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Forum on Franchising

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Message from the Forum Chair

By Karen Satterlee, Hilton Hotels

One of the most frequent questions I am asked by Forum members is, "What do I need to do to be eligible to speak at the Forum"? In order to be eligible to speak, Forum members must demonstrate that they possess the writing skills necessary to produce a substantive paper that will qualify for continuing legal education credit by authoring or co-authoring an article for *The Franchise Lawyer*, the *Franchise Law Journal*, or another Forum publication. Forum Members who meet this threshold requirement are in the pool of candidates whom the Co-Chairs and the Planning Committee may consider for speaking slots at each Annual Meeting.

In reviewing the list of candidates eligible to speak, the Planning Committee considers a number of additional factors, such as subject matter expertise, substantive participation on committees and caucuses, the need to develop new talent for future meetings, and the need to ensure that the Annual Meeting has a diverse panel of speakers. In addition, to ensure that no one firm or company dominates the Forum, we limit each firm's and company's participation to two speakers at each Annual Meeting. Finally, we do not invite members to speak at consecutive Annual Meeting programs, with the exception of Governing Committee members, who are required to speak two out of three years as part of their term.

If you have not met the Forum's writing requirement, I urge you to consider writing for the Forum today so that you will be prepared when the opportunity to speak presents itself. Please contact Heather Carson Perkins, who takes over as Editor in Chief of *The Franchise Lawyer* with the Fall issue, or Gary Batenhorst, who serves as Editor in Chief of the *Franchise Law Journal*, to propose a topic for an article or to request a current list of topics. They can also suggest potential co-authors.

Miami in November: Register Today!

Speaking of the Annual Meeting, if you have not yet registered, I urge you to do so today. The 39th Annual Forum on Franchising will be held on November 2-4, 2016, at the historic Fontainebleau hotel in Miami. The hotel is filling up fast, so don't wait! In addition, please remember to register for our Thursday and Friday night social events in Miami. Thursday

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Canada's Competition Law: What Franchises Should Know

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Although franchising in Canada is governed principally by provincial legislation, franchisors and franchisees operating there must also comply with the federal Competition Act, R.S.C. 1985, c. C-34, as amended. The Competition Act, which has no provincial or territorial counterparts, applies to all businesses and industries in Canada. Its objective is to "maintain and encourage competition in Canada."

This article provides a primer on aspects of the Competition Act most relevant to the franchise industry.

The Competition Act is administered and enforced by the Commissioner of Competition, who heads the Competition Bureau (Bureau). The Bureau has a wide array of investigative tools at its disposal, including the power to obtain search warrants and wiretaps and to compel production of documents and testimony under oath.

The Competition Act's prohibitions are broadly divided into two categories: criminal offenses and "reviewable matters," also referred to as "reviewable practices." The principal criminal offenses under the Act are criminal agreements between competitors (conspiracies) and bid-rigging. Certain deceptive marketing practices, including pyramid schemes and multi-level marketing plans, are also criminal offenses. These offenses are prosecuted in the criminal courts by federal prosecutors. They are subject to sanctions such as fines and imprisonment.

The principal reviewable matters under the Act include abuse of dominance (monopolization); distribution practices
such as exclusive dealing, market restrictions, tied selling, and refusal to deal; price maintenance; non-criminal agreements between competitors; mergers; and deceptive marketing practices such as misleading "ordinary sales price" representations. These matters are governed by a civil adjudication regime, with applications brought by the Bureau principally to the Competition Tribunal (Tribunal), a specialized administrative body. Potential remedies include injunctive-type relief and administrative monetary penalties.

Private enforcement of the Competition Act is also available. For reviewable matters, private parties may seek leave from the Tribunal to apply for relief where the Bureau has declined to bring proceedings. This right of private application is only available for certain reviewable matters (for example, it does not apply to allegations of abuse of dominance), and damages may not be claimed. For criminal offenses, on the other hand, private parties may sue for damages.

Few successful private applications have been brought under the reviewable matters provisions. But civil claims for damages for criminal offenses are common, usually in the form of class actions, and have yielded substantial damages, typically from negotiated settlements.

Criminal Conspiracies

Section 45 of the Act makes it a criminal offense

for competitors to agree to fix prices; allocate sales, territories, customers, or markets; or restrict the production or supply of a product. Amendments to the Act in 2009 made Section 45 a *per se* offense. This means no harm to the marketplace need be shown; the offense is in the agreement itself.

Section 45 contains a potential defense if conduct is "ancillary and reasonably related to" an otherwise-legal agreement. This defense has been asserted successfully in at least one franchise-related case, *Fairview Donut Inc. v. The TDL Group Corp.*, 2012 ONSC 1252 (CanLII). In that case, franchisees brought a class action for damages alleging price maintenance and price fixing against franchisor Tim Hortons. The court dismissed all claims, relying in part on the ancillary restraints defense of Section 45.

"Civil claims for damages for criminal offenses are common...and have yielded substantial damages."

The Bureau's Competitor Collaboration Guidelines (Guidelines) state that because Section 45 refers to agreements between competitors, it does not apply to vertical arrangements between suppliers and their customers. Thus, to the extent competition issues arise, the Bureau would examine them under the civil reviewable practices provisions.

The Guidelines cite agreements between franchisors and franchisees to illustrate this point. They state that even if a franchisor's agreements effectively allocate markets or customers (for example, by creating limited sales territories for franchisees), the Bureau will not consider such arrangements to fall under Section 45 because they are vertical and do not involve competitors.

That said, the Guidelines caution that franchise-related conduct could fall under Section 45 if, for example, franchisors agreed with other franchisors, or franchisees agreed with other franchisees, to restrain competition among themselves by allocating markets or fixing prices. Franchisors also could be subject to prosecution under the Canadian Criminal Code's "aiding and abetting" offenses if they facilitated an anti-competitive agreement among their franchisees.

The Guidelines also address "dual distribution" situations, in which a franchisor sells its products to franchisees for resale to customers, but also competes with franchisees by selling directly to customers. Potentially anti-competitive arrangements in this context are not treated as *per se* offenses under Section 45, even though they contain both vertical and horizontal elements, but are assessed under the civil reviewable practices provisions.

Price Maintenance

An important issue for franchisors is whether, and to what extent, they can control the prices at which products are resold by franchisees, known as "price maintenance." Franchisors may have an interest in prices being lower (to drive demand) or higher (to ensure that franchisees earn sufficient margins or to protect a product's image). Canadian law does not prohibit a franchisor from imposing a *maximum* resale price on a franchisee. But Section 76 of the Act may prohibit a franchisor from imposing a *minimum* resale price on a franchisee or otherwise seeking to "influence upward or discourage the reduction of a resale price."

Price maintenance had been a *per se* criminal offense until Section 76, enacted in 2009, made it a civil reviewable practice subject to only injunctive relief. Moreover, under Section 76, price maintenance is actionable only if it has had, is having, or is likely to have an "adverse effect on competition in a market." According to the Bureau's Price Maintenance Enforcement Guidelines (2014), price maintenance conduct will have this effect only where it is likely to "create, preserve or enhance the market power" of the supplier – that is, to give the supplier the ability to behave relatively independently of the market.

The Bureau generally will not be concerned about "market power" where a supplier has less than a 35% share of the relevant market. This is an important safe harbor. But even if a supplier's market share exceeds 35%, the Bureau (or a private applicant) would have to prove that the supplier's conduct has harmed competition. This is no easy task, as seen by the virtual absence of price maintenance cases since 2009.

The repeal of Section 45's *per se* price maintenance offense and the enactment of Section 76 were intended to give suppliers more flexibility to impose resale pricing restrictions – in keeping

with the prevailing economic and legal thought that price maintenance could promote competition and should not be automatically proscribed. These changes were also intended to harmonize Canadian law with U.S. federal law after the U.S. Supreme Court's decision in *Leegin Creative Leather Prods. Inc. v. PSKS, Inc.*, 551 U.S. 87 (2007), which held that price maintenance agreements should be subject to a "rule of reason" analysis that takes into account market impact.

Even under the current law, however, franchisors and franchisees must be careful to avoid conduct that could violate other provisions of the Competition Act, such as Section 45. For example, competing franchisors should not agree to use price maintenance policies to facilitate less vigorous price competition among themselves or to help police a price-fixing arrangement. And franchisees and their franchisor should not agree to engage in price maintenance with a view to limiting competition at the franchisee level (for example, to help police a price-fixing arrangement among franchisees).

Distribution Practices

Franchise relationships may impose restrictions regarding franchisees' purchase and sale of products. For instance, franchisees may be required to purchase certain products only from the franchisor or a supplier designated by the franchisor. Franchisees also may be required to sell products only in a certain territory or to certain types of customers.

Section 77 of the Competition Act contains several reviewable pratices prohibiting a franchisor from engaging in exclusive dealing, market restrictions, or tied selling. These restrictions apply only when the franchisor is a "major supplier of a product in a market" and the conduct is likely to lessen competition substantially or otherwise have any exclusionary effect. Given the limited applicability of these restrictions, few cases are brought under Section 77. Moreover, applications brought by the Bureau are typically rolled into "abuse of dominance" cases.

Section 79 of the Competition Act proscribes "abuse of a dominant position." This is a reviewable practice that requires proof that a dominant party in a market has used "anti-competitive acts" to harm competition. The abuse of dominance provision historically was limited to conduct targeted at competitors, but a recent decision has expanded its reach to a dominant supplier engaging in conduct that harms competition in a downstream market. *See Comm'r of Competition v. Toronto Real Estate. Bd.*, 2014 FCA 29 (Fed. C.A.). Franchisors should be mindful of this provision if their business strategies could impact competition among their franchisees. The Tribunal may impose substantial fines for violations of Section 79.

Section 75 of the Competition Act limits parties' ability to terminate business relationships where such a refusal to deal will substantially affect people in their business or preclude them from carrying on business, and will have an "adverse effect on competition in a market." There have been few successful Section 75 applications in recent years. A franchisor planning to terminate a franchise agreement should factor this provision into its risk assessment, but the likelihood that termination would have an "adverse effect on competition" is minimal.

Conclusion

Franchisors and franchisees operating in Canada must comply with all provisions of the Competition Act that apply to their businesses. Otherwise, they risk an array of criminal or administrative penalties. ■