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Attention: Michel Gagnier
Commissioner of Competition
Competition Bureau
Place du Portage, Phase 1
50 Victoria Street
Hull, Quebec K1A 0C9

April 30, 2001

Re: “Consent Order” of April 17, 2001, in the matter of Chapters / Indigo / Trilogy

Dear Mr. Gagnier;

I am writing to intervene in the Competition Bureau’s recent ruling in this case, within the window allowed for public interveners on the ruling, set to close on May 8, 2001.

It is my view that the Bureau’s ruling in this case is fundamentally flawed, because in essence it ratifies and entrenches a mistaken earlier decision made by the Bureau to approve the merger of Coles and Smithbooks in 1995 to create what was to become Chapters Inc., and all of its related corporate entities. Let me begin by restating why that original 1995 decision was wrong:

In 1994-95, when Mr. Larry Stevenson first raised the straw man of the threat of a possible simultaneous bankruptcy of both Coles and Smithbooks, what was the Canadian book trade facing? The loss of what the industry then estimated was 45% of the retail trade flowing through those two chains, which between them had 420 bookstores located in “shopping centres and other high traffic areas.” But even if both chains were **threatened** with bankruptcy back then (which there remains little if any disagreement about), how would that circumstance have “rolled out” had their merger been denied?

First of all, it is highly unlikely that both chains would have gone bankrupt simultaneously. Thus, in the event of the bankruptcy of **one** of the chains, the independent book-sellers through whom 55% of the retail trade was then flowing, along with the +/- 50% of the chain retail volume of the chain left standing after the first of them went down, or +/- 75% of the total retailers remaining, could have absorbed, though not without this generating some difficulty in the trade, the volume of sales which formerly had flowed through the one chain which was now bankrupt.

That scenario would have allowed the industry as a whole to carry out the “necessary rationalization” of the chain business by reducing the number of chain stores then

operating by about 200, (which, by the time Chapters Inc. gets around to “completing the necessary rationalization of its ‘traditional stores’” is about the same amount that it will have put out to pasture) **but it also would have strengthened, not weakened the independents.** The bankruptcy of the second chain, in these historic circumstances, would have been a possibility so remote that it’s not even worth considering because, just like Chapters today, it would no longer have faced any viable competition from any other chain. The one thing this scenario would have done, however, is to cause some pretty severe short term pain on the road to the eventual long term gain: the failure of some publishers whose product was very chain-reliant, and some fairly acute short term hardship to those publishers who survived. At the end of that process, however, because competitive forces would have been allowed to self-regulate and reconstitute the marketplace, the Canadian book trade as a whole, including its readers, would have been stronger, with good, healthy independents dominating that market and outnumbering the chain outlets today.

In short, the Canadian book trade never needed Mr. Stevenson’s “solution” to a “problem” that in fact never existed as he portrayed it in his own self interest. Had the Competition Bureau done its job in 1995, and disallowed the Chapters proposal so that competitive forces could continue to work in favour of **all** of the players in the Canadian book trade, rather than in favour of just one of them, (Chapters), the Canadian owned sector of the publishing industry would not be as threatened with extinction as it is today.

With the Bureau’s “Consent Order” in the matter of Chapters, the self-interest of the parties involved in the current, 2001 merger of Trilogy, Indigo and Chapters is once again the order of the day, and the “threat to the industry” that the **disallowance** of this merger is alleged to have posed to the Canadian book trade is as much a straw man today as it was in 1995. Here, in my view, is what is wrong with the current “Consent Order:”

1) Perhaps most serious of all is the Bureau’s omission to investigate the clear instances of “abuse of market dominance” indulged in by Chapters Inc., and its related corporate entities, prior to the hostile takeover bid launched by Trilogy (Indigo) in November of 2000, and between November 2000 and February of 2001, during which time that hostile takeover was effectively completed. These abuses were as follows:

a) The accelerating practise, by Chapters, from April 1995 through February 2001, of violating publishers’ and distributors’ published terms of trade with respect to their accounts payable practises. In my own company’s (and my own distributor’s) particular case, this involved Chapters increasingly violating our “payment within 60 days of invoice date” terms which we made universally and fairly available to all book retailers in Canada through our distributor, GDS Ltd. According to GDS, by the spring of 2000 at the latest, Chapters had extended its own payment schedule on invoices issued by our distributor on our behalf by well over double our published terms (over 120 days). In addition to weakening the supply side of the Canadian book trade, these payment practices unilaterally

appropriated by Chapters in spite of the published terms of trade under which they purchased our products caused a cash-flow crisis among suppliers which resulted in those suppliers' ever more stringent attempts to enforce accounts payable terms on **other** players in the retail sector, profoundly disadvantaging them with respect to the de-facto special payment terms that only Chapters had the clout, or more technically, the "market dominance" to "abusively" award itself.

b) In the third quarter of 2000, Chapters, on the advice of a product manager they acquired from Loblaws, began a process of product diversification in their superstores which involved, generally, the use of roughly 20% of the floor and / or shelf space in these stores for new, non-book items. While Chapters had every right to make this product diversification decision and to implement it, Chapters did not have the right to implement it in the way they did: simply by returning the books needed to free up this space for non-book items to their suppliers without any regard whatsoever to those suppliers' terms of trade with respect to the rules governing the allowable return of book products. Thus, Chapters illegally returned vast quantities of damaged books along with books outside of the allowable "returns window" (generally not before three months after, but not after twelve months after, initial purchase by the retailer) in this period, and, like with its payment practises, simply debited themselves for those returns without having them approved and validated by their suppliers. Once again, Chapters' abusive appropriation of these "special terms" afforded them by their "market dominance" occurred in the absence of their competitors' ability to avail themselves of the same advantage. We have currently lodged a demand with our distributor that these illegal returns be appropriately billed back, with no results having been attained to date.

c) Once Trilogy had launched its hostile takeover bid for Chapters in November of 2000, Chapters continued the large scale, indiscriminate and illegal returns practises that had worked for them so well during their third quarter of 2000 for the purposes of product diversification, throughout the fourth quarter of 2000 and into the first quarter of 2001, but this time with a different purpose: to improve their debt-equity ratio in an attempt to increase the trading value of their shares, thereby forcing up the bidding for those shares by Trilogy. Once again, the value-added benefits of such unfair trade practises at Chapters accrued only to the shareholders of Chapters Inc., and were achieved at the expense of every other sector of the Canadian book trade, including, ironically, their then direct competitor in the superstore market, Indigo Books & Music.

2) The "divestiture" order issued by the Competition Bureau involving 13 superstores and 10 mall stores of the newly merged Indigo / Chapters / Trilogy organization, along with the order to sell its "distribution facility" (the former Pegasus) does nothing but attempt to virtualize the marketplace conditions which existed prior the Bureau's approval of this merger. Each of these 13 superstores was either not profitable and / or redundant pre-approval because of the ongoing head-to-head competition between Chapters and Indigo.

Chapters had been closing mall stores relentlessly at a pace greater than ten per year, on average, pre-approval, since 1995. And Chapters already had Pegasus up for sale prior to the Competition Bureau's ruling. So what did the Competition Bureau's divestiture order actually accomplish? Nothing, except the hypocritical virtualization of the very real situation which pre-existed the hostile takeover bid: a situation in which Chapters was faced with redundant competition from 14 Indigo superstores; where Chapters' closure of its mall stores was an ongoing process; and where Chapters had its "distribution centre," Pegasus, up for sale. Canadians did not need the Competition Bureau to create the illusion of "competition" its current divestiture order mandates because that situation already substantively pre-existed that order. Had the Bureau simply disallowed the merger, the very real situation the divestiture order attempts to virtually (re)create would simply have continued, and competitive market forces would eventually have removed this redundancy(s) and lack of profitability from the sector solely at the expense of the shareholders in these enterprises, and not at the expense of the Canadian book trade in general. By acting, with this order, in a situation where it did not need to, the Bureau has virtually guaranteed that the vestigial competition that Indigo afforded the Chapters empire before this conditionally approved merger will be eliminated in the post-conditional-approval real world. Whom, exactly, does the Bureau think it's fooling in its pretence that any credible, competitive buyer will ever be found for these unprofitable and / or redundant superstores; these unprofitable and / or redundant mall stores; and this unprofitable wholesaler? And in the absence of such a credible buyer, what will happen to these operations? Market forces will dictate that they eventually be closed. And all competition for Chapters will have been eliminated and its hegemony in the retail marketplace will have been re-enforced with the assistance of the Competition Bureau. It would be difficult for the average Canadian citizen, much less a participant in the Canadian book trade, to imagine a more perverse inversion of the mandate in any federal government agency which the conditional approval of this merger by the Competition Bureau manifests.

3) a) The Competition Bureau's mandated "code of conduct" with respect to retail sector discounts offered by suppliers to Chapters actually circumvents the "goods of like quality and quantity" measure, which previously had insured customers who purchased in higher volume per location a discount advantage or incentive, and in fact standardizes and universalizes the retail discount in Canada irrespective of quantity purchased, at 45-46%.

b) The code of conduct formalizes and entrenches a permanent discount advantage to the chain (as opposed to independent booksellers) by mandating a discount spread of an additional 2 % for "goods sent to the same location."

c) Since this code of conduct represents an imposed, standardized discount higher than the average discount which pertained in the retail sector prior to its introduction, the Bureau is actually directly responsible for an immediate increase in the retail price of books distributed in Canada to consumers of approximately 12.5%. [For a detailed analy-

sis of the economics of this equation, see my report to the Parliamentary Standing Committee on Canadian Heritage, March 2, 2000.] This increases neither competition nor access in the Canadian book trade, which the Bureau is mandated to ensure.

4) a) The Competition Bureau's "code of conduct" with respect to payment terms offered by suppliers to Chapters mandates the unrestrained, speculative and unlimited use, by any and all corporations in the Canadian book retail sector (because such payment terms must now be universally available to all players in the retail book sector in order for suppliers not to be seen to be acting in restraint of trade), of the assets of otherwise unrelated arm's length, third party corporations (their suppliers) for the purposes of generating profits within those retail operations, for a period of twenty days for the next twelve months, and ten days for a subsequent twelve months, without any requirement of accountability to those suppliers for their responsible use of those assets. In which other industry sector in Canada is the unrestrained piracy by one corporation of the assets of another corporation considered to be "good for competition" by the Bureau?

b) Given the Competition Bureau's complete failure to either investigate or take action against the "unlimited returns" policy Chapters has clearly granted itself for the past nine months, in contravention of the terms of trade under which it acquired its product, [referred to in item # 1) above], what credible reason does the Bureau have for granting to Chapters (and, by extension of its own rules, the entire Canadian retail book sector) payment terms which exceed by twenty days for the first year, and by ten days in the second year, the date by which any player in this sector can return to its suppliers any and all unsold product in lieu of payment? Given that Chapters has already reduced its inventory (and therefore its risk) well beyond the point allowed by its current suppliers' terms of trade, why are these "extra" 20 and 10 days for payment "needed" by the newly restructured and merged Chapters / Indigo / Trilogy?

c) By standardizing, universalizing and entrenching payment terms in the retail sector of the Canadian book trade within two years at ninety days, or on the same day that any and all goods purchased by that sector from its suppliers can be returned to those suppliers in lieu of payment for that product (not just, as is the Bureau's stated intent, only at Chapters, because to do so would be to violate the Bureau's own rules of trade, although given the percentage of that trade now controlled by Chapters, the point not only seems to be, but is, moot), the Competition Bureau has effectively changed the way books are sold in Canada from one in which the retail sector is required to invest its capital in some level of risk associated with the acquisition of inventory (its cost of goods sold), to one in which no risk capital at all is required by corporations wishing to enter the retail sector of the Canadian book trade. Under these mandated terms of payment, any unsold product a retailer has acquired from a supplier without any payment whatsoever to that supplier for that product, may be returned to that supplier (publisher) in lieu of payment 90 days after it was so acquired. How can this Competition Bureau's mandated transformation of the

retail trade in books in Canada into a “consignment trade” in which the retailer is required to engage in absolutely no risk capital transaction whatsoever possibly be good for competition in the Canadian book trade?

5) Given that the pre-merged Chapters had already started a process of “product diversification” in its superstores into “non-book items” in the third quarter of 2000; and given further the repeated public statements by the CEO of the newly merged Chapters / Indigo / Trilogy that it is her ambition not to operate these superstores primarily as **bookstores** but as “cultural supermarkets,” it is very clear that the newly merged chain will contain not just books and periodicals, but also CDs and DVDs, possibly new and alternate media, and, specifically, “flowers.” This will create a situation in which these superstores will evolve much like the big-box “drugstore” chains have. The sale of books, the original “purpose” of these stores, will be increasingly marginalized in these stores until their **book sections** are not significantly larger than the mall chain stores which the same organization operates. Within the ten years since 1995, the current Consent Order of the Competition Bureau will have effectively stripped the Canadian book trade of the diversity of selection among book product available to Canadian consumers prior to the Competition Bureau’s first merger approval in the matter of Chapters in 1995. The chief alleged competitive “virtue” of the superstore portion of the Chapters operation has always been a selection of books in each of these superstores greater than that of its independent competitors. It is this greater selection (and the ability of Chapters to extort and appropriate from its suppliers unfair competitive advantages because of its “abuse of market dominance” throughout this period, some of which it managed to pass on to its customers in the form of discounts its competitors could not afford to offer [again, see my testimony to the Parliamentary Standing Committee on Canadian Heritages, March 2, 2000]) which has allowed Chapters to force most of its large independent competitors out of business since 1995. It is astonishing that nowhere in its current Consent Order did the Competition Bureau mandate a permanent, minimum degree of book selection in these superstores, at a level at least as broad as that available in the Canadian book trade prior to 1995, as a condition of approving this merger. By allowing the **book sections** of these “cultural department stores” to shrink to whatever size current management deems appropriate over time, we will end up, at the end of this process, with a Canadian book trade which still has roughly the same number of Mall-type bookstores (in both malls and superstores), stocking a narrow selection of bestsellers, remainders, periodicals and ostensibly “related” non-book items, but none of the broad book selection the independents used to offer the public before Chapters began the long process of putting the best of them out of business. Some would argue that such an evolution at Chapters would inevitably recreate the demand, and therefore the competitive room for, a re-establishment of independent bookstores in Canada as an alternative. Anyone naive enough to speculate along those lines has, like the Competition Bureau, wilfully turned a blind eye to the predatory trade practises conducted by the chains in their relentless drive of all competitors out of what they now clearly regard as “their market.” Under the current consent order, Chapters retains both the elasticity and

the competitive advantage to ensure that any attempt to compete with them in the Canadian book trade will result in failure. Thus, with its most recent ruling in the matter of Chapters, the Competition Bureau has come full circle in ratifying its original mistaken decision of 1995.

6) Even if the rules, regulations and protocols contained in the Competition Bureau's Consent Order in the matter of the merger of Chapters, Indigo and Trilogy were visibly and transparently designed to ensure the ongoing consumer benefits of competition in the book trade in Canada (and they demonstrably are not), over 50% of which is now dominated by one publicly traded player, why is the Bureau placing a limitation of five years on the conditional approval of that merger which the elements of its Consent Order imply. What is it that the Competition Bureau either knows or hypothesizes about the retail book trade in Canada five years hence that would lead it to believe any conditions it wishes to impose on its consent to this merger will no longer be required to maintain competition in the Canadian retail book trade five years from now? Why is the Bureau not sharing its insight and foresight into such matters with those of us most profoundly affected by this Consent Order?

Let me clarify, in concluding, the intent of this formal intervention. It is specifically not to be asked to appear before the Bureau or its tribunals in this case. Any and all issues raised in this intervention have been tabled prior to its submission: first during my testimony before the Parliamentary Standing Committee on Canadian Heritage on March 2, 2000, a hearing which officials of your Bureau attended; and second during a visit by those same officials to our publishing offices in our distributor's western warehouse in the summer of 2000. In the ongoing failure of the Competition Bureau to act on these issues in a manner effective to prevent past, present and future clear abuses of market dominance by the Chapters organization, I have nothing more to add to the debate at this time. I merely wish to place in the public record my ongoing observation that the Competition Bureau has consistently failed in its mandated task to prevent the abuse of market dominance by Chapters in 1995; in 2001; in the period intervening; and in the future as it has been mandated by its current five-year Consent Order.

Yours truly,

Karl H. Siegler
President & Publisher
Talon Books Ltd.

cc The Honourable Ms. Sheila Copps, Minister of Canadian Heritage
Mr. Keith Kelly, The Canada Council for the Arts
Mr. David Caron, The Literary Press Group of Canada
Ms. Monique Smith, The Association of Canadian Publishers
Ms. Penny Dickens, The Writers' Union of Canada
Ms. Angela Rebeiro, Playwrights Union Canada
Ms. Edita Petrauskaite, The League of Canadian Poets
Ms. Sheryl McKean, The Canadian Booksellers' Association
Mr. Jack Stoddart, General Distribution Services Ltd.