Enforcing Consistent Pricing Within Franchise Systems

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It has been almost two years since changes to the *Competition Act*, R.S.C., 1985, c. C-34 ("*Competition Act")* decriminalized resale price maintenance, arguably paving the way for franchisors to mandate uniform pricing among franchisees. Yet, awareness of the change in the law appears relatively low among the franchise community. While the terms of existing franchise agreements may prevent franchisors from immediately imposing uniform pricing policies on their current franchisees, there has been no sign of a stampede of franchisors to their lawyers to update their franchise agreements to take advantage of the change in the future.

The Prior Regime

Prior to March 2010, it was a "*per se*" criminal offence for anyone to attempt by agreement, threat, promise or any like means to influence upward, or to discourage the reduction of the price at which any other person sold a product. This is referred to as "price maintenance". Any policy by a franchisor requiring franchisees to sell products at a particular price, or setting minimum levels which franchisees could not sell below, would certainly have constituted price maintenance under the *Competition Act*, exposing the franchisor to substantial penalties. It was also illegal to refuse to supply a product to a franchisee because of a franchisee's low pricing policy or to otherwise discriminate against a franchisee for that reason. A "*per se*" offence is one in which simply engaging in the conduct is sufficient to commit the offence; the resulting competitive effect of the conduct is irrelevant. Most franchise agreements are written with the old provisions of the *Competition Act* in mind to avoid any allegation of price maintenance; they may provide that the franchisor can set only the maximum price levels at which franchisees may sell their products, but that franchisees are otherwise free to set their own prices. Some agreements provide that the franchisor may recommend prices, but that the franchisee is not bound to follow the recommendation. This approach to managing pricing was as far as franchisors could go without offending the *Competition Act* and exposing themselves to substantial penalties.

The Current Law

As price maintenance is no longer a criminal offence, the penalties formerly associated with price maintenance are now gone. Rather, price maintenance is now only subject to civil administrative review by the Competition Tribunal based on a competitive effects test. The Competition Tribunal has the power to issue an order to prohibit a company from continuing to engage in the conduct, but no power to award damages or levy penalties. Private parties that are "directly affected" by the conduct covered by the price maintenance provision can, with leave of the Competition Tribunal, also apply for a remedial order, but they can no longer sue for damages in relation to price maintenance.

With the changes to the *Competition Act* which came into force in March 2010, for conduct to constitute price maintenance today, the conduct must have or be likely to have an "adverse effect on competition in a market". It is not entirely clear, however, what the "adverse effect on competition" threshold means in respect of price maintenance, although it is a lower threshold than "substantial prevention or lessening of competition" (the threshold used for other provisions of the *Competition Act*) and therefore more easily triggered. There are no Competition Tribunal decisions considering the threshold as it applies to the new price maintenance provision, nor has the Competition Bureau published any guidance on how the new price maintenance provision will be enforced. There are, however, two Competition Tribunal decisions that have considered "adverse effect on competition" in the context of another reviewable matter under the *Competition Act*, the "refusal to deal" provision (*B-Filer Inc. v. The Bank of Nova Scotia*, 2006 Comp. Trib. 42 and *Nadeau Poultry Farm Limited v. Groupe Westco Inc. et al.*, 2009 Comp. Trib. 06). In those cases, the Tribunal has said that for the conduct to have an "adverse effect on a market, the remaining market participants must be placed in a position, as a result of the refusal, of created, enhanced or preserved market power" and that "without market power there can be no adverse effect in a market". The Tribunal did not in either case identify a market share threshold for market power in the context of refusal to deal (and thus a parallel with price maintenance cannot be made); although the Tribunal indicated that market power is generally the ability to set prices above competitive levels for a considerable period. The Tribunal also identified indicators of market power that it would consider, including: (1) market share and market concentration; (2) barriers to entry; (3) impact on prices; (4) the effect of the refusal on rival's costs; (5) the impact on quality and variety of the product; (6) possible foreclosure of supply to other customers in the market; and (7) the impact of possible elimination of an efficient customer. It may not be unreasonable to postulate that in the franchise context in considering what constitutes a "market", the Competition

Tribunal would look at inter-brand competition as opposed to considering a single brand as a market, and that a franchise system would have to hold considerable market share in order to be considered to have "market power" and therefore possibly causing any adverse effect on a market. However, in a matter relating to price maintenance that is currently before the Competition Tribunal (*The Commissioner of Competition v. Visa Canada Corporation and MasterCard International Incorporated*, (filed December 15, 2010), Ottawa CT-2010-010 (Competition Tribunal) (Notice of Application)), the Commissioner of Competition has asked the Competition Tribunal to consider the effect of the respondents' conduct in lessening competition within their own networks, in addition to considering the broader market.

Abuse of Dominance

Franchisors with considerable market power, however, should also be aware that although the criminal prohibition against price maintenance was repealed, the practice may be reviewable under the *Competition Act's* abuse of dominance provisions (Sections 78 and 79). The abuse of dominance provisions in the *Competition Act* are directed at redressing anti-competitive practices (engaged in either unilaterally or jointly) by dominant firms that may prevent or lessen competition substantially in a market. The Competition Tribunal may, on application of the Commissioner of Competition, issue prohibition and other orders in respect of the conduct, or may impose administrative monetary penalties. The elements of the abuse of dominance provisions that are required to be established for the Tribunal to issue an order are: (1) market power of the alleged dominant firm(s); (2) a "practice" of anti-competitive acts – i.e. acts that are predatory, exclusionary or disciplinary against a competitor, having regard to the intent of the acting dominant firm(s), the effects of the act, and any valid business justification; and (3) a substantial prevention or lessening competition. All of these elements would have to be satisfied for a practice of price maintenance to contravene the abuse of dominance provisions.

Horizontal Price Maintenance

Franchisors need also to be wary of any allegation that setting minimum or system prices was done at the behest of a franchisee (e.g. complaining about discounters) and open themselves to an allegation of conspiring or agreeing with a franchisee to fix prices and thereby a potential charge under the new Section 45 of the *Competition Act*, a *per se* offence that captures, among other things, horizontal price fixing. This risk is also possible where a franchisor operates company stores that compete with franchised locations.

The U.S. Experience

The 2009 changes to the *Competition Act* (some of which, such as the change to price maintenance, did not take effect until 2010) were the result of a review and report by the Competition Policy Review Panel, which was mandated to review Canada's competition and foreign investment policies and to make recommendations for making Canada more competitive in an increasingly global market place. In their 2008 report ("Compete to Win") the Panel expressed the view that to some extent some of the proposed changes would harmonize our laws with the those of the U.S.

In 2007 the United States Supreme Court overturned longstanding U.S. Supreme Court jurisprudence that held that minimum price maintenance was *per se* illegal under Section 1 of *The Sherman Anti- Trust Act* (1890) *("Sherman Act")*. (Violations of Section 1 of the *Sherman Act* can lead to criminal prosecutions and/or private actions for damages). In its decision in *Leegin Creative Leather Products Inc. v. PSKS Inc.,*127 S. Ct. 2705 (2007) ("*Leegin*") the court reversed the *per se* treatment of minimum price maintenance under the *Sherman Act*, making price maintenance subject to a rule of reason. Under the rule of reason approach, the court weighs all the circumstances to assess whether the restraint is an unreasonable restraint on competition, including an assessment of information about the relevant business, the restraint's history, nature and effect, and whether the businesses involved have market power.

In the U.S., where *Leegin* was heralded by some as lifting the ban on minimum resale pricing, many have expressed a wait and see approach, given concern about the negative reaction of state courts and legislatures (and, initially, the introduction of a contrary bill in Congress). In April 2007, the state of Maryland passed legislation that would override *Leegin* to preserve the *per se* treatment of minimum resale price agreements in that state

Conclusion

Notwithstanding important differences between Canada and the U.S. in the treatment of price maintenance, the decriminalization of price maintenance in Canada is consistent with the rule of reason approach in the U.S. While both countries have liberalized their laws with respect to price maintenance, it does not appear that franchisors in either country have embraced policies of mandating system prices or setting minimum price levels, however. Yet, one would expect that being able to ensure consistent prices among franchisees would be another element of the brand experience where franchisors would want to maintain uniformity. Also, discounting by some franchisees could erode franchisee profit margins, damaging the system and undermining the franchisor's ability to sell franchises. It could be, however, that discounting by franchisees is simply not a prevalent practice causing concern for franchisors. More likely, however, is that the uncertainty that continues to surround the law on price maintenance in both countries is sufficient to dissuade franchisors from dictating prices. In Canada, although the remedies under the new price maintenance provision are relatively innocuous, proceedings before the Competition Tribunal can be costly and are public. Put another way, the perceived risks may currently outweigh the perceived benefits. Certainly, franchisors should be updating their forms of franchise agreement to permit the option to enforce consistent pricing in the future, so that if and franchisors become comfortable with the law in that regard, they are not prevented from doing so by the terms of their existing franchise agreements.

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