, instead of local information. Power Gum has spent decades building its brand name through significant advertising expenditures. Its brand recognition makes it difficult for rivals, such as Local Bubble, to gain market share. Local Bubble estimates that its overall market share nationally is 10%, but the company has a 50% market share in a few local markets. By using national numbers, any type of shelf space allocation scheme would be skewed in favour of Power Gum.

Power Gum claims that it has bought its information from independent sources. As a category manager, the company and the retailers have agreed that shelf space allocation should be based on sales. That is, the higher the product's sales, the more space the product receives. Retailers do not wish to allocate large portions of shelf space to products that do not sell quickly. Hence, the data is obtained from independent sources in order to gain any credibility with the retailers. While some of the data is aggregated, Power Gum has used regional data whenever possible in order to appease retailers. Clearly, there is a limit on how much the data can be disaggregated and still enable the independent sources of the data to remain confidential.

ANALYSIS

Power Gum is likely in a dominant position based on its market share and the presence of substantial barriers to entry. The practice of assigning shelf space with respect to historical data can have similar effects to those associated with exclusive dealing. A supplier becomes the exclusive dealer for a fixed amount of shelf space. There is a strong incentive for the use of this practice by Power Gum as this practice serves to maintain Power Gum's percentage of shelf space which has a direct impact on its ability to maintain its market share. Given Power Gum's dominant position and the exclusionary effect of this category management practice, the matter is likely to substantially lessen or prevent competition as it reduces the ability of competitors to expand their presence in the market. Therefore, the Bureau is likely to examine the conduct of Power Gum under the abuse of dominance provisions of the Act.

EXAMPLE 4: TIED SELLING - FRANCHISE CONTRACTS

Since commencing operations, ABC Supermarket has purchased goods from a variety of specialized wholesalers. ABC Supermarket purchases all its grocery products from Smith Wholesale except its meat and produce products because they are available at a lower price elsewhere. ABC Supermarket has also attempted to source directly from grocery manufacturers. Given its small purchase volume, ABC Supermarket cannot set up its own grocery wholesale business. In addition, no other wholesaler can economically supply the bulk of the grocery products into its area of operation. Further, an estimated 40% of ABC Supermarket's revenues come from goods supplied by Smith Wholesale.

Besides wholesaling, Smith Wholesale is also a grocery franchisor. Recently, Smith Wholesale has demanded that either ABC Supermarket becomes one of its franchises or ABC Supermarket must find a new wholesaler. To prevent any free riding and to ensure the same standard among all franchisees, the franchise contract restricts franchisees from using alternative suppliers.

ABC Supermarket finds Smith Wholesale's demands to be unreasonable. As a franchise, the independent grocer believes that it will have to raise its prices and its profits will be lower since Smith Wholesale is simply not efficient in handling perishables such as meat or produce items. Unfortunately, ABC Supermarket has no alternative source of supplies and appeals to the Bureau for assistance.

ANALYSIS

Smith Wholesale appears to be in a dominant position since it is the only grocery wholesaler able to supply the local market. The important competition issue in this case involving franchise contracts is the timing of the franchise offer since it was made after Smith Wholesale was already supplying ABC Supermarket. If Smith Wholesale made the offer before it started supplying ABC Supermarket, then ABC Supermarket is free to decide whether it is feasible to commence a business without efficient sources of supply. By having supplied ABC Supermarket, Smith Wholesale has established that ABC Supermarket has a viable business. A primary issue for the Bureau is what impact the exit of ABC Supermarket will have on competition among suppliers.

The franchise contracts of Smith Wholesale in this situation would be considered by the Bureau as constituting full-line forcing¹⁵ or tied-selling¹⁶, either is an anti-competitive act when engaged in by a dominant supplier. The advantage of being a franchise is that ABC Supermarket can potentially benefit from Smith Wholesale's experience and economies ranging from larger purchasing power to advertising. As a franchisee, ABC Supermarket cannot buy certain products, notably perishables, from independent wholesalers and manufacturers as it did in the past. This franchising practice by Smith Wholesale may have exclusionary effects as ABC Supermarket's former suppliers will be excluded. The practice is likely to substantially lessen or prevent competition since it reduces the number of competitive suppliers in this market. In this situation, the Bureau would likely examine the conduct of Smith Wholesale under the abuse of dominance provisions of the Act.

¹⁵Full-line forcing means that a manufacturer requires retailers to stock each of its products.

¹⁶Tied-selling exists when a supplier, as a condition of supplying a particular product, requires or induces a customer to buy a second product.