Reference: *Kobo Inc. v. The Commissioner of Competition,* 2014 Comp. Trib. 2
File No.: CT-2014-02
Registry Document No.: 41

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

AND IN THE MATTER OF an inquiry commenced under section 10 of the *Competition Act*, relating to certain alleged anti-competitive conduct in the markets for E-books in Canada;

AND IN THE MATTER OF the filing and registration of a consent agreement pursuant to section 105 of the *Competition Act*;

AND IN THE MATTER OF an application under section 106(2) of the *Competition Act*, by Kobo Inc. to rescind or vary the Consent Agreement between the Commissioner of Competition and Hachette Book Group Canada Ltd., Hachette Book Group, Inc., Hachette Digital, Inc.; HarperCollins Canada Limited; Holtzbrinck Publishers, LLC; and Simon & Schuster Canada, a division of CBS Canada Holdings Co. filed and registered with the Competition Tribunal on February 7, 2014, under section 105 of the *Competition Act*.

BETWEEN:

Kobo Inc.
(applicant)

and

The Commissioner of Competition,
Hachette Book Group Canada Ltd.,
Hachette Book Group, Inc.,
Hachette Digital Inc.,
HarperCollins Canada Limited,
Holtzbrinck Publishers, LLC; and
Simon & Schuster Canada, a division of CBS Canada Holdings Co.
(respondents)

Date of hearing: 20140317
Before Judicial Member: Rennie J. (Chairperson)
Reasons for Order: March 27, 2014
Reasons signed by: Mr. Justice Donald J. Rennie

REASONS FOR ORDER GRANTING THE APPLICANT'S MOTION FOR A STAY

I. INTRODUCTION

[1] Kobo Inc. (the "Applicant" or "Kobo") brought a motion to stay the implementation of a consent agreement reached pursuant to section 105 of the *Competition Act*, RSC 1985, c C-34 (the "Act"), signed February 6, 2014 and registered February 7, 2014 (the "Consent Agreement"), between the Commissioner of Competition (the "Commissioner") and Hachette Book Group Canada Ltd., Hachette Book Group, Inc., Hachette Digital, Inc.; HarperCollins Canada Limited; Holtzbrinck Publishers, LLC; and Simon & Schuster Canada, a division of CBS Canada Holdings Co. (collectively, the "Consenting Publishers") on the basis that Kobo has filed an application under subection 106(2) of the Act to rescind or vary the Consent Agreement.

[2] These reasons are further to my order of March 18, 2014 granting the stay sought by Kobo.

II. BACKGROUND

[3] Kobo is an E-book retailer operating in Canada since February 2009. It is the largest E-book retailer in Canada.

[4] In the summer of 2012, the Commissioner commenced an investigation into the E-book industry in Canada. This investigation came on the heels of an investigation by the United States Department of Justice ("U.S. DOJ") into the E-book market in the U.S., which resulted in settlement agreements between the U.S. DOJ and several U.S. publishers, some of which are the U.S. affiliates of the Consenting Publishers. In Canada, the Commissioner's 18-month investigation culminated in the registration of the Consent Agreement on February 7, 2014.

[5] The Consent Agreement requires each Consenting Publisher to amend or terminate any contract it has with an E-book retailer that, directly or indirectly, restricts the E-book retailer's ability to discount the price of E-books sold to consumers in Canada or that makes the retail price of an E-book sold by one retailer dependent on the retail price of the same E-book sold by another retailer (this latter type of clause is known as a "Price MFN clause"). The effective period of the Consent Agreement would commence forty (40) days following the date of its registration and last for eighteen (18) months. As the Consent Agreement was registered on February 7, 2014, its effective period is set to commence on March 19, 2014.

[6] Kobo's contracts with each of the Consenting Publishers are "Agency Agreements". Agency Agreements are typically agreements where the retailer is appointed as a non-exclusive agent for the marketing and delivery of E-books on the publisher's behalf. The publisher sets the retail price, and the retailer receives a commission (usually 30%) for each E-book sold. It is apparent that some or all of Kobo's Agency Agreements contain clauses that would be prohibited by the Consent Agreement.

[7] On February 21, 2014, Kobo brought an application to rescind or vary the Consent Agreement pursuant to subection 106(2) of the Act, which provides that:

(2) A person directly affected by a consent agreement, other than a party to that agreement, may apply to the Tribunal within 60 days after the registration of the agreement to have one or more of its terms rescinded or varied. The Tribunal may grant the application if it finds that the person has established that the terms could not be the subject of an order of the Tribunal.	(2) Toute personne directement touchée par le consentement — à l'exclusion d'une partie à celui-ci — peut, dans les soixante jours suivant l'enregistrement, demander au Tribunal d'en annuler ou d'en modifier une ou plusieurs modalités. Le Tribunal peut accueillir la demande s'il conclut que la personne a établi que les modalités ne pourraient faire l'objet d'une ordonnance du Tribunal.

[8] Subsection 106(2) was added to the Act as part of the 2002 amendments replacing the old consent order regime, wherein draft consent orders required the Tribunal's pre-approval, with the current consent agreement regime, which does not. The old regime was inefficient and ineffective, and Parliament intended for the amendments to create a more streamlined and timely process (*Burns Lake Native Development Corporation v Commissioner of Competition and West Fraser Timber Co Ltd*, 2006 Comp Trib 16, at para 26-32) [*Burns Lake*]).

[9] On February 21, 2014, Kobo also brought the present motion for an order staying the registration of the Consent Agreement pending the determination of its application under subsection 106(2). The motion was heard on March 17, 2014, and at the hearing, counsel for the Respondents took no position and made no submissions. The Consent Agreement provides that the Consenting Publishers will not, for the purposes of the agreement only, including execution, registration, enforcement, variation or rescission, contest the Commissioner's allegations that further to an agreement or arrangement, they have engaged in conduct with the result that competition in the markets for E-books in Canada has been substantially prevented or lessened, contrary to section 90.1 of the Act.

[10] On March 18, 2014, I granted Kobo's motion for an order staying the Consent Agreement and these are the reasons for that order.

III. ISSUES & DISCUSSION

[11] A consent agreement, filed pursuant to section 105 of the Act, has, upon registration, the same force and effect, and proceedings may be taken, as if it were an order of the Tribunal. Such a consent agreement is to be based on terms that could be the subject of an order of the Tribunal.

[12] The issue on this motion is whether the Tribunal should stay the implementation of the Consent Agreement pending the disposition of Kobo's subsection 106(2) application. The test

for stay was established by the Supreme Court of Canada in *RJR-MacDonald Inc v Canada (Attorney General)*, [1994] 1 SCR 311 at p 334 [*RJR-MacDonald*]:

a) There is a serious issue to be tried;
b) The applicant will suffer irreparable harm if the stay is not granted; and
c) The balance of convenience favours granting the stay.

[13] I deal with each element of the test in turn.

a. Serious issue to be tried

[14] For the limited purposes of this stay motion, the Commissioner concedes that Kobo is a "person directly affected" within the meaning of subsection 106(2).

[15] Kobo argues that the legislative history of subsection 106(2) of the Act indicates that it was meant to operate as a meaningful "safety valve" on the Commissioner's power to enter into consent agreements, and the serious issues it proposes must be looked at in that context.

[16] Kobo asserts that its application raises important unanswered questions about the Consent agreement and the operation of subsection 106(2). It contends that its application raises two serious triable issues. The basis for these serious issues is the fact that the Consent Agreement was reached notwithstanding that the Commissioner has failed to articulate the existence of an agreement or arrangement between the Consenting Publishers falling under section 90.1 of the Act (a "90.1 agreement"). Kobo argues that the fact that the Commissioner has not made allegations or proven the existence of a 90.1 agreement leads to the first serious issue, which is:

> Does the Tribunal have jurisdiction to make any order under s. 90.1 in the absence of an existing or proposed agreement or arrangement among competitors (or even an allegation of such an agreement)?

[17] Kobo argues that the Tribunal lacks such jurisdiction. Its position, therefore, is that a consent agreement under section 105 purporting to defeat a 90.1 agreement must satisfy the substantive requirements of section 90.1. It argues against a narrow interpretation of subsection 106(2) wherein the Tribunal need only be satisfied that it has jurisdiction to make orders of the nature contemplated in a consent agreement. However, in the event that such a narrow interpretation is adopted, Kobo argues that a second serious issue nonetheless arises, which is:

> Can the Tribunal make an order prohibiting a person from doing anything under a putative 90.1 agreement where it has not identified any terms of such an agreement or is not satisfied that such an agreement exists or is proposed?

[18] Kobo again argues that it cannot, as paragraph 90.1(1)(*a*) gives the Tribunal the power to prohibit a person from doing anything under a 90.1 agreement, a power that is impossible to exercise without actually identifying such an agreement. Although paragraph 90.1(1)(*b*) permits

a consent agreement to require a third party to "take any other action", Kobo argues this still requires a determination that there has been a 90.1 agreement, and in any case that the Consent Agreement contains prohibitions, placing it firmly within the scope of paragraph 90.1(1)(*a*).

[19] Kobo further asserts that the Commissioner has in the past acknowledged the seriousness of a question similar to the ones it now proposes. In *Burns Lake*, the Tribunal answered two questions brought to it by the Commissioner on reference, but there was actually a third question that was initially raised by the Commissioner but later dropped. This question was: "In an application under subsection 106(2) of the Act to vary or rescind the terms of a consent agreement, is the Tribunal authorized, by the language "that the terms could not be the subject of an order of the Tribunal," to engage in a *de novo* review of whether the merger or proposed merger is likely to substantially lessen or prevent competition?" (*Burns Lake Native Development Corporation v Commissioner of Competition and West Fraser Timber Co Ltd*, 2005 Comp Trib 19, at para 39, aff'd *Burns Lake Native Development Corporation v. Canada (Commissioner of Competition),* 2006 FCA 97). In other words, it had to do with the Tribunal's scope of review on a 106(2) application. This, Kobo argues, is analogous to the serious questions it now raises, and if it was serious enough to be considered on a reference by the Commissioner, it is serious enough to pass the low threshold of the *RJR-MacDonald* test.

[20] The Commissioner, on the other hand, contends that Kobo has failed to raise any serious issue because subsection 106(2) should be read restrictively, such that consent agreements under section 105 should not be tied to the substantive provisions of section 90.1. The Commissioner points out that under Rule 106(2) of the *Competition Tribunal Rules*, SOR/2008-141, there are only three statutory requirements for a valid consent agreement, namely that the consent agreement must set out:

> (a) the sections of the Act under which the agreement is made;
> (b) the name and address of each person in respect of whom the agreement is sought; and
> (c) the terms of the agreement.

[21] It is therefore not necessary, the Commissioner submits, for a consent agreement to provide any particulars that go beyond these three statutory requirements. As such, the Consent Agreement did not need to indicate the particulars of any existing or proposed 90.1 agreement that may have existed between the Consenting Publishers. Consent agreements are negotiations, and part of those negotiations may include what is not revealed to the public.

[22] Alternatively, the Commissioner argues that even if the Tribunal finds that a consent agreement must be substantively tied to and establish the elements of the alleged anti-competitive conduct, the consent agreement nonetheless accords with section 90.1 of the Act, as paragraph 90.1(1)(*b*) gives the Tribunal the power to prohibit a person, on consent of that person and the Commissioner, from taking "any other action".

[23] The threshold for this element of the test is a low one, once the decision-maker is satisfied that the application is neither vexatious nor frivolous, he should proceed to consider the other elements (*RJR-MacDonald*, at p 337). In my view, there is no doubt that Kobo's application raises serious issues related to the interpretation of subsection 106(2). The fact that

the Commissioner in *Burns Lake* had initially listed a virtually identical issue in the reference is a compelling point. The application also raises the bigger, underlying question of whether a consent agreement under section 105 of the Act that purports to defeat a 90.1 agreement requires the Commissioner to satisfy the substantive requirements of section 90.1, and if so, to what extent. This interplay of sections 90.1 and 105, and how it relates to applications under subsection 106(2), is an issue that has not been previously dealt with by the Tribunal, and is neither vexatious nor frivolous in nature. Indeed, the fact that Kobo and the Commissioner have each offered multiple possible theories of this interplay testifies to the fact that there is a serious issue to be determined.

[24] The first element of the *RJR-MacDonald* test is accordingly met.

b. Irreparable harm

[25] Kobo submits that it will suffer irreparable financial harm if this stay is not granted. It bases this harm on four sources of evidence:

> (i) the Commissioner's press release of February 7, 2014 announcing the Consent Agreement (the "Press Release") and a newspaper article dated March 13, 2014;
> (ii) two letters of termination/amendment that Kobo received from two of the four Consenting Publishers following registration of the Consent Agreement (the "Amendment Letters");
> (iii) Kobo's experience in the U.S. following implementation of settlement agreements there; and
> (iv) Kobo's internal business forecasting.

[26] Kobo argues that it will be only E-book retailers like Kobo, not the Consenting Publishers, that will suffer financial loss due to the implementation of the Consent Agreement. This is demonstrated by the Press Release and especially by the Amendment Letters. The Amendment Letters unilaterally purport to transform the existing Agency Agreements into "Agency Lite" agreements, whereby pricing restrictions are lifted but the Consenting Publishers are still entitled to revenues of 70% of the retail price that they set. This means that Kobo alone would bear the cost of any discount they choose to offer on the retail price. Thus, Kobo asserts that the financial harm from the Consent Agreement will fall squarely on Kobo, and on other E-book retailers like it, and not on the Consenting Publishers.

[27] Based on its experience in the U.S. market following the implementation of similar settlement agreements there, Kobo has calculated that it will suffer substantial financial losses as a result. It maintains that the U.S. is an apt comparator market on which to base its forecasting. Kobo also provides internal financial forecasts predicting significant losses that would result from the implementation of the Consent Agreement, and argues that the assumptions made in those forecasts are fair, as explained in the affidavit of Michael Tamblyn, Kobo's Chief Content Officer. Kobo also makes the point that it is the type and not the magnitude of harm that is relevant on a motion for stay, but nonetheless provides numbers to demonstrate that it has a clear evidentiary basis for its assertion of harm.

[28] Kobo submits that the time and money it would have to spend on switching to an Agency Lite model would also contribute to its harm.

[29] Finally, Kobo argues it would have no right to claim damages from the Commissioner, and this makes the harm it will suffer irreparable.

[30] The Commissioner argues that Kobo will not suffer financial harm because of its current financial position. Further, its evidence of financial loss is speculative, since its methodology for calculating losses incorporates many flawed assumptions and does not take into account all relevant economic factors. One of these flawed assumptions is that as the price of e-books would drop, Kobo's volume of sale would remain constant. The Commissioner submits that this is contrary to basic economic theory which recognizes that as the price drops, the volume of sales increases.

[31] The Commissioner also argues that any financial harm suffered by Kobo can be avoided because part of their projected losses results from the business strategy it has intentionally adopted. Such losses can also likely be remedied, as there is evidence that Kobo has been developing contingency plans to deal with the implementation of the Consent Agreement.

[32] From a policy perspective, the Commissioner urges the Tribunal not to accept financial harm as a valid basis for staying the registration of the Consent Agreement, as to do so would be wholly at odds with the purpose of the Act, which is to protect competition, not competitors. Any financial harm suffered by Kobo, the Commissioner argues, would not be caused by the Consent Agreement; rather, it would be caused by Kobo no longer being able to charge artificially-inflated, anti-competitive prices for its E-books. The Commissioner submits that this is not the type of "harm" that the Act should in any way protect.

[33] The Commissioner also presents a "floodgates" argument. He contends that if this stay is granted on the basis of this type of harm, it will undermine the consent agreement regime because future consent agreements will be subjected to stays, since third parties will almost invariably be affected financially by such agreements. This runs counter to the intention of Parliament in implementing a streamlined and proficient consent agreement regime.

[34] In reply to the Commissioner's allegation that its loss is speculative because of flawed assumptions, Kobo notes that the Commissioner only questioned Mr. Tamblyn on one assumption and not any of the others, and this failure to cross-examine shifts the burden to the Commissioner in demonstrating the assumptions were inappropriate pursuant to the Federal Court decision in *Effem Foods Ltd. v. H.J. Heinz Co. of Canada* (1997), 75 C.P.R. (3d) 331. Kobo further retorts that the Commissioner cannot assert that Kobo is benefiting from inflated prices for E-books when he has never alleged, let alone proven, that Kobo is or has ever been engaged in any kind of anti-competitive conduct.

[35] In my view, Kobo has established, on the balance of probabilities, that it will suffer irreparable harm if this stay is not granted. The profitability of Kobo's business has no bearing on whether it will suffer harm, and the jurisprudence recognizes that harm can occur to a

company whose path to profitability is blocked (*Danone Canada Inc v Canada (Attorney General)*, 2009 FC 44 at para 59, 343 FTR 17). I am also not convinced by the Commissioner's argument that Kobo's forecasting data are speculative. The Commissioner has adduced no evidence to challenge the soundness of Kobo's methodology. I therefore find that Kobo's financial projections are not merely speculative.

[36] I do not accept the Commissioner's assertion that Kobo's projected losses arise from the business strategy it has intentionally adopted and so are avoidable, as there is no evidence of this. The argument that any harm Kobo might suffer can be remedied since Kobo has contingency plans also fails. The fact that Kobo is prepared for the worst merely shows that it has prudent business sense.

[37] Further, I cannot accept the Commissioner's policy argument that the type of harm Kobo asserts cannot qualify as harm for the purposes of this stay because that would be contrary to the purposes of the Act. While a reduction in E-book prices may ostensibly be good for consumers, the Commissioner has provided no legal reason why financial loss on part of a retailer resulting from such price reductions cannot constitute harm for the purposes of the stay test.

[38] The Commissioner argues that recognizing this type of harm will open the floodgates, resulting in stays of future consent agreements as a matter of course. However, this is speculative, and ignores the fact that any future applicant must still prove that such harm will indeed result, as well as satisfy the other two elements of the *RJR-MacDonald* test. It also assumes, in so far as applications are made under subsection 106(2), that the tribunal will not manage them in a manner that respects a balance between the interest of the business community in certainty, the interest of the Commissioner in enforcement of the Act and those of others who are directly affected by the consent agreement.

[39] In conclusion, I am therefore satisfied that Kobo will suffer financial harm and that such harm is not speculative. In reaching this conclusion, it should be noted that the evidence of harm before the Tribunal is neither speculative nor comprised of mere assertions; rather the evidence is comprised of actual financial data, reasoned projections, and further validated by reference to the known experience in the U.S. market. The evidence before the Tribunal is markedly different than that before the Federal Court of Appeal in *Gateway City Church v. Canada (Minister of National Revenue)*, 2013 FCA 126, relied upon by the Commissioner.

[40] The harm would be irreparable. The Federal Court of Appeal has recognized that an applicant's inability to claim damages from the Commissioner in the event it is successful in its application contributes to the irreparable nature of the financial harm (*Tervita Corp v Canada (Commissioner of Competition)*, 2012 FCA 223 at para 15, 434 NR 159 [*Tervita*]; *Canada (Commissioner of Competition) v Canadian Waste Services Holdings Inc*, 2004 FCA 273 at para 18; *Nadeau Poultry Farm Limited v. Groupe Westco Inc. et al.*, 2008 Comp. Trib. 16, at para. 29).

[41] The second element of the *RJR-MacDonald* test is accordingly met.

c. Balance of convenience

[42] Kobo submits that the balance of convenience lies in its favour because the public will not be prejudiced by the issuance of the stay, but Kobo will be greatly prejudiced if the stay is not granted. In fact, Kobo argues that the public interest actually favours granting a stay.

[43] Kobo asserts that the public will not be prejudiced because the Consent Agreement does not impose a permanent ban on the clauses therein prohibited; it simply imposes an 18 month ban. The granting of the stay will therefore not make the Consent Agreement any less effective; it will simply be effective for a later set of customers. The fact that in the U.S., each settlement agreement was implemented approximately six months after it was filed and the implementation of the agreements spanned 16 months indicates that there is no urgency. Kobo therefore contends that it stands to reason that delay in implementing the Consent Agreement will not make its terms any less effective.

[44] On the other hand, Kobo argues that without a stay it will be severely prejudiced, because it is very likely that its application will become moot. Without the stay, there would be very little incentive for Kobo to continue its application, since even if Kobo were ultimately successful in its application, without staying the Consent Agreement, the damage will be done, the market will have shifted, and there would be no way for it to recoup its losses.

[45] Kobo submits that despite the fact that the Consent Agreement is the result of the actions of a government officer in the implementation of his statutory duties, the public interest does not weigh heavily in the Commissioner's favour because this is not a case where Kobo is asking for the suspension of a law or program. Rather, this stay is more akin to an exemption, in which the public interest weighs less heavily in favour of the government. Indeed, Kobo argues that the public interest favours granting the stay and hearing its 106(2) application on the merits, since the public deserves clarity, transparency and direction in the consent agreement process, which is currently lacking in light of the pending serious questions.

[46] Kobo finally contends that it has acted in a timely manner. Subsection 106(2) permits that an application may be brought within 60 days of the registration of a consent agreement, but Kobo brought its application within two weeks. Indeed, Kobo points out that the Consent Agreement is set to be implemented 40 days after registration, which is 20 days prior to the expiry of the 60 day period permitted to bring a 106(2) application under the Act. The implication is that the terms of the Consent Agreement frustrate or restrict Kobo's rights under section 106(2), and this should also favour granting a stay until Kobo's application can be decided on the merits.

[47] The Commissioner argues that the balance of convenience favours rejecting the stay because to do otherwise would frustrate the purpose of the Act in maintaining and encouraging competition in Canada. Without the implementation of the Consent Agreement, the public will continue to be deprived of the benefits of open price competition in the E-book market. The Commissioner submits that that public interest weighs heavily in his favour because this is a situation where a public officer is carrying out his statutory duties (*RJR-MacDonald*). The

Commissioner further argues that since Kobo’s financial harm is speculative, there is no real prejudice to it should the Consent Agreement go forward.

[48] In my view, the balance of convenience favours granting the stay. While maintaining the *status quo* might have the effect of depriving consumers of lower E-book prices in the short term, not granting the stay will certainly have a profound impact on the usefulness of Kobo’s application. In the event that Kobo is successful in its application and the Tribunal finds that the Consent Agreement ought to be rescinded or varied, Kobo would have already suffered loss and there would be no way to wind back the clock.

[49] I am also swayed by Kobo’s argument that the public interest does not weigh heavily in favour of the Commissioner, because Kobo’s application raises concerns that are in the public’s interest to resolve. The Commissioner has not satisfied me that the potential of lower prices of E-books is such an urgent matter so as to outweigh the importance of resolving the questions raised by Kobo in its application. That lack of urgency is demonstrated by the fact that similar agreements in the U.S. were implemented in a staggered fashion over the course of 16 months. In my view, the best way to balance the competing public interests at stake here is to grant this stay and move Kobo’s application along as expeditiously as possible. Justice Mainville adopted a similar approach in *Tervita* at para 19.

[50] Thus, the balance of convenience favours granting the stay.

[51] The third and final element of the *RJR-MacDonald* test is accordingly met. Kobo is therefore entitled to the stay that it seeks.

[52] These reasons are in support of the order dated March 18, 2014 granting the stay.

DATED at Ottawa, this 27th day of March, 2014.

SIGNED on behalf of the Tribunal by the Chairperson.

(s) Donald J. Rennie

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