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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Respondents

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RESPONSE OF THE RESPONDENTS PWA CORPORATION, CANADIAN AIRLINES INTERNATIONAL LTD. AND 154793 CANADA LTD.

I. INTRODUCTION

1. The Respondents PWA Corporation ("PWAC"), Canadian Airlines International Ltd. ("CANADIAN") (which includes Pacific Western Airlines Ltd. ("PWAL") and Canadian Pacific Air Lines, Limited ("CPAL") by virtue of an amalgamation on January 1, 1988) and 154793 Canada Ltd. ("154793") (hereinafter collectively referred to as "the Respondents") oppose the application by the Director of Investigation and Research ("the Director") before the Competition Tribunal ("the Tribunal") on the grounds:

(a) that the creation of Gemini ("the Merger"), which is the subject of the said application, does not prevent or lessen, and is not likely to prevent or lessen, competition substantially in the provision of computer reservation system ("CRS") services to airlines, travel agents and consumers in Canada within the meaning of section 64 of the Competition Act; and

(b) that even if the Merger prevented or lessened competition substantially, it will bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that could result from the Merger and that the gains in efficiency would not be attained if the Merger was dissolved.

2. Gemini is a Canadian CRS made up of the former Reservec system of Air Canada and the unsuccessful Pegasus system of CPAL. It has an investment of approximately $100 million and approximately 630 highly qualified employees in Canada.

3. The establishment of Gemini pursuant to the Merger is necessary:

(a) to establish a Canadian airline owned CRS that will potentially be able to compete with stronger foreign CRS competition which has made substantial and rapid inroads in the Canadian CRS marketplace.

(b) to enable CANADIAN to obtain ownership participation in a Canadian CRS given the inevitable demise of Pegasus, which lost approximately $15 million on gross revenues of approximately $3.3 million in its 2 full years of operation (1985 and 1986), with additional losses of approximately $7 million projected for 1987. With only approximately 7% of the market based on flight segments booked, and no possibility of long term survival independently on a full cost recovery basis, Pegasus offered illusory competition to Reservec and Sabre (a division of AMR Information Services Inc. which owns American Airlines).

(c) to increase inter-airline competition within Canada by enabling Gemini's air carrier users to compete more effectively with each other on the basis of unbiased information with respect to such matters as flight times, fares, availability, classes and standards of service.

(d) to achieve substantial operational, technological and administrative efficiency gains.

(e) to enhance the functionality of CRS services provided in Canada by focusing technological developments on the unique requirements of the Canadian market.

4. The Merger is consistent with the express purpose enunciated in Section 1.1 of the Competition Act in that it will "maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy, in order to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada, in order to ensure that small and medium sized enterprises have an equitable opportunity to participate in the Canadian economy and in order to provide consumers with competitive prices and product choices."

5. The Director's application is based upon an erroneous perception of the nature of the CRS industry domestically and worldwide. CRS's are extremely large scale operations and by their nature are limited in number. There will only be 9-10 CRSs in the world, of which Gemini will be the smallest. The Canadian market can support 1 CRS, at most, on a full cost recovery basis. If Gemini is to have a chance of competing nationally and internationally, and if the unbiased access of Canadian carriers

to foreign markets and foreign CRS's is to be protected, the uncertainty caused by the Director's application must be removed quickly.

6. The Director's application appears to be a misdirected attempt to assist Sabre, the world's largest and most profitable CRS. It competes in the Canadian market on an incremental cost basis with negligible investment in Canada other than terminal equipment and a minimal sales force of approximately 20 salesmen. The Director and user groups have suggested that Gemini is currently not as functional as is Sabre. Gemini does not challenge Sabre's right to compete in Canada but objects to unnecessary and unreasonable support of Sabre by the Director.

7. The Director's application is premature and raises no case or likelihood of competition being substantially lessened at the present time. The Director postulates that if Gemini is successful and acts contrary to the written undertakings of its owners then it might have the potential to lessen competition. Apart from implying that Gemini and its owners cannot be trusted, this contention ignores the market forces that will discipline Gemini.

8. It is obvious Parliament could not have intended the Director to impede and perhaps destroy Canadian businesses, especially in critical industries where time is important and delay works to the advantage of large and powerful foreign competition.

II BACKGROUND

A. The Parties

9. The Respondents do not disagree with the description of the parties contained in paragraphs 4 through 8 of the Statement filed by the Director subject to the following corrections and/or additions:

(a) Flight segments booked through a CRS is a more appropriate measure of the market share of a CRS than that of travel agency locations used by the Director, since bookings are the commercial units which generate the revenues earned by the CRS. A flight segment represents travel on 1 direct flight which may have intermediate stops but involves no connections.

Ultimately the financial success or degree of competitive significance of a CRS must be measured by its ability to generate flight segment booking fees.

(b) In paragraph 28 of the Statement filed by the Director, he states that Reservec accounted for approximately 70% and Pegasus approximately 7% of the flight segments booked in Canada. By implication, the U.S. CRSs accounted for the balance of approximately 23% (with Sabre having approximately 22% and Apollo and SystemOne having approximately 1%) of the market. While it is difficult to obtain a precise count of the flight segments booked in Canada, the figures used by the Director appear to be reasonably representative and are accepted and relied upon by the Respondents for the purpose of this Response.

B. The Airline Industry in Canada

10. The Respondents disagree with the description of the airline industry in Canada contained in paragraphs 11 through 16 of the Statement filed by the Director.

11. The Director has overstated the degree of concentration that exists in the airline business in Canada by using scheduled revenue passenger kilometers flown in Canada ("RPK") as a measure. The more appropriate measure in the context of the CRS industry in Canada would also include transborder and international flights commencing in Canada, since seats on most of these flights would be booked within Canada through a CRS. Using this measure, the market shares of Air Canada and CANADIAN would be reduced significantly. In any event, the existing levels of concentration in the airline passenger market are a historical fact and are not relevant to an analysis of the extent to which the Merger has affected competition in the provision of CRS services.

12. The Respondents disagree with the characterization contained in paragraph 12 of the Statement filed by the Director that Air Canada and CANADIAN have "complete or partial control of almost all turbo-prop or jet regional carriers". CANADIAN has no equity investment whatsoever in any other airline in Canada. Its relationship with other airlines is purely that of a commercial competitor. PWAC has equity investments in some other carriers but in every case holds a minority interest and does not have control.

C. The CRS Industry

13. The Respondents disagree with the description of the CRS industry contained in paragraphs 17 through 23 of the Statement filed by the Director.

14. The majority of tickets for scheduled passenger airline travel in Canada are purchased through travel agents utilizing a CRS rather than through the airlines directly. A CRS enables a travel agent to check schedules, fares and seat availability as well as make reservations and issue tickets instantaneously. Travel agents lease or purchase the CRS terminal and related equipment from the CRS vendor. There is a contractual subscriber relationship between travel agents and CRS vendors pursuant to which CRS vendors charge travel agents subscriber fees.

15. An airline must maintain its own internal reservation and seat control function in a single system. Major airlines like Air Canada and CANADIAN maintain their own internal reservation facilities while others are "hosted" in another carrier's reservation system. Airlines will also elect to "participate" in any CRS offering a significant number of subscribing travel agencies in order to achieve maximum distribution of their product (airline seats). All of the CRSs in which an airline participates are linked to its internal reservation system. A CRS charges participating carriers booking fees for each flight segment booked through the CRS by subscribing agencies.

16. CRS vendors also earn booking revenues from hotels, car rental agencies and other such entities whose products are sold through the CRS.

17. Worldwide fares and schedules are provided by the airlines to a small number of non-airline firms who, in turn, supply these consolidated fares and schedule databases to all internal airline reservation systems and CRSs. Each CRS, to assure that it is most functional to its subscribing agencies, will contain and display this fare and schedule information on all major airlines, regardless of whether that airline participates in the CRS.

18. The Director in paragraph 21 has overstated the degree of concern about loss of reservations when a carrier is participating in, rather than hosted on, a CRS. This has not been a problem for CANADIAN.

19. The significance of "Last Seat Availability" ("LSA") has been overstated by the Director in paragraphs 22 and 23 as evidenced by Sabre's success and rapid growth in the Canadian market to date without LSA on CANADIAN or Air Canada.

20. CRS technology is extremely large scale, relative to the market for these services. There will only be 9-10 independent CRSs worldwide, although there are over 170 airlines who have automated their internal reservations function. In the whole of the U.S. there are only 5 CRSs (Sabre, Apollo, Pars, SystemOne and Datas II) and Sabre and Apollo dominate that market. The national markets of the 21 European carriers will be served by 2 CRSs (Galileo and Amadeus). In addition, there are 2 CRSs in the formative stages in Asia/Pacific but it is likely that only 1 will survive on a stand alone basis.

21. The CRS industry in Canada and the rest of the world is different from that in the U.S. With almost 31,000 travel agencies, the U.S. market is many times larger than that of other countries. Sabre has more subscribing agencies than there are agencies in all of Europe; the agency population in the U.S. is ten times larger than that of Canada. A modern CRS is so costly to create and maintain that it must be jointly-owned and, at least in Europe and Asia, established in multiple national markets to achieve the necessary operating economies from a larger subscribing agency base.

22. The 5 U.S. CRSs are the only independently created CRSs in the world. Because of the massive investment costs and length of time required to develop a CRS, the CRSs presently being created (Amadeus, Galileo, Gemini and in Asia) will be modifications of systems purchased from the U.S. CRSs, and will be owned jointly by groups of carriers.

23. In Canada, Gemini will always face rigorous competition from the U.S. CRSs, particularly Sabre (American Airlines), Apollo (United Airlines) and SystemOne (Texas Air), all of whom have achieved a secure subscriber base in the United States and are expanding their subscribing agency bases in Canada.

D. Reasons for the Merger

24. The Canadian CRS market was established in 1973 when Air Canada expanded Reservec, its existing internal reservations system, to provide automated reservation services to travel agents. Reservec was the only CRS operating in Canada until 1983

when Sabre, already the world's largest CRS, entered the market. At approximately the same time, CPAL determined that it needed an ownership interest in a CRS to increase its competitiveness in the air transport market and to ensure control of its automation costs and long term access to the agency distribution system.

25. In April 1984, CPAL launched Pegasus 2000 ("Pegasus") in the belief that Pegasus, which utilized a personal computer for travel agent use, represented a sufficiently differentiated and attractive product that would enable it to capture a significant share of the Canadian CRS market and become profitable.

26. Upon entry however, CPAL experienced immediate difficulty in attempting to convert the profitable high volume urban travel agencies which had already adopted Reservec and/or Sabre. Pegasus was forced to seek out lower volume agencies, often in non urban areas. This resulted in Pegasus having the lowest volume of flight segments booked per travel agency or terminal, and the lowest number of terminals per travel agency. From the outset, more CPAL flight segments were booked by travel agents through Reservec than through Pegasus. By February, 1986, Sabre surpassed Pegasus in subscribing travel agent bookings on CPAL.

27. By late 1985, it was apparent to CPAL that Pegasus was incurring excessive losses and could not achieve the necessary revenues and critical mass that would permit it to survive independently in the long term. Nonetheless, CPAL remained of the view that it was desirable to acquire an equity position in a viable CRS.

28. During 1986, CPAL examined a "multi-hosting" proposal from Sabre. It was economically unwise for CPAL as it would have been hosted in Sabre and assumed responsibility for all network, telecommunications and support costs for Sabre agencies in Canada. In addition, CPAL would have been required to provide performance guarantees to Sabre and to share all profits. The proposal was financially unattractive, gave CPAL no equity position in Sabre and was rejected.

29. At Air Canada's initiative, CPAL and Air Canada commenced negotiations regarding the possible acquisition by CPAL of an equity position in Reservec. Subsequently a further proposal was made by Sabre to CPAL that was similar to the initial proposal outlined above in paragraph 28 except that it involved a "prime-host" arrangement whereby CPAL would continue to

use Pegasus for its internal reservation system.

30. Following the acquisition of CPAL in January, 1987, PWAC was faced with the decision of how to deal with CPAL's failing CRS. PWAC reviewed and rejected Sabre's "prime-host" proposal which was still financially unattractive and gave PWAC no equity in Sabre. PWAC shared CPAL's view that an equity position in a viable CRS was desirable.

31. The merger of Reservec and Pegasus was the only viable alternative for Pegasus. It allowed PWAC to become an equal equity participant with Air Canada in a CRS oriented to the needs of Canada. Both the Pegasus and Reservec systems were outdated compared with Sabre and the other U.S. CRSs. Major capital expenditures and ongoing development costs would have to be expended by both Pegasus and Reservec to make and keep either competitive. On its own, Pegasus could not justify that type of investment. It was contemplated that Gemini would initially operate both Reservec and Pegasus until a single world class successor system could be adopted. Together, Air Canada and PWAC could share the costs of developing a consolidated CRS that would hopefully be strong enough to achieve the full cost recovery necessary to survive long term in competition in Canada with the U.S. CRSs.

E. The Formation of Gemini

32. The Respondents do not disagree with the description of the Merger contained in paragraphs 9 and 10 of the Statement filed by the Director.

33. The Merger gave each of Air Canada and CANADIAN an equal voice in Gemini from the outset and ensured that it would not be utilized in any manner which could benefit one of the airlines to the detriment of the public. Gemini was designed to operate on an autonomous basis separate from its airline parents and structured to allow other equity investors, particularly other members of the air travel industry, to join in its ownership.

34. An opportunity to invest in Gemini was offered to Wardair. Wardair declined and instead became hosted in SHARES (the internal reservation system of Continental Airlines), and a participating carrier in Gemini.

35. Letters were written to the then Minister of Transport, John C. Crosbie, by Messrs. Rhys T. Eyton, Chairman of the Board

and the Chief Executive Officer of PWAC dated June 10, 1987 and by Claude I. Taylor, Chairman of the Board of Air Canada dated June 29, 1987, confirming the manner in which Gemini is to be operated. Mr. Eyton stated in part:

> "With respect to the concern expressed that all carriers would not be able to invest in the new company, I wish to assure you that we are contemplating equity investment by other participants. To date, we have had several North American prospective investor participants indicate an interest. In addition, I can confirm that partnership airlines and allied carriers will not enjoy a preferred level of service. Access to the system will be provided on a fair and equitable basis with consideration being given, consistent with sound business practices, to volume users.
>
> I can confirm that the investment in the Company will be by PWA Corporation and that the Company operating the services will be at arm's length from Canadian Airlines International Ltd.
>
> In addition, I can give you my assurance that new entrants and small carriers will have nondiscriminatory access to the proposed system whereby fair and unbiased display of all airlines' schedules and rates would occur."

36. Mr. Taylor stated in part:

> "On behalf of Air Canada, I would like to assure you that we are prepared to consider equity participation by other organizations and small carriers, provided that any proposals made are based on sound business practices. Also, irrespective of whether or not small carriers and other potential users of the system are equity investors, access to the system will be extended to them on a fair and equitable basis, again based on sound business practices. There will be no preferred level of service to the partner airlines or their allied carriers, other than in respect of any proprietary products developed at a specific carrier's cost, as is now the case. As in the past, the display will be unbiased.
>
> I can also confirm that the partnership will be operated by a corporate general partner acting at arm's length from Air Canada and PWA Corporation."

37. These principles were enshrined in the contractual agreements and other documentation governing Gemini.

38. Gemini's structure is pro-competitive. Formed by intense airline competitors, and eventually to be owned by all interested Canadian carriers and operated independently of any of them, Gemini deprives any one carrier of the opportunity to manipulate the CRS to the detriment of its competitors or the public.

III COMPETITION ANALYSIS

A. Definition of the Relevant Market

39. Merger analysis requires definition of the product and geographic dimensions of the relevant market. Neither of these were specifically defined in the Statement filed by the Director.

40. The relevant product market is the market for the reservation and sale of air and other travel services through a CRS.

41. The relevant geographic market for many CRS issues is the Canadian market. However, for some issues such as the determination of potential suppliers of CRS services, the North American market is more appropriate. For other issues, it may be useful to examine smaller regions of the country.

B. Factors to be Considered

42. Section 65 of the Competition Act specifically refers to a number of factors which may be taken into account by the Tribunal in determining whether a merger prevents or lessens, or is likely to prevent or lessen, competition substantially.

(a) Effective Competition.

> "(a) the extent to which foreign products or foreign competitors provide or are likely to provide effective competition to the business of the parties to the merger or proposed merger;"
>
> "(e) the extent to which effective competition remains or would remain in a market that is or would be affected by the merger or proposed merger;"

43. Currently, there are only 5 (U.S.) CRSs in North America which have achieved the critical scale in terms of agency subscriber base necessary for long-term survival on a full cost-recovery basis. The Merger will not diminish the "effective competition" in the Canadian CRS market provided by these U.S. CRSs, particularly Sabre, which recover their CRS costs in the U.S. market and compete in Canada on a low incremental cost basis.

44. Sabre is the second largest CRS in Canada. It moved

from a market share of zero to approximately 22% based on flight segments booked in the 3 years since its entry into the Canadian market in 1983. Sabre's existing share of the market is protected through minimum transaction requirements and five year contracts containing high liquidated damages provisions should the travel agent want to cancel its lease. It continues to grow selectively, primarily in large high volume urban travel agencies.

45. The Merger has a pro-competitive impact on the CRS market in Canada as nothing less than the consolidated effort of Air Canada and CANADIAN offers any hope for the creation of a sixth North American CRS.

(b) Failure of Pegasus

> "(b) whether the business, or a part of the business, of a party to the merger or proposed merger has failed or is likely to fail;"
>
> "(f) any likelihood that the merger or proposed merger will or would result in the removal of a vigorous and effective competitor;"

46. Pegasus was clearly a failing business. The suggestion that it constituted "a vigorous and effective competitor" to Reservec and Sabre with only 7% of the market (which, in view of its imminent failure, overstated its relative competitive significance in any event) is nonsense.

47. In the two years prior to the Merger (1985 and 1986), Pegasus lost approximately $15 million on gross revenues of approximately $3.3 million. Additional losses of approximately $7 million were projected for 1987. (It should be noted that this calculation is based upon revenue from external sources only. If booking fees from CPAL for 1985 and 1986 were also included, the gross revenues over that period would be increased by approximately $1 million and the losses decreased by a corresponding amount).

48. Converting Pegasus to a profitable business was not possible. In the absence of the Merger, Pegasus would have been forced to discontinue its operations. Describing Pegasus as a "failing business" is an understatement as that implies a degree of success at some stage of its existence. In fact, Pegasus never succeeded, was never close to succeeding and had no prospects for independent survival on a full cost recovery basis.

49. Pegasus had secured, by and large, the least lucrative locations and had the lowest number of bookings per location or terminal, and the least number of terminals per location. If the Merger had not occurred and Pegasus had been discontinued, most of the remaining Pegasus' business would have moved to Reservec upon Pegasus' demise. The Pegasus locations were generally incompatible with those sought by Sabre which concentrates on the most profitable large high volume urban locations which can be easily and economically serviced from their existing data base and network facilities located in the U.S.

(c) Barriers to Entry

> "(d) any barriers to entry into a market including:
>
> (i) tariff and non-tariff barriers to international trade,
>
> (ii) interprovincial barriers to trade, and
>
> (iii) regulatory control over entry, and any effect of the merger or proposed merger on such barriers;"

50. There are no legal or regulatory barriers as described above in paragraphs 65(d)(i), (ii) or (iii) that preclude entry into the Canadian CRS market by foreign or other CRS competitors.

51. The Director has alleged that a lack of access to "Last Seat Availability" ("LSA") on Air Canada and CANADIAN flights constitutes a barrier to entry faced by Sabre and other foreign CRS vendors. Any travel agent can access these last remaining seats by calling the airline directly. While LSA on Air Canada and CANADIAN may represent a perceived competitive advantage that is available to Gemini, it is obviously not a barrier to entry as is evidenced by Sabre's dramatic acquisition over a 3 year period of approximately 22% of the Canadian CRS market based on flight segments booked.

52. The major limitations upon *de novo* entry into a CRS market are the massive investment and length of time needed to develop a CRS and the large number of agencies required to generate revenues sufficient to support full cost recovery. None of these factors constitute barriers that will prevent Sabre and the other existing U.S. CRSs, who have already recovered their costs in the U.S. market, from competing in Canada on an incremental cost basis.

53. Since 1982, when Reservec was the only CRS in Canada, four new systems entered the market and acquired approximately 30% of the market based on flight segments booked.

(d) Innovation in the Market

> "(g) the nature and extent of change and innovation in a relevant market"

54. The CRS industry which emerged in the late seventies is based upon rapidly evolving technology. Gemini will enable Air Canada and PWAC to pool their resources to fund the substantial research and development costs necessary to remain competitive in this dynamic market. As well, Gemini will be able to direct technological developments towards the unique needs of the Canadian air travel market, such as detailed Canadian hotel, car rental agency and other travel industry listings and French language capability.

(e) Other Criteria

> "(h) any other factor that is relevant to competition in a market that is or would be affected by the merger or proposed merger."

(i) Industry Support

55. Gemini will be more responsive than foreign CRSs to the concerns of the Alliance of Canadian Travel Associations ("ACTA") and the particular needs of Canadian travel agents.

56. Even prior to the establishment of Gemini, the possibility of a merger of the Reservec and Pegasus systems had been actively promoted by the travel agency industry. The Executive Committee of ACTA passed the following resolution in September, 1986:

> "{That} the ACTA Board indicate to Air Canada and Canadian Pacific Airlines that a meeting of the two parties is required urgently to discuss the implementation of a single Canadian industry reservation system fully supported by ACTA; failing which ACTA will commence investigations of several options identified by the Automation Task Force as a method of establishing said system".

57. Following the announcement of the proposed establishment

of Gemini, ACTA published an unsolicited advertisement in the Globe and Mail on May 16, 1987 which stated:

> "ACTA welcomes the recent decision by Canadian Airlines International and Air Canada to unify their forces to form a joint computerized reservation system for Canadian travel agents. It is a step that ACTA has sought for many years and should benefit the entire travel industry in Canada and the public they serve."

58. This support is a reflection of the anticipated increased public convenience and efficiency of a combined system and indicates that the travel agent industry is not generally concerned that the Merger will give rise to a substantial lessening of competition.

(ii) Commitment to Fairness

59. The established principles upon which Gemini is operated are designed to ensure the availability of equal access, competitive market rates and security of information to "hosted" and "participating" carriers, in addition to the absence of "avoidable" bias. Accordingly, the integrated system will operate on an equitable and fair basis vis-a-vis all such carriers. This is consistent with the Report of the Joint Government-Industry Task Force into Computer Reservation Systems chaired by Anne-Marie Trahan, Q.C. delivered on June 11, 1985 ("the Task Force") that Reservec and Pegasus were "committed to supplying a fair, unbiased display of information on airline schedules, fares, seat availability etc., and to meet carrier automation requirements as efficiently and as effectively as possible, consistent with the capabilities of their systems." By contrast, the Report noted that the U.S. Civil Aeronautics Board had found in 1984 that "the few U.S. airlines providing CRS services to travel agents (American and United were considered to have had about 70 percent of the market) were using their systems in ways that favoured the selection of their services and hence inhibited competition and caused consumer injury".

60. A failure to provide effective indigenous Canadian competition to foreign CRS vendors could result in a bias in favour of foreign based carriers with corresponding prejudice to Canadian air carriers and distortion of the preferences of consumers.

(iii) Autonomy from the Airlines

61. The Merger effectively implements a recommendation of

the Task Force that steps be taken to ensure that the CRS businesses of the two airlines be operated as independent entities, free of airline bias. The 50%-50% ownership and deadlocked control structure of the new joint enterprise ensures neutrality as neither airline will control Gemini.

(iv) Other Safeguards

62. Rejection of the Director's Application at this stage will not preclude subsequent action on the part of the Director or the Tribunal in respect of the Merger if, during the remaining 2 years of the statutory limitation period, it appears that there has been a substantial lessening of competition brought about by the Merger. The Director will not be impeded in his ongoing ability at any time to investigate and challenge any suspected anti-competitive activities of the parties under the conspiracy (section 32), price discrimination or predatory pricing practices (section 34), refusal to deal (section 47), tied selling or exclusive dealing (section 49), or abuse of dominance (sections 50 and 51) provisions of the Competition Act.

(v) Increased Inter Airline Competition

63. The Merger has a pro-competitive impact on airline competition in Canada. Air carrier users of Gemini will now compete more effectively with each other based on traditional competitive criteria such as departure times, seat availability, flight duration, fares, classes and standards of service. A unified system will provide a greater volume of information regarding the availability of various travel services as well as greater convenience and efficiency in accessing such services.

(vi) Canadian Competitive Considerations

64. Gemini will ensure that the schedules of air carriers are provided to the Canadian travelling public on a non-biased, readily accessible basis, will enable a Canadian-owned CRS to compete with foreign CRSs, and will provide a base for expansion of the CRS (and Canadian carriers who use that system) internationally. Gemini will be more sensitive than foreign CRSs to the requirements of the Canadian marketplace, including in-depth Canadian travel listings and French language capability, a facility which Sabre notably lacks.

65. The worldwide distribution system for international air travel is managed by a few national or multi-national CRSs, all

owned singularly or jointly by airlines. A viable Canadian CRS is essential to Canadian carriers' collective ability to negotiate reciprocal access to unbiased display in foreign CRSs. The bargaining rights to CRS access in Canada should belong to Canadian, rather than U.S. carriers, as CRS owners.

C. Efficiency Gains

66. If the Tribunal were to conclude that the Merger might otherwise be considered to give rise to a substantial lessening of competition, the transaction is not one in respect of which an order should be made under section 64 of the Act. This is because the Merger will result in significant gains in efficiency which will outweigh any adverse effects arising from any potential lessening of competition. Section 68 of the Act specifically mandates that no order shall be made pursuant to section 64 in respect of a merger where gains in efficiency dominate.

67. Prior to the Merger, Reservec and Pegasus had each devoted substantial resources towards the development of duplicative CRS capabilities, resulting in significant cost and operational inefficiencies in the aggregate. It has been estimated that Gemini will generate annualized real cost savings in excess of $15 million once the planned integration is completed.

D. Market Concentration

68. Section 64(2) of the Competition Act specifically directs that "the Tribunal shall not find that a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially solely on the basis of evidence of concentration or market share".

69. The Director has focused on the increase in CRS market concentration resulting from the Merger. Gemini now has approximately 77% of the market, whereas previously Reservec had approximately 70% and Pegasus approximately 7% of the market, based on flight segments booked. In view of Pegasus' imminent demise and the vigorous competition Gemini faces from Sabre and the other U.S. CRSs, it is obvious that the Merger has not prevented or lessened competition substantially.

E. Speculation as to Gemini's Future Conduct

70. Much of the focus of the Director's Statement, and in

particular paragraphs 30, 31, 33, 43, 46, 47, 48, 49, 51 and 52, is based upon groundless speculation on possible improper practices. These practices are contrary to the "commitment to fairness" principles enshrined in the documentation governing Gemini and are inconsistent with the representations given by the executive officers of Air Canada and PWAC confirming the manner in which Gemini will be operated. It is surprising that the Director appears to believe that now that the Merger is completed the owners of Gemini will systematically begin to violate the law and ignore their undertakings. This is a disservice to the companies and ignores the discipline imposed by market forces and the powers retained by the Director under the Competition Act in the event that any anti-competitive practices were adopted by Gemini.

71. It is inappropriate for the Tribunal to base its decision upon unfounded speculation.

F. Implications of Dissolving Gemini

72. The dissolution of the Merger would result in a less competitive environment in the CRS market in Canada than that which will prevail if Gemini is allowed to proceed.

73. The dissolution would not simply place airlines, travel agents and consumers back in the situation that existed prior to the Merger. As a result of Pegasus' disastrous financial performance and its inability to obtain the critical mass necessary to survive on an independent basis over the long term, Pegasus would likely be forced out of the market. The majority of its agencies would then go to Reservec as they are incompatible with the high volume urban accounts pursued by Sabre.

74. Reservec would potentially be in a position similar to that now occupied by Gemini but without the critical mass necessary to establish a competitive world class Canadian based CRS. As well, the joint contractual "commitment to fairness", the discipline imposed by Gemini's joint ownership and control structure, the pro-competitive aspects and the efficiency gains resulting from the Merger would be lost.

75. It is unlikely CANADIAN would be able to acquire an equity position in another CRS, much less a half interest. As well, the opportunity for other Canadian carriers and industry participants to acquire an ownership interest in a CRS would be lost.

G. Specific Responses to the Director's Statement

76. To the extent that the Respondents have not dealt with any of the grounds or any of the material facts relevant to each ground set out in the Director's Statement and to the extent they allege misconduct or seek dissolution or other remedies against the Respondents, the Respondents hereby deny each of those grounds and material facts.

IV RELIEF SOUGHT BY THE RESPONDENTS

77. The Respondents request that the application be dismissed.

V. ADDRESS FOR SERVICE OF THE RESPONDENTS

78. Service on the Respondents of any documents in connection with this proceeding may be effected on Messrs. Bennett Jones, Barristers and Solicitors, 3200 Shell Centre, 400 - 4th Avenue S.W., Calgary, Alberta, T2P 0X9, Attention: J. C. Major, Q.C., Solicitors for the Respondents.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 21st DAY OF APRIL, 1988.

BENNETT JONES

Per: ______________________

Solicitors for the Respondents PWA Corporation, Canadian Airlines International Ltd. and 154793 Canada Ltd.