

DISTRIBUTION CHANNELS AND DISCRIMINATORY PRICING: GUIDELINES FOR COMPLYING WITH THE *COMPETITION ACT*

Profound changes in retail industries and distribution channels have occurred in recent years. The emergence of warehouse clubs, superstores and efficient multi-national mass merchandisers is exerting enormous pressure on retail competitors and suppliers. Specialty retail chains and buying groups have also proliferated. In Canada, these developments have taken place against the backdrop of a rigid price discrimination law enacted in the 1950s. Fortunately, the *Price Discrimination Enforcement Guidelines* (PDEGs) issued by the Competition Bureau in 1992 greatly expanded the flexibility for businesses to use innovative and customized pricing arrangements without risking criminal prosecution under the price discrimination provisions of the *Competition Act*.¹

THE PRICE DISCRIMINATION OFFENCE

The price discrimination offence is premised on a belief that competitors should not be handicapped by unequal pricing from a common supplier. The *Competition Act* prohibits the granting of a price concession to a favoured “purchaser” which is not “available” to “competitors” of the purchaser. While these terms are the focus of the PDEGs, the offence also has several other elements:

- **There must be a “sale”.** Thus leasing, licensing, agency and consignment transactions are not covered (although consignment selling for the purpose of price discrimination is a non-criminal reviewable practice).
- **The sale must involve “articles”.** Services are not subject to the price discrimination rules.
- **The offence applies to anyone who “is a party or privy to, or assists in” the sale.** This could include a seller’s agents and employees. Buyers are not exposed to liability by bargaining for preferential pricing.
- **The seller must have granted a “discount, rebate, allowance, price concession or other advantage”.** The phrase “other advantage” will be confined to monetary arrangements (including credit terms) which lower the effective price of the product.² Thus technical assistance, equipment and related services can be provided by a seller on an unequal basis without fear of violating the price discrimination rules.

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¹ *The PDEGs outline an enforcement approach that is as responsive to marketplace realities as could be achieved under an antiquated and inflexible law. However, in a private civil suit for damages by a customer claiming to have been injured by price discrimination, it is possible that a court would adopt a more interventionist approach.*

² *With respect to promotional allowances, the Act contains even more restrictive rules which basically require that they be offered to competing purchasers on proportionate terms. The PDEGs do not directly address this area.*

- The discrimination must arise in respect of sales of “like quality and quantity”. The PDEGs confirm that “like” means similar, not identical. A trademark or label may affect like quality - at least if it impacts on the price that a customer ordinarily pays. Moreover, a multi-line seller will not be discriminating against purchasers of one or a few products if it bases volume rebates on aggregate purchases.
- The discrimination must arise “at the time” of the sale to the preferred purchaser. For longer-term contractual relationships, the PDEGs express a willingness to consider the time at which price levels or formulas were agreed upon by the parties.
- The seller must engage in a “practice of discriminating”. Short term price reductions, occasional discounts for promotional events and offering generous terms to attract a new account normally will not be classified as a practice. (Aside from this, there is no “meeting competition” defence in the Canadian law.)
- The seller must have “knowledge” that it is discriminating. While knowledge of each of the elements comprising the offence is required, it may be inferred from circumstantial evidence. Willful blindness is tantamount to knowledge.

THE AVAILABILITY REQUIREMENT

Price concessions granted to one purchaser need not be given automatically to competing purchasers as long as they are “available” (*i.e.* accessible or obtainable). Most price discrimination cases turn on whether there was adequate disclosure of the price concession or whether the conditions attached to a concession rendered it unavailable.

The PDEGs suggest that, to meet the availability requirement, unilateral concessions by a seller (*e.g.* a standard volume rebate plan) generally should be disclosed in a full and timely manner to competing purchasers. In contrast, where the purchaser initiates negotiations and agrees to provide a service in exchange for the price concession (*e.g.* picking up the goods), the concession need not be broadcast as long as the seller is prepared to grant a comparable concession when requested by competing purchasers in exchange for comparable services. Unfortunately, most real-world circumstances fall between these two clear scenarios.

CONDITIONAL DISCOUNTS

Conditional discounts are fundamental to many multi-channel distribution strategies. The most important initiative in the PDEGs was the liberalization of the enforcement policy for conditional discounts. Three basic principles now apply:

- Conditions of virtually any sort may be imposed as long as competing purchasers are all entitled to comparable treatment.
- A concession will not be regarded as “available” if the conditions are “contrived” to “favour or deprive” particular purchasers.
- Attainment of conditions should be verifiable and promised concessions should be granted consistently.

Within these parameters, sellers have a wide berth for using conditional pricing strategies including volume-based discounts (provided that prepayments based on historical or estimated purchases are adjusted for any shortfalls), growth bonuses, functional discounts (concessions granted in exchange for the purchaser performing a function which the seller would otherwise provide) and exclusive dealing discounts (subject to the Competition Tribunal’s power to review and prohibit exclusive dealing if competition is likely to be lessened substantially).

COMPETING PURCHASERS

In determining whether the alleged victim of price discrimination and the favoured purchaser are competitors, the PDEGs focus on whether they are “rivals for the custom of the same buyers”. The Bureau will employ the approach to product and geographic market definition in its *Merger Enforcement Guidelines* (which has also been adopted in the *Predatory Pricing Enforcement Guidelines*). While consistency of approach is generally admirable, the market definition methodology in the *Merger Guidelines* is rather complex and cumbersome for day-to-day pricing decisions.

Complications often arise in identifying the “true purchaser” and its competitors in situations involving affiliates, buying groups, franchises or multinational firms. The PDEGs provide helpful guidance in each of these areas.

Affiliates

There is no statutory exemption for preferred pricing to affiliates. However, the PDEGs allow substantial latitude for intercompany transactions by acknowledging that affiliates may set transfer prices “reflective of their interests acting as a single economic entity” which would not amount to the granting of a “concession in respect of a sale”.

Buying Groups

The PDEGs recognize that buying groups can provide efficiency benefits to both sellers and buyers. In determining whether a buying group constitutes a true purchaser, the Bureau will focus on the existence of a contractual commitment to acquire the goods (rather than the precise invoicing and payment arrangements) and is willing to examine marketplace realities in particular circumstances. However, it normally will focus on three key factors: whether the buying group is a separate legal entity; whether it takes title to the goods (with or without possession); and whether it assumes liability for payment. While these guidelines are less rigid than historical enforcement policies, suppliers need to be watchful because many buying groups still do not meet these tests. The PDEGs do not mention the risks that may be faced by participants in buying groups of other potential exposures under the *Competition Act*, including possible applications of the criminal provisions of the Act. Agreements among purchasers with market power may, in some circumstances, create some risks that require careful consideration.

Franchising Systems

A more flexible approach applies to franchising. Even if a franchiser does not purchase and resell to, or purchase on behalf of its franchisees, it may be regarded as the true purchaser if it controls the franchisees’ choice of supplier. However, the guidelines seem to require that such control be exercised by contract rather than on an informal *de facto* basis.

Volume-Based Concessions for Multinational Firms

Sellers may find it in their interest to grant price concessions tied to aggregate purchases by a multinational enterprise. If the parent firm has negotiated and committed its affiliates to the arrangements, the PDEGs accept that it can qualify as the true purchaser. This is becoming increasingly common as both buyers and sellers become more North American in their operations.

ENFORCEMENT AND COMPLIANCE

When the Bureau becomes aware of potential price discrimination or other criminal conduct under the *Competition Act*, it usually conducts an informal preliminary examination. If it uncovers reasonable grounds for believing that an offence has been committed, a formal “inquiry” may be commenced to gather relevant evidence.³ This typically involves contacting customers, competitors, suppliers and possibly the use of formal investigative powers. Decisions to prosecute rest with the Attorney General but are influenced significantly by the recommendations made by the Bureau.⁴

The price discrimination rules in the *Competition Act* can pose significant compliance challenges for firms that employ complex distribution channels or operate in volatile pricing environments. Standard procedures and controls — whether on a stand alone basis or as part of a broader competition law compliance program — can provide a cost-effective mechanism for managing legal risks in these situations.

³ *The Bureau may also be required to commence an inquiry by the Minister of Industry or upon the application of any six Canadian residents.*

⁴ *Persons injured by price discrimination may also bring an action to recover damages plus their costs of investigation and litigation.*

More information about price discrimination and other competition-related topics can be found on the McMillan Binch Mendelsohn Canadian Antitrust website at <http://www.mcmbm.com/CompetitionAntitrust.html>

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