PUBLIC

[redacted]

File No. CT-2002-004

THE COMPETITION TRIBUNAL

IN THE MATTER OF THE *COMPETITION ACT*, R.S., 1985, c. C-34, as amended;

AND IN THE MATTER OF an inquiry pursuant to subparagraph 10(1)(b)(ii) of the *Competition Act* relating to certain marketing practices of Sears Canada Inc.;

AND IN THE MATTER OF an Application by the Commissioner of Competition for an order pursuant to section 74.1 of the *Competition Act*.

B E T W E E N:

THE COMMISSIONER OF COMPETITION

Applicant

-and-

SEARS CANADA INC.

Respondent

WRITTEN REPLY ARGUMENT OF THE COMMISSIONER OF COMPETITION

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1. This is the Commissioner of Competition's (the "Commissioner") Reply to Sears Canada Inc.'s ("Sears") June 17, 2004 Response ("Response" or "Sears' Response").

2. This Reply addresses the following issues:

- the time test, including "substantial period of time" and "good faith";
- subsection 74.01(5); and
- remedy, including due diligence.

I. TIME TEST

(a) Substantial Period of Time

i. Six Months is the Appropriate Reference Period

3. Sears argues that the appropriate time period for purposes of assessing whether Sears complied with the time test is 12 months. In respect of that position, Sears states as follows:

> Sears bases this submission on the fact that analysis of sale and promotion of passenger tires reveals an unparalleled, seasonal spike in the Fall months, and thus a twelve month period is more appropriately used to determine whether Sears has met the frequency requirements of the time test.
>
> ***Response, paras 151, 152***

4. However, Sears offers no explanation as to why a spike in Fall sales necessitates using a 12 month period.

5. The Commissioner submits that using a period six months prior to the representations at issue (the "Representations") would capture any seasonal spike, as well as slower sales months over the summer period, while not offending the "recently before" requirement in ss. 74.01(3)(b).

> ***See also paras 107 - 115 of the Commissioner's Written Final Argument ("Argument" or "Commissioner's Argument")***

6. Sears has included in this sub-section of its argument, a paragraph addressing the meaning of the word "substantial". The Commissioner submits that Sears has misread ss. 74.01(3)(b). It is not the reference period - whether six or twelve months - that must be "substantial". Rather it is the percentage of time within that reference period that the tires were offered at the Regular Single Unit price which must be "substantial". The meaning of the word "substantial" is addressed below.

ii. Substantial Period of Time

Meaning of "Substantial"

7. Sears argues that there is no basis in law or on the facts of this case which would oblige it to comply with the 50% requirement in the guidelines issued by the Commissioner concerning ordinary price claims.

Response, para 156

8. In terms of the meaning of the word "substantial", Sears relies on the Tribunal's decision in *Director of Investigation & Research v. Chrysler Canada Ltd.* and the District Court of Ontario's decision in *Re Catholic Children's Aid Society.*

Response, para 150

9. The Commissioner submits that both of these decisions are context and provision specific and in view of that fact, the Tribunal should not adopt the definitions for "substantial" set out therein.

10. Sears argues that *Chrysler* stands for the proposition that "substantial" means "more than something just beyond *de minimis*".

Response, para 150

11. However, Sears has only included part of the relevant passage from *Chrysler*. In its decision, the Tribunal stated as follows:

> To evaluate the changes in sales and profits experienced by Brunet, it is necessary to determine the meaning of "substantially affected". The Applicant [Director] submits that "substantially affected" simply means more than a de minimis effect. This conclusion is based on the fact that an earlier draft of the Act required only that the person be "adversely affected" which could mean a negative effect to a small degree.
>
> The Respondent [Chrysler] submits that "substantially" does not simply mean "some" or "to a degree" but rather "major" or "significant". The respondent takes the position that the ordinary dictionary definition should be used in the absence of strong reasons to the contrary. The Tribunal agrees that "substantial" should be given its ordinary meaning, which means more than something just beyond de minimis. While terms such as "important" are acceptable synonyms, further clarification can only be provided through evaluations of actual situations.
>
> ***Director of Investigation & Research v. Chrysler Canada Ltd, 27 C.P.R. (3d) 1 at 23***

12. The Commissioner submits that two points may be gleaned from the foregoing. First, the Tribunal agreed with Chrysler that "substantial" means something more than just beyond *de minimis* and that terms such as "important" are acceptable synonyms for "substantial". Second, an evaluation of whether a phenomenon can be considered "substantial" can only made by examining the facts at issue in the particular case.

13. The Commissioner submits that *Re Catholic Children's Aid* does not assist Sears. Sears submits that *Re Catholic Children's Aid* stands for the proposition that "substantial" means "actual, real, not illusory". However, the court in that case was dealing with the

"placement" of a child and the relevant provision stated that the child should be placed in a certain setting "unless there is a substantial reason for placing the child elsewhere". Moreover, what the court said was as follows:

> I agree, as well, that in s. 53(5) of the Act the word "substantial" should be interpreted qualitatively was meaning 'actual, real, not illusory' rather than quantitatively. [emphasis added]
>
> ***Re Catholic Children's Aid Society of Toronto v. M et al. (1987), 62 O.R. (2d) 535 at 538***

14. The Commissioner submits that a determination as to how much time constitutes a "substantial period of time" is largely a quantitative issue.

The 50% Threshold

15. Sears submits that if a 12 month reference period is used, the Response RST Touring 2000 ("Response RST") and the BF Goodrich Plus ("Goodrich Plus") were offered at the Regular Single Unit price more than 50% of the time and thus met the threshold. Sears submits that the Silverguard Ultra IV ("Silverguard") was offered at the Regular Single Unit price 49.6% of the time and that the 0.4% deficit should be considered *de minimis*.

Response, paras 157, 158

16. Sears submits that while the Roadhandler T Plus ("Roadhandler") and Michelin Weatherwise ("Weatherwise") did not meet the 50% threshold, this was due to two "commercial factors". This issue is addressed below.

17. The Commissioner submits that if the Tribunal concludes that six months is the appropriate reference period, then the foregoing numbers are irrelevant.

18. Even if the Tribunal does consider 12 months to be the appropriate reference period, the Commissioner submits that Sears' percentage figure for the Response RST is misleading. The Response RST was not sold by Sears until April 1, 1999. Notwithstanding that fact, for purposes of its percentage calculation, Sears would appear to be counting the time before April 1 as a time when the Response RST was not offered at promotional prices. It wasn't offered at promotional prices because Sears did not sell the tire in that period.

Exhibit CA101
Pub. Hr. Tr. Vol. 8, 1388 (15) - 1389 (24)

Roadhandler/Weatherwise - Commercial Factors

19. Sears submits that the Weatherwise and Roadhandler tires were offered at Regular Single Unit Prices less than 50% of the time in the 12 month period preceding the Representations due to commercial factors beyond Sears' control. The Commissioner understands Sears' position to be that, but for those factors, Sears would have met the 50% threshold for both the Weatherwise and the Roadhandler.

20. Regarding the Weatherwise, Mr. Cathcart testified that due to the unavailability of the Roadhandler in the 80 aspect ratio size, in order to avoid disappointing customers, Sears

"would simultaneously offer at promotional prices the Michelin Weatherwise, which was available in the 80 aspect ratio."

Response, para 160

21. Regarding the Weatherwise and the Roadhandler, Mr. Cathcart testified that a labour dispute in the Orient resulted in Sears not receiving a shipment of snow tires in November 1999. He stated that advertising space had been booked in flyers for those tires. So as to avoid running a "blank page", Sears obtained a "further supply" of tires from Michelin and advertised them instead.

Response, para 161

22. The Commissioner submits that when the timeframe in which the alleged commercial factors arose is considered, it is clear that Mr. Cathcart's explanation is wanting.

23. Mr. Cathcart testified that as a result of the 80 aspect ratio factor, "beginning in about the third quarter, I chose to advertise the Weatherwise, not necessarily at the same price but at the same time as the T Plus."

Pub. Hr. Tr. Vol 16, 2610, (9 - 16)

24. The labour dispute factor arose in the fourth quarter and resulted in Sears not getting a shipment of tires in November. Therefore, any increase in the frequency of the promotion of the Weatherwise and Roadhandler arising as a result of substituting those tires for the

ones not received from the Orient, could only have been in November or December, at the earliest.

Pub. Hr. Tr. Vol 16, 2610, (9 - 16)

25. If, as Sears suggests, the Weatherwise and the Roadhandler were on sale more than 50% of the time because of "commercial factors", then it would be reasonable to expect that in the periods before those factors were "in play", those Tires would have been offered at the Regular Single Unit prices more than 50% of the time. However, they were not.

26. The evidence (which Sears does not contest), shows that for the six month period prior to July 3, 1999 (January 1 to July 2, 1999) both the Weatherwise and the Roadhandler were offered by Sears' at sale prices more than 50% of the time.

Exhibit CA 91 and CA 92

27. In the six months (April 1 to Sept 30, 1999) prior to the 4th quarter in which the shipping issue arose, the RoadHandler T Plus was "on sale" 113 of 183 days or 61.7% of the time and the Weatherwise was "on sale" 133 of 183 days or 72.7% of the time. Thus the shipping issue had little or no effect in putting these tires "off-side" in terms of the time test.

28. In light of the foregoing and the reasons set out at paragraphs 107 - 121 of the Commissioner's Argument, the Commissioner submits that six months is the appropriate

reference period, that four out of the five Tires were not offered at Sears Regular Single Unit price in that period and that, in respect of those four Tires, Sears has not met the time test.

29. However, if the Tribunal concludes that 12 months is the appropriate reference period and that the Response RST, Goodrich Plus, Silverguard, Roadhandler T Plus and the Weatherwise were offered for a substantial period of time at the Regular Single Unit price in that period, then the question remains - were they offered by Sears at the Regular Single Unit price in "good faith" during that period?

(b) Good Faith

i. Good Faith - Subjective/Objective

30. Sears argues that it offered the Tires at Regular Single Unit prices in good faith.

31. The Commissioner submits that running through Sears' "good faith" argument is the notion that "good faith" in ss. 74.01(3)(b) of the Act is an objective concept. Repeatedly in its "good faith" argument, Sears asserts that evidence regarding the regular prices charged by Sears' competitors for tires comparable to the Tires would "appear to be highly relevant to the question of Sears good faith". Sears states that it is "astonishing" that the Commissioner led very little evidence about the regular prices of Sears competitors (particularly its Hi-Low competitors) for comparable tires.

Response, paras 144, 145. See also para 45 of Sears Response

32. The Commissioner submits Sears' position regarding the nature of good faith is incorrect.

33. The Commissioner submits that good faith is an inherently subjective concept.

34. In *Dorman Timber Ltd. British Columbia*, the BC Court of Appeal considered an appeal from a decision in which the Crown had been held not to be vicariously liable for acts of a public servant. Section 3(2) of the *Crown Proceeding Act* exempted the relevant Crown employees from liability for "for anything done or omitted to be done by a person acting reasonably and in good faith while discharging or purporting to discharge responsibilities (I) of a judicial nature vested in him." [emphasis added]

Dorman Timber Ltd. British Columbia, [1997] B.C.J. No. 2117 at para 58

35. After canvassing a number of authorities, including the Supreme Court of Canada's decision in *Chaput v. Romain*, the BC Court of Appeal stated as follows:

> Kellock J.'s formulation [in Chaput] clearly tends towards a subjective understanding of honest belief, but Taschereau J.'s formulation removes all doubt. There is good faith when there is "a state of mind" that the acts are authorized. Kellock J.'s reasons give content to what this "state of mind" is: a "belief in the existence of a state of facts which, had they existed, would have justified him in acting as he did." As was noted in *Hermann*, the reasonableness of the belief is a factor to consider in determining whether the belief was honestly held, but reasonableness is not the issue.
>
> ***Dorman, supra at para 69***

36. The court concluded as follows:

> My conclusion is that the correct test of good faith is subjective: there is good faith if the public servant honestly believes (understood as a state of mind) that he or she has authority. There are of course limits to a belief that, even though genuine, a court can accept as honest. Where there is absolutely no foundation at all for the belief, it will not be honest. Likewise, if the public servant is

willfully blind to the true facts, the belief will not be honest. In this context, the reasonableness of a belief will assist in determining whether the belief is honest. But a belief may be unreasonable and yet honestly held because of the subjective situation of the public servant.

Dorman, supra at para 72

See also, Nelson v. Saskatchewan [2003] S.J. No. 437 (Sask Q.B.) at 102-109 ; Ontario (Human Rights Commission) v. Etobicoke (Borough), [1982] 1 S.C.R. 202; Martel Building Ltd. v. Canada, 193 D.L.R. (4th) 1 at para 84 (SCC); Gerarts v. Peel Condominium Corp. No. 95 [1993] O.J. No. 848 (Ont. C. of J.); and, 430707 B.C. Ltd. v. Royal Bank of Canada [2004] B.C.J. No. 558 BCSC paras 48, 49

37. To determine whether a person acted in good faith, it is necessary to gain an understanding of what that person believed. Did they hold an honest belief that what they were doing was right or authorized? For example, did the police officer believe that s/he had the power to arrest or the nurse believe that s/he was administering the correct medication?

38. Sears argues that one of the central factual considerations pertaining to good faith is the use of Manufacturers' Suggested Retail Prices ("MSRPs") for tires in the marketplace. Sears asserts that the existence of MSRPs in the market constitutes an objective, independent mechanism to directly verify the *bona fides* of Sears' Regular Single Unit prices for the Weatherwise, Roadhandler and Goodrich Plus and, indirectly, the bona fides of the Regular Single Unit prices for the Response RST and the Silverguard Tires.

Response para 13

39. Sears then canvasses at length the evidence given by Messrs. Merkley, King, Cathcart, and McKenna regarding MSRPs.[1] It then asserts as follows:

> Mr. Cathcart's evidence, along with that of Messrs. Merkley and King regarding the existence and use of the MSRP by Sears' competitors in the marketplace, makes it apparent that the good faith requirements were met in this instance. Sears submits that, objectively, its regular prices were "based on sound pricing principles, were reasonable in light of competition in the relevant market", were prices which Sears "fully expected the market to validate", were prices "at which genuine sales occurred" and/or were "prices comparable to those offered by competitors", as stipulated in the Competition Bureau's *Information Bulletin - Ordinary Price Claims* (the "Guidelines") [emphasis added]
>
> ***Response para 45***

40. The Commissioner submits that the evidence of Messrs. Cathcart, Merkley and King regarding the use of MSRPs (even if it was as characterized in Sears' Response), simply does not logically support the conclusions concerning Sears Regular Single Unit prices set out above (i.e., that those prices were "based on sound pricing principles ...", etc.).

41. Sears has admitted that in 1999, it sold only 1.28% of the Tires at Regular Single Unit prices. The question is: In 1999, given its view of its position in the tire market, did Sears truly believe that it would sell more than a very small percentage of the Tires at its Regular Single Unit prices and that the market would validate those prices?

42. To gain an understanding of what Sears believed, the Tribunal must look inside the mind of Sears, not outside at what Sears' competitors were doing.

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[1] The Commissioner takes issue with a number of Sears' assertions and characterizations re this evidence.

43. Mr. Cathcart, Sears' Retail Marketing Manager for Automotive, acknowledged that going into 1999, it was Sears expectation and belief that it would sell approximately 90% of the Tires at promotional prices and the balance,10%, at Regular Single Unit and 2for prices.

Pub. Hr. Tr., Vol. 17, 2861 (6)- 2862 (23)

44. This view is consistent with the picture painted by Sears' internal documents which were, for the most part, prepared by Mr. Keith who: was Sears' tire product and market expert; built Sears' tire line structure and was responsible for setting Sears' tire prices; and, formulated Sears' tire strategy for private label and national brand tires for 1999 and communicated that strategy to Sears' most senior management, including the CEO.

Exhibits CA 23, CA 30, A 33, A 34, A 35, CA 36, CA 37 and CA 48.

45. The documents reveal that Sears had assessed the private label and national brand markets and knew that it was not competitive in either of those markets at its Regular Single Unit prices. Notwithstanding the "central" role Sears now attempts to cast for MSRP, those prices apparently did not factor into Mr. Keith's assessment of the market in 1999 or was so insignificant as to not warrant a mention.

46. The Commissioner submits that aside from Mr. Cathcart's candid admission regarding Sears' expectations heading into 1999, the best evidence regarding Sears' beliefs may be gained from the documents. These documents, which were prepared in 1998 and 1999, before the Commissioner's inquiry was commenced, represent a candid and honest picture of how Sears viewed the market.

47. Documents prepared in the course of business are routinely accepted into evidence for the truth of their contents, as they are generally found to meet the necessary requirement of reliability. Their evidentiary value rests on their unbiased nature, which flows from the fact that they were prepared by disinterested parties, not in anticipation of litigation, but in the normal course of business. Sophinka's comments on the issue are instructive:

> The trustworthiness of business documents is based on the reliability placed on such records by the commercial world. In the absence of routineness, there exists the danger that the maker of the record may not be motivated to be accurate. It is the mercantile nature of the record which attracts trustworthiness, not just the fact that the document was prepared in the regular course of business.
>
> ***The Law of Evidence in Canada, Sopinka, Lederman and Bryant (1999) (2d ed)***

48. Moreover, Sears has led no evidence which rebuts the "*prima facie* proof" which these documents constitute. In particular, with respect to the Automotive Reviews, Mr. Cathcart repeatedly indicated that he was "confused" by the language and did not understand why Mr. Keith would have written what he did. Mr. Cathcart's explanation that Mr. Keith's mischaracterization of the pricing strategy of one group of Sears' competitors may have resulted from a typographical error is simply not credible, particularly when it is recalled that the document in which that supposed error appear was part of a key presentation to, among others, Sears' CEO.

Pub. Hr. Tr., Vol. 16, 2564 (10) - 2562 (3)
Conf. Hr. Tr., Vol. 8, 204 (12-16)
Conf. Hr. Tr., Vol. 8, 205 (24) - 206 (23)
Conf. Hr. Tr., Vol. 8, 211 (20) - 212 (10)
Con. Hr. Tr., Vol. 9, 239 (4-17)
Pub. Hr. Tr., Vol. 16, 2633 (23) - 2637 (1)

49. The Commissioner submits that, in the absence of credible evidence to the contrary, these documents are proof of, among other things, Sears' beliefs regarding the tire market, its competition within that market and where it had to be in terms of price to be competitive. In particular:

– that Sears believed that the pricing strategy of tire stores, including the independents, was to price their tires at a "[redacted]". Mr. Cathcart agreed that "value priced" meant the same thing as EDLP; (i.e. offering the same price everyday).

Exhibit CA 30, 1482
Pub. Hr. Tr., Vol. 16, 2701 (15-20)

– that Sears believed that for both its Private Label and National Brand tires to be competitive, they had to be priced at certain levels -- levels far below Sears' Regular Single Unit prices; and

Exhibits CA 30, 1483-84; CA 33; A 34; A 35; CA 36 and CA 37

– that Sears set its prices for tires at a level where Sears Automotive could meet its margin requirements in respect of tires by selling 90% of tires at promotional prices and only a very small quantity of tires at Regular Single unit prices.

CA-48: Buying Plans for each of the five Tires and one for all lines.
Pub. Hr. Tr. Vol. 19, 3100 (17) - 3101 (11)

50. In terms of expectations regarding tire sales at Regular Single Unit prices, Sears maintains that it knew that there was a consistent segment of purchasers who purchased a single tire. It asserts that its Regular Single Unit prices were validated because approximately 31% of single unit tire purchases were made at those prices. In other words, because Sears' expectation was that it would sell a certain percentage of the tires it sold singly at Regular Single Unit prices, those prices represented "good faith" prices.

Response paras 137, 138

51. The Commissioner submits that Sears' argument is not supported by the evidence. The facts are:

– Sears knew that 5-10% of tires were sold singly;

– given that the Tires were, on average, on sale more than 50% of the time, of that 5-10% of tires sold singly, Sears also knew that less than half of that 5-10% would be sold at Regular Single prices;

– Sears' representations to the public regarding the Tires were for the purpose of capturing single and multiple sales. In Mr. McMahon's words, Sears, "wanted singles. We wanted two tires. We wanted four tires. We didn't care how we got it."

Pub. Hr. Tr., Vol. 20, 3404 (20-22)

– In Sears' internal records sales volumes at Regular Single Unit prices and 2for prices were aggregated. Moreover, none of Sears' documents contemplate that single and multiple tires constitute separate products or product markets. Whereas Sears' Automotive Reviews for 1999 (Spring and Fall) set out separate strategies for "Private Label" and "National Brand" tires, there is no similar bifurcation for single v. multiple tire product markets;

– Sears viewed tire sales as a whole, not split between single and multiple. Therefore, it was Sears' expectation that it would sell only a very small percentage of the tires it sold at Regular Single Unit prices.

52. The Commissioner submits that all of the evidence taken together, including the foregoing and the evidence referred to in the Commissioner's Argument of April 19, 2004, leads inescapably to the conclusion that Sears did not believe that its Regular Single Unit prices were competitive and that Sears did not expect to sell anything more than a very small quantity of Tires at Regular Single Unit prices. Accordingly, Sears did not offer the Tires to the public at the Regular Single Unit prices in good faith.

ii. MSRP

53. As submitted above, even if the evidence regarding MSRPs was as Sears asserts, it does little to advance Sears' position in this case. Even if tire dealers were using MSRPs as

their regular prices (which is not admitted), it does not follow, without more, that Sears' Regular Single Unit prices for the Tires were good faith prices. As discussed above, good faith is an inherently subjective concept. Therefore, the proposition that Sears' hi-low competitors were using MSRPs as their regular prices, even if correct, provides little information about Sears' actual beliefs or expectations concerning whether it would sell anything more than a small quantity of Tires at Regular Single Unit prices and whether the market would validate those prices.

54. Moreover, the alleged use of MSRPs by dealers as regular prices does not assist Sears at all in regard to the Response RST and the Silverguard, as they are private label tires.

55. The Commissioner also submits that the evidence does not support Sears claim that MSRPs were used widely or even commonly by dealers as their regular prices.

McKenna

56. While Mr. McKenna did testify that Mr. Keith used the manufacturers' MSRP books in setting Sears Regular Single Unit prices, he did not testify that the dealers used the MSRP as their regular offering price to the public.

[redacted]

Merkley

57. Mr. Merkley did testify that "some" dealers would use list prices as their regular offering prices. He also testified that in 1999, the norm for dealers' transaction prices would have been in the 30 - 35% off list range.

Pub. Hr. Tr. Vol. 10, 1645 (8) - 1635 (16)

Pub. Hr. Tr. Vol. 10, 1695 (3-5)

King

58. When asked by counsel for Sears whether a MSRP would be a price at which tires were sold to consumers in 1999, Mr. King responded, "Not to my knowledge". Mr. King also testified that 35% off MSRP was the market price in 1999.

Pub. Hr. Tr., Vol 7. P. 1168 (11-23)
Pub. Hr. Tr., Vol. 7, 1180, 12-13

59. Sears suggests in paragraph 34 of its memorandum that Mr. King's evidence regarding MSRP was "anecdotal at best". The Commissioner submits that this suggestion is without merit when Mr. King's responsibilities at Bridgestone/Firestone are examined. In October 1997, Mr. King began working for Bridgestone/Firestone as the Sales Manager for Associate Brands, until August 1999 when he became the Sales Manager for Corporate Accounts and Original Equipment. His responsibilities in that position included managing Bridgestone/Firestone's corporate accounts such as Sears, Canadian Tire, Wal-Mart, and Cost-Co. Sears' submission regarding the anecdotal nature of Mr.

King's evidence is remarkable in view of Sears' reliance on Mr. Cathcart's highly anecdotal evidence regarding his "drive about" in Ottawa.

Pub. Hr. Tr., Vol. 7, 1105 (2) - 1107 (9)
Pub. Hr. Tr., Vol. 14, 2451 (1) - 2454 (5)

Gauthier

60. In paragraphs 29 and 30 of his expert report Mr. Gauthier stated as follows:

> 29. The tire retailers then set their own pricing in the marketplace and, based on my experience, they tended to establish this price as a percentage off of list, as well. A small number of dealers will establish their selling price by simply marking up their cost a set amount (ie; $25 per 13"tire, $30 per 14" tire, $35 15" tire etc, etc).
>
> 30. For example, in 1999 if a dealer was buying Firestone brand tires at list less 50%, he would retail them in the neighbourhood of list less 25% - 35%, depending on the established price level (the level other retailers were selling at) in the market. Tire dealers tended to investigate competitive selling prices before establishing their own retail price level. This scenario holds true for other manufacturers tire brands. If the dealer was buying Michelin X one's at list less 50%, he would also retail the product at list less 25%-35%.
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> ***CA 116, paras 29, 30***

61. In testimony before the Tribunal, Mr. Gauthier indicated regarding the dealer price at 25-35% off MSRP in the example contained in paragraph 30 of his Report (and in the example he provide orally) that it represented a typical everyday selling price.He testified:

> MR. GAUTHIER: Retail selling. Everyday selling price. This is not a sale, it is an everyday selling price, a typical everyday selling price.
>
> ***Pub. Hr. Tr., Vol. 11, 1855 (5-8)***
> ***See also Pub. Hr. Tr., Vol. 11, 1838 (16-23)***

62. In cross-examination, Mr. Gauthier testified with respect to MSRP:

> MR. McNAMARA: It is fair to say then that based on that and based on the factors that you identified in paragraph 29 of your affidavit, those list prices were not disconnected from the reality of the market. Isn't that right?
> MR. GAUTHIER: They are disconnected from the reality of the market in the sense that product wasn't sold at that level.
>
> ***Pub. Hr. Tr., Vol. 11, 1887 (19) - 1888(2)***

63. After walking Mr. Gauthier through who at Bridgestone-Firestone would have worked on preparing the list price books and who in the market would receive those books, Mr. McNamara and Mr. Gauthier had the following exchange:

> MR. McNAMARA: Surely Bridgestone/Firestone's Marketing Department wouldn't be giving the list prices to all of its dealers. That didn't make any sense. Is that right?
> MR. GAUTHIER: No, it is not right.
> MR. McNAMARA: So what's in the books doesn't make any sense.
> MR. GAUTHIER: When it comes to actual selling price at that level, no. It is used to establish acquisition price and then retail sell price.
>
> ***Pub. Hr. Tr., Vol 11, 1892 (4-16)***

64. Later in his cross-examination, counsel for Sears asked Mr. Gauthier whether car dealers "might" have been selling at or close to list prices in 1999:

> MR. McNAMARA: So that for that segment of the market, for example, there might be transactions at list price or close to list price. Is that not right?
> MR. GAUTHIER: To my knowledge, no. My experience, no.
>
> ***Pub. Hr. Tr., Vol. 11, 1896 (12 - 17)***

[redacted]

Cathcart

65. In its Response, Sears cites various parts of Mr. Cathcart's testimony wherein he stated that Sears used MSRPs in setting its Regular Single Unit prices for tires.

66. In his testimony regarding his "drive about" in Ottawa, Mr. Cathcart did not state that the dealers he visited were offering tires at the MSRP. He said that the dealers he visited were prepared to offer him a volume discount off the regular price if he purchased 4 tires. That testimony provides no information regarding the use of MSRPs by dealers.

67. Morcover, for the following reasons, the Commissioner submits that Mr. Cathcart was not a credible witness.

68. First, notwithstanding the fact that he was Sears Retail Marketing Manager for Automotive in 1999, he was unable to answer numerous questions regarding Sears' 1999 Automotive Reviews, which he agreed were marketing documents. He repeatedly said that he found the document confusing and that he didn't understand why Mr. Keith had said this or that. Given the significance of those documents, the Commissioner submits that for Mr. Cathcart to testify that he didn't understand or was confused by them simply strains the bounds of credibility. Either Mr. Cathcart knew what they meant and was not

entirely candid in that regard or Mr. Cathcart truly did not know what they meant. Which ever is true, Mr. Cathcart's evidence should be accorded little weight.

Pub. Hr. Tr., Vol. 16, 2564 (10) - 2562 (3)
Conf. Hr. Tr., Vol. 8, 204 (12-16)
Conf. Hr. Tr., Vol. 8, 205 (24) - 206 (23)
Conf. Hr. Tr., Vol. 8, 211 (20) - 212 (10)
Con. Hr. Tr., Vol. 9, 239 (4-17)
Pub. Hr. Tr., Vol. 16, 2633 (23) - 2637 (1)

69. Second, the evidence presented at the hearing established unequivocally that Mr. Keith had an exhaustive knowledge of tires and the tire market. Mr. Cathcart agreed, among other things, that Mr. Keith knew the tire market better than he did. Among other things, it was Mr. Keith that conceived of, prepared and presented Sears' Automotive strategic marketing plan to the CEO.

See cites at paras 132-134 of Commissioner's Argument

70. Notwithstanding the foregoing, counsel for Sears and Mr. Cathcart had the following exchange in re-direct:

> MR. McNAMARA: You were asked about Mr. Keith's expertise in tires. Was Mr. Keith an expert in marketing?
> MR. CATHCART: He would think so, sir, but I would not.

Pub. Hr. Tr. Vol. 17, 2897 (6-10)

71. Third, in direct testimony regarding the Competitive Profile for the Weatherwise, Mr. Cathcart had a concise, clear response for why the profile referred to "35% OFF LIST".

[redacted]

72. [redacted]

Conf. Hr. Tr., Vol. 9, 251 (19-24)

73. The Commissioner submits that in view of all of the foregoing, at a minimum, raises a serious question as to Mr. Cathcart's credibility and reliability. Mr. Cathcart's evidence should be accorded little weight.

74. Mr. Gauthier's credibility was not shaken.[2] Mr. King's credibility was not challenged.

[2] In the course of Mr. Gauthier's qualification as an expert witness, Sears alleged that Mr. Gauthier was not independent. The Tribunal did not accept that argument. Notwithstanding that, Sears persists in arguing that Mr. Gauthier is not independent.

74a. The Commissioner submits that with respect to the MSRP issue, Mr. Gauthier's detailed evidence, as supported by Mr. King's evidence, should be accepted over that of Mr. Cathcart and Mr. Merkley's evidence that "some" dealers used MSRP"

iii. Relevant Geographic Market

75. Sears suggests that in order to assess the "good faith" of its prices, a comparison with prices of competitors in local markets is required.

76. As discussed above, good faith is inherently a subjective notion and in this case turns on Sears' subjective view of the genuineness of its Regular Single Unit prices.

77. Sears' prices were not set on a local market basis and there is a complete absence of evidence that Sears put its mind to the competitiveness of its Regular Single Unit prices on a local market basis. Rather, Sears' marketing strategy and prices for the Tires were set at Sears' head office for the entire country. In view of that, the notion that Sears' good faith should be assessed on a local market basis is simply untenable.

78. In this case, all of the evidence all of the evidence suggests that the volume and time tests are best assessed by reference to the entire area over which the representations were made - that is, Canada. In this regard, the Commissioner notes that:

– The flyers and newspapers containing the Representations were distributed nationally;

– There was no regional variation in the Representations;

– Sears prices were set on a national basis, without regional variation;

– The promotional events described in the Representations were designed and conducted as national events in response of [redacted] Canada; and

– Sears tracked estimated sales volumes and promotional periods on a national basis only.

II. *COMPETITION ACT* - SS. 74.01(5)

79. Subsection 74.01(5) of the Act provides as follows:

> (5) Subsections (2) and (3) do not apply to a person who establishes that, in the circumstances, a representation as to price is not false or misleading in a material respect.

80. Sears has argued that the OSP representations at issue in this proceeding were not false or misleading in a material respect because, in short:

– Sears customers who purchased the Tires in 1999:

  – did not simply rely on Sears advertisements. Instead, these customers comparison shopped and made informed decisions regarding their purchases;

  – did not consider price to be the most important factor in their purchase of Sears tires; and

  – were satisfied with their purchases; and

– advertisements that Sears ran in 1999 that did not contain a OSP representations or a "save story" were equally effective in generating sales.

(a) False or Misleading to the "Ordinary Citizen"

81. The Commissioner submits that to prevail under ss. 74.01(5), Sears must "establish" that the Representations were not false or misleading in a material respect to the "ordinary citizen".

82. In *R. v. Kenitex Canada Ltd.*, Kenitex and three individuals were charged with making representations that were false or misleading in a material respect to promote their business interests. Misner, J. held that the key issue to be decided in the case was whether or not the representations at issue conveyed an impression to the "ordinary citizen" which was false or misleading. With respect to the meaning of the words "ordinary citizen" Misner, J. stated:

> The ordinary citizen is, by definition, a fictional cross-section of the public lacking any relevant expertise, but as well possessing the ordinary reason and intelligence and common sense that such a cross-section of the public would inevitably reveal. In the last analysis, therefore, it is for the trier of fact to determine what impression any such representation would create, not by applying his own reason, intelligence and common sense, but rather by defining the impression that that fictional ordinary citizen would gain from hearing or reading the representation.
>
> ***R. v. Kenitex Canada Ltd. [1981] 51 C.P.R. (2d) 103 (Ont. C.C.) at pp.107-108 (reversed in part on other grounds 59 C.P.R. (2d) 34 (Ont. C.A.)***
>
> ***See also R v. Shaheen Ltd. (1975), 28 C.P.R. (2d) 147 at 149; Queen v. Canadian Tire Corp., Ltd. et al., 14 C.P.R. (3d) 373, R v. Westfair Foods, Manitoba Judgements [1986] M.J. No. 216 (Q.B.) At p. 9 of 19; and, R v. D.E.S Security Systems [1987] O.J. No. 2489 at para. 10.***

83. It follows from the foregoing that, it is not necessary for the Commissioner to establish that any person was actually misled or harmed by an impugned representation.

84. It was argued by the defence in *R v. Simpsons* that there was no evidence that any person had in fact been induced by the promotion in issue to go to a Simpsons store or purchase a product. In respect of that argument Justice Sheard stated as follows:

> "To prove the offence it is not necessary for the Crown to prove that the purpose of the representation was achieved. The offence is committed at the point when the materially false or misleading representation is made to the public, whatever may have been in fact the consequential result of the misrepresentation."
>
> ***R. v. Simpson, 25 C.P.R. (3d) 34 at 38.***
> ***R v. Tege Investments Ltd. (1978) 51 C.P.R. (2d) 216, para 10.***

85. Therefore, the Commissioner submits that to determine that the Representations were not false or misleading in a material respect, the Tribunal must:

– determine whether the Representations were false or misleading; and

– if it finds that the Representations were false or misleading, determine whether they were false or misleading <u>in a material respect</u>.

86. In making these determinations, the Tribunal must take into account ss. 74.01(6) of the Act. It provides:

> In proceedings under this section, the general impression conveyed by a representation as well as its literal meaning shall be taken into account in determining whether or not the representation is false or misleading in a material respect.

87. With respect to the issue of general impression, in *R. v. Imperial Tobacco Products Ltd.*, the Alberta Supreme Court, Appellate Division, referred with approval to the following passage from *F.T.C. v. Sterling Drug, Inc.*, a decision of the United States Court of Appeals, Second Circuit:

> It is therefore necessary in these cases to consider the advertisement in its entirety and not to engage in disputatious dissection. The entire mosaic should be viewed rather than each tile separately. The buying public does not ordinarily carefully study or weigh each word in an advertisement. The ultimate impression upon the mind of the reader arises from the sum-total of not only what is said but also of all that is reasonably implied.

R. v. Imperial Tobacco Products Ltd., (1971), 4 C.C.C. (2d) 423 at 441
F.T.C. v. Sterling Drug, Inc. (1963), 317 F. 2d 669 at 674
The Commissioner of Competition v. P.V.I. International, 2002 Comp. Trib. 24 at para 24
See also R v. Conroy Electronics, 17 C.P.R. (3d) 175 at 184; and R v. Muralex Distributions Inc. 15 B.C.L.R. (2d) 151

(b) False or Misleading in a Material Respect

88. The Commissioner submits that Sears has failed to establish that the Representation were not false or misleading in a material respect.

i. Sears' Representations were False or Misleading

89. The Commissioner submits that the general impression conveyed by the Representations is that consumers purchasing the Tires at Sears at promotional prices would realize substantial savings over what they would have paid for those Tires but for the sales promotion.

90. However, the Representations were false or misleading. They grossly overstated the savings that would be realized on 90 to 95% of the Tires Sears sold at sales events.

91. In 1999:

– 90-95% of tires were sold in multiples as opposed to singly;

Pub. Hr. Tr., Vol. 14, 2486 (13-24)
Pub. Hr. Tr., Vol. 16, 2726 (5-12)

– for any given Tire, the 2for price was always substantially lower than the Regular Single Unit price;

– Sears never advertised its 2for price. It always used its Regular Single Unit price as the OSP or reference price in its advertising, including in the Representations;

– when a given Tire line was not "on sale", Tires from that line could always be purchased at Sears' 2for price if purchased in multiples; and

– the Regular Single Unit price would have never come into play on sales of multiple tires.

Pub. Hr. Tr., Vol. 17, 2759 (13-24)

92. Mr. Cathcart agreed that for tires purchased in multiples at Sears' promotional events, which would include events of the sort promoted by the Representations, the savings realized by Sears' customers on the purchase of multiple tires would **not** have been the difference between Sears' Regular Single Unit price and the its promotional price, but rather the difference between the 2for price that the purchaser would have paid if the tires were not on sale and the promotional price.

Pub. Hr. Tr., Vol. 17, 2760 (3-19)

93. For example, based on Sears' representations in Sales Event #1 regarding the Response RST Touring 2000 , an "ordinary citizen" contemplating the purchase of 4 tires (size P215/70R14)[3] would reasonably believe that their savings on the transaction would be $246.00. That would be false. The savings off Sears' own prices would have been only $62. The table below sets out the calculations.

[3] All of the Tires were offered to the public in a variety of sizes. Where in this Reply pricing and other examples are set out necessarily using one size or another of a given Tire. The examples are intended to be illustrative of pricing relationships which exist within Sears' tire lines and between Sears prices and those of its competitors. Using a different size of tire for purposes of any given example may alter the absolute numbers, but will not materially alter the relative pricing relationships.

[redacted]

Response 2000 RST

Regular Single Unit price	Purchase of 4 Tires at Regular Single Unit price	Great Item price	Purchase of 4 Tires at Great Item price	Purported Savings
$133.99	$535.96	$72.49	$289.96	$535.96 -$289.96 **$246.00**
		2 for price	**Purchase of 4 Tires at 2 for price**	**Savings (off Sears' 2 for price)**
		$87.99	$351.96	$351.96 -$289.96 **$62.00**

Exhibits A-12 - 14, and CA-35.

94. In the foregoing example, Sears misled ordinary Canadians - its customers and prospective customers - into believing that they would realize substantial savings by purchasing four units of the Response on sale. In the foregoing example, the savings are overstated by 300%.

95. In view of the fact that for any given size of any Tire, Sears' 2for price was always substantially lower than its Single Unit price for that size of Tire, it necessarily follows that Sears substantially overstated the savings its customers and prospective customers would realize in every single OSP sale representation Sears made to the public concerning the Tires in 1999.

Sears made False or Misleading Representations to Millions of Canadians

96. The Commissioner submits that to rebut the "false or misleading" aspect of Sears ss. 74.01(5) defence, it would be sufficient for the Commissioner to demonstrate that Sears had made a false or misleading representation to one member of the public. However, Sears went much further.

R v. Simpsons Ltd., 25 C.P.R. (3d) 34 at 37

97. By making the Representations in flyers, newspaper advertisements and other media, Sears repeatedly and routinely made false or misleading representations of the type described above to millions of Canadians from coast to coast. What's more, given that Sears knew that 90-95% of Tires were sold in multiples and that it had an unadvertised 2for pricing structure in place, Sears would have to had known that it was making these false representations to Canadians.

Exhibit CA-9: McMahon Feb. 1, 2001 affidavit, paras. 16, 28, 31-33.
Exhibit CA-10: Exhibit "A" to the McMahon Feb. 1, 2001 affidavit, preprint circulation flyers.
Exhibit CA-11: Exhibit "B" to the McMahon Feb. 1, 2001 affidavit, Chronological Listing of Newspapers - 1999

ii. False or Misleading "in a Material Respect"

Meaning of Materiality

98. Sears has focussed its ss. 74.01(5) argument on the issue of materiality.

99. The issue of materiality in the context of deceptive marketing is not new to the Act. Both the former ss. 52(1) of the Act and predecessor deceptive marketing provisions in the Act and the *Combines Investigation Act* incorporated the concept of materiality.

100. In *R. v. Simpsons*, Sheard J. considered the meaning of the word "material" in the context of a case in which it was alleged that Simpsons had made representations that were false or misleading in a material respect. After canvassing the various authorities on that issue, including *R. v. Canadian Tire*, Sheard J. stated as follows in respect of Simpsons representations:

> The representation was part of a sales promotion scheme designed to draw customers into a Simpsons store and there to make a purchase or purchases. To induce that course of conduct was obviously the purpose of the promotion and the purpose of the misrepresentation. The misrepresentation was "material" in the ordinary and dictionary meaning of that word.
>
> ***R. v. Simpson, supra at 38.***

101. In *Canadian Tire*, the Provincial Court of Manitoba referred to with approval the definition of materiality used in *R. v. Tege Investments Ltd.*:

> The word material, I take to mean... the shorter Oxford Dictionary meaning of much consequence, or importance or pertinent or germane or essential to the matter.
>
> ***R. v. Canadian Tire Corp. Ltd. 14 C.P.R. (3d) 372 at p. 382***
> ***R. v. Tege Investments Ltd., supra at p. 219***
> ***See also v. D.E.S Security Systems, supra at para 14***

102. Similarly, in *R. v. Kenitex,* the court stated:

> In my view that element simply means that the representation will be false or misleading in a material respect if, in the context in which it is made, it readily conveys an impression to the ordinary citizen which is, in fact, false or misleading and if that ordinary citizen would likely be influenced by that impression in deciding whether or not he would purchase the product being offered.
>
> ***R. v. Kenitex, supra at p. 107***

103. In considering the meaning of the term "material" in the context of misleading advertising and representations, US courts have come to similar results.

> ***Novartis v. FTC 223 F (3d) 783, 787 (DC Cir. 2000), citing Cliffdale Assocs., 103 FTC at 165.***

104. The Commissioner submits that the test for whether a representation was material in the context of ss. 74.01(5) it readily conveys an impression to the ordinary citizen which is false or misleading and if that ordinary citizen would likely be influenced by that impression in deciding whether or not he would purchase the product and includes circumstances surrounding the purchase, such as a decision to visit a particular store or website, and is not limited to the actual decision to purchase.

Sears' Representations were False or Misleading in a Material Respect

105. Sears' false or misleading representations pertained to the prices at which consumers could purchase the Tires from Sears and the savings they could allegedly enjoy by purchasing those Tires at a Sears' sales event. The Commissioner submits that it is a matter of common sense that for the ordinary citizen contemplating the purchase of tires, price and savings would be a material consideration.

106. Moreover, the Commissioner submits that the evidence demonstrates that the Representations this case were false or misleading in a material respect.

107. Clearly Sears believed that OSP representations were a material consideration to prospective customers. In the Representations, although there is typically mention of warranty and sometimes reference to performance characteristics, the most space, largest font and boldest text were reserved for price and saving messages. Sears knew what Professor Lichenstein stated, OSP representations build traffic and move product.

108. In this regard, Mr. McMahon testified that the representations that Sears made regarding tires in 1999 in flyers and newspapers (which included OSP representations) were "meant to drive business into our stores on the items that were promoted -- based on the items that were promoted".

Pub. Hr. Tr., Vol 20, 3397 (14-23)

109. Mr. McKenna agreed that Sears ran the OSP representations at issue in this case "to build in-store traffic and to increase tire sales". Mr. McKenna also agreed that when Sears made high/low representations to the public regarding tires in 1999 and offered tires on sale, it sold more units than when any given tire was not on promotion.

Pub. Hr. Tr., Vol. 19, 3158 (14-25)

110. Sears had Normal promotional prices and Great Item promotional prices. For any given Tire, the Great Item promotional price was always greater than the Normal promotional price. Mr. McKenna agreed that, all other things being equal, in a given time period, if Sears advertised a Tire at Great Item price as opposed to Normal promo price, it would expect to sell more Tires.

Pub. Hr. Tr., Vol. 19 (3162, 2-7)

111. Sears' post-1999 experience confirms the materiality of OSP representations.

112. [redacted] If consumer purchases were predicated on transaction prices for the Tires, as opposed to the perceived value/savings created by Sears' OSP representations, then [redacted]

Conf. Hr. Tr., Vol. 11, 282 (9-19)

113. However, following its reduction of Regular Single Unit prices, Sears' sales volumes at promotional prices decreased. In cross-examination, Mr. McMahon admitted that "it was probably true" that the reason promotional sales decreased was that when it lowered

its Regular Single Unit prices, Sears could not use as favourable save stories in its promotions.

Pub. Hr. Tr., Vol 20, 3386 (21) - 3387 (1)

114. In short, notwithstanding the fact that it did not alter its promotional prices, when Sears reduced its Regular Single Unit prices and thus used less favourable save stories, Sears' customers changed their behaviour and promotional sales declined. In fact, promotional sales declined to the point that, notwithstanding the fact that Sears' tire sales at Regular Single prices had increased, Sears was not meeting its profit objectives in respect of tires.

115. Finally, the views expressed in Sears Fall 2000 Automotive Review offer further evidence of Sears' belief that OSP advertising drives traffic and sales for tires and other automotive goods. For example, the first bullet in the "Gross Profit-Strategic Direction - Marketing and Sales Promotion states that "[redacted]"

Exhibit CR 141: Fall 2000 Automotive Review, p. 16515

See also p. 16519

116. The evidence of expert witnesses provides further confirmation of materiality.

117. Numerous marketing studies document that if a promotional flyer or advertisement includes a regular price in addition to the sale price, consumers are likely to respond even

more positively than if a sale price is depicted without an accompanying regular price. This is because, when a regular price is present in the promotional flyer or advertisement, consumers are likely to use the regular price as a reference price to make judgements about "perceived value," which is then used to make decisions about: (a) whether to buy now or wait, (b) which brand/model of tire to buy, (c) whether to buy tires at the promoting retailer or at another retailer. Moreover, OSP Representations have a positive influence on consumers' value perception and a negative influence on consumers intent to search.

Exhibit CA 123: Moorthy's Expert Report, para. 26.
Exhibit CA 120: Lichtenstein's Expert Report (Main Case), para. 40.
Pub. Hr. Tr., Vol. 12, 1989-1990.

118. Numerous marketing studies also document that consumers respond to promotional flyers/advertisements by increasing their purchases of the promoted product at the promoting retailer.

Exhibit CA 123: Moorthy's Expert Report, para. 25.

Impact of being a Private Label Good

119. The Tires were exclusive to Sears in 1999. As such it was difficult for the average consumer to compare the Tires with competing offerings. Sears recognized this fact. The first two bullets on the first page of a section of the 2000 Fall Review called "Gross Profit - Strategic Direction - Assortment" state:

[redacted]

CR 141: Fall 2000 Automotive Review, p. 16514

120. When consumers cannot assess intrinsic attributes of a product, they cue on extrinsic attributes (store names, brand names, perceived value). As such, the likelihood increases that they would respond to a merchant advertising "exceptional values," especially if the merchant, such as Sears, is perceived to be credible. Further, there is widespread recognition that OSP representations are likely to have a greater impact for product categories such as the Tires where intrinsic attributes are hard for consumers to assess.

Exhibit CA 120: Lichtenstein's Expert Report (Main Case), paras. 45-47 and 50. Pub. Hr. Tr., Vol. 12, 1997 (8) - 1999 (3); and 2003 (24) - 2004 (2).

Impact of Sears' Credibility

121. Sears is perceived to have very high credibility. Exposure to an OSP claim for tires from a credible merchant such as Sears that signals a good deal to consumers would be expected to result in less time and effort spent searching for and evaluating alternative products, and increase the probability of purchasing tires from the advertising merchant.

Consequently, consumers who are in the market for tires and who are exposed to the Sears OSP claim are likely to be influenced to visit the Sears Automotive Centre and purchase Sears tires during that visit.

Exhibit CA 120: Lichtenstein's Expert Report (Main Case), paras. 40, 52.
R v. T Eaton Co. Ltd., 4 C.P.R. (2d) 226 at 227-28.
R v. Ben Moss Jewelers Ltd. (1972), 7 C.P.R. (2d) 184 at 186

Impact of being a Shopping Good

122. All-season tires for the mass-market are a shopping good. Research shows that consumers engage in a low level of search for shopping goods such as the Tires.

Exhibit CA 120: Lichtenstein's Expert Report (Main Case), paras. 26, 37 and 39.
Pub. Hr. Tr., Vol. 12, 1986 (17-25).

123. Statements made by Mr. Cathcart are consistent with this conclusion, that for most consumers the level of involvement with the product category of tires is not high.

Exhibit CA 120: Lichtenstein's Expert Report (Main Case), para. 38.

124. Moreover, even if accepted, evidence that consumers shopped does not assist Sears in this case.

R v. Mann's TV & Stere Limited (unreported) 1883 (Ont. P.C.) at 9-10

Extensive use of OSP advertising by Sears

125. It is submitted that materiality of the OSP representation is reflected in Sears conduct. Sears must have believed that the OSP representations were effective and had a material effect on consumer purchasing decisions. Moreover, Sears continues to make extensive use OSP advertising.

Harm

126. Finally, running through Sears case is the notion that no one was harmed and consumers got good value for their money. Whether that is true or not is a matter of conjecture. The important point is that even if that were true, it does not assist Sears in this case. As the court stated in *R v. Kellys on Seymour*:

> Now a mere misrepresentation is not sufficient to justify a conviction; it must be one which is material and defence counsel argued, and quite properly so, that the material misrepresentation could, and perhaps I should say and/or should apply to the end result, that is, the value of what th person was obtaining. But I think this, again, cannot be upheld. This submission has been made on prior occasions and it has been held that even though the person in fact got a bargain, and may in fact also have paid less than he would ordinarily gave paid, this is not the criteria. The criteria is, did in fact the person think that what he was buying was, to the ordinary purchaser, in the ordinary market, worth the price it is purported to be worth, and from which it is reduced.
>
> ***R* v. *Kelly's on Seymour*, (1960) 60 C.P.R. 24 at 26**
> ***See also R* v. *Patton Place Ltd.*, supra at 16; and *R* v. *J. Pascal Hardware Co. Ltd.* (1972), 8 C.P.R. (2d) 155 at 159**

III. REMEDY

(a) Order Pursuant to ss. 74.1(1)(a)

127. The Commissioner is seeking an order requiring that Sears not engage in the impugned conduct or substantially similar conduct (a "prohibition order"). In its Response, Sears asserts the following:

- that the Commissioner inappropriately seeks to "punish" Sears for relying on hi-lo marketing and advertising;

Response paras 191 - 193

- that a prohibition order would be inappropriate having regard to the due diligence undertaken by Sears; and

Response paras 194 - 195, 206-207

- that any prohibition order should be limited to the Tires.

128. These arguments will be dealt with in turn.

i. *Hi-Lo Marketing Generally*

129. Sears asserts that hi-low marketing is an accepted marketing and pricing strategy in Canada, and that the Commissioner seeks to punish Sears for marketing its products in this manner. It is submitted that Sears has misstated the Commissioner's position. The Commissioner acknowledges that hi-low pricing is a legitimate practice. What the

Commissioner *does* oppose is OSP representations which contravene the Act by using inflated regular prices to drive traffic and sales.

ii. *Due Diligence*

130. The Commissioner submits that due diligence is irrelevant for the purposes of determining whether the Tribunal should make a prohibition order under 74.1 of the Act.

iii. *Scope of the Prohibition Order*

131. It is submitted that the Remedial Order should apply to all goods sold by Sears, not only the Tires, for the following reasons:

132. Paragraph 74.1(1)(a) provides that when the Tribunal makes a finding of reviewable conduct, it may order a person not to engage in "conduct or substantially similar conduct". In 1999, Sears used OSP representations in promoting 27 of the 28 tires it sold to the public. As a hi-low retailer, Sears also used OSP representation in promoting a broad variety of other products it sold. Whereas Sears has stopped using OSP representations to promote tires, it continues to use them to promote various other goods.

133. As discussed below, the 1999 Memorandum was produced by Sears' in-house Legal Department. The Commissioner notes that this document was provided to all Sears' Vice-Presidents by Sears' Legal Department with the instruction that it be provided to

their direct reports. It, along with Policy M-968, was Sears' internal policy regarding OSP advertising. As noted above, the 1999 Memorandum is devoid of any substantive discussion of good faith.

134. The Commissioner submits that is reasonable to infer that, given the arithmetic approach to the time test prescribed by the 1999 Memorandum and the fact that the Memorandum was Sears' Sears-wide OSP policy, a reasonable inference can be drawn that all "groups" within Sears followed a similar approach to OSP compliance to Sears Automotive.

135. The Commissioner submits that the "conduct" contemplated by paragraph 74.1(1)(a) is the making of OSP representations which do not conform with the Act. With the inclusion of the words "substantially similar conduct", Parliament has provided the Tribunal with the power to craft an order which addresses the "mischief" sought to be addressed by, among other provisions, ss. 74.01(3) of the Act.

136. If Sears' position with respect to the scope of any prohibition order were accepted, it would mean that, for a large retailer, like Sears, to enforce the Act, the Commissioner would have to bring a succession of cases to address the "conduct" (construed narrowly) in respect of each good or product sold by that retailer.

137. It is apparent from the amount of time and resources expended to bring and have this application heard that this would be hugely impractical, if not impossible. As such, it is

submitted that when a retailer employs the same pricing strategy with respect to most of its products, and is found to be implementing this pricing strategy in contravention of the Act with respect to some products, a prohibition order should apply to all the products it retails using this marketing strategy.

138. The Commissioner submits that there is ample authority for the proposition, in the criminal context (including in the OSP context), that prohibition orders should reach beyond the particulars which underpin the conviction and prohibit the offensive conduct more generally.

R v. Sunbeam Corporation (Canada) Ltd. 62 D.L.R. (2d) 75 (Ont. C.A.) at 93-93; and1 D.L.R. (3d) 161 (SCC) at 175

Rv. Kresge Co. Ltd 8 Nfld & P.E.I.R. 415 at para 5, 6, 13, 14, 15

R v. St. Lawrence Corp. Ltd, (1969) 3 C.C.C. 263 at 289-293

139. However, there is also authority in the OSP context for the proposition that a prohibition order should not necessarily relate to all goods sold by an offender, but rather should be limited to goods which are similar or of a like kind.

R v. Woolworth 18 C.C.C. (2d) 23 at 35-36

(b) Corrective Notice and Administrative Monetary Penalty

i. Due Diligence

140. Sears argues that it exercised due diligence with respect to the Representations and hence a corrective notice and an AMP should not be ordered.

141. The Commissioner submits that, in 1999, in respect of Representations, Sears failed to exercise due diligence to ensure compliance with subsection 74.01(3) of Act.

142. In accordance with the Supreme Court of Canada's decision in *R. v. Sault St. Marie (City)*, a party asserting due diligence must establish on a balance of probabilities that all due care was taken to avoid committing the prohibited act.

***R. v. Sault St. Marie (City)*, [1978] 2 SCR 1299**

Sears' Pricing Policy

143. Sears recognized that its pricing strategy as an off-price retailer and, in particular, its practice of referencing Regular Prices in the save stories it employed in its advertising, created certain obligations under the Act. In recognition of and to ensure compliance with those obligations, in 1995 Sears instituted a pricing policy in the form of Bulletin M—968 (hereinafter the "Pricing Policy"), which applied to all departments, including Automotive. The Pricing Policy was posted electronically on Sears' internal system for all key staff to review.

144. In terms of the use of price comparison type representations of the sort which underpin this Application, the Pricing Policy required, among other things, that:

a) "All comparison prices must refer to the last Sears price which was active within the preceding [redacted] months, unless otherwise stated. Comparison prices which imply savings must be to our regular selling price."; and

b) "... the comparison price should reflect a substantial sales volume."

145. The Pricing Policy was in effect throughout 1999, and those persons within Sears' Automotive who were responsible for ensuring compliance with the Act relied on the policy in connection with the making of regular price representations such as the Representations.

146. However, Sears failed to adhere to, or even apply, its Pricing Policy in connection with the Representations it made to the public regarding the Tires in 1999.

147. The Pricing Policy required that before a comparison price (i.e., a regular price) for a given item was utilized, that there be "a substantial sales volume" at that price. To determine whether in any given instance there had been a substantial sales volume at a given comparison price, it would of course be necessary for Sears to first determine what volume of sales had been made at that price. Only once that determination had been

made, would it be possible for Sears to assess whether the volume of sales at the comparison price could be considered "substantial".

148. In 1999, Sears never determined the volume of sales for any of the Tires at the Sears' Regular Price. Sears did not collect data on the volume of sales of the Tires at the Regular Prices used in its advertising. Instead, in respect of each of the Tires, Sears combined or aggregated the volume of sales at the Regular Price and at the 2 For Price. In fact, Sears' information gathering systems were not configured in a manner which would allow Sears to obtain a report or generate data regarding the volume of Tire sales at Regular Prices. Those systems had been programmed such that they could only provide reports in respect of any given tire that would indicate the volume of that tire sold at the Regular Price and 2 For Price on an aggregate basis.

149. In view of the foregoing, it was impossible for Sears to assess whether or not there had been a substantial volume of sales at the Regular Prices.

150. To the extent that Sears did attempt to assess whether there had been a substantial sales volume in 1999, at the Regular Prices for any of the Tires, the Sears' personnel responsible for compliance with the Pricing Policy considered the total volume of sales for the Tires at both the Regular Price and the 2 For Price on a combined basis. In other words, contrary to Sears' Pricing Policy, Sears failed to consider the volume of Tire sales at Sears' comparison price (i.e. Sears Regular Price).

151. Therefore, prior to making the representations regarding the Tires which are set out in the Representations, contrary to its own Pricing Policy, Sears did not ensure that the comparison price reflected a "substantial sales volume".

152. The practice of considering aggregated Regular Price and 2 For Price sales data was followed consistently in 1999 despite the fact that only Regular Prices and not 2 For Prices were used as a comparison price when promoting tires on sale.

153. In addition to the foregoing, the Pricing Policy provided that, "Generally speaking, substantial sales volume will be achieved when the product has been sold at regular price for more than [redacted] of the time it is offered by Sears". However, Sears failed to achieve sales of the tires at the Regular Prices [redacted] of the time. Rather, Sears sold only 1.28% of the Tires at Regular Prices.

154. Sears also never considered whether its Regular Prices were reasonable in light of competitors' prices in connection with compliance under the Pricing Policy.

155. In addition, notwithstanding the very small sales volumes of the Tires at Regular Prices in 1999, Sears did not adjust its Regular Prices downwards.

The 1999 Memorandum

156. On May 11, 1999, Sears legal department circulated a memorandum (hereinafter the "1999 Memorandum") to all Vice-Presidents. The 1999 Memorandum summarized the changes to the Act relating to "regular selling price claims" which came into force on March 18, 1999. It indicated that if a claim passed either the time or the volume test, "... it will be considered legitimate".

157. Consistent with this view of compliance, throughout 1999 Sears used a "checkerboard" document as a planning tool to keep track of the frequency with which tires were put on sale. Using the checkerboard, various tires were rotated through promotional sales. Sears used the checkerboard to assist it in an attempt to ensure that the tires that it sold in 1999 were "on sale" less than 50% of the time. The checkerboard was also used to accumulate historical data regarding what tires had been "on sale" in a given period and what the results of those sales promotions had been.

158. The 1999 Memorandum was never converted into a formal bulletin by Sears, nor was the Pricing Policy amended to reflect the 1999 Memorandum. Sears' Automotive Retail Marketing Manager in 1999, who was one of the key individuals responsible for ensuring compliance with the Pricing Policy, was only vaguely familiar with the 1999

Memorandum. Moreover he testified that even after the 1999 Memorandum was circulated, he did not alter he mode of attempting to ensure compliance with the OSP provisions in the Act.

159. In any event, the 1999 Memorandum indicated that meeting the volume test under the Act required that more than 50% of sales must be at or above the "higher comparison price". As noted above, Sears did not meet the "volume test" with respect to any of the Tires, in that Sears only sold an average of 1.28% of the Tires at Regular Price.

160. In terms of the "time test", the 1999 Memorandum indicated that the "substantial period of time requirement will be met if the product is offered at the higher comparison price for more than 50% of the time period considered." The 1999 Memorandum indicated that, in general, the time period considered would be 6 months. However, in respect of 4 out of 5 of the Tires, Sears failed to meet the "substantial period of time requirement" which it had ostensibly established for itself.

161. In addition to the foregoing, the 1999 Memorandum recognized, in passing, that the time test requires that the product at issue must have been "offered for sale, in good faith, for a substantial period of time". However, the 1999 Memorandum provides no guidance as to how the words "in good faith" should be interpreted or applied. The 1999 Memorandum

ignores the good faith element of the time test and simply prescribes an arithmetic or mechanical approach, which focuses on the percentage of time the product was offered at the comparison price.

162. Sears failed to ensure that the Pricing Policy was amended to take into account the information contained in the 1999 Memorandum. Sears failed to ensure that the 1999 Memorandum was provided to those persons within its Automotive Department who were responsible for ensuring compliance with the Pricing Policy and ultimately subsection 74.01(3) of the Act.

163. Even if Sears had used the 1999 Memorandum in connection with the marketing of tires in 1999, it failed to adhere to its provisions with a view to complying with the ordinary selling price provisions of the Act with respect to the Tires. Further, the 1999 Memorandum was inadequate to achieve compliance with the provisions of the Act even if Sears had incorporated it into its Pricing Policy and adhered to it, in that it failed to adequately address the "good faith" component of the time test, and instead provided only for a mechanical calculation of "substantial period of time" to achieve compliance with the Act.

164. In summary, Sears was not duly diligent in ensuring that its representations to the public in respect of the Tires complied with the Act. In fact, Sears utilized a marketing structure designed to mislead consumers into believing that Sears' promotions offered better product value than was actually the case. Specifically:

a) Sears' own documents reveal that it knew that its Regular Single Unit Prices on the Tires were not comparable to the regular prices offered by competitors;

b) Sears' own documents indicate that it knew that its Regular Single Unit Prices for the Tires were not reasonable in light of competition;

c) Sears' own documents also indicate that it knew that there was no reasonable likelihood that its Regular Single Unit Prices would be validated by the market;

d) in any event, Sears knew that the vast majority of tires are purchased in multiples of two or more, and that as such, its Regular Single Unit Prices were only relevant for approximately 6% of the market; and

e) Sears knew or was wilfully blind to that fact that it was failing to generate substantial sales at the Regular Single Unit Prices for the Tires, yet failed to take action to change either the Regular Prices for the Tires or to stop using those

Regular Prices as a reference price for promotional purposes. Instead, Sears advertisements towards the end of 1999 continued to rely heavily on alleged savings off the Regular Price to entice consumers and drive sales.

(b) Corrective Notice

165. Sears argues that a Corrective Notice should not be ordered because:

- of the passage of time and the low likelihood that residual mistaken impressions would be corrected by a Notice; and

- the class of persons affected by the impugned conduct did not suffer any harm.

i. The Passage of Time

166. As Professor Lichtenstein noted, it is well recognised that consumers do not want to invalidate their perception that they got a 'deal' when buying an item on sale. As a result of this, there is very little post-purchase searching of the market-place for prices or any such attempt to validate or examine the prices paid. This is supported in this case by the results of the Deal survey, which indicates that five years on, consumers still have positive impressions about their Tire purchases. It is submitted that nothing has occurred in the marketplace that would have corrected consumer misapprehension about the regular prices of the Tires, and the percentage savings they actually received. The only way to correct consumer's mistaken impressions about their prior Tire purchases, and the value offered by a purchase from Sears, is to publish a corrective notice.

167. It is further submitted that when considering the passage of time in deciding whether to order a Corrective Notice, one must consider the amount of time that has elapsed in the context of the type of conduct this provision covers. Of necessity, a significant amount of time will generally elapse between the time impugned conduct took place and an Order by the Tribunal following an application - the conduct itself will span 6 -12 months, and then must be reviewed retroactively.

ii. Consumer Harm

168. It is submitted that the Commissioner does not have to demonstrate consumer harm, either to obtain a finding of reviewable conduct, or a corrective notice. Notwithstanding that, the Commissioner has provided a detailed discussion of the harm that flows from the impugned conduct in paras. 69 to 77 of the written argument re the constitutional challenge.

(c) AMP

(i) Additional Evidence and Argument

169. The Commissioner also submits that Sears is not entitled to file further evidence in respect of the aggravating and mitigating factors specified in ss. 74.01(5).

170. The Commissioner's Application set out in detail the remedies requested by the Commissioner. Similarly, at paragraphs 194 - 197 of its Responding Statement of Grounds and Material Facts, Sears addressed, in detail, issues and material facts relating to the remedies requested by the Commissioner in the Application.

171. In accordance with the *Competition Tribunal Rules*, the Commissioner filed a proposed schedule for the oral hearing of the Application. Sears made multiple oral and written submissions in respect of the proposed schedule. At no time did Sears suggest in its submissions on the schedule for the hearing that a separate hearing should be conducted in relation to the issue of remedy.

172. By order dated May 30, 2003, Madam Justice Dawson issued a Scheduling Order. Paragraph 7 of the Scheduling Order states:

> The hearing of the application shall commence on October 20, 2003, at 9:30 a.m. in the hearing room of the Competition Tribunal at 90 Sparks Street, Room 610, Ottawa, Ontario. The hearing will continue to November 14, 2003, and final arguments will take place from December 1, 2003 to December 5, 2003.

173. The Scheduling Order did not contemplate a separate hearing on the issue of remedy.

174. It was not until the 19th day of the hearing that counsel for Sears first referred to the notion of a separate hearing to consider remedy. Counsel for Sears made this comment in response to statements by counsel to the Commissioner that certain cross-examination questions were relevant to subsection 74.01(5).

Pub. Hr. Tr., Vol. 19, p. 3209.

175. Counsel for Sears closed its case on February 2, 2004.

Pub. Hr. Tr., Vol. 24, 3943 (3-4)

176. The Commissioner notes that the Competition Tribunal has not typically held a separate evidentiary hearing in respect of remedies. In *PVI,* for example, the only other case to date which has proceeded under section 74.01, there was no separate process to consider remedy. Similarly, in the four abuse of dominance cases that have been brought before the Tribunal, reviewable conduct and remedy were addressed in a single proceeding. Indeed, the only instances in which separate hearings on remedy have been held are two merger cases - *Southam* and *Waste* - in which the parties expressly agreed to a two-stage process, with the latter stage focussing on remedy.

***Commissioner of Competition v. Canadian Waste Services Holdings Inc.* [2001] CCTD No. 3**
***Canada (Director of Investigation and Research, Competition) v. Southam Inc.* [1992] 43 CPR (3d) 161**

177. In the circumstances, the Commissioner submits that Sears cannot "reserve its right" to introduce new evidence at this time.

ii. Administrative Monetary Penalty

178. Sears argues that the maximum AMP that can be ordered in this case is $100,000 and that imposition of any AMP in this case would be "improperly punitive".

179. This Application concerns OSP representations by Sears in respect of five separate products. The representations in respect of *each* of the five Tires constitute *separate* instances of reviewable conduct.

180. In effect, Sears' position is that the $100,000 cap expressed in paragraph 74.1(1)(c) applies on a per application basis, regardless of the number of instances of reviewable conduct that are found to have occurred.

181. Similarly, the quote from the *Consultative Panel Report* does not assist Sears, since it clearly refers to "*a* first *breach* (e.g. a number of separate advertisements involving the *same* misrepresentation in various media over a period of months would constitute one breach)." As noted above, in this case, there are different representations in relation to five different tires that were made in various media.

182. More generally, Sears' interpretation of paragraph 74.1(1)(c) would give rise to perverse results. Under Sears' approach, if the Commissioner files individual applications in respect of each instance of reviewable conduct (e.g. a number of separate advertisements involving the same misrepresentation), the Tribunal has the authority to grant an AMP of up to $100,000 in respect of each instance of reviewable conduct (assuming that such conduct is proven). However, if the Commissioner files as single application in respect of multiple instances of reviewable conduct - as it did in this case - the maximum AMP available is $100,000.

183. The Commissioner submits therefore that the maximum AMP that can be ordered by the Tribunal in respect of *each* of the five instances of reviewable conduct established in this case is $100,000. Accordingly, the maximum total AMP that can be ordered in this case, if there is a finding that Sears engaged in reviewable conduct in respect of each of the five Tires, is $500,000.

184. Furthermore, in light of the aggravating and mitigating factors discussed at paragraphs 201- 223 of the Commissioner's Argument, the Commissioner submits that the maximum AMP is required in this case to promote compliance, and is not in the nature of a punitive remedy. In this regard, the Commissioner notes that Sears' costs of defending its actions in this proceeding and modifying its behaviour to comply with ss. 74.01(3) are not factors that are relevant to the determination of an appropriate AMP. Indeed, consideration of these factors would effectively reward a person that has engaged in reviewable conduct.

ALL OF WHICH IS RESPECTFULLY SUBMITTED.

Dated at Gatineau, Québec, June 25, 2004.

John L. Syme
Arsalaan Hyder
Leslie Milton
Geneviève Léveille
Competition Law Division, Department of Justice
Counsel to Commissioner of Competition
2220 - 50 Victoria Street
Gatineau, Quebec K1A 0C9
Telephone: (819) 997-3325
Facsimile: (819) 953-9267