

THE COMPETITION TRIBUNAL

IN THE MATTER OF the *Competition Act*, R.S.C. 1985, c. C-34, as amended;

IN THE MATTER OF an application by the Commissioner of Competition pursuant to section 79 of the *Competition Act*;

IN THE MATTER OF certain policies and procedures of Reliance Comfort Limited Partnership

COMPETITION TRIBUNAL TRIBUNAL DE LA CONCURRENCE	
FILED / PRODUIT	
August 12, 2013	
Jos LaRose for / pour REGISTRAR / REGISTRAIRE	
OTTAWA, ONT	# 38

B E T W E E N:

THE COMMISSIONER OF COMPETITION

Applicant

and

RELIANCE COMFORT LIMITED PARTNERSHIP

Respondent

**RESPONSE OF RELIANCE COMFORT LIMITED PARTNERSHIP
TO THE NOTICE OF APPLICATION**

PART I: OVERVIEW

1. The Application filed by the Commissioner of Competition (“**Commissioner**”) against Reliance Comfort Limited Partnership (“**Reliance**”) is premised upon a fundamentally flawed market definition and assessment of Reliance’s market position.
2. The relevant market for the purposes of the Application is the market for the supply of residential water heater products or services in the province of Ontario (“**Relevant Market**”), not the undefined and artificially disaggregated markets proposed by the Commissioner.

3. Reliance does not substantially or completely control the Relevant Market. With a market share estimated at less than 25% in 2012, Reliance's share of annual sales in the Relevant Market is well below the market share threshold of dominance. Consumers can and do elect to own, rent or finance water heaters from a diverse range of suppliers across Ontario: ranging from plumbers, heating, ventilation and air conditioning contractors, rental supply companies (such as Reliance), retailers (including Sears, Canadian Tire, Home Depot, RONA and Lowes), local utility companies and resource and energy suppliers (such as Imperial Oil). Further, consumers regularly switch suppliers.

4. Reliance's return policies and procedures do not constitute a practice of anti-competitive acts and have not and are not likely to substantially lessen or prevent competition. In fact the return processes and procedures that the Commissioner takes issue with were in part introduced by Reliance to protect and educate consumers against the dishonest behavior of some rival firms to Reliance who seek to compete not on price, service and quality, but rather through the use of false and misleading door-to-door sales practices, a consumer protection issue that is well-documented, is the subject of legislation currently before Ontario's legislature (namely, *Bill 55, Stronger Protection for Ontario Consumers Act, 2013*).

5. All of Reliance's Union Gas legacy customers can terminate their rental agreement with Reliance at any time and are not subject to any minimum term contract.

6. In the circumstances, the Commissioner is unable to discharge the applicable statutory burden under either subsection 79(1) or subsection 79(2) of the *Competition Act*.

7. Reliance has at all times cooperated with the Competition Bureau, including by responding to voluntary information requests. The imposition of an administrative monetary penalty in these circumstances is both unwarranted and an over-extension of the objectives of the *Competition Act*.

PART II: ADMISSIONS AND DENIALS

8. Except as expressly admitted below, Reliance denies all allegations contained in the Application and puts the Commissioner to the strict proof thereof.

9. Reliance admits paragraphs 5 and 11 of the Application.

10. Reliance generally admits paragraph 6 of the Application, other than to state that it is indirectly wholly owned by investment funds managed by Alinda Capital Partners I Ltd.

11. Reliance generally admits paragraph 10 of the Application, but states further that residential consumers are increasingly adopting solar, ground and alternative energy sources to heat water and, in addition to natural gas and electric water heaters, may choose to purchase or rent a combined space and water heater or water heaters fueled by propane, oil, solar power, ground source or some other alternative fuel source.

PART III: MATERIAL FACTS ON WHICH RELIANCE RELIES

A. Industry background

12. In Ontario, the business of renting water heaters was created in the 1950s by the natural gas distributors Consumers Gas and Union Gas as a way of encouraging the retail consumption of natural gas. Rentals of both electric and gas water heaters were later made available through other companies, including many utilities large and small such as Ontario Hydro, North Bay Hydro and Collingwood Utility Services. While consumers could always purchase their water heaters, water heater rental businesses were tied to the suppliers' distribution and utility networks.

13. As part of the deregulation of the Ontario energy industry in the late 1990s, Consumers Gas and Union Gas unbundled their water heater portfolios from their gas distribution businesses, which prior to this time had been tied to these regulated monopolies for natural gas supply. Consumers Gas (by then renamed Enbridge Gas) sold its water heater portfolio to what is now Direct Energy Marketing Limited ("**Direct Energy**"), while Union Gas sold its water heater portfolio to Union Energy Inc. (now Reliance). As the predictable result of this history, a

large number of Reliance and Direct Energy's customers are located in areas where the regulated monopoly markets for natural gas distribution had existed prior to deregulation.

14. The unbundling process initiated greater competition in the market for the supply of residential water heaters: rental suppliers could operate inside and outside the regulated boundaries of the gas distributors. These new suppliers range in size from small independent contractors to wholly owned subsidiaries of large multinational energy providers such as National Energy Inc., doing business as National Home Services ("**National**"). National is a wholly owned subsidiary of Just Energy, Inc., one of the largest retail energy and home comfort suppliers in North America serving over 1.8 million customers and listed on both the New York and Toronto stock exchanges.

15. Today homeowners can own, rent or finance a water heater from a number of sources, including: retailers such as Sears, Canadian Tire, RONA, Lowes and The Home Depot; heating, ventilation and air conditioning contractors; plumbers; rental suppliers (such as Reliance, Direct Energy and National), local utility companies and resource and energy suppliers (such as Imperial Oil).

16. Apart from warranty replacements, water heaters sales result from:

- (a) a consumer electing to replace their water heater (whether for reasons of age, tank size, fuel type, or energy efficiency); and
- (b) the installation of water heaters into newly constructed homes.

17. Many new entrants seek to acquire new sales by driving demand through door-to-door sales activity. Unfortunately, this door-to-door sales activity has also corresponded with a significant and well documented increase in marketplace abuses. Since 2009 the use of misleading door-to-door sales practices by certain suppliers of residential water heaters has continued to rise. The prevalence of the problem has been well documented by the media, the Better Business Bureau, and Ontario's Ministry of Consumer Services ("**Ministry**"). In fact, the Ministry has reported that water heater rentals were the third most frequent source of consumer complaints in 2010 and the second most frequent source of complaints in both 2011 and 2012.

18. Examples of the false and misleading sales practices that have become prevalent in the water heater industry (particularly through the door-to-door sales channel) include sales representatives:

- (a) falsely identifying themselves as working for a customer's existing supplier in order to create the impression that replacement of their water heater would not entail a change of suppliers or termination of their existing rental agreement;
- (b) falsely identifying themselves as a representative of a utility or government agency responsible for inspection of household appliances;
- (c) falsely claiming to be upgrading water heaters for efficiency purposes on behalf of a utility or government agency;
- (d) falsely claiming to be authorized to replace the water heaters throughout a neighbourhood or development;
- (e) falsely claiming that the customer's existing supplier assigned their contract to the salesperson's company;
- (f) falsely claiming that the customer's existing water heater is substandard, beyond its useful life, not installed pursuant to applicable building codes and/or generally unsafe;
- (g) falsely overstating the energy or costs savings that might be realised by switching suppliers;
- (h) misleading or failing to explain fully to the customer their existing supplier's return policies;
- (i) misrepresenting or failing to disclose the term of the contract to which the customer is committing; and
- (j) misrepresenting the actual costs of the regular monthly payments and other charges.

19. That consumers are being misled by door to door sales tactics is borne out by the fact that the majority of Reliance Customers who switch as a result of a door-to-door sales approach are locked into contracts with higher monthly rates. It was also the subject of an independent study funded in part by Industry Canada.

20. Another type of marketplace abuse involves the circumvention of the provisions of Ontario's *Consumer Protection Act, 2002* ("CPA"). The CPA generally provides consumers with a 10 day cooling off period during which they can rescind their contract with a new supplier without penalty. However, certain suppliers seek to negate the statutory protection under the CPA by immediately replacing a switching customer's water heater and then attempting to protect against the original supplier getting notice of the removal by delaying the return of the removed water heater until after the 10 day cooling off period has expired. These competitors are aware that should the consumer contact their existing supplier they will be made aware of their statutory rights and they therefore take all steps to prevent the consumer from contacting their current provider.

21. *Bill 55, Stronger Protection for Ontario Consumers Act, 2013* is currently before Ontario's legislature and has provisions directly intended to address some of the misleading sales tactics that are directly relevant to the Commissioner's allegations against Reliance and have been designed to help ensure consumers approached by door-to-door salespersons of water heaters are properly informed and benefit from a meaningful statutory cooling off period. Reliance was actively involved in the Ministry's consultation process that preceded the introduction of Bill 55.

B. The Relevant Market

22. Residential consumers in Ontario either rent or own their water heaters for the purpose of providing their residence with hot water. Ontario is unique in Canada and in North America generally with very limited exceptions, in that a majority of homeowners have historically rented rather than owned their water heaters.

23. However, like most of Canada and North America, residential consumers in Ontario have a number of options with respect to heating water, including:

- (a) owning or renting a storage water heater;
- (b) owning or renting a tankless water heater (also known as “instantaneous” or “on-demand” water heaters); or
- (c) owning or renting a combination boiler that combines central heating with the domestic water heater.

24. The average useful life of a natural gas or electric residential water heater is approximately 13 to 17 years. During the term of its useful life, a water heater will require very limited maintenance. Whether a water heater is rented or purchased it is typically accompanied by a lengthy warranty or service guarantee from the rental provider or seller as the case may be.

25. While natural gas and electric water heaters are the most common type of water heaters used by urban residential consumers, consumers, particularly those in rural areas, also acquire water heaters that use alternative fuel sources including propane, oil, solar and ground source heating. There is no basis or facts alleged by the Commissioner to support the contention that the product market for the supply of residential water heaters should be disaggregated based on fuel source. Reliance states that water heaters utilizing various fuel sources are substitutes that should be included in the relevant product market.

26. Reliance denies the product markets proposed by the Commissioner and states instead that the relevant product market is the market for the supply of residential water heater products and services.

27. The Commissioner purports to define the relevant geographic market as “(i) the local markets of Ontario where Union Gas distributed natural gas and (ii) certain other local rural markets in Ontario”.

28. Reliance denies that it is appropriate to define the relevant geographic market by reference to the distribution area of a third party to which Reliance has no relationship and in respect of which the boundaries of the markets served have changed since Reliance acquired the

water heater rental business from Union Gas in 1999. Furthermore, the Commissioner has stated no facts to support this market definition and has failed to state any economic theory to support the contention that these areas of Ontario, which were previously regulated natural gas supply monopolies, are relevant or appropriate markets for the purposes of analyzing current competitive interaction.

29. Further, Reliance notes that no facts have been pleaded to support the boundaries of the Commissioner's proposed geographic market or explain the areas purported to be captured by the reference to "certain other local rural markets in Ontario". These alleged markets are undefined and unknown.

30. Reliance denies the market definition proposed by the Commissioner and states that the relevant market is the market for the supply of residential water heater products and services in the province of Ontario ("**Relevant Market**"). Reliance competes throughout the province of Ontario with a myriad of large and small competitors. The competitiveness of the market is in part evidenced by the fact that Reliance has experienced an ongoing erosion of its customer base due to the large number of new competitors that have entered the market. In fact this erosion or attrition rate has increased since Reliance adopted the return policies and procedures in respect of which the Commission bases his allegation of abuse of dominance.

C. The correct approach to measuring market share

31. Contrary to the approach adopted by the Commissioner, the size of Reliance's existing customer base relative to other suppliers (whether measured by units or derived revenue) is not an appropriate basis for measuring or establishing market power.

32. The appropriate and typical measure of market share is share of sales. The number of households with a Reliance water heater installed in their home says nothing about Reliance's current share of the market for the supply of residential water heaters. This is especially so in circumstances where the bulk of Reliance's customers were inherited from a regulated monopoly or acquired from other third parties.

33. By analogy, the number of General Motors vehicles currently under existing leases provides no insight into General Motors' current competitiveness or the state of competition in

the automotive market. Rather an analysis of competitiveness in the market would study the number of vehicles sold or leased by General Motors as a percentage of the total number of vehicles sold in the market in a given year. To the extent that market share reflects the competitiveness of a market it is a question of current sales activity or success among rivals that would typically and appropriately be considered.

34. In 2012, Reliance’s share of the Relevant Market’s annual sales was estimated at less than 25% - well below the threshold for dominance. The Commissioner states no facts or basis other than the percentage of Reliance’s installed based to support the contention that Reliance is in a dominant position in the market place. In fact, since at least 2008, both Reliance and Direct Energy have experienced annual increases in the number of customers leaving its residential rental program in favour of competitors. The table below sets out as a percentage of total customers, the percentage of customers who left Reliance’s and Direct Energy’s residential rental programs year on year since 2007:

	2007	2008	2009	2010	2011	Sept. 2012
Reliance	2.4%	2.4%	3.1%	3.9%	4.0%	4.5%
Direct Energy	2.1%	3.2%	8.0%	6.4%	6.0%	6.1%

35. For the period 2007 to 2011, 16.0% of Reliance’s customers and 25.5% of Direct Energy’s customers switched suppliers. For the period January 1, 2012 to September 30, 2012, 4.5 % of Reliance’s customers and 6.1% of Direct Energy’s customers switched suppliers. This represents a dramatic shift in market share particularly in light of the fact that water heaters have a 13 to 17 year lifespan, meaning that only a small proportion of Reliance’s customers would typically be acquiring a new water heater at any given time.

36. Reliance states that it is not dominant in the Relevant Market, nor is it dominant in any market as alleged by the Commissioner in the Application. To the contrary, the competitiveness of the market is indicated by the successful entry of new competitors and the erosion of the customer bases of incumbent rental providers such as Reliance and Direct Energy. Further the

introduction in May 2010 of the return policies and procedures cited by the Commissioner has not deterred the success of Reliance's rivals. There are absolutely no facts nor evidence to suggest that there has been a negative impact on competition whatsoever. In fact, Reliance's policies and procedures have increased competitiveness and supported consumer choices by enabling consumers to avoid unlawful sales practices and permit competition between competitors.

D. Low barriers to entry

37. As acknowledged by the Commissioner at paragraph 50 of the Application, the Relevant Market is characterised by no or very low barriers to entry:

- (a) as demonstrated by the range in the size of suppliers supplying the market, the supply of residential water heaters is commercially viable with or without scale.
- (b) new entrants can begin supplying residential water heaters with minimal upfront capital investment;
- (c) new entrants can finance growth through readily available financing options, including in the case of National, MorEnergy, LivClean and Ontario Consumers Home Services, through securitization;
- (d) supply of water heaters is not, and never has been, regulated.

E. Reliance's residential water heater business

38. Reliance's principal lines of business: are (i) its water heater business through which it rents water heaters to both residential and commercial customers; (ii) its heating, ventilation and air conditioning business; and (iii) its security and monitoring business. Reliance also engages in the business of financing consumer purchases of heating, venting and air conditioning and ancillary home comfort equipment, as well as consumer purchases of boilers, water heaters, water treatment equipment and fireplaces.

39. Operating under the "Reliance Home Comfort" brand, Reliance rents natural gas and electric water heaters to approximately 1.2 million residential customers in approximately 400 communities across Ontario. Reliance owns the water heaters it rents. It manages the sale,

rental, maintenance and service of its products both directly and through the use of independent contractors.

40. While Reliance's customer base was originally concentrated in the regulated monopoly territories of Union Gas, it has expanded its rental water heater business beyond these areas into new communities in Ontario.

41. Reliance rents the following types of water heaters:

- (a) natural gas fueled storage water heaters – conventionally vented, direct vented and power vented models;
- (b) electric storage water heaters;
- (c) gas fuelled tankless residential water heaters; and
- (d) propane water heaters in rural areas of Ontario.

42. In Ontario, Reliance acquires new customers by reason of:

- (a) a customer deciding to switch from his or her current rental supplier to Reliance;
- (b) a customer deciding to rent rather than own their water heater (for example, when their currently installed water heater reaches the end of its useful life);
- (c) a customer purchasing a new home from a builder in which a Reliance rental water heater has been installed;
- (d) acquisition of a third party's rental water heater assets.

F. Reliance's rental terms and conditions

43. All of Reliance's Union Gas legacy customers can terminate their rental agreement at any time by simply returning Reliance's water heater and paying any applicable account closure charge. As at January 2013, only an insignificant number amounting to approximately 7% of Reliance's total customer base may be required to buy out their water heater.

44. The applicable fees and account closure charges to be paid upon termination of a Reliance rental arrangement are based on the age of the water heater being returned and whether or not the terminating customer has requested Reliance carry out some or all of the services required to be performed in order to facilitate the return of the water heater.

Account closure fees

45. All Union Gas legacy customers can terminate their rental agreement with Reliance subject only to the payment of the applicable account closure fee.

46. For customers with a water heater that is over 10 years old, no account closure fee is payable. For customers with a water heater that is between one to ten years old, an account closure fee of \$40 is payable. For customers with a water heater that is less than one year old, an account closure fee of \$200 is payable.

Disconnect and removal fees

47. Suppliers that rent residential water heaters each have policies and procedures (whether arising from their contractual arrangements with customers or otherwise) that govern the way in which their water heaters may be drained, disconnected, removed and returned to them following a customer's decision to terminate their rental agreement.

48. Reliance allows customers leaving its rental program to drain, disconnect, remove and return their Reliance water heater. Therefore Reliance customers are not obligated to pay any fees for these services to Reliance upon termination of their water heater rental agreement. This is in distinct contrast to most other providers of rental water heaters, such as National that specifically prohibit customers from disconnecting, removing and returning rental water heaters. These competitors require their customers to pay fees to them to carry out those services. For example, National charges some of its customers \$337.50 for removal and return of conventional or electric tanks and \$472.50 for removal and return of a power vented tank.

49. By comparison, if a switching customer chooses to have Reliance drain, disconnect, remove and pick up its water heater, Reliance charges that customer \$125.00 (regardless of the

type of water heater). The \$125 charge offsets, but does not cover, Reliance's actual costs of sending a fully licensed contractor to the customer's home to:

- (a) drain the water from the tank;
- (b) disconnect the water heater from the home's water supply;
- (c) where applicable, disconnect the water heater from the home's gas and/or electric supply;
- (d) remove the water heater from the customer's home; and
- (e) return the water heater to a Reliance return location.

Damages charges

50. Consistent with general leasing practices, customers are liable to incur a damage charge if Reliance's water heater is returned with damage beyond normal wear and tear. Until recently it was Reliance's policy and practice to charge the lower of the fair retail value of the cost of the necessary repair or the buy-out cost of the water heater. Effective January 2013, Reliance's policy and practice is to charge the lower of Reliance's average calculated cost of the necessary repair or the buy-out cost of the water heater.

51. Only an insignificant number of customers who returned their water heater during the period 2009 to end of year 2012 were charged a damages charge by Reliance.

G. Reliance's termination and return policy

52. Effective May 17, 2010 Reliance implemented the following termination and return policy ("**RRN Policy**"):

- (a) Customers must call Reliance directly in order to initiate the process of terminating their rental agreement;
- (b) If after speaking with a Reliance representative, the customer still wants to terminate their rental agreement, the customer will be provided with a unique

tracking number – called a “Removal Reference Number” (“RRN”) and details of their nearest return location;

- (c) The RRN is to be recorded on a Reliance form (available to competitors or customers at Reliance drop-off locations) which records certain identifying information regarding the water heater, the customer and the person returning the water heater (if different from the customer). The water heater and form is to be returned to the nearest return location (as communicated to the customer in the manner set out above);
- (d) Reliance will recognize as customer agent any third party to whom the customer has chosen to provide their RRN;
- (e) For the purpose of arranging for the removal or return of Reliance’s water heater, Reliance will only deal with the customer or any third party agent to whom the customer has provided the RRN.
- (f) Reliance will refuse to accept a removed water heater from any person who is unable to either:
 - (i) identify themselves as Reliance’s customer; or
 - (ii) quote the applicable RRN and thereby provide Reliance with assurance that they have been authorised by the customer to effect the return.

53. The RRN Policy initiates the termination process, allows for the tracking of returns, processing of billing and accounting changes and provides customers with a simple means through which to appoint a third party agent to undertake the replacement of their water heater and the return of the water heater to Reliance. This policy is similar to the typical and ordinary return procedures adopted by many commercial enterprises.

54. Contrary to the allegations made by the Commissioner, Reliance does not through its RRN Policy refuse to recognize agency agreements that give competitors the authority on behalf of the customer to disconnect and return Reliance rental water heaters. As pleaded above,

Reliance will recognize as customer agent any person to whom a customer has provided their RRN.

55. What Reliance does through its RRN Policy is refuse to recognize agency agreements that give competitors the authority to terminate a customer's agreement with Reliance. This element of Reliance's RRN Policy has been the subject of judicial consideration in the Ontario Superior Courts:

- (a) In *Weller v. Reliance Home Comfort Limited Partnership*, 2011 ONSC 3148, Justice Strathy found (such finding undisturbed on appeal):

The amendment being introduced by Reliance is, from the consumer's point of view, entirely innocuous. It imposes no additional burden on the consumer, other than the burden of picking up the telephone and informing Reliance that he or she wishes to terminate the contract and have the water heater removed – and perhaps the additional burden of being subjected to questions about the reasons for the termination and possibly a sales pitch as to why the customer should continue to do business with Reliance. If, as Reliance asserts and this proceeding suggests, the amendment is impeding National's efforts to convert Reliance's customers, it may not be a bad thing, from a consumer protection perspective, to provide some counter-balance to the entreaties of the "door knockers". (emphasis added)

- (b) In *MacGregor v. Reliance Comfort Limited Partnership*, 2010 ONSC 6925, Justice Enchin, in considering the nature of the contractual amendment that introduced the RRN Policy found:

I find that the requirements advised by Reliance to MacGregor on May 5, 2010 were reasonable and, given the structure of the relationship between the parties, as evidence by the contract, do not amount to an amendment or variation. I can find no term that has been modified. Rather, the method of termination and return of the tank has been clarified in a contractual arrangement that did not contain all of the specifics. (emphasis added)

56. Reliance's primary reasons for implementing and maintaining the RRN Policy were and are:

- (a) to provide Reliance with an opportunity to speak with its customer prior to removal of its water heater to ensure given the prevailing marketplace abuses that its customer:
 - (i) understood they were switching rental suppliers and terminating their agreement with Reliance;
 - (ii) was basing his or her decision to switch on accurate information about Reliance's products and services; and
 - (iii) was aware of their rights under the CPA including their right to a 10 day cooling off period;
- (b) to provide Reliance with an opportunity to attempt to compete to retain the customer;
- (c) to protect its customer's privacy as well as Reliance's potential liability by providing a means of ensuring Reliance was only dealing with a customer's authorised representative;
- (d) to provide a means of tracking water heaters assets during the removal and return process; and
- (e) to allow processing of accounts and adjustment of the outgoing customer's rental charges in a more timely manner.

H. Returns of Reliance's water heaters by third parties (including other suppliers)

57. As set out above, customers can provide any third party of their choosing with details of the RRN and return depot location provided to them by Reliance. Additionally, if a third party is able to quote a valid RRN, Reliance's policy and practice is to provide that contractor or competitor with the return location closest to the address at which the related Reliance water heater had been installed. Reliance's experience, however, is that third parties that routinely seek

to return Reliance's water heaters to it are aware of both the locations and hours of operation of Reliance's return locations.

58. On occasion, certain competitors have made attempts to return dozens, and in some instances, hundreds, of stockpiled water heaters to Reliance in bulk. When faced with competitors seeking to return an unreasonable volume of water heaters in bulk without notice, Reliance has on occasion refused to accept any water heaters beyond the volume that a return location can safely and reasonably accommodate. However, where Reliance is provided with advance notice of bulk returns, it has accommodated these returns to the extent possible.

PART IV: STATEMENT OF THE GROUNDS ON WHICH THE APPLICATION IS OPPOSED

59. The Commissioner bears the burden of establishing that:

- (a) Reliance substantially or completely controls the Relevant Market;
- (b) Reliance's return policies and procedures constitute a practice of anti-competitive acts; and
- (c) Reliance's return policies and procedures have had, are having or are likely to have the effect of preventing or lessening competition substantially in the Relevant Market.

60. For the reasons set out below, the Commissioner cannot satisfy any one of the elements required by section 79. Therefore the application must necessarily fail.

Reliance does not substantially or completely control the relevant markets

61. Reliance does not substantially or completely control the market for the supply of residential water heater products or services, regardless of how such market is ultimately defined. Barriers to entry are low and consumers benefit from numerous competitive supply options.

62. Reliance's percentage of annual sales in the Relevant Market was estimated to be less than 25% in 2012. During the period 2009 through 2012 inclusive, Reliance has experienced

year on year increases in customers leaving its rental program for the purpose of either switching suppliers or purchasing its water heater.

Reliance has not and is not engaged in a practice of anti-competitive acts

63. The conduct impugned by the Commissioner does not constitute a practice of anti-competitive acts for the purpose of subparagraph 79(1)(b) of the Act.

64. Contrary to the Commissioner's allegations, Reliance's return policies and procedures:

- (a) do not have the nature or character of anti-competitive acts;
- (b) are not objectively predatory, exclusionary or disciplinary; and
- (c) are reasonable commercial practices.

65. Reliance's RRN Policy was designed and implemented to provide Reliance with an opportunity to speak with its customer prior to removal of its water heater, to provide a means of tracking water heaters during the removal and return process, and to allow processing of accounts and adjustment of the outgoing customer's rental charges in a more timely manner.

66. Reliance's RRN Policy:

- (a) is procompetitive in that it permits consumers to benefit from competition between competitors;
- (b) encourages competition on the merits, rather than through the use of false and misleading sales tactics and to ensure consumers are fully informed during the decision making process;
- (c) ensures that consumers are apprised of their rights under Ontario's *Consumer Protection Act*, 2002 and are provided with the opportunity to exercise their statutorily protected cooling off period without any negative consequence, as intended by the Ontario legislature;
- (d) protects Reliance against any liability for inadvertently breaching its obligations to customers by relying on invalid agency appointments;

- (e) ensures Reliance's customers understand their ongoing contractual obligations in order to ensure they are benefiting from the competitive process;
- (f) preserves customers' privacy; and
- (g) provides an efficient means for switching customers to appoint a third party to arrange for the removal and return of Reliance's water heater.

67. Reliance's policies and procedures with respect to the times, locations and numbers of returns it will accept at any one time are a legitimate and reasonable commercial response to the need for Reliance to balance its ability to accept, store and process returned water heaters with other legitimate operational, logistical and occupational health and safety concerns. Any such restrictions on the number of water heaters returnable by competitors at one time are reasonable and do not present any barrier or obstacle to competition.

68. The majority of Reliance's fees and charges are avoidable. The only unavoidable fee on termination is the account closure fee which for virtually all of Reliance's customers who decide to switch providers is \$40 or less. Where other charges do apply, those charges are low by industry standards and are commercially fair and reasonable.

There has not, is not and is not likely to be a substantial lessening or prevention of competition

69. In any event, in circumstances where:

- (a) Reliance enjoys less than 25% of sales of residential water heaters;
- (b) all of Reliance's Union Gas legacy customers are free to terminate their water heater rental agreement at any time;
- (c) Reliance has continued to experience an increase in the number of residential customers leaving its rental program, notwithstanding the introduction of the RRN Policy;

(d) Reliance's account closure charges and disconnect and return fees will generally have no impact on a customer's decision to switch suppliers and in any event have remained unchanged since 2005; and

(e) new entrants have been rapidly gaining market share,

there is absolutely no basis for the Commissioner's allegation that "but for" certain of Reliance's return policies and procedures, there would likely be greater entry or expansion of the market and consumers would likely benefit from substantially greater competition.

An administrative monetary penalty is not warranted

70. Reliance has at all times cooperated with and been responsive to requests from the Competition Bureau.

71. Counsel to the Commissioner was carbon copied multiple times on letters of correspondence received by Reliance from certain of its competitors that specifically related to the RRN Policy. At no time did the Competition Bureau or the Commissioner make enquiries of Reliance with respect to this correspondence.

72. In August 2010, after the implementation of Reliance's RRN Policy, counsel for Reliance was advised by a representative of the Competition Bureau to the effect that the Competition Bureau saw increasing competition for the supply of residential water heater services and while it continued to watch the market, had no concerns. It was not until June 2012, when the Commissioner obtained *ex parte* an order against Reliance under section 11 of the Act that Reliance first became aware that the Commissioner had any concerns about Reliance's conduct. Reliance had absolutely no contact from the Commissioner after complying with the section 11 order until late November 2012, at which time it was notified by the Commissioner that the Commissioner had concluded that Reliance was engaged in conduct in breach of section 79 of the Act.

73. The marketplace abuses that the RRN Policy is in part designed to combat are well documented including by various provincial police services, the Ministry and the press. In fact,

as pleaded above, there is currently legislation before the Ontario legislature specifically designed to address such conduct. Further, in July 2012, National (one of Reliance's competitors) was found guilty of breaching section 52 of the Act by the Ontario Superior Court.

74. The Commissioner is under a statutory duty to conduct an inquiry whenever he believes on reasonable grounds that grounds exist for the making of an order under Part VII.1 of the Act (relating to deceptive marketing practices including the making of false or misleading representations) or an offence under Part VI of the Act (including the offence of knowingly or recklessly making a false or misleading representation) has been or is about to be committed. It is inconceivable in the circumstances that the Commissioner was unaware of the marketplace abuses. Despite this and despite being advised by Reliance that the RRN Policy was in part designed to combat the problem of marketplace abuses, the Commissioner made no attempts to investigate the problem prior to commencement of the Application.

75. On December 19, 2012 the Commissioner received a six resident complaint pursuant to section 9 of the Act specifically requesting that he commence an investigation with respect to the marketplace abuses occurring within the Relevant Market. Notwithstanding the direct relevance of that complaint and the now ongoing inquiry pursuant to section 10 of the Act, the Commissioner commenced the Application. In the circumstances, there is no basis upon which the Tribunal should issue an order requiring Reliance to pay any administrative monetary penalty, let alone a penalty in the amount of \$10 million.

76. Further, Reliance says that the Tribunal has no jurisdiction to order an administrative monetary penalty in the amount sought by the Commissioner as the order of such a penalty would be unconstitutional in circumstances where Reliance has not been afforded protection under section 11 of the *Canadian Charter of Rights and Freedoms* and section 2(e) of the *Bill of Rights*.

PART V: STATEMENT OF ECONOMIC THEORY

77. Reliance's Concise Statement of Economic Theory is set out in Schedule "A" to this Response.

PART VI: RELIEF SOUGHT

78. Reliance requests an Order dismissing the Application with costs payable to Reliance.

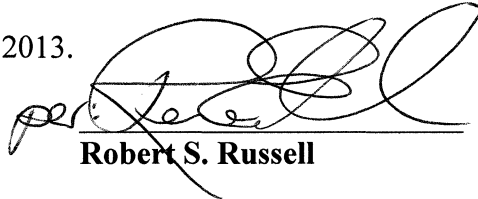
79. Reliance submits that the circumstances surrounding the commencement of this Application warrant the awarding of costs to Reliance on a full indemnity basis.

PART VII: PROCEDURAL MATTERS

80. Reliance agrees that the Application be heard in English and confirms its intention to use English in the proceedings.

81. Reliance requests that the Application be heard in the City of Toronto.

DATED AT Toronto, this 12th day of August, 2013.



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SCHEDULE A

CONCISE STATEMENT OF ECONOMIC THEORY

I. INTRODUCTION AND SUMMARY

1. Most residential water heaters in Ontario are provided to consumers as rentals through either a utility company or through a rental water heater provider. Additionally, a growing number of consumers own their own water heaters. Sales and rentals are made to owners of existing homes and construction companies. The relevant product market is thus the market for the supply of residential water heater products and services.

2. The geographic market consists of all the areas in which Reliance serves customers, competes for customers, or could potentially serve customers. The geographic market also consists of the service areas of all retail and rental operations that serve these same current and potential customers. For the purposes of the Application, the relevant geographic market is the province of Ontario.

3. The relevant market for the purpose of the Application is therefore the market for the supply of residential water heater products and services in the province of Ontario. Reliance is not dominant in this market.

4. Reliance owns the water heaters it rents, and like any rental company (including its competitors), contracts with its customers. Any rental contract involving a durable good must involve some terms, if only to ensure the safe return of the owner's property at the expiration of the rental contract. The requirement for the renter to contact Reliance directly in order to obtain a return number is not onerous and is not a significant switching cost.

5. The vast majority of Reliance's customers have open-ended rental agreements and are able to switch suppliers at any time. For the small percentage who are under a minimum term rental contract (currently approximately 7%), all are able to switch suppliers before the expiration of the contract by buying out their rental unit or with a small fee. These terms are similar to (and often more favourable than) terms offered by other water heater rental companies and are comparable to the approach adopted by suppliers of other long term consumer contracts, for example car leases and home mortgages.

6. Competition takes place for new customers, for customers whose rental agreements are expiring and for customers who have open-ended agreements. Such competition is fierce and vigorous, and consists of both retaining current customers as well as winning new customers. Reliance's share of annual new agreements (including renewals) is less than 25% in the relevant geographic market, a small market share in a competitive market that is too small for Reliance to exercise market power, and too small for Reliance to be identified as a dominant firm.

II. RELEVANT MARKET

7. Residential water heaters are designed to heat water for purposes of bathing and washing dishes and clothes. Most commonly, the water heater is a tank that is constantly filled with ready-to-use hot water. The water is heated through gas, electricity, and in some cases, oil or alternative fuels. Although additional types (such as tankless water heaters) also exist in a limited number of homes, they all serve the same function. Water heaters are considered an essential good in almost every home, and last approximately 13 to 17 years.

8. The relevant product market is the market for water heater products and services, whether obtained through the rental of a water heater or through the purchase of a water heater. Essentially, the market ensures that customers have hot water when they need it. The precise technology that underlies the water heater system is not necessarily relevant for the vast majority of customers. Customers may switch between heat sources, model type and functionality, and between renting and buying – further supporting the importance of the overall service of hot water on demand rather than the precise contractual and physical means by which the water is supplied. As with any other durable good, competition occurs at the margin of new sales, so a measure of competition can be obtained from the share of new sales and rental agreements obtained by each of the market participants.

9. Consider by analogy the assessment of competition in automobiles – another durable good where new vehicles are both sold and rented (leased). The structure of the market from a competition perspective is defined in terms of market shares of new vehicles by different manufacturers, not with reference to the “installed base” of existing vehicles (i.e. those on the road or parked in driveways). This conclusion would hold even in an extreme case where all vehicles were leased, and even if those leases contained exit payments. Moreover, even if one

manufacturer, say General Motors, had produced a large percentage of the cars currently on the road, no one would suggest that this fact implied market power for General Motors, particularly if its share of new car sales was small.

10. The relevant geographic market is at least as large as the entire area served by Reliance and all its competitors in these areas, as well as in the areas Reliance could potentially serve. First, other than adjusting for water hardness, Reliance charges the same price for water heater rental services to all its customers. Reliance does not price discriminate between different groups of customers who are geographically dispersed. Moreover, the rental rates are published and publicly available on the webpages of many water heater suppliers, demonstrating that Reliance's major competitors do not price discriminate between customers. This fact alone is sufficient to define the geographic market as the province of Ontario.

11. Second, the geographic market includes the location of all suppliers who compete for the business of consumers of water heater products and services. In every municipality of greater than a few thousand inhabitants there are many suppliers who are willing and able to offer a water heater or a water heater contract to builders of new homes and existing homeowners who are interested in changing suppliers. Even assuming that the markets are "local" – the overlapping "local" areas of competitor water heater rental firms and water heater retailers extends the market beyond the narrow boundaries described in the Application. A geographic market that is constructed along the boundaries of legacy gas utility markets creates artificial boundaries of no practical relevance. Union Gas, for example, lists both Direct Energy and Reliance as water heater rental suppliers on its website, along with Sears and the Home Depot as places to purchase a water heater. Enbridge lists six water heater rental providers in its 2011 Builder Guide, including both Direct Energy and Reliance. Many residences (newly constructed and existing homes) purchase their water heaters and all retailers who can potentially sell water heaters to Reliance customers are included within the geographic market. Prominent examples would be the large hardware chains, such as Home Depot, Canadian Tire, Rona and Lowes; and smaller hardware chains. Local plumbing contractors also supply water heaters, either on a rental or purchase basis. There are suppliers in each of these categories who compete with Reliance, and with the other rental companies, and in many cases are willing to offer either contracts to purchase and install a water heater or a contract to install a rental water heater,

depending on the choice of the customer. The location of these suppliers must also be included in the geographic market, supporting the conclusion that the geographic market is the province of Ontario.

III. BARRIERS TO ENTRY AND SWITCHING COSTS

12. The barriers to entry in the water heater rental or retail business are low; a fact acknowledged by the Commissioner in his Application and supported by the number of small suppliers, together with the number of new entrants.

13. No Exclusionary Contracts. Only a small fraction (approximately 7%) of Reliance's customers have minimum term contracts and the vast majority of customers face no contractual penalties should they wish to switch to an alternative provider or purchase their own water heater (whether by buying out their water heater or acquiring a water heater from a retailer). Moreover, the fees associated with contract termination are minimal and do not have the effect of preventing customers from switching to a more competitive source of supply, if one were offered. Taken together, the minimal cancellation fees and the contract conditions, to the extent they apply at all, have an insignificant competitive impact.

IV. MARKET POWER

14. The supply of water heater products and services, whether rented or purchased, is an industry with intrinsically low barriers to entry. As discussed above, competition takes place on a continuous basis, to both gain and retain customers.

15. Given that low switching costs that have already been identified, it is not possible that Reliance could possess market power. It is a fundamental principle of industrial organization economics that market power cannot be exercised in an industry with low barriers to entry and low switching costs for customers. Any attempt to exercise market power by restricting supply or raising prices would be met with more competitive offers from rival suppliers, and with a rapid erosion of the market share of a firm attempting to increase its price.

V. NO PRACTICE OF ANTI-COMPETITIVE ACTS

16. The policies adopted by Reliance to ensure the safe return of their equipment, and to prevent customers from being exploited by deceptive door-to-door sales practices are not anti-competitive acts. To the contrary, their net effect is likely to enhance competition by improving transparency and information available to the consumer and allowing the consumer to make a clear choice between the services offered by competing suppliers. Reliance has a valid and legitimate business purpose for seeking to prevent its customers from making an ill-informed decision to switch their business away from Reliance.

17. The Commissioner identifies the Removal Reference Number (RRN) policy as “exclusionary”. The policy is designed to facilitate a secure transfer of a Reliance water heater back to Reliance should the customer make a choice to switch suppliers. In addition, by insisting on communicating directly with the customer, Reliance is ensuring that the customers’ wishes are clearly communicated and that the customer is making an informed decision.

18. Judged as a switching cost, the requirement to obtain an RRN number is negligible. It amounts to the requirement to make a single phone call.

19. The business practices of Reliance identified by the Commissioner as anti-competitive are informed by a legitimate business purpose and in fact serve to strengthen competition by improving transparency of the actual terms offered by rival suppliers of water heater products and services. They are designed to strengthen the relationship between Reliance and its customers and make future customers more likely to choose Reliance as their supplier.

VI: NO SUBSTANTIAL LESSENING OR PREVENTION OF COMPETITION

20. Reliance has evolved an efficient business model and has taken advantage of scale and network economies to remain a low cost supplier in the Ontario industry.

21. The market for water heater products and services in Ontario is highly competitive, and increasingly so. During the time period put in issue by the Application, Reliance’s market share has been steadily eroded by competitors.

22. Reliance is not dominant in the Relevant Market. Moreover, given the extremely low barriers to entry and negligible switching costs, even if Reliance were dominant, it would not be possible for Reliance to exercise its market power or likely that any of the practices challenged by the Commissioner could lead to a substantial lessening or prevention of competition.

COMPETITION TRIBUNAL

BETWEEN:

THE COMMISSIONER OF COMPETITION

Applicant

and

RELIANCE COMFORT LIMITED
PARTNERSHIP

Respondent

**RESPONSE
TO THE NOTICE OF APPLICATION**

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