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

COMPETITION TRIBUNAL
TRIBUNAL DE LA CONCURRENCE

FILED / PRODUIT
Date: March 5, 2001
CT-2001/002
Jos LaRose
for / pour
REGISTRAR / REGISTRAIRE

OTTAWA, ONT. #001

– and –

AIR CANADA

Respondent

NOTICE OF APPLICATION

TAKE NOTICE THAT the Applicant, the Commissioner of Competition (the "Commissioner") will make an Application to the Competition Tribunal (the "Tribunal"), as outlined in the Statement of Grounds and Material Facts attached, on a day and place to be determined by the Competition Tribunal, pursuant to section 79 of the *Competition Act*, R.S.C. 1985 (the "Act"), for:

1. An Order prohibiting the Respondent, including its affiliates, officers or agents (collectively, "Air Canada") from:

   a) operating capacity at fares that do not cover the avoidable cost of providing the service on the following routes (the "Air Canada Affected Routes"):

      i) St John's, Nfld (YYT) – Halifax (YHZ)

      ii) Montreal (YUL) – Halifax (YHZ)

      iii) Ottawa (YOW) – Halifax (YHZ)

      iv) Toronto (YYZ) – Moncton (YQM)

      v) Toronto (YYZ) – Fredericton (YFC)

      vi) Toronto (YYZ) – Saint John, NB (YSJ)

      vii) Toronto (YYZ) – Charlottetown (YYG)

   b) Increasing capacity on the Air Canada Affected Routes at fares that do not cover the avoidable cost of providing the service;

   c) Engaging in a policy of "matching" fares offered by low cost carriers on the Affected Routes (as that term is defined in the Statement of Grounds and Material Facts) and operating capacity at those fares:

      i) Without regard for the effect of such fares on Air Canada's profitability;

      ii) Without regard to the additional benefits associated with the service offered by Air Canada; and

      iii) With the foreseeable effect of significantly diluting revenues of low cost carriers, rendering their operations unprofitable.

2. If necessary, an Order under section 104 prohibiting Air Canada from offering fares or operating capacity on the Affected Routes on such terms as may be requested by the Commissioner.

3. Such further or other Order as the Tribunal considers appropriate.

AND TAKE NOTICE that if you do not file a Response with the Registrar of the Tribunal within 30 days of the date upon which this Application is served upon you, the Tribunal may, upon *ex parte* application by the Commissioner, make such order as it may consider just.

ADDRESSES FOR SERVICE ON THE RESPONDENTS ARE:

Air Canada
Air Canada Centre
7373 Cote Vertu West
St Laurent, Quebec
H4Y 1C2

THE COMMISSIONER proposes that the hearing of this Application be held in Ottawa, Ontario, and that the proceedings be conducted in the English language.

For purposes of this Application, service of all documents on the Commissioner can be served on:

Kelly Affleck Greene
Barristers and Solicitors
One First Canadian Place
Suite 840, P.O. Box 489
Toronto, Ontario M5X 1E5

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Place du Portage, Phase I
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Counsel to the Commissioner of Competition

DATED at Hull, Quebec, this 5th day of March, 2001

Konrad von Finckenstein, Q.C.,
Commissioner of Competition

TO: **The Registrar of the Competition Tribunal**
Royal Bank Building
90 Sparks Street, suite 600
Ottawa, Ontario
K1P 5B4

AND TO: **Air Canada**
Air Canada Centre
7373 Cote Vertu West
St Laurent, Quebec
H4Y 1C2

STATEMENT OF GROUNDS AND MATERIAL FACTS

I Overview

1. The Commissioner makes this Application pursuant to section 79 of the *Competition Act*, R.S.C. 1985, c. C-34 (the "Act") and the *Regulations Respecting Anti-Competitive Acts of Persons Operating a Domestic Service*, SOR/2000-324 made pursuant to subsection 78(2) of the Act (the "Airline Regulations").

2. The purpose of this Application is to prevent the substantial lessening or prevention of competition in the supply of passenger airline service that will likely result if Air Canada is permitted to continue to engage in anti-competitive acts that are likely to eliminate or discipline low cost carriers operating on the Affected Routes (as defined below).

3. Air Canada substantially or completely controls the supply of passenger airline service in Canada, as well as on the Affected Routes.

4. Air Canada has engaged in and continues to engage in practices of anti-competitive acts within the meaning of s. 78 of the Act and the Airline Regulations. These anti-competitive acts consist of,

  a) Operating capacity on the Affected Routes at fares that do not cover the avoidable cost of providing the service;

  b) Increasing capacity on the Affected Routes at fares that do not cover the avoidable cost of providing the service;

  c) Engaging in a policy of "matching" fares offered by low cost carriers on the Affected Routes and operating capacity at those fares:

    i) Without regard for the effect of such fares on Air Canada's profitability;

    ii) Without regard to the additional benefits associated with the service offered by Air Canada; and

iii) With the foreseeable effect of significantly diluting revenues of low cost carriers, rendering their operations unprofitable.

II Definitions

5. In this Application, the following terms have the meaning set out below:

"Affected Halifax Routes"	Means routes flown between the following city pairs, in both directions: St. John's, Nfld. (YYT) – Halifax (YHZ) Montreal (YUL) – Halifax (YHZ) Ottawa (YOW) – Halifax (YHZ)
"Affected Moncton Area Routes"	Means routes flown between the following city pairs, in both directions: Toronto (YYZ) – Moncton (YQM) Toronto (YYZ) – Fredericton (YFC) Toronto (YYZ) – Saint John, NB (YSJ) Toronto (YYZ) – Charlottetown (YYG) Hamilton (YHM) – Moncton (YQM)
"Affected Routes"	Means routes flown between the following city pairs, in both directions: St John's, Nfld (YYT) – Halifax (YHZ) Montreal (YUL) – Halifax (YHZ) Ottawa (YOW) – Halifax (YHZ)

Toronto (YYZ) – Moncton (YQM)

Toronto (YYZ) – Fredericton (YFC)

Toronto (YYZ) – Saint John, NB (YSJ)

Toronto (YYZ) – Charlottetown (YYG)

Hamilton (YHM) – Moncton (YQM)

"ASMs"	Means "available seat mile", which is a measure of capacity. A flight's number of ASMs is equal to the number of seats on the aircraft times the miles flown.
"booking class"	Means a single letter designation that represents the grouping of a number of airfares that are contained within the same category of seat inventory for purposes of yield management.
"carrier"	Means a passenger air carrier or a passenger airline.
"domestic service"	Has the meaning set out in s. 55 of the *Canada Transportation Act*
"fare basis code"	Means the code assigned to a particular fare offered by an airline (eg. "L14EASTS").
"fare"	Means the price of a ticket and its associated restrictions or characteristics.
"fareclass"	Means a collection of fares, usually identified by a letter. (See also "booking class")
"fences"	Means the restrictions that are associated with a particular fare.
"flight"	Means departures of a carrier on a city-pair route that occur at identical or similar times.

"load factor"	Means the percentage of seats occupied by revenue passengers on a given route. Frequently abbreviated as "PLF" (passenger load factor). It is calculated as follows: PLF = RPM / ASM
"low cost carrier"	Means a carrier that has a relatively low level of costs and follows a business plan of offering lower fares and fewer frills aimed primarily at leisure travellers. Carriers following the low-cost, low fare model (described below) are low cost carriers.
"major network carrier"	Means an airline that operates a large collection of integrated domestic, transborder and international scheduled routes that are designed to flow traffic throughout the scheduled network of the airline.
"RPM"	Means "revenue passenger mile", which is equal to the number of passengers on a flight times the mileage of the flight.

III The Parties

6. The Applicant, the Commissioner of Competition (the "Commissioner"), is appointed under s. 7 of the Act and is charged with the administration and enforcement of the Act.

7. Air Canada is the dominant airline in Canada and Canada's only network carrier. Air Canada is subject to the *Canada Business Corporations Act* and the *Air Canada Public Participation Act*. Air Canada operates domestic services and international services (as those terms are defined in the *Canada Transportation Act*).

8. Air Canada operates passenger airline services itself and through a number of subsidiaries, under a number of different brands. Air Canada's two mainline brands are Air Canada and Canadian Airlines (also known as "Canadian"). Air Canada operates four regional

airline brands through a subsidiary, Air Canada Regional Inc.: Air Ontario, Air Nova, AirBC, and Canadian Regional Airlines (“CRAL”).

IV Other Market Participants

A. WestJet

9. WestJet Airlines Ltd. (“WestJet”) is a low cost carrier. It operates a domestic service within the meaning of the *Canada* Transportation *Act*. It commenced operations in western Canada in February, 1996. WestJet currently serves 16 Canadian cities with 23 Boeing 737-200 aircraft. WestJet is a publicly traded company listed on the TSE.

10. WestJet has commitments to acquire 36 Boeing 737-700 aircraft between 2001-2007 and options to acquire up to 58 Boeing 737-700 aircraft between 2005-2008.

11. WestJet follows the low-cost, low-fare model pioneered in the U.S. by Southwest Airlines. This model relies on several strategies to keep costs, and thus fares, down: short haul routes (initially), no-frills service (no meals, no headsets, no advance seat selection no frequent flyer points), and operation of only one aircraft type (Boeing 737).

12. In 2000, WestJet commenced service in central and atlantic Canada on the following routes:

a) Hamilton (YHM) – Thunder Bay (YQT) (service commenced March 8, 2000)

b) Hamilton (YHM) – Winnipeg (YWG) (service commenced March 9, 2000)

c) Hamilton (YHM) – Moncton (YQM) (service commenced April 19, 2000)

d) Hamilton (YHM) – Ottawa (YOW) (service commenced June 8, 2000)

B. CanJet

13. CanJet Airlines (“CanJet”) is a new low cost carrier entrant in central and atlantic Canada.

14. CanJet operates a domestic service within the meaning of the *Canada Transportation Act*. CanJet is a division of I.M.P. Group Limited ("IMP"), a Canadian aerospace, general aviation, and flight management company based in Halifax, Nova Scotia.

15. CanJet currently provides service to six domestic destinations with a fleet of six 737-200 aircraft.

16. CanJet also follows the low cost, low fare model.

17. In April, 2000, CanJet announced its intention to offer passenger airline service from Halifax to a number of eastern Canadian cities. CanJet announced its routes, schedule and fares and began selling tickets in late July. CanJet began providing service linking Halifax, Ottawa, Toronto, Windsor on September 5, 2000. On September 25, 2000, CanJet added service to St. John's, Montreal and Winnipeg and increased frequencies on its existing routes.

18. On October 23, 2000, CanJet announced that it would stop providing service to Windsor in November, 2000.

C. Royal Airlines & Canada 3000

19. Royal Airlines ("Royal") was founded in 1979 principally as a charter carrier and has evolved into a low cost schedule carrier serving Canadian and some international destinations. Royal is a public company with its head office in Montreal. It has a fleet of 17 jet aircraft (Boeing 737, 757, and Airbus 310).

20. Royal serves a variety of domestic routes, including the following:

a) Halifax (YHZ) – Montreal (YUL)

b) Halifax (YHZ) – Ottawa (YOW)

21. Royal also offers limited service for ten weeks during the summer on the following routes:

a) Toronto (YYZ) – Saint John (YSJ)

b) Toronto (YYZ) – Fredericton (YFC)

c) Toronto (YYZ) – Moncton (YQM)

d) Toronto (YYZ) – Charlottetown (YYG)

22. Royal operates as a low cost carrier using Boeing 737 aircraft on the above routes.

23. Canada 3000 was founded in 1988. It serves both Canadian and international destinations with its fleet of 15 jet aircraft. Canada 3000 is a public company with its head office in Toronto.

24. Canada 3000 provides limited service on some of the Affected Routes.

25. On January 29, 2001, Canada 3000 and Royal announced plans to merge. The merger has not yet been completed.

D. Other

26. Air Transat operates limited service on some of the Affected Routes. Air Transat operates principally as a charter carrier on international routes, offering service to Europe and the Caribbean.

27. Roots Air is a domestic carrier operated by Sky Service. It is expected to commence operations on March 26, 2001, between Toronto and Calgary. Roots Air has not announced plans to serve any of the Affected Routes. Roots Air has announced plans to focus on business travellers and high-end leisure travel.

V Background

A. Consolidation of the Canadian passenger airline industry

28. Until December, 1999, Canada had two full-service network carriers that offered domestic and international services: Air Canada and Canadian Airlines. These two carriers accounted for over 80% of passengers in the top 200 city-pair markets in Canada in 1999. These city-pairs represented approximately 90% of total domestic passengers.

29. Air Canada acquired Canadian Airlines Corporation and Canadian Airlines International Ltd. (which operated Canadian Airlines), including their regional airline subsidiary, Canadian

Regional Airlines (1998) Ltd. in late 1999 – early 2000 after giving a series of undertakings to the Commissioner designed to address some of the anti-competitive effects of the merger. Air Canada completed its acquisition of Canadian Airlines in July 2000, and the two corporations were amalgamated under the corporate name “Air Canada” in January, 2001.

30. As a result of its acquisition of Canadian, Air Canada is the dominant domestic airline in Canada. Air Canada has a 90% share of Canadian travel agency sales for domestic markets and at least a 75% share based on seat capacity. Air Canada is the seventh largest passenger airline in North America and the twelfth largest in the world. It operates 375 aircraft and carries over 30 million passengers a year.

B. Legislation affecting airlines

31. Airlines operating in Canada are subject to the provisions of the *Canada Transportation Act*, S.C. 1996, c. 10, and the *Aeronautics Act*, R.S.C. 1985, c. A-2.

32. The *Canada Transportation Act* distinguishes between a “domestic service”, which is an air service between points in Canada, and “international service”, which is an air service between a point in Canada and a point in another country. The statutory distinction between “scheduled” and “charter” carriers has been abolished in the case of domestic services, but not in the case of international services.

33. The *Canada Transportation Act* imposes foreign ownership limits on carriers wishing to operate a domestic service. Such carriers must be Canadian-controlled. Foreign-owned carriers cannot carry passengers between points in Canada.

34. With a few exceptions, airlines are unregulated in setting fares and determining what domestic destinations they will serve.

35. In response to the merger of Air Canada and Canadian, Parliament enacted changes to the *Canada Transportation Act* and the Act. Among other things, s. 78(1)(j) and s. 78(2) were added to the Act, giving the Governor in Council the power to make regulations specifying acts or conduct of a person operating a domestic service as “anti-competitive” for purposes of ss. 78 and 79. The Airline Regulations were made pursuant to this power.

C. Fares, restrictions, and classes of service

36. Airfares vary widely in level of price, availability, conditions (or "fences") that are associated with the fare, whether the fare is for one-way or return travel, and class of service (i.e., business and economy classes). Fares with fewer restrictions are generally higher than fares with more restrictions. The restrictions imposed by network carriers may include the following:

a) Advance booking and purchase requirements;

b) Minimum and maximum stay requirements;

c) Limits on refundability;

d) Limits on changes and change fees; and

e) Time of day, day of week, and flight specific restrictions.

37. Low cost carriers typically have fewer fare restrictions. They often practice yield management by not applying any fare conditions, but simply by limiting the number of seats allocated to various fareclasses, forcing customers to "buy up" to the next highest fare when the seats in a lower fare class are sold out.

38. Airlines use conditions attached to fares to charge different prices to travellers who have different needs. For example, the Saturday stay-over restriction attached to many low fares is designed to make the fare less attractive to business travellers, who generally prefer not to stay over a weekend on domestic business trips.

39. Airlines use the term "fareclass" or "booking class" to denote a ticket with a particular price and associated set of characteristics or restrictions. Usually the fareclass is assigned a letter code. For example, Air Canada has assigned letter "J" to its business class fares and "Y" to its full fare economy fares. Each fare within a fareclass is assigned a "fare basis code" beginning with the letter assigned to that fareclass. For instance, Air Canada introduced the fare basis code "L14EASTS" within the fareclass "L" (which is Air Canada's "leisure" booking class) in response to CanJet's entry. Not all fares in a fareclass have the same restrictions. For instance, advance purchase requirements vary among Air Canada's "L" fares.

40. Carriers have access to extensive "real time" information on their competitors' activities and can respond to competitive initiatives more precisely and swiftly than firms in other industries. Carriers have access to this information because carriers publish their fares and schedule information through a variety of sources, including: computer reservation systems ("CRS"), the Airline Tariff Publishing Company ("ATPCO"), the internet, newspaper advertising, and press releases. Air Canada can, and does, monitor the activities of its competitors, including WestJet, CanJet, and Royal, on a daily basis.

41. Airlines use seat management, also known as yield or revenue management, to price discriminate.

42. Seat management has two phases. The first is the setting of the initial allocation of seats on a flight to different fare classes. This is done in advance of the flight. For example, a flight in the busy Christmas season will have most seats "protected" for higher fareclasses.

43. The second phase is the process by which airlines change those initial seat allocations as bookings occur as the day of the flight approaches. Generally, as more seats on a flight are sold as the date approaches, the seat management system will reduce the number of seats available at the deepest discounts, retaining remaining seats for the late booking high fare traveller.

44. Carriers can quickly shift large amounts of capacity between fareclasses. In this way, carriers can make a large number of less expensive fares available in a market without making any changes in total capacity or to the schedule.

D. Frequencies, connections, frequent flyer points and frills

45. Major network carriers such as Air Canada offer a more attractive, and thus more valuable, service than their low-cost, low-fare rivals. The following features make Air Canada flights more attractive to consumers:

a) *Frequencies:* Air Canada offers more frequencies on all of the Affected Routes than any of its competitors. Air Canada offers more non-stop service than any of its competitors in Canada.

b) *Connections:* Air Canada has an extensive domestic and international network and is affiliated with a number of international carriers though its participation in the Star Alliance of carriers.

c) *Frequent flyer points:* Air Canada offers Aeroplan frequent flyer points that can be redeemed for free air travel.

d) *Frills:* unlike its low-cost, low-fare rivals, Air Canada offers meals and/or snacks, audio and audiovisual entertainment, pillows and blankets, and in-flight telephones on some or all of its flights. Air Canada also offers special services for business travellers, such as the Maple Leaf executive class lounges (available for passengers travelling on executive class or “Élite” and “Super-Élite” Aeroplan members) and executive class service on many of its aircraft.

46. Air Canada has a well-established brand and a long-standing reputation for reliability and safety. Air Canada’s brand and reputation give it an advantage over its newer, smaller competitors, which reinforces its dominance.

47. As a result of its frequencies, connections, frequent flyer points and frills, as well as its reputational advantage, Air Canada offers a service that is more valuable than that offered by its domestic competitors. At equal prices, passengers will generally choose Air Canada’s service over that offered by another domestic competitor.

48. Low cost carriers, particularly new entrants, lack Air Canada’s frequencies, connections, frequent flyer points, frills and reputational advantage. The primary basis they have to compete with Air Canada is price. In order to attract passengers, low cost carriers must generally undercut Air Canada’s price.

49. When Air Canada purportedly *matches* the price set by one of its low-cost competitors, it is effectively offering a lower price, leaving the competitor with little choice but to lower its own price further in order to retain business. Air Canada thus deprives that competitor of the primary basis on which it can compete with Air Canada.

50. Air Canada has higher operating expenses than WestJet, CanJet, or Royal, both on a system-wide basis and on the Affected Routes in particular.

VI Market definition

A. Relevant product market

51. Airline passenger service is a separate product market from other modes of transportation. Bus, rail and other forms of transportation are not close substitutes for passenger airline service on the Affected Routes.

52. Passenger airline services comprise two broad segments: business and leisure travellers, which can, in certain circumstances, be considered separate product markets.

53. Business travellers tend to consider time of day, frequency of service, lack of stops, convenience of connections, frequent flyer points, and service (including meals, business class airport lounges and business class seating) to be as, or more important than price.

54. Leisure travellers tend to be more price conscious. Frequency, connections, frequent flyer points and service are generally less important to leisure travellers than to business travellers. However, some leisure travellers are prepared to pay a premium for these features.

B. Relevant geographic markets

(1) Relevant city-pairs

55. Relevant geographic markets for passenger airline service consist of origin-destination city-pairs, including the catchment areas served by the relevant airports.

56. The following are the specific routes in regard to which Air Canada has engaged in a practice of anti-competitive acts:

a) *Affected Halifax Routes*

i) St. John's, Nfld (YYT) – Halifax (YHZ)

ii) Montreal (YUL) – Halifax (YHZ)

iii) Ottawa (YOW) – Halifax (YHZ)

b) *Affected Moncton Area Routes*

i) Toronto (YYZ) – Moncton (YQM)

ii) Toronto (YYZ) – Fredericton (YFC)

iii) Toronto (YYZ) – Saint John, NB (YSJ)

iv) Toronto (YYZ) – Charlottetown (YYG)

v) Hamilton (YHM) – Moncton (YQM)

57. Air Canada is also the dominant carrier on most domestic routes. Its overall dominance is relevant to this Application as discussed below. In addition, Air Canada's actions have and are likely to prevent competition substantially on other domestic routes.

(2) Relevant catchment areas

58. Airport catchment areas sometimes overlap such that the airports constitute substitutes for each other for some travellers. Leisure travellers, in particular, tend to be price sensitive and more willing to drive to a more distant airport to take advantage of cheaper fares.

59. The following airports that are relevant to this Application have catchment areas that overlap:

a) John C Munro International Airport in Hamilton ("Hamilton Airport") (YHM) and Lester B. Pearson International Airport ("Pearson") (YYZ), (the "Toronto-Hamilton Catchment Area") (Note: Toronto Island Airport (YTO) is also within this catchment area, but no flights on the Affected Routes leave from this airport).

b) Moncton (YQM), Saint John (YSJ), Fredericton (JFC), and Charlottetown (YYG) (the "Moncton Catchment Area"). These cities are all within a reasonable driving distance of the Moncton Airport.

60. Flights offered between Toronto and Moncton are substitutes for and compete with flights offered between Hamilton and Moncton.

61. Flights offered by Air Canada between Toronto and airports in the Moncton Catchment Area are substitutes for, and compete with, flights offered by WestJet between Hamilton and Moncton.

62. Consequently, the city-pair markets identified as Affected Moncton Area Routes can be expressed more broadly to encompass passenger airline travel between the following catchment areas: the Toronto-Hamilton Catchment Area and Moncton; and the Toronto-Hamilton Catchment Area and the Moncton Catchment Area.

63. Air Canada's response to WestJet's entry on the Hamilton-Moncton route included increased capacity and reduced fares on routes between Toronto and Fredericton, Saint John, and Charlottetown, as well as on the Toronto-Moncton route.

(3) Summary — relevant geographic markets

64. The following are the relevant geographic markets in this Application:

a) All domestic city-pair markets;

b) The Affected Halifax Routes, each of which is a relevant geographic market:

   i) St. John's (YYT) – Halifax (YHZ)

   ii) Montreal (YUL) – Halifax (YHZ)

   iii) Ottawa (YOW) – Halifax (YHZ);

c) The Affected Moncton Area Routes, which can be grouped into the following overlapping geographic markets based on catchment areas:

   i) Toronto-Hamilton Catchment Area and Moncton (YQM)

   ii) Toronto-Hamilton Catchment Area and Moncton Catchment Area.

VII Air Canada's Dominant Position

A. Air Canada's dominant position over passenger airline services in Canada

65. Air Canada substantially or completely controls the supply of domestic passenger airline services on most domestic routes in Canada.

66. Air Canada is the only national full-service major network carrier in Canada. It accounts for:

a) over 80% of domestic airline passengers on the top 200 city pairs (which collectively represent over 90% of all domestic airline passengers) (based on 1999 combined Air Canada and Canadian data);

b) 90% of Canadian travel agency sales.

67. Among Air Canada, WestJet, CanJet, Royal, Canada 3000, and Air Transat, Air Canada accounts for:

a) More than 80% of domestic ASMs; and

b) nearly 90% of domestic airline passenger revenues.

68. WestJet is Air Canada's largest domestic competitor, yet Air Canada has more than nine times WestJet's ASMs and RPMs compared to Air Canada's domestic services.

69. Moreover, Air Canada has an overall fleet of 375 aircraft, about eight times the combined fleets of WestJet (23 aircraft), CanJet (6 aircraft) and Royal (17 aircraft). When domestic carriers that are affiliated with but not owned by Air Canada are included, the fleet of the Air Canada family of carriers consists of about 430 aircraft.

70. Air Canada's dominance over the supply of domestic airline services to business travellers is even greater. No competitor of Air Canada offers frequencies, connections, frequent flyer points, or other product characteristics sought by business travellers that are similar to those offered by Air Canada.

71. As the dominant carrier in Canada and the only major network carrier, Air Canada has the ability to redeploy assets (both aircraft and personnel) and capacity between routes.

72. As the dominant airline in most domestic markets, Air Canada is able to sustain unprofitable flights and fare offerings from revenues it earns from profitable flights and fare offerings. Its domestic competitors do not have that ability.

73. Air Canada is Canada's largest international carrier. Air Canada accounts for over half of all traffic on transborder routes including U.S. carriers (routes between Canada and the U.S.).

74. Air Canada is a member of Star Alliance, the world's largest and most comprehensive airline alliance group.

B. Air Canada's dominant position on the Affected Routes

75. Air Canada substantially or completely controls the supply of passenger airline service on the Affected Routes.

76. Air Canada has more frequencies, more capacity, and more passenger revenue on the Affected Routes than any of its competitors. Air Canada's share of weekly frequencies exceeds 50% on all of the Affected Routes, as does its share of weekly capacity (measured by number of seats).

77. Air Canada's share of passenger revenue on each of the Affected Routes is greater than its share of frequencies and capacity.

78. Air Canada controls nearly 100% of the capacity and passenger revenues on the Toronto-Fredericton, Toronto-Saint John, and Toronto-Charlottetown routes.

C. Barriers to entry

79. New entrants into the business of providing passenger airline services in Canada face high costs and barriers to sustainable entry. They include:

a) Requirements in the *Canada Transportation Act* that domestic carriers, including new entrants, must be Canadian owned and "controlled in fact". This imposes restrictions on the financing and contractual relationships that Canadian carriers can have with foreign carriers;

b) Lack of feed traffic at both ends of their routes;

c) Lack of an effective frequent flyer program;

d) Lack of business class airport lounges;

e) Lack of an established brand and reputation for reliability and safety;

f) Costs of leasing or purchasing aircraft;

g) Costs of hiring flight crew (pilots) and cabin crew;

h) Obtaining access to certain airport facilities, including gates, loading bridges, ticket counters and baggage systems;

i) Costs of committing to a schedule in order to establish a reputation for reliability;

j) Advertising, travel agent familiarization costs, and other marketing costs;

k) Scarcity of peak time slots at Toronto Pearson (YYZ).

80. As discussed below, Air Canada’s practices of anti-competitive acts create a significant reputational barrier to entry by other potential new entrants.

VIII Anti-competitive Acts

81. In response to new entry or expansion on the Affected Routes, Air Canada has engaged in and is engaging in a practice of anti-competitive acts within the meaning of s. 78(1) of the Act and the Airline Regulations. Air Canada has engaged in the following anti-competitive acts:

a) Operating capacity on the Affected Moncton Area Routes and the Affected Halifax Routes at fares that do not cover the avoidable cost of providing the service;

b) Increasing capacity on the Affected Moncton Area Routes and the Affected Halifax Routes at fares that do not cover the avoidable cost of providing the service;

c) Engaging in a policy of matching fares offered by low cost carriers on the Affected Routes and operating capacity at those fares:

i) Without regard for the effect of such fares on Air Canada's profitability;

ii) Without regard to the additional benefits associated with the service offered by Air Canada; and

iii) With the foreseeable effect of significantly diluting revenues of low cost carriers, rendering their operations unprofitable.

82. Particulars of these anti-competitive acts are set out below.

A. Avoidable costs

83. Avoidable costs are the costs that an airline could avoid in the event that it removed a flight from its schedule or decided not to add a flight to its schedule. Costs may be avoided either because they would not be incurred (for example, fuel costs), or because the activity or asset could be re-deployed (for example, aircraft and flight crew).

84. Avoidable costs include variable costs and flight specific fixed costs.

85. In determining whether an airline is offering capacity below avoidable costs, it is appropriate to take into account an acceptable rate of return on capital.

86. The Airline Regulations define as an anti-competitive act "…operating capacity on a route at fares that do not cover the avoidable cost of providing the service". Operating a flight on a route at fares that do not cover the avoidable cost of providing the flight constitutes an anti-competitive act within the meaning of the Airline Regulations.

87. With regard to Air Canada's flights on the Affected Routes, the principal general cost categories that are avoidable by Air Canada include the following:

a) Expenses that vary with the number of passengers, such as passenger insurance, travel agent commissions, food and beverages.

b) Expenses that vary with the number of flights, such as fuel and oil, navigation fees, and landing fees.

c) Expenses that either would not be incurred at all, or could be avoided through redeployment, such as aircraft costs, flight crew and cabin crew labour, and maintenance.

88. All of the costs referred to in paragraph 87 are avoidable within a period one of month or less.

89. Air Canada is able to make rapid adjustments in capacity on a route either by adjusting the size of aircraft used for a flight, or by adding or removing a flight from its schedule.

90. For Air Canada, as a major network carrier, many costs are avoidable through the redeployment of assets to other parts of its network. Air Canada is able to redeploy its aircraft, flight crew, cabin crew, and other assets and personnel rapidly. Smaller carriers have less (if any) ability to avoid costs by redeployment of assets.

91. Major network carriers such as Air Canada are able to avoid more of their costs than new entrant low cost carriers. Moreover, as stated above, Air Canada's costs on the Affected Routes are higher than the costs of WestJet, CanJet, and Royal.

92. As discussed below, between April 2000 and the date of this Application, Air Canada has operated flights on the Affected Routes at fares that did not cover the avoidable cost of providing those flights.

<u>B. Air Canada's anti-competitive response to WestJet's entry</u>

(1) WestJet's entry onto the Hamilton-Moncton route

93. On February 29, 2000, WestJet announced that it would begin service between Hamilton and Moncton with one-way fares beginning at $129. WestJet began single daily flights between Hamilton and Moncton on April 19, 2000.

94. WestJet's service between Hamilton and Moncton was its first offering east of Hamilton. It was intended to be the beginning of WestJet's expansion into eastern Canada.

(2) Air Canada's response to WestJet's entry

95. In February, 2000, prior to WestJet's announcement of its Hamilton–Moncton service, Air Canada had announced capacity reductions of approximately 15% system-wide on domestic routes, including reduced capacity on its Toronto-Moncton route.

96. Air Canada has responded to WestJet's entry into the Hamilton–Moncton city-pair by:

a) in the spring, 2000, significantly increasing its capacity on the Toronto-Moncton, Toronto-Fredericton, Toronto-Saint John and Toronto-Charlottetown routes;

b) in the case of Toronto-Moncton, maintaining that increased capacity up to the date of this Application;

c) in the case of Toronto-Fredericton, Toronto-Saint John, and Toronto-Charlottetown, maintaining at least a portion of that increased capacity up to the date of this Application;

d) the introduction of substantially lower fares on the above routes;

e) substantially lowering its average fares by allocating seats to new, lower fares, and by increasing the allocation of seats to cheaper fareclasses, and

f) operating capacity on the above routes at fares which do not cover the avoidable costs of providing the service.

97. In April, 2000, Air Canada introduced the following new fares on its Toronto-Moncton, Toronto-Fredericton and Toronto-Saint John routes:

a) A one-way fare of $129 with a ten day advance purchase restriction, matching WestJet's lowest one-way fare.

b) A one way fare of $179 with an advance purchase requirement of five days.

c) A one way “walk up” fare of $249 with no advance purchase requirement, $90 cheaper than WestJet’s walk up fare of $339. Before WestJet’s entry, Air Canada’s one way walk up fare on these routes was $605.

98. Air Canada set fares on its Toronto-Charlottetown route at $20 higher than on the above routes.

99. These new fares offered prices significantly below those which Air Canada had previously offered on the above routes.

100. Since the spring, 2000, Air Canada has maintained these fares, or substantially similar fares, on all of the above routes.

101. On its Toronto-Moncton route, Air Canada added one frequency and increased its capacity by 73 seats daily, an increase of 40%. On its Toronto-Fredericton and Toronto-Saint John routes, Air Canada added one frequency and increased its capacity by 70 seats, or 46%.

(3) Operating/Increasing capacity below avoidable cost

102. The actions taken by Air Canada in response to WestJet’s entry resulted in Air Canada operating capacity, and increasing capacity, on the Affected Moncton Area Routes, at fares that did not cover the avoidable cost of providing the service. Air Canada operated a significant number of flights on these routes at fares that did not cover the avoidable cost of operating those flights during at least the months of September, October, and November, 2000.

103. Air Canada has continued to operate capacity on the Affected Moncton Area Routes at fares that do not cover the avoidable cost of providing the service. Air Canada has done so while at the same time reducing capacity on other domestic routes.

(4) Anti-competitive fare “matching”

104. As part of its response to WestJet’s entry onto the Hamilton-Moncton route, Air Canada generally matched, or offered prices similar to, WestJet’s prices. For one class of fares, it offered prices below WestJet’s prices.

105. Air Canada offered fares that matched WestJet's prices without regard to the effect of these fares on Air Canada's profitability.

106. By matching WestJet's prices, Air Canada was in fact undercutting WestJet's prices, since, as described more fully above, Air Canada's service is more valuable than that offered by WestJet due to the frequencies, connections, frequent flyer points and frills offered by Air Canada and Air Canada's reputational advantage. Air Canada matched WestJet's prices without regard to the additional benefits associated with the service.

107. By matching WestJet's prices, Air Canada forced WestJet to choose between losing a substantial portion of WestJet passengers to Air Canada, or lowering its prices further in order to retain traffic.

(5) Anti-competitive effect of Air Canada's response to WestJet's entry

108. As described more fully below, Air Canada's response to WestJet's entry has had and will likely have anti-competitive effects. Among other things, Air Canada's response has diluted WestJet's profitability on its Hamilton-Moncton route significantly. As a result, WestJet has curtailed plans to expand its operations on this route on a year-round basis, and has not expanded further to points east of Ottawa.

C. Air Canada's anti-competitive response to CanJet's entry

(1) CanJet's entry

109. In April, 2000, CanJet announced its intention to offer passenger airline service from Halifax to a number of eastern Canadian cities. CanJet announced its routes, schedule and fares and began selling tickets in late July. CanJet began providing service linking Halifax, Ottawa, Toronto, Windsor on September 5, 2000. On September 25, 2000, CanJet added service to St John's, Montreal and Winnipeg and increased frequencies on its existing routes.

(2) Air Canada's response to CanJet's entry

110. Air Canada responded to CanJet's entry on the Affected Halifax Routes by:

a) in the summer, 2000, adding capacity on its Montreal-Halifax, Ottawa-Halifax, and St. John's-Halifax routes;

b) maintaining all or part of that additional capacity through the fall, 2000;

c) introducing new lower fares in September, 2000, and subsequently;

d) substantially lowering its average fares by allocating seats to new, lower fares, and by increasing the allocation of seats to cheaper fare classes, and

e) operating capacity on the Affected Halifax Routes at fares which do not cover the avoidable costs of providing the service.

111. On September 1, 2000, the day after CanJet received its operating licence, Air Canada introduced a new fare, L14EASTS, which generally matched the lowest fares announced by CanJet in August. L14EASTS fares were applicable on its Halifax-Montreal; Halifax-Ottawa; Halifax-St. John's, Toronto-Winnipeg, Toronto-Windsor and Ottawa-Windsor routes.

112. Air Canada's L14EASTS fares offered prices significantly below those which Air Canada had previously offered on the above routes. For example, on Halifax-Ottawa, Air Canada's one-way fare prior to CanJet's entry was $605. Post CanJet's entry, Air Canada introduced its L14EASTS one-way fare on this route at $109 and further reduced its one-way fare to $99 (LAC) introduced on February 13, 2001.

113. On October 12, 2000, the Commissioner ordered Air Canada to withdraw these fares from all of these routes (except for Toronto-Winnipeg), pursuant to section 104.1 of the *Competition Act*.

114. In late October, 2000, Air Canada introduced "L14SPCL" fares on its Halifax-Montreal; Halifax-Ottawa; Halifax-St. John's, and Toronto-Halifax routes. These fares expired in December, 2000.

115. In late December 2000, Air Canada then introduced "Value" fares on the Affected Halifax Routes.

116. In February, 2001, Air Canada introduced LAC fares on its Halifax-Montreal, Halifax-Ottawa, Halifax-St. John's, Toronto-Halifax, and Toronto-Winnipeg routes. The LAC fares were lower than any of Air Canada's previous fares on these routes, and had few restrictions (one-way, no advance purchase requirement).

117. In response to concerns raised by the Competition Bureau, Air Canada withdrew the "LAC" fares on the Halifax-Montreal, Halifax-Ottawa and Halifax-St. John's routes on February 24, 2001.

(3) Operating capacity below avoidable cost

118. The actions taken by Air Canada in response to CanJet's entry resulted in Air Canada operating capacity, and increasing capacity on the Affected Halifax Routes, at fares that did not cover the avoidable cost of providing the service.

119. During the months of September, October, and November, 2000, and subsequently, Air Canada operated a significant number of flights on the Affected Halifax Routes at fares that did not cover the avoidable cost of operating those flights.

120. While Air Canada has made some downward adjustments to its capacity on these routes in October, 2000, and January, 2001, it has continued to operate flights on the Affected Halifax Routes at fares that do not cover the avoidable cost of providing the flights.

(4) Anti-competitive fare matching

121. As part of its response to CanJet's entry, Air Canada generally matched the lowest prices originally announced by CanJet on the Affected Halifax Routes, and later, with the introduction of the LAC fares, matched CanJet's lowest prices then in effect.

122. As a result of Air Canada's matching its prices, CanJet has been forced to lower its prices further and/or to increase the allocation of seats to its lowest fares.

123. Air Canada offered fares which matched CanJet's prices without regard to the effect of these fares on Air Canada's profitability.

124. By matching CanJet's prices, Air Canada was in fact undercutting CanJet's prices, since, as described more fully above, Air Canada's service is more valuable than that offered by CanJet due to the frequencies, connections, frequent flyer points and frills offered by Air Canada and Air Canada's reputational advantage. Air Canada matched CanJet's prices without regard to the additional benefits associated with the service it offers.

125. By matching CanJet's prices, Air Canada forced CanJet to choose between losing a substantial portion of its passengers to Air Canada, or lowering its prices still further in order to retain traffic. In either case, CanJet would not be able to operate its service on these routes profitably.

(5) Anti-competitive effect of Air Canada's response to CanJet's entry

126. As described more fully below, Air Canada's response to CanJet's entry has had and will likely have anti-competitive effects. Among other things, Air Canada's response has made CanJet's entry onto the Affected Halifax Routes unprofitable. As a result, CanJet is likely either to exit these routes or curtail its activities.

IX Substantial lessening or prevention of competition

127. Air Canada's practice of anti-competitive acts outlined above is having or is likely to have the effect of preventing or lessening competition substantially in the following markets:

a) The supply of passenger airlines service on the Affected Halifax Routes;

b) The supply of passenger airline service between the Toronto-Hamilton Catchment Area and Moncton Catchment Area; and

c) The supply of passenger airline service between the Toronto-Hamilton Catchment Area and the Moncton Catchment Area.

128. In addition, Air Canada's practice of anti-competitive acts will likely substantially prevent competition by stifling expansion of the operations of WestJet, CanJet and other carriers in these markets and other markets in Canada.

A. Substantial Lessening of Competition

129. Air Canada's actions have had and continue to have the following effects on WestJet:

a) WestJet's performance on the Hamilton (YHM) – Moncton (YQM) route has been and continues to be unprofitable.

b) WestJet is unlikely to operate profitably on this route in the future if Air Canada is permitted to continue engaging in the practice of anti-competitive acts outlined above;

c) WestJet has curtailed its plans to expand to twice daily service on the Hamilton-Moncton route on a year-round basis; and

d) WestJet has not expanded its service to other points east of Ottawa.

130. Air Canada's actions have had and continue to have the following effects on CanJet:

a) CanJet's performance on the Affected Halifax Routes has been and continues to be unprofitable.

b) CanJet is unlikely to operate profitably on these route in the future if Air Canada is permitted to continue engaging in the practice of anti-competitive acts outlined above.

c) CanJet has curtailed expansion on the Affected Routes and other routes in eastern Canada.

131. Air Canada's actions have had and continue to have the following effects on Royal:

a) Royal's performance on the Halifax-Montreal and Halifax-Ottawa routes has been and continues to be unprofitable;

b) Royal is unlikely to operate profitably on these route in the future if Air Canada is permitted to continue engaging in the practice of anti-competitive acts outlined above.

132. Air Canada’s practice of anti-competitive acts is likely to result in a substantial lessening of competition on the Affected Routes, because:

a) WestJet, CanJet, and Royal are Air Canada’s only significant competitors on the Affected Routes;

b) WestJet, CanJet and Royal are likely to exit or curtail their operations on the Affected Routes if their operations on those routes continue to be profitable;

c) If WestJet exits the Hamilton (YHM) – Moncton (YQM) route, Air Canada will have a monopoly over the supply of passenger airline service between the Toronto-Hamilton Catchment Area and the Moncton Catchment Area;

d) If either of CanJet or Royal exits the Affected Halifax Routes, Air Canada will face substantially less competition on those routes, and its dominant position over those routes will be strengthened;

e) If both CanJet and Royal exit the Affected Halifax Routes, Air Canada will have a near monopoly over the supply of passenger airline service on those routes;

f) The Affected Halifax Routes comprise the majority of CanJet’s service. If it exits these markets, it will likely leave the passenger airline business altogether.

B. Substantial prevention of competition

133. Air Canada’s practice of anti-competitive acts is likely to substantially prevent competition in the supply of passenger airline service in eastern Canada because WestJet, CanJet, Royal and others are not likely to expand their operations in eastern Canada.

C. Barriers to entry

134. As stated above, potential new entrants into the business of providing passenger airline service face high costs and barriers to sustainable entry.

135. Air Canada’s practice of anti-competitive acts creates a significant reputational barrier to entry by other potential new entrants. Air Canada’s response to WestJet’s and CanJet’s entry

onto the Affected Routes signals to potential new entrants the type of response they would face if they attempted to enter domestic markets. Rational potential new entrants will factor in such a response to their business plans, making new entry unlikely. If Air Canada is successful in forcing WestJet, CanJet, or Royal from any of the Affected Routes, this reputational barrier will be raised even higher.

X Conclusion

136. Air Canada substantially or completely controls the supply of passenger airline services in Canada as well as on the Affected Routes.

137. Air Canada has engaged in and continues to engage in a practice of anti-competitive acts, as outlined above.

138. These anti-competitive acts are likely to result in a substantial lessening of competition on the Affected Routes. Air Canada’s anti-competitive acts have made entry or expansion by CanJet, WestJet, and Royal unprofitable; and these airlines are likely to exit these routes or retrench their presence on the Affected Routes.

139. Air Canada’s acts are also likely to result in a substantial prevention of competition on the Affected Routes and other city pairs in eastern Canada. WestJet, CanJet, Royal and others are unlikely to expand their operations in eastern Canada.

XI Relief sought

140. The Commissioner requests an Order prohibiting the Respondent, including its affiliates, officers or agents (collectively, “Air Canada”) from:

a) operating capacity at fares that do not cover the avoidable cost of providing the service on the following routes (the “Air Canada Affected Routes”):

i) St John’s, Nfld (YYT) – Halifax (YHZ)

ii) Montreal (YUL) – Halifax (YHZ)

iii) Ottawa (YOW) – Halifax (YHZ)

iv) Toronto (YYZ) – Moncton (YQM)

v) Toronto (YYZ) – Fredericton (YFC)

vi) Toronto (YYZ) – Saint John, NB (YSJ)

vii) Toronto (YYZ) – Charlottetown (YYG)

b) Increasing capacity on the Air Canada Affected Routes at fares that do not cover the avoidable cost of providing the service;

c) Engaging in a policy of “matching” fares offered by low cost carriers on the Affected Routes and operating capacity at those fares;

i) Without regard for the effect of such fares on Air Canada’s profitability;

ii) Without regard to the additional benefits associated with the service offered by Air Canada as a result of its market dominance; and

iii) With the foreseeable effect of significantly diluting revenues of low cost carriers, rendering their operations unprofitable.

141. If necessary, the Commissioner will request an Order under section 104 prohibiting Air Canada from offering fares or operating capacity on the Affected Routes on such terms as may be requested by the Commissioner.

XII Procedural Matters

142. The Commissioner requests that this Application be heard on an expedited basis.

143. The Commissioner requests that this Application be heard in Ottawa in the English language.

144. For purposes of this Application, service of all documents on the Commissioner can be served on:

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Counsel to the Commissioner of Competition

DATED at Hull, Quebec, this 5th day of March, 2001

Konrad von Finckenstein, Q.C.,
Commissioner of Competition

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

NOTICE OF APPLICATION

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