

COMPETITION TRIBUNAL/TRIBUNAL DE LA CONCURRENCE

Court File No.: 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. 1985, c. C-34 to vary the Consent Order of the Tribunal dated July 7, 1989.

B E T W E E N :

FILED	COMPETITION TRIBUNAL TRIBUNAL DE LA CONCURRENCE	P R O D U I T
	DEC 14 1992 <i>RB</i>	
REGISTRAR - REGISTRAIRE		
OTTAWA, ONT.	#654	

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

Intervenors

REPLY

REPLY OF THE DIRECTOR OF INVESTIGATION AND RESEARCH

1. The Competition Tribunal has received four Responses from the Respondents, one from Air Canada (the "AC response"), one from PWA Corporation and Canadian Airlines International Ltd. (the "CDN response"), one from The Gemini Group Limited Partnership and The Gemini Group Automated Distribution Systems Inc. (the "Gemini response") and one from Covia Canada Corp. and Covia Canada Partnership Corp. (the "Covia" response). This is the Director's Reply to all four Responses.

S. 106 Changed Circumstances

2. Under s.106 of the Competition Act, the Competition Tribunal has the authority to grant the relief sought by the Director on the basis of the changed circumstances described in the Director's Application.

3. The circumstances which led to the Gemini Consent Order included the circumstance of competition between AC and CDN in domestic airline markets, and the assumption that such competition would continue. It was not known or anticipated at the time of the Consent Order that:

- (a) CDN's financial condition would deteriorate to the point that it cannot survive on its own; or
- (b) that the Gemini Hosting Contract would facilitate the creation of a virtual monopoly for AC in domestic airline markets.

4. In the present circumstances, the Director would not have consented to the Gemini Consent Order, nor in the respectful submission of the Director, would the Tribunal have issued it without provision for early termination of the Gemini Hosting Contract.

5. CDN entered into a hosting contract with Gemini as part of the Gemini merger. The Gemini Hosting Contract is the successor of that contract and was facilitated by the Gemini Consent Order. It could have been a term of the

Consent Order (and would have been in the present circumstances) that provision be made for the early termination of the Gemini Hosting Contract. Without the Gemini Consent Order, the Director's Application for dissolution of Gemini would have continued.

6. Under s.106, the Tribunal has authority to vary its Consent Order now, with or without the consent of the Respondents, to require that provision be made for early termination of the Gemini Hosting Contract.

7. The Director agrees with the Respondents that the primary concern of his original Application was the distribution services provided by CRS vendors, and that hosting services were not a major focus of the Application. However, the Director's Application, the Consent Order and the Reasons for the Consent Order also addressed competition in airline markets. If, as the Director alleges, the Tribunal would not have issued the Consent Order on the same terms in the present circumstances because of concerns about competition in airline markets, the Tribunal can and should vary its order to address these concerns. It does not matter that these concerns were not the primary focus or any part of the original Application.

8. The Director also agrees with the Respondents that the financial deterioration of CDN was not caused by the Gemini Consent Order or the Gemini Hosting Contract. The Director asserts that a change in circumstances does not have to be caused by or related to the previous order to give the Tribunal authority to vary any such order under s. 106.

Effect of a Successful Application on Gemini and on CRS markets

9. In the responses of AC, Gemini and Covia, it is alleged that the early termination of the Gemini Hosting Contract will cause Gemini to fail and thereby create a monopoly in CRS markets in Canada. This is not the case for the following reasons, among others:

(a) The hosting of CDN provides only a portion of Gemini's total revenue and total income. In paragraph 25 of the Covia response, Covia estimates that CDN hosting revenue generates only 23% of Gemini's total income.

(b) The hosting revenue generated from AC and CDN is based on a formula of cost plus a margin of between 2% and 12%. If CDN is allowed to terminate its hosting relationship with Gemini, many of the costs associated with providing that service will disappear over time. CDN is still hosted on the Pegasus system, which is IBM- based, while AC is still hosted on Reservec, which is Unisys- based. The differences in these hosting systems means that some of the costs associated with operating them are independent of one another .

(c) According to Gemini and Covia, Gemini now has between 60% to 65% of the travel agent locations in Canada. It has maintained this dominant position despite the fact that it has just recently finished converting its travel agent subscriber base from the functionally inferior Reservec and Pegasus systems to the modified Apollo software known as "Apollo by Gemini" ("APG"). The Apollo software is widely acknowledged to be competitive to any CRS software in the world. It was developed by Covia, which is the second largest CRS in the United States. Gemini claims that the APG product is in fact superior to Sabre in Canada because of a number of unique aspects, such a French language capability. Now that Gemini has a functionally competitive product, it should be able to maintain a strong market position in Canada.

(d) AC can continue to host in Gemini. AC is the largest scheduled airline in Canada, carrying 59% of scheduled airline passengers in the top 205 domestic city pairs in Canada in 1990. In paragraph 25 of the Covia response, Covia admits that:

"...travel agents prefer to use the CRS system on which an airline is hosted in the belief that they are in that case booking with directly with the airline internal reservation system resulting in greater accuracy and security."

If this "halo effect" is still important given today's technology and CRS rules on tying, then the majority of travel agents should still prefer to use Gemini because AC is the airline they most frequently book.

(e) Prior to the Gemini merger, Reservec held a market position similar to that now held by Gemini and did not host CDN. It was profitable.

10. If CDN fails, then Gemini will immediately lose this source of revenue in any event.

11. PWA and CDN have alleged in other proceedings that Gemini is already insolvent. The Director takes no position on this issue. The Director does say, however, that the early termination of CDN hosting contract will not result in any insolvency or financial failure of Gemini.

12. Even if Gemini were to fail, that would not result in a monopoly in CRS markets in Canada. Covia is the second largest CRS in the United States. Covia would not give up in the Canadian marketplace when it now enjoys, through its clone CRS, APG, the largest market penetration of any market it now serves. AC, which is the largest airline in Canada, has the incentive to support both Covia, in which it has an ownership interest, or SystemOne, in which AC will also have an interest, pending regulatory and bankruptcy court approval of its bid for Continental Airlines Corp.

13. If CDN is allowed to withdraw from the hosting contract, Gemini will likely be reorganized. This would have happened in any event. The partners of Gemini have not been satisfied with the financial situation of Gemini and have discussed options for the restructuring of Gemini since 1991.

14. One of those options under consideration was the repatriation of the hosting functions by AC and CDN, leaving Gemini as a marketing and distribution company, with all CRS distribution processing and most software development continuing to be done in Denver, Colorado, as is the case today (the "repatriation option").

15. AC has recently acquired from British Airways an extensive package of hosting software with the intention of converting Reservec to an IBM-based hosting system with much greater functionality than Reservec now has. AC has already made a significant investment in this project. Given this investment, it is questionable whether AC itself would want to continue to use Gemini or whether it would prefer to perform the hosting function itself.

16. During the merger discussions between AC and CDN, there were discussions about repatriation of the host function from Gemini to the merged airline, either on the new Reservec system or a modified Pegasus system. AC representatives expressed the view that AC would prefer to takeover the hosting function from Gemini once the new Reservec system was in place.

17. AC, along with non-airline partners have made a bid for control of Continental Airlines Corp. which has been accepted by the Board of Directors of Continental. The proposal is subject to regulatory approval of the U.S. Department of Transportation and the bankruptcy court. If AC is successful in its bid, then it will also acquire an interest in SystemOne, which is controlled by Continental. System One is the fourth largest CRS in the U.S. SystemOne also markets hosting services through its "Shares" system and hosts over 20 carriers on its system. The Continental transaction creates another opportunity for AC to re-examine its hosting relationship with Gemini.

18. The repatriation option which the Director's Application would facilitate, and which was discussed as part of the proposed AC/CDN merger, would have financial benefits for AC. AC's opposition to repatriation and to this Application furthers the result of achieving a virtual monopoly in Canadian domestic airline markets.

AMR/Employee Council Proposal

19. Gemini claims in paragraphs 33 to 35 of its response that AMR's requirement that CDN be hosted on Sabre is unnecessary and unreasonable. The AMR proposal encompasses a wide range of services beyond mere hosting, which are both cost-reducing and revenue-enhancing for CDN and which are integrated with the Sabre system.

20. In any event, the AMR/Employee Council proposal is the only viable option for maintaining significant competition in domestic airline markets. No other proposal has come forward as part of the solicitation process for alternative offers for PWA requested by the Director. Without the early termination of the Gemini Hosting Contract, this proposal will not be

implemented, resulting in a substantial lessening of competition in domestic airline markets.

Global Alliances

21. In paragraph 36 of its response, Gemini states that the integration of hosting functions between carriers has not been a customary feature of recent investments in major airlines. While this is true, the advantages of sharing common distribution and hosting systems are such that some airline alliances in the future will likely involve such commonality among systems. This is true because it is more cost effective to do so and because it facilitates the provision of "seamless service" among the alliance partners which the new global airline alliances seek to achieve. The proposed AMR/Employee Council/CDN transaction is an example of such an alliance.

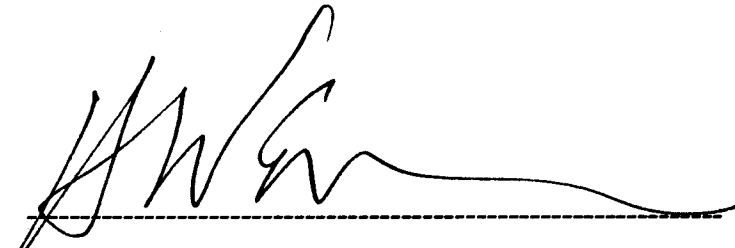
Director's Conduct

22. Gemini alleges in paragraph 2 of its response that the Director acted improperly in bringing this application. Covia claims in paragraph 21 of its response that the Director's application "...not only favours Sabre but also AA and provides a method for AA to fund its investment in PWA at Gemini's expense". These allegations are without foundation. The Director restates paragraph 43 of his reply in the original Gemini case:

"...This Application is not brought to assist the business interests of any particular entity, but rather, is made in an attempt to maintain and encourage competition in Canada in accordance with the provisions of the Competition Act."

23. To the extent that the Director has not dealt specifically with any particular ground or material fact set out in the Respondent's Responses, the Director denies each of those grounds and material facts.

Dated at Hull, Quebec, this 14th day of December, 1992



Director of Investigation and Research

L. Yves Fortier, Q.C.
Jean Bertrand
Ogilvy, Renault
Barristers & Solicitors
1981 McGill College Avenue
Suite 1100
Montreal, Quebec
H3A 3C1

Tel: (514) 847-4747
Fax: (514) 286-5474

Donald B. Houston
Department of Justice
Legal Branch
Consumer and Corporate Affairs
50 Victoria Street, 22nd Floor
Hull, Quebec
K1A 0C9

Tel: (819) 997-3325
Fax: (819) 953-9267

Counsel for the Director