Competition Tribunal Tribunal de la Concurrence

Reference: *Commissioner of Competition v. Trilogy Retail Enterprises L.P.,* 2001 Comp. Trib. 29
File no.: CT2001003
Registry document no.: 033

IN THE MATTER OF an application by the Commissioner of Competition for a consent order pursuant to sections 92 and 105 of the *Competition Act*, R.S.C. 1985, c. C-34;

AND IN THE MATTER OF the acquisition of a majority share of Chapters Inc. by Trilogy Retail Enterprises L.P. and the proposed merger of Indigo Books & Music Inc. and Chapters Inc. and their respective affiliates, Indigo Online Inc. and Chapters Online Inc.

B E T W E E N:

The Commissioner of Competition
(applicant)

and

Trilogy Retail Enterprises L.P.
Chapters Inc.
Indigo Books & Music Inc.
(respondents)

and

Anil Amlani and Bruce Barr
(intervenors)

Dates of hearing: 20010605 to 20010606
Member: Nadon J. (presiding), L.P. Schwartz, A.L. Reny
Date of reasons: 20010713
Reasons signed by: Nadon J.

REASONS REGARDING CONSENT ORDER

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I. INTRODUCTION

[1] On April 18, 2001, the Commissioner of Competition (the "Commissioner") brought an application pursuant to sections 92 and 105 of the *Competition Act*, R.S.C. 1985, c. C-34 (the "Act") for a consent order directing the divestiture of certain assets and requesting certain remedies in respect of the acquisition of a majority share of Chapters Inc. ("Chapters") by Trilogy Retail Enterprises L.P. ("Trilogy") and the proposed merger of Indigo Books & Music Inc. ("Indigo") and Chapters and their respective affiliates, Indigo Online Inc. and Chapters Online Inc. The parties submitted a draft consent order ("DCO") for the Tribunal's approval.

[2] The Commissioner brought the application on the grounds that the acquisition and proposed merger would, in the absence of the DCO, be likely to prevent or lessen competition substantially in the national distribution of English language trade books from publishers to booksellers and in the local distribution of English-language trade books from booksellers to consumers through large-format and small-format retail stores. The Commissioner is concerned with the effects of the merger on the downstream supply to consumers of English-language trade books and the upstream exercise of market power in relation to publishers of English-language trade books.

[3] The Commissioner seeks an order approving the DCO and requiring the respondents to offer for sale 13 large-format stores ("superstores") and 10 small-format stores located in shopping malls ("mall stores"), certain online assets, certain trade names and a distribution facility and to commit to certain minimum acceptable terms of trade with suppliers in order to avoid the substantial lessening of competition or prevention of competition arising from the merger. The Commissioner submits that the DCO will remove the likelihood of a substantial lessening or prevention of competition resulting from the merger.

[4] The panel prepared a series of questions regarding the DCO, prior to the hearing, which were sent to counsel for the parties and for the intervenors. Responses to the panel members' questions were filed by the respondents on June 4, 2001, and by the Commissioner and the intervenors on June 5, 2001. The answers provided by counsel for the parties and for the intervenors contributed to clarify many of the questions and issues raised by the panel with respect to the DCO and hence, led to an expeditious hearing.

[5] The main issue before the Tribunal is whether the DCO will likely eliminate the substantial lessening of competition. In coming to this conclusion, the Tribunal must be satisfied that the measures proposed in the DCO are sufficiently effective and enforceable and that the proposed remedies meet the objectives of the Act.

[6] The hearing of the Commissioner's application took place in Ottawa on June 5 and 6, 2001. After hearing counsel for the parties and for the intervenors, the Tribunal advised counsel that it would approve the DCO. On June 8, 2001, the consent order was issued. What follows are the Tribunal's reason for that order.

II. PARTIES

A. APPLICANT

[7] The Commissioner is the officer appointed by the Governor in Council under section 7 of the Act to administer and enforce the Act and is the only person authorized to bring this application.

B. RESPONDENTS

[8] Trilogy is an Ontario limited partnership, controlled by Gerald Schwartz and formed for the purpose of acquiring control of Chapters and proposing a merger between Indigo and Chapters. Trilogy's general partner is Trilogy Retail Enterprises Inc., an Ontario company.

[9] Indigo is an Ontario corporation, incorporated in 1996. Indigo operates 15 superstores and Indigo Online Inc. whose primary business is bookselling over the Internet at Indigo.ca. The superstores are located in British Columbia (one), in Alberta (three), in Ontario (ten) and in Quebec (one). Gerald Schwartz and Heather Reisman, together with corporations controlled by them, hold in aggregate approximately 42 percent of Indigo's voting shares. Indigo holds approximately 96 percent of the shares of Indigo Online Inc.

[10] Chapters is a public corporation incorporated under the laws of Ontario. Chapters was formed following the 1995 merger of SmithBooks, operated by FICG Inc. and Coles Book Stores Limited, a subsidiary of Southam Inc. Chapters operates a total of 76 superstores under the Chapters trade name, one superstore under the name the World's Biggest Bookstore and 231 small-format stores under the names Coles, SmithBooks, Librairie Smith, Classic Books and The Book Company. Chapters has three subsidiaries: Chapters Canadian University Bookstores Limited, Chapters Online Inc. and Pegasus Wholesale Inc. Chapters owns approximately 70 percent of Chapters Online Inc. which is responsible for Chapters' selling activities over the Internet including Chapters.ca. Pegasus Wholesale Inc., a wholly-owned subsidiary of Chapters, is the distribution division of Chapters and until recently was positioned to be Canada's largest national wholesaler of books.

III. MERGER AND ITS COMPETITIVE IMPACT

[11] On November 28, 2000, the Commissioner received notification pursuant to section 114 of the Act of a proposed offer by Trilogy to acquire approximately 50.1 percent of Chapters. A second notification was received by the Commissioner of a proposed acquisition of the shares of Chapters by Indigo on December 7, 2000. The Commissioner was also advised of Trilogy's intention to merge Chapters and Indigo. After a series of negotiations, the Commissioner and the respondents agreed on the DCO to address the Commissioner's concerns resulting from the merger of Chapters and Indigo.

[12] On February 1, 2001, Trilogy became Chapters' controlling shareholder as the result of a hostile take-over. Trilogy proposes to merge Indigo and Chapters and to merge Indigo Online Inc. and Chapters Online Inc.

[13] Chapters and Indigo are the two largest trade book retailers in Canada. Chapters and Indigo have 92 of the 96 stores in Canada that can be characterized as superstores. According to the Commissioner, the estimates of their combined share of sales in the relevant market vary depending on the measurement of total relevant book sales in the country. However, the Commissioner evaluates that their market share is approximately between 55 and 70 percent. Further, Indigo and Chapters have a 100 percent market share of the superstore category in each metropolitan area in which they overlap.

[14] According to the Commissioner, the high market share of the merged entity, the removal of the most vigorous and effective competitor from the market, the high barriers to entry and expansion and the foreclosure of significant foreign competition leads to a conclusion that the merger will likely result in a substantial lessening and prevention of competition in a number of local markets in Canada. The likely effects of the merger would have an impact both downstream, on suppliers of books to consumers and upstream, on purchasers of books from publishers.

IV. EVIDENCE BEFORE THE TRIBUNAL

[15] In considering the DCO, the Tribunal had before it the affidavit of Glenn McDonald dated April 17, 2001, a Senior Competition Law Officer with the Mergers Branch of the Competition Bureau, who has been engaged in the review of the transaction at issue. The Tribunal also considered the evidence submitted by counsel for the intervenors.

V. PUBLIC COMMENTS AND INTERVENTION

[16] Paragraph 65(2)(f) of the *Competition Tribunal Rules* (SOR96/307) (the "Rules") provides that, when a notice is published by the Registrar in the *Canada Gazette* and the newspapers consequent to the filing of an application for a consent order, the notice shall state the date on or before which comments or a request for leave to intervene must be filed, which date shall be 21 clear days after the date of publication of the notice in the Canada Gazette. In this case, the respondents filed a motion for an order shortening the time period for filing comments and requests for leave to intervene from the 21 clear days to 10 clear days after publication of the consent application in the *Canada Gazette*. The Tribunal granted the respondents' motion on April 19, 2001.

[17] A total of nine comments were filed with the Tribunal. Those comments were filed by: The Book Shelf of Guelph, Tanners Books, the Association of Canadian Publishers, the Canadian Booksellers Association, Cambridge Shopping Centres Limited, Owners and Manager Scarborough Town Centre, the Canadian Publishers' Council, Talon Books Ltd. and, Harper Collins Canada Ltd. Replies to these comments were filed by the Commissioner and the respondents.

[18] A request for leave to intervene was filed by Anil Amlani and Bruce Barr on May 8, 2001. Their request was granted on May 17, 2001. Messrs. Amlani and Barr are members of a group of investors that is considering whether to make a bid for the assets identified for divestiture in the DCO. Counsel for Messrs. Amlani and Barr made representations concerning the effectiveness of the consent order and the likelihood that there will be a buyer for the designated assets.

[19] The Tribunal considered the submissions made by the intervenors and discusses them under that part of these reasons entitled "Analysis of the Draft Consent Order".

VI. APPLICABLE LEGAL TEST

[20] As stated in *Director of Investigation and Research v. Imperial Oil Limited* (26 January 1990), CT8903/390, Reasons and Decision at 14, [1990] C.C.T.D. No. 1 (QL) (Comp. Trib.):

> . . . the burden of proof in a consent order application is on the parties and particularly on the Director. That burden requires the parties to prove that the order which they seek is one which will in all likelihood eliminate the substantial lessening of competition, which they have agreed (by way of presumption) will arise from the merger. (reference omitted)

[21] The test to be applied by the Tribunal in determining whether to issue a consent order is not whether the remedy will create a more competitive environment than existed prior to the merger or even restore competition to the pre-merger level. The relevant question for the Tribunal to answer is whether the remedy will, in all likelihood, eliminate the substantial lessening or prevention of competition which is presumed (but not admitted by the respondents in this case) to arise from the merger. In *Director of Investigation and Research v. Air Canada* (1989), 27 C.P.R. (3d) 476 at 512-513, [1989] C.C.T.D. No. 29 (QL) (Comp. Trib.) the Tribunal stated:

> It is clear that the tribunal's constituent legislation does not contemplate that the tribunal will be a mere rubber stamp. The legislation, for example, does not provide for the automatic filing by the director of settlements which he reaches with respondents so that they automatically become orders of the tribunal. This type of procedure is found, for example, in the *Canadian Human Rights Act;* R.S.C. 1985, c. H-6, s. 57; the filing of an order of a Human Rights Tribunal in the Registry of the Federal Court constitutes an order of that court for the purpose of enforcement. The tribunal is composed of judicial members and of non-judicial members who have expertise in areas relevant to the work of the tribunal. It is required to sit in panels of three, even for the purpose of granting consent orders. It is clear that Parliament intended the tribunal to exercise an independent judgment with respect to such orders.
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> At the same time, the legislation sends a very clear message to the tribunal that it is not anticipated that the tribunal should take a detailed role in the crafting of consent orders.
>
> ...
>
> The tribunal accepts the Director's argument that the role of the tribunal is not to ask whether the consent order is the optimum solution to the anti-competitive effects which it is assumed would arise as a result to the merger. The tribunal agrees that its role is to determine whether the consent order meets a minimum test. That test is whether the merger, as conditioned by the terms of the consent order, results in a situation where the substantial lessening of competition, which it is presumed will arise from the merger, has, in all likelihood, been eliminated. (reference omitted)

[22] As stated above, the elimination of the substantial lessening or prevention of competition does not require that competition be restored to the pre-merger level. As stated by the Supreme Court of Canada in *Director of Investigation and Research v. Southam Inc.*, [1997] 1 S.C.R 748 at 789-790:

> It hardly needs arguing that the appropriate remedy for a substantial lessening of competition is to restore competition to the point at which it can no longer be said to be substantially less than it was before the merger. This is the test that the Tribunal has applied in consent cases.

[23] The more recent *Ultramar* decision (2000) 6 C.P.R. (4th) 519, [2000] C.C.T.D. No. 4 (QL) (Comp. Trib.) also clearly established that, in order to make the order sought, the Tribunal must be satisfied "that the measures proposed in the DCO are sufficiently well-defined to be effective and enforceable" and that the proposed remedy meets the objectives of the Act. The Tribunal's role is to determine if the proposed measures are adequate to eliminate the substantial lessening of competition that would otherwise arise from the merger. The Tribunal must not determine whether other remedies are more likely to achieve the elimination of the substantial lessening of competition.

VII. ANALYSIS OF THE DRAFT CONSENT ORDER

[24] The DCO provides for a combination of structural and behavioural obligations to be assumed by the respondents. Among those, the DCO provides for: the divestiture of 23 stores operated by the respondents; the sale of all rights, title and interest of whatever character in Indigo Online Inc., including any leasehold interest in equipment, software and portal agreements that the respondents or their affiliates may own in respect of Indigo Online Inc.; the sale of Indigo's distribution facility located in Mississauga; the sale of all rights, title and interest of whatever character in one of the following tradenames: "Classic Books", "Prospero" and "SmithBooks"; a prohibition to acquire a retail bookstore outlet in a shopping centre or mall in which it has already an outlet for the five-year term of the DCO; and the adoption by the respondents of certain prescribed minimum acceptable terms of trade with its trade book suppliers.

[25] In these reasons, the Tribunal will only address those parts of the DCO that raised concerns at the outset. As stated above, in order to approve the DCO, the Tribunal must be satisfied that the measures proposed are sufficiently effective and enforceable and that the proposed remedies meet the objectives of the Act.

[26] In concluding that the DCO meets the objective of the Act, the Tribunal considered the effectiveness of the remedies proposed. With respect to the proposed divestiture, the Tribunal considered certain issues such as the quantity and the overall quality of the assets selected for divestiture and the possibility that those assets might be sold to more than one purchaser. Further, the Tribunal questioned the validity of paragraph 5(b) of the DCO which provides the following:

as a condition to any divestiture of some or all of the Designated Assets, the Purchaser must obtain a full release of the Parties and their respective Affiliates from all liabilities and financial obligations as lessee or related to the lease, relating to any of such Designated Assets, and neither any of the Parties nor any of their Affiliates will have any financial interest in or obligation to or owed by any Purchaser, or any third party in respect of any Designated Assets, other than obligations in respect of any representations, warranties and covenants included in any agreement between any of the Parties and any Purchaser(s). Should the Purchaser not be able to obtain any required release, the Parties, the Purchaser or the Commissioner may apply to the Tribunal for an order releasing the Parties from any such liabilities or obligations;

The Tribunal also considered the validity of the arbitration procedure set out in Appendix II to Schedule C of the DCO.

A. DIVESTITURE OF ASSETS

[27] The DCO provides for the divestiture of nine superstores and ten small stores operated by Chapters and four superstores operated by Indigo. The Commissioner submits that the divestiture of those assets approximates Indigo's pre-merger retail presence and overall size, in terms of trade books sales and store performance. Further, the Commissioner argues that the divestiture package includes assets that are superior in quality to those operated by Indigo as the earnings before interest, taxes, depreciation and amortization ("EBITDA") of the stores in the divestiture package was approximately 156 percent of that of Indigo's.

[28] Counsel for the Commissioner also underlined the fact that the intention of the Commissioner in this case was not to replicate the business model of Indigo (i.e. 15 superstores) but rather to provide a new entrant with some flexibility with respect to the business model that it deemed appropriate to enter the market. According to the Commissioner, the divestiture of ten mall stores accommodates that need for flexibility. Further, the individual stores selected for divestiture were chosen on the basis of Indigo's pre-merger geographic representation and likely expansion.

[29] Counsel for the intervenors submits that a prospective purchaser does require a critical mass of stores to achieve the economies of scale necessary to compete against the new Chapters/Indigo entity and that the assets designated for divestiture under the DCO are "unlikely to be sufficiently profitable to be attractive to a purchaser". Further, counsel argues that the divestiture of 13 superstores is well below the estimated 24 superstores that are needed to establish a "minimum critical mass" of superstores necessary to compete with the new Chapters/Indigo entity and that it does not provide a large enough base or the scale necessary to spread common costs and be cost-competitive with the merged Chapters/Indigo.

[30] Counsel for the intervenors also submits that the mall stores are not effective competitors for superstores and that they cannot provide a viable platform for competing with the merged entity.

[31] In addition, counsel for the intervenors submits that a prospective purchaser will look to the underlying characteristics of the markets served by the superstores. Markets with: (i) a higher percentage of adults; (ii) a high percentage of persons with a university education; and (iii) a higher income are "considered prime". Counsel submits that the characteristics of the areas served by the stores designated for divestiture are consistently weaker than the characteristics of the markets served by the stores that will be retained by Chapters/Indigo. Further, counsel submits that the merged entity will benefit from clustering, economies of scale and the advantages of superior store locations, advantages that will not be available to a prospective purchaser of the designated assets.

[32] The Tribunal appreciates the submissions made by counsel but does not agree. First, counsel argues that 24 superstores are required to create a critical mass of stores. There is no evidence before the Tribunal to support that submission. Even if that submission were correct, the Tribunal is only bound to approve a remedy that will restore competition to the level at which it can no longer be said to be *substantially* less that it was before the merger. Prior to the merger Indigo operated 15 superstores. The divestiture package includes 13 superstores and 10 mall stores. It appears that the intervenors would like to restore competition to a point beyond which it existed prior to the Chapters/Indigo merger. Therefore, the argument submitted by the intervenors that 24 superstores should be divested by the respondents in order to allow a new entrant to compete cannot succeed.

[33] As to the criticism made with respect to the location of the superstores designated to be divested, the Tribunal is in no position to assess which ones are the most profitable or whether it would have been preferable to divest superstores located in metropolitan areas where an overlap exists. Counsel for the Commissioner submitted that a new entrant would have a better chance of success by acquiring stores that face no direct competition in order to avoid "cannibalization". The Tribunal is not in a position to examine the profitability and attributes of each of the assets selected for divestiture by the Commissioner. No evidence was adduced by the parties or the intervenors on that point. The scope of review in consent proceedings is narrower than in contested proceedings. The Tribunal's role is to determine whether, on the whole, the remedy or remedies proposed are likely to be effective in restoring competition to the point at which it can no longer be said to be substantially less that it was before the merger. The evidence before the Tribunal is that the EBITDA of the stores in the divestiture package is approximately 156 percent of that of Indigo's. This factor was considered highly relevant by the Tribunal in concluding that the proposed divestiture of the designated assets was likely to be effective.

VIII. JURISDICTIONAL CONCERNS

A. RELEASE OF LIABILITIES OR OBLIGATIONS ARISING FROM A LEASE

[34] Under paragraph 5(b) of the DCO, the purchaser is responsible for negotiating releases from obligations that might arise under the leases related to the designated assets. However, in the event that the purchaser is unable to obtain a release, paragraph 5(b) of the DCO allows the Parties, the Purchaser or the Commissioner to apply to the Tribunal for an order releasing the Parties from any such liabilities or obligations.

[35] Although the Tribunal is not a court of inherent jurisdiction, the Tribunal does possess the powers to interfere with the property rights of the parties before it, as well as the property rights of third parties. Indeed, the Act contemplates that orders of the Tribunal may bind non-parties. For instance, paragraphs 92(1)(e) and (f) of the Act provide that the Tribunal may, in the case of a completed or proposed merger, make an order against any party to the merger "or any other person". As stated by the Tribunal in *Director of Investigation and Research v. Laidlaw Waste Systems Ltd.* (1992), 40 C.P.R. (3d) 289 at 352, [1992] c.c.t.d. No. 1 (QL) (Comp. Trib.):

> In so far as declaring the restrictive covenants in the acquisition agreements to be null and void . . . , counsel for Laidlaw argues that this type of remedy is not within the jurisdiction of the tribunal because it is a blatant interference with the property rights of the parties to those contracts. It is argued that the tribunal is a creature of statute and not a court of inherent jurisdiction and therefore cannot grant the remedy sought.
>
> There is no doubt that the tribunal is not a court of inherent jurisdiction and is a creature of statute. At the same time, it is clear from the types of remedies which are expressly *included within* the tribunal's mandate (ordering sales of shares and assets) that the tribunal was given broad jurisdiction to interfere with property rights not only of the party or parties before it but also of third parties who have contracts with the respondent. This is clear not only from the remedies expressly described but also from the types of activity which the tribunal is mandated to restrain: pre-emption of scarce resources; buying up products to prevent erosion of existing price levels; adoption of product specifications; requiring or ordering a seller to sell only or primarily to certain customers. [emphasis added]

[36] Whether or not, on an application, the Tribunal would interfere with the property rights of third parties, will depend entirely on the specific facts.

B. CODE OF CONDUCT

[37] The DCO includes a code of conduct which requires the respondents to adopt certain prescribed minimum acceptable terms of trade with its trade book suppliers. Further, it is provided that any and all disputes arising out of or relating to these terms of trade shall be exclusively and finally settled by arbitration pursuant to the DCO.

[38] The DCO provides for an arbitration procedure set out in Appendix II to Schedule C. Pursuant to paragraph 6, an arbitrator shall determine:

> ...Any and all controversies, questions, claims or other disputes arising out of or relating to this Schedule "C" including, without limitation, issues concerning the arbitrability of any dispute and any dispute concerning the interpretation or application of Schedule "C"...

[39] As the code of conduct comprises certain behavioural obligations that are part of the combination of remedies stated in the DCO, the Tribunal questioned whether these matters could be delegated to an arbitrator. Indeed, the Tribunal has jurisdiction pursuant to subsection 8(2) of the *Competition Tribunal Act,* R.S.C. 1985, c. 19 (2d Supp.) ("CTA") to hear and determine all matters, *including the power to enforce its orders* and to make a finding of contempt (subsection 8(3) of the CTA). The Tribunal was concerned that the effect of the arbitration procedure provided for in the DCO might be construed as a delegation to a third party of its jurisdiction to enforce the DCO.

[40] After considering the submissions made by counsel for the parties and for the intervenors, both in their responses and at the hearing, the Tribunal is satisfied that the arbitration procedure relates only to disputes arising out of the code of conduct, which provides for ceilings on the terms of contracts between Chapters and its books suppliers. It is those contracts which provide for an arbitration mechanism to resolve disputes. By the arbitration clause, the Tribunal is not waiving or abandoning its jurisdiction to enforce the consent order. Should Chapters not adopt the code of conduct, it could find itself in breach of a term of the Tribunal's order and thus, subject to contempt proceedings.

[41] An agreement by parties to submit to an arbitration clause is not unique to this DCO. In the past, the Tribunal has approved such clauses to resolve contractual disputes. For instance, in *Director of Investigation and Research v. ADM Agri-Industries, Ltd.,* [1997] CT9702/13, 8 May, 1997) C.C.T.D. No. 25 (QL) (Comp. Trib.) the Tribunal approved a consent order which gave the purchaser of the divested assets the right to enter into a flour supply agreement with ADM. In that case, disputes arising under the supply agreement were to be settled by arbitration. In *Director of Investigation and Research v. Canadian Waste Services Inc.* (23 April 1998) CT9801/10, [1998] C.C.T.D. No. 10 (QL) (Comp. Trib.) a clause provided that disputes arising under the required landfill tipping agreement be settled by arbitration. Finally, in the Gemini Consent Order case *Director of Investigation and Research v. Air Canada* (1990), 27 C.P.R. (3d) 476, [1989] C.C.T.D. No. 30 (QL) (Comp. Trib.) where the consent order included a "code of conduct" governing an industry, the Tribunal authorized the creation of the Computer Reservation System Rules which provided that disputes were to be settled by arbitration. As the provisions set out in the code of conduct deal only with contractual obligations, the Tribunal is satisfied that the arbitration clause and the procedure set out therein are proper.

IX. CONCLUSION

[42] For these reasons, the Tribunal is satisfied that the consent order proposed by the parties will, in all likelihood, eliminate the substantial lessening of competition which is presumed (but not admitted by the respondents) to arise from the merger.

DATED at Ottawa, this 13th day of July, 2001.

SIGNED on behalf of the Tribunal by the presiding judicial member.

(s) Marc Nadon

APPEARANCES:

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The Commissioner of Competition

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