

THE COMPETITION TRIBUNAL

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

AND IN THE MATTER OF an inquiry pursuant to subsection 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 74.10 of the *Competition Act*;

AND IN THE MATTER OF Sears Canada Inc.'s opposition to the Application and Sears Canada Inc.'s request for certain relief from the Competition Tribunal;

B E T W E E N:

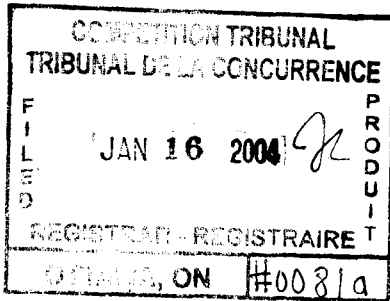
THE COMMISSIONER OF COMPETITION

Applicant

- and -

SEARS CANADA INC.

Respondent



REPLY AFFIDAVIT OF MICHAEL J. TREBILCOCK

(sworn October 3, 2003)

I, MICHAEL J. TREBILCOCK, of the City of Toronto, in the Province of Ontario,
SWEAR THAT:

1. I have been asked by counsel to Sears Canada Inc. ("Sears") to reply to certain points raised in the affidavit of Professor Sridhar Moorthy sworn September 22, 2003 ("Moorthy affidavit") and the affidavit of Donald R. Lichtenstein sworn September 22, 2003 ("Lichtenstein affidavit") filed by the Commissioner of Competition ("Commissioner") in this matter.

2. The two issues that I will address in this reply affidavit are:
 - a) Geographic market definition; and,
 - b) Whether Sears' regular single-unit tire prices made rational economic sense.

A. GEOGRAPHIC MARKET DEFINITION

3. It is not correct to define a relevant geographic market based solely on the retailer's use of "differentiated" or "undifferentiated" marketing strategies as Professor Moorthy does [at paragraphs 14-22].
4. As noted in the Lichtenstein affidavit [at paragraph 41 of Exhibit "B"], a relevant issue in this matter is whether the ordinary sales price claim "is not made in a good faith manner, such that reliance on the claim results in injury to consumers and competition". Thus, the relevant geographic market needs to be defined on the basis of the alternatives available to consumers and the supply responses of competitors. As noted in my affidavit sworn September 22, 2003 ("my initial affidavit"), these considerations will give rise to local geographic markets.
5. Within any particular local market, consumers have various supply choices, which are not limited to national retailers.
6. As a matter of practical convenience, there is no harm in examining aggregate data of consumer behaviour across Canada when one believes that the position of Sears relative to all competing retailers is similar across local markets. But this does not mean the relevant geographic market is properly defined to be Canada. To reiterate, it is important not to artificially restrict the set of relevant competitors to only those who have retail locations across the country.

7. Within any particular local market, Sears faced many different competitors, including the various tire retailers discussed in the affidavit of Donald Gauthier sworn September 22, 2003 (“Gauthier affidavit”) wherein he indicates [at paragraphs 12-24] that tire retailers include many alternative suppliers, the largest category of which is accounted for by tire dealers.
8. Thus, when determining whether Sears’ regular single-unit and regular multiple-unit tire prices were offered in good faith, it is inappropriate to focus solely on the one other national retailer – Canadian Tire – since within any local market Sears faced many competing tire retailers.

B. DID SEARS’ REGULAR SINGLE-UNIT TIRE PRICES MAKE RATIONAL ECONOMIC SENSE?

9. The test for good faith in pricing proposed in the Moorthy affidavit is to determine whether the price offer makes “rational economic sense” [at paragraph 57], with rationality determined by the profitability of the price [at paragraph 58].
10. Professor Moorthy claims [at paragraph 61] that Sears’ tire business would have been unprofitable in 1999 if it depended on sales at regular prices. There is no doubt that the regular single-unit and regular multiple-unit prices used by Sears in 1999 for the five subject tires more than fully covered Sears’ costs for those tires. Instead, Professor Moorthy’s point appears to be that if Sears were forced to sell all its tires at its regular single-unit prices it would have made so few sales relative to its competitors that it would not have found this hypothesized strategy profitable (assuming that Sears’ purchases of tires were not reduced suitably to reflect the higher average selling price per unit). This is an inappropriate test for determining profitability of a pricing strategy.

11. It would not be uncommon for a retailer to have a profitable – economically rational – pricing strategy without having each and every price in that strategy maximize profits if the subject price was the only price. For example, a scheduled air carrier would not necessarily find it profitable to charge all airline passengers travelling between Ottawa and Toronto throughout the year the business class airfare. Such a strategy would likely result in too few tickets sold to cover the airline’s cost of traveling between Ottawa and Toronto. Likewise, if the scheduled air carrier was to charge all passengers its lowest seat sale price all year round, this may generate too little revenue to cover the costs of traveling between Ottawa and Toronto all year. Does this make either of these prices economically irrational? No.
12. The test of economic rationality should be made on the basis of the overall pricing strategy, not on whether any single price if charged to all consumers all year round maximizes profits. The very fact that some retailers choose to have different prices throughout the year is an indication that differential pricing is a more profitable strategy for those retailers than maintaining a single price – either a high or low price – all year round.
13. This raises the more general point of why we might find differential pricing in the retailing of tires, with multiple tires sold at lower per-unit prices than single tires. Volume discounts allow a retailer to improve the attractiveness of purchasing multiple tires for those consumers who might initially only wish to purchase a single tire. It also allows a retailer to differentiate between those consumers with more inelastic demand (i.e., consumers who, as a result of some sort of tire failure, require tire replacement quickly and only want a single tire) from those consumers with more elastic demand (i.e., consumers replacing tires as part of regular maintenance). Such differential pricing is not uncommon. For example, referring back to my scheduled air carrier example, higher airfares are charged to consumers with inelastic demand (i.e., must-go business travellers flying full-fare economy during the week) compared to consumers with more elastic demand (i.e., leisure travellers considering various vacation options and planning in

advance). It is well known within economics that differential pricing of this nature is often economically efficient.

14. In light of these differences between consumers, when considering the good faith nature of Sears' regular pricing in my initial affidavit I compare the percentage of Sears' total sales of single-unit tires made at regular prices to those made at promotional prices. Similarly, I compare Sears' total sales of multiple-unit tires at regular and promotional prices. In contrast, the Moorthy affidavit compares Sears' single-unit sales at regular prices to all of Sears' tire sales, including multiple units, which explains the lower percentages expressed at paragraph 49 of the Moorthy affidavit compared to those expressed in my initial affidavit at paragraphs 45 and 46.
15. Turning to the profitability of Sears' particular retail pricing strategy for the subject tires in 1999, there is no evidence that it was unprofitable. Sears' combination of higher regular single-unit prices, lower multiple-unit prices and promotional prices generated mark ups on average selling prices that ranged from [REDACTED] per cent.¹
16. Finally, as discussed in my initial affidavit, Sears' regular single-unit and regular multiple-unit prices were also comparable to those of its various competitors.
17. The fact that Sears did sell a considerable volume of the subject tires at its regular single-unit and regular multiple-unit prices, and that such prices were comparable to the prices of its competitors indicates, in my opinion, that such prices were genuine and offered in good faith.

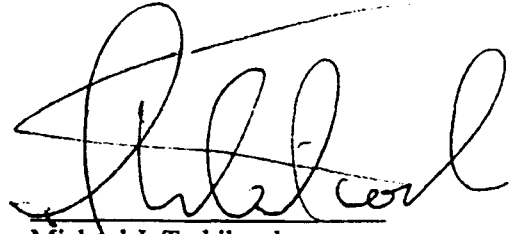
¹ Sears' responses to undertakings given under reserve of objection during the examinations of William F. McMahon and Paul Cathcart, conducted February 27 to March 5, 2002, pursuant to section 11(1)(a) of the *Competition Act* (x-ref. to Competition Bureau's Disclosure Statement #74).

18. I swear this reply affidavit in support of Sears' Response to the Commissioners' Application in this matter and for no other or improper purpose.

SWORN BEFORE ME in the City of Toronto,
in the Province of Ontario, this 3rd day of
October, 2003.



**ERIN LOUISE MILLER, a
Commissioner, etc., Province of Ontario,
while a student-at-law.
Sworn May 8, 2003.**

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Michael J. Trebilcock