

THE COMPETITION TRIBUNAL

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

IN THE MATTER OF the proposed transborder joint venture between Air Canada and United Continental Holdings, Inc.;

AND IN THE MATTER OF the "Marketing Cooperation Agreement" between Air Canada and United Air Lines, Inc.;

AND IN THE MATTER OF the "Alliance Expansion Agreement" between Air Canada and United Air Lines, Inc.;

AND IN THE MATTER OF the "Air Canada/Continental Alliance Agreement" between Air Canada and Continental Airlines Inc.;

AND IN THE MATTER OF an Application by the Commissioner of Competition for one or more Orders pursuant to sections 90.1 and 92 of the *Competition Act*.

BETWEEN:

COMPETITION TRIBUNAL TRIBUNAL DE LA CONCURRENCE	
FILED / PRODUIT August 15, 2011	
Jos LaRose for / pour REGISTRAR / REGISTRAIRE	
OTTAWA, ONT	# 14

THE COMMISSIONER OF COMPETITION

Applicant

- and -

**AIR CANADA, UNITED CONTINENTAL HOLDINGS, INC.,
UNITED AIR LINES, INC., and CONTINENTAL AIRLINES INC.**

Respondents

RESPONSE OF AIR CANADA

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OVERVIEW OF RESPONSE

1. In her Application, the Commissioner of Competition (the “**Commissioner**”) seeks to unwind longstanding agreements (of over 15 years) between Air Canada and United Air Lines, Inc. (“**United**”) which have brought substantial benefits to airline passengers travelling on routes that originate in Canada and terminate in the United States and vice versa (“**Transborder Routes**”), and to unwind a similar bilateral agreement between Air Canada and Continental Airlines, Inc. (“**Continental**”) entered into in 2009. The Commissioner also seeks to prevent a proposed transborder joint venture (the “**TBJV**”) among the Respondents which is intended to and will lead to lower prices and further enhance flight options for transborder passengers, to the substantial benefit of Canadian consumers and the Canadian economy.

2. The Commissioner’s Application is fundamentally misconceived. The Application ignores Canada’s “Blue Sky” international air transportation policy, developments in air transportation in the U.S. and other countries around the world, and relevant facts and circumstances which the Respondents sought to review with the Competition Bureau (the “**Bureau**”) in the course of their efforts to engage with the Bureau in a review process and to address any concerns it may have in relation to the proposed TBJV. Rather than pursue that process with the parties, the Commissioner commenced the Application.

3. The Commissioner has failed to consider several matters which are critical to a proper analysis of the issues arising from the Application, including:

- a) the Application is wholly inconsistent with the international air transportation policy of the government of Canada, known as “Blue Sky”, which promotes the liberalization of competition between air carriers in different countries, the removal of barriers to competition and the deregulation of markets;

- b) turning more specifically to the Canada-U.S. situation, the Application is wholly inconsistent with "Open Skies" agreements between the governments of Canada and the United States (which themselves reflect the "Blue Sky" policy of the Canadian government), which have the objective of increasing competition by eliminating legal or regulatory barriers to entry and expansion;
- c) the nature of the competitive landscape, which includes the proliferation of competition at the level of alliances, networks and joint ventures between airlines in different countries and around the world;
- d) the rapid growth and success of non-legacy carriers and the extensive competition among legacy and non-legacy carriers in all markets, including the transborder market, in which the Respondents face highly capitalized and established competitors currently competing on most Transborder Routes and poised to enter on others;
- e) the substantial gains in efficiency which have been achieved with the existing bilateral arrangements and will be achieved with the TBJV, including increased numbers of routes served, increased flight frequencies, reduced fares, harmonized service and fare structures, and greater connectivity and convenience for passengers;
- f) the Commissioner¹ provided a favourable written advisory opinion regarding the bilateral arrangements between Air Canada and United over 15 years ago, which the Commissioner now challenges;
- g) express approvals given by regulatory authorities in other jurisdictions all over the world in favour of alliance and joint venture relationships such as the ones the Commissioner is challenging, including approval by the U.S. Department of Transportation (the "U.S. DOT") of these very same alliance arrangements;
- h) the Commissioner - only 22 months ago - provided approval to the trans-Atlantic joint venture called Atlantic Plus Plus ("A++") among Air Canada, United, Continental and Deutsche Lufthansa AG ("Lufthansa"), which has the very same precepts and general structure as the TBJV (indeed, the TBJV is modelled on and complementary to the A++ relationships);
- i) the airline industry has been battered by constant challenges and ongoing threats of insolvency, such that new models, approaches and efforts to develop the efficiencies required to compete internationally are crucial to ongoing viability of international legacy carriers such as the Respondents; and

¹ References in this Response to the "Commissioner" are to the position of Commissioner of Competition, the head of the Bureau. The predecessor title for the Commissioner position was Director of Investigation and Research.

- j) to give effect to the Commissioner's position would significantly impede Air Canada's ability to compete, would have significant adverse effects on Canadian consumers and the development of Canada's hub airports, and would relegate Canada and Canadian air carriers to a marginalized regional or local status in the international air transportation world.

4. Furthermore, the Application is inconsistent with the purpose of the *Competition Act*² as set out in section 1.1 of the *Act*, which is to maintain and encourage competition to promote the efficiency and adaptability of the Canadian economy, to expand opportunities for Canadian participation in world markets, and to provide consumers with competitive prices and product choices. This purpose is aligned with the objectives of the *Canada Transportation Act*³, which are to create a competitive, economic, and efficient transportation system, at the lowest total cost, to enable competitiveness and economic growth throughout Canada. The Alliance Agreements (as defined in paragraph 8 below) and the TBJV serve all of those goals.

5. If granted, the relief requested by the Commissioner would prevent or eliminate the significant efficiencies and benefits for the economy and Canadian consumers created by the Alliance Agreements and the TBJV, would harm the Respondents, and would defeat the purposes of the *Competition Act*, the *Canada Transportation Act*, and Canada's international air transportation policy. The Application should be dismissed.

PART I - GROUNDS ON WHICH THE APPLICATION IS OPPOSED

6. Air Canada also adopts and relies on the Response of United Continental Holdings, Inc. ("UCH"), United and Continental.

² *Competition Act*, R.S.C. 1985, c.C-34

³ *Canada Transportation Act*, S.C. 1996, c.10

A. The Relationships Between the Respondents and Their Benefits

7. Beginning in 1997, following the advisory opinion of the Commissioner dated August 12, 1996 (the "**Advisory Opinion**"), Air Canada and United have been coordinating with respect to various aspects of their businesses, including code sharing operations, certain joint fare discounts and incentive programs, on most Transborder Routes pursuant to bilateral coordination agreements (which are referred to as "**AC-United Alliance Agreements**" in the Application). After the Commissioner had reviewed the proposed arrangements and issued the favourable Advisory Opinion in 1996, and after Air Canada and United had been granted an order by the U.S. Department of Transportation ("**U.S. DOT**") conferring antitrust immunity with respect to providing coordinated transborder passenger airline service pursuant to the AC-United Alliance Agreements in 1997, Air Canada and United implemented the agreements.

8. The AC-United Alliance Agreements have (among other benefits) contributed to a substantial expansion of service on Transborder Routes, including service on new non-stop Transborder Routes, the addition of service on new "origin and destination" ("**O&D**") pairs and routings connecting them, and significant growth in daily flights and total airline passengers on Transborder Routes. The AC-United Alliance Agreements have allowed for the development of harmonized seat sales, pricing structures and fare rules, a variety of joint fare discounts, joint frequent flyer program incentives, and marketing initiatives covering Transborder Routes. Coordination pursuant to the bilateral coordination agreements between Air Canada and Continental (referred to in the Application as the "**AC-CO Alliance Agreement**"), and together with the AC-United Alliance Agreements, as the "**Alliance Agreements**"), including code sharing and reciprocal frequent flyer programs, also has provided significant benefits to consumers.

9. Despite their significant and demonstrable pro-competitive effects, including better service, lower fares and greater fare options, the Commissioner seeks to unwind certain aspects of the Alliance Agreements, thereby eliminating the substantial benefits to Canadian consumers they have provided.

10. The Commissioner also seeks an order prohibiting the TBJV among Air Canada, United and Continental, to which the Respondents agreed in principle (subject to certain conditions) in the fall of 2010. The TBJV will complement the Alliance Agreements, allowing the Respondents to give effect to certain provisions of those agreements in relation to Transborder Routes and to achieve “metal neutrality” in respect of service on Transborder Routes. If implemented, through metal neutrality (as described further in paragraph 48 below), the TBJV will result in deeper and more comprehensive integration and coordination on Transborder Routes than has yet occurred between Air Canada and United and between Air Canada and Continental under their respective bilateral Alliance Agreements, and will yield significant additional benefits to transborder passengers.

11. The TBJV is based on the same principles as other successful international airline joint ventures that are beginning to proliferate internationally, including A++ which involves revenue sharing and other coordination among the Respondents and Lufthansa on trans-Atlantic routes. The Commissioner acknowledged the pro-competitive benefits that result from such a metal neutral joint venture by issuing an advance ruling certificate clearing A++ in October 2009 (the “**Advance Ruling Certificate**”).

12. The Alliance Agreements and the TBJV are a direct result of the increasingly liberalized international air transportation policy adopted by the Canadian government in the 1990s to promote such agreements, and are fundamental to realizing the economic objectives and consumer benefits contemplated by policy-makers in developing the Blue Sky

policy. They are also a crucial aspect of Air Canada's ability to compete with other airlines and to remain viable in the long term.

13. If the relief sought by the Commissioner were granted, the benefits already realized from implementation of the Alliance Agreements, as well as those which would be realized through implementation of the TBJV, would be lost, to the detriment of Canadian consumers, the Canadian economy, and Canadian airport authorities seeking to develop air passenger traffic in Canada. Canadian airport authorities and independent travel agencies are supportive of the arrangements between the Respondents and are concerned about the loss of the benefits they have already provided and would in future provide, as described in letters sent to the Commissioner and Air Canada expressing support for the cooperative arrangements challenged in the Application and decrying their unwinding as regrettable steps backwards for Canada's air transportation industry.

B. The Commissioner's Allegations Are Unfounded

14. Contrary to the Commissioner's allegations at paragraph 22 of the Application, the TBJV and the Alliance Agreements do not, individually or collectively, create or enhance the Respondents' ability to exercise market power on Transborder Routes or prevent or lessen competition substantially.

15. As a threshold factual matter, the Commissioner's presentation of "market share" data on the alleged "Transborder Overlap Routes" (discussed below) at paragraph 42, Table 1 of the Application is fundamentally flawed. As indicated in the Application, the source of the data used by the Commissioner to derive the market share numbers is the U.S. DOT's T-100 database. The U.S. DOT's T-100 database includes every passenger travelling on each flight, whether they are local or connecting passengers. Accordingly, Table 1 at paragraph 42

of the Application vastly overstates the Respondents' shares of local passenger traffic on the alleged "Transborder Overlap Routes".

16. There are currently 106 Transborder Routes on which at least one of the Respondents provides non-stop service using its own aircraft (including routes operated by third parties that provide scheduled passenger air transportation on behalf of the Respondents), but there is no overlap in non-stop service on 89 (84%) of these routes. There is no factual basis or rationale provided in the Application in support of the Commissioner's bald assertions that the Alliance Agreements have had, and the TBJV would have, anti-competitive effects on competition with respect to these routes.

17. With respect to the few Transborder Routes currently served non-stop by Air Canada and either United or Continental (the "overlap routes"), the Commissioner's allegations that the TBJV would create or enhance an ability to exercise market power on the part of the Respondents are misguided. After implementation of the TBJV, the Respondents would (as they do today) continue to face actual non-stop service competition on at least nine of the overlap routes, and would face potential non-stop and actual one-stop service competition on every one of the overlap routes, from legacy and non-legacy carriers and likely new entrants. Substantial economic empirical literature supports the conclusion that potential competition - *i.e.*, the threat of entry by airlines not currently serving a particular route - is a powerful constraint on airline pricing. This constraint arises from and is reflective of the ease and frequency of route-specific entry and exit.

18. The provision of transborder passenger service in North America is highly competitive and has been marked by continuous vigorous competition from legacy carriers and substantial new entry by and exponential growth of non-legacy carriers on Transborder Routes. The Respondents' actual and potential competitors in the provision of transborder

passenger service include Alaska Airlines (“**Alaska**”), American Airlines (“**American**”), Delta Air Lines (“**Delta**”), Frontier Airlines (“**Frontier**”), JetBlue Airways (“**JetBlue**”), Porter Airlines (“**Porter**”), Southwest Airlines (“**Southwest**”), Spirit Airlines (“**Spirit**”), US Airways (“**US Airways**”), Virgin America (“**Virgin America**”), and WestJet Airlines (“**WestJet**”). All of these carriers can operate without regulatory restriction in the provision of transborder passenger service, and all are formidable competitors (actual or potential): compared to Air Canada (regarding those carriers for which financial data is publicly filed), all of the carriers, other than WestJet and Spirit, have higher market capitalization and enterprise values, and all except US Airways have either higher liquidity as a percentage of revenues or higher absolute liquidity (and, in most cases, both). There are no barriers to entry for these carriers, and all have the ability and the financial strength to compete with the Respondents.

19. Actual experience of recent new entry directly contradicts the Commissioner’s allegations that there are significant barriers to entry or expansion with respect to providing passenger air transportation services on the Transborder Routes, and that the Respondents currently are, or would be, able to impose “materially higher prices” on overlap routes if the TBJV is implemented. Actual competition and the threat of entry do, and will continue to, act as a discipline on pricing on overlap routes.

20. The absence of a substantial lessening or prevention of competition from the Alliance Agreements or the TBJV is fatal to the Application. That said, the Commissioner also ignores the very substantial gains in efficiency that have resulted from the Alliance Agreements and that will result from the implementation of the TBJV but would be lost or not realized if the relief sought by the Commissioner is granted.

21. The pro-competitive effects of the TBJV include increased output, including in the form of new Transborder Routes, increased flight frequencies, greater capacity and increased

passenger volume, and improved product quality, through (for example) a more comprehensive route network, optimized schedules, and single online prices on connecting itineraries. The TBJV will enable the Respondents to optimize routings, simplify and harmonize their fare structures and rules, and provide lower fares on Transborder Routes, including on those connecting routes which serve passengers travelling from origin points “behind” and to destinations “beyond” gateway airports in the U.S. and Canada.

22. These benefits, which have been recognized by industry and competition regulators around the world, are critical to the Respondents’ competitiveness and would more than offset any alleged lessening or prevention of competition on overlap routes (which lessening or prevention is denied). The TBJV also will allow the Respondents to more efficiently utilize aircraft and other resources, which will free up real resources for redeployment elsewhere in the economy. The consumer or producer efficiencies described above are not likely to be achieved if any order sought by the Commissioner were issued by the Competition Tribunal.

C. The Commissioner’s Application is Wholly Inconsistent with Canadian International Air Transportation Policy and Open Skies Agreements

23. The global airline industry has seen a proliferation of international agreements intended to liberalize competition and deregulate markets for the provision of passenger air transportation services, commonly referred to as “Open Skies” agreements. As described throughout this Response, the Alliance Agreements and the TBJV are consistent with Canada’s Blue Sky policy and the Canada-U.S. Open Skies agreements and are a component necessary to achieve the benefits contemplated by that policy. The Blue Sky policy reflects the Canadian government’s objective that Canadian passenger carriers obtain greater access

to larger markets, such as the U.S., as a platform from which to provide service to other countries and stimulate growth.

24. Canada and the United States reached their first Open Skies agreement with respect to the provision of passenger air transportation services in 1995. An expanded Canada-U.S. Open Skies agreement (the “**Open Skies Agreement**”) came into effect in March 2007, which further liberalized the provision of transborder and international passenger services via Canada and the United States. Under the Open Skies Agreement, Canadian and U.S. air carriers are permitted to operate transborder scheduled services, on an unrestricted basis, without limit, between any point or points in Canada and any point or points in the U.S. and beyond any Canadian or U.S. city as a continuation of a transborder journey.

25. The Canada-U.S. Open Skies Agreement has the purpose (among others) of maximizing competition among airlines in the marketplace with minimum government interference and regulations. This treaty restricts the ability of each country to limit unilaterally the volume of traffic or frequency or regularity of services of the airlines of the other country and prevents the imposition of requirements with respect to capacity, frequency, or traffic which would be inconsistent with the purpose of the Open Skies Agreement. Significantly, the Open Skies Agreement specifically contemplates coordination activities, such as cooperative marketing arrangements, among the airlines of both countries. The Commissioner’s Application, if granted, would significantly impede market developments specifically contemplated by the Open Skies Agreement, by limiting the growth of capacity, frequency or traffic.

26. The expanded Canada-U.S. Open Skies Agreement was initialled by the two governments in November 2005 but was not formally signed until March 2007, just after the U.S. DOT had conferred antitrust immunity on Air Canada’s membership in an expanded

Star Alliance network with United, Lufthansa, SAS, and Austrian Airlines (among others) as network partners. The timing of these events indicates that the Canadian government recognized the link between the Blue Sky policy, the Open Skies Agreement and carrier alliances, and the importance it attributed to the relationship between integrated alliance arrangements and the realization of the benefits contemplated by Canada's liberalized international air transportation policy, as well as to Air Canada's continued growth and vitality as one component of a means to achieve those benefits.

27. The Alliance Agreements and the TBJV further the fundamental purpose sought and achieved by Canada's international air transportation policy and the Canada-U.S. Open Skies Agreement, which encourages coordination among airlines in furtherance of the objective of providing a variety of service options at the lowest prices to passengers. The Commissioner previously publicly expressed strong support for such international agreements, recognizing that they "provide Canadian carriers with expanded opportunities to serve transborder or international markets"⁴ and enhance competition. By contrast, the relief sought by the Commissioner in the Application is inconsistent with this prior position and the stated objectives of the Open Skies Agreement, would severely limit coordination, and would inhibit or eliminate efficiency, contrary to Canada's international air transportation policy.

PART II - RESPONSE TO PARTICULARS OF COMMISSIONER'S STATEMENT OF GROUNDS AND MATERIAL FACTS

28. Air Canada denies each and every allegation in the Commissioner's Statement of Grounds and Material Facts, except as expressly admitted herein.

⁴ Bureau, "Speaking Notes for Sheridan Scott Commissioner of Competition - Air Liberalization and the Canadian Airports System" (May 4, 2005), Remarks to the House of Commons Standing Committee on Transport

PART III - MATERIAL FACTS RELIED ON BY AIR CANADA

A. The Respondents

29. As alleged in paragraph 12 of the Application, Air Canada is a publicly-traded Canadian company. Air Canada operates scheduled passenger air transportation services to destinations in Canada, the U.S., and around the world. Air Canada faces substantial competition in the provision of passenger services from other Canadian airlines, including WestJet and Porter, from U.S. airlines including those identified in paragraph 18 above, and numerous Asia/Pacific, European, Latin American, and, increasingly, Persian Gulf competitors.

30. The substantial benefits to airline passengers provided by the current level of Air Canada's transborder service have been enabled to a significant extent by cooperation between Air Canada and United pursuant to the AC-United Alliance Agreements over the past 15 years, following the first stage Canada-U.S. Open Skies agreement (signed in 1995) which originally spawned the alliance relationship.

31. As alleged in paragraph 14 of the Application, Air Canada has established network "hubs" in Montreal, Toronto, Calgary and Vancouver. Air Canada faces substantial competition for the provision of passenger air transportation services from numerous legacy and non-legacy carriers which also provide service to and from these hub cities, as well as other cities. All major U.S. legacy carriers (such as American, Delta, and US Airways) operate services to Canada, and these services offer competitive schedules and pricing to their entire network via their own hubs. WestJet, currently serving 59 Transborder Routes, and Porter, currently serving 4 routes, are embarking on significant expansion in the U.S., while Southwest Airlines and JetBlue are poised to launch services to Canada. With the Canada-U.S. Open Skies Agreement, there are no barriers to entry or other regulatory

impediments for either a U.S. or Canadian carrier to launch service on any Canada-U.S. route. In addition, there has been substantial growth in competition emanating from airports in U.S. border cities targeting Canadian origin travellers.

32. As alleged in paragraph 20 of the Application, Air Canada and United are founding carriers of the Star Alliance network, founded in 1997, which Continental joined in October 2009. The U.S. DOT amended an existing order conferring antitrust immunity to include Continental among the Star Alliance carriers that were granted antitrust immunity and to approve the A++ joint venture, finding that it would provide substantial additional benefits to consumers, including the creation of a more comprehensive route network, the convenience of coordinated schedules, and reciprocal frequent flyer programs. Continental and United merged on October 1, 2010, after the Commissioner reviewed and cleared that transaction in July 2010.

33. Members of the Star Alliance network face worldwide competition at the alliance level from two other major global alliances, oneworld (which includes American Airlines, British Airways, Iberia and Cathay Pacific, among other carriers) and SkyTeam (which includes Delta, Air France/KLM, Alitalia and Korean Air, among other carriers). State-owned airlines from the Persian Gulf region (such as Emirates, Etihad, and Qatar Airlines, among others) are also expanding aggressively in many international markets.

B. The Agreements Among the Respondents

1. Air Canada-United Bilateral Agreements

34. Air Canada has entered into bilateral agreements with United, including (among others) a Marketing Cooperation Agreement dated May 30, 1995 (the "1995 Agreement") and an Alliance Expansion Agreement dated May 31, 1996 (the "1996 Expansion Agreement"), which generally cover all of the parties' Transborder Routes.

35. The 1995 Agreement provides for, among other forms of limited cooperation, the establishment and marketing of code share operations between Canada and the U.S. and beyond. More specifically, the 1995 Agreement sets out that Air Canada and United will engage in joint promotion of their enhanced services, will take measures to align their respective distribution systems, and will develop certain joint operational programs.

36. The 1996 Expansion Agreement is an umbrella agreement that enables more integrated cooperation between Air Canada and United. Among other things, it enables Air Canada and United to further coordinate their activities in substantive areas including route and schedule coordination; marketing, advertising and distribution; co-branding and joint product development; code sharing; pricing, inventory and yield management coordination; revenue and cost sharing; joint procurement; support services; frequent flyer programs; harmonization of standards/quality assurance; technical services and maintenance; and facilities.

37. As noted above, in 1996 Air Canada sought an Advisory Opinion from the Commissioner, and the parties made a joint application to the U.S. DOT requesting antitrust immunity with respect to their planned cooperation on Transborder Routes pursuant to the 1996 Expansion Agreement. In August 1996, Air Canada received a favourable Advisory Opinion from the Commissioner with respect to the proposed arrangement, except with respect to pricing, inventory or yield management coordination and pooling of revenues with respect to local point-of-sale passengers flying between Toronto and San Francisco until February 25, 1998, when the phase-in period for the implementation of the Open Skies Agreement between Canada and the United States would end.

38. In 1997, the U.S. DOT granted an order conferring antitrust immunity upon Air Canada and United for transborder passenger service coordination, and specifically

approved the 1996 Alliance Expansion Agreement (except with respect to pricing, inventory or yield management coordination and pooling of revenues on certain fares for local U.S. point-of-sale passengers flying non-stop between Chicago and Toronto and between San Francisco and Toronto). The U.S. DOT found that coordination of Air Canada and United's passenger air transportation services on the Transborder Routes would benefit the public by providing better service, enabling the airlines to operate more efficiently, and would significantly increase competition and service opportunities for millions of passengers travelling from origin cities "behind" and to cities "beyond" gateway airports in the United States and Canada.

39. Since 1997, Air Canada and United have been coordinating on some (but not all) aspects of passenger air transportation services on Transborder Routes addressed in the 1996 Expansion Agreement, including with respect to code sharing services, reciprocal frequent flyer programs, and certain joint fare discount and incentive programs. There has not been coordination between Air Canada and United on capacity or revenue sharing. These aspects of the Expansion Agreement will be implemented through the TBJV (as described below). Air Canada and United have engaged in coordination activities pursuant to the AC-United Alliance Agreements only to the extent covered by the antitrust immunity conferred by the U.S. DOT.

2. Air Canada-Continental Bilateral Alliance Agreement

40. Air Canada and Continental entered into the AC-CO Alliance Agreement dated October 25, 2009, as alleged at paragraph 29 of the Application. The AC-CO Alliance Agreement is an umbrella agreement that sets out the basic framework for the organization of the alliance relationship between the two companies.

41. While the AC-CO Alliance Agreement permits the parties to evaluate and potentially implement forms of coordination similar to those set out in the 1996 Expansion Agreement between Air Canada and United, the AC-CO Alliance Agreement does not create a positive obligation on either of the parties to integrate their activities in any of the substantive areas alleged by the Commissioner at paragraph 29 of the Application. To the contrary, the AC-CO Alliance Agreement clearly states that the parties “may” integrate their activities in an enumerated list of areas, and specifies at section 3.3.1 that “[e]ach Party retains the right to make independent operational and business decisions”. To date, Air Canada and Continental have coordinated principally with respect to code sharing on Transborder Routes and providing reciprocal frequent flyer programs.

42. In 2009, the U.S. DOT amended an existing order of antitrust immunity to include Continental among the Star Alliance carriers granted antitrust immunity, which grant included coordination with Air Canada on transborder passenger air transportation services (except with respect to existing carve outs and with respect to pricing, inventory or yield management coordination and pooling of revenues on certain fares for local U.S. point-of-sale passengers flying non-stop between Cleveland and Toronto, Houston and Calgary, Houston and Toronto, and New York and Ottawa). This order extends antitrust immunity to the Alliance Agreements and the TBJV, subject to the submission of the TBJV for approval by the U.S. DOT as a “subsequent subsidiary agreement”.

3. The TBJV

43. As alleged at paragraph 33 of the Application, Air Canada, Continental and United executed a Memorandum of Understanding (the “MOU”) with respect to the TBJV in September 2010. The MOU contemplates a definitive agreement with respect to the TBJV which has not yet been concluded by the Respondents. The TBJV is in effect an extension of

the Alliance Agreements, in that it will establish the mechanics to carry out many of the activities contemplated by the Alliance Agreements, in keeping with global aviation trends in other parts of the world.

44. The TBJV provides for broader and deeper integration between the passenger air transportation services of the Respondents on the Transborder Routes than currently exists between Air Canada and United or Air Canada and Continental pursuant to their bilateral Alliance Agreements. Such integration with respect to Transborder Routes would include (among other things) joint pricing, joint route planning and scheduling, coordinated marketing, harmonization of sales processes, and revenue sharing between the Respondents, in the same way that such activities are contemplated under A++. Thus, the TBJV adds to the number of coordinated activities engaged in by the Respondents with respect to the provision of passenger air transportation services on Transborder Routes, and would also formalize and enhance the degree of coordination on activities in respect of which the Respondents have been cooperating pursuant to the Alliance Agreements.

45. Contrary to the Commissioner's allegation at paragraph 38 of the Application, the TBJV is not an anti-competitive attempt by the Respondents to "share the revenues from their reduced competition" on Transborder Routes. The TBJV is in fact pro-competitive. It is designed to increase the value and reduce the price of the Respondents' services to consumers, enabling the Respondents to better compete with rival alliances, legacy carriers, non-legacy carriers, and other competitors while increasing network traffic, efficiency and profitability. The TBJV will create strong incentives for the Respondents to increase the efficiency and the capacity of their respective transborder operations.

46. Although the TBJV contemplates substantial integration of the Respondents' operations regarding service on Transborder Routes, it is not correct that the TBJV would

result in the Respondents making joint “decisions on all aspects of competitive behaviour” as alleged at paragraph 37 of the Application. Unlike the integration which would typically occur in connection with a merger, the TBJV will not result in the complete integration of the Respondents’ business operations, nor would it result in profit sharing. Moreover, while the TBJV provides for revenue sharing, it does not generally provide for cost sharing, and thus each Respondent will continue to have every incentive to operate efficiently.

47. As noted above, the Commissioner’s position is also fundamentally at odds with the Blue Sky policy of the Canadian government (and other governments), which permits (indeed, encourages and recognizes the value of) the formation of integrated alliances and joint venture arrangements among carriers from different countries. International air transportation policies in Canada and elsewhere recognize that the formation of alliances and joint ventures is beneficial and necessary for such carriers, in part because of foreign ownership restrictions which prevent mergers between the carriers. It is recognized that such forms of cooperation enhance the ability to achieve economies of scale which promote efficient competition in a global industry (which are achieved by firms in other industries through full scale mergers).

48. The TBJV is intended to achieve “metal neutrality” on Transborder Routes, meaning that each Respondent will be indifferent as to which airline collects fares or operates a particular route with its own aircraft. By providing for the pooling of resources and revenue sharing to achieve metal neutrality, the TBJV would create common incentives for each Respondent to maximize growth of the overall Canada-U.S. transborder network and allow the Respondents to focus on gaining the customer’s business on Transborder Routes by providing the best available fares, routing, and scheduling between any two cities.

49. The TBJV is similar in principle to existing metal neutral joint ventures between international passenger airlines, including A++, which involves substantial integration and cooperation on trans-Atlantic routes. As noted above, in 2009 the Commissioner issued an Advance Ruling Certificate in respect of A++, and A++ was also granted an order conferring antitrust immunity by the U.S. DOT. The pro-competitive benefits of metal neutral joint ventures such as A++ (and the TBJV) have been widely recognized and demonstrated by experience in the airline industry, and include the ability for carriers to provide service on new non-stop routes, an increase in the number of online competitors on such newly enabled O&D pairs, and improved quality of connecting services.

50. As alleged at paragraph 36 of the Application, on November 5, 2010, the Respondents made a filing to the Bureau seeking review of the TBJV as a merger under section 92 of the *Competition Act*. The Respondents requested an Advance Ruling Certificate clearing the TBJV pursuant to section 102 of the *Competition Act* (as had been granted in respect of A++ in 2009). The Commissioner's assertions in the Application about the purported anti-competitive intent and impact of the TBJV are inconsistent with the Commissioner's consideration of and issuance of an Advance Ruling Certificate in respect of A++, and with the analysis and conclusions of competition authorities in several other jurisdictions, including the United States, with respect to similar agreements.

C. Passenger Air Transportation Services Industry

51. By significantly enhancing efficiency through greater coordination of service, the TBJV is intended to enhance the Respondents' competitiveness, which is of critical importance in light of the substantial and continuous challenges faced by passenger airlines in the industry today and the intense competition faced by Air Canada (and the other

Respondents) in the provision of domestic, transborder, and international passenger air transportation services.

1. Continuous Challenges in the Airline Industry

52. Over the past 25 years (at least), airlines have sustained widespread and significant losses, including losses of nearly U.S. \$50 billion worldwide between 2000 and 2009. Numerous carriers have failed. Continental went through two court-supervised insolvency processes, the second ending in 1993. In 2003-2004, Air Canada underwent a court-supervised insolvency/corporate reorganization process. United's court-supervised restructuring process lasted from 2002 to 2006. In 2008-2009, the global economic crisis caused a severe reduction in demand for air travel, exacerbating the significant business challenges faced by the industry, including the Respondents. The current global economic climate is no more favourable.

53. The airline industry is a high cost business, with substantial cost commitments (such as for aircraft leases and labour expense) which cannot be shed except over the long (often very long) term. Carriers also face substantial cost volatility, notably with respect to the cost of fuel. The past several years have seen dramatic jet fuel price increases (current jet fuel prices are nearly four times higher than 2000 prices). Air Canada also faces significant cost volatility in relation to solvency deficit payment obligations for its pension plans.

54. Air Canada and the other Respondents also face substantial demand volatility for passenger transportation services. Demand for scheduled passenger air travel varies substantially over the course of a business cycle, and is highly susceptible to demand shocks based on unpredictable global events, recent examples of which include the volcanic ash crisis in the summer of 2010 and the earthquake in Japan earlier this year.

55. In addition to the challenges facing passenger air carriers around the world, carriers providing passenger air transportation services on Transborder Routes face challenges which are unique to that segment. One key challenge is the existence of highly price-sensitive air transportation passengers in Canada, combined with the availability of highly substitutable alternatives to transborder flights. At least 75 percent of the Canadian population is located within 160 kilometres (100 miles) of the U.S. border, and Canadian travelers are increasingly driving to U.S. airports marketing directly to Canadian passengers and located conveniently close to the Canada/U.S. border (including those in Burlington, Vermont; Plattsburgh, New York; Buffalo, New York; and Bellingham, Washington) to access lower cost U.S. domestic flights rather than transborder flights, effectively providing another form of "transborder" competition for the Respondents. Travellers are also becoming more price sensitive as technological alternatives to air travel, such as video-conferencing, gain more acceptance. These price sensitivities are reflected in increased use of lower priced connecting itineraries, bookings of the most restrictive airfares, and the use of large travel management companies to leverage purchasing power.

56. In light of the significant challenges posed by the current business environment, maintaining the benefits of the existing bilateral cooperation, and the substantial cost savings, demand stimulus, lower prices, and improved service options on Transborder Routes which would be made possible by the TBJV, are of critical importance to the business and competitiveness of Air Canada (and the other Respondents).

57. By achieving metal neutral service on Transborder Routes, the TBJV would allow Air Canada to achieve greater efficiencies and better enable it to tap passenger traffic originating in the U.S. cities behind its Canadian gateways, benefits which are critical to Air Canada's ability to remain a viable competitor in increasingly competitive domestic, transborder and

international markets, and, at the same time, to buttress its service to more international destinations from its Canadian hub airports with the feed provided by the larger volume of passengers from the United States.

58. Air Canada has invested billions of dollars in aircraft acquisitions and in the expansion of its U.S. network, which has underpinned Air Canada's international growth strategy over the past several years. By tapping into the U.S. market, through coordination with United pursuant to the AC-United Alliance Agreements and with the liberalized air transportation policy and Open Skies agreements since 1995, Air Canada has been able to attract a large volume of U.S. traffic over its major hubs of Montreal, Vancouver and, especially, Toronto. As a source of incremental U.S. traffic, the AC-United Alliance Agreements have enabled Air Canada to pursue an aggressive international growth plan and initiate new long-haul international flights out of Toronto to key Asian cities such as Tokyo, Beijing, Shanghai, Hong Kong, and out of Toronto and Montreal to European cities such as Rome, Barcelona, Madrid, Copenhagen, Athens, Geneva, Zurich, and Brussels, in addition to its flagship routes to London, Paris, and Frankfurt. The Commissioner's Application places Air Canada's international growth strategy at severe risk.

59. Air Canada has not been the only beneficiary of the growth fostered by the expansion of its U.S. network. Canadian airports and local communities have also reaped significant economic benefits from Air Canada's international growth strategy, although they too have had to invest hundreds of millions of dollars to build new and large facilities to support such growth. Through its strategic investments and with the efficiencies and expansion of service made possible by metal neutral joint ventures, such as the TBJV and A++, Air Canada is now poised to play a major role on the global aviation scene and Canadian airports to become prime gateways to attract major traffic flows between the Americas, on the one hand, and

Asia and Europe, on the other hand, to the substantial benefit of consumers and the Canadian economy.

60. The Commissioner's challenge to the Alliance Agreements and the TBJV detracts from, rather than promotes, open market competition.

2. Global Consolidation and Competition

61. Air Canada and the other Respondents face intense competition in the provision of their domestic, transborder, and international passenger services. The industry has become increasingly global and has seen a wave of mergers and consolidation in recent years, such that many major international carriers have expanded in terms of their size, revenue, and the geographic scope of their operations. Global carriers which have developed much more extensive networks via consolidation include Delta/Northwest, the largest carrier in the world, which provides transborder service to 13 Canadian cities from six hubs in the U.S., Air France/KLM, and British Airways/Iberia.

62. The liberalization of international passenger air transportation services, fostered by international Open Skies type agreements, is such that North American carriers today face increased competition on U.S. and Canadian international routes, including competition from increasingly established and very well capitalized carriers from emerging economies in the Middle East and South Asia. Persian Gulf carriers such as Emirates, Etihad, and Qatar, for example, are a growing international force and aggressive competitors operating fleets of wide body, high capacity aircraft with plans for rapid and significant expansion of their networks.

63. Competition is also intensifying among the three major global alliances of carriers, oneworld, SkyTeam, and Star Alliance. Metal neutral trans-Atlantic joint ventures have been created among carriers within each of those three alliances, including A++ as well as other

ventures between Air France/KLM and Delta Airlines and between British Airways/Iberia and American Airlines. Those metal neutral joint ventures have also been conferred antitrust immunity by orders of the U.S. DOT. Carriers within oneworld and the Star Alliance have also formed trans-Pacific joint ventures, and carriers within all three alliances have formed other regional joint ventures, including Europe-Asia and U.K.-Australia services, which have been approved by various regulators in other countries.

64. Carriers have formed international alliances and joint ventures in order to overcome the obstacles to efficient organization presented by legal restrictions on the foreign ownership or control of airlines, and the high costs of developing stand-alone networks to adapt to an increasingly global industry. Such alliances have been studied and considered in detail by U.S. and European Union regulators, among others, which have noted the importance of these alliances as a critical competitive tool to ensure the viability of legacy carriers in a liberalized global competitive environment. These regulators have found that the alliance strategy is driven by network economics in a global economy predicated on a “from anywhere to everywhere” consumer model requiring development of a worldwide hub and spoke system, such that legacy carriers must seek commercial partners and develop alliances to help them provide greater network coverage and service options to air travellers. This is particularly so in the face of foreign ownership and control restrictions (which ownership restrictions exist in both Canada and the United States). Greater competition from non-legacy carriers also means that legacy carriers need to broaden and deepen their global network integration with alliance partners to gain access to greater traffic flows and remain viable competitors on short-, medium-, and long-haul routes.

65. Alliances and joint ventures among international carriers are a clear and demonstrable worldwide trend of growing importance for all airlines, one that leading

economists around the world recognize as leading to substantial gains in efficiency. The efficiencies created by the TBJV are critical to enabling the Respondents to meet the challenges presented by the widespread and increasing industry consolidation and coordination and increasing competition on a worldwide basis.

66. Preventing Air Canada from adapting to succeed in what will inevitably continue to develop as a more economically efficient international industry will put the Canadian aviation industry at risk, diminish Canada's attractiveness as a market, and undermine long term economic growth across a range of other industries in Canada. If the relief requested by the Commissioner is granted, Air Canada risks becoming marginalized on the global scene and relegated to being a mostly local/regional player. Canadian airports, which like Air Canada have invested heavily in an international growth strategy premised on alliances and coordination, risk suffering the same fate and have expressed their concerns, as demonstrated by letters sent by Canadian airport authorities to the Commissioner and Air Canada expressing their support for the TBJV (and opposition to the Application). Their correspondence emphasizes the economic efficiencies and benefits the TBJV would create for Canada's airports and the passengers and communities they serve, and the importance of generating such efficiencies in light of the competitiveness of the markets for passenger air transportation services. Canada should not be left to become a backwater of international aviation by ignoring this important trend underpinning global competition in the airline industry.

3. Competition In Transborder Passenger Service

67. Air Canada faces intense actual competition and the threat of new competition on its domestic Canadian and transborder services from numerous established and very well

capitalized competitors, including Alaska, American, Delta, Frontier, JetBlue, Porter, Southwest, Spirit, US Airways, Virgin America, and WestJet.

68. With respect to Canadian domestic passenger air transportation services, Air Canada faces substantial and growing competition from other Canadian carriers, including WestJet and Porter. Other carriers now have approximately a 44% share of Canadian domestic scheduled passenger service capacity.

69. While non-legacy carriers have only relatively recently begun serving Transborder Routes, their share of transborder capacity based on available seat miles has grown swiftly from less than 1% in 2002 to over 18% in 2011. Furthermore, they have been rapidly expanding into new Transborder Routes, and are poised to continue to expand rapidly. In the last five years alone, WestJet has added approximately 30 new Transborder Routes, bringing its total Transborder Routes to 59, and Porter has entered four Transborder Routes. In July 2011, Porter publicly announced that it plans to add transborder service to/from Washington, D.C. within the next 12 months, and that it is considering entry on additional Transborder Routes, including Toronto to Cleveland and service to Philadelphia International Airport.

70. Non-legacy carriers also have consolidated and expanded their domestic and Canada-U.S. transborder networks, including through cooperation with other carriers. For example, WestJet and American Airlines entered into a code share agreement on March 29, 2011, which includes up to 20 Canadian cities. WestJet had earlier announced an interline agreement with Delta, effective as of February 7, 2011. Southwest Airlines' recent merger with Air Tran will result in the largest North American carrier by both origin and destination passengers and enplanements, which will be well placed to begin offering passenger air

transportation service on Transborder Routes, in respect of which there would be no restrictions under the Open Skies Agreement.

71. Non-legacy carriers are present at all of Air Canada's Canadian hub cities and at all of United/Continental's mainland U.S. hub cities. They also offer competing non-stop service on all Air Canada hub-to-hub routes in Canada and, as of 2011, serve almost 70% of U.S. legacy hub-to-hub routes non-stop. In the last few years, Porter and WestJet have substantially increased the number of their transborder departures, their seat capacity, and their average seat-miles flown on Transborder Routes. Non-legacy carriers are a robust and growing competitive presence on Transborder Routes.

72. This competition from non-legacy carriers is in addition to competition from existing legacy carriers. All major U.S. network carriers operate services to Canada, including services to smaller airports that are not Air Canada hubs, and these carriers offer competitive schedules and pricing to their entire network via their own hubs. Legacy carriers, including carriers participating in all three major global alliances (such as American, US Airways and Delta), offer non-stop and connecting service in competition with the Respondents on all of the overlap routes, and are actively working to increase the quality of their transborder offerings, including through new interline and code share agreements with Canadian carriers. As noted above, in 2011 American entered into a comprehensive code sharing and frequent flyer agreement with WestJet, which enables it to market service on three of the overlap routes (Calgary-Chicago, Toronto-Chicago, and Montreal-Chicago).

73. Legacy carriers also are likely to enter on Transborder Routes, including the overlap routes. For example, US Airways has announced it intends to enter onto two of the overlap routes, Montreal-Washington and Ottawa-Washington, following completion of its slot swap with Delta, which was tentatively approved by the U.S. DOT on July 21, 2011. Moreover,

there has been consolidation among U.S. legacy carriers (including notably Delta-Northwest, now the largest airline in the world) which has improved their position in offering passenger transportation services on Transborder Routes.

74. In addition, the Respondents face competition on Transborder Routes from international network carriers, such as, for example, Cathay Pacific on the Vancouver-New York route, and such competition can be expected to increase with continued implementation of the Blue Sky policy.

75. Moreover, as noted above, Canadians looking to travel to U.S. destinations are increasingly being lured by U.S. border airports, including those in Burlington, Vermont; Plattsburgh, New York (whose airport, Plattsburgh International Airport, bills itself as “Montreal’s U.S. Airport”); Buffalo, New York; and Bellingham, Washington, which compete with Canadian airports and carriers to attract “transborder” passengers.

76. In short, where competitors to Air Canada and the other Respondents perceive an opportunity to enter a route and earn revenue, they seize it, including by the redeployment of their aircraft and other assets to new routes to provide additional competition to the Respondents. The transborder market is viewed by these competitors as offering viable opportunities to compete, and both actual and threatened entry on these routes is and will remain a competitive reality.

D. Legal Framework

77. Air Canada submits this Response without prejudice to and under express reservation of its rights to pursue any other proceedings and remedies in connection with the purported exercise of the Commissioner’s jurisdiction.

78. As discussed above, Air Canada submits that the relief sought by the Commissioner is fundamentally inconsistent with Canada’s Blue Sky policy and Open Skies agreements

with the United States. Pursuant to subsection 4(3) of the *Canada Transportation Act*, in the event of any inconsistency or conflict between an international agreement or convention respecting air services to which Canada is a party and the *Competition Act*, the provisions of the agreement or convention prevail to the extent of the inconsistency or conflict. Air Canada pleads and relies on subsection 4(3) of the *Canada Transportation Act*.

79. Air Canada further submits that, to the extent the Commissioner seeks an order which would affect customers purchasing air transportation services outside of Canada, such an order would be outside the jurisdiction of the Competition Tribunal under the *Competition Act*.

80. Air Canada further submits that the Commissioner is not entitled to seek orders under both sections 90.1 and 92 of the *Competition Act* in the Application. Subsections 90.1(10)(b) and 98(b) of the *Competition Act* prevent the Commissioner from bringing an application under both sections 90.1 and 92 on the basis of facts that are the same or substantially the same. In the Application, the relief sought under both sections is based on the same facts: the TBJV is an agreement to implement the coordination contemplated by the Alliance Agreements. Air Canada pleads and relies on subsections 90.1(10)(b) and 98(b) of the *Competition Act*.

81. The Commissioner seeks an order under section 92 of the *Competition Act* prohibiting the Respondents from entering into the TBJV or, in the alternative, from implementing the TBJV in relation to direct passenger air transportation services operated by the Respondents on the 19 identified Transborder Routes on which their services allegedly overlap. Before an order may be made under section 92 of the *Competition Act*, the Tribunal must find (among other things) that the proposed merger “prevents or lessens, or is likely to prevent or lessen, competition substantially”. Air Canada denies that the TBJV would lessen or prevent, or be

likely to lessen or prevent, competition substantially as required by section 92 of the *Competition Act* and submits that for this reason alone, the Commissioner is not entitled to the relief sought in respect of the TBJV.

82. The Commissioner also seeks an order under subsection 90.1(1) of the *Competition Act* prohibiting the Respondents from implementing certain coordination activities pursuant to the Alliance Agreements, with respect to all Transborder Routes, or in the alternative with respect to the 19 Transborder Routes alleged to overlap by the Commissioner. Before an order may be made under subsection 90.1 of the *Competition Act*, the Tribunal must find (among other things) that an agreement or arrangement involving at least two (potential) competitors “prevents or lessens, or is likely to prevent or lessen, competition substantially in a market.” Air Canada denies that the Alliance Agreements have lessened or prevented, or would likely lessen or prevent, competition substantially in a market as required by section 90.1(1) of the *Competition Act* and submits that for this reason alone, the Commissioner is not entitled to the relief sought in respect of the Alliance Agreements.

83. Air Canada further submits that in the Application, the Commissioner mischaracterizes the applicable legal test under sections 90.1 and 92 of the *Competition Act*. These provisions allow the Tribunal to issue an order where an agreement or a merger, respectively, is likely to prevent or lessen competition substantially. The Commissioner’s assertion that the Alliance Agreements and the TBJV will increase the ability of the Respondents to exercise market power, even if true (which is denied), would not constitute a substantial lessening or prevention of competition under the *Act*.

84. Even if the Tribunal were to find that the TBJV or the Alliance Agreements have resulted or would result in a substantial lessening or prevention of competition, which is denied, section 96 and subsection 90.1(4) of the *Competition Act* provide that no order may be

made under section 92 or subsection 90.1(1), respectively, where the Tribunal finds that the proposed merger or arrangement between competitors “has brought about or is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result or is likely to result from” the proposed merger or arrangement, and that “the gains in efficiency would not likely be attained if the order were made.” Air Canada states that the bilateral Alliance Agreements have provided and the TBJV will provide substantial gains in efficiency which are greater than and more than offset the effects of any lessening or prevention of competition (which lessening or prevention is denied) from those agreements. These efficiencies, which are essential to the Respondents and which benefit consumers, would not be attained if the relief sought by the Commissioner were granted. Air Canada pleads and relies on section 96 and subsection 90.1(4) of the *Competition Act* in response to the Application.

E. Relevant Market

85. Air Canada denies the Commissioner’s assertion at paragraph 40 of the Application that the “relevant market for assessing the likely effects” of the TBJV and each of the Alliance Agreements is “direct passenger air transportation services between city pairs involving an end point in each of Canada and the U.S.”

86. The Commissioner’s exclusive focus on specific “city-pairs” is unduly narrow. A “city pair” route provides only a starting point, not the end point, in defining the relevant market and analyzing the effects of the TBJV and the Alliance Agreements.

87. Air Canada denies the Commissioner’s assertion that connecting passenger air transportation services is “not a close substitute” for direct (non-stop) services on Transborder Routes. Passengers are increasingly treating connecting service as a close substitute for direct service. Connecting service is part of the relevant product market,

particularly for long-haul flights, and must be considered in analyzing the competitive effects of the TBJV and Alliance Agreements.

88. Air Canada submits that Canadian and U.S. border airports are in the same relevant geographic market, and that the competitive constraints on transborder air carriers as a result of U.S. border airports must be considered in analyzing the competitive effects of the TBJV and Alliance Agreements. For example, passengers living in Southern Ontario are increasingly travelling across the U.S. border to Buffalo, New York to take a flight to a U.S. destination originating from there, rather than taking a transborder flight originating from Toronto. More generally, the ability (and willingness) of passengers to choose between different cities and routes when making their transborder travel plans further illustrates that the Commissioner's exclusive focus on specific "city pairs" is unduly narrow.

89. Air Canada further submits that the analysis of the competitive effects of the Alliance Agreements and TBJV must take into consideration the broader context of competition between carriers on a network, and indeed global alliance, level. As stated above, the liberalization of international air transportation services has led to increasing worldwide competition among carriers in global alliances, which increases the need for carriers to broaden and deepen their network integration with commercial partners to gain access to greater traffic flows and remain viable competitors on short-, medium-, and long-haul domestic, transborder and international routes. Accordingly, an assessment of individual Transborder Routes is not appropriate as a sole focus for defining a relevant market and for undertaking the competitive effects analysis, contrary to the Commissioner's position in the Application.

F. The Alliance Agreements and TBJV are Pro-Competitive

1. The Alliance Agreements

90. The Commissioner's allegations that even if the TBJV were disallowed, the bilateral Alliance Agreements would "continue to substantially prevent or lessen competition by reason of the ability of the Respondents to integrate their businesses and act as a single competitor" are unfounded. To the extent the Commissioner is alleging that the Alliance Agreements, as implemented to date, have caused a substantial lessening of competition, that assertion is without any factual foundation. To the extent the Application alleges that the Alliance Agreements could become anti-competitive if more complete integration of the Respondents' transborder services occurred pursuant to them than has occurred to date, that assertion is unfounded and is refuted by the pro-competitive effects of the TBJV.

91. The Application does not specify a single allegedly anti-competitive effect of the Alliance Agreements. Furthermore, the 1996 Expansion Agreement between Air Canada and United was implemented only after the parties received a favourable Advisory Opinion from the Commissioner following a competition assessment. While the Advisory Opinion does state that the Commissioner's conclusions might be "revised" should "new evidence" become available on the competitive impact of the AC-United Alliance Agreements, no evidence which would undermine the conclusions of the Advisory Opinion has (ever) been identified by the Commissioner. Air Canada states that the Commissioner is estopped, based on the Advisory Opinion and the passage of 15 years, from taking the position that the AC-United Alliance Agreements (and in particular the 1996 Expansion Agreement) were intended to restrain, or have restrained, competition for passenger services on Transborder Routes.

92. Contrary to the Commissioner's bald assertions in the Application, the coordination on Transborder Routes which has been developed over the past 15 years pursuant to the AC-United Alliance Agreements, and more recently pursuant to the AC-CO Alliance Agreement, has increased output and improved product quality. Since transborder coordination between Air Canada and United began, the parties have substantially increased the number of non-stop Transborder Routes they serve, the number of daily transborder flights they offer, and the total number of transborder passengers they carry (with such increases well above the industry average). In addition, Air Canada and United have developed joint discounted specialized fare products over a wider range of destinations than was previously possible. These benefits would not have been achieved to the same extent without the bilateral Alliance Agreements. Furthermore, notwithstanding the Alliance Agreements, competing legacy carriers have continued to expand their service, and entry by non-legacy carriers has occurred. There is simply no factual basis for the Commissioner's suggestion that those agreements have caused a substantial lessening or prevention of competition.

2. The TBJV

93. Contrary to the Commissioner's assertions in the Application, the increased integration of the Respondents' passenger air transportation services on Transborder Routes and the achievement of metal neutrality contemplated by the TBJV are intended to and will create substantially greater pro-competitive efficiencies than have been realized to date by Air Canada and United, or by Air Canada and Continental, pursuant to the Alliance Agreements.

94. Among many other substantial benefits (discussed below), the TBJV would lower fares for transborder passengers and stimulate demand for transborder service by

eliminating inefficiencies created by the "double marginalization" problem, that is, the imposition of successive "mark-ups" on airline tickets involving flight segments operated by different carriers. Double marginalization occurs in the absence of revenue sharing integration between the carriers on such interline flights, because each carrier has an incentive to mark up the fare for its own flight segment(s) with regard only to the impact on demand for its own flights, but not the demand for flights of the carrier operating the other segment(s). It results in higher fares (and lower demand and output) than would be optimal if an effectively single entity were responsible for determining the price on the routes.

95. The metal neutral TBJV is designed to and will substantially eliminate double marginalization on Transborder Routes by creating shared incentives for each Respondent to maximize the success of the joint venture over its individual corporate interests, thus enhancing the Respondents' ability to provide the best available fares, fare rules, schedules and routings for the customer, and stimulating demand for transborder service. These enhanced efficiencies would enable the Respondents to provide more transborder service, including service on routes which would not be economically viable for any Respondent to operate independently in the absence of the TBJV.

96. As noted above, mergers of airlines in different countries typically cannot be effected given foreign ownership restrictions. Metal neutral joint ventures are intended to replicate the efficiencies and other pro-competitive economic effects of mergers, which are well documented in the economics literature and have been amply demonstrated by experience in the industry.

97. As the U.S. DOT has concluded, these pro-competitive benefits would not be realized by lesser types of integration between the Respondents, such as traditional code sharing arrangements, including because metal neutral integration is required to create sufficient

incentives for the effective elimination of double marginalization. Indeed, the U.S. DOT has recognized that metal neutrality is a “prerequisite” for obtaining many cost benefits and synergies from joint ventures.

98. As noted above, the TBJV is similar in principle to the metal neutral trans-Atlantic A++ joint venture for which the Commissioner issued an Advance Ruling Certificate and for which antitrust immunity was conferred by the U.S. DOT in 2009. Over the past two years, A++ has enabled the carrier partners to add non-stop service on 20 trans-Atlantic routes, including six routes involving a Canadian airport in the past year, and to retain flight schedules which otherwise might have had to be cancelled or reduced. The A++ network presently covers 108 non-stop trans-Atlantic routes on which the A++ carriers operate nearly 260 daily departures, and capacity has been in the last year or will soon be expanded on six existing non-stop routes.

99. The A++ network currently extends to approximately 52,000 connecting airport pairs; A++ carriers have coordinated their respective schedules, not only to increase the number of connecting service options available to customers by adding alternative route paths and connecting points for passengers to travel to their destinations across the A++ network, but also to reduce layover and overall travel times for customers. With single point pricing, the A++ carriers have been able to offer consumers a broader range of fares and enhance competition with other airlines and alliances. As a result of A++, passengers have gained enhanced service and more fare options. Similar benefits and gains in efficiency are the objectives of and will be achieved by the TBJV.

G. No Substantial Lessening or Prevention of Competition on Transborder Routes

100. Contrary to the Commissioner’s assertions, there is and would be no substantial lessening or prevention of competition on Transborder Routes from the Alliance Agreements

or the TBJV. As stated above, there are 106 non-stop Transborder Routes covered by at least one party to the TBJV using its own aircraft, but there is no overlap in non-stop service among the Respondents on the very substantial majority (84%) of these routes: 89 of these 106 routes do not overlap. The Application is silent as to how the Alliance Agreements or TBJV would result in a substantial lessening or prevention of competition on those routes and there is no factual basis whatsoever for such an assertion.

101. The Commissioner's assertion that the TBJV would enable the Respondents to exercise market power and lessen competition substantially on all overlap routes is also without any factual foundation. Contrary to the Commissioner's allegations, the Respondents currently face, and after implementation of the TBJV would continue to face, strong competition from actual and potential competitors on all overlap routes, from established and well capitalized legacy and non-legacy carriers. There are no material barriers to entry or expansion on the overlap routes, and the TBJV would not give the Respondents market power (the ability to charge supra-competitive prices) on the Transborder Routes. Indeed, after implementation of the TBJV (as now), the Respondents would face competition from (among others) established carriers such as WestJet, Porter, American, Delta, US Airways, and Alaska, and potential new entrants such as Southwest and Jet Blue.

1. There is Substantial Effective Competition on Overlap Routes

102. Although the Commissioner has alleged that there are 19 overlap routes, two of those 19 routes identified in the Application (Calgary-San Francisco and Calgary-Chicago) do not involve overlapping transborder service. Air Canada ceased to provide (what had been only seasonal) service on the Calgary-Chicago route in August 2010 and exited the Calgary-San Francisco route in May 2011, in each case for reasons unrelated to the TBJV (because those

routes were not viable). The TBJV therefore would not involve a reduction in competitors (let alone a substantial lessening or prevention of competition) on those two routes. Moreover, the recent overlap on the Montreal-Houston route was created only in anticipation of the TBJV by both Air Canada and United, and in the absence of the TBJV either or both carriers may be unable to sustain service on this route.

103. With respect to the 17 actual routes where there is some overlap, the Commissioner's allegation that there either is or would be "no effective competition remaining on any" of those routes after implementation of the TBJV is fundamentally flawed in multiple respects.

104. The Commissioner's allegations ignore that five of the overlap routes (Calgary-Chicago, Montreal-Chicago, Toronto-New York, Toronto-Chicago and Montreal-New York) currently have three or more non-stop legacy carrier competitors, such that the Respondents would face non-stop competition from legacy carriers after implementation of the TBJV. For example, American currently offers eight daily weekday departures from Toronto to Chicago, which directly contradicts the Commissioner's assertion that no "effective competition" exists on that overlap route.

105. Six of the overlap routes (Vancouver-New York, Vancouver-San Francisco, Calgary-San Francisco, Vancouver-Los Angeles, Toronto-New York, and Toronto-Chicago) also already have non-stop service provided by non-legacy carriers. For example, Porter offers 11 daily weekday departures from Toronto to New York, which further contradicts the Commissioner's bald assertion at paragraph 55 of the Application that there is no effective competition on overlap routes. In an article in the *Globe & Mail* dated July 6, 2011, and reflecting the ease with which airlines can enter or expand service on Transborder Routes, it was reported that Porter Airlines would begin to provide non-stop services on a sixth route, Toronto-Washington (which is entirely inconsistent with the Commissioner's assertions in

paragraph 54a of the Application). Such service would further increase the presence of non-legacy carriers on overlap routes.

106. In addition to the actual non-stop competition from legacy and non-legacy carriers on overlap routes, the Commissioner's allegations also ignore competition from connecting service. Contrary to the Commissioner's allegations, given the increasingly price-sensitive nature of many passengers, the existence of connecting service options serve to restrain price increases on non-stop Transborder Routes, particularly those involving long-haul flights (over 1200 miles), such as Vancouver-New York and Toronto-Denver.

107. The Application also fails to take into account the existence of U.S. border airports in close driving proximity to Vancouver, Toronto, and Montreal, which as direct substitutes for the services have seen substantial increases in traffic from Canadian passengers driving across the border to take domestic U.S. flights rather than transborder flights in the past few years. The increasing price sensitivity of air transportation customers, who have options to use U.S. border airports instead of departing from Canada, also serves to restrain price increases on Transborder Routes.

108. The Application further completely ignores the existence of additional potential competition, either by expansion or by entry on the overlap routes.

2. There are No Material Barriers to Entry or Expansion

109. The Commissioner's assertions at paragraphs 7 and 56 of the Application that (the Respondents' potential and) actual competitors on the overlap routes "are significantly constrained by barriers to entry or expansion", such that "timely and viable entry" is "unlikely to occur" on those routes, are simply wrong. There has been substantial entry and growth of non-legacy carriers in the last several years, and further entry and expansion of transborder service by these carriers and other new entrants is likely on Transborder Routes.

Moreover, expansion is readily available as carriers already offering service on routes can readily “upgauge” (use a larger aircraft) to increase capacity even without additional slots.

110. There is no factual basis for the Commissioner’s assertion at paragraph 54 of the Application that “[t]o operate on a viable scale, a potential entrant requires an ability to attract feeder traffic at both ends of the route.” That assertion is flatly contradicted by actual experience of entry and expansion on overlap routes. New non-legacy Canadian carriers, in particular WestJet and Porter, have entered and grown their shares of transborder service using a “point-to-point” business model which is predicated on stimulating substantial local traffic and is not dependent on connecting traffic to or from hub airports. Using this point-to-point model, WestJet and Porter have substantially increased and continue to increase the number of Transborder Routes on which they offer service.

111. In addition, non-legacy carriers have successfully entered all of Air Canada’s and United/Continental’s hub airports, and all of United/Continental’s hub-to-hub routes. In the past decade, non-legacy carriers’ share of passengers has grown very substantially at United/Continental’s hub airports, by way of example now reaching more than 50% in Denver and more than 30% in New York. This successful entry by non-legacy carriers demonstrates that the assertion that network carriers’ concentration of traffic into hubs creates effective barriers to entry or expansion is simply wrong. Moreover, the presence of non-legacy carriers at hub airports on one or both ends of Transborder Routes disciplines fares on those routes, whether or not the particular route is currently served by the non-legacy carrier.

112. The Commissioner’s assertions at paragraph 54 of the Application that frequent flyer programs and alleged incentives “towards exclusivity in corporate customer contracts” create “significant switching costs” are also unfounded. The entrance and growth of non-

legacy carriers at hub cities in Canada and the U.S. demonstrate that frequent flyer loyalty programs and other "incentives" do not cause customers to eschew lower priced alternatives. The ease and willingness of customers to switch carriers on Transborder Routes constrain the Respondents' ability to raise prices on all overlap routes and would continue to do so if the TBJV is implemented. Moreover, both WestJet and Porter have their own internal rewards programs which may make it more attractive for customers to switch.

113. In addition, the Commissioner's allegations that barriers to "effective entry or expansion" are created by "insufficient capacity" at "certain airports," which purportedly impedes "access to take-off and landing slots" on overlap routes, are factually wrong. There are no material slot constraints at any of the airports on the overlap routes. All of the Canadian and most of the U.S. airports on those routes have available slot capacity, which can be acquired by new entrants. Even for the few U.S. airports (in the New York City area) in respect of which slot access is regulated by the U.S. Federal Aviation Administration (FAA), air carriers seeking to add departures and landings at these airports have been able to obtain slots either from the FAA or through an active secondary market in which new carriers can obtain access to take-off and landing slots, thus permitting carriers to enter or add capacity at those airports as well. Furthermore, virtually all of the carriers operating passenger air transportation services on the Transborder Routes, as well as large U.S. non-legacy carriers that are well positioned to enter into transborder service should they choose to do so, have substantial slot holdings at one or more of the New York airports (including Delta, which recently acquired slots in New York) and easily could enter on a Transborder Route from that airport to a Canadian destination if they so choose. The Commissioner's Application ignores the fact that competitive discipline derives not only from actual entry but also from the threat of entry from credible poised entrants.

114. Moreover, the Commissioner's position on the lack of potential entry by competitors on overlap routes is inconsistent with the position the Commissioner has previously taken on the ability of airlines to redeploy their resources to more profitable uses quickly in response to market conditions. In prior proceedings against Air Canada before the Competition Tribunal, the Commissioner asserted that "[a]irlines can and do adjust capacity in a market rapidly ... because the essence of their business consists of moving their principal resources - aircraft, pilots and flight attendants - from place to place".⁵ The Commissioner similarly argued before the Tribunal that airlines can avoid costs and take advantage of profitable opportunities by redeploying aircraft and other resources from one flight or route to another, and the Commissioner's position that redeployment opportunities were relevant to assessing avoidable costs and pricing in airline markets was embodied in the Bureau's draft Enforcement Guidelines on Abuse of Dominance in the Airline Industry. The assertion at paragraph 56 of the Application that "timely and viable entry" by potential competitors is "unlikely to occur" on any of the overlap routes in response to a hypothetical non-transitory anti-competitive price increase by the Respondents, therefore, is fundamentally at odds with the position the Commissioner has previously asserted, emphasizing redeployment opportunities and the ability of Air Canada's rivals "to make changes to its operations quickly".⁶

115. In light of the strong existing competition and the significant prospect of additional competition faced by the Respondents on all of the overlap routes, and the absence of barriers deterring the ability of legacy and non-legacy carriers to enter and/or expand

⁵ *Commissioner of Competition v. Air Canada*, CT-2001/02, Commissioner's Final Argument, February 26, 2002, at para. 71

⁶ *Commissioner of Competition v. Air Canada*, CT-2001/02, Commissioner's Final Argument, February 26, 2002, at para. 445

services on those routes, the Respondents do not have, and would not have if the TBJV or other aspects of the Alliance Agreements were implemented, the market power to impose and sustain a profitable non-transitory fare increase on the overlap routes or the Transborder Routes as a whole.

H. The Alliance Agreements and the TBJV Create Substantial Gains in Efficiency

116. The Alliance Agreements have resulted in substantial gains in efficiency. In particular, they have resulted in efficiencies by increasing the number of routes served, increasing flight frequencies and reducing (without eliminating) double marginalization. Other efficiencies created by the Alliance Agreements which are of significant benefit to consumers include and result from harmonized seat sales, pricing structures and fare rules, a variety of joint fare discounts, joint frequent flyer program incentives, and marketing initiatives covering Transborder Routes. Moreover, the implementation of the TBJV (and, by extension, certain provisions of the Alliance Agreements that thus far have not been implemented), are expected to lead to significant additional gains in efficiency.

117. As discussed above, the Alliance Agreements and the TBJV are expected to result in numerous consumer benefits, including more streamlined and harmonized fare products (with respect to fares, fare rules, surcharges, booking classes and baggage services, among others), lower fares through the substantial elimination of double marginalization on interline flights, improved connection times, and more choice in destination and scheduling options, which would not be achieved if the orders sought by the Commissioner were granted. These benefits have been recognized by numerous independent Canadian travel agencies that have sent letters to the Commissioner and Air Canada expressing their support for the TBJV (and opposition to the Application), which emphasize the significant pricing,

product and service benefits that alliance coordination among airlines has brought, and the TBJV is expected to bring, to Canadian consumers.

118. The Alliance Agreements and the TBJV are also expected to result in significantly increased traffic volumes, and thus output, across the Respondents' networks. After implementation of the TBJV, passengers flying from Canada on Transborder Routes will be able to connect through metal neutral service to an additional 161 airports served by Continental or United, which are not served by Air Canada, and passengers flying from one of those 161 airports via a Transborder Route to Canada will be able to connect to an additional 45 Canadian airports served by Air Canada that are not served by Continental or United. This would result in over 7,200 online O&D pairings with metal neutral service created through the TBJV. Consumers will experience more convenient flight connections, a greater choice of schedules, aligned fare rules, and an increase in the number of competitors on these O&D pairings, which can be expected to increase travel significantly on these routes.

119. Increased demand flowing from the elimination of double marginalization will lead to an increase in "load factors" (the percentage of seats filled on an airplane) on transborder flights. Greater load factors will enable the Respondents to add capacity on existing Transborder Routes, either by adding flights or upgauging to larger aircraft, or both. The efficiencies created by the implementation of the Alliance Agreements through the TBJV would also allow the Respondents to add new Transborder Routes which would not otherwise be economically feasible for any Respondent to operate on its own.

120. The Alliance Agreements and the TBJV will also create substantial gains in efficiency flowing from significant fixed and variable cost savings that will be enabled through the implementation of the TBJV, including with respect to labour, fuel and maintenance costs,

and landing and terminal fees. By increasing load factors and optimizing the size of aircraft deployed on Transborder Routes, the implementation of the Alliance Agreements through the TBJV will allow the Respondents to free up aircraft and complementary resources to be redeployed elsewhere on their networks to serve new passengers or in the economy. The substantial gains in such "field operations" efficiency would not be expected to be realized by the Respondents in the absence of the deeper integration made possible by the TBJV.

121. The significant gains in efficiency described in this section would more than offset any alleged lessening or prevention of competition (which lessening or prevention is denied) from the Alliance Agreements and the TBJV. The Alliance Agreements and the TBJV will provide real benefits to Canadian consumers and the Canadian economy which would not be expected to be realized if the relief requested by the Commissioner is granted.

PART IV - STATEMENT OF ECONOMIC THEORY

122. As set out in Schedule "A" hereto.

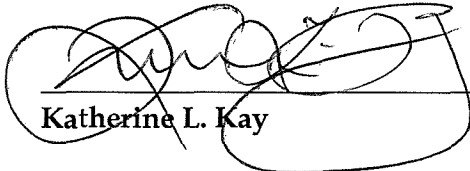
PART V - RELIEF SOUGHT

123. Air Canada requests an Order dismissing the Application with costs payable to Air Canada in an amount to be determined by the Tribunal after hearing submissions from the parties.

PART VI - PROCEDURAL MATTERS

124. Air Canada agrees that the Application be heard in English, in Ottawa.
125. Air Canada agrees that documents be filed electronically.

DATED at Toronto, this 15th day of August, 2011



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SCHEDULE "A"

AIR CANADA'S CONCISE STATEMENT OF ECONOMIC THEORY

Introduction

1. The Alliance Agreements and the TBJV do not, and would not likely, lessen or prevent competition substantially in the provision of passenger air transportation service.
2. In addition, the Alliance Agreements have generated and, with the TBJV, are likely to generate substantial further gains in efficiency and provide real benefits to Canadian consumers and the Canadian economy. These efficiencies would be greater than, and would more than offset, any lessening or prevention of competition (which lessening or prevention is denied) from the arrangements which are challenged in the Application, but these efficiencies likely would not be attained if any of the orders requested by the Commissioner are made.
3. This Concise Statement of Economic Theory is to be read in conjunction with the Response.

Market Definition

4. The Commissioner alleges that the relevant market for the assessment of any competitive effects is direct passenger air transportation service between city pairs involving an end point in each of Canada and the U.S. This leads the Commissioner to focus exclusively on effects related to a limited number of city-pair routes on which the Respondents currently provide overlapping non-stop service. The Commissioner expressly denies that "indirect" flights (referred to as "connecting" flights in the industry, which involve one or more connections between a particular city pair involving an end point in each of Canada and the U.S.) are a close substitute for direct (non-stop) passenger air transportation service on Transborder Routes.

5. The Commissioner's approach to these issues ignores the proper economic framework for analyzing the relevant market and pro-competitive effects of the Alliance Agreements and the TBJV.

6. The relevant product market is the market for the supply of passenger air transportation service. Passenger air transportation service on a city-pair route is the typical starting point for a competition analysis of a relevant product market in the airline business. However, the Commissioner's Application examines only the city-pair routes, which is too narrow a focus and not a sound economic approach.

7. The Respondents are legacy "network carriers", which compete against numerous competitors including other network carriers which also offer transborder service. A large component of the value they provide to consumers is the comprehensive domestic, North American and global networks they provide and connect to, which allow passengers to consume the widest range of high quality output. As in any such network, it is simply an error in economic policy to assess market power or competitive effects while looking at only a narrow aspect of the network.

8. In addition, the Commissioner does not take into account the discipline imposed by competitors offering connecting service. Connecting transborder service falls within the same product market for at least some passengers and markets and provides a competitive constraint on non-stop transborder service. The discipline exerted by competitors offering connecting service is very real; ignoring it distorts any market definition or market analysis.

9. The Commissioner also does not consider the competitive impact of U.S. border airports, which serve as a viable option for many transborder travellers and are properly included within the relevant geographic market. For example, passengers in Southern Ontario are increasingly travelling to Buffalo, New York to take a flight originating from

there, rather than taking a transborder flight originating from Toronto. More generally, the ability (and willingness) of passengers to choose between different cities and routes when making their transborder travel plans further illustrates that the Commissioner's exclusive focus on specific "city pairs" is inappropriate.

No Substantial Lessening or Prevention of Competition on Overlap Routes

10. The Alliance Agreements and the TBJV will not lessen or prevent competition substantially in the supply of passenger air transportation service, as they do not create, preserve, maintain or enhance market power on the part of the Respondents. The Respondents will continue to face significant competition from other network and non-network carriers. The Alliance Agreements and the TBJV will not allow the Respondents to behave independently of the market or to profitably increase and sustain prices for transborder service above levels that would have prevailed in the absence of the Alliance Agreements and/or the TBJV.

11. Even with respect to the limited number of overlap routes served by the Respondents, the Commissioner's assertion that the TBJV would provide "sufficient scope" for the Respondents "to unilaterally exercise market power" is fundamentally wrong as a matter of economics.

12. On the overlap routes identified by the Commissioner (including those purported "overlap routes" on which non-stop service is not even offered by both Air Canada and either United or Continental), the Respondents face actual or potential non-stop service competition, and actual connecting service competition, from legacy and non-legacy carriers, which do and will continue to discipline pricing on these routes.

13. The Commissioner also erroneously asserts that actual or potential competitors are "significantly constrained by barriers to entry or expansion", including "airport capacity

constraints” and frequent flyer and other incentive programs. In addition to existing competition from U.S. legacy carriers offering transborder service between Canada and the U.S., transborder service has been characterized by wide-ranging new entry and by substantial growth of non-legacy carriers. This experience demonstrates that there are no effective barriers to entry on the overlap routes, including no material slot constraints. Moreover, air carriers that presently offer service on overlap routes face no material barriers to expansion. Carriers already offering service on routes can easily upgauge aircraft to increase capacity even without additional slots, while slots are in fact readily available to carriers operating out of cities served by each of the overlap routes. In any event, the mere threat of entry by well-positioned competitors is sufficient to make a substantial lessening or prevention of competition unlikely.

The TBJV and Alliance Agreements Provide Substantial Gains in Efficiency

14. The gains in efficiency likely to be achieved through the Alliance Agreements and the TBJV are greater than, and will more than offset, the effects of any lessening or prevention of competition (which is denied), and these efficiencies would not likely be achieved if the orders requested by the Commissioner are made.

15. While the existing Alliance Agreements, to the extent they have been implemented, have generated efficiencies and consumer benefits, deeper implementation of the Alliance Agreements, including implementation of the TBJV, involves a more integrated relationship that will allow the Respondents to realize significant additional efficiencies and create substantial additional benefits for consumers flowing from the achievement of metal neutrality within the TBJV.

16. The pro-competitive economic benefits sought to be achieved by metal neutral transborder joint ventures such as the TBJV are well documented in the economics literature

and have been amply demonstrated by experience in the industry. Such joint ventures result in lower costs, better service and lower fares for consumers. They also stimulate passenger demand, resulting in new direct routes, increased flight frequencies, greater capacity, and increased passenger volume for the airlines, as synergies from the integrated joint venture are realized over time.

17. Building on the Alliance Agreements, the TBJV will create additional efficiencies and lower prices for passengers by, among other things, substantially eliminating the imposition of successive mark-ups on airline tickets involving flight segments operated by different carriers (*i.e.*, interline flights), referred to in economics as the “double marginalization” problem. Double marginalization results in higher fares (and lower demand and output) than would be optimal if an effectively single entity were responsible for determining the price on the flights. While lesser forms of integration between carriers can reduce double marginalization on interline flights to a certain extent, the inefficiencies created by double marginalization cannot fully be addressed without integrated pricing and revenue sharing between the carriers.

18. Substantial other efficiencies have been realized with the Alliance Agreements and will be realized to a greater extent with the TBJV, including: efficiency gains that result from more efficient resource use, reduced costs, reduced prices, increased output, and an improvement in the quality of output; passenger benefits resulting from more harmonized fare products, more convenient metal neutral schedules; schedule optimization and more efficient deployment of aircraft and complementary resources; and increases in the number of online offerings and new non-stop offerings.

THE COMPETITION TRIBUNAL

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

IN THE MATTER OF the proposed transborder joint venture between Air Canada and United Continental Holdings, Inc.;

AND IN THE MATTER OF the "Marketing Cooperation Agreement" between Air Canada and United Air Lines, Inc.;

AND IN THE MATTER OF the "Alliance Expansion Agreement" between Air Canada and United Air Lines, Inc.;

AND IN THE MATTER OF the "Air Canada/Continental Alliance Agreement" between Air Canada and Continental Airlines Inc.;

AND IN THE MATTER OF an Application by the Commissioner of Competition for one or more Orders pursuant to sections 90.1 and 92 of the *Competition Act*.

THE COMMISSIONER OF COMPETITION

Applicant

- and -

AIR CANADA, UNITED CONTINENTAL HOLDINGS, INC., UNITED AIR LINES, INC., and CONTINENTAL AIRLINES INC.

Respondents

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