

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.;

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;

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*.

B E T W E E N :

COMPETITION TRIBUNAL TRIBUNAL DE LA CONCURRENCE FILED / PRODUIT August 15, 2011 Jos LaRose for / pour REGISTRAR / REGISTRAIRE	
OTTAWA, ONT	# 16

THE COMMISSIONER OF COMPETITION

Applicant

- and -

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

Respondents

**RESPONSE OF UNITED CONTINENTAL HOLDINGS, INC.,
UNITED AIR LINES, INC. AND CONTINENTAL AIRLINES, INC.**

OVERVIEW OF RESPONSE

1. This is the Response of United Continental Holdings, Inc. (“UCH”), United Air Lines, Inc. (“United”) and Continental Airlines, Inc. (“Continental”) (collectively, the “UCH Respondents”) to the Application of the Commissioner of Competition (“Commissioner”) to unwind longstanding agreements between United and Air

Canada (the “AC-United Alliance Agreements”) and the bilateral agreement between Continental and Air Canada (the “AC-CO Alliance Agreement”, together with the AC-United Alliance Agreements, the “Alliance Agreements”), as well as to prevent a proposed transborder joint venture between the Respondents (the “TBJV”) which in effect implements the Alliance Agreements.

2. The Commissioner’s Application is based on fundamental misconceptions respecting the airline industry and in particular the nature and effect of cooperation between airlines. A combination of factors – including adverse economic conditions and events specifically affecting the airline industry, the liberalization of the regulatory environment governing international passenger air transportation services, international treaties between countries, including between Canada and the U.S., embracing coordination between air carriers, and entry and expansion by non-legacy carriers in the market – have forced carriers, particularly legacy carriers (including the Respondents), to search for opportunities to lower their costs and to operate more efficiently, such as through alliances, joint ventures and mergers (where mergers are not prohibited by foreign ownership restrictions).
3. The Commissioner mistakenly claims that the Respondents are entering into the TBJV in order to share the revenues resulting from their reduced competition with one another. This is flatly wrong. The TBJV will not generate revenues because of reduced competition between the Respondents. Rather, the TBJV is designed to increase demand for the Respondents’ services on routes that originate in the U.S. and terminate in Canada or vice versa (“Transborder Routes”) by, among other things, allowing for the development of a more comprehensive network, increasing flight

frequencies, optimizing schedules and reducing prices. This increased demand will improve economies of density on the Respondents' networks and increase overall profitability, while delivering substantial benefits to consumers.

4. The benefits of alliances in the airline industry have long been recognized. Indeed, in 1997, the U.S. Department of Transportation ("U.S. DOT") granted an order conferring antitrust immunity ("ATI") upon United and Air Canada for transborder passenger air transportation service coordination under the AC-United Alliance Agreements. In granting ATI, the U.S. DOT found that coordination of United and Air Canada's passenger air transportation services on 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 U.S. and Canada. In 1996, the Canadian Competition Bureau also issued a favourable Advisory Opinion with respect to the AC-United Alliance Agreements. Similarly, in 2009, the U.S. DOT amended an existing order of ATI to include Continental among the Star Alliance carriers granted ATI and to approve the Atlantic Plus-Plus ("A++") joint venture, finding that the resulting increased integration among the carriers would provide substantial additional benefits for consumers. The Commissioner's Application is out of step with the treatment given to metal neutral joint ventures by many other regulatory agencies around the world.
5. The Commissioner now seeks to unwind the AC-United Alliance Agreements which have facilitated cooperation between United and Air Canada for approximately 15 years and which have led to many benefits, including a substantial expansion of

service on Transborder Routes, service on new non-stop Transborder Routes, improved product quality, the addition of service on new origin and destination pairs and routings connecting them, significant growth in daily flights and total airline passengers on Transborder Routes, 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. The Commissioner also seeks to unwind the AC-CO Alliance Agreement and she seeks to prevent the implementation of the TBJV. The orders sought by the Commissioner, if issued, would stifle the resultant public benefits that have been and will be derived through the Alliance Agreements and the TBJV.

6. Moreover, the orders sought by the Commissioner are inconsistent with the purposes of the *Competition Act*, as set out in section 1.1 of the *Act*, because, among other things, they would have the effect of reducing product choices for consumers and increasing the cost of air travel.
7. The Alliance Agreements and the TBJV do not, and are not likely to, prevent or lessen competition substantially. Rather, they enable substantial consumer benefits including enhanced choice and greater convenience in passenger air travel. Moreover, the gains in efficiency that have arisen and are likely to arise from the Alliance Agreements and the TBJV are greater than, and more than offset, any prevention or lessening of competition (which lessening or prevention is denied), and such efficiencies would not be achieved if any of the orders sought by the Commissioner are issued by the Competition Tribunal.

PART I - GROUNDS ON WHICH THE APPLICATION IS OPPOSED

8. The UCH Respondents adopt the grounds on which the Application is opposed set out in paragraphs 7 to 27 of the Air Canada Response.

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

9. The UCH Respondents deny all allegations contained in the Application of the Commissioner, except as admitted expressly below.

PART III - MATERIAL FACTS RELIED ON BY THE UCH RESPONDENTS**A. THE RESPONDENTS****1. UCH**

10. UCH is a U.S.-based holding company, incorporated as UAL Corporation on December 30, 1968, not on October 1, 2010, as alleged by the Commissioner in paragraph 15 of the Application.
11. On October 1, 2010, a wholly-owned subsidiary of UAL Corporation merged with and into Continental, with Continental surviving as a wholly-owned subsidiary of UAL Corporation. At such time, UAL Corporation changed its name to UCH. The Commissioner reviewed that transaction and confirmed to counsel by way of a letter dated July 2, 2010 that she did not have sufficient grounds on which to apply to the Competition Tribunal under section 92 of the *Competition Act* with respect to the merger. Since the transaction, United and Continental have operated under common ownership and have worked to integrate their operations with the plan to create a single airline with a better network for consumers.

12. Contrary to what is suggested by the Commissioner at paragraph 17 of the Application, UCH's regional partners are not "affiliates" of United or Continental as that term is defined in subsection 2(2) of the *Competition Act*. UCH's regional partners are independent corporate entities, not controlled by any of the UCH Respondents within the meaning of subsection 2(4) of the *Competition Act*.
13. United and Continental, together with their regional partners, serve 364 destinations including seasonal service with 5,528 daily flights on average. The network includes over 350 airports, including the ten hub airports listed by the Commissioner in paragraph 17 of the Application.
14. As of August 2011, United, including its regional partners, operate non-stop passenger air transportation services on 28 Transborder Routes. Continental, including its regional partners, operate non-stop passenger air transportation services on 15 Transborder Routes. As is set out in paragraph 102 of the Air Canada Response, which the UCH Respondents adopt, Air Canada operates direct passenger air transportation services on 17 of these Transborder Routes, not 19 as stated by the Commissioner at paragraph 18 of the Commissioner's Application.

2. Air Canada

15. The UCH Respondents adopt the description of Air Canada set out in Part III A of the Air Canada Response.

B. THE AGREEMENTS AMONG THE RESPONDENTS

16. The UCH Respondents adopt paragraphs 34 to 42 of the Air Canada Response with respect to the Alliance Agreements. The UCH Respondents adopt paragraphs 43 to 50 of the Air Canada Response with respect to the TBJV.

17. ATI extends to the Alliance Agreements. In particular, in 1997 the U.S. DOT issued an order extending ATI to Air Canada and United on transborder passenger air transportation service coordination (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). In 2009, the U.S. DOT amended an existing order of ATI to include Continental among the Star Alliance carriers granted ATI, which included coordination with Air Canada with respect to transborder passenger air transportation services (except with respect to existing carve outs and 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 Cleveland and Toronto, Houston and Calgary, Houston and Toronto, and New York/Newark and Ottawa).

18. The U.S. DOT determined, after extensive consultations, that transborder coordination between Air Canada and each of United and Continental would benefit the public by providing better service and enabling them to operate more efficiently, and would significantly increase competition and service opportunities for millions of transborder passengers travelling from origin cities “behind” and to cities “beyond” gateway

airports in the U.S. and Canada. The orders granting ATI to the Respondents in respect of transborder coordination between Air Canada and each of United and Continental extend ATI to the Alliance Agreements including subsidiary agreements such as the TBJV, subject to the DOT submission requirement.

19. Moreover, while the U.S. DOT imposed very limited “carve outs” in its grant of ATI to the Alliance Agreements between Air Canada and each of United and Continental, it has recognized that carve outs are not desirable in the case of metal neutral joint ventures. The U.S. DOT has consistently found that where an integrated metal neutral joint venture is present, carve outs inhibit the realization of efficiencies, which ATI is designed to enable.

C. PASSENGER AIR TRANSPORTATION SERVICES INDUSTRY

20. As is set out in paragraphs 51 to 76 of the Air Canada Response, which the UCH Respondents adopt (except the last sentence in paragraph 53 and paragraphs 57-59, which contain information of which UCH has no knowledge), the air transportation services industry has faced, and continues to face, significant adverse economic conditions over at least the past twenty-five years and operates in an intensely competitive environment for network air carriers such as the UCH Respondents in the provision of their domestic (U.S.), Canada-U.S. transborder, and international passenger air transportation services.

1. Competition with Non-Legacy Carriers

21. The Respondents and other legacy carriers face competition from the continued growth of new entrants and low cost carriers in North America and elsewhere (“non-legacy carriers”).
22. Following domestic airline deregulation in the U.S. (in 1978), Canada (in the 1980s) and elsewhere, new entrants were freed of certain capacity, pricing and geographical regulatory constraints and rapidly developed the knowledge and experience to compete fiercely with the legacy network carriers in Canada, the U.S. and elsewhere. Non-legacy carriers typically focus on high density routes, which includes most hub-to-hub routes, to maximize profitability within certain segments of the overall passenger air transportation services market. Indeed, contrary to what is suggested in paragraph 54a of the Commissioner’s Application, the growth of non-legacy carriers at cities such as Denver, New York/Newark and Washington D.C., where the UCH Respondents operate hubs, has been particularly strong.
23. Non-legacy carriers have grown rapidly and have dramatically altered the competitive landscape. Competition from non-legacy carriers, often through discounted pricing policies, has placed significant downward pressure on prices on routes they have entered and on routes they are positioned to enter (even where no entry has been planned or announced).

2. Competition with Other Legacy Carriers

24. There have been many mergers within the global airline industry with the result being that many major international carriers have expanded the size and geographic scope of

their operations. National and global carriers that have developed much more extensive networks via consolidation include, in addition to United and Continental, Air France/KLM, Delta/Northwest, and British Airways/Iberia.

25. A further development in the competitive landscape is a dramatic increase in the number of alliances entered into by network carriers to increase the scope of their service offerings to consumers and to enhance economies of density. Alliances in the passenger air transportation services industry take many forms and may involve many different degrees of integration. The greatest degree of integration comes in the form of metal neutral joint ventures which maximize the benefits of cooperation by fully aligning partner carriers' incentives and enabling them to provide the best possible service to customers, while at the same time maximizing the efficiencies generated.
26. The Respondents, who are founding members of the Star Alliance network, face worldwide competition at the alliance level from the 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 Lines, Air France/KLM, Alitalia and Korean Air, among other carriers).
27. In the past five years, oneworld and SkyTeam have announced implementation of several metal neutral joint ventures following receipt of required antitrust and regulatory approvals. The Respondents and Deutsche Lufthansa AG are also themselves parties to the A++ metal neutral agreement, which received ATI from the U.S. DOT in July 2009 and in respect of which the Commissioner issued an advance ruling certificate pursuant to subsection 102(1) of the *Competition Act* in October

2009. Carriers within each of the three alliances also have formed trans-Pacific joint ventures, as well as other regional joint ventures, including Europe-Asia and U.K.-Australia services. Metal neutral joint ventures are also entered into outside main alliances, a recent example being the joint venture between Etihad Airways and Virgin Blue, and also can be entered into between a member and a non-member of an alliance, such as the trans-Pacific joint venture between Delta Air Lines and Virgin Blue.

3. Metal Neutral Joint Ventures

28. Contrary to what is pleaded by the Commissioner in paragraph 38 of the Application, metal neutral joint venture agreements, including the TBJV, do not involve the sharing of revenues because of reduced competition. Rather, under a metal neutral joint venture agreement, parties work together to grow their respective networks and to attract passengers by offering better, more convenient service and adding new routes and increasing capacity on existing routes. The aim of metal neutral joint ventures is not to reduce competition, but to attract more passengers by offering them the best possible product offering.

29. Metal neutral joint ventures give passengers the widest range of potential alternative travel options at competitive prices, as each party is indifferent as to whether a passenger travels on its own aircraft or that of its joint venture partner. This accelerates the growth of the parties' networks and offerings, increases economies of density, and delivers better value to consumers.

30. Consumers benefit from metal neutral joint venture agreements, including through optimized schedules, shorter connection times, more efficient routing, more fare options, and more integrated frequent flier program coordination. Metal neutrality also results in lower prices for consumers. Metal neutral joint ventures thereby increase the value delivered to consumers, while capturing revenue and cost benefits from additional traffic.
31. Competition and transportation agencies around the world (“Global Competition/Regulatory Agencies”) have recognized that metal neutral joint ventures result in lower prices. For example, the Australian Competition and Consumer Commission (the “ACCC”) determined, in its approval of a metal neutral joint venture between Virgin Blue and Air New Zealand, that the alliance was likely to result in the “potential for lower fares as a result of cost savings and efficiency improvements through removal of double marginalization and higher load factors”. Similarly, the U.S. DOT, in commenting on the fact that the metal neutral joint venture between oneworld alliance members American Airlines, British Airways, Iberia, Finnair, and Royal Jordanian would allow the carriers the ability to cooperatively price itineraries, noted that this was “likely to significantly reduce fares on ‘interline’ routes ... which benefits consumers and the alliance as a whole”. These conclusions are supported by substantial economic empirical literature finding that airline alliances tend to reduce fares, and that greater levels of integration are associated with greater reduction in fares.
32. Global Competition/Regulatory Agencies also have found that metal neutral joint ventures provide increased consumer utility through enhanced quality options. The

ACCC recognized that the joint venture between Virgin Blue and Air New Zealand likely would result in “material public benefits in the form of: enhancement of the applicants’ products and services offering (including increased access to existing frequencies, increased online connection options, better schedule spread, enhanced value added services and new frequencies) and associated consumer choice...”. Similarly, in granting ATI to the A++ joint venture, the U.S. DOT stated that, “joint venture agreements give passengers access to certain fares or itinerary routing options not previously offered”.

33. Global Competition/Regulatory Agencies also recognize that metal neutral joint ventures result in substantial cost and network efficiencies, and that these efficiencies would not be achievable in the absence of such metal neutral joint ventures. For instance, the U.S. DOT noted in granting ATI to the A++ joint venture that “metal neutrality is also a prerequisite for many cost benefits and synergies obtainable through immunized alliances, such as those obtained by combining sales forces, achieving sales targets for airline representatives for all flights operated by the alliance members, and combining sales, reservation, and distribution infrastructure to reduce costs,” and stated that the A++ joint venture, “pools resources to achieve substantial efficiencies through cost savings”.
34. Accordingly, the Commissioner’s assertions at paragraph 6 of the Application that the Respondents “... will share the increased revenues that result from [the] elimination of competition” and at paragraph 38 that the Respondents “... will share the revenues resulting from their reduced competition with one another” are not only without foundation but are also out of step with the treatment given to metal neutral joint

ventures by Global Competition/Regulatory Agencies. Although these decisions are not binding on the Tribunal and were not rendered under the *Competition Act*, they demonstrate that the Commissioner's assertion regarding the Respondents' underlying rationale for the Alliance Agreements and TBJV is not consistent with the conclusions of numerous Global Competition/Regulatory Agencies regarding the purpose and effects of similar agreements.

D. LEGAL FRAMEWORK

35. The UCH Respondents adopt paragraphs 77 to 84 of the Air Canada Response with respect to the legal framework.

E. RELEVANT MARKET

36. The UCH Respondents adopt paragraphs 85 to 89 of the Air Canada Response with respect to the relevant market.

F. THE ALLIANCE AGREEMENTS AND TBJV ARE PRO-COMPETITIVE

37. As pleaded above, metal neutral joint venture agreements are increasingly prevalent in the airline industry because they provide benefits to consumer and are pro-competitive. As to the Alliance Agreements and the TBJV in particular, the UCH Respondents adopt paragraphs 90 to 99 of the Air Canada Response with respect to the pro-competitive nature of these agreements.

G. NO SUBSTANTIAL LESSENING OR PREVENTION OF COMPETITION ON TRANSBORDER ROUTES

38. Contrary to what is pleaded by the Commissioner at paragraphs 42 to 62 of her Application, the Alliance Agreements and the TBJV have not resulted and will not likely result in a substantial prevention or lessening of competition. The UCH Respondents adopt paragraphs 100 to 115 of the Air Canada Response in this respect.

H. THE ALLIANCE AGREEMENTS AND THE TBJV ARE DESIGNED TO CREATE SUBSTANTIAL GAINS IN EFFICIENCY

39. The UCH Respondents adopt paragraphs 116 to 121 of the Air Canada Response with respect to the gains in efficiencies, and state that the gains in efficiency resulting from the Alliance Agreements thus far and those that are likely to result from implementation of the TBJV would more than offset any alleged lessening or prevention of competition (which lessening or prevention is denied) from the Alliance Agreement and the TBJV.

PART IV - STATEMENT OF ECONOMIC THEORY

40. The UCH Respondents adopt the statement of economic theory set out in Schedule “A” of the Air Canada Response.

PART V - RELIEF SOUGHT

41. The UCH Respondents request an Order dismissing the Application with costs payable to the UCH Respondents in an amount to be determined by the Tribunal after hearing submissions from the parties.

PART VI - PROCEDURAL MATTERS

42. The UCH Respondents agree that this Application be heard in English, in Ottawa.
43. The UCH Respondents agree that documents be filed electronically.

Dated at Toronto, Ontario, this 15th day of August, 2011.

BLAKE, CASSELS & GRAYDON LLP
Barristers & Solicitors
4000 Commerce Court West
199 Bay Street
Toronto, Ontario M5L 1A9

Ryder Gilliland
Phone: (416) 863-5849
Email: ryder.gilliland@blakes.com

Jason Gudofsky
Phone: (416) 863-3184
Email: jason.gudofsky@blakes.com

Randall Hofley
Phone: (416) 863-2387
Email: Randall.hofley@blakes.com

Micah Wood
Phone: (416) 863-4164
Email: micah.wood@blakes.com

Fax: (416) 863-2653

Counsel for the Respondents, United
Continental Holdings, Inc., United Air
Lines, Inc. and Continental Airlines, Inc.

TO: **BABIN BARRISTERS LLP**
65 Front Street East, Suite 101
Toronto, ON M5E 1 B5

Edward J. Babin
Cynthia L. Spry
Tel: (416) 637-3294
Fax: (416) 637-3243

AND TO: **DEPARTMENT OF JUSTICE CANADA**
Competition Bureau, Legal Services
Place du Portage, Phase I
50 Victoria Street, 22nd Floor
Gatineau QC KIA OC9

William J. Miller
Tel: (819) 953-3903
Fax: (819) 953-9267

Counsel for the Commissioner of Competition

AND TO: **Stikeman Elliott LLP**
5300 Commerce Court West
199 Bay Street
Toronto, Ontario M5L 1B9

Katherine L. Kay
Eliot N. Kolers
Mark E. Walli

Counsel for the Respondent, Air Canada

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BLAKE, CASSELS & GRAYDON LLP
Barristers & Solicitors
Box 25, Commerce Court West,
Toronto, Ontario M5L 1A9
Fax: (416) 863-2653

Ryder Gilliland
Tel: (416) 863-5849 / email: ryder.gilliland@blakes.com

Jason Gudofsky
Tel: (416) 863.3184 / email: jason.gudofsky@blakes.com

Randall Hofley
Tel: (416) 863.2387 / randall.hofley@blakes.com

Micah Wood
Tel: (416) 863.4164 / micah.wood@blakes.com

Counsel for the Respondents, United Continental Holdings Inc., United Air Lines, Inc. and Continental Airlines, Inc.