CT-2011-004

THE COMPETITION TRIBUNAL

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

AND 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

THE COMMISSIONER OF COMPETITION

Applicant

-AND-

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

Respondents

REPLY OF THE COMMISSIONER OF COMPETITION TO THE RESPONSES OF AIR CANADA, UNITED CONTINENTAL HOLDINGS, INC., UNITED AIR LINES, INC., AND CONTINENTAL AIRLINES, INC.

I. Overview

1. The Responses of Air Canada and UCH[1], United, and Continental (collectively, the "UCH Respondents") materially misrepresent the purpose of the Commissioner's Application and the relief sought therein. Air Canada's appeal to nationalistic sympathies, suggesting that competition policy should support a "national champion" in the "international air transportation world" – by permitting monopolistic prices, reduced service, and less consumer choice – is contrary to the Act and, in any event, exceeds this Tribunal's jurisdiction.

2. In contrast to what is claimed, the Commissioner does not seek to prevent a continued alliance relationship among the Respondents. Rather, the Commissioner seeks to prohibit the Respondents from engaging in specific business activities that will enable them to exercise market power to prevent or lessen competition substantially on Transborder Routes that are vitally important to the Canadian economy and key to the Canadian travelling public.

3. The business activities proposed by the Respondents, including "net revenue"/profit sharing and price and capacity coordination, allow the Respondents to harm Canadian consumers and the Canadian economy by removing all incentives to compete with one another. In the absence of an incentive to compete, regardless of what they claim, the Respondents will not compete; to do otherwise would be irrational and violate their obligations to their respective shareholders. If the Respondents are permitted to behave in this manner, and cease competing with one another, consumers will face higher prices, reduced service, and less choice on Transborder Routes, and the efficiency and adaptability of the Canadian economy will be undermined.

4. The Commissioner repeats the allegations and matters pleaded in her Application, and denies the allegations and matters pleaded in the Responses of Air Canada and the UCH Respondents. Contrary to the Respondents' positions:

    a. The Application is consistent with, and indeed necessary to support, the objectives of the Canadian government's "Blue Sky" policy and the Canada-U.S.

[1] Unless otherwise indicated, defined terms in this Reply have the meaning ascribed to them in the Commissioner's Notice of Application and Statement of Grounds and Material Facts (together, the "Application").

"Open Skies" agreement; in any event, the Respondents' claims in this regard are utterly irrelevant to the Commissioner's Application;

b. There are no existing competitors, or "poised entrants", on Transborder Overlap Routes that can provide effective competition to, or constrain an exercise of market power by, the Respondents; and

c. The so-called "gains in efficiency" that the Respondents claim will flow from greater integration under the Alliance Agreements or the implementation of the Proposed Merger are, in fact illusory, achievable without the detrimental effects of the Alliance Agreements or the Proposed Merger, and/or unlikely to be greater than, and offset, those detrimental effects.

II. The Application Is Consistent With Blue Sky And Open Skies

5. There is no conflict between the Application and subsection 4(3) of the *Canada Transportation Act*; quite the contrary. The Canadian government's "Blue Sky" international air policy and the Canada-U.S. "Open Skies" agreement share the same goal as the relief sought in the Application: to provide for free, liberalized competition in air services markets.

6. The Blue Sky policy promotes the negotiation of bilateral "Open Skies" agreements between Canada and other countries. Providing a framework to encourage competition is the first objective listed in the Blue Sky policy, and allowing "market forces", rather than an exercise of market power, to "determine the price, quality, frequency, and range of air services options" is a driving principle of the policy. Likewise, the Air Transport Agreement of 1995 – the predecessor to the Open Skies agreement – was enacted with the desire to "promote fair and equal opportunities for airlines to compete in the marketplace", and the Open Skies agreement was enacted with the desire to "maximize competition". The objective of the Blue Sky policy and these agreements is not, as the Respondents seek to argue, to sacrifice competition so that a "national champion" airline may aspire to participate in the "international air transportation world" at the expense of travellers and the Canadian economy; it is rather to inspire and encourage choice and genuine competition in air services markets through introducing and maintaining meaningful competitive vigour.

7. The Commissioner's Application, like Blue Sky, Open Skies, and the Air Transport Agreement of 1995, seeks to ensure that greater competition will prevail on Transborder Routes. Preserving the economic incentive of both Air Canada and the UCH Respondents to act as independent competitors, and preventing the Respondents from exercising market power at the expense of competition and Canadian consumers, is necessary to ensure that the benefits of a greater number of competitors on Transborder Routes are realized, including lower prices, better service, and greater choice for consumers.

8. Notwithstanding the clear congruence within which the Application, Blue Sky, and Open Skies operate, the only relevant assessment for this Tribunal, in any event, is the harm to Canadian consumers that will result from the implementation of certain provisions of the Alliance Agreements and/or implementation of the Proposed Merger.

III. No Airlines Constrain The Respondents On Transborder Routes

9. The Respondents claim that competitors exist on Transborder Overlap Routes that would be sufficient to discipline the Respondents' ability to exercise market power. This is wrong and, absent the relief sought, prices will rise, service will be reduced, and consumer choice will suffer.

10. On ten Transborder Overlap Routes, the Respondents face *no* remaining competition. On the remaining nine Transborder Overlap Routes for which the Commissioner seeks to protect competition, a limited number of third party air carriers provide some level of service; however, these carriers face significant barriers to expansion, and are unable to provide sufficient competitive discipline to counter an exercise of market power by the Respondents:

    a. WestJet Airlines Ltd. ("WestJet") is present on only three of 19 Transborder Overlap Routes, and Porter Aviation Holdings Ltd. ("Porter") is present on only two. On the Transborder Overlap Routes that they serve, WestJet and Porter account for an average of 11.2% market share, while the Respondents' average combined market share on such routes is 69.1%. In other words, for every available seat flown by either WestJet or Porter on a Transborder Overlap Route, the Respondents offer more than six times as many seats. In addition to not constraining the Respondents today, it is extremely unlikely that these carriers will

have a competitive effect sufficient to discipline the Respondents in the future in light of the significant barriers to entry and expansion that Canadian non-legacy carriers face; and

b. U.S.-based legacy carriers (other than the Respondents) are present on only six Transborder Overlap Routes, and there is no evidence that they are likely to impose any effective discipline on the inevitable exercise of market power by the Respondents if the Respondents proceed with implementation of certain provisions of the Alliance Agreements and/or implementation of the Proposed Merger.

11. Further, the Respondents attribute competitive discipline to third party air carriers who have not participated, do not, and are not likely to participate as effective competitors on Transborder Routes:

a. U.S.-based non-legacy carriers simply do not participate on Transborder Routes, and there is no evidence that they are likely to impose any effective discipline on the inevitable exercise of market power by the Respondents if the Respondents proceed with implementation of certain provisions of the Alliance Agreements and/or the Proposed Merger; and

b. The Respondents cannot be effectively disciplined on Transborder Overlap Routes by airlines operating from airports located in the U.S.

12. The Respondents are subject to varying levels of competitive discipline on some Transborder Routes that involve a so-called “sun destination”. These low-frequency routes are characterized by a high proportion of “leisure” travellers who more readily respond to price differentials than consumers on other Transborder Routes. Not one of the Transborder Overlap Routes serves a “sun destination”.

IV. Gains In Efficiency Are Not Sufficient To Trigger Section 96

13. The Respondents suggest that the anti-competitive effects on Transborder Routes alleged in the Application are somehow permissible owing to speculative, unsupported, and illusory “gains in efficiency”. In fact, these purported “gains in efficiency” are not real, are not likely to be brought about by, and/or are not likely to be greater than and offset

the effects of the prevention and/or lessening of competition from the Respondents' proposed coordination, because:

a. The Respondents currently cooperate, although not to the full extent contemplated by the Alliance Agreements or the Proposed Merger, on Transborder Route flights. As such, to the extent that there is an opportunity to achieve efficiencies on shared routes, those efficiencies will not be eliminated by the relief sought; by definition, those "efficiencies" cannot be included in a trade-off analysis under section 96 of the Act to counter the material anti-competitive effects or greater coordination.

b. Any small amount of incremental gain in efficiency that may flow from implementation of the anti-competitive aspects of the Alliance Agreements or implementation of the Proposed Merger is not likely to be greater than, and not likely to offset, the impact of higher prices, reduced service, and less choice that the Respondents would impose on Canadian consumers and businesses; and

c. The Respondents have pleaded no material facts to support a claim that gains in efficiency are in fact likely to occur.

V. The Remainder Of The Respondents' Pleadings Are Not Relevant

(a) The 1996 Non-Binding Advisory Opinion

14. An explicitly non-binding opinion, based on facts supplied 15 years ago by the Respondents, is irrelevant to the Application. Since that time, both the Act and the competitive landscape in the passenger airline industry have changed significantly. These points were made known to the Respondents in a February 2011 letter where the Competition Bureau explicitly noted that the 1996 non-binding advisory opinion would receive no weight in its enforcement decision in the review of this matter.

(b) Other Regulatory Authorities Do Oppose Alliances And Joint Ventures

15. The Respondents claim that foreign regulatory and/or antitrust agencies have reviewed and approved similar alliances and joint ventures in the past, and that the Application is therefore somehow unique in concluding an anti-competitive outcome. This is inaccurate and, in any event, irrelevant to the Application.

16. First, decisions by foreign regulatory authorities, with different mandates in the context of different competitive landscapes, are irrelevant to the exercise of the Tribunal's exclusive jurisdiction to assess whether the Alliance Agreements and/or the Proposed Merger are likely to substantially prevent or lessen competition in Canada, contrary to the Act.

17. Second, and in any event, foreign regulatory and/or antitrust agencies' reviews of alliances and joint ventures vary in their mandate and in their conclusions; indeed, these foreign agencies have often sought and obtained commitments from the parties to such agreements (including the Respondents) in an effort to protect against adverse or anti-competitive effects that would otherwise result from their implementation.

18. Specifically contrary to the Respondents' misleading claims, no foreign regulatory agency, including the U.S., has approved the Proposed Merger. Indeed, the Respondents have not yet even applied to have their Proposed Merger considered by U.S. regulators. Moreover, as pleaded above, the treatment of the Respondents' agreements by foreign regulatory and/or antitrust agencies cannot be relevant to the Application, as the only relevant assessment for this Tribunal is the harm to Canadian consumers and businesses that will result from the implementation of the Proposed Merger and/or the certain challenged aspects of the Alliance Agreements.

(c) Clearance Of The Atlantic Plus Plus Joint Venture Is No Precedent

19. The Advance Ruling Certificate ("ARC") issued by the Commissioner in respect of the "Atlantic Plus Plus" joint venture in 2009 is irrelevant to the Application. Atlantic Plus Plus is an agreement among different parties, and affects routes in a different geographic area with a different competitive landscape from that relevant to the Alliance Agreements and the Proposed Merger.

(d) The Relief Sought Does Not Threaten Air Canada's "Viability"

20. In its Response, Air Canada makes dramatic claims that greater coordination under the Alliance Agreements and/or the Proposed Merger is crucial for its continued "viability". "Viability" is not a relevant concept in Canadian competition law. The competition concept that Air Canada alludes to is that of the "failing firm" consideration in subparagraph 93(b) of the Act; however, Air Canada is clearly not "failing", and has provided no evidence to support such a claim.

21. Further, even if cooperation among the Respondents was necessary for Air Canada to remain "viable", further implementation of the Alliance Agreements and/or the Proposed Merger is not required to achieve that level of cooperation. Air Canada currently gains access to international flight networks, and Canadian passengers in turn are served, through "codesharing" relationships with, among others, the UCH Respondents. None of the relief sought in the Commissioner's Application interferes with these relationships, and therefore Air Canada may, even if the Commissioner's relief is granted, continue to maintain and pursue such codesharing relationships in the future.

(e) Air Canada Is Bound By An Order Of The Tribunal

22. Air Canada, in paragraph 77 of its Response, pleads that it is reserving its rights and submitting to this Tribunal "without prejudice". Air Canada is bound by its pleading and any Order of the Tribunal. The Commissioner pleads subsection 9(1) of the *Competition Tribunal Act*.

(f) The Application Under Sections 90.1 And 92 Of The Act Does Not Rely On The Same Or Substantially The Same Facts

23. The Respondents erroneously claim that the Application violates subparagraph 90.1(10)(b) of the Act by seeking an Order or Orders pursuant to both sections 90.1 and 92 of the Act on the basis of the same or substantially the same facts. This too is wrong.

24. As outlined in the Application, the Alliance Agreements are separate and distinct agreements from the Proposed Merger. Pursuant to section 90.1 of the Act, the Commissioner seeks an Order or Orders limiting the extent to which the Respondents may implement their Alliance Agreements. Under section 92 of the Act, the Commissioner seeks relief regarding the Proposed Merger. The Order or Orders sought in the Application under each of section 90.1 and 92 are based on different agreements, and are not sought on the basis of facts that are the "same or substantially the same".

25. Further, it is the Respondents that have, by choice, structured their cooperation using several distinct agreements that separately define the degree of coordination between Air Canada and each of the UCH Respondents. In other words, the Respondents have crafted distinct fact sets with each of the Alliance Agreements, and the Proposed Merger

in turn, that are not the "same or substantially the same". As such, the Respondents cannot argue that the Application is somehow improper.

VI. Conclusion

26. The Respondents are unable to defend the anti-competitive impacts of the Alliance Agreements and/or the Proposed Merger, and therefore seek to obscure such impacts by claiming that Air Canada is entitled to prevent or lessen competition substantially in order to facilitate its ascent to "national champion" status, not through the beneficial aspects of competition, but through an anti-competitive exercise of market power that will be funded by Canadian consumers and the Canadian economy. Any such argument is improper and irrelevant, as it ignores: (i) that the only relevant assessment for this Tribunal is the harm to Canadians that will result from the implementation of the Alliance Agreements or the Proposed Merger, and (ii) the requirement that the scope of the Tribunal Application is determined by the Commissioner's Application.

DATED AT TORONTO, ONTARIO, this 29th day of August, 2011.

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CT-2011-004

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August 29, 2011

VIA E-MAIL

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Dear Mr. LaRose:

RE: Reply of the Commissioner in *Commissioner v. Air Canada et al.*, File No. CT-2011-004

We are counsel to the Commissioner of Competition (the "Commissioner").

Attached please find the Commissioner's Reply in the above-noted matter, as well as an affidavit of service regarding same. Please accept the Reply for immediate filing in accordance with Rule 39(1) of the *Competition Tribunal Rules* (the "Rules").

Please contact us if you have any questions.

Yours truly,

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