CT-88/1

THE COMPETITION TRIBUNAL

IN THE MATTER OF an application by the Director of Investigation and Research under Section 64(1) of the Competition Act, R.S. 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.

B E T W E E N:

THE DIRECTOR OF INVESTIGATION AND RESEARCH,

Applicant

- and -

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- and -

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- and -

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Respondents

STATEMENT OF GROUNDS AND MATERIAL FACTS FOR THE APPLICATION BY THE DIRECTOR OF INVESTIGATION AND RESEARCH UNDER SECTION 64 OF THE COMPETITION ACT AS AMENDED BY THE ADDITION OF PART II

PART I - THE GEMINI TRANSACTION

A. INTRODUCTION

1. This application submits that the Respondents have effected a merger which prevents or lessens or is likely to prevent or lessen competition substantially in the provision of computer reservation systems ("CRS") services to airlines, travel agents and consumers in Canada within the meaning of section 64 of the Competition Act.

2. On or about June 1, 1987 Air Canada ("AC") and PWA Corporation merged, through the vehicle of a Limited Partnership, ownership of their respective computer reservation systems ("CRS"). Management of the business and affairs of the Limited Partnership is the responsibility of The Gemini Group Automated Distribution Systems Inc. ("Gemini"), a wholly and equally owned company of AC and PWA Corporation. Gemini distributes flight and related information on behalf of AC, Canadian Airlines International Limited and others. On or about October 31, 1987 an electronic direct access link was established between the CRSs hosting AC and Canadian Airlines International as the first major step in the integration of the operations of the two CRSs.

3. Computer Reservations Systems are a critical component in the distribution and sale of airline passenger seats to travel agents and the travelling public and have no effective substitutes. These systems distribute information on schedules, fares, rules and seat availability to subscribers (usually travel agents) for the airlines which are hosted on or participate in the system. This is done electronically through a cathode ray tube terminal ("CRT terminal") which is sold or leased to the subscriber and which is located on the subscriber's premises. The CRT terminal displays the relevant information on request for the purpose of booking seats on the flights requested by the travelling public.

B. BACKGROUND

(a) The Parties

4. AC is a Crown corporation wholly owned by the Government of Canada and incorporated pursuant to the *Air Canada Act, 1977*, S.C. 1977-78, c. 5 as amended. It is subject to the *Competition Act* notwithstanding it is a Crown corporation. AC is the largest operating air carrier in Canada and serves an extensive network of domestic, transborder and international routes using jet airplanes. Prior to May 1, 1987 AC exclusively owned and operated a CRS under the tradename Reservec II ("Reservec").

5. Reservec distributes information to approximately 2,900 travel agencies on behalf of 50 airlines, railways and car rental agencies, 3,000 hotels and 16 tour

wholesalers. It is the dominant CRS in Canada, holding about 72% of the CRS market as measured by travel agent locations.

6. Air Canada Services Inc. is a wholly owned subsidiary of AC. On May 1, 1987 AC transferred certain assets of Reservec to Air Canada Services Inc. in exchange for shares of Air Canada Services Inc.

7. PWA Corporation is a company incorporated under the laws of Alberta on February 22, 1956 and continued under the <u>Business Corporations Act</u>, S.A. 1981, c. B-15 as amended, on January 27, 1983. At the time of the merger PWA Corporation was the sole owner of Pacific Western Airlines Ltd. and Canadian Pacific Air Lines, Limited ("CPAL") and these airlines carried on business in Canada as Canadian Airlines International. On January 1, 1988, Canadian Airlines International Ltd. ("CAIL") resulted from the amalgamation of Pacific Western Airlines Ltd., CPAL, PWA Holdings (1987) Ltd., and B.C. Air Lines Limited. CAIL carries on business in Canada in competition with AC and other airlines.

8. Prior to May 31, 1987 CPAL exclusively owned a CRS called Pegasus 2000 ("Pegasus"). Pegasus entered the Canadian market in 1984 and introduced some innovative features, providing competition for Reservec. Between 1984 and 1987 Pegasus established its system in approximately 720 travel agencies. It also provides CRS services to 60 airlines, 14 car rental agencies, 3000 hotels and tour wholesalers. It is the second largest CRS in Canada, holding approximately 18% of the CRS market as measured by travel agent locations. On May 31, 1987 certain assets of the Pegasus system were transferred from CPAL to 154793 Canada Ltd. in return for shares of 154793 Canada Ltd.

(b) The Transaction

9. On June 1, 1987, AC, PWA Corporation and 153333 Canada Inc. formed 153333 Canada Limited Partnership (the "Limited Partnership"), an Ontario limited partnership formed for the purpose of operating a CRS. 153333 Canada Inc. was appointed the general partner for the purpose of managing the business and affairs of the Limited Partnership. AC and PWA Corporation, the limited partners, each own 50% of the common shares of 153333 Canada Inc. (the "General Partner"). On August 12, 1987 the General Partner changed its name to Gemini. On June 1, 1987, AC transferred its remaining interest in Reservec and its shares in Air Canada Services Inc., together encompassing all of the assets and employees of Reservec, to the Limited Partnership. On the same date, CPAL transferred all of its remaining interest in Pegasus, and all of its shares of 154793 Canada Ltd., together encompassing all of the assets and employees of Pegasus to the same Limited Partnership.

10. In return for the transfer of its Reservec assets, and its shares of Air Canada Services Inc., AC received 29.4 million units of the Limited Partnership and a promissory note in the amount of $60 million. CPAL also received 29.4 million units of the Limited Partnership in return for the transfer of its Pegasus assets, its shares of 154793 Canada Ltd., and a cash payment of $10 million to the Limited Partnership. The partnership units received by CPAL have been transferred to PWA Corporation as the continuing limited partner. Ten million dollars of the promissory note was repaid on June 1, 1987. The balance of the promissory note is to be repaid by the Limited Partnership over a 5 year period. PWA Corporation has provided a guarantee, operative in certain circumstances, of the payment of one-half of the outstanding principal amount of the promissory note and the interest thereon payable by the Limited Partnership to AC.

(c) The Airline Industry

11. AC and CAIL dominate the airline passenger market in Canada. AC controls approximately 56% of the market for scheduled revenue passenger kilometers ("RPK") flown in Canada whereas CAIL has approximately 37% of the market. Accordingly, the limited partners of Gemini represent over 90% of the RPKs flown in Canada. In addition, AC, CAIL and their affiliates are the only carriers operating in 18 of the top 25 city pair markets in Canada. A city pair market refers to the air passenger travel between two cities such as Toronto and Ottawa.

12. AC and CAIL have complete or partial control of almost all turbo-prop and jet regional carriers which provide feed traffic for longer haul routes operated by AC and CAIL. AC has recently acquired Air Nova, Air B.C., Air Ontario and a 75% interest in Austin Airways. PWA Corporation purchased CPAL in January 1987. PWA Corporation also owns or has a significant interest in Air Atlantic, Inter Canadian (Quebec), Ontario Express, Time Air, Calm Air and Norcan Air. These affiliated or aligned carriers are hosted with either Pegasus or Reservec, depending on their affiliation.

13. Wardair Canada Inc. ("Wardair") also offers regular scheduled passenger jet service in Canada. Wardair has approximately 7% of the passenger airline market as measured by the RPKs flown in Canada. Wardair is a "participating carrier" in Reservec and Pegasus but does not distribute a CRS to travel agents. It is "hosted" on Soda/System One, a CRS service owned by Texas Air Corporation. (See paragraph 19 for the definition of participating and hosted carrier).

14. There are a few turbo-prop airlines which operate scheduled service in various places in Canada which are not controlled or affiliated with AC and CAIL. The largest independent turbo-prop airline, City Express, provides a competitive service to AC and CAIL in the Montreal-Ottawa-Toronto corridor. City Express is hosted on Reservec.

15. There are several domestic, U.S. and international carriers which operate in transborder and international markets between Canada and other countries. Entry into transborder and international markets is regulated.

16. Prior to January 1, 1988 the Air Transport Committee of the Canadian Transport Commission regulated the domestic airline industry under the National Transportation Act, R.S. 1970, c. N-17 as amended, and Part II of the Aeronautics Act, R.S. 1970, c. A-3 as amended, including regulation of entry, exit and fares. The new National Transportation Act, 1987, S.C. 1987, c. 34 which came into force on January 1, 1988, substantially deregulated the airline industry in Canada below the 55th parallel. Now, domestic carriers are able to enter domestic markets more easily and accordingly, there is the potential for increased competition between carriers.

(d) The CRS Industry

17. Prior to the merger, Reservec, with approximately 72% of the CRS market, and Pegasus, with approximately 18%, were the largest CRS vendors in Canada. There are three other competitors, including Sabre, a subsidiary of AMR Corporation, which also owns American Airlines.

Sabre entered the market in Canada in 1983 and by June 1987 had approximately 10% of the market as measured by travel agent locations. The other two competitors, namely Apollo, a CRS operated by Covia Corporation which is owned by United Airlines, and Soda/System One, owned by Texas Air Corporation, have an extremely small presence in the market with a combined market share of less than 1%.

18. Travel agencies are the primary means for airlines to distribute their product to the travelling public. Approximately 70% of the tickets sold by Canadian airlines are sold through travel agencies and approximately 90% of all Canadian travel agencies use a CRS to make airline reservations and print tickets. The other 30% of the tickets are sold by the airlines directly to the travelling public. In almost all cases, the airlines use a CRS to assist in the sales.

19. An airline can be represented in a CRS system either as a "hosted carrier" or a "participating carrier". If it is hosted, it stores its complete airline inventory information in the CRS. In this case, the CRS provides the carrier with both an internal reservation and management system to manage its inventory and an external reservation system to distribute its product to travel agents and, ultimately, consumers. AC and CAIL are now hosted with Gemini. If the airline is a "participating carrier", the CRS vendor does not supply an internal reservation and management system but lists only the information on fares, schedules and seat availability which the participating carrier supplies. However, a participating carrier may choose not to supply all of its inventory so that certain classes of

seats may not be displayed on the CRS in which the airline is participating. AC and CAIL are participating carriers with Sabre.

20. CRS vendors charge participating carriers booking fees for each flight segment booked on the CRS. A flight segment is defined as one takeoff and landing. Therefore, a journey with several stops would have several flight segments. On the other hand, CRS vendors negotiate their fees individually with hosted carriers and the type and amount of fees charged may vary for different carriers. In addition, CRS vendors also earn revenues from travel agents from the rental or sale of CRT terminals and in related line and service charges.

21. The completeness, accuracy and timeliness of information on airlines which the travel agent most frequently books is the most important attribute of the service provided by a CRS. When an airline is hosted on a CRS, the users of that CRS will have the most complete, accurate and timely information available on that airline. The user can also have greater confidence that the reservation will not be lost because it is made directly with the airline's database. In addition, the users may have access to enhanced services, such as the ability to receive boarding passes or reserve a specific seat before going to the airport, which may not be possible if the airline is only participating in the CRS used by the travel agent.

22. One aspect of completeness that is of particular importance is last seat availability. If an airline is participating in a CRS it will usually hold back a number of seats in inventory so that these seats will

not be available to the users of that CRS. In order for the travel agent to book those last few seats, he must use a CRS on which that airline is hosted or use another CRS that has an electronic direct access link to the airline's database. Travel agents value access to last seat availability because it allows them to provide the best possible service, particularly to the lucrative business travel market which desires seats on heavily booked flights.

23. For practical purposes, an airline can store its entire inventory in only one place, which means that it can participate in a number of CRS systems but can be hosted by only one. However, many of the advantages of complete, timely and accurate information, including last seat availability, can be accomplished by means of a direct access link between the CRS and the database of the participating airline. There are several CRS vendors in the United States, all of which have a direct access link with carriers who are hosted in another CRS. These links mean that these CRS vendors compete on the basis of what their systems can do and the price at which they do it rather than on the basis of exclusive control of airline inventory. In Canada, prior to October 31, 1987, there were no direct access links between the three largest CRS vendors in Canada namely Reservec, Pegasus and Sabre. On or about October 31, 1987 an electronic direct access link was established between Reservec and Pegasus, giving users of either Reservec or Pegasus last seat availability on AC and Canadian Airlines International.

C. COMPETITION ASSESSMENT

I. Factors to be considered with respect to the Competitive Impact of Gemini in the CRS Market in Canada

(a) Increased Concentration

24. This merger has resulted in a substantial increase in market concentration, has reduced the number of significant CRS competitors in Canada from three to two and in many non-urban areas has eliminated competition completely.

25. As of June, 1987, the market shares for the CRS vendors in Canada, based on number of travel agent locations and the number of CRT terminals, were as follows:

(i) Number of Travel Agent Locations (June 1987)

SYSTEM	LOCATIONS	MARKET SHARE %	POST MERGER MARKET SHARE %
Reservec	2926	72	--
Pegasus	720	17.7	--
Gemini	--	--	89.7
Sabre	390	9.6	9.6
Apollo	25	0.6	0.6
Soda/System One	1	0.05	0.05

(ii) Number of CRT Terminals in Travel Agencies (June 1987)

SYSTEM	CRT TERMINALS	MARKET SHARE %	POST MERGER MARKET SHARE %
Reservec	6025	71	--
Pegasus	1362	16	--
Gemini	--	--	87
Sabre	1100	13	13

26. Some travel agencies use more than one system. Most travel agents using Sabre retain at least one Reservec terminal in order to obtain last seat availability on AC.

27. Sabre has virtually no market share in non-urban areas. Competition to Reservec in some of these non-urban areas was offered by Pegasus prior to the merger. Non-urban areas account for approximately 27% of the total CRS market as measured by CRT terminals. As a result of this merger Gemini will have nearly 100% market share in non-urban areas and 77% in urban areas.

28. In addition, Gemini is the dominant CRS vendor in the sale of airline seats in Canada. For example, in 1986 Reservec accounted for approximately 70% of the flight segments booked in Canada whereas Pegasus accounted for approximately 7%. Gemini, therefore, accounts for about 77% of the flight segments booked in Canada.

(b) Barriers to Entry

(i) Air Transport Dominance

29. AC and CAIL dominate the airline passenger market in Canada. This dominance, coupled with the vertical integration of Gemini with AC and CAIL, will ensure that Gemini alone will be able to provide the most complete, accurate and timely information, including last seat availability, on virtually all Canadian carriers of interest to Canadian travel agents because AC, CAIL and their affiliated and aligned carriers are hosted only on Gemini and there are no direct access links between these carriers and other CRSs.

30. Control of the information vital to the success of a competing CRS gives AC and CAIL the ability to block, retard or delay the entry or expansion of competing CRS vendors in Canada. They can exclude competitors of Gemini by refusing them access to fare, schedule, and

seat availability on AC and CAIL flights and by refusing to pay booking fees for AC and CAIL flights booked on another CRS. For example, if AC and CAIL refused to participate in Sabre, Sabre would lose the major source of revenues for its services in Canada, namely booking fees for AC and CAIL flight segments. Travel agents using Sabre would find that they would be unable to receive timely or reliable information on AC and CAIL flights, fares, rules and seat availability and thus would be uncompetitive in the sale of seats on the major Canadian carriers. Under these conditions, few travel agents would subscribe to Sabre.

31. AC and CAIL can also reduce or eliminate the effectiveness of Gemini's competitors if they do not fully participate in other CRSs by not providing complete, timely or accurate information. This will undermine the confidence of Canadian travel agents trying to book AC or CAIL flights on a CRS other than Gemini. While the impact on competing CRSs would not be as great as non-participation, because booking fees would continue to be paid and AC or CAIL reservations would still be possible, such measures could severely inhibit growth of CRS competition.

32. Gemini also has significant marketing advantages over its remaining competitors. In particular, Gemini is the only CRS vendor which can provide last seat availability and other enhancements (such as automated pre-reserved seating) on AC and CAIL flights. Furthermore, travel agents will also have greater confidence that reservation records on AC or CAIL flights will not be lost because the reservation is made directly with the supplier's database.

33. The air transport dominance of AC and CAIL also gives Gemini the ability to maintain or extend its CRS dominance by tying airline commissions to the use of the CRS. For example, airline commissions paid to travel agents by AC and CAIL, could be based in whole or in part on whether or not Gemini is used. Since commissions from AC and CAIL constitute the great majority of income for most Canadian travel agents, such conditions would be powerful incentives to use Gemini rather than a competing CRS. Gemini could also extend its dominance by requiring travel agents who use the Gemini CRS to agree not to use any other CRS.

34. The market power generated by passenger airline dominance has been exercised in the past by one of the Gemini partners. Until July, 1986, AC refused to participate in Pegasus and refused to pay booking fees. Since AC controlled over 55% of the Canadian jet passenger market, this refusal placed the Pegasus system at a severe disadvantage to AC's CRS. AC also refused to allow a direct access link to be set up between Pegasus and Reservec. This would have enabled Pegasus users to obtain last seat availability on AC flights. These measures had the effect of limiting the growth of Pegasus.

35. AC was able to maintain a dominant position in the CRS market (approximately 72% of the travel agent locations) when it had over a 55% share of the Canadian jet passenger market. Many travel agents regarded Reservec as a compulsory system because only Reservec could provide the most complete, timely and accurate information, including last seat availability, on AC. This merger will increase the underlying passenger

airline share to approximately 90% and for this reason Gemini will become even more of a compulsory system for most Canadian travel agents.

36. Gemini's control over the information on almost all of the Canadian carriers, coupled with its already dominant position among travel agents, makes entry or expansion by other airline CRS vendors very unlikely.

(ii) Other Barriers to Entry

37. The possibility of new entry into the CRS market by a non-airline vendor is remote. There are substantial costs associated with the development of software, purchase of hardware and cost of marketing. Airline vendors, however, enjoy significant economies of scope because airlines must have a reservation system in any event. Hardware, for example, can be shared between the system used for internal purposes and the system sold to travel agents. In addition, there is considerable overlap in the personnel and learning required to operate both systems. Finally, the operation of a CRS allows airlines to earn revenues from increased ticket sales that result solely from having a CRT terminal in an agency (called the "halo" effect), or from deliberate bias of the CRS display of carriers. Incremental revenues and economies of scope enjoyed by CRS vendors which are owned by airlines give them a large competitive advantage over non-airline CRS vendors. To date no effective competition in any CRS market has been offered by a vendor not affiliated with an air carrier.

(c) **Availability of Substitutes**

38. As indicated in paragraph 18, there are no effective substitutes with respect to the distribution of airline information to travel agents. Other sources of information, such as manual reference to the Official Airline Guide and use of the telephone to make airline reservations are too time-consuming to interest, or be a practical alternative for, the vast majority of travel agents.

(d) **Effective Competition Remaining and Removal of a Competitor**

39. Sabre entered the Canadian market in 1983. It has a very extensive schedule and fare base for transborder, intra USA and international fares (over 300 participating airlines, 14000 hotel properties and 25 rental car companies). Sabre offers superior functionality to both Reservec and Pegasus. Functionality refers to the ability of the CRS to manipulate the data it contains to perform certain useful functions automatically, such as finding the cheapest fare between two points or quoting international fares combining several airlines and flight segments. The back office accounting system that can be joined with Sabre (called ADS) is also believed by some travel agents to be superior to the accounting product mated with Reservec.

40. No Canadian airline is hosted in or linked to Sabre. As a result, Sabre cannot provide last seat availability on any Canadian airline. It has less complete

information on Canadian hotels, trains and tour wholesalers than Reservec. Sabre, unlike Reservec, has no French language capability.

41. Sabre and Pegasus were very close to concluding a joint venture arrangement in early 1987 before PWA Corporation took over CPAL. This alternative, if adopted, would have created a strong competitor to Reservec and increased competition in the Canadian CRS market. One of the major reasons for the Gemini merger is to forestall the growth of competition from other CRS vendors. The Gemini merger eliminates competition between Reservec and Pegasus and reduces the possibility of another CRS vendor entering or expanding in the market because competing vendors will not have the opportunity to have CAIL, the second largest carrier in Canada, host in their CRS.

42. This merger will reduce the effectiveness of Sabre as a competitor because Sabre, in the absence of a direct access link with AC, CAIL and Gemini, will not be able to provide its travel agent subscribers with last seat availability and other enhancements on AC and CAIL flights. Before the merger, no one CRS offered last seat availability on both major Canadian carriers which, with their affiliated and aligned carriers, comprise over 90% of the air passenger market. Due to the merger, only Gemini will be able to provide this information and enhancements on AC and CAIL.

43. As a competitive force, Sabre could be quickly neutralized by the partners of Gemini if they choose to exercise the market power they hold by reason of their dominant position. AC and CAIL are now participating carriers in Sabre and they pay Sabre $1.75 U.S. for

every AC or CAIL flight segment booked on Sabre. Non-participation by AC and CAIL in Sabre would likely force Sabre to withdraw from the Canadian market because Sabre would then be providing a service without any booking fee revenue. Moreover, without such participation the confidence of the travel agent in the information displayed on AC and CAIL flights in Sabre would be much less. This is so because Sabre would then have to rely on other industry sources for fare, schedule and rule information with respect to AC and CAIL flights. These sources are often out of date, inaccurate or incomplete.

44. Sabre has created competitive pressure on Reservec to improve its system and, more recently, to lower its price. In January, 1987, in direct response to Sabre price competition, Reservec introduced a 30 cent per flight segment rebate payable on all segments booked on Reservec. Reservec has also recently introduced an international fare quote capability to match a similar feature offered by Sabre.

45. This merger both eliminates and reduces existing competition substantially. It eliminates the competitive pressure generated by Pegasus on Reservec, particularly in those non-urban areas where it was the only alternative to Reservec. In addition, to the extent that it reduces the ability of Sabre to maintain or expand its market position, it reduces the competitive pressure that Sabre has been able to exert on Reservec in terms of both price and product offerings.

II. Other Effects of the Merger

(a) Impact on Competition in the Airline Industry

46. This merger will likely entrench the dominant position of AC and CAIL in the airline industry in Canada at the expense of Wardair and potential new entrants in both the jet carrier and turbo-prop airline markets in Canada as well as U.S. and international carriers who compete with AC and CAIL in transborder and international markets. These carriers must either be hosted or participate in Gemini or be hosted or participate in another CRS in order to distribute their airline seat inventory to travel agents and the public. If competing carriers host or participate with Gemini, they may be subject to bias and other disadvantages outlined in paragraph 47 which could severely inhibit their ability to compete. Travel agents are also more likely to book AC or CAIL flights than carriers which only participate in Gemini because the most complete and timely information is available only with hosting. Hosting or participating in another CRS will be far less attractive because of the limited distribution offered by CRS systems competing with Gemini.

47. As a result of this merger, AC and CAIL will be able to disadvantage their airline competitors by the following means:

(a) deny or delay access to the CRS;

(b) load the participating airlines' information in a incomplete, inaccurate, or untimely fashion;

(c) bias the display of the flights so that competitor's flights appear lower in the display or on other screens;

(d) charge competitors very high booking fees for use of the CRS.

The impact of these anticompetitve practices on the airline market increases with the dominance of the CRS vendor in the CRS market. Since Gemini has 87% to 90% of the CRS market for travel agents, the use of one or more of the above practices would make entry or expansion by airline competitors very difficult because it would reduce or eliminate travel agents as an effective method of distribution for those airlines. Travel agents are vital to such distribution.

48. In the United States, the actual and potential abuse by CRS vendors outlined in paragraph 47 prompted the Civil Aeronautics Board in 1984 to devise an extensive code of regulation governing CRS vendors. In Canada there is no regulation of CRS vendors and the practices that they may engage in to disadvantage airline or CRS rivals. In view of Gemini's overwhelming share of the CRS market, it will have an effective monopoly or near monopoly which is not regulated under the National Transportation Act, 1987, S.C. 1987, c. 34 or any other federal or provincial statute.

49. The ability of Gemini to exclude, deter, or raise the cost of entry for airline competitors of the partners of Gemini is increased as a result of the greater market power in the CRS market resulting from this merger. If this market power is exercised, the result will likely be a reduction in competition in Canadian airline markets and higher prices for air transportation, defeating many of the benefits expected to result from the recent deregulation of the Canadian airline market.

50. The use of a CRS is one of the most important ways in which airlines compete with one another. This merger eliminates this element of competition as between AC and CAIL, the two major airlines in Canada.

(b) **Impact on Travel Agents and Consumers**

51. This merger will reduce or eliminate the benefits of competition in the provision of CRS services to travel agents and consumers in Canada. These benefits include the more rapid introduction of new and more effective technology, greater sophistication and efficiency in managing airline and other travel data, increased productivity for both airlines and travel agents, and, more importantly, increased consumer choice in arranging travel plans at a reasonable cost. For example, elimination of CRS competition may preclude or seriously reduce the availability of certain features which permit the travel agent to find the lowest fare available for the customer.

52. It is likely that Gemini will become the CRS of choice for all travel agents in Canada because it will be the only CRS with complete schedule, inventory and fare information as well as last seat availability and other enhancements as they become available on flights on Air Canada and CAIL and their respective affiliates. This merger will also have an adverse impact on travel agents and consumers by eliminating competitive alternatives and increasing the likelihood of higher subscriber fees to airlines, travel agencies, car rental agencies, hotels and, as stated above, reducing consumer choice in arranging plans at a reasonable cost.

THEREFORE, MAY IT PLEASE THE COMPETITION TRIBUNAL TO:

1. Order the Respondents to dissolve the Limited Partnership formed to combine the operations of Reservec and Pegasus computer reservation systems, a merger within the meaning of section 63 of the Competition Act, between Air Canada and PWA Corporation, in such manner as the Tribunal directs; within 90 days following the order, or within any other period that the Tribunal considers appropriate;

2. Order the Respondents not to take any further steps to combine the operations of Reservec and Pegasus pursuant to an interim order granted under section 76 of the Competition Act;

- and -

3. Make any other order that the Tribunal considers appropriate to which the Respondents and the Director consent.

Hull, this 3rd day of March, 1988

The Director of Investigation
and Research

PART II - THE PARS TRANSACTION

Description of Gemini - PARS Transaction

53. On September 28, 1988, Gemini and PARS Travel Information Systems ("PTIS") of Kansas City, Missouri, publicly announced plans for their owners to become partners in an expanded CRS organization. PTIS provides a common electronic distribution and reservations system for the travel and tourism industry and is sold primarily in the United States. PTIS is owned equally by Trans World Airlines Inc. and NWA Inc., (the parent of Northwest Airlines) and carries on business as "PARS". In 1986 PARS's market share in the U.S., based on travel agent locations, was 13 percent and it ranked fourth behind Sabre with a 35 percent market share, Apollo with 26 percent and SystemOne with 17 percent. The fifth major CRS, Datas II, has an 8 percent market share. Gemini has stated that, with the addition of the Gemini subscribers in Canada, PARS would become the second largest CRS operating in North America, based on travel agent locations.

54. On September 13, 1988, prior to the public announcement, Air Canada ("AC"), PWA Corporation ("PWAC"), Trans World Airlines, Inc. ("TWA") and NWA Inc. ("NW") entered into a Memorandum of Understanding concerning a proposed merger ("the PARS merger") whereby:

    a) AC and PWAC will sell either their respective equity interests in Gemini or certain assets of Gemini to PTIS and PARS Service Partnership ("PSP"), the latter to be the owner of all the PTIS system hardware and programs;

b) AC and PWAC will acquire equity interests in PTIS and PSP; and

c) the operations of Gemini, PTIS and PSP will be integrated.

55. AC and PWAC will each pay $40 million (U.S.) to TWA and NW for a 23.14 percent interest each in PTIS such that the equity ownership of the parties upon completion would be as follows:

TWA	23.14%
NW	23.14
PWAC	23.14
AC	23.14
	92.56%

56. It is assumed that ABACUS, the CRS owned by Singapore Airlines, Thai International and Cathay Pacific Airways, will own the remaining 7.44 percent of PTIS. If ABACUS does not become an equity owner, it is the intent of PWAC and AC to increase their ownership to 25 percent.

57. AC and PWAC will also pay $12.5 million (U.S.) each to TWA and NW for a 25 percent interest each in PSP such that the equity ownership of the parties upon completion would be as follows:

TWA	25%
NW	25
PWAC	25
AC	25
	100%

58. The above transactions have not been completed but, subject to paragraph 59 herein, are expected to close either in late December, 1988 or early January, 1989 and constitute a "merger" as defined in section 63 of the Competition Act.

59. On December 5, 1988, the Director was advised by the Respondents that the PARS merger will not likely proceed in accordance with the terms of the Memorandum of Understanding set out in paragraph 54 herein. As the nature and structure of the transaction are presently unclear, the Director can only proceed with this application on the basis of the PARS merger as outlined above. However, the Respondents have advised the Director that there would be no dissolution of Gemini in any restructuring of the PARS transaction. In any event, the Respondents have confirmed that, regardless of the nature and structure of the transaction, PARS CRS software will be acquired by Gemini in Canada.

Competition Assessment

60. The PARS merger, in conjunction with the Gemini merger, prevents or lessens, or is likely to prevent or lessen, competition substantially in CRS in Canada and does not in any material way reduce the competition concerns outlined in Part I herein. The PARS merger, in addition to the Gemini merger, enables Gemini and its airline owners to sell a share of their near monopoly in CRS in Canada to another company, in exchange for the PARS CRS technology, without diluting the market power that flows from the Gemini merger. As discussed below, the PARS merger does not reduce either the incentive or the ability of Gemini to exercise that market power to prevent or lessen competition in Canada.

61. The PARS merger does not change or reduce the sources of Gemini's market power, namely the control by AC and CAIL of over 90% of the domestic airline traffic in Canada. Access to the fare and flight inventory data of AC and CAIL is necessary for a CRS competitor to effectively enter and expand in the Canadian market. Control over these data, which flows from the vertical integration of the two national carriers into the CRS industry, has allowed AC's Reservec and now Gemini to maintain their dominant CRS market position despite the inferior functionality of their product.

62. The PARS merger makes it even more likely that Gemini will maintain or increase its overwhelming market dominance. As long as AC and CAIL refuse to allow direct access links to other CRS systems from their complete inventory of schedules, fare rules, seat classes and seat availability, the enhanced functionality of PARS over Gemini makes it even more unlikely that any other CRS will be able to effectively compete in Canada.

63. The PARS merger will also eliminate additional possibilities for enhanced CRS competition and entry in Canada. PARS could have sold its CRS software to either Reservec or Pegasus; become an independent entrant in Canada; or more likely become a joint venture partner with one of the Gemini airline owners with the other free to operate independently or join with one of the other major U.S. or European CRSs as a second major CRS competitor in Canada.

64. The PARS merger demonstrates that the Gemini merger is not necessary to acquire state-of-the-art CRS technology for Canada. Such technology is readily available in the U.S. and elsewhere, and AC or CAIL individually could acquire such technology by joint venture or by a hardware and software purchase from a number of CRS vendors. Gemini does not need a near monopoly in Canada in order to build a "made-in-Canada" CRS and, indeed, with the PARS merger has chosen not to do so.

65. The PARS merger does not change Gemini's ability or incentive to drive or exclude other CRS vendors from the market, to disadvantage airline competitors or to raise prices to travel agents and other subscribers. All of the owners of PARS, including AC and CAIL, would benefit directly from the increased profits such anti-competitive actions would bring.

Impact on Competition in the Airline Industry

66. The PARS merger does not alter the competitive effects of the Reservec-Pegasus merger in the airline industry as described in paragraphs 46 to 50 herein. AC and CAIL will continue to have the incentive and ability to prevent or lessen competition in airline markets in which they operate. Moreover, the remaining partners in PARS, TWA and NW, will have no incentive to stop this prevention or lessening of competition within Canadian airline markets because they do not serve domestic Canadian city-pairs and would not be adversely affected by any reduction in domestic airline competition. Nor does the PARS merger reduce the likelihood that AC and

CAIL could obtain access to confidential data on each other's sales and yields, leading to the possibility of coordinated pricing between these two national carriers.

67. The U.S. CAB rules (as described in paragraph 48 herein) do not have extra-territorial application. Thus PARS would be able to engage in CRS abuses in Canada without being subject to any CRS rules or regulations.

68. The current PARS display is ordered in such a way that interline connections (e.g. Wardair-AC/CAIL) are penalized and given a lower priority in the display as compared to online connections (e.g. AC-AC, CAIL-CAIL). This is accomplished by the PARS algorithm which adds 30 minutes to the elapsed time of online connections, but adds 120 minutes to the elapsed time of interline connections. No interline penalty is imposed on connections between AC/CAIL and their respective affiliates. The interline penalty in PARS means that Wardair flights which connect with AC or CAIL or their affiliated carriers would often be displayed on a second or later screen. This is the case notwithstanding that the interline connection that includes Wardair may provide a shorter elapsed travelling time. This reduces consumer choice in that travel agent subscribers book the majority of flights off the first screen. The inability of carriers such as Wardair to have their flights and fares displayed without the substantial interline penalty imposed through the PARS merger prevents such carriers from competing with the two dominant carriers - AC and CAIL.

69. As described in paragraph 12 herein, AC and CAIL have acquired complete or partial control of nearly all the feed carriers in Canada which provide connecting passengers or feed traffic for the airline trunk routes on which AC, CAIL and Wardair are typically the major competitors. Control over feed traffic is a significant barrier to entry into certain city-pair markets as well as into the airline industry, generally. The heavy penalty against interline connections imposed through the PARS merger serves to prevent competition by heightening this barrier.

Remedy Sought in Respect of Part II

Therefore, may it please the Competition Tribunal to:

1. Order the Respondents not to proceed with the PARS merger or any part thereof pursuant to section 64(1)(f) of the Competition Act; or

2. If the PARS merger is completed at the time of the hearing of this application, order the Respondents to dispose of their respective assets or shares acquired as a result of the PARS merger in such manner as the Tribunal directs pursuant to section 64(1)(e) of the Competition Act, within 60 days following the order or within any other period that the Tribunal considers appropriate;

- and -

3. Make any other order that the Tribunal considers appropriate pursuant to sections 64(1)(e)(iii), 71(1)(b), 76 or 77 of the Competition Act.

Hull, this 7th day of December, 1988

The Director of Investigation and Research