CT-2001/002

THE COMPETITION TRIBUNAL

IN THE MATTER OF an application by the Commissioner of Competition under section 79 of the *Competition Act*, R.S.C. 1985, c. C-34, as amended.

AND IN THE MATTER OF the *Regulations Respecting Anti-Competitive Acts of Persons Operating a Domestic Service*, SOR/2000-324 made pursuant to subsection 78(2) of the *Competition Act*.

AND IN THE MATTER OF certain practices of anti-competitive acts by Air Canada.

THE COMMISSIONER OF COMPETITION

Applicant

- and -

AIR CANADA

Respondent

RESPONSE

1. Unless otherwise defined, capitalized terms in this Response have the same meanings as assigned to them in paragraph 5 of the Statement of Grounds and Material Facts (the "SGMF") filed by the Commissioner of Competition (the "Commissioner") in this Application.

Overview of Air Canada's Position

2. Air Canada states that the Commissioner's position and approach to the within Application and to dealing with Air Canada since the failure of Canadian Airlines is inappropriate and without legal or factual foundation. In particular:

a) The Commissioner ignores the regulatory and legislative environment in which Air Canada is required to operate, including:

i) the service, employment and other commitments made by Air Canada in undertakings given by Air Canada on December 21, 1999 in connection with the acquisition of Canadian Airlines (the "Undertakings");

ii) the fact that the Commissioner's own actions in issuing and threatening to issue temporary "cease and desist" orders have significantly constrained both Air Canada's ability to compete and its economic performance on certain of the Affected Routes; and

iii) the regulatory inconsistencies between the Commissioner and the Canadian Transportation Agency (the "CTA"), the former requiring Air Canada to raise its prices and the latter requiring Air Canada to reduce its prices.

b) The Commissioner ignores both the state of competition as it existed at the time of some of the historical events at issue in the Application as well as the changes in the state of competition which have arisen since the Application was issued and which will continue, and which undermine as a factual matter the allegations made by the Commissioner.

c) The Commissioner ignores the elements of an abuse of dominance analysis and a predatory pricing analysis (including the absence of any evidence of predatory intent and recoupment), instead focussing on the narrow issue of "avoidable costs" which he construes entirely inconsistently with business reality and the legislation in which the term is found.

d) The Commissioner's approach would prohibit Air Canada from responding to competition, a result wholly at odds with competition law and policy.

e) The Commissioner purports to "blame" Air Canada for what he alleges is poor economic performance of some of Air Canada's competitors, which on its face ignores the natural result of effective competition. The Commissioner's approach further purports to require Air Canada to consider the economic performance of

its competitors and to alter its conduct if Air Canada's competitive response might impact upon the profitability of a competitor.

f) The remedy proposed by the Commissioner is completely unworkable, includes elements that are inappropriate even if they could be implemented, and is inconsistent with the Commissioner's own approach to the analysis, insofar as the Commissioner looks at revenues in comparison to costs but the remedy sought is based on fares (and not revenues, even on a per flight basis).

3. Air Canada denies that it substantially or completely controls the supply of passenger airline services on the Affected Routes, and further denies that it has engaged in a practice of anti-competitive acts (as defined in section 78 of the Act or in the Airline Regulations) on the Affected Routes or otherwise.

4. Between the issuance of the Application and April 4, 2001, there have been at least the following changes to the state of competition in the airline industry in Canada:

a) The acquisition by Canada 3000 of Royal has been completed.

b) CanJet announced an expansion of its services to a number of additional routes.

c) Canada 3000 and CanJet announced the acquisition by Canada 3000 of CanJet.

d) Canada 3000 has announced that it will unveil a new integrated schedule for what is essentially a new, much larger competitor which will likely now have a presence on a number of the Affected Routes.

e) Roots Air commenced its service in Canada and announced an expansion within Canada of the routes it will be serving.

f) WestJet has announced the expansion of its schedule in eastern Canada, including to a number of new routes.

5. In summary, both before and after this Application was commenced, the Canadian airline industry has witnessed a number of new entrants, some consolidation resulting in a stronger

competitor, an expansion by competitors on initial routes as well as to new routes, and constant changes in the state of competition on the Affected Routes and throughout Canada. This activity disproves the Commissioner's own allegations regarding, *inter alia*, barriers to entry and the impact of Air Canada's conduct. Air Canada must be in a position to respond to competition; the Commissioner's approach purports to preclude Air Canada from doing so.

6. Air Canada's conduct on the Affected Routes was at all material times appropriate and measured activity taken in competitive response to the actions of CanJet, WestJet and Royal on those routes. In challenging Air Canada's conduct, the Commissioner seeks to prevent legitimate competition in order to assist particular competitors. However, Air Canada's conduct did not and would not result in a substantial lessening or prevention of competition.

7. As described herein, the Commissioner has adopted an unrealistic, impractical and unworkable interpretation of the Airline Regulations in his approach to this Application (as well as in proposed Guidelines issued by the Commissioner in draft a short time prior to the issuance of this Application). The Commissioner's approach results in the labelling as "anti-competitive" any flight operated by Air Canada over a one-month period that generates revenues lower than its "avoidable costs". The flaws in this approach are numerous and include the following:

a) The Airline Regulations which the Commissioner is supposed to be applying defines as an anti-competitive act to "operate capacity on a route or routes at fares that do not cover the avoidable cost of providing the services". There is no mention of flights in the definition.

b) By using the unit of a single flight, the Commissioner ignores the fact that frequency of service is part of Air Canada's product as a "Major Network Carrier". Product and schedule integrity are crucial to a network carrier and can result in unprofitable flights on a route in order for other flights on the same route to be profitable. As a Major Network Carrier, Air Canada's schedule requires that aircraft be available at specific places at specific times, which means that airplanes (however full) must be repositioned. The Commissioner ignores the fact that as a business matter, flying an airplane which carries twenty passengers on a flight when that airplane would otherwise fly empty or sit idle may be a better

business proposition, even if not all avoidable costs (as defined by the Commissioner) are covered.

c) The Commissioner's approach to avoidable costs also fails to consider the potential impact on Air Canada's profitability (including loss of passenger traffic and decline in revenues) had Air Canada not responded to competition (as well as when Air Canada was precluded from responding because of the Commissioner's temporary order).

d) By conducting his analysis in one-month increments, the Commissioner ignores the seasonality of the airline industry. The appropriate period of measurement is at least one year, so as to account for seasonal changes in traffic flow.

e) By focusing on the revenues generated from a particular flight (for which there is no basis in the Airline Regulations), it cannot be determined whether the flight will be deemed "anti-competitive" until long after it has departed when all revenue and costs information becomes available.

f) The Commissioner has included in his definition of "avoidable costs" significant cost items which are not avoidable over a one month (or in some cases, even a twelve month) period of time.

g) The Commissioner takes no account of the economic contribution which a flight makes to the network, which can be measured and should be considered in a profitability analysis.

8. Air Canada respectfully states that no Order under section 79 should be made in respect of Air Canada's conduct and requests that this Application be dismissed.

Response to Particulars of Commissioner's SGMF

A. *Parties and Market Participants*

9. Air Canada denies the allegations contained in paragraphs 2, 3 and 4 of the SGMF.

10. Although, as noted above, Air Canada will use the same defined terms in this Response as the Commissioner identified in paragraph 5 of the SGMF, Air Canada does not admit that "Low Cost Carriers" necessarily have lower costs on an individual flight basis than does Air Canada. Air Canada agrees that most of the so-called "Low Cost Carriers" offer fewer frills than Air Canada, but this would not necessarily result in a significant cost reduction in the operation of a flight.

11. Air Canada admits the allegations contained in paragraphs 6 and 7 of the SGMF, except that it denies the characterization of Air Canada as "the dominant airline in Canada" (to the extent this refers to dominance in the legal sense) in paragraph 7.

12. Air Canada admits the allegations contained in paragraph 8 of the SGMF, but adds that it is in the process of integrating the "Canadian" brand with the Air Canada brand. Further, with respect to Air Canada Regional Inc., its various brands will be streamlined under a single operating name.

13. With respect to the allegations contained in paragraphs 9 to 25 of the SGMF, Air Canada states generally that as described in paragraphs 4 and 5 above, the state of competition in the airline industry in Canada has changed and continues to change substantially. Thus many of the allegations in the SGMF are no longer accurate.

14. With those qualifications and subject to paragraph 10 above, Air Canada admits the allegations in paragraph 9, 11 and 12 of the SGMF and has no specific knowledge of the allegation in paragraph 10 of the SGMF.

15. The changes to the state of competition and identity of market participants described in paragraphs 4 and 5 above substantially affect CanJet and the allegations made by the Commissioner in paragraphs 13 to 18 of the SGMF. As of the date of the Application, Air Canada admits that the allegations in paragraphs 13, 14, 16, 17 and 18 of the SGMF were accurate, subject to paragraph 10 above. With respect to paragraph 15, Air Canada states that at all times since September 25, 2000, CanJet operated on at least 12 city-pair routes. Further, in early March 2001, CanJet announced an expansion of its domestic service so as to increase the number of both domestic destinations and city-pair routes which it served.

16. On March 28, 2001, Canada 3000 and CanJet announced that Canada 3000 intended to acquire CanJet effective May 1, 2001.

17. Again, changes to the airline industry in Canada are not reflected in the SGMF. As of the date of the Application, Air Canada admits that the allegations in paragraphs 19, 20, 21 and 23 of the SGMF were accurate, except to the extent that the Commissioner alleges Royal is or operates as a "Low Cost Carrier" as defined by the Commissioner in paragraph 5 of the SGMF. In fact, Royal offers frequent flyer points and many of the frills described in paragraph 45 of the SGMF, it operates more than one aircraft type and offers a form of business class service on several of its flights. Air Canada denies the allegations in paragraph 22 of the SGMF for these reasons.

18. With respect to paragraphs 24 and 25 of the SGMF, the merger of Royal and Canada 3000 was completed in March 2001. As described above, Canada 3000 is also intending to acquire CanJet. Canada 3000 is and will continue to be a significant competitor on the Affected Routes and other routes.

19. Air Canada admits the allegations in paragraphs 26 and 27 of the SGMF, but adds to paragraph 27 that Roots Air did commence operations on March 26, 2001 with service between Toronto and Calgary as well as between Toronto and Vancouver. Further, Roots Air has stated that it will begin service to Montreal on June 6, 2001 and is currently selling tickets for travel to Montreal from Toronto, Calgary and Vancouver, and has announced plans to offer service between Edmonton and Toronto and Montreal (cancelling earlier plans to fly between Toronto and Los Angeles in favour of adding Edmonton domestically).

B. *Background*

20. Air Canada admits the allegations contained in paragraphs 28 and 29 of the SGMF.

21. With respect to paragraph 29 of the SGMF, Air Canada adds that its acquisition of Canadian in 2000 was approved by both the Minister of Transport and the Commissioner of Competition in light of Canadian's impending bankruptcy in December 1999. At the time these approvals were given, Air Canada gave the Undertakings to the Commissioner and the government of Canada, including assurances that:

a) Air Canada would continue to provide, for at least three years, air service to every community in Canada which received air service from either Air Canada or Canadian as of December, 1999. This Undertaking was to be honoured regardless of whether Air Canada was profitable on all such routes.

b) Before March 2002, Air Canada would not involuntarily layoff or relocate unionized employees of Air Canada or Canadian as a result of the acquisition of Canadian.

c) For a period of three years, Air Canada is obliged to make available any surplus aircraft for purchase by Canadian Air Carriers (as defined) at an appraised value; those carriers also have a right to match any third party offer within certain time periods. This Undertaking impacts the timing and marketability of surplus aircraft for Air Canada.

22. Air Canada denies the allegations in the first two sentences of paragraph 30 of the SGMF, and in particular the allegation that it is the "dominant domestic airline in Canada" in the legal sense. Dominance is measured in relation to a market and Canada as a whole is not a market for these purposes. Air Canada admits the allegations contained in the third and fourth sentences of paragraph 30 of the SGMF.

23. Air Canada admits the allegations contained in paragraphs 31, 32, 33 and 35 of the SGMF. Air Canada agrees with paragraph 34 in general that airlines as a group tend not to be regulated in the setting of fares or determining which destinations to serve. However, Air Canada states that it is significantly constrained in its decisions regarding termination of service to domestic destinations due to the Undertakings described above. Further, the Commissioner and the CTA have effectively become Air Canada's regulators in respect of the fares it charges on domestic routes. For example, on October 12, 2000, the Commissioner issued a temporary order under section 104.1 of the Act in effect requiring Air Canada to increase its fares on the Affected Halifax Routes. After the expiry of the temporary order, Air Canada introduced new competitive fares on the Affected Halifax Routes and was threatened by the Commissioner that further temporary orders would be made requiring Air Canada to raise its fares. In the same time period, the CTA issued a decision indicating it intends to require Air Canada to reduce a fare it

charges on a route (Prince Rupert-Vancouver) to a level which Air Canada's competitor on that route (HawkAir) suggests will lead it to abandon the route, and has also investigated whether fares prohibited by the Commissioner (L14EASTS, as described below) should be offered on another allegedly comparable route (Quebec–Toronto). In so doing, the CTA has obviously reached conclusions of fact and law which are different from those being asserted by the Commissioner in this Application.

24. Air Canada admits the allegations contained in paragraphs 36 (except that the restrictions listed may be imposed by any airline and not just by "network carriers"), 37 (except for the first sentence), 38 and 39 of the SGMF. With respect to the first sentence of paragraph 37, Air Canada states that many of its fares (such as the "J" and "Y" fareclasses mentioned in paragraph 39 of the SGMF) have no restrictions and are fully refundable. "Low Cost Carriers" are just as likely as "Major Network Carriers" to have limits on refundability, flight-specific restrictions, limits on changes and change fees.

25. With respect to paragraph 40 of the SGMF, Air Canada states that WestJet and CanJet do not publish their fares through ATPCO. The fare and schedule information available from the sources listed in paragraph 40 of the SGMF other than ATPCO is incomplete and sporadic. As a result, Air Canada is unable to obtain accurate daily information about the fares and schedules of CanJet and WestJet as alleged.

26. With respect to paragraph 41 of the SGMF, Air Canada agrees that airlines exercise price differentiation. Air Canada admits the allegations contained in paragraphs 42 of the SGMF.

27. Air Canada disputes the characterization of the "second phase" of the seat management process, as described in paragraph 43 of the SGMF. The seat management system, which is in fact referred to as the "inventory management system", adjusts the number of available seats based on a comparison of actual bookings to historical bookings on a flight. As such, this system will both increase and reduce the number of seats available in all fareclasses, depending on the bookings for the flight, as the date of departure approaches. The suggestion in the SGMF that the system only reduces the number of discounted seats available is not accurate.

28. Air Canada denies the allegations contained in paragraph 44 of the SGMF.

29. With respect to paragraph 45 of the SGMF, Air Canada admits the description of its frequencies, connections, frequent flyer points and "frills". Air Canada also admits the first sentence of paragraph 46. Air Canada does not agree with the allegation in the first sentence of paragraph 45 that its service is necessarily "more valuable" than that of a Low Cost Carrier in the view of consumers. Some consumers prefer a point-to-point carrier with a limited schedule. Although airlines compete in a variety of ways, including frequencies, connections, points and frills, price is the single most important consideration for the majority of consumers.

30. Air Canada denies that the nature of its service can "reinforce its dominance" as alleged in the second sentence of paragraph 46 of the SGMF. Dominance is a market based legal concept which cannot be "reinforced" by the provision of a quality service. To the extent that consumers perceive a product as superior, that is a natural result of competition which is not attributable to anti-competitive conduct, nor should Air Canada be "penalized" for it.

31. Air Canada denies the allegations contained in paragraphs 47, 48, 49 and 50 of the SGMF. The suggestion made in these paragraphs is that because Air Canada offers a better service or has developed more goodwill than, for instance, CanJet, it should be required to charge more for its service. The Commissioner's approach is to shield so-called Low Cost Carriers from the rigours of price competition – and not just of undercutting, but even of price matching. Air Canada did not undercut the fares of the Low Cost Carriers on the Affected Routes, but rather only sought to match certain of their prices after the prices had been selected by the Low Cost Carriers. Matching a competitor's price cannot constitute anti-competitive or predatory conduct, nor does it "deprive" a competitor of its ability to compete.

32. Historically, Air Canada has competed with WestJet in Western Canada by matching its fares. Notwithstanding Air Canada's frequencies, connections, points and frills, WestJet has succeeded and grown as an effective competitor, even with price competition from Air Canada.

C. Market Issues

33. With respect to paragraph 51 of the SGMF, Air Canada states that bus, rail and other forms of transportation can be close substitutes for a passenger airline service in certain markets.

34. Air Canada denies that business and leisure travellers comprise separate product markets as is apparently alleged in paragraphs 52, 53 and 54 of the SGMF. However, Air Canada does acknowledge that leisure travellers as a group tend to be more price conscious than business travellers as a group.

35. Air Canada denies the allegations contained in paragraph 55 of the SGMF. Air Canada denies that it has engaged in a practice of anti-competitive acts as alleged in paragraph 56 of the SGMF.

36. Air Canada denies the allegations contained in paragraph 57 of the SGMF.

37. Air Canada admits the allegations contained in paragraph 58 of the SGMF. Air Canada does not admit the allegations in paragraphs 59, 60, 61 and 62 of the SGMF for the purposes of this Application and points out that the CTA has ruled that Toronto and Hamilton are not in the same catchment area.

38. Air Canada admits the allegations contained in paragraph 63 of the SGMF.

39. Air Canada denies the allegations contained in paragraph 64 of the SGMF. With respect to subparagraph 64(a), Air Canada does not agree that "all domestic city-pair markets" are the relevant markets in the within Application, nor has the Commissioner asserted any facts which would apply to such markets (other than the Affected Routes) so as to bring them within the scope of this Application.

40. Air Canada denies the allegations contained in paragraph 65 of the SGMF. Although Air Canada serves the greatest number of domestic routes in Canada, it does not control the supply of passenger airline services on the busiest domestic routes, which include but are not limited to the Affected Routes.

41. Furthermore, given that the Commissioner "considers control to be synonymous with market power, where market power is the ability to profitably set prices above competitive levels for a considerable period of time" (as described in his draft Abuse of Dominance Guidelines), Air Canada states that it does not control "most domestic routes in Canada" or the Affected Routes, as plainly evidenced by the historical events at issue in this Application. Air Canada has

not set prices above competitive levels, except where ordered to do so by the Commissioner himself.

42. Air Canada does not admit the allegations contained in paragraphs 66, 67 and 68 of the SGMF. The information on its face is two years old. Air Canada is also unaware of the relevant information as it relates to its competitors. However, Air Canada believes its share of domestic airline passengers and travel agency sales has declined from the numbers contained in paragraph 66 of the SGMF.

43. Air Canada denies the allegations contained in paragraph 69 of the SGMF. The information is out of date and does not take account of Canada 3000 and the changes in the state of competition as described in paragraphs 4 and 5 above.

44. With respect to paragraph 70 of the SGMF, Air Canada denies that business travellers constitute a separate product market for "domestic airline services".

45. Air Canada denies the allegations contained in paragraphs 71 and 72 of the SGMF. Routine redeployment of aircraft and personnel is impractical. Further, redeployment would only make business sense if it were expected to result in higher marginal contribution to operations.

46. Air Canada admits the allegations contained in paragraphs 73 and 74 of the SGMF, but states that they are irrelevant to the within Application.

47. Air Canada denies the allegations contained in paragraph 75 of the SGMF. Air Canada had barely more than half of the capacity on certain of the Affected Routes and the new Canada 3000 schedule and other changes will further impact the assessment of control. As described in paragraph 41 above, Air Canada does not control the supply of passenger airline service on the Affected Routes.

48. Air Canada denies the allegations in paragraphs 76, 77 and 78 of the SGMF.

49. Air Canada denies that there are high barriers to entry facing potential new entrants in the passenger airline service business as alleged in paragraph 79 of the SGMF. Many of the purported barriers to entry listed in paragraph 79 are issues that were addressed and accounted

for in the Undertakings given by Air Canada in December 1999 at the time the Commissioner approved Air Canada's acquisition of Canadian. Other of the purported barriers to entry (for example, the "lack of an established brand" in subparagraph (e)) is a fact of life for any new entrant in any industry with respect to any product. In any event, since July 2000, when Canadian became a subsidiary of Air Canada, two new passenger airlines started up and three others have expanded their domestic service offerings.

50. With respect to the allegations contained in paragraph 80 of the SGMF, Air Canada states that there is no "reputational barrier to entry" and relies on the new entrants as evidence that the Commissioner's allegations are unfounded. Furthermore, Air Canada denies that its competitive responses constitute a "practice" as a matter of law.

D. Unfounded Allegations of Anti-Competitive Acts

51. Air Canada denies the allegations contained in paragraphs 81 and 82 of the SGMF and expressly denies that it has engaged in any anti-competitive acts.

52. Air Canada denies the allegations contained in paragraphs 83, 84 and 85 of the SGMF.

53. With respect to paragraph 86 of the SGMF, Air Canada states that the Airline Regulations refer only to "operating capacity on a route or routes"; nowhere in the Airline Regulations is reference made to the operation of a single flight. The Commissioner's approach to the avoidable costs issue of considering whether the revenues generated by each flight offered by Air Canada cover its costs both ignores the actual language of the Airline Regulations and is entirely inconsistent with the business reality of operating a network carrier. The Airline Regulations clearly refer to "fares" on "routes", not "revenues from a flight".

54. Air Canada agrees with the general categorization contained in subparagraphs 87(a) and (b) of the SGMF, but denies that the category of expenses identified in subparagraph 87(c) is avoidable. However, Air Canada is unaware of the complete list of costs which the Commissioner would seek to include in each of the three categories of expenses listed in paragraph 87 of the SGMF.

55. With respect to paragraph 88 of the SGMF, Air Canada states that no costs are listed in paragraph 79 of the SGMF. Assuming that the Commissioner intended paragraph 88 to make reference to the general categories of costs identified in paragraph 87 of the SGMF, Air Canada denies the allegation. Air Canada states in any event that the appropriate time period for the consideration of whether a cost is avoidable is at least one year, not one month.

56. Air Canada denies the allegations contained in paragraphs 89, 90, 91 and 92 of the SGMF. With respect to paragraphs 89 and 90, Air Canada states that aircraft redeployment or scheduling overhauls can require a significant amount of lead time. However, as noted in paragraph 45 above, even if Air Canada could make significant rapid adjustments as alleged, the Commissioner's allegations ignore the fact that Air Canada's "redeployment" of aircraft would only make business sense if they could be operated with higher marginal contribution.

57. Air Canada's fleet size is dictated by Air Canada's needs during the peak summer season, yet it must operate and maintain that fleet even through the low seasons. This is particularly the case in light of the Undertakings given regarding points of service and employment.

58. Air Canada admits the allegations contained in paragraphs 93 and 94 of the SGMF, except that it has no knowledge of WestJet's intentions as described in the second sentence of paragraph 94.

59. With respect to paragraph 95, it is unclear what the Commissioner is comparing when he alleges Air Canada reduced its capacity in February 2000. Air Canada states that it did reduce capacity on many domestic routes in February and March 2000 as a result of the fact that Canadian had been acquired by 853350 Alberta Ltd. ("853350") on January 4, 2000, and Air Canada was assisting Canadian to reduce its costs (at the time, Canadian was losing approximately $2 million per day), in part through the reduction of competition between Air Canada and Canadian (as had been approved by the Commissioner in December 1999). In February 2000, Air Canada and Canadian began eliminating redundant flights. While Air Canada alone may have offered fewer flights between Toronto and Moncton in February 2000 than it had in January 2000, the combined capacity of Canadian and Air Canada on the route was greater than Air Canada's capacity alone had been in December 1999, before Canadian was acquired by 853350.

60. Many communities in Canada responded negatively to the capacity reductions implemented in February and March 2000 and requested that Air Canada reintroduce capacity on many routes. Air Canada responded to these consumer demands starting in March and April 2000 by adding capacity back to routes which had been reduced too quickly in February.

61. With respect to the allegations contained in paragraph 96 of the SGMF, Air Canada states that it increased its capacity on its Toronto-Moncton, Toronto-Fredericton, Toronto-Saint John and Toronto-Charlottetown routes in the Spring of 2000, and that it has since reduced some of that capacity on the Toronto-Fredericton, Toronto-Saint John and Toronto-Charlottetown routes. As indicated above, Air Canada was making numerous capacity adjustments in 2000 due to its efforts to integrate the schedules of Air Canada and Canadian and to achieve an appropriate service balance to various destinations in Canada. Air Canada denies the balance of the allegations in paragraph 96 of the SGMF.

62. Air Canada admits the allegations contained in paragraphs 97 and 98 of the SGMF.

63. Air Canada denies the allegations contained in paragraph 99 of the SGMF

64. Air Canada admits the allegations contained in paragraphs 100 and 101 of the SGMF.

65. Air Canada denies the allegations contained in paragraphs 102, 103, 104, 105, 106, 107 and 108 of the SGMF. With respect to paragraph 107, Air Canada states that its conduct in matching WestJet's prices did not "force" WestJet to make the choice described. Air Canada made an appropriate competitive response to which WestJet was free to respond as it deemed necessary and appropriate. The natural consequence of competition may be a "dilution of profitability" for a particular competitor, or (for that matter) for all competitors, but this is beneficial for consumers and is not attributable to any anti-competitive conduct of Air Canada.

66. Air Canada admits the allegations contained in paragraph 109 of the SGMF. With respect to paragraph 110, Air Canada denies that it added any capacity to the Affected Halifax Routes in response to CanJet's entry, or that it undercut CanJet's prices or operated capacity on the Affected Halifax Routes at fares below Air Canada's avoidable costs.

67. With respect to paragraph 111 of the SGMF, Air Canada admits that it introduced the L14EASTS fares on the routes identified in that paragraph (the "L14EASTS Routes"). However, although the prices of the various L14EASTS tickets matched the fares initially announced by CanJet in August 2000, they were significantly higher than the fares actually being charged by CanJet on September 1, 2000 (the day they were introduced by Air Canada). Prior to Air Canada's introduction of the L14EASTS fares, a price war between CanJet and Royal had led CanJet to reduce its fares from those it had introduced in August.

68. Air Canada denies the allegation in paragraph 112 of the SGMF that the L14EASTS fares were at prices significantly lower than had been previously offered on the L14EASTS Routes. As is well known by the Commissioner, the comparison of the L14EASTS fare to Air Canada's previously offered one-way fare is entirely inappropriate given that the previous one-way fare was a full-fare economy ticket with no restrictions, and the L14EASTS fare was a highly restricted fare.

69. Air Canada admits the allegations contained in paragraph 113 of the SGMF but adds that the Commissioner's extension of the temporary (cease and desist) order did not include the two Windsor routes as CanJet had already announced its withdrawal from these routes. On the Windsor routes, restraining Air Canada from competing with CanJet did not lead to an improvement in CanJet's performance.

70. Air Canada admits the allegations contained in paragraphs 114, 115 and 116 of the SGMF. The L14SPCL and Value fares referred to in paragraphs 114 and 115 were priced higher than the L14EASTS fares had been. Air Canada admits paragraph 117 of the SGMF and adds that it withdrew the LAC fares in response to a threat by the Commissioner that he would impose another temporary order under section 104.1 of the Act if the fares were not voluntarily withdrawn by Air Canada.

71. Air Canada denies the allegations contained in paragraphs 118, 119 and 120 of the SGMF. With respect to the allegations in paragraphs 119 and 120, Air Canada states, *inter alia*, that:

a) The months of September through November are a "low season" for the airline industry when revenues decline and where many airlines have historically reported overall losses.

b) It is in part this seasonality that makes it necessary to consider the issue of avoidable costs over a period of at least twelve months rather than one.

c) September through November 2000 coincided with an economic slowdown, to which the airline industry is quite vulnerable.

d) If Air Canada were operating any of its flights below avoidable costs, as alleged by the Commissioner (Air Canada does not admit that it was, and further denies that it is appropriate to consider the economics of a single flight), this was due in whole or in part to Air Canada's inability to compete on price (and the resulting loss of revenue) on the Affected Halifax Routes as a result of the Temporary Order and other actions of the Commissioner.

72. Air Canada admits the allegations contained in paragraph 121 of the SGMF, except that the LAC fares matched CanJet's lowest everyday fare, not the lowest fares actually offered by CanJet at the time.

73. Air Canada denies the allegations contained in paragraphs 122, 123, 124, 125 and 126 of the SGMF. With respect to paragraph 122, the Commissioner ignores the fact that CanJet faced competition from Royal, among other airlines, and it was only in response to that competition that CanJet lowered its fares; to Air Canada's knowledge, CanJet never lowered its fares on the Affected Halifax Routes in response to an Air Canada pricing initiative. With respect to paragraph 125, Air Canada states that it did not "force" CanJet to make the choice described for the reasons expressed in paragraph 65 above. Furthermore, if CanJet could not operate profitably in the face of competition from Air Canada as alleged by the Commissioner, this highlights the inadequacies in CanJet's business plan. It is not for Air Canada to concern itself with CanJet's profitability, nor should it be the Commissioner's role to protect one competitor at the expense of proper and vibrant competition.

E. Unfounded Allegations of Substantial Lessening or Prevention of Competition

74. Air Canada denies the allegations contained in paragraphs 127, 128, 129, 130, 131 and 132 of the SGMF. As described above, the Commissioner's allegations completely ignore the developments in the state of competition over the last several months. The facts are that there has been significant new entry and significant expansion in the industry. Air Canada denies that its actions have caused or are continuing to cause the effects listed in paragraphs 129, 130 and 131 of the SGMF. Air Canada states that the Commissioner is ignoring entirely the effect of historical competition among CanJet, WestJet and Royal (among others) and purports to impugn Air Canada (which has been significantly restrained from competing on many of the Affected Routes since October 2000) for the natural effects of such competition.

75. Air Canada denies the allegations contained in paragraphs 133, 134 and 135 of the SGMF. With respect to paragraph 133, Air Canada states that Canada 3000 has expanded significantly in eastern Canada (in part by acquiring Royal and CanJet) in the Spring of 2001. Air Canada's conduct is having no detrimental effect on competition. With respect to paragraph 135 of the SGMF, as described above, there is no basis in fact or law for a claim of "reputational barrier to entry".

76. Air Canada denies the allegations contained in paragraphs 136, 137, 138 and 139 of the SGMF for the reasons set out above. Air Canada states that its conduct (to the extent it was not restrained by the Commissioner) simply responded appropriately to competition in the airline industry.

77. Air Canada states that the relief sought by the Commissioner in paragraph 140 of the SGMF is entirely inappropriate. It incorporates the Commissioner's distortion of the Airline Regulations, yet provides no guidance to Air Canada about what it can or cannot do. It requires the Tribunal to become a price regulator of one competitor in an industry, but (on the Commissioner's interpretation of avoidable costs) it cannot be known until after a flight has departed and the revenue generated by the flight is known whether a particular fare sold on the flight was inappropriate. Finally, it seeks to prohibit price matching in certain circumstances despite the fact that such conduct is a hallmark of effective competition.

78. For the foregoing reasons. Air Canada asks that the Application be dismissed.

Procedural Matters

79. Air Canada requests that this Application be heard in either Toronto or Ottawa in the English language.

80. For the purposes of this Application, service of all documents on Air Canada may be made on:

Stikeman, Elliott
53 Commerce Court West
199 Bay Street
Toronto, Ontario
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Solicitors for Air Canada

Dated at Toronto this 5th day of April, 2001.

Katherine L. Kay
STIKEMAN ELLIOTT

File No. CT-2001/002

THE COMPETITION TRIBUNAL

IN THE MATTER OF an application by the Commissioner of Competition under section 79 of the *Competition Act*, R.S.C. 1985, c. C-34, as amended.

AND IN THE MATTER OF the *Regulations Respecting Anti-Competitive Acts of* Persons *Operating a Domestic Service*, SOR/2000-324 made pursuant to subsection 78(2) of the *Competition Act*.

AND IN THE MATTER OF certain practices of anti-competitive acts by Air Canada.

THE COMMISSIONER OF COMPETITION

Applicant

- and -

AIR CANADA

Respondent

RESPONSE

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