COMPETITION TRIBUNAL/TRIBUNAL DE LA CONCURRENCE

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.

BETWEEN:

The Director of Investigation and Research

Applicant

COMPETITION TRIBUNAL
TRIBUNAL DE LA CONCURRENCE
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REGISTRAR - REGISTRAIRE
OTTAWA, ONT. #638

- 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

RESPONSE OF THE RESPONDENTS, COVIA CANADA CORP. and COVIA CANADA PARTNERSHIP CORP. TO NOTICE OF APPLICATION

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AND TO: **THE GEMINI GROUP LIMITED PARTNERSHIP**
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AND TO: **THE GEMINI GROUP AUTOMATED DISTRIBUTION SYSTEMS INC.**
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The Respondents, Covia Canada Partnership Corp. and Covia Canada Corp. ("Covia") oppose the application by the Director of Investigation and Research ("the Director") before the Competition Tribunal.

I - GROUNDS FOR OPPOSITION

THE GROUNDS FOR OPPOSITION ARE THE FOLLOWING:

1. The situation alleged in the Application does not involve a change in circumstances within the meaning of section 106 of the Competition Act.

2. For the purposes of section 106 of the Competition Act there is no substantial lessening of competition arising from the Gemini merger itself. Any alleged competitive impact is not as a result of the merger or of the Consent Order of July 7, 1989. Rather, any difficulties arise by virtue of the unnecessary and improper demand of American Airlines ("AA") and Canadian Airlines International Ltd. ("CDN"). Demands for the benefit of one party cannot constitute changed circumstances within the meaning of section 106 of the Competition Act.

3. The Gemini Hosting Contract does not preclude alliances or investments between CDN and PWA and any other airline.

4. There has been no change in circumstances in the CRS market or any of the matters dealt with in the Consent Order of July 7, 1989.

5. The Consent Order of July 7, 1989 has worked effectively and achieved its purpose since that time. There have been no difficulties with the operation of the CRS Industry in Canada pursuant to the order nor are any such difficulties alleged.

6. The relief requested by the Director will result in the demise of Gemini as presently constituted leaving Sabre (the CRS owned by AA) with a virtual monopoly in the CRS market in Canada. The relief requested by the Director will reverse the achievements of the consent order of July 7, 1989 and create a substantial lessening of competition in the CRS industry.

7. The requested relief does not fall within the power to rescind or vary an order pursuant to section 106 of the Competition Act.

8. It was only the partnership and co-ownership of Gemini by Air Canada ("AC") and CDN that gave rise to the Application in 1988 and the Consent Order of 1989 and which gave jurisdiction to the Director and the Tribunal. There was no jurisdiction by virtue of the Hosting Contract itself and therefore the Hosting Contract cannot be the subject of an order under section 106 of the Competition Act.

9. Even if the circumstances alleged by the Director technically fall within section 106 of the Competition Act, the Competition Tribunal should exercise its discretion to refuse the relief due to the following:

(a) Covia relied on the Consent Order of the Competition Tribunal of July 7, 1989 and would not have invested in the Gemini partnership without the Order or without a hosting contract between Gemini and CDN.

(b) The requested relief, in the circumstances, amounts to the misuse of the Competition Act. Permitting termination of previously approved business arrangements for the benefit of third parties will undermine the confidence of the business community in the Competition Act and the Competition Tribunal.

(c) AA's demand that CDN transfer its hosting to Sabre is not required from a technical standpoint. It is demanded in order that hosting revenue provide the funding of AA's investment in CDN and to favour Sabre which is owned by AA at the expense of Sabre's competitor, Gemini. The situation is artificially created to benefit Sabre and AA and amounts to a forced liquidation without compensation at the demand of a competitor.

(d) The Gemini merger occurred more than five (5) years ago and the hosting contract was entered into over three (3) years ago and it would be improper to terminate these arrangements after such a period of time. Otherwise, business finality and stability would be undermined. It is unfair to numerous parties who have relied upon the structure and continued existence of Gemini such as travel agents, participants using Gemini to distribute services and those that have provided goods and services to Gemini.

10. Covia denies the grounds relied upon by the Director.

II. MATERIAL FACTS

1. The Respondents do not disagree with the description of the parties set out in paragraphs 1 to 4 of the Director's Application except to note the following.

2. Covia Canada Partnership Corp. is a limited partner in The Gemini Group Limited Partnership ("Gemini Partnership") along with AC and PWA.

3. Covia Canada Corp. is a one-third shareholder in The Gemini Group Automated Distribution Systems, Inc. ("Gemini") which is the general partner of the Gemini Partnership.

4. Covia Canada Partnership Corp. and Covia Canada Corp. (collectively referred to as "Covia") are each incorporated under the laws of Ontario and are wholly owned affiliates of Covia Partnership which owns and operates the Apollo CRS in the United States.

5. Covia and Covia Partnership are solely involved in the CRS and computer industries. They are not an airline and are neutral as between airlines. Covia Partnership is owned by several airlines only one of which is United Airlines ("United"). Although United has a 50% interest in Covia Partnership, it does not control Covia Partnership or its operation of Apollo.

6. Covia entered the Gemini Partnership solely for the purpose of investing in and participating in Gemini as a CRS. Covia is not integrated with or related to AC or CDN and has no interest in the airline industry other than to benefit from airlines as major customers. In entering into the Gemini Partnership, Covia relied upon the Consent Order of July 7, 1989. It would not have invested or participated in the Gemini Partnership without the Consent Order or without the Hosting Contracts with AC and CDN.

7. Covia was not a party to the Application of the Director under Section 64(1) of the Competition Act for an Order dissolving Gemini nor was Covia a party to the Application for the Consent Order under Section 105 of the Competition Act.

8. The Consent Order Application as well as the initial Application to dissolve Gemini was focused upon and primarily concerned with the CRS market. There were only specific and limited implications raised and addressed with respect to the airline industry. There have been no changes in circumstances with respect to any aspect of the Order in relation to either the CRS industry or the airline industry.

9. It was joint ownership of Gemini and not the Hosting Contracts that gave rise to the 1988 Application and the 1989 Consent Order. Without co-ownership and joint

control of Gemini by the airlines there would be nothing to review and there would have been no jurisdiction in the Competition Bureau or the Competition Tribunal to review the hosting arrangements nor in fact were the hosting arrangements the subject of the review. There are airlines which have no ownership interest in the CRS's on which they are hosted. If CDN had merely been a hosted customer of Gemini with a hosting contract but no other relationship there would have been no basis for a review under the Competition Act. Since the Hosting Contract does not form any basis of the jurisdiction of either the Competition Bureau or the Competition Tribunal in this matter, there is no basis for reviewing the Hosting Contract under section 106. Since jurisdiction only arises by virtue of the partnership, only the partnership can be at issue now.

10. Therefore, even if the present financial circumstances of CDN are as alleged and even if they were anticipated in 1989, all the Director could have contested was the ownership aspect of the Gemini arrangements and not the hosting contract. Therefore, the alleged changed circumstances do not give rise to a jurisdiction to review the Hosting Contract at this time.

11. Although the co-ownership of Gemini was the subject of the prior application and could be reviewed under section 106, there are no changed circumstances alleged that arise from the fact of the co-ownership between the airlines. There would be no need to dissolve the partnership and no basis for doing so. Even if there were some competition issue arising from the fact of co-ownership that could form a basis of a review under section 106, the most that could result in would be the selling of PWA's partnership share which would still leave the Hosting Contract in place.

12. In paragraph 56 and 57 of the Agreed Statement of Facts filed in the Consent Order proceedings, the Director and other parties before the Competition Tribunal relied upon the participation of Covia to ensure against collusion and relied upon the provision of software and expertise by Covia to provide the necessary functional enhancements to alleviate against the anti-competitive concerns that had been raised.

13. Covia has fulfilled its role. The Consent Order has been functioning well since 1989. Covia knows of no complaints having been raised with respect to it, nor does the Director allege any difficulties with the operation of the Consent Order in this Application.

14. In paragraph 22 of the Application, the Director appears to infer through innuendo that the alliance agreement between AC and United interferes with Covia's "anticipated" ability to address concerns about collusion between AC and CDN. This is a groundless and unfair insinuation. No allegation of collusion under the Consent Order has ever been made nor does the Director make one in this Application. There is nothing "anticipated" about Covia's role. Covia is solely a CRS and has no interest in assisting collusion between AC and CDN.

15. The recent marketing agreement between AC and United in no way affects the foregoing nor is it in any way a changed circumstance having any competitive effect. In his application, the Director fails to indicate any actual or possible way in which the AC and United alliance could or would have any impact on Gemini, Covia's role in Gemini, the CRS industry or the successful operation of the Consent Order. The Air Canada and United affiliation has absolutely no impact on the Consent Order or the operation of the CRS by Gemini.

16. United owns 50% of Covia Partnership in the United States but is only one of several airline owners. All of the airline owners of Covia Partnership are committed to Covia earning income as a CRS and not acting in the interests of any particular airline.

17. United does not control Covia Partnership nor can United take any significant action with respect to Covia Partnership on its own. United does not control the Board and does not control the daily operations of the Apollo CRS which is owned and operated by Covia Partnership. Covia Partnership and its Apollo CRS are completely independent of

United in operation having separate staff and premises and with no overriding vote power on the part of United.

18. Covia has done absolutely nothing to help Air Canada with respect to any of its negotiations or positions concerning CDN. Covia has repeatedly urged both AC and CDN to join in negotiations to secure Gemini's future. Covia remains ready to meet with both AC and CDN and has in fact met with CDN in the past.

19. The Consent Order has resulted in a more competitive CRS industry in Canada. In paragraph 19 of the Impact Statement filed by the Director in the Consent Order proceedings, it was noted that Sabre would have the capability of becoming a more effective competitor in Canada. This is exactly what has happened. At the time of the Consent Order Sabre's market share was approximately 20% and under the Consent Order it has grown to approximately 35% of the Canadian CRS market.

20. It was acknowledged during the 1988 Application and 1989 Consent Order proceedings that the trend in CRS industry was toward increased globalization and the evolution of only a few large CRS providers. It is therefore fortunate and unusual for Canada with its relatively small population and air traffic to have a domestic CRS participant. The domestic CRS industry in the form of Gemini and the fair and effective competition that exists under the Consent Order will disappear if the current Application is granted.

21. In paragraph 6 of their response to the initial application of the Director in 1988, PWA and CDN stated that the Director's application appeared to be "a misdirected attempt to assist Sabre, of the world's largest and most profitable CRS". This appears to be even more the case with respect to the current Application which not only favours Sabre but also AA and provides a method for AA to fund its investment in PWA at Gemini's expense.

22. The Director's request for the dissolution of Gemini will obviously leave Sabre with a virtual monopoly in the Canadian CRS market.

23. Termination of the Hosting Contract with CDN will also threaten the financial viability of Gemini and undermine its ability to either continue at all or remain as an effective competitor to Sabre.

24. Termination of the Hosting Contract with CDN will result in the failure of Gemini without drastic restructuring. Any restructuring sufficient to provide for the survival of Gemini could only occur with significant financial compensation for loss of the Hosting Contract in order to cover costs of the restructuring including downsizing and increased overhead and operating costs. The necessary funds are not forthcoming or available to Gemini.

25. Currently Gemini is a viable operation that is breaking even. The loss of CDN hosting would render Gemini an uneconomical entity. Hosting revenue accounts for approximately 50% of Gemini's income and the loss of hosting revenue from CDN will result in approximately a 23% income loss. Also, there will be approximately a 20% reduction in CRS business (travel agent bookings). This is due to the fact 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 directly with the airline internal reservation system resulting in greater accuracy and security. This is not in fact the case because Gemini subscribers can automatically book in AA's system or that of any other airline. The psychological factor is nonetheless prevalent in the market and will therefore result in a significant loss of CRS business in Gemini. This psychological factor in the CRS market was acknowledged by the Director in paragraph 15 of the Consent Order Impact Statement filed by the Director in the Consent Order proceedings.

26. The significant decline in hosting and CRS revenue will not be offset by a corresponding expense reduction. A large part of the hardware network is shared and

common to all participants in Gemini. Therefore very little of the physical network can be removed or downsized in response to loss of hosting services provided to CDN. Gemini will continue to have fixed costs for its equipment and dedicated lines resulting in an inefficient economy of scale and higher unit costs. Therefore, even if it could survive it would be an ineffective competitor against Sabre.

27. Any restructuring that could leave Gemini in some modified existence would require substantial sums of money that are unavailable to Gemini unless provided by CDN and/or AA. In any event, any such structuring would leave Gemini as a smaller, weaker field operation with little of its own technology or hardware. Much of the technology would leave Canada alone with many of the high tech jobs. There would also be a large overall loss of Gemini employees.

28. The demise or weakening of Gemini would also affect other users such as travel agents, VIA Rail, hotels, car rental agencies, theatres and others which sell through the Gemini system. Those distributing through Gemini will suffer switching costs and loss of sales and all will suffer price increases and service decreases due to the lack of competition.

29. Besides losing its investment in Gemini, Covia will also lose substantial sums earned as a service provider to Gemini. Covia currently earns revenue from transaction processing services and development services. As well, Covia has made significant cost centre expenditures since 1989 pursuant to its obligations as a service provider to Gemini for CDN's benefit and at CDN's direction.

30. In paragraph 25 of the Application, the Director implies that Gemini is insolvent and that CDN will obtain a Declaration to that effect with the result that the Hosting Contract will be terminated in any event. Despite the efforts of CDN to make it so, Gemini is not insolvent. Gemini has broken even and is currently operating under a budget that will break even. CDN refused to attend the Board meetings to approve the

budget. Further, CDN has failed to make its payments to Gemini in a further effort to deprive it of revenue. Despite CDN's efforts, Gemini is solvent.

31. CDN has acknowledged that Gemini is not insolvent. On December 2, 1992, CDN placed a message over the Gemini system to screens of travel agency terminals in which CDN stated its position with respect to the Gemini issue. CDN stated that the withdrawal of hosting would not cause the financial demise of Gemini. If CDN believes that to be the case it certainly cannot believe that Gemini is at this point insolvent.

32. In paragraph 17 of the Application, the Director refers to reorganization discussions by the Gemini partners. The Director does not give any detail as to potential reorganization plans nor the implications for these proceedings or the future of Gemini. The inference appears to be that the relief requested by the Director was something considered by the Gemini partners in any event. Any such inference is unwarranted and untrue.

33. Terminating CDN hosting services from Gemini is totally inconsistent with any reorganization proposals discussed between the Gemini partners. Any such suggestion was raised by CDN alone and was rejected by Gemini and the partners.

34. Various reorganization options have been discussed or generated by either Gemini management or the partners. The basic issue was that the link premium for last seat availability, which is .25¢ per booking, is waived for AC and CDN and bookings for these airlines make up most of the Gemini bookings. On the other hand, AC and CDN pay the extra .25¢ to Sabre thereby benefitting Gemini's competitor. Covia wanted AC and CDN to pay the market rate for the last seat availability link. Also, Covia wanted AC and CDN to pay for the trunk link between Winnipeg and the Covia computer in Denver. AC and CDN should have contributed approximately $2,000,000.00 for the link. On the other hand, Covia was prepared to convert its loan to equity and to reduce its processing fee in Denver by 20%. These arrangements would have greatly strengthened Gemini.

35. In March, 1992, after many months of negotiation and drafting, the Gemini partners agreed on a Memorandum Of Understanding (MOU) containing a reorganization of Gemini along the lines set out above. The parties met in Toronto to conclude the MOU and Covia and AC signed it. The representatives of CDN agreed verbally to the MOU and stated that they would sign it on that day or the next but that they had to take it back to CDN offices in order to do so because two original signatures were said to be required. Everyone left with the understanding that the MOU would proceed but CDN has continuously delayed and has failed to sign the MOU.

36. Discussions between AMR and PWA were ongoing prior to PWA's verbal agreement to the MOU in March, 1992.

37. Covia has not and would not agree to a reorganization involving the termination of the CDN hosting services from Gemini.

38. CDN has never sought to negotiate termination of the Hosting Contract with its Gemini partners on any commercial basis and is now simply attempting to terminate the contract without compensation.

39. The Gemini Hosting Contract with CDN does not impede any pro-competitive solution to any difficulties PWA or CDN may have. There is no technological or other legitimate reason requiring CDN to transfer its hosting to the CRS of AMR or any other CRS. Other airlines have formed alliances without a transfer of hosting services and without the allied airlines being hosted in the same CRS. The current links between CRS services and airline internal reservation systems providing last seat availability and other enhancements obviate the need for uniform hosting of allied airlines.

40. In paragraph 1 (d) of the Application, the Director seems to imply that strategic alliance partnerships require that the coordination of marketing and information services which in turn requires hosting in the same CRS. This is not true. CDN would be

free to move its accounting functions to AMR and still remain on Gemini with respect to hosting services. CDN conducts its own accounting functions under the current arrangements in any event.

41. Although there is no technological requirement for the transfer of hosting services, AMR is demanding the transfer to its Sabre CRS in order to increase the market share of Sabre and to fund the AMR investment in CDN. This is an illegitimate use of the Competition Bureau and the Competition Act. It is essentially an effort by AMR to have Gemini and its partners fund its PWA investment. It is also essentially the forced liquidation of Gemini at the behest of Gemini's competitor.

42. In any event, it is premature to state that an arrangement between AMR and CDN will assist CDN and PWA and that therefore termination of the Hosting Contract is required. There is at this point no binding commitment between AMR and CDN but only a proposal. The Director's Application chronicles a number of proposals that have come and gone and therefore the same may occur with respect to the premise for this Application.

43. Covia has no direct knowledge of the financial situation of PWA and CDN but it does not concede that they will terminate without the proposal with AMR. Covia will seek to fully explore the current and likely financial situation as well as the impact of a proposal from AMR. It may well be that PWA and CDN can survive without the particular proposal from AMR or, conversely, that the proposal from AMR would not be sufficient. In either of these events it would be inappropriate to terminate the Hosting Contract to the immediate detriment of Gemini.

44. There is nothing to prevent CDN from simply terminating its involvement in the Hosting Contract by way of breach or offering to compensate for the contemplated breach and transferring its hosting services to Sabre. This would be the normal commercial course that a company would follow if it had determined that breaching a contract in order to enter into another one was to its commercial advantage. The only difference here is that

CDN wishes to use the Competition Tribunal to enable it to breach the Hosting Contract without paying any compensation. This is a total abuse of the Competition Act and the Competition Tribunal.

45. To the extent that the Respondents have not dealt with any particular ground or material fact set out in the Director's Application, the Respondents deny each of those grounds and material facts.

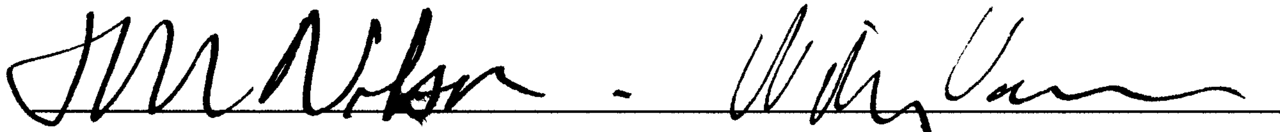
III - RELIEF SOUGHT BY RESPONDENTS

1. The Respondents request that the Application be dismissed.

IV - ADDRESS FOR SERVICE

1. Service on the Respondents, Covia Canada Partnership Corp., and Covia Canada Corp. of any documents in connection with this proceeding may be effected on Gowling, Strathy & Henderson, Suite 2600, 160 Elgin Street, Ottawa, Ontario, Canada, K1N 8S3, Atten: Robert Nelson or William Vanveen, Solicitors for the Respondents.

All of which is respectfully submitted this 9th day of December, 1992.



TO: **COUNSEL FOR ALL PARTIES**

AND TO: **THE REGISTRAR, COMPETITION TRIBUNAL**

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