Vertical Restraints:
Dos and Don’ts in Antitrust

WS 03 National/General Report of Canada

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1. INTRODUCTION AND OVERVIEW

1.1 Please provide an outline of the antitrust or competition laws (referred to collectively as "antitrust laws") which apply in your country.

Canada's *Competition Act*[1] ("the Act") governs all Canadian antitrust matters and, with few exceptions, applies to all businesses in Canada. The Act contains a mix of criminal offences and discretionary reviewable practices. Criminal offences are prosecuted in criminal courts. Non-criminal "reviewable practices" that substantially lessen competition may be restrained by the Competition Tribunal (the "Tribunal"),[2] a specialized body for the adjudication of such matters. Private rights of actions are available in respect of all the criminal offences and will soon be introduced for selected reviewable practices

1.2 Is the concept of a vertical restraint given a special description or definition in the actual antitrust law of your country?

The Act does not contain a specific definition of the concept of "vertical restraint". Instead this concept is embodied in a number of provisions dealing principally with resale price maintenance, predatory pricing, refusals to deal, exclusive dealing, tied selling and market restrictions (*i.e* .exclusive territories or classes of customers). As noted above, the Act adopts a bifurcated approach to regulating competitive conduct: some conduct is treated as sufficiently egregious to competition to warrant criminal sanction if the offence is proved to a criminal standard ("criminal offences"); conversely, other behaviour is considered only potentially anti-competitive, and therefore may be subject to review and possible prohibition or other remedial orders if the conduct is established as anti-competitive in the actual case at hand (the so-called "reviewable practices"). In terms of vertical restraints, the Act treats resale price maintenance as a criminal offence and refusals to deal, exclusive dealing, tied selling, and market restriction as discretionary reviewable practices.[3] Criminal offences are prosecuted by the Attorney General based on evidence referred by the Commissioner.

In addition to the Act's specific provisions dealing with vertical restraints, the Act's abuse of dominant position provision, section 79, permits the Tribunal to prohibit any "practice of anti-competitive acts"[4], including anti-competitive vertical restraints — even if more specifically addressed by the Act's vertical restraint provisions — when the following three elements are found to exist by the Tribunal:

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

– that person or those persons have engaged or are engaging in a practice of anti-competitive acts; and

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[1] R.S.C. 1985, c. C-34, as am., hereinafter [*Competition Act*].
[2] The Tribunal is created by the *Competition Tribunal Act*, R.S.C. 1985, c.19, (2nd Supp.), as am.
[3] For a more complete overview of Canada's laws on vertical restraints, see Vertical Agreements & Practices (§200.03) in Chapter 200: Canada, by J.F. Clifford and S.L. Walker, Vol. 9, Antitrust laws and Trade Regulation, 2nd ed., Julian von Kalinowski et al. (New York, NY: Matthew Bender, 1996-); and A. N. Campbell, "Vertical Non-Price Restraints," Insight, 1993, available on-line at http://www.mcbinch.com/antitrust/Inprint/Vertical/.
[4] *Competition Act*, *supra*, note 1, at §79(1).

– the practice has had, is having or is likely to have the effect of preventing or lessening competition substantially in a market. [5]

The Commissioner of Competition (the "Commissioner") (see section 1.3 below) will consider a number of factors in determining whether market power exists including technological change, recent entry or exit, industry supply capacity and the countervailing market power of customers and distributors. The most important factors, however, are market shares (and hence remaining competition) and barriers to entry. The Commissioner's *Abuse of Dominance Enforcement Guidelines*[6] prescribe the following guidelines in terms of the Commissioner 's approach to market shares:

– a market share of less than 35% will generally not give rise to concerns of market power or dominance;

– a market share of over 35% will generally prompt further examination; and

– a market share of over 50% in the case of a single firm will *prima facie* be considered dominant (the figure rises to 60-65% in cases where a group of firms is alleged to be jointly dominant).

The Commissioner does not consider market share by itself to be sufficient to prove market power. Barriers to entry must also be considered. Section 78(1) of the Act sets out an explicitly *non-exhaustive* list of practices which, if the three factors set out above are proven by the Commissioner, will result in a remedial order from the Tribunal to enjoin or modify the behaviour. As noted, the scope of section 79 could also extend to vertical restraints. A number of Tribunal decisions to date have dealt with a party's alleged abuse of dominance under section 79 in conjunction with the tied selling[7], exclusive dealing[8] and refusal to deal[9] provisions of the Act. Therefore, throughout this report, the general applicability of section 79 to vertical practices must be kept in mind.

1.3 How are antitrust laws enforced? Is there a government regulator to enforce the provisions of your antitrust act?

The Commissioner serves as Canada's chief antitrust enforcement official. In charge of the Competition Bureau (the "Bureau"), the Commissioner has exclusive statutory authority to administer and enforce the Act.[10] Only the Commissioner may investigate breaches of the Act and initiate proceedings for reviewable practices. Criminal offences are prosecuted by the Attorney General based on evidence referred by the Commissioner.

[5] *Ibid.*, *supra*, note 4, at §79(1).
[6] Competition Bureau, *Abuse of Dominance Enforcement Guidelines* (Ottawa: Industry Canada, 2001) at § 3.2[hereinafter "ADEGs"].
[7] *Canada (Director of Investigation and Research)* v. *Tele-Direct (Publications) Inc.*, 73 C.P.R. (3d) 1 at 34 (Comp. Trib.) [hereinafter *Tele-Direct*].
[8] *Canada (Director of Investigation & Research)* v. *NutraSweet Co.* 32 C.P.R. (3d) 1 (Comp. Trib.) [hereinafter *NutraSweet*].
[9] *Tele-Direct*, *supra*, note 7.
[10] *Competition Act*, *supra*, note 1 at §7(1)(a).

The Commissioner must commence a formal inquiry whenever there is reason to believe a criminal offence has been, or is about to be, committed.[11] A formal inquiry must also be commenced whenever grounds exist for the Tribunal to make an order regarding a reviewable practice.[12] Although most inquiries begin at the Commissioner's instance, the Commissioner must also commence an inquiry when the federal Minister of Industry so directs, [13] or on the sworn application of six Canadian residents.[14] All inquiries are conducted in private and strict rules of confidentiality are applied.[15]

1.4 What powers does the regulator referred to in section 1.3 above have? In particular what powers does it have to (i) compel parties to provide statements; (ii) to require the production of documents; or (iii) to inspect the actual premises of parties suspected of being involved in a contravention?

A full arsenal of investigative tools is available to assist the Commissioner in his investigations. Exercise of these powers is subject to court supervision and must comply with the constitutional protection afforded all individuals under Canada's *Charter of Rights and Freedoms*.[16]

The Act permits the Commissioner to apply to a provincial superior court or the Federal Court, on an *ex parte* basis, for an order compelling "any person" to:

– testify under oath or solemn affirmation;

– produce a record[17] or other documentary or physical evidence; or

– produce a written response to questions posed in the order.[18]

Moreover, records or other evidence in the possession of a foreign affiliate of the Canadian entity under investigation must also be produced if so ordered.[19] In addition, the Commissioner has the ability to apply on an *ex parte* basis to a court for a warrant authorizing the search and seizure (including the subsequent copying) of any "record or other thing."[20] In recognition of the significant evidentiary value of computer records, the Act contains a specific provision relating to the "operation of a computer system" which allows any one authorized by a search warrant to use, or compel the use of, a computer system within the warrant's scope "to search any data contained in or available to the

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[11] *Ibid.*, §10(1)(b)(i).
[12] *Ibid.*, §10(1)(b)(ii).
[13] *Ibid.*, §10(1)(c).
[14] *Ibid.*, §9(1).
[15] *Ibid.*, §10(3) and §29.
[16] *Canadian Chapter of Rights and Freedoms*, Part I of the *Constitution Act, 1982*, being Schedule B to the *Canada Act* 1982 (U.K.), 1982, c.11.
[17] The Act defines "record" very broadly at §2(1) to include "any correspondence, memorandum, book, plan, map, drawing, diagram, pictorial or graphic work, photograph, film, microform, sound recording, videotape, machine readable record, and any other documentary material, regardless of physical form or characteristics and any copy or portion thereof."
[18] *Competition Act*, *supra*, note 1 at §11(1).
[19] *Ibid.*, §11(2).
[20] *Ibid.*, §15(1).

computer system."[21] In an era of almost universally networked computer systems, the latter part of this provision — "available to the computer system" — means that a search warrant relating to only one physical location can potentially authorize the search and seizure of computer data on a world-wide basis.

1.5 Does the regulator have the power both to investigate potential breaches and also to make decisions about antitrust breaches (like the European Commission)? Or is the regulator required to take enforcement proceedings before a separate court or tribunal (as in the case in the United States or Australia?)

The Commissioner is only authorized to investigate and initiate proceedings before the Tribunal, in the case of reviewable practices, or investigate and recommend prosecution by the Attorney General in the case of criminal offences. Thus, in both the civil and criminal contexts, the Commissioner has no formal legal power to make a final, binding decision on the party or parties before him. However, given the costs and risks of litigation, the Commissioner's status as the one person who has carriage of both civil and criminal investigations provides him significant leverage in practice to persuade the parties under investigation to modify their behaviour. The Commissioner has published a "Conformity Continuum" which describes the important role of settlements and other alternative case resolution instruments.[22]

1.6 If you country has a competition law, are agreements containing vertical restraints submitted to any authorisation or is there a general block exemption that generally authorises such agreements subject to conditions? Please kindly generally describe any formal requirements and procedure for approval.

There are no requirements under the Act for submission of agreements containing vertical restraints to the competition authorities. Concomitantly, there is no system of block exemptions.

The Commissioner operates an "Advisory Opinion" program pursuant to which private parties may obtain advice about vertical restraints or other activities that would give rise to an inquiry under the Act.[23]

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[21] *Ibid.*, §16(1).

[22] See *Conformity Continuum Information Bulletin* (Ottawa: Industry Canada, 2000). Available on-line at http://strategis.ic.gc.ca/pics/ct/continuum.pdf.

[23] See *Fee and Service Standards Handbook* (Ottawa: Industry Canada, 1999). Available on-line at http://strategis.ic.gc.ca/SSG/ct01236e.html#appa.

2. ANTITRUST ISSUES IN SPECIFIC COMMERCIAL RELATIONSHIPS – DISTRIBUTION AGREEMENTS

2.1 Most jurisdictions with antitrust laws restrict or prohibit the extent to which the seller imposes a restriction or a condition on the buyer that the buyer will not sell below certain minimum prescribed prices. This is sometimes called resale price maintenance ("RPM") and is a form of price fixing, which will nearly always be prohibited. The supplier's incentive in engaging in RPM is essentially anti-competitive - the supplier can ensure a consistency of retail prices for its products in a given area. Please comment on:

2.1.1 How is RPM dealt with in your jurisdiction?

Price maintenance is one of the major criminal offences under the Act. Section 61(1) of the Act provides that:

> [n]o person who is engaged in the business of producing or supplying a product, who extends credit by way of credit cards or is otherwise engaged in a business that relates to credit cards, or who has the exclusive rights and privileges conferred by a patent, trade-mark, copyright, registered industrial design or registered integrated circuit topography, shall, directly or indirectly,
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> (a) by agreement, threat, promise or any like means, attempt to influence upward, or to discourage the reduction of, the price at which any other person engaged in business in Canada supplies or offers to supply or advertises a product within Canada; or
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> (b) refuse to supply a product to or otherwise discriminate against any other person engaged in business in Canada because of the low pricing policy of that other person.

Thus the attempt to influence upward, or discourage the reduction of, the price at which anyone sells a product constitutes a crminal offence. As such, persons who supply or produce a product and who suggest resale prices or minimum resale prices must clearly state that their customers are under no obligation to accept their suggestions. If they fail to make this clear to the customer, the suggested or minimum resale price will serve as proof of an attempt to influence the resale price.[24] The wording of paragraph 61(1)(a) of the Act states that, for an offence to have been committed, the supplier must have attempted to influence the price "by agreement, threat, promise or any like means...". In *R.* v. *Shell Canada Products Ltd.,* Kennedy J. offered some clarification on the meaning of a threat:

> In ordinary language, the word "threat" is easily understood. It is an urged course of action which carries with it some sanction or penalty if not carried out. It is a form of intimidation, fulmination, harassment or warning which carries with it some form of penalty.[25]

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[24] *Competition Act*, *supra*, at §61(3). See also the refusal to deal provision at §75 of the Act, discussed below in greater detail at section 2.4 of this report.

[25] (1989), 24 C.P.R. (3d) 501 (Man. Q.B.) at 507, leave to appeal conviction ref'd (1990), 29 C.P.R. (3d) 32 (Man. C.A.).

A narrow interpretation of the wording in paragraph 61(1)(a) suggests that not all price maintenance behaviour will not be an offence under the Act.[26] Attempts to maintain prices through "discussion, persuasion, complaints, suggestions, requests, or advice" that are not otherwise in contravention of section 61 have been deemed legal in Canada.[27]

Under a related offence, suppliers may not refuse to supply or otherwise discriminate against potential customers because of their low pricing policies (section 61(1)(b)). The Act provides various defences for persons charged with refusing to supply to, or discriminating against, a customer under section 61(1)(b). In certain cases, where the supplier's customer is engaged in conduct that is seen by the Act as unfair to the supplier (such as loss-leadering and misleading advertising) refusals to supply and discrimination may be deemed acceptable.[28] There is also a general exception in the Act for both section 61(1)(a) and (b) when the dealing is between affiliated entities or between principals and agents.[29]

It is worth noting that while price maintenance prosecutions traditionally focused on vertical relationships, two convictions were entered in 1994 in connection with horizontal relationships.[30] The accused in each case were convicted of attempting to influence competitors' prices upwards, rather than prices charged by customers. The punishment for contravening section 61 is an unlimited fine, a maximum term of imprisonment of five years, or both.[31] Finally, in addition to fines, courts will frequently issue prohibition orders under section 34 of the Act to prohibit formally further resale price maintenance by the convicted supplier.[32]

2.1.2 Please comment specifically on how RPM can arise in a distribution contract through indirect or subtle means, namely: (i) fixing the "distributors margin"; (ii) making the reimbursement of promotional expenses conditional upon the re sale of goods at certain minimum prices; (iii) threats to terminate or actual termination or withholding of supply to the distributor by the manufacturer if the distributor will not comply with the manufacturer's request; (iv) the implementation of a computerised price monitoring system or other measures that identifies price-cutting distributors; or (v) any other means.

Under section 61(1)(a)'s broad language — "[n]o person who is engaged in the business of producing or supplying a product… shall… by agreement, threat, promise or any like means, attempt to influence upward, or to discourage the reduction of, the price at which any other person … supplies or offers to supply or advertises a product …" — all of the conduct described above constitute illegal criminal offences except the implementation of a computerized monitoring system to identify price-cutters.[33] Such an action merely

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[26] *R.* v. *Schelew* (1984), 78 C.P.R. (2d) 102 at 109-110 (per La Forest J.A.) and at 111 (per Angers J.A.) (N.B.C.A.).
[27] *R.* v. *Les Must de Cartier Canada, Inc.* (1989), 27 C.P.R. (3d) 37 at 41 (Ont. Dist. Ct.).
[28] *Ibid.*, §61(10)(a) and (c).
[29] *Ibid.*, §61(2).
[30] *R.* v. *Royal LePage Real Estate Services Ltd.,* [1994] A.J. No. 823 (Q.L.) (Q.B.). See also Director of Investigation and Research, Competition Act, *Annual Report for the Year Ended March 31, 1995* (Ottawa: Industry Canada, 1995) at 20.
[31] *Ibid.,* §61(9).
[32] See, *e.g.*, "Nintendo Distributor Gets Fined $210,000" *The Financial Post* (26 June 1992).
[33] A refusal to supply would also violate §61(1)(b).

identifies, but does not constitute an agreement with or threat or promise to, a customer. However, were a supplier to use the fact of the *existence* of such a monitoring system as a threat to a price-cutter it could constitute an offence.

2.1.3 How (if at all) does the law of your jurisdiction allow the manufacturer to require that the distributor not sell above a maximum prescribed resale price?

The Act does not prohibit a supplier from stipulating a maximum resale price to a distributor.

2.2 Distribution Agreements usually contain provisions which seek to define/limit the territory (geographical area) into which the distributor may sell the goods or the customers to whom the distributor may sell the goods. Please comment/respond to the following matters.

2.2.1 To what extent can these provisions be permitted under the antitrust laws of your jurisdiction? Please address specifically whether there are any automatic or block exemptions that apply to any prohibited conduct if certain conditions are met.

Section 77 of the Act creates the reviewable practice of "market restriction" and allows the Tribunal, on application by the Commissioner, to review the practices used in a seller's distribution system if "market restrictions" are imposed on buyers. A market restriction occurs when a supplier requires a customer to re-sell a product "only in a defined market or exacts a penalty of any kind" if the customer sells outside the defined market.[34] Before it may issue an order prohibiting the supplier of a product from "continuing to engage in market restriction and containing any other requirement that, in its opinion, is necessary to restore or stimulate competition in relation to the product", the Tribunal must find that the conduct in question "because it is engaged in by a major supplier of a product or because it is widespread in relation to a product, is likely to substantially lessen competition in relation to the product".[35]

There are no decided cases on this provision of the Act so its exact interpretation by the Tribunal is not certain. Nevertheless, the term "defined market" in the definition of a market restriction very likely refers both to geographic markets and to restrictions based on classes of customers. Thus it would include the scenarios contemplated above in which the provisions of a distribution agreement define or limit the customers to whom the distributor may sell goods as well as the area in which it may sell.

In order to make out a case for an improper market restriction, the Commissioner must prove that the market restriction must have been part of a "practice" of conduct, that is likely

[34] *Competition Act, supra,* note 1 at §77(1).

[35] *Competition Act*, *supra*, note 1 at §77(3). In contrast to exclusive dealing (see section 3.1.1 of this report), the "market restriction" definition above does not explicitly refer to inducements. Accordingly, there appears to be room for a supplier to provide voluntary incentives to customers to adhere to particular market territories as long as they are not structured as penalties or mandatory conditions of supply.

to lead to a substantial lessening of competition and that the market restriction is either engaged in by a major supplier or is widespread in relation to a product.[36] "Practice" means more than a single instance of a particular conduct[37] and a "substantial lessening of competition" means the preservation or enhancement of market power.[38]

Arrangements entered into by affiliates are permitted by a statutory defence.[39] Similarly, if a practice of market restriction is engaged in only for a reasonable period of time to facilitate market entry of a new product or firm, the conduct will qualify for a statutory "entry defence".[40]

There are no block exemptions that would permit market restrictions of the kind described above. Instead, as noted, the practice is generally non-problematic unless it can be shown to have had an adverse effect on competition in a particular case.

2.2.2 In determining whether these provisions can be permitted under 2.2.1 above to what extent are the market shares of the manufacturer and distributor relevant?

As noted, the Commissioner must prove that substantial lessening of competition is the result of market restriction which is either engaged in by a "major supplier" or is widespread in relation to a product. [41] The related "exclusive dealing" and "tied selling" provisions of the Act (see further discussion at section 3.1.1 below) also makes reference to a "major supplier".[42] In one case on exclusive dealing, a "major supplier" was held to be one "whose actions have an appreciable or significant impact on the markets in which it sells" and it was noted that a "firm's market shares is a good indication of its importance" in such markets.[43]

The Act provides no indication of how a "substanial lessening of competition" is to be determined by the Tribunal under the market restriction provision. However, in the context of the related exclusive dealing provision, a "substantial lessening of competition" has been interpreted to mean the acqusition of "market power" or the ability to behave independently of the market at large. One method of assessing market power, the so-called "structural" approach, considers the market shares of the firm in a relevant market and whether there are barriers to entry which would protect incumbents. Thus market shares would be relevant to such a determination under the "market restriction" provisions of the Act.

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[36] *Ibid*.
[37] However, an Ontario case suggests that a sale of product over a one-week duration is a "practice". *R.* v. *William E. Coutts Co. Ltd.* (1966), 52 C.P.R. 21at 28, aff'd (1968), 67 D.L.R. (2d) 87 (Ont. C.A.).
[38] *NutraSweet, supra*, note 8 at 47.
[39] *Competition Act, supra,* note 1 at §77(5). The definition of an affiliate is expanded for purposes of the market restriction provision by §77(6). Where one person supplies ingredients to another person who further processes them into an article of food or drink, which is then sold in association with the first person's trademark, the two are deemed to be affiliated. This unusual provision has been described as the "soft drink bottlers' exemption".
[40] *Competition Act, supra,* note 1 at §77(4)(a).
[41] *Ibid.*, §77(3).
[42] *Ibid.*, §77(2).
[43] *Canada (Director of Investigation and Research)* v. *Bombardier Ltd.* (1980), 53 C.P.R. (2d) 47 (R.T.P. Comm.) at 55 [hereinafter *Bombardier*].

2.2.3 How are the market shares referred to in 2.2.2 above determined?

Market shares will, of course, be determined by reference to a relevant market. As noted, there are no decided cases dealing with the reviewable practice of market restriction. However, in other contexts, the Commissioner has established approaches to defining the relevant market. The Commissioner's approach to relevant market analysis in abuse of dominance cases[44] is distinct from the approach adopted by him in the *Merger Enforcement Guidelines*[45] in that in abuse cases there is a likelihood that market power may already exist, in which case prices would be expected to be higher than in a competitive market.[46] The *NutraSweet* case, while it dealt with exclusive dealing and not market restiction, established that the approach to defining the relevant market in that context was essentially the same as in the case of abuse of dominance.[47]

In defining the relevant product market, the Tribunal[48] has focussed on the extent to which the dominant firm's product can be substituted with other products. The Tribunal has looked to a number of indicia of substitutability. In *Canada (Director of Investigation and Research) v. D&B Companies of Canada*,[49] the Tribunal considered whether small changes in relative price would cause buyers to switch from one product to another.[50] Where direct evidence of switching behavior is not available, the Tribunal has examined evidence from both buyers and suppliers regarding product end uses and physical/technical characteristics, switching costs, price relationships and relative price levels, regulatory barriers affecting substitutability (for example, health regulations), and whether a distinct group of users use one product and not a related product (or service).[51] In his investigation, the Commissioner will consider whether buyers would turn to substitutes if prices were raised above competitive levels by a significant amount (generally 5%) for a non-transitory period of time (normally one year).[52] Quantitative techniques such as price correlation analysis, price elasticity analysis and diversion ratio analysis are often used when data are available.[53]

In *NutraSweet*, the Tribunal described identification of the geographic market as "an attempt to determine the extent of the territory where there is competition and in which prices for a

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[44] ADEGs, *supra,* note 6 at §3.2.
[45] Competition Bureau, *Merger Enforcement Guidelines* (Ottawa: Industry Canada, 1991) [hereinafter "MEGs"].
[46] *Canada (Director of Investigation and Research) v. Laidlaw Waste Systems* (1992), 40 C.P.R. (3d) 289 at 320 (Comp. Trib.) [hereinafter *Laidlaw*]. See also *Canada (Commissioner of Competition)* v. *Canadian Waste Services Holdings Inc.* (2001), 11 C.P.R. (4th) 425 (Comp. Trib.), at pp. 463-465.
[47] *NutraSweet*, *supra*, note 8 at 47.
[48] *Tele-Direct*, *supra*, note 7, at 34. See also ADEGs at §3.21(a).
[49] 64 C.P.R. (3d) 216 (Comp. Trib.) [hereinafter *Nielsen*].
[50] *Nielsen*, *supra*, note 50 at 241.
[51] *Nielsen*, *supra*, note 50 at 241 and *NutraSweet*, *supra*, note 8 at 10-15, and ADEGs, *supra*, note 6 at §3.2.1(a); and *cf.* MEGs, *supra*, note 46 at §3.2. The Commissioner has also provided some guidance as to its views on market definition for transactions or conduct involving intellectual property: see Competition Bureau, *Intellectual Property Enforcement Guidelines* (Ottawa: Industry Canada, 2000), §5.1. In such cases, the Commissioner is likely to define the market around one or more of the following: the intangible knowledge of know-how that constitutes the IP, processes that are based on the IP rights, or the final intermediate goods resulting from, or incorporating the IP. The Commissioner prefers to concentrate on price or output effects and therefore generally does not define markets based on research and development activity or innovation efforts alone. However, he will examine the effects of marketplace conduct on non-price dimensions of competition including innovation where relevant.
[52] ADEGs, *supra*, note 6 at §3.2.1(a). This approach was utilized by the Tribunal in both *Laidlaw* and *Nielsen*.
[53] *Ibid.*, §3.2.1(a).

product tend to uniformity."[54] An area's inclusion in the relevant geographic market depends chiefly upon whether it is "sufficiently insulated from price pressures emanating from other areas, so that its unique characteristics can result in its prices differing significantly for any period of time from those in other areas."[55] In *NutraSweet*, the Tribunal considered that 6% to 13% differences in average prices in different countries supported the determination that these countries should not be included in the same relevant geographic market as *NutraSweet*.[56]

Similar to the analysis undertaken under product market definition, the following factors may be considered: transportation costs, switching costs, price relationships and related price levels and shipment patterns.[57] Irregular provision of service is not sufficient.[58] Non-tariff regulatory barriers and foreign competition may also be significant in defining market boundaries.[59] The Commissioner also will utilize some of the quantitative techniques used in product market definition when determining the appropriate geographic market.[60]

2.2.4 Do your antitrust laws make a distinction between active and passive sales?

Active sales refer to sales that a distributor may make outside the territory where the distributor has actively promoted and sought the sale of the goods through, for example a promotional campaign or where the distributor has made a direct approach to an exclusive customer group. Passive sales refers to unsolicited requests from individual customers.

The Act makes no distinction between active and passive sales nor has this issue arisen in any of the litigated cases to date.

2.2.5 The EU Block Exemption Guidelines (paragraphs 46 and 47) refers to the use of the Internet by a distributor. Promotional material placed by distributor on the internet is clearly capable of being viewed outside the distributor's defined territory or by customers outside the exclusive defined customer group. In your jurisdiction please comment on the extent to which (if at all) the distributor's ability to advertise over the Internet could be limited. What kind of disclaimers (if any) can the manufacturer require the distributor to use?

Provided such a contractual arrangement between a manufacturer and a supplier is not found to be an anti-competitive market restriction in accordance with the approach set out under sections 2.2.1 through 2.2.3 above, a manufacturer could limit its distributor's ability to advertise its products over the Internet by agreement.

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[54] *NutraSweet*, *supra*, note 8 at 21.
[55] *Ibid.* at 20-21.
[56] *Ibid.* at 22.
[57] ADEGs, *supra*, note 6 at §3.2.1(b). See also *NutraSweet*, *supra*, note 8 at 21.
[58] *Laidlaw* at 324.
[59] For example, in *Laidlaw*, *supra*, note 47, municipal bylaws that restricted the transfer of solid waste into certain landfill sites were cited in support of a narrower market definition. See ADEGs, *supra*, note 6 at §3.2.1(b); and *cf.* MEGs, *supra*, note 46 at §3.3.
[60] ADEGs, *supra*, note 6 at §3.2.1(b).

2.2.6 Are there any restriction on cross supplies (*i.e.* on the ability of the distributors in the network to purchase from one another)?

Contractual restrictions on cross supplies amongst distributors in a network could constitute market restrictions as described above at section 2.2.1. They could also run afoul of the Act's "exclusive dealing" provision, section 77(1). For more details on this provision of the Act see section 3.1.1 below.

2.2.7 Please refer to any other exemptions that may be applicable (*i.e.* a prohibition on the distributor to sell to certain categories of end users on health and safety grounds).

As noted above at section 2.2.1 above, certain statutory exemptions to the market restriction and exclusive dealing provisions of the Act exist. These are exemptions for (i) dealings amongst affiliates,[61] and (ii) temporary arrangements designed to "facilitate entry of a new supplier of a product into a market or a new product into a market".[62]

2.3 Non-Compete Obligations or Restraints of Trade

During the term of a distribution agreement the distributor will gain an insight an understanding of the manufacturer's business and necessarily an intimate knowledge of the relevant industry. The manufacturer may therefore require the distributor to agree: not to sell goods which are competitive with the manufacture at all or subject to certain limits; and, after termination of the agreement not to make certain agreements with competitors. In some jurisdictions, these obligations may only be enforceable if can truly be said that they are necessary for protecting the know how that may have been "transferred" to the distributor during the term of the agreement. In respect of the non-compete arrangements described above (including post-termination arrangements):

2.3.1 Are non-compete obligations or restraints of trade obligations permitted under the antitrust laws of your jurisdiction and what are the conditions or circumstances in which they will be enforced?

Both common law principles and the Act have a bearing on covenants in restraint of trade. In 1894, the British House of Lords held (and thus Canadian courts were bound to hold) that contracts in restraint of trade are *prima facie* unenforceable unless they are reasonable with regard to the interests of the parties involved and the public at large.[63] While restrictive covenants may take a number of forms, a covenant in restraint of trade is "one in which a party...agrees with any other party...to restrict his liberty in the future to carry on trade with other persons not parties to the contract...".[64] The courts have held that restraint of trade may occur both vertically (as in exclusive purchasing agreements) and horizontally (as in the operation of cartels).[65]

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[61] *Competition Act*, *supra*, note 1 at §77(4) and (5).
[62] *Ibid.*, §77(4)(a).
[63] *Nordenfelt* v. *Maxim Nordenfelt Guns & Ammunitions Co., Ltd.*, [1894] A.C. 535.
[64] *Petrofina (Great Britain), Ltd.* v. *Martin*, [1966] Ch. D. 146 at 180.
[65] J.B. Dunlop, D. McQueen, and M.J. Trebilcock, *Canadian Competition Policy. A Legal and Economic Analysis* (Toronto: Canada Law Book, 1987).

Under the common law restraint of trade doctrine, the party seeking to enforce a restrictive covenant must establish that the restraint does not extend beyond what is necessary to protect that party's legitimate interest.[66] This is judged with reference to the products covered, the geographic scope of the non-compete and the time-period. Courts are far more willing to strike down restrictive agreements reached between parties enjoying unequal bargaining power than those involving parties of comparable size and financial means.[67]

The public interest branch of the restraint of trade doctrine is of less practical significance mainly because of the Canadian courts' failure to discuss explicitly the indices against which the public interest must be measured. The party challenging enforcement of the restrictive covenant bears the burden of proving that the covenant violates the public interest.[68] A violation of the criminal offences in the Act would normally suffice to establish this, but courts have held that the reviewable practices in the Act do not because such conduct is lawful until a prohibition order is issued.[69]

The courts generally will not amend the geographical scope, time horizons, or other elements of the restrictive covenant to make it more reasonable and will instead consider the whole contract unenforceable[70] or, where an element of the covenant stands as a separate and distinct provision, may strike the offensive portions of the agreement, if just and reasonable to do so.[71]

The Act's conspiracy provision, section 45, may also affect the ability of parties to enter into a non-compete covenant.

Section 45(1) of the Act contains the core of the Canadian criminal conspiracy prohibition. The section states:

> Every one who conspires, combines, agrees or arranges with another person
>
> (a) to limit unduly the facilities for transporting, producing, manufacturing, supplying, storing or dealing in any product,
>
> (b) to prevent, limit or lessen, unduly, the manufacture or production of a product or to enhance unreasonably the price thereof,
>
> (c) to prevent or lessen, unduly, competition in the production, manufacture, purchase, barter, sale, storage, rental, transportation or supply of a product, or in the price of insurance on persons or property, or
>
> (d) to otherwise restrain or injure competition unduly,

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[66] *Herbert Morris Ltd.* v. *Saxelby*, [1916] 1 A.C. 688 [hereinafter *Herbert Morris*].
[67] See, for instance, *Maguire* v. *Northland Drug Co.*, [1935] S.C.R. 412.
[68] *Herbert Morris*, *supra,* note 66.
[69] A.N. Campbell and J. W. Rowley QC, "Private Litigation Over Reviewable Practices: A Cost-Benefit Analysis – Appendix V: Common Law Causes of Action" at 205 in *Should Reviewable Practices Be Turned into Competition Torts?: A Report Prepared for The Competition Policy Group (Toronto: The Competition Policy Group, 2001)* at 211.
[70] See, for instance, *Canadian American Financial Corp. (Canada) Ltd.* v. *King and Douglas W. King Marketing Corp.* (1989), 60 D.L.R. (4th) 293 (B.C.C.A.).
[71] *Attwood* v. *Lamont*, [1920] 3 K.B. 571.

> is guilty of an indictable offence and liable to imprisonment for a term not exceeding five years or to a fine not exceeding ten million dollars or to both.[72]

Conspiracies are not *per se* illegal in Canada. Rather, the Act prohibits those conspiracies that are likely to have undue anti-competitive effects, as determined under a "partial rule of reason" analysis.[73]

Because section 45(1) creates a criminal offence, a conviction requires the Attorney General to prove beyond a reasonable doubt both the *actus reus* (illegal acts) and *mens rea* (guilty mind) of the offence. Under section 45(1)(c), the *actus reus* is established if the Crown proves beyond a reasonable doubt that: (i) the accused was a party to a conspiracy, combination, agreement or arrangement, and (ii) the conspiracy, combination, agreement or arrangement, if implemented, would likely prevent or lessen competition unduly. A finding of "undue lessening of competition" requires the Attorney General to prove that the accused both possessed market power in a relevant market and engaged in some form of behaviour which was injurious to competition within that market.[74]

In the *Nova Scotia Pharmaceutical* case, the Supreme Court of Canada held that the *mens rea* under section 45 has both a subjective and an objective element. The court ruled that, to satisfy the subjective element, the Attorney General must prove that the accused intended to enter into the agreement and had knowledge of the agreement's terms (at which point, unless there is evidence to the contrary, it is reasonable to infer that the accused intended to carry out those terms). The Attorney General meets the objective element of the *mens rea* by proving that, on an objective view of the evidence it can be inferred that a reasonable business person, presumed to be familiar with the business in which he or she engages, would or should have known that the likely effect of the agreement would be to substantially lessen competition.[75]

Thus, a covenant in restraint of trade, if it met the requirements for a criminal conspiracy set out in section 45 of the Act would not only give rise to criminal liability under the Act but would also be unenforceable under contract law by virtue of being a criminal agreement. As a practical matter, few non-compete clauses contained in distribution agreements will violate section 45 of the Act as they will have been negotiated between arm's length parties. Consequently, the party subject to the non-compete clause will typcially neogtiate the narrowest possible such clause, thus making it unlikely that any lessening of competition

[72] Conduct which violates section 45 can also lead to exposure for civil damages under 36 of the Act.

[73] *R. v. Nova Scotia Pharmaceutical Society* [1992] 2 S.C.R. 606, 93 D.L.R. (4th) 36, 43 C.P.R. (3d) 18 [hereinafter *Nova Scotia Pharmaceutical*]. The case involved an alleged conspiracy among the members of the Nova Scotia Pharmaceutical Society, who arranged to set the fees charged to private insurance companies in the province of Nova Scotia. The Society, as part of its negotiations with providers of direct-pay prescription insurance plans on behalf of member pharmacies, obtained agreement on the maximum fee that could be charged for dispensing pharmaceuticals by member pharmacies. In addition, to ensure that each insurer agreed to the maximum fee, the Society threatened boycotts and termination by the pharmacists of acceptance of individual insurer's direct-pay cards. The Society also sought uniform contracts between pharmacies and insurers.

[74] *Nova Scotia Pharmaceutical*, *supra*, note 73 at ●.

[75] *Ibid*, at 39. Note that section 45(2.2) provides that in establishing a contravention of section 45(1), the Crown must show that the parties intended to and did enter into the conspiracy, combination, agreement or arrangement. It is not necessary to prove that the parties intended that the conspiracy, combination, agreement or arrangement have any effect set out in subsection (1).

flowing from the non-compete clause would be injurious to competition in a relevant market.

2.3.2 What are the restrictions on the time periods for these restraints?

As noted in section 2.3.1 above, there are no pre-established time periods for covenants in restraint of trade. Instead, in the common law context, courts will evaluate the time-periods of the covenant sought to be enforced in light of the circumstances prevailing between the parties. If found to be unreasonably long, the time-period of a covenant in restraint of trade can of itself justify not enforcing the contract.

In the context of section 45 of the Act, the duration of the restraint is not directly relevant to its potential criminality but, because a shorter restraint may not be particulary injurious to competition, it will sometimes bear indirectly on its “undueness”.

2.4 Termination of Distributorships

Some jurisdictions have specific requirements for the termination of commercial agreements including distributorships and these requirements include minimum notice periods, which may apply, despite what may be specified the agreement. Are there any such provisions in your jurisdiction and how do they operate?

There are no specific provisions concerned with the termination of distributorships under the Act. However, as in the case of covenants in restraint of trade (see section 2.3.1 above), both the common law and part of the Act touch on this topic.

2.4.1 Refusals to Deal Under the Common Law

A supplier’s potential liability to a dealer or distributor for termination in breach of an agreement depends largely on the nature of the contract between the parties. Contracts may be written with an express termination provision, written with no termination provision, or oral (usually without any explicit termination arrangements). In each instance, the nature and content of the agreement is the starting point for analysis. The facts of each case are also important.

In the most straightforward scenario, the written contract has a clause indicating the amount of notice each party must provide the other to end the relationship. Courts generally will enforce clear written agreements in accordance with their terms. Yet, even a relatively clear-cut case can present problems. In some cases, courts find ambiguity in the contract’s termination clause. If the court finds an ambiguity it will be resolved against the writer (normally the supplier or manufacturer), especially if it is in a position of superior bargaining power. Courts have taken this approach with distributorship agreements even where the termination clause, on a fair reading, was relatively clear.[76] In such cases, courts replace the agreement’s termination clause with an implied term requiring reasonable notice.

Also, express terms specifying the notice period might not be enforced where the contracting parties’ conduct or collateral agreements indicate that different time periods should apply. This may occur, for example, where the dealer or distributor alleges that the

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[76] *Hillis Oil & Sales Limited* v. *Wynn’s Canada Ltd.* [1986] 1 S.C.R. 57.

supplier has not acted in good faith in deciding to terminate the contract. In such cases, courts may impose their own idea of what constitutes reasonable notice of termination.

If the parties operate under an oral or written contract that does not contain a notice requirement for termination, the common law will imply a term requiring the supplier to provide the dealer or distributor with "reasonable notice" of termination. The courts will determine what constitutes "reasonable notice" having regard to the circumstances between the parties.[77] Reasonable notice is required, among other reasons, to give the dealer or distributor time to obtain an alternative supply of goods or otherwise re-arrange its affairs to adapt to the changed circumstances.

Examination of the cases decided to date produces a list of major and minor factors that courts typically consider in defining the reasonable notice period.

In determining the length of notice required, courts commonly are most influenced by the following: (i) the length of the parties' relationship; (ii) whether the arrangement is exclusive, including whether the dealer or distributor sells products of competing suppliers; (iii) the percentage of the distributor's total sales or income represented by the supplier; (iv) the extent of the distributor's investment in inventory and sales force, and (v) the time needed to replace the product line or otherwise re-establish a viable business.[78]

Accordingly, suppliers should expect courts to demand longer notice periods where parties have a long-standing, exclusive arrangement representing a significant portion of distributor's total business.

In addition to the above, courts will frequently consider: (i) the established practice in the particular business or trade, including examination of the notice period generally included in similar businesses' agreements; (ii) the distributor's efforts expended and results achieved for the supplier; (iii) the timing of the termination, including whether the supplier chooses to end the relationship during the distributor's peak season; (iv) whether the supplier had recently expressed satisfaction with the distributor or indicated an interest in continuing the relationship; (v) whether the supplier's products are relatively well-known (as it is presumed that well-known products require less promotional efforts and therefore shorter notice to terminate), and (vi) nuances of the individual market.[79]

Generally, no single factor will dictate the notice period's length. Instead, courts weigh competing factors in light of the overall business context to decide what is reasonable for those particular parties. For example, as little as two months notice could be reasonable where the parties had only a two-year relationship, and the distributor acquired no inventory under the agreement's terms. Conversely, the court might require substantially longer notice to end a forty year-old exclusive distributorship, where the supplier's products represent a significant portion of the distributor's sales. Courts very rarely will require more than 12 months notice in all but the most egregious circumstances.

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[77] *Western Equipment Ltd. and W.E.L. Industrial Sales Ltd.* v. *A.W. Chesterton Company*, *Chesco Inc.* and *A.W. Chesterton Company Limited* (1983), 46 B.C.L.R. 64.

[78] *Yamaha Canada Music Limited* v. *MacDonald and Oryall Limited* (1990), 46 B.C.L.R. (2d) 363 (C.A.); *Marbry Distributors Ltd*. v. *Avrecan International Inc*. (1999), 67 B.C.L.R. (3d) 102 (B.C.C.A.).

[79] For example, courts recognise that contracts in the furniture trade take longer to negotiate; thus, a longer notice period may be needed to terminate a furniture dealership agreement.

2.4.2 Refusals to Deal Under the Act

In terms of the Act's bearing on the termination of a distribution contract, unlike most jurisdictions, Canada has a stand-alone refusal to deal provision in its antitrust laws which could affect the ability of a supplier to sever its relationship with its distributor.[80] The Commissioner may investigate and apply to the Tribunal make an order to supply on usual trade terms (*i.e.* the Tribunal may order a supplier to accept a person as its customer). A refusal to deal is a non-criminal reviewable practice with four basic elements:[81] (1) the purchaser's business must be "substantially affected" by its inability to source a product anytwhere in a market; (2) this inability must result from "insufficient competition" among suppliers; (3) the purchaser must be willing to meet "usual trade terms"[82]; and (4) the product must be "in ample supply". It is important to note that the refusal to deal provision does not contain the "substantial lessening of competition" test which appears in virtually all of the other reviewable practices.

If these four factors are proved by the Commissioner, the Tribunal "may" order a supplier to sell to the customer on usual trade terms. The third and fourth elements are readily satisfied in most situations. However, the other two merit further elaboration. Two cases, *Canada (Director of Investigation and Research)* v. *Chrysler Canada Ltd.*[83] and *Canada* (*Director of Investigation and Research)* v. *Xerox Canada Inc.*[84]*,* provide useful illustrations of these elements. In both cases, the suppliers were ordered to sell replacement parts to customers. In *Xerox*, the customer was also a competitor in the repair and service of photocopiers.

The person refused supply must be "substantially affected" or "precluded from carrying on business".[85] The Tribunal has stated that the word "substantial" "should be given its ordinary meaning, which means more than something just beyond *de minimis*" and that "important" is an "acceptable synonym".[86] This analysis will tend to focus on the customer's sales and profits and, in particular, on the impact on the customer's sales and profits as a result of the refusal to supply. In *Chrysler*, the complainant's overall sales had actually increased after Chrysler had refused to supply its automobile parts. The increase, however, was due to the sale of non-Chrysler parts. The Tribunal focussed on the specific area of the complainant's business that had been affected by the refusal to deal: the complainant's profits from the resale of Chrysler parts.[87] Also, substantial effects on a business must result

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[80] Note that refusals to deal may also fall under the Act's conspiracy provisions in the case of group boycotts (§45) and, in certain fact situations, the Act's sections on price maintenance (§61(1)(b)), tied selling (§77(2)), exclusive dealing (§77(2)), or abuse of dominance (§79). The Act also contains a provision concerning refusals to supply by foreign suppliers which allows the Tribunal to order the Canadian purchaser of a foreign supplier's products whose exercise of buyer power over the foreign supplier has caused the foreign supplier to refuse to supply another customer in Canada to (i) supply the customer who has been refused supply or (ii) from dealing in the foreign supplier's products at all (§84).

[81] *Competition Act, supra,* note 1 at §75(1).

[82] Trade terms are defined to include payment terms, units of purchase and "reasonable technical and servicing requirements", *Competition Act, supra,* note 1 at §75(3).

[83] (1989), 27 C.P.R. (3d) 1 (Comp. Trib.), aff'd (1991), 38 C.P.R. (3d) 25 (Fed. C.A.), aff'd (1992), 138 N.R. 319 (note) (S.C.C.) [hereinafter *Chrysler*];

[84] (1990), 33 C.P.R. (3d) 83 (Competition Tribunal) [hereinafter *Xerox*].

[85] *Competition Act, supra,* note 1 at §75(1)(a).

[86] *Chrysler*, *supra,* note 83 at 23.

[87] *Ibid.,* at 20-21.

from "inability to obtain adequate supplies of a product anywhere in a market on usual trade terms"[88] because of "insufficient competition among suppliers of the product in the market".[89] If the refusal to supply is instead based on efficient reorganization of a distribution system or some other rational business justification, a necessary element of this reviewable practice will be missing. However, the Tribunal will want concrete evidence in support of such claims; economic theory alone will not suffice.[90]

Definition of the relevant product and geographic market is distinctive in refusal to supply cases. In *Chrysler*, the Tribunal decided that "the starting point for the definition of "product" under section 75 is the buyer's customers".[91] This approach ultimately led the Tribunal to conclude that the branded proprietary parts of a single original equipment manufacturer constituted the relevant market. The same conclusion was reached in the *Xerox* case a year later.[92]

The Act contains a specific provision dealing with market definition for branded products:

> For the purposes of this section, an article is not a separate product in a market only because it is differentiated from other articles in its class by a trade-mark, proprietary name or the like, unless the article so differentiated occupies such a dominant position in that market as to substantially affect the ability of a person to carry on business in that class of articles unless that person has access to the article so differentiated.[93]

This awkwardly worded section was interpreted very literally in *Chrysler*: it does not provide a complete framework for assessing whether a branded item constitutes a distinct relevant product market, but merely describes the limited conditions under which such a finding can be based solely on the existence of the trademark or proprietary name.[94]

The definition of the relevant product and geographic markets obviously has a significant impact on the assessment of the extent to which competition exists among suppliers of the product. Once proprietary branded parts were identified as the relevant product markets in *Chrysler* and *Xerox*, for example, there was virtually no effective competition to be found.

The Commissioner's complaint in the *Chrysler* case was brought on behalf of Ralph Brunet, the operator of an auto parts export business located in Montreal. Brunet sold Chrysler and other brands of auto parts to after market customers in various countries outside of North America. In October 1986 the Chrysler organization took various steps to channel Brunet's orders to Chrysler US rather than Chrysler Canada.[95]

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88 *Competition Act, supra,* note 1 at §75(1)(a).
89 *Competition Act, supra,* note 1 at §75(1)(b).
90 Efficiency explanations offered by expert economists were given short shrift by the Tribunal in both *Chrysler, supra,* note 83 at 12-17 and 26 and *Xerox, supra,* note 84 at 113-114.
91 *Chrysler*, *supra,* note 83 at 10.
92 *Xerox, supra,* note 84 at 103-116.
93 *Competition Act, supra,* note 1 at §75(2).
94 *Chrysler, supra,* note 83 at 10-11.
95 In economic terms, there was not really a refusal to supply at all. One economic entity - the Chrysler organization - simply altered the prices and conditions of sale to one customer in order to put him on a level playing field with other US-based distributors of parts to export markets. This point was made by the economic expert who testified in Chrysler's defence (see Exhibit 29: *Report Prepared by R. A. Winter,* June 20, 1989, pp. 12-13, paras. IV.A.2-4). The

The Tribunal concluded that the relevant product market was Chrysler auto parts (both "captive" and "competitive"[96]) and that the relevant geographic market was Canada.[97] Based on these findings, it was easy to hold that the required elements in section 75 of the Act were satisfied: Brunet's business appeared to be substantially affected by his inability to obtain adequate supplies of Chrysler auto parts in Canada on usual trade terms; the inability resulted from insufficient competition among suppliers of Chrysler auto parts in Canada (Chrysler Canada being the only effective supplier[98] — at least for captive parts); Brunet was willing to meet usual trade terms; and the parts were in ample supply. The Tribunal properly recognized that it had discretion to make a remedial order ("may", not "shall", is the Act's language) once the foregoing elements were established. It decided to exercise its discretion in favour of Brunet after considering:

> The Tribunal accepts that Chrysler or Chrysler Canada does not occupy a very strong market position in the automobile industry (even though, as might be expected, it is in a very strong position with respect to the distribution of its products) and that it may have legitimate business interests that it is trying to protect. Weighing against this consideration is the long relationship between Brunet and Chrysler Canada, the manner in which sales to Brunet were terminated, and the fact that the respondent has not made any effort to establish that the granting of an order by the Tribunal would prejudice it in any way.[99]

The concluding sentence suggests that a reversal of the onus onto the supplier will occur once this stage of the analysis is reached. There is no obvious reason for such a reversal, nor was any justification for it provided by the Tribunal.

The Director's complaint in *Xerox* was brought on behalf of Exdos Corporation, an independent service organization ("ISO") involved in refurbishing copiers and providing service for Xerox machines. Exdos and other ISO's competed directly against Xerox in the servicing of copiers until 1988 when Xerox Canada adopted a policy of supplying parts for post-1983 copiers only to the end users of such machines. The Canadian decision was part of a general worldwide policy shift by the Xerox organization. There was little dispute that Exdos was substantially affected by Xerox's refusal to supply; it was willing to meet usual trade terms; and post-1983 copier parts were not in short supply. Thus once the Tribunal determined that post-1983 Xerox parts were the relevant product market, it was quick to conclude that Exdos' inability to obtain supply resulted "because of insufficient competition" in the market.[100] Unlike *Chrysler*, there was no explicit consideration of

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Tribunal ignored the point, perhaps because it viewed the separate legal status of Chrysler Canada to be determinative for purposes of the *Competition Act.*

96 "Captive" parts were available only from Chrysler (*e.g.* various sheet metal parts and interior mouldings), in contrast to "competitive" parts which were available from other independent automotive parts manufacturers as well (*e.g.* shock absorbers and fan belts).

97 *Chrysler, supra,* note 83 at 10-17.

98 Since Chrysler Canada dealers could not supply Brunet except surreptitiously, they were "inferior sources of supply"; *ibid.* at 23.

99 *Ibid.*, at 27.

100 See *Xerox, supra,* note 85 at 103-116. The Tribunal did, however, exclude parts for Xerox's new 50 Series Copiers from its order because such parts had never been supplied to ISO's. The relevant geographic market was assumed by all parties to be Canada: *ibid.* at 103.

whether the Tribunal should decline to exercise its discretion to make a remedial order once the various elements of section 75 were proven.[101]

In the more recent *Warner Music*[102] case, the Competition Tribunal decisively ruled that the refusal to deal provisions of the *Competition Act* cannot be used to compel the holder of a copyright to grant a license. Canada's *Warner Music* case contrasts sharply with the *Kodak* decision[103] which significantly limited the availability of intellectual property-related defences in refusal to deal cases in the United States.

2.4.3 Refusals to Deal Involving Intellectual Property

The *Warner Music* case arose from a complaint to the Commissioner by BMG Direct Ltd. ("BMG"), a direct-mail record club. BMG's main competitor in Canada was the Columbia House Company record club, an established player in the Canadian market. Columbia House was an equal partnership of Warner Music Canada Ltd. ("Warner") and Sony Music Entertainment (Canada) Inc. The Warner and Sony organizations had each granted master recording licenses to Columbia House. However, both refused to license BMG in Canada. BMG took the position that Warner was refusing to deal contrary to section 75 of the Act and that Warner's repertoire was so large that BMG's business was "substantially affected" as a result. It was an undisputed fact that BMG could obtain an ample supply of Warner records (*i.e.* finished goods) at the wholesale level. However, wholesale prices were too high to enable BMG to compete with Columbia House in the direct-mail business. To compete effectively, BMG claimed it needed the cost savings that would flow from manufacturing the recordings itself under license from Warner.

The fundamental problem underlying the Commissioner's application in this case lay in the conflict between the allegedly improper refusal to deal and the central concepts upon which copyright is founded. Section 3 of the Canadian *Copyright Act*[104] defines copyright in a work as "the sole right to produce or reproduce the work or any substantial part thereof in any material form whatsoever." Accordingly, as a matter of basic Canadian copyright law, Warner was entitled to refuse to license its master recordings to BMG. The Tribunal accepted Warner's argument that the section 75 requirements that there be an "ample supply" of the product and that the complainant be unable to obtain "adequate supplies" are fundamentally inconsistent with the basic premise of copyright. The Tribunal concluded that the unilateral refusal to grant copyright licenses was not anti-competitive:

> the right granted by Parliament to exclude others is fundamental to intellectual property rights and cannot be considered to be anti-competitive, and there is nothing in the legislative history of section 75 of the Act which would reveal an intention to have section 75 operate as a compulsory licensing provision for intellectual property.[105]

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[101] See I*bid.,* at 127: "...the tribunal finds that all the requirements of §75 have been met. Therefore an order will issue...".

[102] (1997), 78 C.P.R. (3d) 321 (Comp. Trib.) [hereinafter *Warner Music*].

[103] *Eastman Kodak Co.* v. *Image Technical Services Inc.,* 1997-2 Trade Cas. (CCH) ¶ 71,908 (1997).

[104] R.S.C. 1985, ch. C-42, as amended. While there are certain discreet compulsory licensing regimes in the *Copyright Act*, such as the distant signal retransmission regime set up in Section 31, there were no compulsory licensing provisions in that legislation which affected Warner's master recording licenses.

[105] *Warner Music*, *supra,* note 102 at 333.

A similar decision was reached in the *Tele-Direct* case with respect to trademarks and the Act's abuse of dominant position provision, section 79. In that case, the Tribunal held that Tele-Direct's refusal to allow competitors to use its trademarks was not an anti-competitive act: "Inherent in the very nature of the right to license a trade-mark is the right for the owner of the trade-mark to determine whether or not, and to whom, to grant a licence; selectivity in licensing is fundamental to the rationale behind protecting trade-marks."[106] The refusal to license was protected from being deemed an anti-competitive act by section 79(5) of the Act.[107]

Thus, suppliers in Canada do not have an unfettered right, either under the common law or under the Act, to terminate distributors but must exercise prudence when seeking to end distribution arrangements. The broader rights afforded "suppliers" of intellectual property, as set out in *Warner Music* are a narrow qualification to the general thrust of the law in this regard.

3. ANTITRUST ISSUES IN SPECIFIC COMMERCIAL RELATIONSHIPS – FRANCHISING, SELECTIVE DISTRIBUTION AND AGENCY AGREEMENTS

3.1 Franchising

Franchising is a business model, which essentially involves the following components:

- *the licensing of a business system or business concept;*
- *which is controlled by the franchisor; and*
- *is under a well known brand(s);*
- *is licensed for a fee or royalty; and*
- *the franchisor provides some technical assistance in return.*

Accordingly the franchise business relationship contains a number of vertical restrictions commonly found in distribution agreements. These specifically include:

- *requirements to stock only the franchisor's branded products (and not competitive products);*
- *requirements to stock only certain types of products (such as for example carbonated beverages but not alcohol);*
- *to prepare products strictly in accordance with directions of the franchisor including requirements to buy products from certain suppliers directed by the franchisor;*
- *not to conduct any business operation, which competes with the business system, licensed by the franchisor.*

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[106] *Tele-Direct*, *supra*, note 48 at 32.
[107] It is interesting to note that in *Warner Music,* the Tribunal also ruled that the inclusion of copyright licenses within the scope of "product" for section 75 would be inconsistent with the operation of section 79(5) of the Act. *Warner Music*, *supra*, note 102 at 333.

3.1.1 Please comment on how the antitrust laws of your jurisdiction deal with these restrictions (and any others you may care to nominate which may arise in the context of a franchise); and

Franchise arrangements chiefly implicate the Act's "exclusive dealing" and "tied selling" provisions (section 77(2)) and, because of the territorial limitations frequently placed on franchisees, the "market restriction" provision (section 77(3)). As the market restriction provisions of the Act were addressed in connection with territorial and customer-related restrictions at sections 2.2.1 through 2.2.7 above, this section will focus on exclusive dealing and tied selling issues.

Exclusive dealing exists when a supplier requires or induces a customer to deal exclusively or primarily in products which it supplies or designates or "requires or induces a customer to refrain from dealing in a specified class or kind of product except as supplied by the supplier or his nominee". The definition is fairly broad because any offer to supply a product on terms or conditions which are more favourable than normal will constitute an inducement. The traditional economic argument against exclusive dealing arrangements is that they foreclose the manufacturer's competitors from access to downstream distribution channels.[108] Like market restriction, exclusive dealing is a non-criminal practice that is reviewable by the Tribunal. These vertical agreements and practices are frequently encountered in contracts between manufacturers and their dealers or distributors, as well as in franchise systems.

Under the definitions set out in section 77(1) of the Act, the exclusive dealing conduct must have been part of a "practice" employed by the supplier.[109] Consequently, an isolated incident of exclusive dealing will not attract the attention of the Commissioner. In addition, the Commissioner must also establish (1) that a likely impediment to entry into, or expansion of, a firm or product into a given market or "any other exclusionary effect in a market" [110] results (2) "because [the exclusive conduct] is engaged in by a major supplier of a product in a market or because it is widespread in a market," (3) and that a substantial lessening of competition results from such exclusionary conduct.[111]

Tied selling is a vertical restraint similar to exclusive dealing. For tied selling to exist, the supplier must have a practice of making the supply of his goods conditional on the customer's agreement either to purchase another product from the supplier or his nominee, or refrain from using or distributing another product not manufactured or designated by the supplier in conjunction with the first product — a not infrequent element of many franchise arrangments. Because both tied selling and exclusive dealing are set out in the same section of the Act, the substantive requirements that the Commissioner needs to prove in alleged cases of tied selling are identical to those for exclusive dealing.

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[108] "The Law and Economics of Vertical Restraints," in F. Mathewson, M. Trebilcock and M. Walker (eds.), *The Law of Economics of Competition Policy* (Vancouver: Fraser Institute, 1990), pp. 127-136.
[109] As it must in the case of the reviewable practice of market restriction; see section 2.2.1 above.
[110] *Competition Act*, *supra*, note 1 at §77(2)(a)-(b).
[111] *Ibid.,* §77(2); in *Bombardier*, *supra*, note 43, the Restrictive Trade Practices Commission (a predecessor of the Tribunal) found that Bombardier was a major supplier at the manufacturing level of the snowmobile industry on the basis of a 30% market share plus its record of innovation; at the distribution level on the basis of provincial market shares between 40-60% and a "strong organization"; and at the retail level on the basis of a large number of strong dealers.

3.1.2 Please comment on how these restriction may be justifiable – These restrictions can be justified on the commercial basis that they are necessary for the maintenance of the common identity and reputation of the franchise network and also in relation to post termination non compete obligations, for the protection of the know how in the franchise system belonging to the franchisor.

For an exclusive dealing, tied selling or a market restriction arrangement to constitute prohibited reviewable practices, the Commissioner will need to prove that the exclusionary effects are likely to result in a substantial lessening of competition in a relevant market (as noted above in connection with market restrictions at section 3.1.1). If sufficient inter-brand or inter-franchise competition exists in the marketplace, the franchisors employing exclusive dealing, tied-selling or market restrictions arrangements would have difficulty exercising market power and thus there will be no basis for review by the Commissioner nor for a remedial order by the Tribunal.

Each of the reviewable practices of exclusive dealing and tied selling have two main defences. Exclusive dealing may be undertaken for a "reasonable period of time" to "facilitate" the entry of a "new" supplier or product into a market.[112] The word "new" and the absence of any reference to "expansion" clearly suggest that only true *de novo* entry initiatives are covered by this defence. The Tribunal has wide discretion in determining what time period will qualify as reasonable in any particular situation. Likewise, tied selling may be undertaken where such an arrangment is reasonable having regard to the technological relationship between the tied and the tying products.[113] Finally, both exclusive dealing or tied selling among affiliates is immune from review.[114]

3.2 Selective Distribution

Selective distribution is a business model, which essentially involves the following components:

- *the supplier selects his customers*
- *in closed systems, customers are required to buy and to sell only within the network, ie. To the supplier or to other authorized customers.*

Accordingly selective distribution systems contain a number of vertical restrictions. These specifically include:

- *refusal to sell to dealers that have not been selected for the system;*
- *in closed systems, requirement not to trade out of the system; and*
- *minimum volume purchase requirements.*

[112] *Ibid*., at §77(4)(a).
[113] *Ibid*., at §77(4)(b).
[114] *Ibid*., at §77(4).

3.2.1 Please comment on how the antitrust laws of your jurisdiction deal with these restrictions (and any others you may care to nominate which may arise in the context of a selective distribution systems).

There is generally nothing problematic under the Act in a supplier selecting particular customers to which it will sell. The Commissoner has, however, taken the view in the *Warner Music* case discussed above at section 2.4.3 that a supplier may be liable to a remedial order under the Act's "refusal to deal" provision (section 75) even where no prior supplier-customer relationship existed but the Tribunal did not rule on this point.

Contractual restrictions which purport to limit the customers to which a distributor may re-sell could run afoul of the Act's "market restiction" provisions, as described in sections 2.2.1 through 2.2.7 above. Likewise, refusals by a dealer to re-sell to dealers outside of the system could implicate the refusal to deal (section 75) provision as set out in section 2.4.2 above.

3.2.2 Please comment on how these restrictions may be justifiable – these restrictions can be justified on the commercial basis that they are necessary for the maintenance of the common identity and reputation of the network and the image of the brand or because of technical requirements involving distribution of the particular products (*e.g.* Guaranty, post-sale service, etc). To what extent are these justifications applicable under the antitrust laws of your jurisdiction?

As both the reviewable practices of exclusive dealing and market restriction require a substantial lessening of competition be proven, to the extent that the effect of such arrangements on competition is minimal or non-existant, they will be permitted under the Act.

Factors such as the maintenance of common identity, technical requirements *etc.* generally will not justify anti-competitive selective distribution arrangements under the Act (see above at sections 2.2.1 and 3.1.1).

4. AGENCY

Agency is a business model, which essentially involves the following components:

- *the agent agrees to promote the principal's goods;*
- *the goods may be manufactured or simply distributed by the principal;*
- *the agent usually does not run the risk of the transaction; and*
- *the agent receives a consideration, usually in the form of commission on volume of sales.*

Accordingly the agency relationship contains a few vertical restrictions. These specifically include:

- *non-competition provision during or after the agency agreement is in force; and*
- *to promote the products strictly in accordance with directions of the principal.*

4.1 Please comment on how the antitrust laws of your jurisdiction deal with these restrictions (and any others you may care to nominate which may arise in the context of agency); are there any requirements on how the supplier should establish his criteria and how should they apply them so that they are not discriminatory?

The comments provided above in connection with covenants in restraint of trade (section 2.3) apply in the context of agency arrangements as well: the scope and duration of the non-compete provision in an agency arrangement must be reasonable having regard to all the circumstances between the parties or a court will rule the contract unenforceable.

Finally, it is worth noting that under the Act's consignment selling provision a seller which "ordinarily sells the product for resale," may not use a "practice" of consignment selling "for the purpose of" controling the price that the product is sold by a dealer in the product or for discriminating between consignees and other purchasers or between different consignees. [115] There is no "substantial lessening of competition" test connected with this reviewable practice and it seems to be designed as an anti-avoidance provision to prevent a supplier from circumventing the Act's price maintenance[116] and price discrimination[117] provisions since these provisions respectively exempt their application to agency relationships or require a discriminatory *sale*. Section 76 does not, however, prohibit the *establishment* of a business on a consignment basis as it relates only to a supplier "ordinarily sells the product for resale." As a practical matter, the Act's consignment selling provision is narrow in scope and there have been no cases decided on it since it was introduced.

4.2 Please comment on how these restrictions may be justifiable – these restrictions can be justified on the basis of the need to distribute those products through distributors that can provide a good image to protect the brand or who have the technical skills involved with post-sale service for the products. To what extent are these justifications applicable under the antitrust laws of your jurisdiction?

As with selective distribution arrangements, factors such as the need to project a good image to protect the brand or the need agents with technical expertise for post-sale service generally will not justify anti-competitive agency arrangements under the Act.

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[115] *Ibid.*, *supra*, note 1 §76.
[116] *Ibid.,* at §61(1).
[117] *Ibid.*, at §50(1).

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