

AFFIDAVIT OF GARY J. DORMAN

d. January 18, 1993

I, GARY J. DORMAN, of the City of Los Angeles in the State of California, one of the United States of America, MAKE OATH AND SAY AS FOLLOWS:

1. I am a Senior Vice President of National Economic Research Associates, Inc. (NERA). NERA has been retained by counsel for American Airlines to analyze certain of the competition issues arising in connection with the Application of The Director of Investigation and Research.

2. I have prepared the attached document entitled "Testimony of Dr. Gary J. Dorman." The opinions expressed therein are true to the best of my knowledge, information and belief. My qualifications to give this testimony are described in Appendix 1 of the attached document.

SWORN before me,
a Notary Public for the State of California, in the United States of America, on the 18th day of January, 1993 at Los Angeles, California in the United States of America

Samala Leonard
Notary Public



Gary J. Dorman

Gary J. Dorman

COMPETITION TRIBUNAL TRIBUNAL DE LA CONCURRENCE	
JAN 18 1993 <i>CB</i>	
REGISTRAR	
OTTAWA, ONT. #724	

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TESTIMONY OF DR. GARY J. DORMAN

I. INTRODUCTION

1. My name is Gary J. Dorman. I am an economist and a Senior Vice President of National Economic Research Associates, Inc. (NERA), where I specialize in antitrust economics. I have conducted research on the airline industry during the past nineteen years, and have published a number of articles on the subject. I have been a consultant to the United States Civil Aeronautics Board (CAB) as well as to several U.S. and foreign air carriers. I have testified as an expert witness in five airline proceedings before the CAB, in three airline proceedings before the U.S. Department of Transportation (DOT), and in two airline antitrust proceedings in the U.S. District Courts.

2. I have studied airline computer reservation systems (CRSs) during the past ten years, and have written a number of reports concerning CRSs. I have testified as an expert witness on CRSs before the Competition Tribunal (In the matter of the combination of the Reservec and Pegasus computer reservation systems into the Gemini Group), in the U.S. District Court for the Central District of California (In Re Air Passenger Computer Reservation Systems Antitrust Litigation), and by affidavit before the U.S. DOT (In Re Computer Reservations Systems). My qualifications are described in detail in Appendix 1 to this testimony.

3. NERA has been retained by counsel for American Airlines to analyze certain of the competition issues arising in connection with the Application of The Director of Investigation and Research in this proceeding. I do not own stock in any U.S. or Canadian airline or CRS, nor do I have any financial stake in the outcome of this proceeding. Based upon my research and analysis, my testimony is as follows.

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II. THE LINKAGE BETWEEN AIRLINE SERVICES AND CRS SERVICES

4. Travel agencies tend to choose the CRS affiliated with the airline with which the agency does the most business, so long as that CRS has reasonable functionality relative to competing CRSs. There is little dispute that this is true. For example, Covia has stated:

[There are] factors other than CRS that would be far more likely to influence Apollo agencies to book more on United or USAir. These factors include (1) the fact that agents in many cases choose the CRS of the airline with which they are doing the most business; ... [Opening Comments of Covia Partnership in Response to Notice of Proposed Rulemaking, June 24, 1991, page 22, U.S. DOT Docket No. 46494.]

5. The empirical evidence for this observation is quite dramatic. In the United States, where the four domestic CRSs are roughly comparable in functionality, SABRE's 1992 share of nationwide locations was 38 percent and its share of bookings was 41 percent. In Minneapolis, however, where Northwest has its principal hub and is by far the largest airline, SABRE's share of locations was 23 percent and its share of bookings was 18 percent. In contrast, the WorldSpan CRS, which is sponsored by Northwest (along with Delta and TWA) and is the third largest CRS in the U.S., had a 57 percent share of locations and a 65 percent share of bookings in Minneapolis.

6. In Houston, a Continental hub, the SystemOne CRS (sponsored by Continental) had a 41 percent share of locations and a 46 percent share of bookings, even though it is the smallest of the four U.S. CRSs. In Raleigh-Durham, an American hub, SABRE's CRS shares are 54 percent of locations and 66 percent of bookings, which are higher than its national averages. In Pittsburgh, a USAir hub, Apollo (owned in part by USAir) has a share of locations of 41 percent and a share of bookings of 47 percent, even

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though it is only the second largest CRS nationwide. Similar results are found at most major hub cities in the United States: a CRS's share in a city tends to be higher where its sponsoring airline is the leading carrier. [These data were calculated by American Airlines using data tapes provided by each of the U.S. CRS vendors; the data are for the first nine months of 1992.] The evidence is overwhelming that travel agencies tend to choose the CRS sponsored by the airline with which the agency does the most business.

III SABRE'S POSITION IN CANADA

7. SABRE has achieved some success in Canada and presently accounts for approximately 35 percent of the CRS business in Canada [Response of the Respondents, Covia Canada Corp. and Covia Canada Partnership Corp. to Notice of Application, paragraph 19]. However, it is important to note that this success was achieved during the period when the systems offered by its primary competition were Reservec and Pegasus, which were functionally inferior to SABRE by a substantial margin. [See, e.g., Air Canada's Responses To Interrogatories Of The Bureau Of Competition Policy Dated May 25, 1987, Director Production Item 85, Groupe Innova Inc. study, pages DHFK 125 to DHFK 215.] In fact, Reservec and Pegasus have recently been scrapped by Gemini as travel agency systems and replaced with Apollo.

8. Since mid-1992, Apollo by Gemini (APG) has been made available to all Reservec/Pegasus/Gemini agents, and Gemini officials believe it to be at least the equal of the SABRE system:

Gemini, Covia, and Galileo are forging a truly worldwide CRS platform jointly owned by 13 airlines that will have a lasting competitive advantage over American Airlines' Sabre. ... Gemini will ensure that Apollo by Gemini remains competitive with Sabre

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in functionality and will add to its already sizable investment to ensure that Apollo by Gemini continues to meet the ongoing needs of the Canadian market.

Gemini and Covia have built a state-of-the-art product that competes with American Airlines' Sabre system. ["Interpretation of Current Events Affecting Gemini," The Gemini Group, November 25, 1992, page 2.]

If, in fact, SABRE's substantial technological advantage has been eliminated, then SABRE's current market penetration may well represent its high water mark.

9. Moreover, even if Canadian Airlines were to be hosted in SABRE rather than Gemini, the tendency of travel agents to choose the CRS of the airline with which they do the most business would still create a marketing advantage for Gemini. At present, Air Canada and its airline partners account for approximately 55 to 60 percent of the airline traffic in Canada, while Canadian and its airline partners account for approximately 35 to 40 percent of the traffic. Even if one were to add American's small traffic share (limited to transborder flights) to Canadian's, purportedly as some measure of SABRE's prospective airline base in Canada, it is still substantially smaller than that of the airlines affiliated with Gemini and Covia: Air Canada, United, USAir, British Airways, Swissair, KLM and Alitalia. There is no basis for the proposition that a linkup between Canadian Airlines and SABRE would create an insurmountable marketing barrier for Gemini, especially given Gemini's self-professed technical equality with SABRE.

IV. IMPROBABILITY OF A SABRE CRS MONOPOLY IN CANADA

10. Even if one were to assume that the transfer of Canadian Airlines hosting from Gemini to SABRE would result in the demise of the Gemini partnership, this would be quite unlikely to result in the creation of a SABRE CRS monopoly in Canada. The

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primary reason is that over 60 percent of the travel agencies in Canada are currently using Apollo by Gemini, and those CRS services almost certainly would not cease if the Gemini partnership is dissolved. The partnership would have every incentive to transfer the Gemini operation directly to Covia because it would obviously be the best way to salvage as much as possible of the partners' investments in Gemini.

11. The logic of such a transfer is reinforced by the following considerations.

(1) The Gemini CRS service is actually provided by computer hardware and software which are physically located in Covia's facility in Denver, Colorado. Gemini itself provides the Canadian communications network and a switch in Winnipeg which connects the Gemini subscribers to the Denver computer center. (2) A transfer of Gemini operations directly to Covia could be made with no disruption to subscribers, since the system is already in place and the agents are already trained. Moreover, Gemini's contract terms permit it to transfer the service to a new CRS provider without the consent of the travel agents. (3) Transferring the Gemini CRS services (as distinct from the hosting services) to Covia would almost certainly be attractive and profitable to Covia, because its incremental costs of serving the Gemini subscriber base would likely be low and many of the necessary investments have already been made. (4) Operating a CRS in a foreign country in conjunction with one or more local airlines is a common practice of U.S. CRS vendors, and has occurred in Asia (Abacus), Australia (Fantasia, Southern Cross) and Europe (Galileo).

12. In summary, the likelihood of a SABRE monopoly of CRS services in Canada is quite remote. Covia is the second largest CRS in the United States, and operates globally through its cross-ownership with Galileo. Covia is a one-third owner of Gemini, which currently has over 60 percent of the CRS locations in Canada. In the event of the

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failure of the Gemini partnership, it is implausible that Covia would simply abandon Canada and the thousands of subscribers now using its CRS pursuant to contracts with Gemini.

13. Moreover, even if Covia were to withdraw from Canada, another CRS would likely seize the opportunity to enter Canada and compete with SABRE for those thousands of travel agencies. One possibility would be WorldSpan, which is now backed by three major U.S. carriers: Delta, Northwest and TWA. Note that at the time of SABRE's entry into Canada, WorldSpan's predecessor--PARS--was owned solely by TWA and was a much weaker competitor. A second possibility would be the entry of SystemOne, especially now that Air Canada has agreed to purchase a substantial share of Continental Airlines, SystemOne's owner. In view of all of the above factors, the prospect of a SABRE CRS monopoly in Canada is extremely remote.

V. THE PROPER FOCUS OF THIS INQUIRY

14. All of the analysis presented above addresses a secondary issue in this proceeding: the possible consequences of the proposed remedies with respect to CRS competition in Canada. The primary issue, which cannot be overemphasized, is the possible consequences of the proposed remedies with respect to airline competition in Canada. In my view, competition policy--whether in the form of antitrust laws or regulatory requirements--has as its goal the protection of the welfare of consumers. The consumers who need protection here are airline travelers to, from and within Canada. They need to be protected from the airline monopoly which would be the inexorable result of the failure and liquidation of Canadian Airlines. (I leave it to other experts to analyze in detail the anticompetitive consequences of such an event.)

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15. With this focus firmly in mind, it is apparent that the CRS market is simply an upstream (input) market wherein airlines and travel agents purchase CRS services to assist them in selling air transportation services to their customers. The secondary risk to consumers (if any) of an upstream CRS monopoly is dwarfed by the primary risk to consumers of a downstream airline monopoly. Moreover, it is difficult to see how the establishment of a SABRE CRS monopoly in Canada (however remote a possibility) would create an airline monopoly in Canada. It is not plausible that the proposed remedies would cause the demise of Air Canada and the establishment of a Canadian Airlines monopoly in Canada. However, denial of the proposed remedies may well cause the demise of Canadian Airlines and the establishment of an Air Canada monopoly in Canada. (Again, I leave this proposition to other experts to analyze in detail.)

16. Finally, it is worth noting that in the disastrous event of an airline monopoly in Canada, a monopoly of CRS services in Canada would likely be of little additional consequence to consumers. The primary benefit to consumers of CRS competition is the increased functionality of CRSs, the most important aspect of which is the capability of these systems to find the lowest fare available. While other CRS capabilities are certainly convenient and desirable (e.g., boarding passes), consumers have consistently shown that their primary concern is obtaining the lowest possible air fare. In the event of an airline monopoly in Canada, the availability of discount fares is likely to be sharply curtailed, so the primary benefit to consumers of (upstream) CRS competition will become of little consequence. It is therefore vital, as a matter of public policy, to focus on the preservation of airline competition in Canada, especially because the proposed remedies do not threaten to create a CRS monopoly in Canada.

GARY J. DORMAN
Airline Industry Experience

Education

Ph.D. in Economics, University of California, Berkeley, 1976

Fields of specialization: Industrial Organization, Microeconomic Theory, Econometrics

Doctoral dissertation: Airline Competition: A Theoretical and Empirical Analysis

A.B. with High Distinction and High Honors in Economics, University of Michigan, 1972

Employment

National Economic Research Associates, Inc., 1980-present (current position: Senior Vice President and Director of Los Angeles office)

Senior Economist, Office of Policy Analysis and Development, National Telecommunications and Information Administration, U.S. Department of Commerce, 1979-1980

Staff Economist, Policy and Evaluation, U.S. Department of Energy, 1978-1979 (on leave from University of Maryland)

Assistant Professor of Economics, University of Maryland, 1976-1979 (on leave during 1978-1979 academic year)

Professional Activities

At National Economic Research Associates:

Fields of specialization: antitrust and trade regulation matters, economic damages

Primary industries studied: airlines, soft drinks, telecommunications equipment and services

Editorial Consultant for The American Economic Review, 1977-1981

Consultant to Office of Economic Analysis, U.S. Civil Aeronautics Board, 1977-1978

Selected Publications

- "Monopsony Revisited: A Comment on Blair & Harrison," with J. Jacobson, Antitrust Bulletin, Spring 1992
- "Joint Purchasing, Monopsony and Antitrust," with J. Jacobson, Antitrust Bulletin, Spring 1991
- "A Model of Unregulated Airline Markets," in Research in Transportation Economics, Volume 1, edited by T. Keeler, JAI Press, 1983
- Review of Airline Deregulation: The Early Experience, by J. Meyer, et al, in Journal of Economic Literature, March 1983
- "Air Service to Small Communities After Airline Deregulation," NERA Topics, January 1982
- Air Transportation Regulatory Reform, American Enterprise Institute for Public Policy Research, Washington, D.C., March 1978

Testimony in Airline Cases Before the U.S. Civil Aeronautics Board (CAB) and the U.S. Department of Transportation (DOT)

- Chicago-Midway Low-Fare Route Proceeding, Docket #30277 (CAB)
- Transcontinental Low-Fare Route Proceeding, Docket #30356 (CAB)
- California-Nevada Low-Fare Route Proceeding, Docket #31574 (CAB)
- Application of Eastern Air Lines, Inc. for Approval of Acquisition of Control of National Air Lines, Inc., Docket #34226 (CAB)
- Texas International-Continental Acquisition Case, Docket #39285 (CAB)
- Pacific Division Transfer Case, Docket #43065 (DOT)
- NWA-Republic Acquisition Case, Docket #43754 (DOT)
- U.S.-London Gateways Case, Docket #44432 (DOT)
- In Re Computer Reservations Systems, Docket #46494 (DOT)

Testimony in Airline Cases Before the Courts

In the Matter of the Combination of the Reservec and Pegasus Computer Reservation Systems into the Gemini Group, The Competition Tribunal of Canada, CT 88/1

In Re Air Passenger Computer Reservation Systems Antitrust Litigation, U.S. District Court (Central District of California), MDL 667 ER (Tx)

Pacific Express, Inc. and Pacific Express Holding, Inc. v. United Air Lines, Inc., U.S. District Court (Central District of California), Case No. CV 84-5185-ER (Mox)

In Re Domestic Air Transportation Antitrust Litigation, U.S. District Court (Northern District of Georgia), Master File No. 1:90-CV-2485-MHS & MDL No. 861

Fellowships and Honors

Faculty Research Award, University of Maryland, 1977

Sloan Transportation Fellowship, University of California, Berkeley, 1975-1976

William H. Probert Scholarship, University of California, Berkeley, 1972-1973

Sims Senior Honors Scholar in Economics, University of Michigan, 1971-1972

Memberships

American Economic Association

Associate, American Bar Association

Phi Beta Kappa

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