

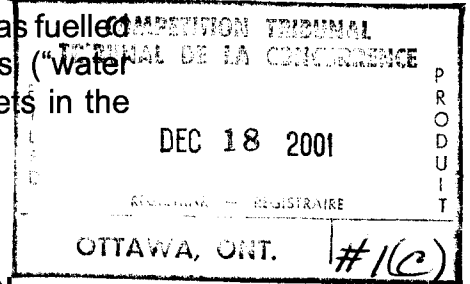
CT-01/008

THE COMPETITION TRIBUNAL

IN THE MATTER OF an application by the Commissioner of Competition for a Consent Order pursuant to sections 79 and 105 of the *Competition Act*, R.S.C. 1985, c. C-34 as amended;

AND IN THE MATTER OF certain practices of anti-competitive acts by Enbridge Services Inc. ("ESI") within certain markets in the province of Ontario;

AND IN THE MATTER OF an abuse of dominant position in the supply of conventional or power vented natural gas fuelled water heaters not used for commercial purposes ("water heaters") and related services within certain markets in the province of Ontario.



BETWEEN:

THE COMMISSIONER OF COMPETITION

Applicant

- AND -

ENBRIDGE SERVICES INC.

Respondent

STATEMENT OF GROUNDS AND MATERIAL FACTS

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I INTRODUCTION

1. The Commissioner of Competition (the “Commissioner”) brings this application for a Consent Order on the grounds that certain practices of Enbridge Services Inc. (“ESI”) have prevented or lessened competition substantially in the natural gas fuelled water heater markets within the franchise territory of The Consumers’ Gas Company Ltd. operating as Enbridge Consumers’ Gas (“ECG”) in the province of Ontario.

2. The Commissioner, with the consent of ESI (the “Respondent”), respectfully submits for approval a Draft Consent Order (“DCO”) that, if implemented, will eliminate the substantial prevention or lessening of competition within the relevant markets in the province of Ontario.

3. The Commissioner alleges certain material facts and makes certain submissions in this Statement of Grounds and Material Facts (the “Statement”). The Respondent does not contest the facts or submissions herein for the purpose of this application, but nothing in this application shall be taken as an admission now or in the future by the Respondent of any such facts or submissions.

II THE PARTIES

4. The Applicant is the Commissioner appointed pursuant to section 7 of the *Competition Act* and is the sole person authorized to make this application to the Competition Tribunal (the “Tribunal”).

5. The Respondent is ESI, an indirect, wholly-owned subsidiary of Enbridge Inc. with its head office in Markham, Ontario. ESI was incorporated in Ontario on November 1, 1996. ESI provides a variety of retail products and services in the energy field. In particular, ESI supplies natural gas appliances, such as water heaters and related services.

6. The involvement of two other companies, ECG and Enbridge Commercial Services Inc. (“ECS”) with the ESI water heater rental program, was also considered in the Inquiry (see paragraph 10 below). After a review by the Bureau, these companies have been excluded as Respondents due to their current roles and responsibilities in regards to the ESI water heater rental program.

7. ECG is the regulated natural gas distribution company for its franchise territory covering much of Ontario. It is an exclusive distributor which is regulated by the Ontario Energy Board (“OEB”). ECG is an indirect, wholly-owned subsidiary of Enbridge Inc. ESI has advised the Bureau that ECG has no ownership,

management or operating role regarding the ESI water heater rental business. Certain undertakings which have been given to the OEB by ECG on the type of business that it can directly operate may prohibit its involvement in this business. ESI's ability to comply with the terms of the DCO is not prevented by any ECG operations or activities. Any remaining services or facilities still shared by ESI and ECG fall outside the issues covered by the DCO and the services fall under the OEB conditions governing the relationship between utilities and their affiliates.

8. ECS is an unregulated affiliate of ECG and a direct wholly-owned subsidiary of Enbridge Inc. ECS provides call centre and billing services to ESI and ECG. The Bureau was advised in writing that ESI has retained full authority over its business. This control includes areas such as the content of communications provided by ECS call centre personnel. ECS furnishes ESI with other services such as support relating to IT systems and its fleet. These services or the underlying agreements between the two companies do not involve management or control of the above business of ESI.

9. The above facts have been confirmed in a statement under oath by the vice-president of the operating division of Enbridge Inc. which includes ESI, ECS, and ECG. In particular, he has confirmed the business roles and relationships of ECS and ECG in relation to the ESI water heater rental business.

III THE COMMISSIONER'S INQUIRY

10. On May 9, 2001, the Commissioner, pursuant to subparagraph 10(1)(b)(ii) of the *Competition Act*, initiated an Inquiry into the activities of ESI in relation to the rental, sale, and servicing of conventional and power vented natural gas water heaters not used for commercial purposes ("water heaters") within certain geographic markets in the province of Ontario. The investigation leading to initiation of the Inquiry commenced in February 2000 in response to concerns expressed to the Competition Bureau (the "Bureau") by competitors of ESI regarding the implementation by ESI of rental water heater exit and pick-up charges in January 2000 applying to ESI's existing rental water heater customer base and new customers.

11. In initiating the Inquiry and making this DCO application, the Commissioner has relied on information provided voluntarily by ESI and on information obtained by the Bureau from the complainants, from other industry participants and from independent sources. In addition, the Commissioner obtained information and analysis from an external industry expert and an external economic expert.

12. Discussions between the Commissioner and the Respondent to resolve this matter began on June 19, 2001. After a series of negotiations, concluded during the month of November 2001, the Commissioner and the Respondent agreed to an Agreement in Principle including the terms of the DCO to address the Commissioner's concerns.

IV DESCRIPTION OF THE INDUSTRY

13. The industry under consideration in this application consists of the supply of water heaters and related services to households in certain geographic markets in the province of Ontario. These markets include close to 1.4 million installed residential water heaters. During year 2000, there were 128,000 new water heater installations in these markets representing an annual market for installations in excess of \$90 million dollars. For the period of January to September 30, 2001, it is estimated that 91,100 new water heaters were installed representing an estimated market of about \$64 million dollars.
14. The water heaters under consideration are directly fueled by natural gas and typically have a capacity in the range of 40 to 75 gallons. They come in two basic configurations, conventionally vented and power vented. Both are constructed as self-contained units requiring no external fitting prior to operation, other than the connections for venting, gas, and water. They include a coated and insulated inner

steel cylinder of 16 to 20 inches in diameter to contain water and are covered by a venter assembly.

15. Conventional water heaters are usually vented by means of a single walled vent to an existing masonry chimney. Power vented water heaters are vented with a plastic vent which is exhausted through the basement foundation to the outside using an electric fan. Conventional water heaters represent the majority of all installed water heaters, approximately 70% of ESI's installed base. They are prevalent in older homes having existing chimneys. Power vented water heaters are more prevalent in newer homes constructed with gas heating as they allow builders to avoid the expense of constructing a chimney.
16. The average useable life of water heaters is approximately 15 years for most households. However, it tends to be shorter in areas with hard water. These are generally areas outside of major urban centres that rely on well water. In these areas, calcium deposits can build up within a household water heater significantly shortening its lifespan.
17. The water heaters are installed on-site in households and are directly connected to incoming natural gas lines. In order to install and disconnect water heaters in Ontario, contractors must be certified by the Ontario Ministry of Consumer and Commercial Relations under the Technical Standards and Safety Act, 2000.

18. The supply of water heaters and related services to Ontario households is carried out through a variety of arrangements. They include: rental programs combining the supply of a water heater and 24 hour servicing; lease-to-own arrangements; the sale of installed water heaters; the supply of extended warranties; and the separate purchase of services and water heaters.
19. The price of water heaters varies depending upon their type and capacity. As an example, the after tax prices of installed ESI conventional 40 and 60 gallon water heaters are, respectively, \$549.98 dollars and \$605.62 dollars. For comparison, an ESI 50 gallon vented water heater has an installed price of \$953.37 dollars. The above prices include an installation charge of \$150.00 dollars.
20. Water heaters are produced by a number of third party manufacturers. There are two that manufacture in Ontario: GSW Water Heating Company in Fergus, Ontario and Rheem Canada Ltd. in Hamilton, Ontario. However, neither company is involved directly in the supply and servicing of water heaters for individual households.
21. Categories of participants or potential participants in the industry include the following:

- C affiliates of gas distribution companies including ESI and Union Energy Inc.;
- multi-product retailers such as Home Depot, Sears and Canadian Tire which sell water heaters and generally offer installation through contractors;
 - large independent energy product and service providers such as Sunoco Inc. and Lennox Canada Inc. which provide gas and equipment on a sale or rental basis; and
 - small independent HVAC (heating ventilation air conditioning) contractors, and networks of contractors providing installation, service and sales or rentals of water heaters.

V. **COMPETITIVE ANALYSIS**

22. Under section 79 of the *Competition Act*, an abuse of a dominant market position occurs when:
- (a) one or more persons substantially or completely control, throughout Canada or any area thereof, a class or species of business;

- (b) that person or persons have engaged in or are engaging in a practice of anti-competitive acts; and
- (c) the practice has had, is having or is likely to have the effect of preventing or lessening competition substantially in a market.

23. The Commissioner has determined that:

- (a) ESI has substantial control over markets for the supply of water heaters and related services in the exclusive gas distribution franchise territory of its affiliate company, ECG;
- (b) ESI has engaged in a practice of anti-competitive acts in relation to its water heater supply and servicing activities in the relevant markets; and
- (c) ESI's practice of anti-competitive acts has resulted in a substantial lessening or prevention of competition in the relevant markets.

A. CONTROL OF A CLASS OR SPECIES OF BUSINESS

24. In previous cases, the Tribunal has defined the various terms contained in the first element of the above section.¹ “Control” has been equated to “market power” or the “ability to set prices above competitive levels for a considerable period.” “Class or species of business” has been determined to mean “product market” and “throughout Canada or any area thereof” to mean the geographic market.
25. Control of a class of business or species of business can be equated to having market power. Therefore, the first step in the analysis of control of a class or species of business is to define the relevant product and geographic markets. The second step involves determining whether the company under investigation substantially controls the relevant markets or has significant market power.

¹ *Canada (Director of Investigation and Research) v. NutraSweet Co.* [1990], 32 C.P.R. (3d) 1 (Comp. Trib.)at 28, 32; *Canada (Director of Investigation and Research) v. The D&B Companies of Canada Ltd.* [1995], 64 C.P.R. (3d) 216 (Comp. Trib.)at 232; *Canada (Director of Investigation and Research) v. Tele-Direct (Publications) Inc.* [1997], 73 C.P.R. (3d) 1 (Comp. Trib.) at 33; *Canada (Director of Investigation and Research) v. Laidlaw Waste Systems Ltd.*[1992], 40 C.P.R. (3d) 289 (Comp. Trib.)at 325.

a. ***Relevant Market Definition***

(i) **The Product Markets**

26. The information obtained by the Bureau supports the definition of a relevant product market in the industry under consideration consisting of the supply to non-commercial customers of water heaters and related services including the installation, disconnection and repair of water heaters. Non-commercial customers are otherwise known as the residential market and consist essentially of households.

27. Water heaters for commercial purposes are not included in the product markets for the following reasons.

- Commercial customers' water heater requirements differ greatly from those of household customers. More specifically, as compared to household customers, they can have widely varying water heating and associated equipment needs based on the nature of their businesses.
- Commercial customers, because they are often tenants, tend to move more frequently than household customers.

- Water heaters for commercial purposes can have different performance levels and configurations than household water heaters. Specifically, water heaters for commercial purposes may have a larger output and, in some cases, use a configuration consisting of two separate units, a burner unit and storage tanks, rather than a single self-contained unit as do household water heaters.
- Contracts for water heaters for commercial purposes tend to be tailored to specific users. This practice for commercial purposes is in contrast to ESI's rental water heater terms and conditions which are standardized for all customers obtaining similar water heaters.

28. As a consequence of these differences, commercial customers form a separate market from household customers. As an indicator of the distinction between the markets, ESI no longer offers to rent new water heaters to commercial customers.

29. In arriving at the above product market definition, consideration was also given to whether other ways of providing hot water to households should be included in the relevant product market. The closest substitute for gas water heating is electric water heating. Electric water heaters, like gas water heaters, provide hot water on demand. The cost of an electric water heater itself is comparable to, or may be significantly less than, a gas water heater of similar performance capability. However, electric water

heaters were excluded from the relevant market because they normally involve substantially higher annual fuel costs to provide the same amount of hot water.

30. As an example, based on September 2001 gas and electricity rates, ESI estimates the average annual savings associated with natural gas versus electric water heating in Ontario to be in excess of \$90 per year for a family of four. Over an anticipated lifetime of a gas water heater of 15 years, and using a real discount rate of 3%, this amounts to expected energy cost savings having a net present value of more than \$1,000. This saving is in excess of the after-tax prices of installed ESI 40 to 60 gallon conventional and vented water heaters which represent the vast majority of installed ESI rental water heaters. These prices are between \$549.98 and \$953.37 dollars.
31. A further consideration in excluding electric water heaters from the relevant market is that significant additional installation costs may be required to install them in replacement for a gas water heater. This occurs where, for example, additional electrical work is required to upgrade a household's electrical panel to provide additional capacity for the electrical wiring required for electric water heaters.
32. Given the manner in which ESI's rental water heater business was initially developed, as described in the following subsection, consideration was also given to restricting the relevant markets to the installed ESI rental water heater customer

base. However, this narrower market definition is not adopted for this application as it does not materially affect the Bureau's finding concerning the contravention of the abuse of dominance provisions of the *Competition Act* by ESI.

(ii) The Geographic Markets

33. Markets for the supply of water heaters and services to individual households are inherently local in nature, reflecting the travel time and costs to deliver water heaters to customers' locations and install them on-site. The relevant geographic markets for the purposes of this application include local markets for the sale, installation and servicing of water heaters within the ECG franchise territory.

34. The local nature of the relevant markets is supported by the following considerations. Household water heaters are shipped from manufacturers to storage sites of companies supplying them to households or HVAC wholesalers and distributors. The water heaters are shipped in bulk and are stored locally.

35. From there, the water heaters are either individually delivered to customers' locations and installed on-site or they are purchased by small independent HVAC contractors for delivery and installation by them. The costs of delivery and installation vary in proportion to the time and distance to travel between the relevant water heater storage site and the household where the heater is being installed. For this reason,

participants in a local geographic market require access to local storage and installation capabilities and installers operate within limited geographic areas.

36. The restriction of the relevant markets to those falling within the ECG franchise territory reflects the manner in which the ESI rental water heater program was initially developed.

37. ECG is the exclusive distributor of natural gas for the franchise territory and, in this activity, is regulated by the OEB. This territory is composed of three large areas of Ontario: first, Eastern Ontario, including Ottawa but excluding the Kingston area; second, the Greater Toronto Area, extending north to Georgian Bay, and east to Peterborough; and third, the Niagara Region covering most of the Niagara peninsula.

38. The water heater rental business now owned and operated by ESI was initially developed within ECG under OEB oversight. A principal objective in developing the business was to expand the year-round demand for natural gas. The rental program operational costs were assessed on a marginal cost basis. The rental program assets were included in the ECG rate base and subject to a regulated rate of return. Rental rates were not set or approved by the OEB, but ECG was required each year to realize an authorized rate of return above recovery of marginal costs. ESI was

required to use returns in excess of this rate as contributions towards its revenue

requirement. Under this form of oversight, ECG developed a large installed base of rental water heater customers but only in its gas distribution franchise territory.

39. The ECG rental water heater business was sold to ESI in October 1999 thereby removing the business from further OEB oversight. ESI, since acquiring the ECG rental water heater business, has offered rental water heaters and services outside the ECG franchise territory. However, ESI has participated in these other markets as a new entrant rather than as the dominant incumbent as is the case in the ECG franchise territory.

b. Control

40. Key considerations in establishing control or market power of relevant markets include the market share of the company under investigation and barriers to entering or expanding in the relevant markets. The information obtained by the Bureau indicates both that ESI has a high market share in the relevant markets and that these markets are characterized by high barriers to entry and expansion.

(i) Market Share

41. For the year 2001 to date, ESI has maintained a market share in excess of 65% of all new water heater installations in the ECG franchise territory including about 80% of all replacement water heater installations.

42. With respect to the provision of services, such as the examination and repair of installed water heaters, a further important consideration is the share of all such installed water heaters in the relevant geographic markets that are under the ESI water heater rental program. As of September, 2001, this market share, based on the stock of installed water heaters, is estimated by ESI to be 86%. More specifically, such market share is estimated at 81.9% in the Niagara area, 86.5% in the Greater Toronto Area and 85.2% in the Eastern Region.

(ii) High Barriers to Entry

43. Markets for the supply of water heaters and related services are not characterized by high technological, scale or sunk cost barriers to entry.

44. The water heaters themselves employ standard technologies and are purchased from third party manufacturers. Persons disconnecting or installing water heaters are

required to be licensed. However, licensing is done through the government of Ontario and provides the licensed individual with the opportunity to work on a wide range of gas services and appliances, such as furnaces, stoves and fireplaces, in addition to water heaters.

45. The absence of significant scale barriers to entry is indicated by the wide range of potential industry participants. They range in size from small independent contractors, to large retailers such as Home Depot, Canadian Tire and Sears. Equipment and facility costs to enter the industry are low and involve a limited sunk cost component. For example, for large multi-product retailers, while there is a need for display and storage space, this space will have alternative uses for vending of other products. Small independent HVAC contractors require little in the way of additional equipment and facilities to participate in the supply of water heaters and related services in addition to the supply and servicing of other gas appliances such as furnaces, fireplaces, barbeques and stoves. There is limited need for them to maintain an inventory of water heaters as water heaters generally can be obtained on an as-required basis from HVAC wholesalers and distributors.
46. The principal barriers to entry in the relevant markets are those erected by ESI through its water heater rental program. These barriers are caused, in particular, by the ESI terms and conditions for ESI rental water heater customers (“ESI customers”) to exit the company’s water heater rental program and by the option

ESI provides to ESI customers to buy-out their installed rental water heaters (the “Buy-Out Plan”) as well as the ESI guarantee to match competitors’ water heater prices (the “Price Match Guarantee”).

47. The ESI rental water heater exit charges and conditions (“exit charges and conditions”) creating the barriers to entry and competition include the following:

- Only ESI personnel are permitted to disconnect and return ESI rental water heaters before a competitor’s water heater can be installed.
- ESI customers are required to pay ESI \$75.00 dollars to disconnect and pick-up a functioning ESI rental water heater until the water heater is 15 years old or the water heater is determined by ESI to be irreparable.
- ESI customers whose rental water heaters are less than 11 years old are required to pay an installation cost recovery charge to exit the ESI water heater rental program. The charge starts at \$125.00 dollars and declines by \$10.00 dollars per year until year 11 when the charge declines by \$25.00 dollars.

48. Under the Buy-Out Plan, ESI customers can leave the company’s water heater rental program by buying out their rental water heaters. The buy-out price for the ESI rental water heaters (the “Buy-Out Price”) is based on the current retail price of a comparable

installed ESI rental water heater and discounted to take into account the age of the ESI rental water heater. The Price Match Guarantee allows the Buy-Out Price for ESI rental water heaters to be adjusted to account for lower, competitor advertised prices for similar water heaters.

49. The height of the barrier created by the exit charges and conditions is indicated by both their size in relation to the costs of a water heater and by the high share of households in the relevant markets with ESI rental water heaters. Consideration of both of these factors indicates that the exit charges and conditions create a major barrier to entry and competition in the relevant markets.
50. In regard to the first of these factors, using ESI's prices as representative, the \$75.00 dollars pick-up charge for ESI rental water heaters is more than 13% of the after tax price of a conventional ESI rental water heater with a 40 gallon capacity. The maximum combined installation cost recovery charge (\$125.00 dollars) and pick-up fee (\$75.00 dollars) is in excess of 35% of the after tax price of such a water heater.
51. The exit charges and conditions impose further indirect costs on ESI customers to switch to an ESI competitor's water heater, including the time costs for ESI customers from having to arrange and be present for separate service calls for ESI to pick up its installed rental water heater and for an ESI competitor to deliver and install their water heater. The costs also include the inconvenience to the ESI customer of being without

hot water between the disconnection and the removal of the ESI rental water heater by ESI and the installation of a competitor's water heater. The size of this barrier to entry will depend on the individual customer's time costs, need for hot water and time needed to arrange and be present for an ESI competitor's heater to be installed. These costs are likely to be substantial for many ESI customers in terms of lost leisure time, potentially lost income, and inconvenience.

52. It may be noted that the costs in the preceding paragraph apply even in cases where an ESI rental water heater has been determined by on-site ESI personnel not to be repairable such that the \$75.00 dollars return charge is not applicable. In such cases, in order to switch to a competitor, an ESI customer is still required to find and arrange for a separate call to have an ESI competitor install a new water heater. The alternative is to allow the on-site ESI personnel to install a new ESI rental water heater under a new ESI rental contract.

53. Although the Buy-Out Plan and Price Match Guarantee create mechanisms by which consumers may opt out of their rental arrangement, these mechanisms also operate jointly to make the installed ESI customer base a barrier to entry. The Buy-Out Plan does this by giving ESI the opportunity to sell installed ESI rental water heaters to ESI customers as another way to prevent them from switching to a competitor's water heater. The Price Match Guarantee allows ESI to adjust its Buy-Out Price to individual ESI customers to meet the competition and prevent them from switching to a

competitor's water heater. Furthermore, since water heaters have limited resale value and their installation costs are sunk, ESI has an incentive to match even very low competitors' prices rather than allow one of its customers to purchase an installed water heater from a competitor.

54. In regard to the second of these factors, as noted in the preceding sub-section, ESI estimates its share to be 86% of all installed water heaters in the relevant markets and in excess of 80% for each of the company's operating regions in the relevant markets. Accordingly, only 14% of all households in the relevant markets are not potentially subject to the Buy-Out Plan and Price Match Guarantee.
55. The Bureau also examined other potential barriers to entry in the relevant markets. The key potential barriers considered include ESI incumbent advantages due to brand-name recognition and the integration of ESI's billing services with those of ECG. These barriers were found not to be as widespread and important as the exit charges and conditions of the ESI water heater rental program.
56. On the first of these matters, ESI has the benefit of a shared brand-name and company logo with ECG which is both the exclusive franchise distributor of natural gas in the relevant markets, and the company that initially developed the rental water heater business. However, other existing or potential market participants also have recognized brand-names. These include, not only large multi-product retailers, such

as Home Depot, Canadian Tire, and Sears, but also established HVAC and energy service companies that are participants in related markets for gas and gas appliances. In the absence of the barriers to entry and competition created by the ESI water heater rental terms and conditions described above, it is anticipated that participants or entrants in the relevant markets would be able to effectively extend their brand-name recognition to include water heaters.

57. On the second of these matters, the integration of ESI's and ECG's billing activities is achieved through ECS. ECS is an affiliate of and provides billing services for both ESI and ECG. A potential concern with respect to the sharing of resources and facilities between a regulated utility, such as ECG, and its affiliates in unregulated markets, such as ESI and ECS, is cross-subsidization. This can occur if the unregulated affiliate is able to shift some of its costs to the regulated affiliate rate base for recovery in distribution rates. However, the potential for such cross-subsidization to occur in the relevant markets is mitigated by OEB oversight of the relations between ECG and its unregulated affiliates to detect such cross-subsidization. The OEB further requires that ESI and ECG charges be separately displayed on the bill.
58. Integration of ECG's billing with ESI's billing provides ESI the unique opportunity of allowing its customers to pay one monthly bill for rental water heaters charges and for gas distribution charges. However, the significance of providing this consolidated bill as a barrier to entry to the relevant markets is limited by a number of considerations.

59. The benefit of being able to provide a bundled monthly bill applies only in cases where there is an ongoing billing relationship, as in a rental or lease arrangement, between a heater supplier and a customer. However, many of the competitors or potential competitors in the relevant markets, other than ESI, are involved only in the sale of installed heaters rather than their long term rental or lease. Ongoing billing relationships between these suppliers of water heaters and customers are likely to be limited in number. This finding is consistent with the water heater markets outside of Ontario. In these other markets, which did not develop in the same unique manner as the markets in Ontario, water heaters are predominantly sold to households rather than rented.
60. In addition, many of the competitors in the relevant markets already have established billing operations that can be extended to cover the supply of water heaters and services. Therefore, such competitors will not be required to invest in new billing operations in order to also participate in the relevant markets for water heaters. Finally, the potential significance of a joint ESI and ECG bill as an advantage to ESI may be further constrained as a consequence of the OEB's proposed Gas Distribution Access Rule (RP-2000-0001). An issue under consideration in the review is the ability for gas marketers in Ontario to provide a consolidated bill for the sale of natural gas and natural gas distribution. If this option is eventually made available and used by independent gas marketers, ESI will no longer have the benefit of an integrated bill for

the households affected.

B. PRACTICE OF ANTI-COMPETITIVE ACTS

61. The second element of an abuse of dominance contravention requires that there be act(s) which are anti-competitive and that these acts constitute a practice. Acts can be determined to be anti-competitive if they are done for a predatory, exclusionary or disciplinary reason.

62. The Bureau has found that ESI is engaging in a practice of anti-competitive acts for the purpose of excluding competitors from entering into or expanding in the relevant markets. This practice consists of anti-competitive acts contained in the provisions of the ESI water heater rental program relating to exit charges and conditions and the Buy-Out Plan and Price Match Guarantee.

a. *Anti-Competitive Acts*

(i) Rental Water Heater Exit Charges and Conditions

63. The exit charges and conditions constituting anti-competitive acts include the following:
(1) ESI prevents competitors from disconnecting and removing its functioning rental water heaters for which it charges its customers \$75.00 dollars in

order to perform this service; and (2) ESI customers must pay an installation cost recovery charge for an 11 year period following the installation of their ESI rental water heaters.

64. ESI's practice of preventing third parties from disconnecting and returning ESI rental water heaters directly excludes competitors by imposing additional costs on ESI customers to switch to an ESI competitor. The imposition of such switching costs on customers is recognized in the case law and economic analysis to have potential exclusionary effects.²
65. The additional switching costs created by the restriction against third party disconnection and removal of ESI rental water heaters depends on the specific circumstances under consideration. For working ESI rental water heaters that are less than 15 years old, the switching costs equal the costs to the ESI customer of paying for and arranging separate service calls to have an ESI water heater removed and a competitor's water heater installed, less the cost of having both services performed by the ESI competitor. In other cases, for example, where ESI rental water heaters have been determined to be non-reparable, the switching costs include those associated with separately arranging for installation of a competitor's water heater and for ESI to

² The imposition of customer switching costs and exit conditions were found by the Tribunal to be anti-competitive acts in *Canada (Director of Investigation and Research) v. The D&B Companies of Canada Ltd.*, *supra* at 266; *Canada (Director of Investigation and Research) v. Laidlaw Waste Systems Ltd.*, *supra* at 339-343.

remove its rental water heater.

66. In determining that the restriction against third party removal of ESI rental water heaters constitutes an anti-competitive act, the Bureau examined whether such restriction is necessary for safety reasons. The Bureau concluded that safety considerations with respect to third party removal of ESI rental water heaters are not of concern since persons removing or installing water heaters for an ESI competitor require a licence or licences from the province of Ontario indicating that they are qualified to perform the necessary work.
67. The requirements for ESI customers to pay an installation cost recovery charge for a period of 11 years excludes ESI competitors by creating an unnecessarily long period during which further significant customer switching costs apply. For example, for a 5 to 6 year old ESI rental water heater, the related exit charge is \$75.00 dollars, or over 13% of the after tax price of an installed ESI 40 gallon conventional water heater. For a 10 to 11 year old ESI rental water heater, the related switching cost represents 4.5 % of the ESI after tax price. In both cases these switching costs are in addition to the other such costs described above.
68. Contracts commonly require that exit fees or charges be paid for early termination. On one hand, these fees or charges can perform an important role in providing incentive for companies to incur up-front costs associated with the supply of a product or service

over time. On the other hand, such fees and charges can provide

incentive for customers to enter supply arrangements extending over a period of time by providing such customers an assured price at which they can exit the arrangement.

69. With respect to the ESI's water heater rental program, the starting point for the "installation cost recovery charge" of \$125.00 dollars is consistent with the actual costs of installing a water heater. However, given ESI's dominant market position, an 11 year period for recovery of the charge, as stipulated in paragraph 45 herein, creates an undue barrier to competition. As a result of ESI's dominance and the 11 year period that the installation cost recovery charge is in effect, related exit charges are likely to apply to significantly more than 70% of ESI's installed base at any point in time, which currently represents in excess of 60% of all potential customers in the relevant markets.

70. In determining that the exit charges and conditions constitute anti-competitive acts, consideration was also given to the manner of the implementation of such exit charges and conditions. The \$75.00 dollars pick-up charge and installation cost recovery charge were implemented by ESI in January 2000 following the transfer of the ECG rental water heater business to ESI. Implementation of the rental water heater exit charges was followed in March 2000 by an increase in the average monthly rate for ESI rental water heaters of 18.2%.

71. The prospect of further increases in the ESI rental water heater rate supported by the exit charges and conditions is provided by other terms and conditions of the ESI water heater rental program. These programs do not guarantee ESI customers a fixed rental price or cap rental rate increases that may be imposed in the future. Rather, ESI is not prevented from implementing future rate hikes while continuing to apply the above-noted exit charges and conditions on its customers.

(ii) Water Heater Buy-Out Plan and Price Match Guarantee

72. Under the Buy-Out Plan, ESI customers can leave the ESI water heater rental program by purchasing their ESI rental water heater at a “competitive” price as determined by ESI. The Buy-Out Price included in the Buy-Out Plan for a particular ESI rental water heater is typically based on the current retail price of the ESI rental water heater. The calculation of the Buy-Out Price includes the above installation cost recovery charge but does not include the pick-up charge. The final Buy-Out Price is discounted to take into account the age of the ESI rental water heater. Alternatively, under the Price Match Guarantee, the Buy-Out Price may be adjusted in relation to a competitor’s lower price.

73. The Price Match Guarantee gives ESI the opportunity to exclude competitors in the supply of water heaters. Such effect is achieved by allowing ESI to discount selectively the Buy-Out Price to prevent ESI customers from switching to take advantage of a preferred competing offer. This effect, in turn, supports ESI’s ability to maintain a

higher overall Buy-Out Price for ESI rental water heaters without switching occurring. Rather than reducing the Buy-Out Prices or rental rates to all ESI customers to prevent them from switching to ESI competitors, the Price Match Guarantee allows ESI to selectively target discounts to ESI customers who are most likely to have identified preferred supply alternatives. The overall impact is to protect ESI's ability to maintain its standard Buy-Out Prices while still preventing switching to competitors.

74. A further effect of the Price Match Guarantee is to increase ESI's rivals' costs. The Price Match Guarantee does this by giving ESI the opportunity to better their competitors' prices after the competitors have invested time and resources to attract the customer.

b. Anti-Competitive Practices

75. The actions being complained of in this case constitute a practice of anti-competitive acts. The exit charges and conditions are being applied to all of ESI's rental water heater contracts, which cover over 86% of the installed water heaters in the relevant markets.

C. SUBSTANTIAL LESSENING OF COMPETITION

76. Factors to be considered in determining whether a practice of anti-competitive acts has substantially lessened or prevented competition include the degree to which the acts enhance or preserve barriers to entry and market share³ and whether the acts have “altered the prospects for economically feasible entry”⁴ and expansion. Information obtained by the Bureau indicates that ESI’s practice of anti-competitive acts creates high barriers to entering and competing in the relevant markets, preserves ESI’s high market share in these markets and greatly restricts the prospect for economic entry and expansion by competitors in the relevant markets.
77. The substantial lessening of competition is caused by the cumulative impact, outlined below, of the anti-competitive acts under consideration.
- The requirement that only ESI personnel disconnect and return the water heaters enhances barriers to entry in the relevant markets by imposing an incremental out-of-pocket costs to ESI customers of up to \$75.00 dollars or more than 13% of the price of an ESI 40 gallon conventional rental water heater.

³ *Canada (Director of Investigation and Research) v. NutraSweet Co.*, *supra* at 28; *Canada (Director of Investigation and Research) v. The D&B Companies of Canada Ltd.*, *supra* at 267.

⁴ *Canada (Director of Investigation and Research) v. The D&B Companies of Canada Ltd.*, *supra* at 267.

In addition, this requirement imposes indirect switching costs on ESI customers, described in paragraph 49 herein, pertaining to the related need for these customers to arrange and be present for separate service calls for disconnection and pick up of the installed ESI rental water heater and delivery and installation of the competitor's water heater.

- The imposition of the installation cost recovery charge of up to \$125.00 dollars preserves barriers to entry in the relevant markets by creating switching costs to ESI customers which extend over a long period of time. For example, an ESI customer exiting the ESI water heater rental program must pay an installation cost recovery charge of \$75.00 dollars for a six year old ESI rental water heater or over 13% of the price of a 40 gallon conventional water heater.
- The Buy-Out Plan and Price Match Guarantee preserve barriers to entry and ESI's market share in the relevant markets by allowing ESI to selectively discount its water heater Buy-Out Prices to prevent ESI customers who have a preferred supply alternative from switching to ESI competitors.

78. The cumulative effects of the practice of the above acts is to prevent ESI competitors from effectively entering and expanding in the relevant markets by creating or maintaining high switching costs for customers and raising rivals' costs.

79. The effect of the anti-competitive acts in substantially lessening competition in the relevant markets is indicated by problems encountered by ESI competitors since January 2000 when the \$75.00 dollars pick-up charge and installation cost recovery charges were implemented. Examples of the problems reported by specific companies include the following:

- C canceled advertising campaign and subsequently withdrew from active solicitation of new customers;

- C healthy growth in water heater sales came to a halt; and

- C installations in the ECG franchise territory far below projections for 2000 and 2001.

80. The effect of the anti-competitive acts in substantially lessening competition is further supported by the company continuing to supply more than 65% of all new water heater installations in the relevant markets and about 80% of all replacement water heater installations.

VI CONCLUSION

81. In respect of the above, the Commissioner concludes that ESI substantially controls the water heater markets within the ECG franchise territory in Ontario and has engaged in a practice of anti-competitive acts leading to a substantial lessening or prevention of competition within certain markets in the province of Ontario.

VII RELIEF SOUGHT

82. It is submitted that the implementation of the following DCO will remove the barriers to entry and eliminate the substantial lessening or prevention of competition identified by the Commissioner, as explained more fully in the following Consent Order Impact Statement (“COIS”).
83. The Commissioner therefore respectfully seeks, pursuant to sections 79 and 105 of the *Competition Act*, the issuance of the DCO by the Tribunal.

THE COMPETITION TRIBUNAL

IN THE MATTER OF an application by the Commissioner of Competition for a Consent Order pursuant to sections 79 and 105 of the *Competition Act*, R.S.C. 1985, c. C-34 as amended;

AND IN THE MATTER OF certain practices of anti-competitive acts by Enbridge Services Inc. ("ESI") within certain markets in the province of Ontario;

AND IN THE MATTER OF an abuse of dominant position in the supply of conventional or power vented natural gas fuelled water heaters not used for commercial purposes ("water heaters") and related services within certain markets in the province of Ontario.

BETWEEN:

THE COMMISSIONER OF COMPETITION

Applicant

- and -

ENBRIDGE SERVICES INC.

Respondent

**STATEMENT OF GROUNDS
AND MATERIAL FACTS**

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