

THE COMPETITION TRIBUNAL

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 (as amended);

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.;

BETWEEN:

THE COMMISSIONER OF COMPETITION

Applicant

-and-

**TRILOGY RETAIL ENTERPRISES L.P.
CHAPTERS INC.
AND INDIGO BOOKS & MUSIC INC.**

COMPETITION TRIBUNAL TRIBUNAL DE LA CONCURRENCE	
F I L E D	APR 18 2001 <i>ejk</i> <small>AVR</small> REGISTRAR - REGISTRAIRE
OTTAWA, ONT. #11(b)	

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Respondents

STATEMENT OF GROUNDS AND MATERIAL FACTS

I. INTRODUCTION

1. The Commissioner of Competition (the "Commissioner") brings this application for a consent order on the grounds that the acquisition by Trilogy Retail Enterprises L.P. ("Trilogy") of the majority of the shares of

of Chapters Inc.

(“Chapters”) and the proposed subsequent merger of Chapters and Indigo Books & Music Inc. (“Indigo”) would, in the absence of the draft consent order (“DCO”), be likely to prevent or lessen competition substantially in the distribution of English-language trade books in various markets in Canada. Collectively, the acquisition and the proposed merger are referred to as the Merger.

2. The Commissioner, with the consent of Trilogy, Chapters and Indigo (the “Respondents”), respectfully submits for approval a DCO that, if implemented, will remove the likelihood of a substantial lessening or prevention of competition resulting from the Merger.
3. The Respondents do not agree with all the facts alleged. They do not admit the nature or degree of the substantial lessening or prevention of competition in this matter as alleged by the Commissioner. However, they do not contest the statement of grounds and material facts or the consent order impact statement for the purposes of this application or of any proceeding relating to the DCO, including an application to vary or rescind the order pursuant to section 106 of the *Competition Act*.

II. THE PARTIES

(A) *The Commissioner*

4. The applicant is the Commissioner appointed under section 7 of the *Competition Act*, R.S.C. 1985, c.C-34, (the “Act”). The Commissioner is the only person authorized to make this application.

(B) *Trilogy Retail Enterprises L.P.*

5. Trilogy is an Ontario limited partnership, controlled by Gerald Schwartz, that was formed for the purpose of acquiring control of Chapters and proposing a merger between Indigo and Chapters. The general partner of Trilogy is Trilogy Retail Enterprises Inc., a recently formed Ontario company.

(C) *Indigo Books & Music Inc.*

6. Indigo is a closely held Ontario corporation, incorporated in 1996. Indigo, which primarily sells books, operates 15 large-format bookstores (superstores) and Indigo Online Inc., the primary business of which is bookselling over the internet at Indigo.ca.
7. Gerald Schwartz and Heather Reisman, together with corporations controlled by them, hold in aggregate approximately 42% of Indigo's voting shares. Indigo holds approximately 96% of the shares of Indigo Online. Heather Reisman and Gerald Schwartz are referred to as the Principals of Indigo.

(D) *Chapters Inc.*

8. Chapters is a public corporation incorporated in Ontario. Chapters was formed following the 1995 merger of SmithBooks, operated by FIGG Inc. and Coles Book Stores Limited, a subsidiary of Southam Inc. Chapters operates 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.
9. Chapters has three subsidiaries: Chapters Canadian University Bookstores Limited ("CCUBL"), Chapters Online Inc. and Pegasus Wholesale Inc.
10. Chapters holds all the shares of CCUBL. CCUBL owns 51% of the shares of Chapters Campus Bookstore Company, a joint venture with Barnes & Noble College Books Stores Inc., a New York corporation. CCUBL manages the

McGill University Bookstore, a superstore, in Montreal and bookstores at several other colleges and universities in Ontario.

11. Chapters owns approximately 70% of Chapters Online Inc. which is responsible for Chapters' selling activities over the internet including Chapters.ca. Chapters.ca sells books, as well as videos, DVDs, music CDs and software.
12. 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. Pegasus has a 330,000 square foot warehouse and distribution centre with automated warehouse management systems.

III. THE TRANSACTION

13. On February 1, 2001, Trilogy became Chapters' controlling shareholder as the result of a hostile take-over. Trilogy proposes to merge Indigo and Chapters. If the merger of Chapters and Indigo is successful, it is intended that Indigo Online and Chapters Online will also merge, subject to the potential divestiture of certain Indigo online assets.

IV. THE COMMISSIONER'S INQUIRY

14. 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% of Chapters. On December 7, 2000, the Commissioner received a second notification pursuant to section 114 of the *Act* of a proposed

acquisition of the shares of Chapters by Indigo. The Commissioner was also advised of Trilogy's intention eventually to merge Chapters and Indigo.

15. The Commissioner received information from the parties to the transactions as well as numerous industry participants. As a result of preliminary information obtained, the Commissioner initiated an inquiry on January 11, 2001 into the proposed acquisition by Trilogy of 50.1% of Chapters pursuant to subparagraph 10(1)(b)(ii) of the *Act*. Following the initiation of the inquiry, the Commissioner received information as a result of Orders under s. 11 of the *Act*.
16. In a letter dated January 19, 2001 ("Commitments Letter"), the Principals made certain commitments ("Commitments") to the Commissioner, including the holding of the Principals' shares of Indigo by a voting trustee.
17. The Principals made the Commitments to provide time for the negotiation of a remedy to any substantial lessening or prevention of competition caused by the Merger. Because the Principals made the Commitments, which would preserve remedies during the Commissioner's inquiry, the Commissioner did not seek an injunction to prevent Trilogy's acquisition of control of Chapters.
18. On February 1, 2001, Trilogy successfully acquired a majority of Chapters' shares.
19. After a series of negotiations, the Commissioner and the Respondents agreed on the DCO to address the Commissioner's concerns about the Merger.

V. DESCRIPTION OF THE INDUSTRY

(A) *Publishers*

20. Publishers select and edit books and arrange for the production and distribution of books, either directly or through wholesalers. Publishers advertise their books directly to the public or through co-operative promotions with booksellers. Traditionally, booksellers can return the books to the publisher without a penalty within a specified period of time (often 3 to 12 months).
21. Publishers may be divided into three groups. The Canadian Publishers' Council represents approximately 25 publishers, primarily subsidiaries of foreign multinationals. Its members collectively account for nearly 75% of all domestic sales of English-language trade books in Canada. The Association of Canadian Publishers represents a group of about 150 Canadian-based publishers. The publishers represented by these two associations generate approximately 85% to 90% of the industry's revenues. In the third group are hundreds of smaller independent publishers, generally publishing a limited number of titles.

(B) *Wholesalers and distributors*

22. Wholesalers distribute books from publishers to booksellers. Often publishers will ship books directly to booksellers. However, in some circumstances, a shipment directly from a publisher to a bookseller may not be economical. For example, when the distance between a bookseller and a publisher is great or the number of books the bookseller needs is small, the bookseller can purchase from a local wholesaler. It was Chapters' intention to create a fully operational national book wholesaler through Pegasus.

Numerous smaller wholesalers, both local and regional, also operate in Canada.

23. Some domestic publishers who do not wish to build full warehousing and fulfillment programs use book distributors. Some foreign-based publishers use these Canadian distributors while others use Canadian-based publishers, or publisher-agents. Services offered can include sales, marketing, promotion, fulfillment, invoicing and collection of receivables.

(C) Superstores

24. Superstores are characterized by large floor space and a large selection of titles. Though superstores sell ancillary products such as candles, compact discs and periodicals, their primary focus is the sale of books. Chapters' superstores range in size from approximately 14,000 square feet to 67,000 square feet, with an average size of approximately 31,000 square feet. Indigo's stores range in size from approximately 16,000 square feet to 38,000 square feet, with an average size of 25,000 square feet. Chapters' stores display between approximately 41,000 and 114,000 titles and display on average 65,000. Superstores provide services related to the sale of books such as special ordering and staff who are knowledgeable about books.
25. At the time of the Notification, Chapters and Indigo, who together owned 92 superstores, dominated the superstore channel. Four other superstores are in the hands of independent operators. In all the local markets where both Chapters and Indigo operate, theirs are the only superstores.

(D) Small-Format Independent Bookstores and Chapters' Mall Stores

26. Small-format independent bookstores and Chapters' mall stores generate most of their revenues through the sale of books. They also sell ancillary

products but these sales generally account for an insignificant proportion of sales. On average, they have about one-tenth the floor space of a superstore and one-tenth the title selection. They provide services related to the sale of books such as special ordering and staff who are knowledgeable about books.

27. Chapters operates 231 small-format stores under the names Coles, SmithBooks, Librairie Smith, Classic Books, and The Book Company. Most other small-format stores operate as single outlets though some operate as local chains. The next largest chain has 10 outlets. Coles is the only chain of small-format bookstores with a national presence.

(E) Specialty Stores

28. Although specialty stores sell books related to the theme of the store, such as outdoor activities, home decorating, sewing or religion, the selection is limited. Staff does not require knowledge of a wide range of books.

(F) Mass Merchandisers

29. Mass merchandisers sell books as part of a wide range of products. The selection of books is normally limited to several hundred titles at any given time. Staff does not require knowledge of a wide range of books nor do they generally provide complementary book services such as special ordering. Mass merchandisers who sell books include, inter alia, Costco, the Bay, Loblaw, London Drugs, Shoppers Drug Mart, Save-on-Foods, Sears, Zellers and Wal-Mart.

(G) Mail Order Book Clubs

30. Two mail order book clubs are known to operate in Canada, Doubleday and Book-of-the-Month Club. Customers choose the kind of books they wish to buy (e.g. science fiction, history, and romance). Customers receive a limited offering of books in the category they have chosen. Traditionally customers

receive a list of available books by mail. Both book clubs also offer their services over the internet.

(H) *Online Book Retailers*

31. Indigo.ca and Chapters.ca are the two largest Canadian-owned online book retailers. Many independent booksellers operate web sites, but they have attained only a very limited share of online book sales in Canada.
32. Foreign online book retailers sell into Canada. However, because of problems with exchange rates, shipping costs, delivery times and customs, many Canadians are unwilling to shop through a foreign web site.

VI. COMPETITIVE ANALYSIS OF THE MERGER

Introduction

33. Chapters and Indigo are the two largest trade book retailers in Canada. Chapters operates 77 book superstores and 231 mall-based bookstores. Indigo operates 15 book superstores. Indigo and Chapters stores are located in multiple provinces. The likely effects of combining the companies will be described both with respect to their role downstream as suppliers of books to consumers and upstream as purchasers of books from publishers.

Competitive Analysis - Downstream

(i) Product Market

34. The relevant downstream product market involves the sale of English-language trade books and related services to the book consumer.

Textbooks are excluded by virtue of their specialized customer base and retail channel, which consists primarily of university bookstores.

French-language books are excluded by virtue of the distinct customer base.

Which retail formats compete in this market will be considered next.

35. Books are generally sold via physical retail stores, also known as “bricks-and-mortar” formats. These can be separated into large (typically 25,000-30,000 square feet) and small (typically 2,000-4,000 square feet) formats. Large-formats are distinguished by virtue of the combined offering of: a) the selection of titles (which is on average 7-10 times larger than small-format); b) their distinct ambience; c) enhanced ancillary services such as cafés, music, and other goods; and d) the level of service provided by knowledgeable staff.
36. The two chain networks, Chapters and Indigo, who are also the two largest Canadian online operations, dominate the large-format sector. As a result, large-format stores in Canada provide the consumer the benefit of facilitating transactions through multiple locations and distribution channels. Kiosks have been set up in Chapters stores to complement online sales; these are further complemented by store- and Internet-wide loyalty programs which are in place at both Indigo and Chapters. Large-format stores have grown tremendously since their inception in Canada in the mid-1990s, mainly at the expense of small-format stores. It can be inferred that this reflects consumer preference based on the superstores’ distinct attributes.
37. Small-format stores tend to fall into two categories: i) those based in malls, which are predominantly owned by Chapters and operated under the Coles, SmithBooks, Librarie Smith, Classic Books and The Book Company banners and ii) those which are predominantly owned by independent single-outlet booksellers, situated as street front stores and, to a much lesser extent, located in malls. Small-format bookstores are not good substitutes

for superstores in terms of selection. The impact of the emergence of the large-format concept is reflected in both net exit in the independent sector and the sharp reduction of mall stores. Moreover, Chapters has found it necessary to alter the positioning of its mall stores, at least in part to avoid cannibalization from the superstores.

38. The internet has developed as a limited alternative form of distribution of books to the end-consumer. Estimates of market share vary, but it is understood to have reached a level of approximately 3-5% of book sales in Canada. Most estimates indicate that this penetration is unlikely to increase significantly within the next two years. The internet competes with large-format stores on breadth of selection, but cannot compete with bricks-and-mortar formats on most other dimensions of competition. For example, it does not provide book purchasers with the ability to inspect books or to take immediate possession of their purchases. Its most successful application in Canada has been as an adjunct and complement to Chapters' and Indigo's store operations.
39. As with the internet, book clubs are hampered with respect to the dimensions of competition in which bricks-and-mortar stores specialize. However, they do not even enjoy the internet's advantage of large selection.
40. There are a number of other retail outlets offering a variety products that also offer a limited selection of books . However, these operations are ineffective substitutes to booksellers. General mass merchandisers, as well as other sellers of books such as grocery stores and drug stores, tend to offer a limited selection of mass market paperbacks and bestsellers. They do not offer a broad selection of other categories of titles. Specialty stores, such as children's bookstores or gardening stores offer, within a narrow range, a selection comparable to superstores, but only with respect to those subjects

in which they specialize and, as a result, provide ineffective competition overall to the broad provision of books by Chapters and Indigo.

(ii) Product Market Conclusion

41. For the reasons cited in paragraphs 34 to 40, the relevant product market for the purpose of the assessment of the likely impact on competition of the Merger on the downstream, or consumer, market is the sale of English-language trade books through large-format and small-format retail stores, and their online presences. As explained in paragraphs 34 to 40, specialty stores, book clubs, mass merchandisers, university bookstores and the online sites maintained by these channels do not provide meaningful competition to large- and small-format bookstores.

(iii) Geographic Market

42. The relevant geographic dimension of the downstream market is an area limited by a radius determined by the drawing area from which each store obtains the bulk of its customers. The size of this area will vary depending on the market, as it is influenced by factors such as population density and rate of daily migration (e.g. from suburbs to city).
43. While the relevant geographic market, whatever its exact size, is local, the internet's geographic dimension is at least national. However, as described above, the internet has experienced limited capture of market share. Moreover, there remains a local aspect to internet sales as they often involve further or complementary transactions at the consumer's local Chapters or Indigo outlet.

(iv) Market Shares

44. Chapters and Indigo have 92 of the 96 stores in Canada that can be characterized as large-format. 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 estimates that their market share is approximately 55-70%.
45. Indigo and Chapters have a 100% share of the superstore category in each metropolitan area in which they overlap. Their respective shares can be seen in Table 1.

Table 1
Number of Superstores by Local Retail Market

Local Market	Chapters	Indigo
Montreal	3	1
Brampton*	1	1
Burlington*	1	1
Toronto*	11	7
Kingston	1	1
Calgary	7	2
Edmonton	4	1
Vancouver	6	1
Total	34	15

* Brampton, Burlington and Toronto are all part of the Greater Toronto Area retail market.

46. Moreover, Indigo was examining plans to open new superstores in several locations, including additional stores in Edmonton, Vancouver and Montreal as well as expansion to Victoria, Winnipeg, London, Ottawa and Halifax.

47. The Commissioner estimates that the combined market share of Indigo and Chapters in the overlap markets, including Chapters' small-format stores and independent small-format stores, is as follows in Table 2.

Table 2
Market Share by Square Footage and by Sales

Market	Indigo's Estimated Market Share (sf)	Estimated Market Share of Chapters/Indigo (sf)	Indigo's Estimated Market Share (sales)	Estimated Market Share of Chapters/Indigo (sales)
Montreal	17.1%	78.2%	14.3%	72.7%
Brampton*	37.4%	90.7%	34.1%	87.3%
Burlington*	30.6%	77.2%	26.5%	70.4%
Toronto*	25.2%	81.8%	22.1%	76.1%
Kingston	25.2%	84.6%	21.7%	80.1%
Calgary	16.1%	88.0%	14.2%	84.2%
Edmonton	9.1%	69.5%	7.3%	63.0%
Vancouver	4.9%	55.1%	3.8%	48.0%

* Brampton, Burlington and Toronto are all part of the Greater Toronto Area retail market.

(v) Removal of a Vigorous and Effective Competitor

48. Indigo was the major trade book retail competitor to Chapters. Both companies saw the other as its main and, often, its only rival.
49. Indigo was the only serious competitor to Chapters in the race to develop large-format retailing in Canada. Indigo was present in many major metropolitan markets in Canada. From time to time, and possibly as late as June 2000, Indigo planning documents showed that it was considering opening additional stores in Edmonton, Vancouver and Montreal as well as expanding to Victoria, Winnipeg, London, Ottawa and Halifax. Thus, the Merger removes any potential competition from Indigo in those areas.

50. Competition between Chapters and Indigo manifested itself in price competition. Consumers received the benefit of discounting on bestsellers by Chapters and Indigo. The two firms also competed through the adoption of loyalty programs which provide members with discounts on the remaining vast range of titles. Chapters has approximately 300,000 members and Indigo approximately 110,000. Chapters and Indigo also competed on price on a large selection of books sold over the internet. In both their bookstore and online operations, the two companies tracked each other's pricing and responded and/or targeted the other when engaging in price initiatives.
51. The Merger will also remove Chapters' main competitor with respect to other aspects of its business. Chapters heightened its provision of service in those trading areas where an Indigo store was also nearby. This included level of staffing, maintenance, customer events and advertising in stores.
52. On this basis, the Merger will remove the most vigorous and effective competitor, in both actual and potential terms, to Chapters.

(vi) Barriers to Entry

53. The key question is whether timely entry of a sustainable, effective competitor with sufficient scale to discipline the merged entity is likely within the next two years.
54. While there has historically been small-scale exit and entry by independent booksellers, only Indigo has entered in recent years with a plan to achieve a large scale and to compete on a multi-locational basis with Chapters. No other such *de novo* entry has been attempted in the last decade. Of the few booksellers with more than one location, exit or contraction has been the experience since the onset of the superstore format. In fact, in the period following the merger of Coles and SmithBooks, one longstanding

micro-chain, Lichtman's (seven locations) exited the market and another, Duthies (nine locations) severely contracted.

55. Several factors should be considered in the determination of the likelihood of effective entry. A critical factor for a prospective entrant is the availability of appropriate real estate. In particular, it is essential to obtain store leases in targeted areas that have favourable population demographics such as an appropriate level of education and income. Within these designated areas, it is necessary to find sites with significant square footage and the right characteristics such as a high level of traffic, parking, ease of access and, generally, a viable competitive opportunity. Other factors to be considered in this regard include co-tenants and the cost of occupancy.
56. Since large-format stores draw from a larger population base than other retail formats and have been restricted to urban or prime suburban areas, limitations on appropriate real estate availability frequently represent a significant impediment to new entry or expansion. There are relatively limited nodes in any given area that can support the high threshold of necessary demographics generally thought to be needed to sustain a superstore. Chapters and Indigo were both of the view that there are few locations remaining in Canada which can support the introduction of new large-format stores.
57. Moreover, since the inception of the format in 1995, construction by Chapters and, on a smaller scale, Indigo has been rapid, leading to the view that major urban markets are largely saturated. Reflective of this, Chapters' expansion plans were scaling down to contemplate more stores of a format between typical large-format and small-format to be built in smaller cities in Canada.
58. Chapters similarly enjoys a dominant status in mall store locations. Chapters has a significant reputational advantage with respect to mall developers who have shown a disinclination in the past to lease to independent booksellers or new entrants. As well, exclusive covenants on mall stores and large-format

stores seriously limit the ability of competing booksellers to enter these locations. The language in these exclusive covenants generally stipulates that no competing bookseller will be permitted to open a store within a designated distance of an existing bookstore. Chapters has exclusive covenants in relation to many of its mall stores. The experience with the few independent booksellers who have been able to secure locations in malls is that they have generally been allocated inferior locations.

59. In order to compete effectively with the post-merger entity it is vital that a competitor achieve economies of scale. Entry on a multi-locational scale within a metropolitan area or across several metropolitan areas generates economies related to distribution, marketing and advertising costs and corporate overhead.
60. A bookstore chain can achieve economies of scale from a strong multi-store regional presence. To support the corporate overhead associated with a national chain, it is understood to be necessary to have a critical mass of stores. Indigo estimated that 24 superstores were necessary as a minimum critical mass for its particular multi-regional presence.
61. Economies of scale also permit competing bookstores to achieve discounts from publishers which more nearly equate to those received by Chapters or Indigo. Where volumes purchased by booksellers are low, it is difficult for them to compete on cost, and therefore on price with Chapters or Indigo.
62. The operation of bookstores in multiple locations generates advantages with respect to brand equity. As well, customer loyalty programs become much more attractive and effective when the consumer has access to multiple outlets and multiple formats. Loyalty programs build customer relationships and assist in building databases of customers, allowing for more targeted marketing.
63. Indigo's experience as a committed large-format entrant is indicative of the risk and difficulties associated with large-scale entry in Canada. Indigo itself

anticipated that it would take four years from start-up to reach a healthy and profitable business base from which further growth could be explored. As well, it encountered significant difficulties in realizing its intended pace of growth.

64. The sunk costs associated with opening superstores, and particularly multiple locations, can run into the millions of dollars. Many capital costs associated with constructing and outfitting superstores can be considered sunk. Chapters invested millions of dollars in brand equity through its stores. It costs \$20-30 million to build an e-commerce platform from which to sell products.
65. Chapters and Indigo have the benefit of first-mover advantage in that they entered superstore markets early and accessed prime real estate. Entry in direct competition with the first-mover tends to significantly heighten the risk of entry.
66. In some instances, Indigo and Chapters positioned themselves within the same geographic area, even where market demographics clearly showed that two superstores were unsustainable. There was heavier discounting on bestsellers in those areas than in other areas of the country. A prospective entrant would have to consider the likelihood of such tactics in its risk assessment.
67. As a result of the foregoing considerations, sustainable, timely and effective entry in the form of multi-market large-format or small-format bookstores is not likely. The loss of competition at the large-format level with respect to all of the aspects of competition for which large-format stores are superior is, the Commissioner concludes, unlikely to be addressed by entry unless that entry is encouraged.

(vii) Foreign Competition

68. The pool of potential entrants is limited by foreign ownership restrictions, making new entry all the more unlikely. Legislation requires that book retailers in Canada be majority-owned, controlled and operated by Canadians. As a result, it is unlikely that Canadian booksellers will be challenged in any meaningful way by a foreign competitor within the next two years.
69. Competition from retailers located outside Canada is only available through the ability of Canadian consumers to purchase books via the internet. The main supplier is Amazon.com, which is the only strictly internet supplier of books of any note. However, the influence of such foreign competition in Canada is limited by, among other things, the cost disadvantage related to shipping and customs charges, the exchange rate, the legislative limitations to opening a distribution centre in Canada, the delay in product delivery and the difficulties associated with returns.

(viii) Effective Remaining Competition

70. The remainder of the trade bookselling industry in Canada is highly fragmented, and confined to limited geographic representation. The vast majority of the independent bookselling sector lacks the financial and strategic resources to expand meaningfully beyond their current base. For the reasons cited in the barriers to entry section, post-merger, it is unlikely that any remaining bookseller will prove effective in constraining the exercise of market power unless expansion is encouraged.
71. Breadth of selection, system costs, discounting requirements and marketing costs all favour large-format stores. Independent booksellers are generally so small that they do not have the ability to purchase books on the same scale as Chapters and do not achieve many of the economies of scale that

Chapters does. In general, the result is that independent booksellers do not price-compete with Chapters, at retail, in the same manner as Indigo.

72. Since the book market in Canada is relatively mature in terms of the growth of its demand base, the development of new modes of supply - superstores and the internet - has meant capture of the market by Chapters and Indigo, the only suppliers with the scale and wherewithal to expand into these segments. Independent booksellers have suffered as a result.
73. There is very little remaining competition in the superstore format, with the exception of isolated single outlets in Winnipeg, Saskatoon, Kelowna and Victoria.
74. As described in paragraphs 28 to 30, other entities that sell books have limited ability to compete effectively with superstores, mall stores and independent bookstores in the market for English-language trade books. As a result, they are not considered to be in the relevant market. In addition, they are unlikely to expand beyond their niche to become more effective competitors subsequent to the merger. For example, mass marketers are considered unlikely to expand their selection significantly at the expense of their other products.

(ix) Change and Innovation

75. The internet represents a unique form of book distribution at the retail level, owing to its technological innovations that facilitate the connection of book retailers to consumers. However, its development has resulted in only limited penetration of the traditional bookselling market and, as a result, the internet has not served as a disciplinary force in the market. Moreover, it does not appear likely that the internet will expand significantly as such a force in the next two years.

76. Notwithstanding potential technological advancements and decreased customer resistance to online purchasing, online suppliers of books are unlikely to provide meaningful competition to the merged entity in the medium term. Online service is, and is likely to continue to be, a complementary support and adjunct to Chapters and Indigo, who enjoy superior advantage in their ability to use the internet to reach consumers.
77. Reflective of this, the Commissioner estimates that, between them, Indigo and Chapters have approximately 60% of the online trade book sales in Canada. Amazon.com is the only other holder of significant market share, but is unlikely to expand its competitive influence into the much larger general trade books market for the reasons cited in paragraph 69.
78. In addition, the high cost of starting an online operation and the reputational, first-mover and complementarity advantages accrued to the merged entity as a result of its dominant position in the retail market post-merger render it unlikely that a new entrant using the internet as a platform will emerge as a competitive constraint on Chapters and Indigo in the near future. While the internet is likely to continue its advancement as an alternative supply channel, both Chapters and Indigo have the considerable head-start advantages of a well-known brand, a retail store network and large-volume distribution capabilities.

(xi) Conclusion

79. As a result of the foregoing, in particular 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, the Merger will likely result in a substantial lessening and prevention of competition in a number of local markets in Canada.

Competitive Analysis - Upstream

(i) Product Market

80. Chapters and Indigo also both participate in a market that can be described as the full range of English-language trade books purchased from publishers. The retail sector serves as an intermediate downstream market for book publishers. In this market, the particular retail format is mainly of importance in that larger-format stores generate greater volumes of books in a broader range for publishers. Superstores, complemented by the internet, have meant enhanced supply channels for a broad range of the catalogue of many publishers.
81. Mass merchandisers and specialty stores are excluded from the relevant markets. For some publishers, depending on their catalogue, these retailers may represent a significant proportion of sales, but this impact is best characterized as niche. For the bulk of publishers, such limited retailers do not represent effective substitutes for the vast majority of titles in their catalogues.

(ii) Geographic Market

82. Publishers located in Canada are generally concerned with securing retail channels through which they can increase their total volume of domestic sales. The geographic location of individual outlets is not a significant concern. For these reasons, the relevant geographic market in terms of an upstream consideration is national.

(iii) Relevant Upstream Market

83. As a result, the relevant upstream market is the purchase, nationally, of English-language trade books from publishers by book retailers with large-format and small-format stores, complemented by their online presences.

(iv) Market Shares

84. In this context, market shares on a national aggregated basis are of relevance to publishers. As reported in paragraph 44, the combined market share of Chapters and Indigo in the relevant market is estimated by the Commissioner to be approximately 55-70%.

(v) Removal of a Vigorous and Effective Competitor

85. Chapters has demonstrated buying power vis-à-vis publishers. Indigo was, and it is submitted that it would have continued to be, a significant alternative customer for publishers on purchases of a wide variety of English-language trade books. Most importantly, Indigo was by far the biggest alternative to Chapters for the purchase of most of the catalogue of most publishers. As such, its presence and potential for growth served as the biggest check on Chapters' buying power with respect to discounts and other terms of trade.

(vi) Barriers to Entry

86. To be an effective alternative for publishers, it would be necessary for a new entrant to create a significant chain of bookstores and to offer a wide selection of titles. The considerations outlined in paragraphs 53 to 66 leads to the conclusion that it is unlikely such entry will occur in the next two years.

(vii) Effective Remaining Competition

87. As a result of their small market shares, independent booksellers provide only limited competition to the merged entity in the purchase of books.
88. Mass merchandisers have a national presence and multiple outlets. However, in most cases, the mass merchandisers sell a selection that is considerably more limited than even the small-format bookstores. The publishers are not able to sell a wide variety of titles to the mass merchandisers. As a result, for most publishers, mass merchandisers provide an alternative on only a very limited number of titles.

(viii) Conclusion

89. As a result of the foregoing, in particular 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, the Merger will likely result in a substantial lessening and prevention of competition in the national market for the purchase of English-language trade books in Canada.

Wholesale market

90. It should be noted that the extent to which Chapters was able to exercise market power with respect to publishers, pre-Merger, was exacerbated by its vertical integration via its ownership of Pegasus, which is positioned as a third-party wholesaling business. During the period of Chapters' operation of Pegasus as a wholesaler, publishers experienced delayed payments, pressure for increased supplier discounts and onerously high return rates. Chapters, under its new management, has expressed its intention to exit the business of third-party wholesaling and it is understood that it currently does not operate Pegasus for this purpose. Indigo had no presence in the wholesale market pre-Merger. However, should Chapters decide to re-enter the wholesaling business, the combination of Chapters' and Indigo's

presence at the retail level could generate concerns with respect to the effects on competition of such vertical integration.

VII RELIEF SOUGHT

91. Given the facts described above, the Commissioner has concluded that the Merger prevents or lessens or is likely to prevent or lessen competition substantially within the relevant markets.
92. The Commissioner therefore respectfully requests, pursuant to paragraph 92(1)(e) and section 105 of the *Act*, that the Tribunal issue the DCO. It is submitted that the likelihood of a substantial lessening or prevention of competition will be removed by the implementation of the DCO. The accompanying consent order impact statement explains more fully how the implementation of the DCO will remove the likelihood of a substantial lessening or prevention of competition by circumscribing the market behaviour of the merged entity and by encouraging entry or expansion leading to the introduction into the market of disciplining competition for the merged entity.

VIII PROCEDURAL

93. The Commissioner requests that this application proceed in Ottawa, Ontario and that the proceeding be conducted in the English language.

94. For purposes of this application, service of all documents on the Commissioner can be served on:

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