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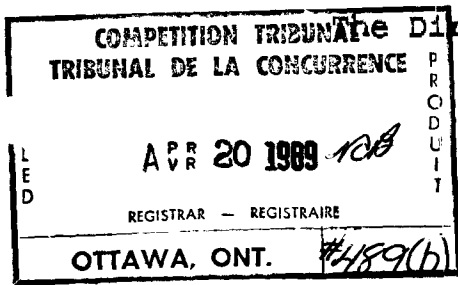
THE COMPETITION TRIBUNAL

IN THE MATTER OF an application by the Director of Investigation and Research under subsection 64(1) of the Competition Act R.S.O. 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 reservations systems

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

BETWEEN:



The Director of Investigation and Research

Applicant

- and -

Air Canada
 Air Canada Services Inc.
 PWA Corporation
 Canadian Airlines International Ltd.
 Pacific Western Airlines Ltd.
 154793 Canada Ltd.
 153333 Canada Limited Partnership
 The Gemini Group Automated Distribution Systems Inc.

Respondents

- and -

Consumers' Association of Canada
 American Airlines, Inc.
 Wardair Canada Inc.
 Attorney General of Manitoba
 Alliance of Canadian Travel Associations
 Bios Computing Corporation
 Air Atonabee Limited

Intervenors

Supplemental Testimony of Gary J. Dorman

AFFIDAVIT OF GARY J. DORMAN

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

1. I am a Vice President of National Economic Research Associates, Inc. (NERA). NERA has been retained by counsel for American Airlines to analyze the competitive impact of the merger between Reservec and Pegasus.

2. I have prepared the attached document entitled "Supplemental Testimony of Dr. Gary J. Dorman." The opinions expressed therein are true to the best of my knowledge, information and belief.

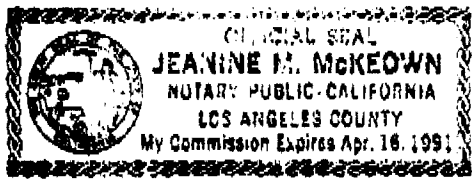
SWORN before me,)
a Notary Public for the State of)
California, in the United States)
of America, on the 20th day of)
April, 1989 at Los Angeles,)
California in the United States)
of America)

Gary J. Dorman

Gary J. Dorman

Jeanine M. McKeown

Notary Public



SUPPLEMENTAL TESTIMONY OF DR. GARY J. DORMAN

**in the matter of
The Reservec-Pegasus Merger**

April 1989

SUPPLEMENTAL TESTIMONY OF DR. GARY J. DORMAN

I. INTRODUCTION

1. My name is Gary J. Dorman. I am an economist and Vice President of National Economic Research Associates, Inc. (NERA). My qualifications to present expert testimony in this proceeding have been described in a prior document entitled "Testimony of Gary J. Dorman in the matter of The Reservec-Pegasus Merger," submitted on March 9, 1989. NERA has been retained by counsel for American Airlines to analyze the competitive impact of the merger between Reservec and Pegasus. This testimony constitutes my response to the proposed "Order" and "Computer Reservation System Rules" submitted to the Competition Tribunal by the Director of Investigation and Research (Director) on April 12, 1989.

II. THE GEMINI MERGER CREATES MONOPOLY POWER

2. As discussed at length in my prior testimony, the Gemini merger has created monopoly power in the Canadian computer reservation system (CRS) market. The affected parties are other CRSs, air carriers, travel agents and--most importantly--ordinary consumers, whose economic interests the competition laws were intended to protect. A further consequence is that Air Canada and Canadian Airlines International, Ltd. (CAIL), which together account for over 90 percent of domestic air traffic, may use Gemini, with its 85 to 90 percent share of automated travel agencies, to erect barriers to new airline competition in Canada. This is a special concern if CAIL acquires Wardair. Finally, with only two significant air carriers in Canada, there is the danger that business ties established between Air Canada and CAIL as a consequence of their joint ownership of Gemini may evolve into a collusive mechanism for reducing airline competition between them.

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III. DISSOLUTION AS A REMEDY

3. The most effective remedy, as discussed in my previous testimony, would consist of the combination of the dissolution of Gemini and the imposition of rules of CRS behavior. This may be the only way to preserve in the long run two competing CRSs in Canada when there are only two significant competing domestic airlines. With a single CRS jointly controlled by Air Canada and CAIL, functionality and innovation may be suppressed, booking fees and subscriber fees may be increased, competing air carriers may be disadvantaged, and consumer-oriented travel agency services may be limited. Furthermore, competing foreign CRSs may be unable to survive in Canada in the long run due to the domestic air transportation dominance of Air Canada and CAIL. Indeed, the Director's own economic expert, Margaret Guerin-Calvert, recognized these concerns [Affidavit of Margaret Guerin-Calvert, March 2, 1989].

IV. CRS RULES AS A REMEDY

4. For present purposes, I have been asked to analyze whether the proposed "Order" and "Computer Reservation System Rules" are by themselves sufficient to prevent the exercise of CRS monopoly power by Gemini and its owners. In my previous testimony, I described the general principles which should form the foundation for appropriate CRS rules. These fall into three categories: (A) non-discriminatory treatment of air carriers and CRS vendors; (B) prohibition of tying practices; and (C) prevention of collusion between joint owners of a CRS. In addition, any effective behavioral rules must have adequate enforcement mechanisms. Each of these is discussed below.

A. Non-discriminatory treatment of air carriers and CRS vendors

5. With respect to the non-discriminatory treatment of participating airlines, the rules should require of each CRS vendor: (1) booking fees and terms of participation which are uniform for all participants in its CRS; (2) non-biased displays, i.e., carrier identity should not be a factor in determining a flight's screen position; (3) enhancements offered to all airlines on non-discriminatory terms if offered to any airline other than the vendor itself (e.g., seat assignments and boarding passes); and (4) loading and processing of carrier data on a non-discriminatory basis (e.g., schedules and fares). With respect to the treatment of CRS vendors, if an airline offers data, facilities or enhancements to one CRS, they are required to be offered to all on non-discriminatory terms (e.g., a direct link).

6. These non-discrimination rules are necessary to ensure that airline competitors and CRS competitors are not improperly disadvantaged as a consequence of Gemini ownership by Air Canada and CAIL, the two dominant Canadian air carriers. An example of the manner in which actual or potential CRS competitors can be disadvantaged in the absence of such rules is contained in one of the Respondents' own documents ["NEWCO Business Plan," April 6, 1987, Air Canada Production Item 27, page 12]:

Without specific agreement from Newco [i.e., Gemini], no foreign competitor will have last-seat availability for AC and CAIL flight inventory. This weakness will prevent US vendors from making serious inroads into Newco market share--beyond the 325 to 400 already achieved.

7. While the proposed settlement goes a long way toward ensuring non-discriminatory treatment, it falls short in several respects. It does not require that:

- Air Canada and CAIL provide "look-but-not-book" direct links with other CRSs as soon as technically feasible, even though such links have already been established with Gemini;

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- "look-and-book" links with Air Canada and CAIL be made available to other CRSs at the same time as they are made available to Gemini;
- the existing direct link between Wardair and SABRE be maintained subsequent to CAIL's proposed acquisition of Wardair;
- Air Canada and CAIL treat Canadian SABRE subscribers non-discriminatorily by requiring those carriers to respond promptly to queue requests for pricing assistance;
- Air Canada and CAIL and their affiliates provide the same facilities and enhancements to other CRSs that they provide to Gemini; and
- an arm's length relationship between Air Canada/CAIL and Gemini be established to ensure that fees are charged and services provided on a non-discriminatory basis with respect to other airlines and CRSs.

Each of these omissions from the proposed settlement provides an opportunity for discriminatory treatment which could adversely affect CRS and airline competition in Canada.

B. Prohibition of tying practices

8. Another threat to airline and CRS competition is the tying of commission overrides or access to discount seats to a travel agency's use of a particular CRS. Specifically, a travel agent would be paid overrides (in addition to the standard commission schedule) or obtain special access to capacity-controlled discount seats only if he agreed to subscribe to that airline's CRS. In the context of the dominance of Canadian air transportation by Air Canada and CAIL, such practices would place any CRS vendor other than Gemini at a severe disadvantage when attempting to market its system to Canadian travel agencies. Tying therefore poses a potentially devastating threat to the limited CRS competition which now exists in Canada.

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9. While the proposed settlement does include a provision which forbids tying, the drawback to a simple prohibition is that it is difficult to enforce. There are subtle ways to condition the payment of override commissions on the travel agent's choice of a CRS. If, however, all promotional offers made by CRS-owning airlines to travel agents above the standard commission were required to be made in writing, then the travel agent would be in a position to insist on receiving the payment or other incentive without having to accept an unwanted CRS. Furthermore, if travel agents were given the right to enforce the terms of such promotional offers, attempts at tying would likely cease.

C. Prevention of collusion between joint owners of a CRS

10. Given the dominant position that Air Canada and CAIL have achieved with respect to Canadian air transportation, it is imperative that Gemini does not become a vehicle for facilitating collusion between these carriers. The danger is clearly present, as evidenced by one of Air Canada's own documents ["Strategic Implications of NEWCO for Air Canada," Air Canada Production Item 37, page 2]:

As the Canadian industry is now an oligopoly dominated by AC and CAIL it becomes increasingly important that each carrier know his market share and average fare performance by class relative to the other to prevent destructive marginal "ego" pricing. NEWCO [i.e., Gemini] should become the clearing-house for city pair passenger and average fare data to be exchanged on a quid pro quo basis with CAIL, ideally expanded to include direct sales as well as travel agency sales (emphasis added).

In order to reduce the likelihood of this form of collusion, the CRS rules must restrict each airline's access to commercially sensitive data and must prevent Gemini personnel from providing a conduit between Air Canada and CAIL whereby airline competition is reduced.

11. The proposed settlement does contain a provision relating to the exchange of sensitive information, but it does not go far enough. The rules should specifically preclude any airline from obtaining access to another's seat inventory,

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except to the extent that limited inventory data are made available to all CRS subscribers in the form of availability displays. In addition, no CRS data should be made available on a route-specific basis to any airlines other than those participating in the booking. Even the dissemination of data regarding total bookings on a particular route is of concern in an industry with only two significant air carriers. Finally, the rules should require that Gemini be structured so as to maintain the maximum separation possible between Gemini and Air Canada and CAIL, thereby reducing the likelihood that Gemini will facilitate collusive behavior on the part of these two airlines.

D. Enforcement of the CRS rules

12. If CRS rules are to be an effective check on the monopoly power possessed by Gemini, they must include adequate enforcement mechanisms. It is essential that parties who are injured by violations of the rules--and are therefore in the best position to detect such violations--have workable and timely procedures available to them to enforce the rules. Furthermore, the rules must be carefully drafted to minimize the possibility of opportunistic behavior. In an industry such as this, with rapidly advancing technology and evolving institutional arrangements, there may be numerous opportunities to circumvent the intent of any CRS rules without technically violating their provisions.

V. CONCLUSIONS

13. The merger of Reservec and Pegasus has created a Gemini system with monopoly power in the Canadian CRS market. The most effective remedy is structural--the dissolution of Gemini--in conjunction with behavioral rules. In the present proceeding, however, the Director and the Respondents have reached a settlement which constitutes only a behavioral solution to the problem of CRS

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monopoly power. Based on my knowledge of the airline and CRS industries and my review of documents and testimony in this proceeding, it is my view that the proposed settlement provides incomplete protection for competing CRSs and airlines, travel agents and especially consumers in Canada.

14. I have outlined above the principles which should form the foundation for adequate CRS rules, and have indicated where the proposed rules fall short of these principles. Unless these deficiencies in the settlement are remedied, it is my view that competition would be better preserved by dissolution of the Gemini merger.