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Competition Law Now Gives Manufacturers, Distributors Latitude When It Comes to Setting Prices

by H. Todd Greenbloom
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Todd Greenbloom is a partner in Blaney McMurtry's corporate/commercial group. His active general business law practice intersects with a host of competition and restrictive trade practices issues. Todd is a recognized authority on all aspects of franchising and licensing. His clients come from a wide variety of industries, including restaurants, food service, hospitality, recreation, trade shows, retailing, manufacturing, advertising and service.

Todd may be reached directly at 416.593.3931 or tgreenbloom@blaney.com.

Tim Hortons' desire to serve fresher donuts and Timbits gives us a fresh look at how manufacturers can establish pricing and stay within the bounds of the new Competition Act.

Before March 2009, the Competition Act provided rules to keep manufacturers and distributors, whether alone or together with others, from increasing prices to the public artificially. In March 2009, the Competition Act was changed to give manufacturers and distributors more flexibility in setting prices while still maintaining restrictions on a manufacturer acting alone or with others.

Under the old version of the Competition Act, there were two restrictions:

(i) section 61, which prohibited persons engaged in producing or supplying a product from attempting to influence upward, or discouraging reductions in, the price at which another person could offer products for sale, whether the influencing was by agreement, threat or promise; and

(ii) conspiring with another person to enhance unreasonably the price of a product.

Under the new version of the Competition Act, the two restrictions are:

(i) a person cannot abuse a dominant position, and

(ii) a person cannot conspire with a competitor to fix, maintain, increase or control the price for the supply of a product.

In addition, under the current version of the Competition Act, an aggrieved person can apply to have the Competition Tribunal look into a person who has, by agreement, threat or promise, allegedly influenced upward, or discouraged the reduction of, a retail price. (This is similar to the Act's old price-maintenance provisions, but it decriminalizes the offence and requires that there be an adverse effect on competition in a market).

Fairview Donut Inc. v the TDL Group Corp. is a recent case which shows how these sections apply under the old and new versions of the Competition Act.

At one point in time, Tim Hortons' franchisees baked their donuts from scratch. Tim Hortons saw a number of difficulties with this methodology. There were concerns about having a sufficient number of trained bakers available, for example, and about the freshness of the product versus the amount of waste.

The solution Tim Hortons came up with was to eliminate "scratch baking" and replace it with supplying partially-frozen baked goods that could be completed on the franchisee's premises. This new method, par baked goods, ensured product consistency across the system and allowed for fresher goods, as it would be easier to meet any store's particular demand requirements.

In order to implement this new method of baking, Tim Hortons entered into a joint venture with an Irish bakery with expertise in par baked goods. The par baked goods were then delivered to a joint venture between Tim Hortons and the Irish baker at a predetermined price for each donut. The joint venture then sold the donuts to the ultimate distributor, who added its own markup.

The franchisees complained and sought relief on the basis of the price-influencing and conspiracy sections of the old version of the Competition Act mentioned above and the conspiracy section of the new version of the Competition Act.(The events in question straddled both versions of the Act.)

Ultimately the franchisees lost on all arguments, but the case illustrates how the same set of circumstances will be viewed with the new version of the Competition Act.

First, it should be observed that the franchisees did not attempt to use the abuse-of-dominant- position provisions in the new version of the Competition Act. This was likely an acknowledgment of the inherent difficulties, which include having to establish that there is a significant anti-competitive effect.

In giving his reasons for rejecting the retail price maintenance claim, Mr. Justice George R. Strathy of the Ontario Superior Court of Justice made it clear that manufacturers and distributors are entitled to make profits. It was made clear that the Competition Act is concerned with the impact on pricing to the public and not with the allocation of profits between the various parties in the supply chain. The amendments to the Competition Act, such as the removal of the offences related to price maintenance, were enacted to promote innovative pricing programs and increase certainty for Canadian businesses.

The conspiracy sections of the older version of the Competition Act required the following:

(i) a conspiracy with another person,

(ii) an unreasonable enhancement of the price,

(iii) a subjective intent to put the agreement into effect, and

(iv) an objective intent to lessen competition unduly.

The franchisees argued that they met these tests on the basis that the agreement with the Irish baker [test (i)] imposed an unreasonably high price on the sale of the products to the distributor; that this resulted in unreasonably high prices to the franchisees that were above market prices [test (ii)], and that the agreement was put in place with the intent of enhancing the price and making the franchisees less profitable [tests (iii) and (iv)].

Mr. Justice Strathy rejected the franchisees' claim on the basis that the mark-up did not enhance the price, but reallocated profit. He concluded that it is not reasonable that a higher price for inputs would reduce competition, especially when the franchisees could sell donuts to the public at whatever price they wanted and, given that the quick service restaurant business is highly competitive, there was no lessening of competition.

The new version of the Competition Act could arguably make it easier for the franchisees to establish their case. Under the new version, the test is not just enhancing unreasonably the price, but fixing, maintaining and controlling the price, as well as increasing the price. Furthermore, the price does not necessarily have to be enhanced unreasonably.

That being said, the new version of the Competition Act requires that the "conspiracy" must be not just between any two people but between competitors, where a competitor is a person who it is reasonable to believe would be likely to compete with respect to the product in the absence of a conspiracy. Furthermore under the new version, there is no conspiracy if it can be established that the agreement was part of a broader or separate agreement, where the broader or separate agreement, when considered alone, does not breach the section.

Mr. Justice Strathy determined that if not for the arrangement with Tim Hortons, the Irish baker would not have come to Canada. For that reason alone, the Irish baker was not a competitor and so the conspiracy sections would not apply. As added commentary, he noted that the agreement with the Irish baker was part of

a broader arrangement for a legitimate business purpose, and on that basis the conspiracy sections also would not apply.

The Tim Horton's case illustrates the flexibility that might be accorded to manufacturers and distributors in setting prices. Caution must still be exercised in setting prices, but there is now more room for creativity, so long as the pricing structure is not an agreement with a competitor, especially if the agreement carves up a market or controls the price of supply. ■