CT - 88 / 1

IN THE MATTER OF an application by the Director of Investigation and Research under subsection 64(1) of the *Competition Act*, R.S.C. 1970, c. C-23, as amended;

AND IN THE MATTER OF a Limited Partnership formed to combine the operations of the Reservec and Pegasus computer reservation systems;

AND IN THE MATTER OF The Gemini Group Automated Distribution Systems Inc.;

AND IN THE MATTER OF an application by the Director of Investigation and Research under section 106 of the *Competition Act*, R.S.C., 1985, c. C-34, as amended,to vary the Consent Order of the Tribunal dated July 7, 1989.

B E T W E E N :

The Director of Investigation and Research

Applicant

\- and -

Air Canada
PWA Corporation
Canadian Airlines International Ltd.
The Gemini Group Limited Partnership
The Gemini Group Automated Distribution Systems Inc.
Covia Canada Corp.
Covia Canada Partnership Corp.

Respondents

\- and -

Consumers' Association of Canada
American Airlines, Inc.
Attorney General of Manitoba
Alliance of Canadian Travel Associations
Bios Computing Corporation
IBM Canada Ltd.
Via Rail Canada Inc.
Unisys Canada Inc.
Council of Canadian Airlines Employees
Attorney General of Alberta

Intervenors

REASONS AND ORDER

Dates of Hearing:

February 1-5, 8-12, 15-19, 22-24, 26; March 1-4, 1993

Presiding Member:

The Honourable Mr. Justice Barry L. Strayer

Lay Members:

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COMPETITION TRIBUNAL

REASONS AND ORDER[1]

The Director of Investigation and Research

v.

Air Canada et al.

I. INTRODUCTION: RELIEF REQUESTED

On July 7, 1989, the Tribunal issued an order, with the consent of all parties, allowing the merger of the computer reservation systems ("CRSs") of Air Canada and Canadian Airlines International Limited ("Canadian") to proceed subject to certain conditions.[2] The resulting merged entity is called "Gemini". Gemini is currently owned equally by three partners, Air Canada, Canadian's parent PWA Corporation ("PWA") and Covia, which is the name used to refer jointly to two related corporations, Covia Canada Partnership Corporation and Covia Canada Corporation.

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[1] After the hearing and after these reasons were drafted the Tribunal was provided with a copy of the decision of the Ontario Court, General Division, in *PWA Corporation v. The Gemini Group Automated Distribution Systems Inc.* (2 April 1993), (Ont. C.J.) [unreported]. Written submissions have been received from counsel as to whether the Tribunal should have regard to that decision. The Tribunal has not found it necessary to do so.

[2] Consent Order (7 July 1989): Exhibit A-XVII-11.

On November 5, 1992, the Director of Investigation and Research ("Director") applied to the Tribunal under section 106 of the *Competition Act*[3] ("Act") for a variation of the 1989 Consent Order. The Director alleges that circumstances have changed since the 1989 Consent Order was issued and that airline competition in Canada is now threatened by a hosting contract entered into by Gemini with its airline partners, Air Canada and Canadian. Pursuant to this contract, Canadian is obliged to buy services relating to the management of its internal reservation systems from Gemini until at least 1999. The Director alleges that in their current financial condition, Canadian and its parent PWA cannot survive on their own and that their demise, whether by failure or merger with Air Canada, would result in a substantial lessening of competition in airline markets in Canada. He submits that the only pro-competitive solution available is a proposed transaction by PWA and Canadian with AMR Corporation ("AMR"), the parent of American Airlines, Inc. ("American"), which incorporates an equity investment by AMR of $246 million, a frequent flyer exchange program and a 20-year service contract. To supply the services, AMR requires a transfer of Canadian's internal reservation system from Gemini to Sabre, the CRS owned by American.[4] The Director therefore

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[3] R.S.C., 1985, c. C-34, as amended.

[4] The proposed transaction is set out in various documents, including the Stock Purchase Agreement (29 December 1992): Confidential Exhibit CA-IX-262. Clause 6.2(j) of that agreement reads:

> Purchaser [AMR through a subsidiary] (i) shall be satisfied, acting reasonably, that neither Company [Canadian], Purchaser nor any of their respective Affiliates is or will become liable or responsible to any of the Gemini Group Limited Partnership or such partnership's partners and related entities including The Gemini Group Automated Distribution Systems Inc. ... for any material loss,

asks the Tribunal to vary its 1989 Consent Order by adding a term to the hosting contract which would permit such a transfer. Of the original parties to the Consent Order, only PWA and Canadian support the Director in the application for this variation; the other partners in Gemini and Gemini itself are strongly opposed.

In the Notice of Application, the Director asked that the Tribunal vary the Consent Order as follows:

> (1) To require the parties to provide for early termination of the Gemini Hosting Contract dated as of June 30, 1989 . . . on such terms as the Tribunal may determine; and
>
> (2) To require the parties to provide for early termination of all other hosting contracts between The Gemini Group Partnership and affiliates of PWA Corporation ("PWA") or AC on such terms as the Tribunal may determine; or
>
> (3) In the alternative, to require dissolution of The Gemini Group Partnership.

During the course of the hearing, the Director amended the request for relief somewhat. On February 10, 1993, he filed a "Draft Consent Order Variation" which requests that the Consent Order be varied by the addition of the following paragraph:

> cost, damage or expense in respect of any claims or potential claims of any nature whatsoever ... arising out of or relating to the negotiation, execution, delivery or performance by Company, PWA or any of their Affiliates of the Transaction Documents to which any of them is a party . . . or (ii) shall have received from Company an unconditional release obtained from Gemini. . . .

> AND IT IS FURTHER ORDERED that Air Canada, Canadian and Gemini shall provide for termination of the hosting services provided by Gemini to Canadian and its affiliates pursuant to the Computer Reservation Systems Contract dated June 1, 1987, or any other or successor agreement, on the following terms:
>
> (a) Canadian shall give reasonable notice of termination to Gemini. In the event of disagreement among the parties as to the appropriate notice period, it shall be fixed by the Tribunal;
>
> (b) on receipt of a notice of termination from Canadian, Gemini shall cooperate fully with Canadian in effecting an orderly transition and termination of Canadian's hosting, on condition that Canadian pay Gemini for all expenses incurred, and pay Gemini at prevailing rates for all work performed by Gemini in the transition process;
>
> (c) if the Tribunal deems it appropriate and the circumstances warrant, Canadian shall make a further payment to Gemini in an amount to be determined by the Tribunal;
>
> (d) such other terms as the Tribunal may order.

In final argument, the Director quantified a period of "reasonable notice" as twelve months. Although otherwise in agreement with paragraphs (a) and (b), PWA and Canadian submit that nine months notice is reasonable. They oppose the making of any "further payment" in compensation to Gemini, as referred to in paragraph (c) above. Counsel for PWA and Canadian did, however, undertake to the Tribunal that upon completion of the transfer of Canadian's hosting to Sabre and the resolution of all ancillary matters, PWA would grant to the other Gemini partners an option to acquire its partnership interest for $1.00. There was no response from any other party.

Among the respondents opposing the Director, Gemini itself argues against an award of compensation, on the grounds that the Tribunal is without jurisdiction to make the award. Covia supports the jurisdiction of the Tribunal to order compensation if the Tribunal has the jurisdiction to grant the variation at all. Air Canada took no position on the issue of compensation.

A number of intervenors also participated in these proceedings.[5] The Attorney General of Alberta, the Alliance of Canadian Travel Associations ("ACTA"), American, the Consumers' Association of Canada and the Council of Canadian Airlines Employees supported the Director's application. IBM Canada Ltd. ("IBM"), Unisys Canada Inc. ("Unisys") and VIA Rail Canada Inc. ("VIA") opposed the application.

All intervenors that considered the issue are in agreement that a reasonable notice period must be provided. American proposes that the date for the transfer of hosting should be no earlier than April 1, 1994. IBM, which supplies Gemini with computer equipment pursuant to financing leases, suggests a date of June 30, 1995, which is the date that Gemini leases with IBM expire. Unisys, which supplies Gemini with computer maintenance pursuant to a contract, would require two years notice, as would VIA, which maintains its internal reservation system in Gemini.

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[5] Although nominally intervenors, the Attorney General of Manitoba and Bios Computing Corporation did not play active roles.

American and ACTA both support, in general terms, some form of payment to Gemini by Canadian for the costs incurred by Gemini in assisting in the transfer of hosting. ACTA proposes several additional terms which would, in essence, give subscribers to any CRS in Canada the option of switching CRSs during a window period immediately after the transfer of Canadian's hosting, irrespective of when their contract would otherwise come up for renewal. ACTA further asks that the Tribunal forbid airline-owners from marketing their CRS in Canada and require PWA to abandon its partnership interest in Gemini if the order is granted.

II. BACKGROUND AND HISTORY OF THE PROCEEDINGS

As of June 1987, Air Canada and Canadian had merged their previously independent CRSs, called Reservec and Pegasus respectively, to form Gemini. The merger was accomplished through the vehicle of a limited partnership. Initially, Air Canada and PWA each held a 50 per cent interest in the partnership (The Gemini Group Limited Partnership) and in the corporate general partner which manages the business of the partnership (The Gemini Group Automated Distribution Systems Inc.).

Consequent upon the merger, Gemini, Air Canada and Canadian entered into the "Computer Reservations System Contract" dated June 1, 1987,[6] which is referred to in the Director's amended prayer for relief quoted above. Pursuant to article 2.02 of that contract, Canadian and Air Canada gave Gemini the exclusive right to manage their internal reservations systems for an extended term. The agreement may be terminated with the consent of the parties, upon termination of the partnership or two years after the date on which either Air Canada or PWA ceases to be a partner (article 9.01). The partnership agreement of the same date provides various "window periods" at ten-year intervals for a partner to leave the partnership by selling its interest with the consent of two-thirds of the limited partners (including itself) and of the general partner.[7] PWA might, therefore, have been able to exit in 1997, the first such window, and terminate Canadian's hosting arrangements with Gemini in 1999.

The 1987 agreement was superseded by the "Gemini Hosting Contract" dated as of June 30, 1989.[8] This successor agreement between the same parties was entered into at the same time as Covia became the third partner in Gemini. The grant of exclusivity in providing hosting services in favour of Gemini is similar in this version. The first window period (which now occur at five-year intervals) that would

[6] Exhibit A-V-105.

[7] Exhibit R-IA-2 at Schedule B.

[8] Exhibit A-I-43.

allow PWA to sell its partnership interest still occurs in 1997, although six months later than in the original partnership agreement.[9]

The Director originally challenged the Gemini merger under section 92 (then section 64) of the Act in March 1988, by bringing an application to the Tribunal to dissolve the merger. The Director alleged in the Notice of Application that the merger was likely to prevent or lessen competition substantially in the "provision of computer reservation systems . . . services to airlines, travel agents and consumers in Canada".[10] It also sets out the factors that the Director intended to put before the Tribunal regarding the competitive impact of Gemini in the Canadian CRS market and other effects of the merger, including its impact on competition in the airline industry and on travel agents and consumers. The Director alleged that Air Canada and Canadian could effectively eliminate Gemini's existing CRS competitors and block entry into the CRS market in Canada by refusing other CRSs access to information provided to Gemini and by not fully participating in other CRSs. He also submitted that they would be able to entrench their dominant position in the airline market by using Gemini to disadvantage actual or potential airline competitors through biased or inaccurate displays or by denying them access to Gemini.

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[9] First Restated and Amended Limited Partnership Agreement (30 June 1989): Exhibit A-I-44 at Schedule B.

[10] Exhibit A-XVII-1 at para. 1.

The contested proceedings were converted to consent proceedings under section 105 of the Act in April 1989. Air Canada, PWA, Gemini and the Director reached agreement on the imposition of terms and conditions on Air Canada, Canadian and Gemini which all parties considered sufficient to allow the merger to proceed without creating a substantial lessening of competition. Those proposed terms and conditions were presented to the Tribunal as a draft consent order which, after various revisions, was ultimately issued on July 7, 1989.

The reasons of the Tribunal describe the Consent Order as composed of "two severable parts". Although various changes were made during the hearing, the basic structure of the order did not alter. The first part is directed primarily at the airline owners of Gemini and their position in the airline market as Canada's two dominant carriers and in the CRS market as joint owners of Gemini. The second part provides a general code of conduct for the operators and owning carriers of CRSs in Canada.

The first part of the order requires Air Canada, Canadian and, through them, their affiliated airlines to participate in all CRSs operating in Canada, to make available to such CRSs all information and features that they provide to Gemini, and to provide direct access links to other CRSs on request. The direct access links allow travel agents to book the final few seats available ("last seat availability") on any Air Canada or Canadian flight through any CRS operating in Canada which has requested

the links. Without the links, only those agents using Gemini would be able to book those last seats.

Air Canada and Canadian must also advise all travel agents selling their products that airline promotions and incentives are not conditional upon the use of a particular CRS. The order further seeks to prevent collusion by the owning carriers in respect of the airline market by prohibiting them from exchanging via Gemini commercially sensitive information that might facilitate market sharing agreements or price fixing.

The second part of the order consists of the "CRS Rules". Air Canada, Canadian, PWA and Gemini are expressly ordered to comply with these Rules. Any other CRSs which request a direct access link from Air Canada or Canadian (which Sabre has since done) are required to incorporate the Rules into the link contract, thus making the Rules generally applicable in Canada.

The Rules provide for the fair recording and display of available flights by a CRS (that is, the flights of the owning carriers cannot be unfairly favoured over those of other carriers participating in the system), provide for the equal treatment of all participating carriers and regulate the terms of the contracts between the system vendor and participating carriers and subscribers (travel agents). The Rules also

oblige the carrier-owner of a CRS to provide timely and complete information to other CRSs, to allow all such systems to issue its tickets and to inform all travel agents that promotions and incentives involving that airline are not conditional upon the use of a particular CRS.

Since the draft consent order that was before the Tribunal reflected the agreement of the Director and the respondents, the areas of concern at the hearing, some of which led to revisions in the draft, were those identified by the various intervenors or the Tribunal itself. These areas of concern are dealt with at some length in the Tribunal's reasons. The main areas highlighted in the reasons were the post-merger market concentration of Gemini, particularly in the smaller centres, the possibility that Air Canada and Canadian would engage in practices involving the tying of their airline services to use of Gemini, the increased opportunity for collusion between Air Canada and Canadian by way of Gemini, and the timing and the price of the direct access links to be provided to other CRSs.

It should be noted that there are also a number of matters not mentioned in the order or the reasons. Neither contains an endorsement or explicit approval by the Tribunal of the merger. As stated in the reasons, the Tribunal's role in a consent order proceeding is to determine whether the consent order meets a minimum test. That test is whether the merger, as conditioned by the terms of the consent order,

results in a situation where the substantial lessening of competition, which it is presumed will arise from the merger has, in all likelihood, been eliminated.[11] The Consent Order does not require that Air Canada and Canadian be hosted on Gemini nor does it mention, much less approve or disapprove, the hosting contract that the Director now seeks to modify. The fact that Air Canada and Canadian were hosted in Gemini (through Reservec and Pegasus) was considered only in a treatment of the background to the consent order proceeding.[12]

The Consent Order has apparently been effective in promoting CRS competition in Canada. Evidence was placed before the Tribunal which indicated that Sabre's Canadian business has grown. Even if Sabre's success in Canada cannot be wholly attributed to the Consent Order, there have been no complaints or concerns brought before the Tribunal with respect to specific terms of the order or the CRS Rules.

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[11] Reasons for Consent Order Dated July 7, 1989: Exhibit A-XVII-12 at 66.

[12] *Ibid.* at 9 note 2, quoting from the Agreed Statement of Facts filed by the parties at para. 24.

III. JURISDICTION OF TRIBUNAL TO VARY THE CONSENT ORDER

A. General Considerations

The jurisdiction of the Tribunal to entertain this application depends on the interpretation and application of section 106 of the Act which provides as follows:

106. Where, on application by the Director or a person against whom an order has been made under this Part, the Tribunal finds that

(a) the circumstances that led to the making of the order have changed and, in the circumstances that exist at the time the application is made under this section, the order would not have been made or would have been ineffective to achieve its intended purpose, or

(b) the Director and the person against whom an order has been made have consented to an alternative order,

the Tribunal may rescind or vary the order accordingly.

106. Le Tribunal peut annuler ou modifier une ordonnance rendue en application de la présente partie lorsque, à la demande du directeur ou de la personne, à l'égard de laquelle l'ordonnance a été rendue, il conclut que :

a) les circonstances ayant entraîné l'ordonnance ont changé et que, sur la base des circonstances qui existent au moment où la demande prévue au présent article est faite, l'ordonnance n'aurait pas été rendue ou n'aurait pas eu les effets nécessaires à la réalisation de son objet;

b) le directeur et la personne à l'égard de laquelle l'ordonnance a été rendue ont consenti à une autre ordonnance.

The Director and those who support him contend that we are entitled to vary the Consent Order of July 7, 1989, along the lines requested, by virtue of paragraph 106(a). Paragraph 106(b) obviously does not apply as some of the parties against whom the Consent Order was made do not now consent to a variation of that order. It will also be noted that the Tribunal is not being asked to rescind the Consent Order:

indeed no complaints are made about what the Consent Order contains, only about what it does not contain.

As the *Competition Tribunal Act*,[13] section 12, provides that only the judicial members are to determine questions of law, and as the members of the present panel do not agree unanimously on the application of section 106 to these facts, it is necessary to distinguish between the questions of law (determinable by the judicial member) and the questions of mixed law and fact, and of fact (determinable by all members).

We have been invited to interpret our jurisdiction herein by reference to various general principles of law and general characteristics of the Tribunal. These principles and characteristics can be of only limited assistance. It has also been suggested that we are in effect wrongly being asked to make policy on foreign ownership or control of airlines and CRSs in Canada, or on "re-regulation" of airlines. The Tribunal of course has no jurisdiction for, nor intention of, making such policy. Our role is the protection of competition in Canada within the criteria established by the *Competition Act*; whether properly mandated decisions under that Act have implications for such policy-making by others cannot be a significant concern for us. We must make our judgments within existing laws and policies.

[13] R.S.C., 1985 (2d Supp.), c. 19.

It is necessary to focus on the words of section 106 to define our jurisdiction. The Competition Tribunal is a statutory body having no substantive authority other than that given to it by Parliament. Thus we must look carefully at the words used by Parliament to ascertain the conditions upon which the power to vary an order can be exercised. The parties have, understandably, been unable to put before the Tribunal any authoritative jurisprudence directly on point as to the meaning of section 106. The powers of the Tribunal under the Act are still in a relatively early stage of interpretation. The Tribunal has been greatly assisted in the present case by the research and argument of counsel on all sides of what is a very difficult question. There was no request that the question of jurisdiction be determined as a preliminary matter as a question of law nor did the presiding judicial member during preliminary interlocutory proceedings consider it appropriate to suggest such a determination. It appeared that the jurisdictional questions in issue could not be confined to questions of pure law capable of determination without factual findings, a requirement which would have applied had we sought to resort by way of section 48 of our Rules[14] to the provisions of Rule 474 of the *Federal Court Rules*.[15]

In interpreting and applying section 106, the Tribunal must give due regard to the broad implications of the interpretation and application which the Director

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[14] *Competition Tribunal Rules*, SOR/87-373.

[15] See *Berneche v. R.*, [1991] 3 F.C. 383 (C.A.).

advocates in requesting this variation of the Consent Order. Such variation would involve adding a condition that would bring to an end a contractual relationship other than a merger. It must be kept in mind that if the original application of the Director under section 92 of the Act had succeeded without any intervening consent by the parties, all that the Tribunal could have done would have been to order dissolution of the merger and divestiture of its assets. By virtue of subparagraph 92(1)(e)(iii) the Tribunal could "take any other action" only with the consent of the parties against whom such action was ordered. Instead of the section 92 application being disposed of by contested proceedings, the parties in settlement of that application applied under section 105 for a consent order. By definition the terms and conditions imposed in a consent order can only be imposed with the consent of all parties. Now the Director asks the Tribunal to amend the Consent Order to impose measures for the termination of the hosting contract, measures which are clearly not consented to by Gemini nor by two of its partner members, Air Canada and Covia. These measures are being sought over five years after the original merger, the attack on which laid the basis for the Consent Order in 1989. To the extent that, as the Director argues, the new measures now being sought can be said to address the merger, they come well after the three year limitation period imposed by section 97 of the Act in respect of proceedings against mergers. The specific validity of ordering such measures which are neither a dissolution nor a divestiture under section

92, nor the subject of consent under sections 105 and 106, will be discussed later. But the significance of the Director's request must at all times be kept in focus.

The Tribunal will consider as a matter of law what criteria section 106 imposes for a variation to be made in any order. It must then determine, as mixed questions of law and fact or as questions of fact, whether those criteria have been met here.

B. Questions of Law

In the view of the Tribunal, paragraph 106(a) of the Act must be interpreted as a whole to allow the Tribunal to vary an earlier order only where the purposes for which the order was sought and made can no longer be adequately served by that order.

Firstly, Parliament provides that a variation may be ordered only where "the circumstances *that led to* the making of the order" have changed. If a change in any background circumstance were sufficient, Parliament would presumably have used language such as "circumstances existing at the time of the making of the order have changed . . .".[16] By using instead the words "that led to", Parliament must have

[16] The French version uses the expression "les circonstances ayant entraîné l'ordonnance . . ." which appears equally to imply a causal connection between the circumstances and the order made.

intended there to be a direct causal link between the existence of certain circumstances and the decision of the Tribunal, and not merely the logical relevance of some background condition existing at that time.

Secondly, by paragraph 106(a) the Tribunal must, in order to vary an order, also find that the change in those circumstances is such that today, in the changed circumstances, "the order would not have been made or would have been ineffective *to achieve its intended purpose*". This phraseology appears to focus on the cause or purpose of the original order just as do the words "circumstances that led . . . ." Thus, the Tribunal cannot vary an earlier order only because that order might today look less than perfect: the order can only be changed if it would not today properly serve the purpose for which it was made or would seriously impair the achievement of that purpose.

Thus, as a matter of law, the circumstances whose change would permit adding terms to an earlier order must be those circumstances that demonstrably were taken into account by the Tribunal at the time of, and directly caused, the making of the order in question. Further, assuming such changed circumstances to exist, the order should still not be changed unless it has become useless or inadequate to its

intended purpose of solving the problem as identified in the relevant circumstances that led to the original order being made.[17]

A further question of law has been raised as to the authority given the Tribunal by the closing words of section 106 to "rescind or vary the order accordingly" where a consent order is involved. A number of arguments have been presented, by those opposed to the present application, concerning the limitations said to be imposed on the Tribunal as to the kind of order which can be made under section 106. It was argued that we could rescind a consent order without consent, where the conditions of paragraph 106(a) were met, but that we could not vary an order without the consent of all parties under paragraph 106(b). This was said to flow from the fact that the power to make any kind of an order under section 92, pursuant to the original application, would have been limited to dissolution and divestiture in the absence of the consent of all parties. Further, the order which was made under section 105 in settlement of the proceedings brought under section 92, being a consent order, had by definition to be with the agreement of all parties. It was argued therefore that section 106 must mean that a consent order can only be varied by consent and that the power to "vary" must be taken to apply only to orders coming within the condition imposed in subparagraph 106(b). It was argued by one

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[17] See also *Jasper Park Chamber of Commerce v. Governor-General in Council* (1982), 141 D.L.R. (3d) 54 at 66-67 (F.C.A.), for the proposition that a power to "vary" can only be exercised in respect of the "same type or kind of order" as the original order.

party that as paragraph 106(a) refers to orders which would not have been made or would have been ineffective to achieve their intended purpose, the closing words authorizing the Tribunal to "rescind or vary . . . accordingly" must be taken to refer respectively to: the rescission of an order that would not have been made in current circumstances; and the variation of an order which has become ineffective to achieve its intended purpose. Reliance was placed on the word "accordingly" at the end of the section as if it meant "respectively".

Neither of these arguments appears tenable. If such distinctions were to be made, Parliament would surely have stated them specifically. Further, the structure of the French version of the section which at its outset gives the Tribunal the power to rescind or vary, does not accord with the view that the word "accordingly", which has no counterpart in the French version, was intended to mean "respectively".

This Tribunal has already expressed the view, admittedly in *obiter dicta*,[18] that the Tribunal can impose terms and conditions under section 106 without the consent of all respondents. This would appear to be most consistent with the phraseology of section 106 which does not expressly limit either the power to rescind or vary consent orders to situations where all original parties consent. It is obvious that section 106 permits the rescission or variation of any orders made under Part

---

[18] In its Reasons for Consent Order Dated July 7, 1989 in the present matter: *supra*, note 11 at 64.

VIII, many of which would not be consent orders: the general phraseology of the section is clearly appropriate for changes in those orders. Parliament would certainly have been more specific if it intended the variation or rescission of consent orders to be treated in a different way.

C. Mixed Questions of Law and Fact and Questions of Fact

(1) Change in Circumstances?

The Tribunal must find that "the circumstances that led to the making of the order have changed . . . " as a prerequisite to varying a consent order. The application of this phrase is one of the most critical in the determination of this case. There are broadly two opposing approaches to such application.

The Director and those who support him would include among "the circumstances that led to the making of the order" a variety of facts logically related to the subject matter of the order. The Director thus argues that the "business relationships associated" with the Gemini merger are all part of the circumstances leading to the Consent Order. According to PWA and Canadian the relevant circumstances are:

> [T]he whole of the circumstances which were either expressly or by reasonable implication within the contemplation of the earlier Tribunal in reaching its original Consent Order - without trying to divine in hindsight which were felt to be "pivotal" or "decisive" in the Tribunal's deliberations.[19]

In their view, the Tribunal could establish its jurisdiction to make the order requested if it were satisfied that in 1989, at the time of the making of the Consent Order, it contemplated "an on-going competitive duopoly in the airline industry in Canada" and that such situation no longer exists.

The Director's stated grounds for the present application are the following:

> 1. The circumstances that led to the making of the Consent Order have changed in that:
>
> (a) PWA and CDN have stated that their financial position has deteriorated to the point that they cannot survive on their own;
>
> (b) on September 9, 1992, PWA accepted a merger proposal from Air Canada. The parties executed a Pre-Merger Agreement on October 8, 1992. On November 3, 1992, AC announced its position that the transaction contemplated by the Pre-Merger Agreement was "unachievable", but that discussions could continue;
>
> (c) if an AC/PWA merger was to take place, or if PWA was to cease operations, the result would be a virtual monopoly in most domestic airline markets in Canada;
>
> (d) airlines have become increasingly information driven. Today, when an airline seeks a strategic alliance partner, it is important that they not only share and co-ordinate marketing, but that they also share and co-ordinate information services;

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[19] Submission of PWA Corporation and Canadian Airlines International Ltd. at para. 14.

> (e) the inability of CDN and PWA to terminate the Gemini Hosting Contract precludes alternative, pro-competitive solutions to PWA's financial difficulties.[20]

(It is not apparent what paragraph 1(d) adds by way of showing changed -- and unforeseen -- circumstances in the period of three years and four months between the making of the Consent Order and the filing of the present application.) The central proposition of the Director and his supporters is that Canadian was a financially viable airline in 1989 and today it is a failing firm. In 1989, the airline market environment in which the Tribunal made its order was that of airline duopoly in Canada, the two major carriers with their affiliated regional carriers sharing over 90 per cent of the domestic airline market. Today, it is said, Canadian is in danger of extinction unless it can complete the tentative agreement with AMR and to do so it must not only be released from the hosting contract with Gemini but, apparently, relieved of any contractual liability in respect thereto.[21] It is alleged that the failure of Canadian will either lead to its merger with Air Canada or, more probably, its exit from the market. In either case Air Canada in its present or merged form would enjoy over 90 per cent of the airline market in Canada, an anticompetitive result, the responsibility for which is said to lie in the Tribunal's Consent Order of 1989. The relevant change in circumstances, then, in the view of the Director and his supporters,

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[20] Notice of Application at 3.

[21] If PWA were to remain contractually liable, then there seems little point to this application except to require Gemini to co-operate, at the technical level, in the "dehosting" of PWA. Note that the Stock Purchase Agreement, *supra*, note 4, requires PWA to be free of any liability to Gemini or its partners as a condition to closing the PWA/AMR transaction.

is the rapidly declining financial position of Canadian and the threat this poses to the maintenance of duopoly in the airline market.

The other approach, expressed in various ways by opponents of this application, is that the existence of an airline duopoly, and the hosting arrangements with Gemini, were part of the background facts to, but not the cause of, the 1989 order. Instead, the direct cause of that order was the need to assure that the merger into one unit of a CRS controlled by the dominant airlines would not allow that CRS to be used in an anticompetitive fashion.

At the core of this issue is the extent of the right that should be accorded to any party to a consent order, including the Director, to resile from a settlement of litigation because that settlement has turned out, for reasons unforeseen at the time, to be less advantageous than expected to the interests of a party or the public. In short, how much risk should parties to a settlement by consent order be expected to bear? In 1989 the parties here agreed to, and the Tribunal approved, an arrangement which implicitly permitted, but did not require, the continuation of the Gemini partnership until at least 1997 and the continuation of the hosting of both airlines in Gemini until 1999. At about the time of the issuance of the Consent Order, and one must assume in reliance on the terms of that order, the two airlines voluntarily entered into a new hosting contract which again involved a commitment to hosting

in Gemini until at least 1999. These commitments involved business risks which the commercial parties assumed without any reference to the Tribunal. To what extent should the Tribunal now be at liberty, against the will of other parties to these contracts, to rescue the Director from his own assessment of the risks to the public interest, or Canadian from its assessment of its business risks?

Applying the statutory criteria defined earlier as a determination of law, one can find in several documents the circumstances that were demonstrably taken into account and actually led to the Consent Order. In the Director's original application filed on March 3, 1988, to dissolve the Gemini partnership, the whole concern expressed was as to this merger preventing or lessening competition substantially in the provision of computer reservation systems services to airlines, travel agents, and consumers.[22] That concern was described in the application as flowing from the ownership of Gemini by the two dominant airlines (enjoying over 90 per cent of the Canadian domestic airline market). This was thought to create a danger of use of that ownership by the owner-airlines to prevent or lessen competition from other CRSs in Canada, and to prejudice airline competitors by restricting or showing bias in the display of their schedules in Gemini or discriminating in fees charged them by Gemini. An amended statement of grounds filed by the Director on

[22] Exhibit A-XVII-1.

December 7, 1988, did not significantly alter the basis for the application.[23] And when the Director applied by notice of motion dated April 12, 1989 to amend the original application in order to seek approval of a draft consent order, he filed an impact statement which described his "two principal concerns" about the merger as being: the effect of the merger on entry into the CRS and airline markets; and the market power which Air Canada and Canadian would gain through ownership of Gemini with respect to travel agents, other airlines and other CRS vendors.[24]

The Consent Order itself, as ultimately issued, is focused completely on preventing the airline owners of Gemini from using this form of vertical integration to prevent or lessen competition from other CRSs (through denial of access to the owner-airlines' information) or from prejudicing actual or potential airline competitors in the way that, or the conditions on which, Gemini's services are made available to those competitors. Further, the order also addresses the problem of the two dominant Canadian carriers using their joint ownership of Gemini as a means of collusion for anticompetitive purposes, to their benefit and to the prejudice of consumers and other airlines. This measure reflected concerns as to the technological means afforded the owner-airlines of access to information through Gemini for collusion in pricing, etc.

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[23] Exhibit A-XVII-6.

[24] Exhibit A-XVII-9 at paras 3-5.

Throughout these documents and the Agreed Statement of Facts filed in support of the consent order application,[25] the existing duopoly in the Canadian airline market, and the hosting of the two major airlines in Gemini, are noted but not identified as causes for making the order. Instead, the principal concern articulated was vertical integration by the two dominant airlines with a single CRS and how this might be used to produce anti-competitive results in both the CRS and airline markets. It is difficult to see why the same analysis might not have applied to a vertical integration between a single airline with over 90 per cent of the Canadian airline market and a previously independent CRS operating in Canada. It was therefore not the existence of an airline duopoly as such which was the operative circumstance leading to the 1989 Consent Order.

That perceived concern about vertical integration does not appear, on the evidence now submitted to the Tribunal, to have changed. In all the likely scenarios flowing from Canadian's pending failure as put before the Tribunal, no obvious change in the need to control vertical integration has been demonstrated. If an airline duopoly continues, involving the two airline partners in Gemini, there would still be a concern about their use of the CRS for their own anti-competitive purposes or the restrictive use of their internal reservation systems to prejudice other CRS or airline competitors. If Canadian fails and Air Canada occupies most of its market share, or

[25] Exhibit A-XVII-10.

if Canadian is forced to merge with Air Canada, there will still be a major airline owner of Gemini in a position to exploit that ownership.

Therefore the circumstances that led to the making of the Consent Order have not changed. The fact that one remedial term of the Consent Order,[26] prohibiting collusive use of Gemini, might no longer be necessary if the airline duopoly becomes a monopoly, does not make the order subject to expansion in order to ensure the preservation of that duopoly.

(2) Would the Order Not Have Been Made or Been Ineffective?

For the same reasons, it is not possible to say that in the circumstances that exist at present the order would not have been made or would have been ineffective to achieve its intended purpose. It is of fundamental importance to note that the Director does not object to the continuation of any provision in the Consent Order. That is, he is not contending that in today's circumstances, all other things being equal, the order would not have been made. This is not surprising since the Consent Order does not either require or endorse the hosting contract which Canadian entered into effective June 30, 1989 (in contemplation of the Consent Order issued on July 7, 1989) which is now seen as the barrier to a pro-competitive salvation of Canadian

[26] *Supra*, note 2 at para. 16.

by AMR. Further, the evidence before the Tribunal is very clear that the Consent Order has worked well and has achieved its essential pro-competitive purposes, having provided an environment in which Sabre has been able to increase its national share of the segments booked by CRSs from about 20 per cent in 1989 to over 40 per cent in 1992. No complaints have been brought to the Tribunal by carriers other than Gemini's owners with respect to the way they are treated by Gemini. Therefore, there is no suggestion, nor could there be, that the order should be rescinded. And if it were rescinded today that would in no way assist Canadian. Canadian would still be bound by the hosting contract which AMR insists it must renounce.

Instead, it is the case of the Director and PWA/Canadian that the order is defective for what it does *not* provide. The order does not include a prohibition of the Gemini merger because the order proceeded on the assumption (without specifically endorsing it) that the merger could continue if the conduct of the parties were properly controlled. The Director in the present application initially asked for dissolution of the merger as an alternative to the preferred remedy of ordering the termination of the hosting contract. He did not press for this in argument. Instead, he argued that if the circumstances of 1989 had been those as described by him today -- namely a failing Canadian unable to extricate itself from the hosting agreement so as to make a provident arrangement for its continued existence with AMR -- the

Tribunal would not have failed to include a term allowing for the unilateral termination by Canadian of any hosting agreement it might have or might enter into thereafter.

Consistently with our determination of law that changes can only be made where the original purpose of a consent order is no longer being served by its terms, it is not possible to say that in circumstances such as the present the Consent Order of 1989 would have been ineffective to achieve its intended purposes. An order designed to prevent the limitation of access to airline data or the manipulation of the operation of a CRS (vertically integrated with those airlines) so as to limit competition in the CRS market or to limit competition in the airline market, would still have been made in present circumstances. It is true that the Director might now have other preoccupations, as would Canadian in its present financial crisis. But would not the same concern still exist with respect to the anti-competitive results of such vertical integration?

As indicated below, we find that the Director has demonstrated that Canadian is likely to fail and that the most probable result of that failure will be either a merger with Air Canada or the accession by Air Canada to most of Canadian's market. It is true that the anti-merger application of 1988 would not have been brought in these precise terms under such circumstances because there the merger had to do with a

combination by two major airlines of their CRS resources by means of the Gemini merger. But the fundamental concern was the use by airline owners of their CRS for anti-competitive purposes and, had the merger been between a single airline with 90 per cent of the market and a previously unrelated CRS system, virtually all of the same concerns addressed in the 1989 order (except for that of collusion between the two airlines by means of the CRS) would have had to be addressed. Thus it cannot be said that the Consent Order would not have been made or would have been ineffective to achieve its intended purpose if it were made today essentially for the same purpose as was present in 1989. What the Director seeks instead is a variation to make that order serve another purpose -- the preservation of airline duopoly.

We are of the view that our continuing powers to vary the consent Order must be exercised only for the original purpose of the Consent Order. This means that we cannot add to the original order a release from a contract that was not required by that original order but which was freely entered into at that time by Canadian for no doubt good commercial reasons, simply because Canadian has since entered into another contract inconsistent with the first, for other good commercial reasons. The first contract was not and is not anticompetitive *per se*. It has become so only because it is an obstacle to restoring Canadian's financial viability -- a viability whose protection was not the object of the Consent Order.

Although we accept that in a proper case a variation of the Consent Order without the consent of all parties would be possible, the present situation does not justify any variation.

D. Conclusion

The majority of the Tribunal is thus of the view that in these circumstances the Tribunal does not have jurisdiction to make the requested order.

We recognize, however, that the legislation is relatively new and that a novel point of jurisdiction has been raised before us. Given the importance of this case we have little doubt that appeals will be launched. In case a different view is taken of our jurisdiction on appeal, we therefore feel it essential to make the findings of fact which would be necessary, should we have jurisdiction, to issue an order. Otherwise, the vast efforts of counsel and the costs of 22 days of hearings would be lost. For the assistance of appellate courts we will also indicate what remedies we believe could and should be ordered if the Tribunal has jurisdiction to do so.

We will therefore proceed to consider what the consequences would be for Canadian of continuation of the hosting agreement, the possible impact on airline competition if Canadian fails and the impact on Gemini and on CRS competition

generally if Canadian fails or if it were released from the hosting contract. We will then describe the remedies we consider would be permissible and appropriate if we had the jurisdiction to vary the Consent Order.

E. Dissent of Dr. Roseman Regarding the Application of Section 106

I differ from the majority opinion with respect to their conclusion that the circumstances that led to the 1989 Consent Order have not changed.

In order to identify those circumstances "that demonstrably were taken into account by the Tribunal at the time of, and directly caused, the making of the order in question", I believe one must start with the provisions of the order itself. They afford the best guide to the considerations that the Tribunal took into account and that, therefore, caused the making of the order. While this point has general application it is particularly appropriate in the case of a consent order. Under the Tribunal's rules of procedure there is opportunity for public comment on consent orders submitted to the Tribunal.[27] Under the *Competition Tribunal Act* there is the possibility of intervention in both consent order and contested proceedings.[28] As the Tribunal has made clear on previous occasions, it will not "rubber stamp" consent

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[27] *Supra*, note 14, s. 35.

[28] *Supra*, note 13, s. 9(3).

orders. A consent order is the document that emerges at the end of a process and it speaks for itself. In the event that the order is unclear, it may be helpful to look to background documents such as the reasons or the Director's impact statement. No one has suggested that there is any ambiguity surrounding any part of the order in question in this application.

It is not always possible to determine the specific circumstances that led to an order by the Tribunal by looking for a common theme in the provisions of the order. An order of the Tribunal pursuant to section 77, 79 or 92 of the Act may address a number of different competitive problems. The only test that is applied by the Tribunal in granting an order is whether the proposed specific provisions individually contribute to meeting, and in combination meet, the test of curing the likely substantial lessening of competition. In *Palm Dairies Limited*[29] the Tribunal refused to grant an order on consent because the provisions in combination did not meet this test. In *Laidlaw Waste Systems Limited*,[30] after contested proceedings, the Tribunal declined to include in its order certain provisions relating to pricing proposed by the Director on the ground that it was not convinced that they would be likely to enhance competition or were necessary given the other provisions in the proposed order.

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[29] (1986), 12 C.P.R. (3d) 540 (Competition Trib.).

[30] (1992), 40 C.P.R. (3d) 289 (Competition Trib.).

The majority have labelled the order as one that primarily or essentially deals with the effects on competition in airline markets and CRS markets arising from vertical integration of an airline and its CRS. Under their approach, the one provision in the order that has no impact on CRS markets but is solely directed at the airline market, the "collusion provision", is treated as secondary -- a footnote.[31] I disagree with this approach on a number of grounds.

First, the order clearly deals with both horizontal and vertical concerns arising from the Gemini merger. Air Canada and Canadian were individually already vertically integrated into hosting and CRS prior to Gemini's formation. In setting up Gemini as a joint venture to perform their hosting and to conduct their CRS business they were engaging in a horizontal merger. It is true that virtually all the terms in the order, except the collusion provision, would have been necessary if the event that triggered the Director's application in 1989 had been a merger between a dominant

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[31] Paragraph 16 of the Consent Order, *supra*, note 2, reads as follows:

> AND IT IS FURTHER ORDERED that the respondents and each and every one of their respective directors, officers, managers, servants, employees, agents, or any of them, shall not share or exchange commercially sensitive airline information through the operations of Gemini, including, but not limited to, seat inventory information in respect of individual carriers to a greater extent than such information is accessible by Gemini subscribers, where such sharing or exchange would facilitate agreement to share markets or fix the level of prices between AC, including its affiliated airlines, on the one hand and PWAC, Wardair and CDN, including its affiliated airlines, on the other. An officer of each of the Respondents shall provide a report to the Director on or before February 1st of each year that it has complied with this provision in the prior year.

airline and a firm in the CRS industry. The order, however, did not result from the merger of a firm in the airline industry and another in the CRS industry but rather from a joint venture in a business in which Air Canada and Canadian were already engaged.

Second, the term concerning collusion that is treated as an exception by the majority is in fact part and parcel of vertical integration. The possible exchange of information addressed by the order results from the vertical integration of each of Air Canada and Canadian with Gemini within the context of the joint venture. Even more to the point, the hosting contract that is the subject of the application and the effect it will have on airline markets in the event that Canadian is not released from its hosting are intimately tied to vertical integration. The hosting arrangement undertaken by an airline with a CRS owned by it is an example of vertical integration. This is not the case where an airline contracts for hosting with a third-party supplier. The fact that Air Canada and Canadian entered into a joint venture in the CRS industry, into which each was already vertically integrated, means that it is hard to point to anything in the order that is not related to vertical integration.

Third, it is difficult and unnecessary to label the purpose of certain provisions of the order as primary or secondary. What are the implications of such a labelling? Would provisions labelled as relating to a secondary purpose not be enforced or be

enforced to a lesser degree? Clearly, the Tribunal will enforce all provisions of its orders equally. Furthermore, the potential adverse consequences of a breach of the collusion provision, relating as it does to carriers accounting for over 90 per cent of passenger traffic on domestic routes, could easily exceed that for other provisions relating to airline competition, such as bias in CRS displays.

What then are the circumstances that led to the order? An examination of the order shows that they clearly include the concerns regarding CRS and airline markets identified by the majority. But the order also includes a provision directed at preventing Air Canada and Canadian from using Gemini to exchange certain information and, thus, to facilitate collusion between them. Since we cannot say that this term is any less important than the others, we cannot ignore the circumstance that led to its inclusion. The circumstance that led to the insertion in the order of the "collusion" provision was the possible use of Gemini by Air Canada and Canadian to lessen competition substantially in airline markets. This is a concern with competition within airline markets that is not related to the operation of a travel agency CRS but to the fact that Air Canada and Canadian were both *hosted* in Gemini. The particular method for lessening competition that was foreseen was the exchange of information through Gemini.

A change in circumstances has taken place. Because of Canadian's financial situation, Gemini can now be used to lessen competition substantially in airline markets in a different, unforeseen manner. The existence of the hosting contract can now be used to prevent Canadian and AMR from completing their tentative agreement with the likely result that competition in airline markets would be substantially lessened by Canadian's disappearance.

In considering the operation of the changed circumstances it is important to take into account that Gemini is a closely-held partnership. It is necessary to look to the interests of the partners to understand how Gemini is being used to lessen competition in the airline industry. Gemini's own attitude is not germane since its position is dictated by the partners.

Since it focuses on a term of a contract, at first sight the Director's application appears to involve the use of the Act to settle a commercial dispute. However, if normal commercial interests relating to Gemini were the only factors at play it is highly doubtful that it would have been necessary for the Director to bring this application. The partners would surely have reached a settlement rather than harm Gemini by making their dispute public. Competitive considerations extending beyond Gemini's interests are motivating parties on both sides of the dispute.

Canadian wants and needs to transfer its hosting to Sabre to satisfy AMR's requirements for an agreement. As discussed elsewhere, since late 1991 Canadian has sought to keep its options open and it thus refused to sign a proposal for reorganizing Gemini. Later, when the transfer of its hosting to Sabre became part of AMR's terms for the deal, it launched a suit to declare Gemini insolvent, since that would permit it to escape from its hosting contract.

The other partners have recognized the negative effect on Gemini of the conflict between the partners but only Covia has considered a commercial resolution of the dispute. Covia considered the matter in several internal deliberations. The first documents, prepared in November and December 1991, estimate what the cost to Covia would be if Covia and Air Canada bought out PWA's partnership interest.[32] Then in July 1992, Paul J. Blackney, President of Covia in Canada and a senior vice-president with its parent in the United States, stated in a memorandum to James Guyette, Executive Vice-President, Marketing and Planning, United Air Lines Inc., that Covia was flexible but that it could do nothing to resolve the impasse between Air Canada and PWA/Canadian since unanimous consent of the partners is required. Mr. Blackney also testified on discovery that Covia would have preferred to see a commercial settlement of the problem.[33]

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[32] Confidential Exhibit CA-XIII-369; Confidential Exhibit CA-XIII-371.

[33] Confidential Exhibit CA-XIII-392; Confidential Exhibit CA-XIX-1 at Q. 522.

Air Canada has shown no interest in a negotiated settlement and, in fact, the evidence indicates that it has avoided even discussing such an option. This is to be expected since there can be no dispute that Air Canada *qua* airline would be the major beneficiary should Canadian fail. The resulting gains to it would dwarf the losses associated with the dispute within the Gemini partnership. In an Air Canada document prepared in about April 1992, there is a discussion of the damage to Gemini of Canadian's efforts to move its hosting. The discussion continues:

> Although it would appear counter-productive to have a dissatisfied partner in Gemini, Air Canada needs to maintain the existing partnership arrangements for the near future to serve as a deterrent and spoiler for the PWA/AMR negotiations.[34]

The documentation distributed to a "Strategic Issues Committee", also in April 1992, reveals an Air Canada "strategy of slowing down/denying the AMR deal".[35]

The uncontradicted evidence of Rhys T. Eyton, Chairman and Chief Executive Officer of PWA, is that "Air Canada has completely refused to meet to even discuss it [a commercial settlement regarding Gemini]".[36] There is nothing in the record, including the exchange of correspondence between Kevin J. Jenkins,

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[34] Exhibit A-XII-341 at 5 (pages not numbered).

[35] Confidential Exhibit CA-III-82 at 12 (pages not numbered).

[36] Transcript at 1:183 (1 February 1993).

President of Canadian, and Hollis Harris, President of Air Canada, in December 1992, that suggests that Air Canada was interested in a negotiated settlement at any time.[37]

Counsel for PWA and Canadian argued that Air Canada had a more encompassing, longer-lasting strategy: to bring about its failure through protracted, fruitless merger negotiations. A document that outlines such a strategy is in evidence.[38] While there is no evidence that this strategy was adopted as policy at the highest level of the company, it is set out in a briefing document for Mr. Harris who joined Air Canada in February 1992. Mr. Harris was not called as a witness. Claude I. Taylor, who retired as Executive Chairman of Air Canada at the end of 1992, denied the strategy, stating that Air Canada negotiated in good faith.[39] While it is not necessary for the Tribunal to rule on this question, a strategy for ensuring the failure of Canadian would be perfectly consistent with Air Canada not being interested in a commercial arrangement that would allow Canadian to transfer its hosting and, presumably, allow PWA to leave the partnership.

It might be argued that since Air Canada is not initiating anything -- it is merely relying on the hosting contract as written -- it cannot be concluded that

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[37] Exhibit R-I-6; Exhibit R-I-8. For a further discussion of this exchange, see *infra* at 56-57.

[38] Exhibit A-XX-3, Feb. 10 #5 at 3.

[39] Confidential transcript at 16:916-17 (23 February 1993).

Gemini is being "used" by Air Canada. This might be convincing if Air Canada was acting in accordance with its commercial interests associated with the contract, that is, the interests of Gemini, and not with respect to strategic considerations related to the airline industry. As a result of a change in circumstances Air Canada has been provided with an opportunity to use Gemini to affect competition in airline markets to a far greater degree than was addressed in the Consent Order.

Even if one accepts the characterization of the majority that the order relates to problems arising from vertical integration, the current application falls squarely within their scheme or purpose once one inquires into the reason why vertical integration was viewed as a problem. An ownership relationship between a CRS and an airline where there is market power at one level or the other creates a situation where the interests of the airline contaminate the operation of the CRS and vice versa. It is ordinarily in the best interests of an airline to be associated with as many CRSs as possible. This may not be true when the airline owns a CRS. Similarly, it is in the best interest of a CRS to provide a superior product with respect to functionality, which includes a lack of bias in display. But this may not be the case if the airline associated with the CRS benefits from biased display. This type of situation, with spillover of interest from one level to another, is precisely what was at issue in the application leading to the Consent Order and what is at issue in the

present application -- the use of Gemini to affect competition in domestic airline markets.

Thus, applying the legal test set out in the majority opinion to the facts, I conclude that the Tribunal has jurisdiction over this matter.

IV. CANADIAN'S CURRENT SITUATION: ALTERNATIVES TO THE AMR DEAL

PWA and Canadian were financially viable at the date of the Consent Order. The evidence is that PWA was profitable at the end of 1988; its first loss in 19 years was reported in 1989. The parties have not pointed to any evidence before the Tribunal during the consent order proceedings in the spring and early summer of 1989 that would lead us to conclude that PWA and Canadian were not financially sound at that time.

However, from 1989 to 1991, PWA recorded increasing operating and overall losses each year. David R. Murphy, Senior Vice-President, Finance for PWA and Canadian, predicted a loss for 1992 of the order of $215 million. PWA has received extraordinary assistance from governments and its employees. On November 22, 1992, the federal government provided PWA with a $50 million loan guarantee.

Alberta and British Columbia provided further loan guarantees of $70 million in December. Employees of Canadian, represented at this hearing by the Council of Canadian Airlines Employees, have agreed to invest $200 million in equity in PWA over four years through wage reductions and to accept a three-year wage freeze. (These concessions are not conditioned on either the completion of the AMR deal or debt restructuring.) However, as of November 29, 1992, PWA suspended payments to its secured creditors: that is, its lenders, lessors of its aircraft and certain other facility lessors. An initial debt restructuring plan was presented to and discussed with creditors in December 1992. The final restructuring plan was to be distributed during the first week of March 1993.

It is clear that PWA and Canadian are unable to meet their obligations as they come due. No evidence to the contrary was presented by either side. We are in no doubt that PWA and Canadian continue to operate today at the forbearance of their creditors.

The respondents opposing the Director argue that, even if Canadian is not released from its hosting commitment to Gemini and the deal with AMR as presently constituted is not completed, it has various alternatives available to it that would ensure its continued survival. The alternatives canvassed were: obtaining an alternative investor or strategic partner; merger with Air Canada; restructuring as a

stand-alone carrier; completing the deal with AMR without terminating the hosting contract; and sale of its international routes.

A. Obtaining an Alternative Investor or Strategic Partner

Starting early in 1991 and continuing through most of 1992, Mr. Eyton contacted "virtually every international airline who we felt had any synergy with us" in an effort to locate a potential investor for Canadian. Mr. Eyton's contacts included British Airways, Air France, Lufthansa, Alitalia, SAS, Japan Airlines, Cathay Pacific, United Airlines, American, Delta and Quantas.[40] PWA also retained Gordon Capital Corporation in the summer of 1991 to search for potential equity investors. These searches identified only Air Canada and American as prospects after British Airways ultimately dropped out of the picture because of what it viewed as a lack of any synergy with Canadian.

In October 1992, the Bureau of Competition Policy conducted a "shop" of PWA as part of the Director's review of a proposed merger of Air Canada and PWA. Both Wood Gundy Inc. and Gordon Capital Corporation were involved: Wood Gundy acted as a monitor of the effectiveness of the search which was handled directly by Gordon Capital. A "broadcast letter" and general information package

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[40] Transcript at 1:163-64 (1 February 1993).

were sent to 33 potential purchasers around the world to attract attention to the company's availability and to solicit interest.[41] The list of potential purchasers included airlines and a number of non-airline entities that might have had an interest in investing in PWA. Follow-up calls were made by Gordon Capital to each recipient of the package. Expressions of interest were to be received within five business days of the letter with detailed non-binding proposals to follow within a further two weeks. Additional detailed information was available to prospective purchasers interested in progressing to the second phase. The shop generated expressions of interest from American and the Council of Canadian Airlines Employees only.

The respondents opposing the Director argue that the October 1992 shop was designed to fail because the time frame was too short, the information inadequate, and all that was offered to prospective buyers was the whole of PWA without debt restructuring or employee concessions. Bernard R. Wilson, an expert witness for Gemini, supports this position. He does not believe that American and Air Canada are the only likely prospective investors and argues that some effort should be made to solicit interest in a "restructured" Canadian.[42]

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[41] Exhibit A-II-52; Exhibit A-II-53.

[42] Expert Affidavit of B.R. Wilson (25 January 1993): Confidential Exhibit CR-I-22 at 10-11.

Mr. Wilson's opinion that another potential investor can be found is speculative. He has not provided the Tribunal with any new information. PWA does not now have the luxury of time to search for an alternative transaction to the AMR deal unless its creditors give it the time. It does not seem likely that the creditors would give PWA additional time to seek an alternative investor while risking the loss of the AMR deal with its cash equity injection.

B. Merger with Air Canada

There is currently no outstanding merger proposal between Air Canada and Canadian although there has been a history of merger discussions between the two companies. Mr. Eyton contacted Air Canada as part of his search for investors in 1991. By the end of 1991, an offer and counter-offer had been exchanged, to no avail. Merger discussions were resumed in late July 1992, culminating in a pre-merger agreement in early October 1992. A draft "Operating, Financing and Transition" plan was prepared jointly by management for presentation to their respective boards of directors. That plan was rejected by Air Canada's board in late October 1992, bringing the merger discussions to an end.

The discussions are unlikely to be revived: Mr. Eyton testified that Air Canada's advisors indicated they would not give a fairness opinion on the merger

without $1.5 to $2.5 billion of "rent-free money", while Mr. Taylor confirmed that the last merger proposal was not approved by the Air Canada board because the financing was too risky.[43] A letter from the president of Air Canada, Mr. Harris, to the president of Canadian, Mr. Jenkins, dated December 23, 1992 was referred to as evidence of Air Canada's continued interest in discussing a merger. That letter stated that Mr. Harris did not believe there was:

> any real likelihood of Canadian ultimately failing. Amongst other reasons, Air Canada remains willing to pursue merger discussions with a restructured Canadian.[44]

The Tribunal puts little weight on this letter. First, it was written in response to a December 21, 1992 letter from Mr. Jenkins to Mr. Harris which dealt with a different subject, a negotiated settlement of the Gemini problem.[45] Second, the willingness of Air Canada to wait for a "restructured" Canadian could in the present circumstances mean waiting for Canadian to fail.

In addition, it is a term of the Canadian employee investments and concessions that they would cease and all amounts paid in would become repayable

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[43] Transcript at 1:178 (1 February 1993) and at 16:3060 (23 February 1993).

[44] Exhibit R-I-6.

[45] Exhibit R-I-8.

to the employees "if there was to be a future contemplation of a merger between Air Canada and Canadian".[46]

C. Restructuring as a Stand-Alone Carrier

Mr. Wilson, Gemini's expert witness, concluded that it might be possible for Canadian to restructure as a stand-alone carrier.[47] His opinion is virtually the only evidence before us that relates to this possibility and we do not accept that Mr. Wilson's expertise extends to airline operations. Mr. Wilson did little or no investigation to substantiate the possibility that he suggests. What is clear is that the existing debt restructuring arrangements that PWA has made with its creditors are in large measure premised upon the AMR deal, although not strictly conditional upon its completion.[48]

D. Completion of AMR Deal Without Terminating Hosting Agreement

Pursuant to the proposed agreement between PWA/Canadian and AMR, AMR will provide Canadian with a package of services including accounting

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[46] Evidence of Sidney O. Fattedad, Chairman, Council of Canadian Airlines Employees: Transcript at 6:891 (8 February 1993).

[47] *Supra*, note 42 at 11-13.

[48] Confidential transcript at 3:112-18 (3 February 1993).

services, yield management, scheduling and flight planning. Donald J. Carty, Executive Vice-President, Finance and Planning of AMR and American, confirmed that AMR would not invest in Canadian without Canadian being dehosted from Gemini and hosted on Sabre. He stated that the information included in the hosting component is necessary to allow AMR to provide a comprehensive package of services to Canadian.[49]

It was argued by the opposing respondents that requiring a transfer of hosting to Sabre is an unnecessary and arbitrary requirement on the part of AMR, designed to inflict maximum harm on Gemini: that it is technologically possible for Sabre to provide at least some of these services to Canadian with Canadian hosted on Gemini. The only evidence before us indicates, however, that creating the necessary links and interfaces between Pegasus and Sabre would be both time-consuming and extremely costly. As a basis for comparison, Brian J. Lupton, Director of Marketing Services at Canadian and responsible both for Canadian's CRS distribution of its product and the management of its hosting relationship with Gemini, referred to several other linkage projects in the industry. For example, the link from Gemini required by the Consent Order, which was relatively simple, took over a year to put in place and cost $200,000. Interfacing Canadian's current yield management system (PROS) to Gemini and Pegasus has been an ongoing linkage project for four years at a cost of

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[49] Transcript at 3:392-93 (3 February 1993).

about $4 million and it too, according to Mr. Lupton, is "very, very small" compared to linking Gemini and Sabre, which was described as a project "of gargantuan size". Such an arrangement would also require Gemini and Sabre to engage in on-going communication and co-ordination of changes to their respective computer systems which would entail continuing higher costs than if hosting were transferred to Sabre.[50] No other evidence was put forward to contradict or challenge Mr. Lupton's assessment. We therefore accept as accurate and reasonable the statement of Mr. Carty that there are legitimate economic reasons for AMR to seek the transfer of Canadian's hosting to Sabre.

E. Sale of International Routes

Although Air Canada had expressed interest in buying Canadian's international routes, there was no evidence that such a sale would leave the remaining domestic portion of Canadian as a profitable enterprise. Mr. Eyton indicated that Canadian had analyzed such a possibility and found that any profit made on the sale of the international routes "was soon completely used in downsizing our domestic operations which would soon go into failure. . . ."[51] Our conclusions, detailed later,[52]

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[50] Transcript at 8:1525-33 (10 February 1993).

[51] Transcript at 2:326 (2 February 1993).

[52] See *infra* at 76ff.

with respect to the importance of feed traffic also indicate that severing an important part of Canadian's network would adversely affect the remaining operations.

F. Conclusion

PWA and Canadian were financially viable in mid-1989 when the Consent Order was issued. Today, they operate only at the forbearance of their creditors. As a practical matter the AMR deal is currently the only transaction available to save PWA and Canadian. Without the cash equity injection from AMR, the risk that the debt restructuring will not be completed is very high and PWA and Canadian are likely to fail. AMR will not complete that transaction without a transfer of hosting to Sabre.

V. IMPACT OF CANADIAN'S FAILURE ON AIRLINE MARKETS

A. Industry Participants

The airline industry in the southern part of Canada is deregulated with respect to fares. There are no regulatory barriers to entry into any domestic city-pair by airlines meeting foreign ownership restrictions. The airlines serving southern routes consist of the two airline networks created by Air Canada and Canadian and three

charter carriers.[53] The Air Canada and Canadian networks consist of Air Canada and Canadian, respectively, along with a number of smaller airlines that are wholly or partially owned by Air Canada and PWA. Air Canada and Canadian are "trunk" carriers; they fly the most heavily travelled routes that allow passengers to travel to major centres anywhere in the country. The networks are completed by regional or "feed" carriers that fly between points off the trunk or carry passengers to and from trunk routes.

Currently the only competition to Air Canada and Canadian on transcontinental routes is offered by the charter carriers Nationair, Canada 3000 and Air Transat. The charter carriers fly one to three times a week between certain city-pairs. For a brief period Nationair recently offered scheduled service on flights on the Montreal-Ottawa-Toronto triangle, and between Toronto-Halifax. These flights have all been discontinued.

There is a product dimension and a geographic dimension to airline markets. For purposes of this application, the Director concluded in final argument that while a distinction can be drawn between the passengers attracted to charter as opposed to scheduled service, he is satisfied "that the relevant product market can be defined as

[53] "Charter" carriers are marketed through tour operators and are not committed to frequent and regular service.

passenger airline service, whether it's scheduled or charter."[54] There is also no dispute with respect to the geographic dimension: an airline market is defined as a city-pair, for example Edmonton-Vancouver, and only domestic city-pairs were considered.

Out of the top 205 city-pairs in 1990, Canadian and Air Canada and their affiliates accounted for at least 95 per cent of passengers travelling on scheduled carriers in all but 16 markets. The overall share for the two systems was 96 per cent.[55] At that time three independent carriers were participating in southern scheduled services (Intair, City Express, First Air); none are present today.

The charter carriers are present on a number of long-haul, high-density city-pairs. For the top 20 city-pairs, charter carriers accounted for more than one per cent of the passengers[56] on only eight city-pairs in 1990 and 11 city-pairs in 1991, with their shares ranging from 2.4 per cent to 20.5 per cent in 1990 and from 1.6 per cent to 19.5 per cent in 1991. Their largest shares were on the Toronto-

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[54] Transcript at 19:3447 (1 March 1993).

[55] Exhibit A-I-31. In final argument, counsel for Air Canada objected to the use of the statistics contained in this exhibit as evidence of market share. The statistics were compiled for Air Canada's internal use. In the circumstances, we see no reason to doubt their accuracy or reliability and, in any event, we would be inclined to admit them under section 69 of the Act.

[56] The passengers referred to are those whose origin and destination are the city-pairs in question. Connecting passengers, who on average are about 25 per cent of the total passengers carried, are excluded. Virtually all connecting passengers are on scheduled carriers.

Vancouver, Calgary-Toronto, Montreal-Vancouver and, in 1991, Edmonton-Toronto routes. Throughout the country charter carriers were responsible for 3.7 per cent of domestic traffic in 1991.[57]

B. Approach to Assessing a Likely Substantial Lessening

The Director alleges that failure of Canadian will likely result in a substantial lessening of competition in domestic passenger airline markets. No attempt has been made to prove the allegation market by market. Although there are a large number of individual city-pair markets, they can reasonably be subdivided into a small number of trunk lines, consisting of transcontinental routes and shorter-haul, high-density routes, and a large number of relatively short and less dense routes. While small individually, the latter are a large part of the aggregate of domestic airline passenger markets.

The Tribunal is of the view that to justify the variation order sought by the Director, he must show that in its absence there would be a substantial lessening of competition for large individual markets or for a number of smaller markets that together form an important part of domestic passenger airline traffic. To prove a

[57] Exhibit A-I-42. This information is taken from a Statistics Canada report, the admissibility of which was challenged by counsel for Air Canada. We are persuaded that the report is admissible under subsection 70(1) of the Act. In this case, the Director was not required to file a certificate pursuant to subsection 70(4) to prove the authenticity of the report since authenticity was admitted by Air Canada. Notice was properly given under section 72.

substantial lessening of competition in specific city-pair markets is not enough in this case. That is, the variation sought, affecting all airline markets served by Canadian, must bear a reasonable relationship to the effects alleged to flow from the change in circumstances that led to the application, namely the effect on domestic airline competition of a Canadian failure.

The respondents opposing the application have argued that the issuance of the order would far from guarantee that Canadian will not fail: restructuring may not succeed; the AMR arrangement may not be approved by the National Transportation Agency; or Canadian could fail even if those hurdles are overcome simply because Canadian and Air Canada may continue to maintain current capacity levels with the resultant higher costs and lower revenues than would exist at lower levels of capacity. We acknowledge that these risks are all present to unknown degrees but see no reason why we should be influenced by them. Either the Tribunal issues the order and Canadian survives to face the other challenges, or the Tribunal does not issue the order and Canadian almost certainly fails. The respondents have not suggested that competition in airline markets (or CRS markets) would be negatively affected in the event that the order was issued and Canadian failed nevertheless.

Counsel for Air Canada also pressed the point that if competition does not develop to as great a degree as he would have the Tribunal believe it will in the event

of Canadian's failure, then there are corrective powers available to the National Transportation Agency under its governing act. The Tribunal does not consider this argument to be relevant. The Tribunal cannot fail to act under its own mandate on the basis that another body may be empowered to cure a problem created by the Tribunal's inaction.

The possible failure of Canadian is analogous, for purposes of competition analysis, to an Air Canada/Canadian merger. The scheme set out in the Act (sections 92 and 93) for evaluating mergers is appropriate for considering the effects on airline competition of a Canadian failure. A finding of substantial lessening of competition as the result of a merger or proposed merger should not be based solely on concentration or market share. The Tribunal must have regard to a number of other factors, the most important and obvious of which are listed in section 93. Air Canada would, however, have an overwhelming share of domestic traffic. This fact is of critical importance in any evaluation unless it can be shown that the remaining competition is widespread and very vigorous and there are no, or very modest, barriers to the expansion of existing carriers or the entry of new carriers into domestic routes. These factors must be weighed in combination in arriving at a final assessment.

C. "Vigorous and Effective Competitor"

With respect to paragraph 93(f), if Canadian can be saved it will undoubtedly mean saving "a vigorous and effective competitor."

D. Foreign Competition

Paragraph 93(a) received some attention in the course of the experts' testimony as to whether foreign airlines are likely to provide effective competition in the Canadian market as a result of changes in international agreements to grant cabotage rights.[58] There was general agreement between the experts on both sides that, as in other industries, the trend to reduced trade barriers would continue. There was also agreement that if foreign carriers were free to serve those routes, competition on high-density domestic routes would not be a problem in the event that Canadian failed. None of the experts suggests, however, that relaxed cabotage rules or "open skies" are imminent. Speculation as to whether a major change might be expected in three or four years or in a decade is not helpful.

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[58] Cabotage is the right accorded to a foreign carrier to provide air services *within* another country.

E. "Effective Competition Remaining"

(1) Charter Carriers

The respondents opposing the Director argue that the charter carriers will continue to provide effective competition (paragraph 93(c) of the Act) to Air Canada in the event Canadian fails and will, in fact, increase their presence.

Harold E. Shenton, a long-time participant in the airline industry in Canada and the United States and an expert witness appearing for Air Canada, characterized the charter carriers as "niche carriers". We find this to be an accurate description: charter carriers fit into a very specific and circumscribed position in terms of the geographic markets they serve and with respect to the product that they offer. Charter carriers appeal to travellers for whom price rather than frequent service is of paramount importance. Although price and frequency are important to all travellers, business travellers tend to consider frequency of flights to be more important than price, while leisure travellers tend to regard price as more important. Another important consideration for business travellers is whether frequent flyer points are offered. Thus, while charter carriers are in the same product market as scheduled carriers, the competition they offer is most strongly felt in the price-conscious segment of that market.

Nevertheless, as indicated in the 1991 *Annual Review* of the National Transportation Agency, the competitive impact of the charter carriers is significant.

> These charter programs are also having an impact on fares as Air Canada and Canadi*n [*sic*] are discounting fares more in markets where the charter carriers are active than in those where they are not present. During the second quarter of 1991, over 72 per cent of the passengers carried by Air Canada and Canadi*n on the city-pairs where the charter carriers were active travelled on some form of discount air fare. This compares to 61 per cent of the travellers on the top 25 city-pairs where domestic charters were not offered. Furthermore, the passengers who travelled on routes where there was charter competition travelled on fares that were discounted by an average of 45 per cent; this compares to an average discount of 33 per cent for passengers travelling on the other top 25 city-pairs. Thus, even a relatively small amount of additional competition can have a significant impact on fares.[59]

The positive impact of the charter carriers on the fares offered by the majors is worth emphasizing. The level of market shares held by the charter carriers might in other types of markets be taken as an indication that the firms in question are fringe players without much influence. In domestic airline markets, however, the charter carriers are important competitors because of the stress that they place on price in selling their product. That is their main, if not their exclusive, attraction.

Since the challenge by and appeal of the charter carriers are based on price, the trunk carriers' response to their inroads is a reduction of their own prices, but not

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[59] Exhibit A-IV-100 at 44.

for all seats on a flight. As is well known, airlines sell seats on any one flight under different prices and conditions with respect to the level of service provided, depending on when the tickets are purchased, when the return flight must be made, and so on. The division of the seats on a flight into fare classes and changes in the allocation of seats to each class as information flows in regarding the course of sales is called "seat management". Major airlines use sophisticated computer programs which constantly compare the distribution and volume of current sales with historical information about sales on that flight. Seat management allows the trunk carriers to respond to the charter carriers, or any other carriers that offer a low-price alternative, by offering a limited number of low-price seats on each flight. This greatly enhances their ability to meet the price offered by low-price carriers without jeopardizing the bulk of their revenue.

The value of seat management as a competitive tool for major scheduled airlines in containing the inroads of low-price, few-frills carriers could conceivably decline should consumers become increasingly price-conscious. Based on the information elicited from witnesses by counsel for Air Canada, this appears to be a trend in both the United States and Canada, although it is more advanced in the former. The trend is fed in large part by faster growth in the number of leisure travellers relative to the number of business travellers. Other evidence before us indicates, however, that the major carriers believe that they will continue to be able

to contain the carriers appealing to the most price-conscious travellers. Air Canada's 1991 report to its board of directors is instructive:

> Air Canada's concern over marketshare erosion translated into the birth of some aggressive pricing and marketing strategies. During 1991, charter carriers redeployed some capacity from the more stagnant summer Atlantic market in favour of transcontinental routes, pushing the charter share of the transcon to approximately 18 per cent (from 8 per cent in 1990). Air Canada replied with aggressive price discounts in the form of seat sales and a competitive commission scheme to travel agents and pushed the charters' share back. 1992 projections peg charter transcon share at 9 per cent.
>
> . . . .
>
> Similarly, the increased presence of charter operators on the Canadian transcontinental routes eroded yields on this market segment and pricing actions were taken to contain these charter operators to their traditional niches.
>
> The 1992 commercial strategy picks up on this trend: adding discounted capacity in the short term ... to discourage other entrants from heavy discounting on high yield domestic and international routes in the long term.[60]

In the spring of 1992, officials from Air Canada and Canada 3000 met to discuss the charter carrier's preliminary expansion plans in the event that Air Canada and Canadian merged or Canadian failed.[61] Canadian and Air Canada were at that time actively pursuing the merger option. Mr. Taylor testified that as part of the operating assumptions for the merger, Air Canada's management discussed a

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[60] Confidential Exhibit CA-III-81 at 5, 9-10.

[61] Evidence of Robert J. Deluce, President, Canada 3000: Confidential transcript at 15:855-60 (22 February 1993).

proposal to transfer Air Canada's DC-9 fleet to Canada 3000 (and keep Canadian's newer 737s) to avoid creating a monopoly for the new merged company.[62] The Tribunal is convinced that Canada 3000 felt constrained from engaging in any serious expansion unless Air Canada left room for it to do so. Air Canada, on the other hand, would be unlikely to assist in creating competition for itself that was likely to get out of hand.

We therefore conclude that while the presence of charter carriers is important in some of the largest markets, their role is circumscribed and they could not take up the competitive slack that would be created in the event that Canadian failed. The charter carriers are not currently present in enough markets to compensate for the removal of Canadian.[63] The fact that, as set out in the National Transportation Agency report, some form of discounting occurred on 61 per cent of the tickets purchased by travellers "on the top 25 city-pairs where domestic charters were *not* offered", and the average discount of 33 per cent on those city-pairs, can only be taken as evidence of the effect of competition between Canadian and Air Canada.[64] Furthermore, Air Canada and Canadian compete across the full range of product characteristics, including frequency of service, choice of service classes, frequent

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[62] Confidential transcript at 16:918-20 (23 February 1993); Confidential Exhibit CA-XX-3, Feb. 10 #6B at 3 (pages not numbered).

[63] See the statistics referred to *supra* at 63.

[64] Emphasis added. See *supra*, note 59 at 44.

flyer programs, distribution through CRSs, as well as price. Charter carriers only compete on price and their influence in this respect can be mitigated by a major airline like Air Canada through the judicious use of seat management.

(2) Regional Carriers

In the event that Canadian failed, the regional airlines affiliated with Canadian would be in serious jeopardy. Their own financial situation is precarious, they rely on Canadian for certain services, and they rely to a significant extent on traffic they are able to feed to Canadian's trunk lines and on traffic they receive from Canadian. On the disappearance of Canadian they would be forced to compete with Air Canada affiliates that would continue to enjoy the benefit of traffic feed. Based on the uncontested evidence of John B. Delaney, Director of Corporate Development and Systems for Canadian Regional Airlines Ltd., all but one of the regional airlines would be likely to fail along with Canadian. Air Canada and its affiliates would be the sole scheduled carrier in most airline markets, including all the major ones.

F. "Barriers to Entry"

The principal point of contention between the parties is with respect to barriers to the expansion of existing carriers and to the entry of new ones upon the

exit of Canadian (paragraph 93(d) of the Act). The current glut of aircraft means that it should be easy for would-be entrants to obtain capacity to compete or to expand service on any city-pair. The question is whether the entrant could obtain an adequate number of passengers at profitable price/cost margins.

Air Canada's expert witness, Mr. Shenton, does not dispute that barriers to entry into airline markets do exist. He is instead of the view that the barriers "are not insurmountable" and that entry in a number of high-density markets is likely:

> It has been asserted that the existing aviation environment favours large airlines, particularly those with global alliances. It has also been said that airlines need large mass to enable them to compete in the world marketplace. These assertions and claims are true only to the extent that large airlines are in competition with one another. Smaller airlines are able to operate profitably within the confines of their defined niche, a niche which for one reason or another large airlines are unable or reluctant to enter. High density destination-and-origin ("O&D") city pair markets are particularly well served by small carriers since these markets are of sufficient size to support O&D traffic without reliance on feed from connecting traffic.[65]

Mr. Shenton's conclusion is supported by the views of other witnesses. There are reasonable prospects for entry of a scheduled carrier in the Toronto-Ottawa-Montreal triangle, and for expansion of charter service on the transcontinental routes and the Edmonton-Calgary, Edmonton-Vancouver and Calgary-Vancouver routes.

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[65] Expert Affidavit of H.E. Shenton (25 January 1993): Confidential Exhibit CR-I-34 at para. 10.

This would still leave most city-pairs that are now served by Canadian and its affiliates with monopoly service from Air Canada. Furthermore, even in those markets where entry or expansion can be anticipated, there is no evidence that it would be of a degree and kind that could be considered a reasonable replacement for Canadian.

There is little prospect that the charter carriers could expand beyond their current limited, albeit important, role. If they tried to do so a number of the barriers identified by Michael W. Tretheway, who appeared as an expert witness for the Director and whose views were corroborated by other evidence, would come into play.[66] A charter carrier that attempted to offer scheduled service would be at a significant disadvantage in competition with a major carrier such as Air Canada if it did not have: feed traffic at both ends of its routes; a widely acceptable frequent flyer program that it could offer at a cost comparable to that of its competitor(s); and a significant volume of business so that it did not have to pay higher additional commissions to agents compared to established airline(s) in order to gain their favour when booking customers without a preference for (or against) a particular airline. The same problems would confront a new scheduled carrier attempting to enter on a small-scale basis.

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[66] Expert Affidavit of M.W. Tretheway (30 December 1992): Exhibit A-XVIII-503 at 29-35.

Feed traffic is necessary to help fill planes and to provide more frequent service, which is an important marketing advantage. Higher traffic volume between a city-pair also results in lower cost per passenger as the costs of the infrastructure (ticket agents, baggage handling, etc.) are spread over more passengers. According to the evidence of George Curley, who was the President of Wardair when it was acquired by PWA, the absence of feed traffic was a serious disadvantage for Wardair.[67] First Air provides and receives feed traffic from Air Canada and competes very successfully against Canadian on routes from Ottawa and Montreal to a number of points in the north. John W. Crichton, Executive Vice-President, stated that his company would be in great jeopardy should Canadian merge with Air Canada or fail. He reasoned that in a merger situation Air Canada would inherit the north-south routes of Canadian which directly compete with First Air service. If Canadian were eliminated altogether, its routes would be available and Air Canada could commence its own service. In either case, First Air would not be able to compete against Air Canada on the north-south routes since First Air would lose, and Air Canada would have the advantage of, the feed traffic from southern routes served by Air Canada. Fifty per cent of First Air's north-south passenger traffic is connecting either to or from other domestic points not served by First Air.[68]

[67] Transcript at 6:1041-42 (8 February 1993).

[68] Transcript at 6:964-66 and 950-51 (8 February 1993).

Beyond this specific evidence is the fact that airlines have taken great pains to structure themselves into networks, simply so that they are not limited to providing point-to-point service between a restricted number of city-pairs. The value of the network, considered as a whole, is greater than the sum of its parts. We accept the evidence of Professor Tretheway that there are significant marketing advantages to large airlines.[69] Passengers perceive greater value when they do not have to worry about transferring their luggage, when they wait a shorter time between flights because flights are co-ordinated and when it is easier to accumulate and use frequent flyer points because of a large number of destinations. The airlines benefit from cost sharing at transfer points, but most importantly they benefit from the passengers they receive from the other airlines on the network.

The importance of being part of a network or at least sharing designator codes extends to the way that flights are displayed on CRSs. Connecting flights with the same code appear ahead of connecting flights with different codes even if the latter require less time. It is non-controversial that earlier appearance on agents' screens greatly improves the chances that a flight will be selected. According to Mr. Crichton, First Air was forced to drop two flights to the United States because of this factor.

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[69] *Supra*, note 66 at 12-13.

Frequent flyer points are most important to regular flyers. There are no firm data on the percentage of seats and revenue accounted for by these consumers, but there can be no dispute that they are a very important segment of the market in terms of numbers and are even more so in terms of revenue. According to a survey of travel agencies reported by the National Transportation Agency, 79 per cent of frequent flyers are members of a frequent flyer program and on average belong to two of them.[70] After first believing that frequent flyer bonuses were not important to the success of Wardair when it entered into scheduled service, its management was quickly forced to change course. Even though the awards they subsequently offered were much more generous than those of the other trunk carriers, they found that the results did not live up to expectations. Mr. Curley attributed this to the fact that Wardair did not offer sufficient choice of destinations.[71]

In order to offer an attractive frequent flyer program, an entrant or a charter attempting to expand might be able to purchase frequent flyer points from an incumbent airline. The entrant would, however, have to find an airline willing to sell the points. Upon the failure of Canadian, Air Canada would be the only remaining source of points. Even if an entrant could purchase points, it could also find that its costs were considerably higher than those incurred by incumbent airlines.[72]

[70] *Supra*, note 59 at 43.

[71] Transcript at 6:1045-46 (8 February 1993).

[72] Evidence of Professor Tretheway: Transcript at 7:1119-20 (9 February 1993).

Airlines pay extra commissions to agents based on the percentage of the agent's sales between two points that accrue to the particular airline. William H.W. Maguire, President of ACTA and himself an agent, described these so-called "override commissions" as payments by the airlines designed "to gain market share and to create a loyalty with a particular airline."[73] Mr. Maguire testified that in his experience agents have the opportunity to select an airline on behalf of the traveller about 25 per cent of the time.[74] Thus the loyalty of agents is an important factor in airline sales. This is a hurdle that a new scheduled carrier would have to overcome.

In some cases, such as code sharing, baggage handling, or even feed traffic, the disadvantages of small airlines vis-à-vis networks can be overcome by agreements. While there might be some marketing disadvantages for an alliance of individual airlines in competition with a network with a common identity, the Tribunal accepts that through operating agreements there could be a significant mitigation of the entry barriers new firms would face in operating alone. However, given the absence of available airlines with whom alliances might be formed, piecemeal entry by individual airlines would leave entrants at a significant

[73] Transcript at 10:1905 (12 February 1993).

[74] *Ibid.* at 1907.

disadvantage when the effect of the entry barriers reviewed above are considered in combination.

G. Conclusion

After considering the initial reduction in competition that would follow Canadian's failure and the competition remaining and likely to arise, it is the Tribunal's conclusion that the end result of that failure would undoubtedly be a substantial lessening of competition in most if not all airline passenger markets on southern routes in Canada. Even in high-density markets where entry is most likely to occur, travellers are unlikely to enjoy competition with respect to matters that are important to them, including frequency of service, range of service and frequent flyer points. Moreover, even for travellers for whom price is of primary importance, it cannot be concluded that they will not be hurt by Canadian's exit from high-density markets. The two trunk carriers *do* compete with each other on price. Both trunk carriers also respond to the inroads of other carriers offering low price options and each of their responses affects the other trunk carrier.

VI. IMPACT OF REQUESTED VARIATION ON CRS MARKETS

A. Introduction

The focus of the evidence regarding CRS markets has been on the effect that a shift of Canadian's hosting from Gemini to Sabre, if made possible by the Tribunal, would have on Gemini and on competition in the provision of CRS services in Canada. The respondents opposing the application argue that Gemini will fail or be seriously weakened if it is granted. In the case of a Gemini failure they submit that there is no guarantee that Gemini will be replaced and the most likely result will be a monopoly for Sabre. Even if Gemini survives, they submit that Sabre will be in a dominant position with the result that competition will be lessened in CRS markets.

The Director's position is that the alleged effect of dehosting on Gemini has been greatly exaggerated. He argues that Gemini is not likely to fail and, further, that even if Gemini in its present form does not survive, there is no danger that competition in CRS markets will be threatened.

The respondents opposing the application are not required to prove that there will be a substantial lessening of competition if the requested order is granted. The burden of proof rests with the Director, as applicant, to show that dehosting of

Canadian is unlikely to result in a substantial lessening of competition in CRS markets. This is the only standard that the Tribunal can apply that affords consistency with that used in evaluating airline markets. It is also the only one that the Tribunal has been directed to use under the Act when evaluating alleged reductions in competition.

B. Industry Participants

As is the case with service markets generally, CRS markets are local in their geographic dimension. Competition in any particular market has not been placed in issue. To the extent that local markets have been addressed in the evidence, it has been for the purpose of estimating changes in global shares of Canadian CRS sales from the constituent local markets. The parties have emphasized shares of Canadian sales. Thus, since nothing turns on the term "market", market share is referred to interchangeably with share of Canadian sales for ease of exposition.

There are currently only two CRSs of any importance operating in Canada: Gemini and Sabre. Throughout 1992, the respective market shares of Gemini and Sabre were changing so rapidly that it is difficult to arrive at any meaningful determination of their current market shares. The most recent information before us

indicates that their relative shares during the month of October 1992 were 52 per cent of total air bookings for Gemini and 48 per cent for Sabre.[75]

C. Operations of Gemini

Gemini has two major businesses: the hosting business and the travel agency CRS business. "Hosting" involves maintaining the internal reservation system of an airline or other travel supplier.[76] It follows from the nature of hosting that a supplier can only be hosted in one location. Gemini provides hosting to Air Canada, Canadian and their affiliates as well as to First Air, Canadian Holidays, VIA Rail and the Department of National Defence. Canadian and Canadian Holidays are hosted on Pegasus, the system owned by Canadian prior to being rolled into Gemini in return for Canadian's share in the partnership. Air Canada and the remaining suppliers are hosted on Reservec, which belonged to Air Canada prior to the merger. Reservec and Pegasus are two separate systems within Gemini.

CRSs, Gemini included, are used by travel suppliers as distribution vehicles through which an airline or other supplier can sell its product in an automated fashion

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[75] Gemini and Sabre 1992 Air Bookings (undated): Exhibit R-I-15.

[76] An internal reservation system "is a large-scale computer system which keeps track of seats available and seats sold, is capable of pricing requested itineraries, and performs other reservations-related functions": Expert Affidavit of W.J. Duffy (25 January 1993): Confidential Exhibit CR-I-21 at 8 (Exhibit A).

to travel agents. Virtually all travel agents are now automated and approximately 80 per cent of airline tickets are sold through travel agencies. Airlines which choose to use CRSs for distribution may market their product through various systems to achieve maximum sales. There is no restriction on the number of CRSs through which an airline may display its flight, fare and schedule information to travel agents.

Gemini's CRS distribution business involves providing a service called "Apollo by Gemini" to approximately 2500 travel agency locations across Canada. Apollo by Gemini ("ApG") is a customized version of the software used by the Apollo CRS in the United States. Both Apollo and ApG are owned by Covia. In return for modifying the software for the Canadian market and allowing Gemini to use it, Covia received its one-third interest in the partnership. The principal changes were the addition of French-language capability, building in the fare structure in Canada, which is apparently unique, and a modification to the waiting time between flights. The data base was broadened as well to include smaller Canadian hotels and car rental companies that were not already included in Apollo. Prior to the acquisition of the new software, travel agents using Gemini continued to use either the Pegasus or the Reservec system that they had been using prior to the merger, with the additional ability to access both Air Canada's and Canadian's information as carriers hosted on Gemini.

The computers running Reservec and Pegasus are located in Winnipeg, while ApG resides on the Covia facility in Denver. A complex telecommunications network links the various components of the system together. The bulk of the processing of a reservation request from a travel agent is in fact done by Covia through ApG in Denver and Gemini pays Covia for this service.[77] When a travel agent accesses Gemini to make a booking on either Air Canada or Canadian, the request is first routed to ApG in Denver. ApG then communicates with either Reservec or Pegasus by means of an "inside link" to determine seat availability and to decrement the inventory accordingly.[78] Once ApG receives an answer, it processes the reservation in Denver and sends a confirmation message back to the travel agent.

Gemini's revenue from its hosting operation consists of the fees paid for hosting services by its partners pursuant to the hosting contract. These payments are based on Gemini's fully allocated costs plus a specified mark-up set by the contract.[79] Gemini's CRS revenue comes from booking fees, mainly from airlines,[80] and subscriber fees from travel agents for the rental of equipment and the

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[77] Gemini pays Covia $.50 US for each booking processed in Denver: Transcript at 11:2035 (15 February 1993).

[78] The "inside link" allows ApG to speak to Pegasus and Reservec in a manner that approximates the degree of functionality that would be achieved if Air Canada and Canadian were hosted directly in ApG. The link replicates the hosting environment so that when travel agents switched from Pegasus or Reservec to ApG they did not lose any functionality in the process.

[79] *Supra*, note 8 at art. 6 and Appendix A.

[80] Gemini projects that hotels and cars will account for only 5 per cent of its total booking fee revenue in 1993.

communications network and various training, maintenance and support services. Booking fees are more important to overall revenues than subscriber fees as the latter tend to be heavily discounted based on the volume of bookings generated by the particular travel agency.

Paul W. Nelson, President and Chief Executive Officer of Gemini, estimated that the approximate annual revenue breakdown for Gemini as between hosting income and CRS distribution income is $70 million from hosting to $80 million from CRS. Canadian provides $30 million of its hosting revenue or somewhat more than 20 per cent of its total revenue. While the hosting operation is profitable by definition since the fees are based on fully allocated costs plus a mark-up, the CRS distribution side is losing money.

D. Gemini's Financial Future

Marilynne Day-Linton, Vice-President, Finance of Gemini, prepared financial forecasts for the 1993-1995 period based on Canadian, its affiliates and Canadian Holidays dehosting from Gemini effective March 31, 1993.[81] Although Gemini projects large net losses in each of the three years, the financial forecasts also show a strong balance sheet in 1995 with about $10 million in cash and virtually no debt

[81] Confidential Exhibit CR-III-94 at 31-51.

owed to third parties (about $2.1 million long-term liabilities and $900,000 current liabilities). The only other items on the liability and owners' equity side are capital contributions by the limited partners. The balance sheet also shows that the partners will have received approximately $10 million from Gemini over the three-year period.

Thus, according to its own estimates, Gemini is unlikely to fail in the foreseeable future. Further, those estimates represent a "worst-case" scenario for Gemini. In forecasting revenues, Ms. Day-Linton accepted the projections of Gemini's expert witness, William J. Duffy, with respect to the market share shift from Gemini to Sabre consequent upon Canadian moving its hosting. She also assumed that the dehosting would take place by March 31, 1993. The merits of Dr. Duffy's projections of market share loss are discussed further below.[82] To the extent that the market share loss is overstated, Gemini's future revenues have been understated in the forecasts. Likewise, the longer that Canadian remains hosted in Gemini, the greater will be Gemini's revenues and the greater its ability to mitigate the costs of downsizing its operations in preparation for Canadian's departure.[83]

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[82] See *infra* at 97ff.

[83] Downsizing costs consist mainly of severance payments to employees.

In addition, Gemini is a limited partnership that provides service to two of its partners (Air Canada and PWA/Canadian) and buys services from the third (Covia). As such, Gemini is to a large extent as profitable or unprofitable as its partners determine. Covia could charge Gemini less for the services it provides; the other partners could pay more for services provided by Gemini; all three could contribute capital to make up for a cash shortfall.

E. Effects of Dehosting on Gemini

Although we have determined that Gemini will likely still be in business in 1995, its mere existence is not a guarantee that there will continue to be vigorous competition in CRS markets in Canada. A broader examination of the operation of those markets is required to resolve whether the proposed variation to the 1989 Consent Order would be likely to have an adverse effect on competition, such as the alleged market dominance of Sabre.

Gemini and Covia argue that Gemini's competitive strength will be adversely affected by losing Canadian's hosting to Sabre because it will not be able to reduce its costs associated with hosting to the same extent as its hosting revenues will decline and because it will experience a decline in CRS distribution revenue as a result of a large market share loss to Sabre. The negative effects on Gemini as a

result of dehosting are alleged to be greater if Canadian survives and places its hosting with Sabre than if it fails and no longer requires hosting.

(1) Effects Directly Related to Dehosting

Through their witnesses, the respondents Gemini and Covia presented the following scenarios if Canadian fails or transfers its hosting to Sabre. Gemini would lose Canadian as a source of hosting revenue in either case. In case of Canadian's failure, after the initial disruptions were overcome airline traffic would recover and Air Canada or other airlines using Gemini for hosting services would virtually compensate for the reduction in revenue experienced by Gemini as a result of Canadian discontinuing operations. But in the case of Canadian shifting its hosting to Sabre, compensatory increases in hosting revenue from other carriers could not be anticipated. Since Gemini is compensated for hosting Canadian on a cost-plus basis, it would lose a contribution to profit. More importantly, the decline in hosting revenue would be a problem to Gemini insofar as it could not reduce its costs to the same extent as its hosting revenue declined.

What emerges from the evidence with respect to Gemini's ability or inability to reduce its costs if Canadian dehosts, is that, first, Gemini has a number of contracts, mainly for the lease of computer and telecommunications equipment, that

do not expire until various times in 1995. It cannot, therefore, immediately reduce these costs upon dehosting.[84] The revenue from hosting that would otherwise cover the cost of these leases was assumed to end in March 1993 in the financial projections of Gemini. The earliest date for dehosting actually proposed by any party was in 1994. The longer the revenue stream continues, the less the loss from this source would be.

Second, costs might not decline as much as revenues if Gemini's cost structure incorporates economies of scale and scope. Insofar as there are economies of scale in the provision of hosting and CRS services, a reduction in the volume of services delivered would result in higher costs per unit. Jerry A. Hausman, the economist appearing as an expert witness for Covia, submitted uncontested evidence based on United States CRSs that there are economies of scale in the delivery of CRS services.[85] While the Tribunal accepts that there are economies of scale in Gemini, we have no direct evidence of their extent.[86] It would be unwise simply to apply findings based on United States CRSs directly to Gemini's situation. Gemini is primarily a conduit between Apollo's computers in Denver and the agents.

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[84] Confidential Exhibit CR-III-85; Evidence of Ms. Day-Linton: Confidential transcript at 12:581-85 (16 February 1993).

[85] Expert Affidavit of J.A. Hausman (25 January 1993): Confidential Exhibit CR-I-28 at paras 11-15.

[86] Indirect evidence might be taken to be embedded in the financial projections of Gemini discussed earlier.

Economies of scale in development costs for CRS software and the undoubtedly large computers used in providing CRS services lie outside of Gemini.

Professor Hausman also suggests that there are economies of scope when airline internal reservation (hosting) systems are operated in conjunction with CRS distribution.[87] Economies of scope occur when unit costs fall as activities are added. Professor Hausman's opinion is based on general information and does not necessarily apply to Gemini. In fact, Gemini's President expressed views at an executive committee meeting in August 1990 that strongly suggest that there are diseconomies of scope associated with the design of the Gemini system: "Paul Nelson explained the inefficiencies in maintaining three systems [Reservec, Pegasus and ApG] and pointed out that this had been the least desirable scenario for Gemini to be in."[88] He pursued this line in a memorandum to the chairman of Gemini's board and at the next executive committee meeting in October 1990, suggesting that the partners might want to rethink things and consider downsizing Gemini to a "marketing/networking" company and moving hosting back to the airlines.[89] In giving evidence, Mr. Nelson explained that Gemini was paying for the inside link processing for Reservec and Pegasus and, in his view, was "effectively

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[87] *Supra*, note 85 at para. 16.

[88] Minutes (22 August 1990): Exhibit A-XV-429 at 2.

[89] Memorandum (16 October 1990): Exhibit A-V-113 at 1.

subsidizing those systems."[90] That is, the airlines were not paying the full costs for the services which they were getting. It is immaterial whether Mr. Nelson's views reflected diseconomies of scope in the design of the system or a failure by the airlines to cover the full costs for services received. In either case the alleged deleterious effects on Gemini of Canadian dehosting are lessened.

(2) Effects on CRS Market Share of Hosting Shift to Sabre

(a) "Predisposition" and Hosting

According to the respondents Gemini and Covia, Gemini would also suffer a large and potentially disastrous loss in CRS market share as a result of Canadian shifting its hosting to Sabre. The cause of the anticipated loss is an alleged "predisposition" on the part of travel agents to favour contracting with the CRS that is associated with the airline with which the agents do most of their business. There is no dispute that it is an advantage to market a CRS that is seen by agents as being in a close relationship with an airline with which those agents do most of their business. This is the case even though the tying of CRS services to airline commissions or any other benefits conferred on an agent by an airline is prohibited by CRS rules in the United States and by the Tribunal's Consent Order in Canada.

[90] Transcript at 11:2122 (15 February 1993).

As Richard S. Kunz, who was Managing Director of Sabre in Canada until July 1990 and is still a senior executive with Sabre in the United States, stated: "Their [the agents'] revenue stream, their livelihood depends on that airline and they would be predisposed to select their product."[91] The same point emerged from the evidence of Mr. Maguire -- agents and airlines do form close working relationships and some relationships are closer than others.

The empirical evidence from the United States is consistent with the presence of a significant predisposition effect there. The market shares of CRSs at certain hubs appear to reflect the market shares of the associated airline at those hubs. At a more micro level, Professor Hausman studied how the share of agents' business with United Airlines in 1986 affected the decision to choose or not choose Apollo, the CRS marketed by United Airlines. He found that the share of an agency's business with United was an important factor in whether the agency selected Apollo.[92]

While there is little dispute about the presence of a predisposition effect in the United States, there is considerable disagreement as to the existence or importance of predisposition for CRS market shares in Canada in the event that Canadian should

[91] Transcript at 7:1330 (9 February 1993).

[92] More specifically, "travel agencies which switched to Apollo had a United Airlines share of business of 0.153 on average while travel agencies which automated with other CRS had a United share of .107": *supra*, note 85 at para. 18.

shift its hosting to Sabre. A preliminary issue is whether hosting *per se* is an important component of predisposition. The question arises because under the proposed agreement with AMR, Canadian's hosting would be shifted to Sabre but Canadian would not market Sabre.

Apart from information on market shares in Pittsburgh that lends some support to Professor Hausman's view that hosting has some independent influence, there is no empirical evidence on the matter. It is not feasible to study the influence of hosting by itself on agents' decisions in the United States since hosting by a CRS of an airline and marketing of the CRS by that airline almost invariably go together in that market. The advantages to a CRS in the United States of being associated with an airline with a major market share go well beyond the mere fact that the airline is hosted on the CRS. There the marketing of a CRS is performed by the personnel of the airline that has an ownership interest in the CRS. In Canada, ApG is marketed by Gemini employees and Sabre does not use American employees but has set up a separate sales force to market its product.

The economists appearing as expert witnesses for the Director and for American as an intervenor, Gloria J. Hurdle and Gary J. Dorman, respectively, are of the opinion that where an airline is hosted is not important to an agent. Access to vital information such as last seat availability does not in the current technological

and regulatory environment depend on using the hosting CRS for that airline. Even Professor Hausman, who considers that hosting does have some importance in the overall predisposition effect, does not attribute it to actual functional differences but rather better perceived service by the travel agent. Drs. Hurdle and Dorman see the active marketing by airlines as the critical nexus between airline market shares and those of their associated CRS. Mr. Maguire is of the view that agents do not care with which CRS an airline is hosted.

In the view of the Tribunal hosting without active selling effort by the airline is of limited importance in predisposition. As matters stand Canadian would not be marketing Sabre, although this would not prevent Sabre from using the relationship between Canadian and itself to its advantage. But this is a long step away from the active participation of Canadian's employees in, or (as in the United States) them being solely responsible for, marketing the CRS. Obviously, Canadian's role could change, but any change in its role would almost certainly be associated with a corresponding change in the participation of Air Canada in marketing ApG.

(b) Magnitude of the Market Share Shift

Various estimates of the extent of market share loss to Sabre resulting from a transfer of Canadian's hosting were presented to us. The approach of the experts

appearing for the respondents Covia and Gemini, Professor Hausman and Dr. Duffy, is to take an estimate of the 1992 market shares of Gemini and Sabre as a starting point or "equilibrium". According to that estimate, Gemini had approximately 55 per cent of domestic bookings and Sabre 45 per cent. They then assume a change in the given circumstances in the form of a shift in Canadian's hosting, estimate the change in Sabre's share of sales and add that to its 1992 starting share and deduct it from Gemini's. Professor Hausman applies the results of his econometric study in the United States of agents who switched to Apollo[93] and concludes that Gemini would experience a share of sales loss of 24 percentage points, which would drive its share down to about 30 per cent and Sabre's up to 70 per cent.[94] Dr. Duffy estimates a shift of 18 percentage points and a resulting share for Gemini of about 37 per cent as early as 1995.[95] (Sabre would then have 63 per cent.)

Two internal estimates of market share shift from Gemini to Sabre were prepared by Canadian.[96] We have disregarded these estimates as they were not serious efforts. At least in one case, the purpose was to search for arguments that

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[93] Note that Air Canada and Canadian's average share of business with agencies is much higher than United's (which ranged from 0.107 to 0.153). This is one of several differences between the CRS and airline industries in Canada and the United States.

[94] *Supra*, note 85 at paras 21-25.

[95] *Supra*, note 76 at 19-21 (Exhibit A).

[96] Handwritten notes (undated): Exhibit A-VI-159; Iceberg Benefits (4 December 1991): Confidential Exhibit CA-VII-238.

could be used in selling a deal with PWA/Canadian to AMR and, therefore, to inflate the amount of the shift that could be expected.

We are not prepared to accept the estimates of the market share shift to Sabre prepared by Covia and Gemini's expert witnesses as credible. Those estimates overstate the magnitude of the market share shift. We have arrived at this conclusion for two main reasons. First, the respondents' experts assume that Gemini is already benefitting fully from the predisposition arising from both Canadian and Air Canada being associated with it and that its current market share reflects that -- a view that the evidence does not support. Second, the estimated magnitude of the shift is based on United States experience with predisposition. It does not reflect that the predicted magnitude of the predisposition effects could not be expected solely from a change in hosting because of how CRSs are marketed in Canada nor does it reflect differences in the airline markets in the two countries.

With respect to the relative market shares of Gemini and Sabre, the trend shown by the evidence is that Gemini has lost share to Sabre since 1985 with a sharp acceleration of that loss in 1990. Gemini continued to lose share in 1991 and 1992, although at a slower pace than in 1990, until losses again accelerated in the latter half of 1992.[97]

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[97] Canadian Sabre Market (9 February 1993): Exhibit A-XVIII-505; Gemini and Sabre 1992 Air Bookings (undated): *supra*, note 75.

Predisposition is only one of four factors identified as important in an agency's selection of a CRS.[98] The others are price, functionality and the quality of the marketing and selling efforts. The situation with respect to functionality has been one of important change in the domestic CRS industry from Gemini's creation until mid-1992.

Prior to the Tribunal's Consent Order in 1989, Sabre had a very small share that was concentrated in a few of the largest centres. Its system was functionally superior to Reservec and Pegasus, which were being marketed by Gemini, in all respects save one: it did not have access to last seat availability on Air Canada and Canadian. This severe handicap was cured by the Consent Order that required that this information be made available to Sabre through a direct link, first a "look but not book" link from January 31, 1990, and then a "look and book" link from June 30, 1991. With the links Sabre had a far superior product to that which Gemini was offering. Clearly this contributed to Sabre's share increases in 1990 and 1991.

Gemini ran into considerable difficulties and cost overruns in setting up its network, upgrading its software and in implementing the conversion from Reservec

[98] Mr. Lupton listed price, functionality and service from the CRS vendor as the important factors in the choice of a CRS by an agent: Transcript at 8:1492 (10 February 1993). Mr. Maguire referred to the nature of the marketing and selling effort of the vendor as a factor in the choice between Sabre and Gemini. Note that he also pointed out that, in general, an agent would be reluctant to change from an existing system and disputed the existence of any predisposition effect: Transcript at 10:1914-15, 1917-18 (12 February 1993).

and Pegasus to another system. It was contemplated from the outset that Gemini would acquire successor software to improve its functionality. In 1988, Air Canada and Canadian had almost completed an arrangement to use PARS, a United States-based CRS, when it fell through with immediate negative consequences for Gemini's credibility with its subscribers.[99] Work on ApG started in the fall of 1989; actual implementation did not get underway until the beginning of 1991. The process of converting the facilities of travel agents to ApG was halted in May 1991 due to problems in the system and outages on the telecommunications network. Conversions went ahead again in September and two-thirds were completed by November, but the last conversions were not made until July 1992.

During the lengthy conversion process, new agencies and those whose contracts were up for renewal had a choice between an existing system with superior functionality (Sabre) and one that had not yet been tried (ApG). It is reasonable to attribute some of the continued gains of Sabre in 1991 to the ongoing difficulties that Gemini was having in perfecting its system and in converting agencies. The fact that agencies had to be converted was in itself also an opportunity for Sabre since conversion is a major event for an agency, even if everything goes smoothly. A change in equipment and wiring is required and personnel must be retrained.

[99] Agents had been told that they would be receiving PARS: Transcript at 11:1971 (15 February 1993).

Gemini's current market share reflects this historical relative weakness in functionality with respect to Sabre. The evidence is that ApG and Sabre are now functionally equivalent. Thus, if the predisposition from being associated with Canadian and Air Canada is operating in Gemini's favour, as hypothesized by Dr. Duffy and Professor Hausman, the earlier losses by Gemini from inferior functionality are now subject to recapture from Sabre. That is, the "equilibrium" or starting point for Gemini's market share from which these experts measure the market share shift to Sabre is too low.

Both experts base their estimates of the magnitude of the market shift on United States data or experience. In our earlier discussion we indicated that hosting on its own is of limited importance in creating a predisposition effect. More depends on the marketing of the CRS, which is carried out differently in Canada than in the United States.

A comparison of airline markets in Canada and the United States also suggests that the magnitude of any predisposition effect is likely to be smaller in Canada and, to the extent that it exists, is likely to favour Air Canada. Hubs have become a predominant characteristic of the airline industry in the United States and, as pointed out earlier, dominance of a hub by an airline is associated with similar dominance by the associated CRS. With the exception of a few multi-airline hubs,

individual airlines dominate most hubs. Such dominance of airline traffic is not found in Canada. Air Canada is stronger in the eastern and Canadian in the western part of the country but the relatively weaker airline is a significant presence in all the larger markets.

Dr. Duffy sets out the share of weekly seat departures of both airlines at major Canadian cities in his affidavit. To the extent that either airline might be considered dominant in any of the 34 "catchment areas" covered by Dr. Duffy, it is Air Canada. In July 1992 it accounted for at least 60 per cent of weekly seat departures by Canadian registry airlines in five of the largest 20 areas, including Toronto, Montreal and Ottawa. It accounted for at least 60 per cent in seven out of all 34 areas. Canadian approached 60 per cent only in Vancouver among the 20 largest centres. It exceeded that mark in three of the 34 areas covered. When both domestic and foreign registry airlines are included, each airline has well below 50 per cent of weekly departures in the "gateways" of Toronto, Montreal and Vancouver.[100]

There is merit in the position of Drs. Hurdle and Dorman that predisposition would favour Gemini more than Sabre in the event of a shift by Canadian to Sabre since Air Canada is larger than Canadian. Given rough functional equivalence between ApG and Sabre, which they take as their starting point, they are of the view

[100] *Supra*, note 76 at Exhibit B.6 (Exhibit A).

that CRS shares should approach those of the airlines that would be associated with each of the CRSs. When we allow for an overly low starting point for Gemini's share and compensate for the fact that the magnitude of the estimated shift is too great given solely a change in hosting, it is difficult to conclude that market shares after dehosting will be significantly different from those now existing.

F. The Future of Gemini and CRS Competition

The fact remains that, in spite of having completed the conversion of its agents to ApG, Gemini has continued to lose market share. It has morale problems among its personnel and credibility problems with its CRS customers. The difficulties encountered in bringing an acceptable product to the market have already been discussed. Gemini has also suffered from long-standing internal difficulties. The costs to establish Gemini were much higher than anticipated and Gemini was under financial pressure from its partners as soon as it started to make major investments in 1990. Various options for reorganizing Gemini, including that of hosting going back to the airlines, were discussed starting in late 1990 in the context of improving its financial position but there appears to have been a lack of a unified vision and commitment by the partners.

Whatever strains existed in the past are minor compared to the recent breakdown of the partnership stemming from Canadian's desire to escape from its hosting contract with Gemini. There has been much documentary and oral evidence relating to when precisely Canadian management knew or had decided that they would have to move hosting to Sabre in order to reach an agreement with AMR. By mid-1991, Gemini's board had settled on an option that would have the airlines' hosting remain with Gemini, increase the payments from the airlines and reduce the payment to Covia so that Gemini would be under less financial strain. This would have permitted it to get on with making whatever expenditures were necessary to improve its position in the long run. A memorandum of understanding to that effect was drafted but it was never signed by Canadian. (The other two partners signed in early 1992.) It temporized and suggested other alternatives. The Tribunal is of the view that at some point in late 1991 Canadian's management had concluded that Canadian had better keep its options open and therefore delayed signing the memorandum of understanding.

The disagreement and lack of common focus among the partners had a serious effect on Gemini personnel. Then Gemini was dealt public blows that could only seriously reduce confidence among subscribers. In August 1992, PWA launched a suit seeking to have Gemini declared insolvent. In November the Director submitted his application, which included the dissolution of Gemini as a

possible remedy. This was followed by public declarations by Mr. Nelson that Gemini's existence was being threatened. There was an apparently precipitous decline[101] in Gemini's market share in the second half of the year for which there is no explanation other than the events described.

These events have placed a cloud over Gemini but, in the end, its fate is in the hands of its partners, as it has always been. Gemini is still in a good position. The large expenditures required to establish its system and to introduce ApG are behind it. It still has a large market share, a good product and, at worst, an association with the largest airline in the country. As discussed earlier, even under the most pessimistic assumptions its financial position is healthy through 1995.

Regardless of whether Gemini survives in its current form, Air Canada and Covia each have a strong motivation to continue in the CRS business. As an airline which markets its product to consumers through CRSs and pays booking fees, it is in Air Canada's interest to ensure that the CRS industry in Canada remains competitive. Air Canada is unlikely to surrender the Canadian market to Sabre.

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[101] A qualification is necessary because there are no overall traffic statistics and comparable data from other years against which to evaluate whether the month-to-month changes recorded in 1992 are abnormal.

For Covia, Gemini's sales represent roughly 12 per cent of its sales in the United States[102] and it would be highly unusual for any company to abandon such a large volume of business unless it is clearly unprofitable. In fact, the evidence is that the processing fee received by Apollo has undoubtedly been profitable.[103] This is not surprising since there was no indication that Sabre's Canadian business, even when at much lower levels, has been unprofitable.

Should the partners decide to wind up Gemini, the transition to a successor organization would be eased by the presence of a clause in Gemini's contracts with its subscribers that allows for their assignment to third parties.[104] As long as the CRS in place, ApG, is still used, there is no obvious reason why a transfer of the contracts from Gemini to some other company should not be readily possible. The decision whether to maintain Gemini or to introduce a new organization depends on the remaining partners' views regarding the most efficient way to deliver CRS services rather than on whether Canadian fails or is allowed to move its hosting to Sabre.

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[102] Gemini - Size of Canadian market (undated): Exhibit A-XIII-402 at 1 (pages not numbered). Gemini's sales as a percentage of Apollo sales was calculated by assuming that Gemini's share of the total Canadian market (bookings) is approximately 55 per cent.

[103] Gemini Limited Partnership Financial Review (24 January 1992): Confidential Exhibit CA-XIII-372 at 2 (pages not numbered). Mr. Blackney confirmed that the profit before tax recorded in the centre column was accurate for 1992: Transcript at 14:2662-63, 2665-66 (18 February 1993).

[104] Exhibit A-XVI-484 at para. 17 of the "Terms and Conditions"; Transcript at 12:2151 (16 February 1993).

G. Conclusion

Gemini is unlikely to fail financially in the foreseeable future, even if Canadian transfers its hosting to Sabre. The long run effect on Gemini of such a shift depends primarily on the losses in its market share that would result. Other effects on Gemini are either short run (downsizing costs and lease commitments until 1995) or are too uncertain (loss of economies of scope) to allow any conclusions to be drawn. For reasons that have been discussed at length the CRS market share losses predicted by the respondents' experts resulting from predisposition are not credible. While the agencies doing a large volume of business with Canadian might well change to Sabre, the fact that ApG is comparable to Sabre with respect to functionality means that earlier gains made by Sabre should be eroded as agents that do a large volume of business with Air Canada move back to Gemini. If Sabre and Gemini are comparable in other respects then predisposition favours Gemini, not Sabre, since the airline associated with Gemini (Air Canada) has a larger share of most domestic airline markets than the airline associated with Sabre (Canadian). There is no good market reason why there should not be two strong CRS networks available in Canada in the event Canadian shifted its hosting to Sabre. Even if Gemini does not succeed in putting its early painful past behind it and becoming a fully effective competitor, market conditions should cause Air Canada or Covia,

singly or together, to provide a successor organization to Gemini in the event that it does not meet their needs.

VII. REMEDIES

A. General Considerations

In the circumstances the application must be dismissed.

However, we have indicated earlier that in a proper case the Tribunal would have jurisdiction to vary contractual obligations incidentally to achieving a pro-competitive result. While the majority are of the view that the criteria for such action have not been met here, it is thought advisable to state the nature of the order which the Tribunal would make, had those criteria been met. This may be of assistance to the parties and to the Court of Appeal should our decision be appealed: it may enable further argument to be presented on the nature of the remedies which the Tribunal could and should award, and facilitate the necessary order being issued by the Court of Appeal or the Tribunal (on reference back) if it should be determined that we have jurisdiction under section 106 of the Act.

There is no jurisprudence to guide the Tribunal on the nature and scope of our power, in varying orders, to impose terms that modify contractual obligations. We start with the premise that our role is to protect the public interest in competition, and not to provide contractual remedies for private parties -- a matter clearly left to the courts. It seems consistent with Parliament's grant of authority to the Tribunal to interfere in a proper case with contracts that have an anti-competitive effect, that we may thereby render such contracts unenforceable. It is also reasonable to assume that Parliament did not intend the Tribunal to provide for compensation when acting in the public interest it deliberately ruptures private contracts. Therefore, we do not believe we would have authority to award compensation for the loss by Gemini or others of future benefits that would have arisen under the hosting contract had it not been terminated under authority of a Tribunal order. Whether private law contractual remedies might nevertheless be available in the superior courts of the provinces is not for us to determine.

We would think it reasonable, however, that in pursuit of the public interest the Tribunal can, in allowing a private party unilaterally and to its own commercial advantage to terminate its contract, impose conditions which will both facilitate that termination and make it less harmful to the other parties. Taking this approach we would regard it within our implicit powers, and to represent a fair balance between public and private interests, to order that Canadian, if allowed to terminate the

hosting contract, be obliged to pay certain of Gemini's costs arising from the termination and dehosting. Those costs are described below. At the same time, Gemini would be required to take the necessary steps to enable Canadian to achieve dehosting.

B. Terms for Dehosting

If the criteria set out in section 106 for the variation of an order had been met, the Tribunal would have granted the Director's request for an amendment to the hosting contract to allow Canadian to dehost from Gemini on certain terms. Canadian would have been required to give at least twelve months notice to Gemini and to reimburse Gemini for the following costs: any costs incurred by Gemini in the migration process itself; and cash costs incurred by Gemini in meeting, and terminating as soon as reasonably possible, expenditures no longer necessary after the shift in the hosting of Canadian to Sabre. Gemini would have been required to co-operate in the transfer of Canadian's hosting to Sabre.

The Director asked for a notice period of twelve months. The only other submission by a party on this question was that of PWA and Canadian, which suggested that notice of nine months was sufficient. We would not be disposed to shorten the notice period from that asked for by the Director when the only evidence indicates that the longer notice period is more beneficial to Gemini.

Gemini itself forecast the types and amount of "downsizing costs" that it would incur in the event that Canadian transferred its hosting to Sabre.[105] These downsizing costs include cash and non-cash costs (costs for accounting purposes only). Gemini should only be compensated for the cash costs, which in its forecast include only the items called "General Provision" and "Severance".[106] Since the Gemini forecast was based on a transfer of hosting effective March 31, 1993, we refer to it only to illustrate the categories of costs that would appear to fall within our intended order as to required reimbursements. The actual amounts projected in those documents are not relevant. With a one-year notice period, costs may not, in fact, be incurred in all the categories mentioned.

Gemini also estimated the costs that it cannot shed immediately upon Canadian's dehosting, largely equipment leases which expire in 1995.[107] Once again, Gemini's estimates serve to illustrate the types of costs that the Tribunal would be prepared to consider for reimbursement as indicated above. Gemini's estimates of its "unsheddable" costs were based on dehosting effective March 31, 1993. We would expect that, given the twelve month notice period, the actual costs will be significantly less than set out in those estimates.

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[105] Exhibit R-III-94 at 45.

[106] Evidence of Ms. Day-Linton: Confidential transcript at 12:667 (16 February 1993).

[107] *Supra*, note 84.

If we were to make such an order for reimbursement of costs, it would be on the basis that if the affected parties could not reach agreement on the amounts to be paid, any of them could apply to the Tribunal for a determination of such amount.

VIII. ORDER

FOR THE REASONS set out above pertaining to the Tribunal's jurisdiction over this matter;

THE TRIBUNAL HEREBY ORDERS THAT the application for a variation of the Consent Order dated July 7, 1989 is dismissed.

DATED at Ottawa, this 22nd day of April, 1993.

SIGNED on behalf of the Tribunal by the presiding judicial member.

(s) B.L. Strayer
B.L. Strayer