



Dominant firms can have loyalty and rebate programs that encourage exclusivity, Tribunal rules

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Bibby, a division of Canada Pipe, dominates the market for cast iron drain, waste and vent pipes. Its rebate program encourages its customers to stock its products exclusively. But Bibby's rebate program is not anti-competitive, and thus Bibby did not abuse its dominant position, the Competition Tribunal ruled in a decision released in February, 2005.¹

The case is important because it provides guidance on how a company with high market shares can structure loyalty and rebate programs without falling afoul of the *Competition Act's* abuse of dominance provisions.

Bibby's loyalty program

Bibby manufactures cast iron drain, waste and vent pipes for use in buildings. It markets most of its products through distributors. Distributors who stock Bibby products exclusively and purchase a minimum amount pay a *much* lower price than non-exclusive distributors (in one example, 40% lower) and also receive quarterly rebates under Bibby's "Stocking Distributor Program".

Bibby's market share is between 80-90%. The only other manufacturer of cast iron drain, waste and vent pipes in Canada, Vandem Industries, was founded in 1997 and has a much smaller market share. It complained to the Competition Bureau that Bibby was abusing its dominant position through its Stocking Distributor Program.

Abuse of dominant position

Section 79 of the *Competition Act* allows the Tribunal to make a remedial order where (1) a firm

"substantially or completely controls" a market (dominance), and (2) engages in a practice of anti-competitive acts, which (3) substantially lessens or prevents competition or is likely to do so.

Bibby dominates the market

Market definition was the major issue before the Tribunal on the dominance element. The Tribunal rejected Bibby's argument that cast iron drain pipes compete with drain pipes made from other materials, such as plastic. Although plastic pipes are increasingly being used by the construction industry, there are important applications, such as tall buildings, for which only cast iron pipes are suitable. The Tribunal thus defined the relevant product market as cast iron drain, waste and vent products.

The Tribunal found that Bibby has market power because its prices and margins are higher in markets where it does not face competition than in markets where Vandem competes with it. Moreover, Bibby's very high market share leads to a *prima facie* conclusion that Bibby has market power.

In this case, there was evidence of entry by Vandem, as well as import competition, which, argued Bibby, rebutted the evidence of market power.² The Tribunal noted that Vandem's entry has yet to be shown to be viable; entry to date has been limited; the market for cast iron drain, waste and vent products is mature and not growing; and Bibby's wide range of products and national presence give it an incumbent advantage. The Tribunal thus concluded that Bibby has market power.

Stocking Distributor Program Not Anti-Competitive

In past cases, distribution arrangements that promote exclusivity have been found to be anti-competitive when engaged in by a dominant firm.

Bibby's Stocking Distributor Program operates as an inducement to exclusive dealing, the Tribunal found. However, several of its key features led the Tribunal to conclude that it is not anti-competitive:

- The terms of the program are clear and transparent. The program operates on a calendar year basis, and distributors renew their commitment to it on a quarterly basis.
- There are no contractual constraints preventing distributors from terminating their participation in the program.
- There are no heavy penalties for leaving the program. Distributors that leave the program do not have to pay back the discounts they obtained. At worst, they may not receive the rebate for purchases already made.

The Tribunal distinguished these features from practices that have in the past been declared "anti-competitive" by the Tribunal. Bibby's program lacked the offensive characteristics found in past cases.

The Tribunal found that although the discounts and rebates are attractive to distributors, and a distributor would weigh them carefully before leaving the program, it did not impose significant "switching costs" on distributors. Indeed, some distributors did leave the program in order to stock competing products. Consequently, the Tribunal found, the Stocking Distributor Program does not have an exclusionary effect and is not anti-competitive.

Bibby had a reasonable business justification for the Stocking Distributor Program, the Tribunal also found. The program kept Bibby's volumes of its standard products high enough that it could offer a complete array of "exotic", or specialized, cast iron fittings.

Finally, the Tribunal found that Bibby's Stock Distributor Program has not lessened or prevented competition substantially.

The Tribunal also analyzed the Stock Distributor Program under the *Competition Act's* exclusive dealing provision (s. 77). It found that the program does constitute exclusive dealing. But since the program does not have an exclusionary effect, and is not likely to impede entry, it has not substantially lessened competition, the Tribunal found.

Conclusion: dominant firms can have loyalty and rebate programs that encourage exclusivity

The *Canada Pipe* decision likely does not change the law on abuse of dominance. Rather, after a string of cases that explored what makes conduct anti-competitive, this case offers guidance on how dominant firm might structure a loyalty or rebate program that encourages exclusivity to avoid it being labelled anti-competitive.

In past cases, long term exclusive contracts, particularly those featuring punitive termination provisions, evergreen clauses, or staggered renewal dates, have been found to raise barriers to entry and impede competition. Other inducements to exclusivity such as right of first refusal clauses, most favoured nation clauses, and negative option pricing clauses have been labelled anti-competitive. Sham litigation, a pattern of anti-competitive acquisitions, predatory pricing, and refusal to deal may also constitute a pattern of anti-competitive acts.³

By contrast, Bibby's Stock Distributor Program was implemented for a reasonable – and not anti-competitive – business purpose; it is open and transparent and does not force distributors to deal exclusively in Bibby products through long term contracts or punitive termination provisions. Rather, distributors are free to leave the program at virtually any time without significant penalties.

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1 *Canada (Commissioner of Competition) v. Canada Pipe Company Ltd.*, 2005 Comp. Trib. 3, available online at http://www.ct-cc.gc.ca/CMFiles/CT-2002-006_0079b_45PWA-2142005-2029.pdf?windowSize=popup

2 Dominance is not possible where barriers to entry are low, because any attempt to exercise market power would lead to immediate entry. *Canada (Director of Investigation and Research) v. Tele-Direct (Publications) Inc.*, [1997] C.C.T.D. No. 8 at ¶232. The Tribunal's treatment of barriers to entry in *Canada Pipe* diverges somewhat from the principle enunciated in *Tele-Direct*. In *Canada Pipe* the Tribunal appears to have considered the evidence that suggested that barriers to entry were low as just another factor in the analysis, rather than a complete defence. However, the Tribunal's finding that the evidence about barriers to entry was inconclusive may explain this. The Tribunal may have been overly cautious in reaching this conclusion. For instance, it found that it was too soon to say whether Vandem's entry was viable – about 7 years (at time of trial) after Vandem's entry! One basis for this finding was that the Commissioner did not lead more evidence of Vandem's financial position. But since the onus was on the Commissioner to show that Vandem's entry was not viable, the Commissioner's failure to lead more evidence should have led the Tribunal to conclude that 7 years of effective entry by Vandem constituted viable entry.

3 For a discussion of past abuse cases, see Michael Osborne, "Fundamentals of Reviewable Matters", August 2004