

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*;

AND IN THE MATTER OF certain policies and procedures of Direct Energy Marketing Limited.

BETWEEN:

THE COMMISSIONER OF COMPETITION

Applicant

AND

DIRECT ENERGY MARKETING LIMITED

Respondent

NOTICE OF APPLICATION

TAKE NOTICE that the Applicant will make an application to the Competition Tribunal (the "**Tribunal**") pursuant to section 79 of the *Competition Act* (the "**Act**") for an Order pursuant to subsections 79(1), 79(2), and 79(3.1) of the Act, prohibiting the Respondent from abusing its dominant position by imposing exclusionary water heater return policies and procedures; directing the

Respondent to take certain other actions necessary to overcome the effects of its practice of anti-competitive acts; and directing the Respondent to pay an administrative monetary penalty and costs. The particulars of the Order sought by the Applicant are set out in paragraphs 51 and 52.

AND TAKE NOTICE that the timing and place of hearing of this matter shall be fixed in accordance with the practice of the Tribunal.

AND TAKE NOTICE that the Applicant has attached hereto as Schedule "A" a concise statement of the economic theory of the case.

AND TAKE FURTHER NOTICE that the Applicant will rely on the following Statement of Grounds and Material Facts in support of this application and on such further or other material as counsel may advise and the Tribunal may permit.

STATEMENT OF GROUNDS AND MATERIAL FACTS

I. OVERVIEW OF GROUNDS

1. The Commissioner of Competition (the “**Commissioner**”) alleges that Direct Energy Marketing Limited (“**Direct Energy**”) has abused and continues to abuse its dominant position in the supply of natural gas water heaters and related services to residential consumers in certain local markets in Ontario (the “**Relevant Market**”, as described more fully at paragraphs 30-33 below).
2. Direct Energy substantially or completely controls the Relevant Market. Since 21 February 2012, Direct Energy has preserved and enhanced its market power in the Relevant Market by implementing water heater return policies and procedures that impose significant costs on competitors and prevent customers from switching to those competitors. Direct Energy’s water heater return policies and procedures constitute a practice of anti-competitive acts, the purpose and effect of which is to exclude competitors in the Relevant Market.
3. Direct Energy imposed these water heater return policies and procedures knowing that they would have a negative exclusionary effect on competitors. Indeed, this is the second proceeding the Commissioner has commenced against Direct Energy or its predecessor for a similar practice of anti-competitive acts. On 20 February 2002, the Competition Tribunal (the “**Tribunal**”) issued a Consent Order against Enbridge Services Inc. (now Direct Energy) pursuant to sections 79 and 105 of the Act (the “**Consent Order**”) prohibiting it from, among other things, preventing competitors from disconnecting and returning its water heaters. For the past ten years, therefore, Direct Energy has known of the negative exclusionary effect on competitors of water heater return policies and procedures similar to those it is currently imposing on customers and competitors.

4. The day after the Consent Order expired, Direct Energy imposed, and continues to impose, the practice of anti-competitive acts that is the basis of the Commissioner's current application. This practice of anti-competitive acts has had and is having the effect of preventing and lessening competition substantially. But for Direct Energy's exclusionary water heater return policies and procedures, competitors would likely enter or expand in the Relevant Market and consumers would likely benefit from substantially greater competition.
5. The Commissioner therefore seeks an Order from the Tribunal: (i) prohibiting Direct Energy from directly or indirectly implementing exclusionary water heater return policies and procedures; (ii) directing Direct Energy to take certain other actions necessary to overcome the effects of its practice of anti-competitive acts; (iii) directing Direct Energy to pay an administrative monetary penalty of \$15,000,000; (iv) directing Direct Energy to pay the costs of this proceeding; and (v) such other relief as the Tribunal considers appropriate.

II. MATERIAL FACTS

A. THE PARTIES

6. The Commissioner is appointed under section 7 of the Act and is charged with the administration and enforcement of the Act.
7. Direct Energy, a wholly-owned subsidiary of Centrica plc, is a privately-held corporation that rents natural gas water heaters and provides related services to consumers in Ontario.

B. INDUSTRY BACKGROUND

(i) Residential Use of Water Heaters in Ontario

8. In Ontario, most residential consumers rent water heaters.

9. A significant majority of water heaters in Ontario are powered by natural gas. The next most common energy source for water heaters is electricity.
10. Residential consumers are limited in their choice of energy source for heating water by where they live and the infrastructure constraints of their residence. In rural areas, most residential consumers use electric water heaters as natural gas is generally not available in these areas. In contrast, in areas where natural gas is available, residential consumers commonly use natural gas instead of electric water heaters. Natural gas water heaters generally cost less to operate than electric water heaters.
11. Residential consumers may rent natural gas and electric water heaters from a utility company, if available, or from a rental water heater provider. Residential consumers may also purchase natural gas and electric water heaters from retailers, such as home improvement centres and hardware stores, or from heating, ventilation and air conditioning contractors. Most residential consumers who rent or purchase a water heater also obtain related water heater services, including installation, repair, maintenance and disconnection. When a customer renting a water heater switches providers, the original rental water heater provider generally requires customers to return the water heater.

(ii) Development of Ontario's Rental Water Heater Industry

12. Ontario's two largest natural gas suppliers, Enbridge, Inc. ("**Enbridge**") and Union Gas Limited ("**Union Gas**"), developed the rental water heater industry in the 1950s to expand the use of natural gas in the distinct areas of Ontario where they each had a monopoly in distributing natural gas. Both natural gas suppliers were also regulated by the Ontario Energy Board (the "**OEB**").
13. In 1999, Enbridge transferred its rental natural gas water heater assets to Enbridge Services Inc, which is now Direct Energy. Similarly, Union Gas transferred its rental natural gas water heater assets to Union Energy Inc.,

which is now Reliance Comfort Limited Partnership ("**Reliance**"). The transfer of these water heater assets to Direct Energy and Reliance effectively removed the OEB's oversight and regulation of Ontario's rental natural gas water heater industry.

14. Since this transfer of natural gas water heater assets in 1999, Direct Energy has been the dominant supplier of natural gas water heaters in those areas of Ontario where Enbridge distributes natural gas. These areas correspond generally to the Ottawa area; to the Greater Toronto Area, north to Georgian Bay and east to Peterborough; and to the Niagara Region, covering most of the Niagara Peninsula.
15. On 9 May 2001, the Commissioner commenced a formal inquiry pursuant to subparagraph 10(1)(b)(ii) of the Act into certain water heater return policies and procedures imposed by Direct Energy (then Enbridge Services, Inc.) in the gas-powered residential water heater markets in those areas of Ontario where Enbridge distributes natural gas. On 20 February 2002, the Tribunal issued a ten year Consent Order against Direct Energy that prohibited it from, among other things, preventing competitors from disconnecting and returning water heaters and from imposing on customers a commercially unreasonable and discriminatory buy-out schedule.
16. On or about 30 April 2010 and while the Consent Order against Direct Energy was still in effect, Direct Energy imposed a new water heater return policy (the "**RAN Return Policy**") on competitors and customers. Before Direct Energy implemented this policy, Direct Energy's competitors regularly disconnected and returned Direct Energy's rental gas water heaters on behalf of customers.
17. The Competition Bureau (the "**Bureau**") received several complaints in relation to the RAN Return Policy. Further to these complaints, the Bureau expressed its concerns to Direct Energy. On 21 June 2010, Direct Energy suspended the RAN Return Policy.

C. DIRECT ENERGY'S EXCLUSIONARY WATER HEATER RETURN POLICIES AND PROCEDURES

18. The day after the Consent Order expired, Direct Energy introduced similar exclusionary water heater return policies and procedures to those prohibited under the Consent Order. These exclusionary policies and procedures were implemented by Direct Energy as an integrated strategy. They relate to Direct Energy's water heater removal process, its return depot operations, and its exit fees and charges, as described below.

(i) Direct Energy Imposes an Exclusionary Removal Authorization Number ("RAN") Return Policy

19. On 21 February 2012, Direct Energy reintroduced a RAN Return Policy.
20. Under the current RAN Return Policy, Direct Energy continues to create significant barriers to the return of its water heaters by, among other things:
- i prohibiting the customer or competitor from returning a water heater unless the customer first obtains a RAN from Direct Energy and has signed and fully completed to Direct Energy's satisfaction a "**Rental Removal Order Form**";
 - ii refusing to provide a RAN to customers who contact Direct Energy with a competitor on the call; in such cases, Direct Energy regularly prevents these competitors from joining in on customer calls, notwithstanding that customers have agreed to have competitors on these calls;
 - iii refusing to provide a RAN to competitors calling Direct Energy on behalf of customers;
 - iv refusing to honour any RAN more than thirty days after its issuance; and

- v refusing to recognize agency agreements between customers and competitors that give competitors the authority on behalf of the customer to disconnect and return Direct Energy rental water heaters.

21. Furthermore, Direct Energy has used its RAN Return Policy to deter, impede and prevent customers from terminating their Direct Energy rental agreements and switching to a competitor by, for example, keeping customers and competitors on hold for lengthy periods of time and intentionally dropping calls.

(ii) Direct Energy Imposes Exclusionary Return Depot Policies and Procedures

22. Through its exclusionary water heater return policies and procedures aimed at return depot operations, Direct Energy has created additional barriers for customers and competitors attempting to return their Direct Energy water heaters.
23. Direct Energy has imposed arbitrary restrictions on the return process at its return depots. These restrictions enable Direct Energy to reject at will attempts by customers and competitors to return water heaters, including by restricting the number of water heater return depots that accept water heater returns, restricting the hours of operation of those depots, and limiting the number of Rental Removal Order Forms it will supply to competitors attempting to return Direct Energy's water heaters. Direct Energy has also arbitrarily restricted the circumstances in which water heaters may be returned to such depots on a given day.
24. Where Direct Energy prevents, impedes or deters competitors from returning Direct Energy's water heaters through its restrictive return depot operations or its RAN Return Policy, competitors are forced to store these water heaters. Moreover, Direct Energy refuses to retrieve its water heaters from

competitors' storage facilities even though it retrieves its water heaters from customers' premises.

(iii) Direct Energy Levies Exclusionary Exit Fees and Charges

25. Further, Direct Energy levies multiple and unwarranted exit fees and charges to impede, prevent and deter customers from switching to competitors and to penalize customers and competitors.
26. Direct Energy regularly continues to charge customers the Direct Energy rental rate after customers have switched to a competitor and Direct Energy has prevented the customer or competitor from returning Direct Energy's water heater. Customers are billed extra rental rates by Direct Energy, in some cases for up to several months. These additional costs place a significant financial burden on customers.
27. Direct Energy also regularly imposes on customers unwarranted drain, disconnection and pick-up charges. Additionally, Direct Energy imposes buyout charges on customers who have been unable to obtain a RAN or who are unable to have competitors return a water heater on their behalf. These charges imposed by Direct Energy prevent customers from switching to competitors and need to be assumed by competitors to facilitate customer switching. Direct Energy also does not publish its buy-out prices; accordingly, customers may be unaware of the buy-out price.
28. Direct Energy employs collection processes to harass customers into paying these multiple and unwarranted exit fees and charges. To avoid this harassment and the potential effects on customers' credit ratings, customers pay these unwarranted fees and charges, and competitors need to assume these costs.

III. SECTION 79 OF THE ACT: DIRECT ENERGY HAS ABUSED AND CONTINUES TO ABUSE ITS DOMINANT POSITION

29. By imposing its various exclusionary water heater policies and procedures, Direct Energy has abused and continues to abuse its dominant position in the Relevant Market.

A. DIRECT ENERGY SUBSTANTIALLY OR COMPLETELY CONTROLS THE RELEVANT MARKET

(i) Relevant Market

30. The relevant product market is the supply of natural gas water heaters and related services to residential consumers. These related services include installation, disconnection, maintenance and repair of water heaters.

31. For the majority of residential consumers, no reasonable substitutes exist for natural gas water heaters.

32. The geographic market for the supply of natural gas water heaters and related services to residential consumers is local in nature. The relevant geographic markets are the local markets of Ontario where Enbridge distributes natural gas. For the purpose of this application, these geographic markets have been aggregated.

33. The Relevant Market is thus the supply of natural gas water heaters and related services to residential consumers in those local markets of Ontario where Enbridge distributes natural gas.

(ii) Direct Energy's Market Power

34. Direct Energy substantially or completely controls the Relevant Market.

35. Direct Energy's market power is indicated, for example, by its market share and by barriers to entry. Direct Energy controls over 70% of the Relevant Market, based on annual revenues. Further, Direct Energy's exclusionary

policies and procedures create significant artificial barriers to entry in the Relevant Market, which would otherwise be characterized by ease of entry.

B. DIRECT ENERGY'S WATER HEATER RETURN POLICIES AND PROCEDURES ARE A PRACTICE OF ANTI-COMPETITIVE ACTS

36. Through the various water heater return policies and procedures described above, Direct Energy has engaged and is engaging in a practice of anti-competitive acts. Direct Energy has imposed and continues to impose its water heater return policies and procedures with the purpose of having an intended negative effect on competitors that is exclusionary.
37. Direct Energy imposed these policies and procedures for the purpose of eliminating and preventing the entry or expansion of competitors and to make competitors less effective in competing against Direct Energy in the Relevant Market.
38. Furthermore, Direct Energy imposed and continues to impose these water heater return policies and procedures knowing of their negative exclusionary effects. Pursuant to the ten year Consent Order, the Tribunal prohibited Direct Energy from implementing similar exclusionary water heater return policies and procedures in the Relevant Market. Direct Energy has thus known for the past ten years of the anti-competitive effects of its water heater return policies and procedures. Notwithstanding the above, Direct Energy re-engaged in a similar practice of anti-competitive acts.
39. These exclusionary water heater return policies and procedures imposed by Direct Energy are intended to, and do, exclude and prevent competitors from entering or expanding in the Relevant Market. Direct Energy's water heater return policies and procedures have the exclusionary effect of imposing significant costs on competitors and preventing customers from switching to those competitors.

40. Direct Energy's RAN Return Policy and its arbitrary changes to return depot operations, along with its other exclusionary water heater return policies and procedures, have caused competitors to incur significant additional and unwarranted costs. These costs include transportation and labour costs, as well as the costs of storing the significant backlog of Direct Energy water heaters that Direct Energy has refused to accept or has prevented competitors from returning. These significant costs imposed by Direct Energy limit competitors' ability to compete effectively against Direct Energy.
41. Direct Energy's exclusionary water heater return policies and procedures also result in significant transactional costs for customers that deter, impede and prevent customers from switching to competitors. To facilitate customer switching, competitors need to assume the unwarranted exit fees and charges imposed by Direct Energy on customers during the water heater return process. Further, Direct Energy uses its RAN Return Policy to influence customers to continue their Direct Energy rental agreements despite their intentions and preferences to switch to competitors.
42. In some cases, competitors have declined to replace Direct Energy water heaters with their own water heaters given the significant costs of the unwarranted exit fees and charges they need to assume to facilitate customer switching. In these cases, Direct Energy customers must continue their Direct Energy rental agreements despite their preference and intentions to terminate these agreements and to switch to competitors.
43. In summary, Direct Energy has imposed and continues to impose its water heater return policies and procedures with the intended negative effect of excluding competitors. Moreover, given the aforementioned exclusionary effects, it was and is reasonably foreseeable that Direct Energy's water heater return policies and procedures would have a negative exclusionary effect on competitors.

C. DIRECT ENERGY'S EXCLUSIONARY WATER HEATER RETURN POLICIES AND PROCEDURES SUBSTANTIALLY LESSEN AND PREVENT COMPETITION

44. The exclusionary water heater return policies and procedures imposed by Direct Energy have substantially lessened and prevented and will continue to substantially lessen and prevent competition in the Relevant Market. But for Direct Energy's exclusionary water heater return policies and procedures, competitors would likely enter or expand in the Relevant Market and consumers would likely benefit from substantially greater competition.
45. Direct Energy's exclusionary water heater return policies and procedures establish significant artificial barriers to entry or expansion in the Relevant Market. These exclusionary policies and procedures have prevented and impeded the entry or expansion of competitors in the Relevant Market.
46. In the absence of Direct Energy's practice of anti-competitive acts, barriers to entry would be low and substantially greater competition would likely emerge in the Relevant Market from rental providers as well as retailers of residential water heaters.
47. Further, in the absence of Direct Energy's practice of anti-competitive acts, customer switching in the Relevant Market would likely be substantially greater, and consumers would likely benefit from lower prices and greater product quality and choice.

IV. CONCLUSION

48. Direct Energy has abused and continues to abuse its dominant position by imposing exclusionary water heater return policies and procedures.
49. Direct Energy implemented its exclusionary water heater return policies and procedures with the purpose and effect of excluding and preventing the entry or expansion of competitors. Direct Energy achieves these negative exclusionary effects by imposing significant costs on competitors and preventing customers from switching to those competitors. Direct Energy thus

relies on its exclusionary water heater return policies and procedures, not superior business performance, to retain customers.

50. Direct Energy's practice of anti-competitive acts has substantially lessened and prevented and continues to substantially lessen and prevent, competition in the Relevant Market.

V. RELIEF SOUGHT

51. The Commissioner seeks an Order from the Tribunal pursuant to subsections 79(1), 79(2), and 79(3.1) of the Act:

- i. prohibiting Direct Energy from directly or indirectly implementing any exclusionary water heater return policies or procedures;
- ii. directing Direct Energy to accept valid agency agreements between customers and competitors for return of Direct Energy water heaters;
- iii. prohibiting Direct Energy from charging customers unwarranted exit fees and charges upon termination of a rental water heater agreement;
- iv. directing Direct Energy to provide customers a fixed and commercially reasonable buy-out price upon entering into a rental water heater agreement with Direct Energy;
- v. directing Direct Energy to provide copies of its buy-out price schedule to customers and to make it readily available on its website;
- vi. directing Direct Energy to pay the amount of \$15,000,000 as an administrative monetary penalty;
- vii. directing Direct Energy to pay the costs of this proceeding;
- viii. granting all other orders or remedies that may be required to give effect to the foregoing prohibitions, to restore competition in the

Relevant Market, or to reflect the intent of the Tribunal and its disposition of this matter; and

- ix. granting such further and other relief as this Tribunal may consider appropriate.

52. In determining the amount of an administrative monetary penalty, the Tribunal should take into account the following aggravating factors:

- i Direct Energy implemented its current exclusionary water heater return policies and procedures knowing that similar water heater return policies and procedures had been prohibited under the ten year Consent Order issued by the Tribunal against Direct Energy and knowing that its water heater return policies and procedures would have a negative exclusionary effect on competitors and competition in the Relevant Market;
- ii As a result of its exclusionary water heater return policies and procedures, Direct Energy impedes, deters and prevents others from entering or expanding in the Relevant Market. Further, competitors have incurred significant costs and lost substantial revenue as a result of Direct Energy's exclusionary water heater return policies and procedures;
- iii Direct Energy has financially benefited from its continued abuse of its dominant position;
- iv The practice of anti-competitive acts has not been self-corrected and is unlikely to be self-corrected; and
- v Any other relevant factor.

VI. PROCEDURAL MATTERS

53. The Applicant requests that this application be heard in English.

54. The Applicant requests that this application be heard in the City of Ottawa.
55. For the purpose of this application, service of all documents on the Applicant may be effected on:

**Department of Justice
Competition Bureau Legal Services**
50 Victoria Street, 22nd Floor
Gatineau, Quebec
K1A 0C9

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TO: Direct Energy Marketing Limited

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**AND TO: The Registrar
Competition Tribunal
Thomas D'Arcy McGee Building
90 Sparks Street, Suite 600
Ottawa, Ontario
K1P 5B4**

DATED AT Gatineau, Quebec, this 20th day of December 2012.

"John Pecman"

John Pecman
Interim Commissioner of Competition

Schedule "A"
CONCISE STATEMENT OF ECONOMIC THEORY

1. Direct Energy has implemented various exclusionary water heater return policies and procedures as an integrated strategy to exclude competitors in the Relevant Market. These exclusionary policies and procedures relate to Direct Energy's water heater removal process, its return depot operations, and its exit fees and charges.
2. Direct Energy's exclusionary water heater return policies and procedures impose significant costs on competitors and prevent consumers from switching to those competitors.
3. Direct Energy's exclusionary policies and procedures have substantially lessened and prevented, and will continue to substantially lessen and prevent, competition in the Relevant Market.

Market Power in the Relevant Market

4. The relevant product market is the supply of natural gas water heaters and related services to residential consumers. Related services include installation, disconnection, maintenance and repair of water heaters.
5. The relevant geographic markets for the supply of natural gas water heaters and related services to residential consumers are local in nature. The relevant geographic markets are the local markets of Ontario where Enbridge distributes natural gas. Direct Energy's water heater business is concentrated in these relevant geographic markets.
6. The relevant geographic markets can be aggregated. Thus, the Relevant Market is the supply of natural gas water heaters and related services to residential consumers in the local markets of Ontario where Enbridge distributes natural gas.

7. Direct Energy substantially or completely controls the Relevant Market. Direct Energy's market power is indicated by, for example, its high market share and barriers to entry.

Practice of Anti-competitive Acts

8. The water heater return policies and procedures imposed by Direct Energy create significant artificial barriers for Direct Energy customers to return their water heaters and switch suppliers. These barriers raise competitors' costs and impede Direct Energy's competitors from successfully winning customers based on the quality and price of their products and services.
9. Direct Energy uses its RAN Return Policy to deter, impede, and prevent customers from terminating their Direct Energy water heater rental agreements, from returning Direct Energy water heaters, and from switching to competitors.
10. In addition, Direct Energy has imposed arbitrary restrictions on the return process. Direct Energy uses these restrictions to enable it to reject at will attempts by customers and competitors to return water heaters. These restrictions impose additional costs on competitors and make it more difficult for them to compete effectively against Direct Energy.
11. Further, Direct Energy regularly levies multiple and unwarranted exit fees and charges on customers to deter impede and prevent customers from switching to competitors and to penalize customers and competitors. To successfully win a new customer from Direct Energy, competitors need to assume these exit fees and charges on behalf of customers, further increasing their costs and diminishing their ability to compete effectively against Direct Energy. In some cases, where a competitor is unable to absorb these significant additional costs, Direct Energy rental customers are prevented from switching to a competing water heater provider.

Substantial Lessening and Prevention of Competition

12. The exclusionary water heater return policies and procedures imposed by Direct Energy have substantially lessened and prevented and will continue to substantially lessen and prevent competition in the Relevant Market. But for Direct Energy's exclusionary water heater return policies and procedures, competitors would likely enter or expand in the Relevant Market and consumers would likely benefit from substantially greater competition.
13. Direct Energy's exclusionary water heater return policies and procedures establish significant artificial barriers to entry or expansion in the Relevant Market. In the absence of Direct Energy's practice of anti-competitive acts, barriers to entry would be low and substantially greater competition would likely emerge in the Relevant Market from rental providers as well as retailers of residential water heaters.
14. Further, in the absence of Direct Energy's practice of anti-competitive acts, customer switching in the Relevant Market would likely be substantially greater, and consumers would likely benefit from lower prices and greater product quality and choice.

COMPETITION TRIBUNAL

BETWEEN:

THE COMMISSIONER OF COMPETITION

(Applicant)

-AND-

DIRECT ENERGY MARKETING LIMITED

(Respondent)

NOTICE OF APPLICATION

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