CT – 2001/002

THE COMPETITION TRIBUNAL

IN THE MATTER OF an application by the Commissioner of Competition under section 79 of the *Competition Act*, R.S.C. 1985, c.C-34, as amended.

AND IN THE MATTER OF the *Regulations Respecting Anti-Competitive Acts of Persons Operating a Domestic Service*, SOR/2000-324 made pursuant to subsection 78(2) of the *Competition Act*.

AND IN THE MATTER OF certain practices of anti-competitive acts by Air Canada

THE COMMISSIONER OF COMPETITION

Applicant

– and –

AIR CANADA

Respondent

COMMISSIONER'S REPLY

1. The Commissioner repeats the allegations in his Notice of Application and Statement of Grounds and Material Facts ("Notice of Application"). Except as is hereinafter expressly admitted, the Commissioner denies each and every allegation in the Response.

2. Terms defined in the Notice of Application have the same meaning in this Reply.

3. Air Canada's dominance over the Affected Routes, and most domestic routes in Canada, is substantial. There are legal limits on the actions it can take to preserve or enhance that

position of dominance. In its Response, Air Canada seeks to obscure those limits. Air Canada advocates an approach that would allow it to effectively preserve and enhance its position of dominance with impunity. That approach is contrary to the *Act* and to the *Airline Regulations*. The Commissioner urges the Tribunal not to adopt it.

A. Recent Developments

4. The Commissioner acknowledges that since March 5, 2001, when the Notice of Application was filed, there have been changes in the Canadian competitive landscape, including the Affected Routes. For the most part, those changes are further evidence of the consequences of Air Canada's anti-competitive actions, as pleaded in the Notice of Application.

5. Royal's performance on the Affected Routes was unprofitable and CanJet was on the brink of failure when Canada 3000 announced its intention to acquire those carriers. If Canada 3000 had not agreed to acquire Royal and CanJet, Royal would likely have curtailed operations on some or all of the Affected Halifax Routes, and CanJet would likely have ceased operations entirely. Prior to Canada 3000's acquisition of Royal, Royal ceased offering non-stop flights between Halifax and Ottawa. Thus, contrary to Air Canada's position, stated at paragraphs 5 and 74, there has not, to date, been sustainable entry into the passenger airline market on the Affected Halifax Routes.

6. Further, the inability of CanJet and Royal to continue as independent competitors on the Affected Routes is evidence of the effects of Air Canada's practice of anti-competitive acts, as pleaded in the Notice of Application.

7. On April 11, 2001, Canada 3000 announced a new schedule that replaces the former schedules of Canada 3000, Royal and CanJet. Overall, Canada 3000's new schedule results in fewer frequencies, less capacity and less competition on the Affected Halifax Routes.

B. Relevant markets

8. In regard to paragraph 39 of Air Canada's Response, the reason that other domestic city-pair markets, in addition to the Affected Routes, are relevant to this Application is that Air Canada can use — and has used — its dominance over the supply of domestic passenger airline

services on most domestic routes in Canada to exert market power over the Affected Routes. These other routes, taken singly or together, comprise a "class or species of business" within the meaning of s. 79(1)(a) of the Act.

9. Hamilton and Toronto are in the same catchment area. The Canadian Transportation Agency ("CTA") has not made any ruling to the contrary. In any event, rulings made by the CTA in fulfilling its particular mandate are not binding on the Tribunal. Air Canada's actions in responding to WestJet's entry on Hamilton-Moncton by adding capacity and reducing fares on its Toronto-Moncton route belie Air Canada's assertion to the contrary at paragraph 37 of its Response.

C. Air Canada's Dominance

10. Air Canada is the dominant carrier on the Affected Routes and on most domestic city pair routes in Canada. Air Canada's denial of its dominance has been publicly and repeatedly contradicted by its chief executive, Mr. Milton:

> "Air Canada is Canada's largest airline…we are the leader in all of the markets we serve. We are the dominant domestic airline, with a 90% share of Canadian travel agency sales and an approximately 75% share based on seat capacity". (February 6, 2001)

D. The Canadian Transportation Agency (CTA)

11. In regard to paragraphs 2(a)(iii), and 23 of the Response, the limited mandate of the CTA in regard to domestic carriers is irrelevant to this Application. Section 66 of the *Canada Transportation Act* authorizes the CTA to take action in respect of "unreasonable" fares charged by a licensee when the licensee is the only person providing a domestic service on a route. It could only have application to the Affected Routes if and when all competitors to Air Canada are driven from the Affected Routes.

E. Avoidable Costs Issues

12. In its Response, Air Canada advocates an approach to avoidable costs which is contrary to the plain wording of the *Airline Regulations*, and which would enable it to operate flights

below avoidable costs for extended periods of time. Such an approach would defeat the purpose of the *Airline Regulations*.

(1) Units of Capacity

13. The Commissioner disputes Air Canada's assertion at paragraphs 7(a) and 53 of its Response, that the only unit of reference for sections 1(a) and (b) of the *Airline Regulations* is a *route* as a whole and not a *flight*.

14. Air Canada's proposed interpretation of sections 1(a) and (b) of the *Airline Regulations* is inconsistent with the wording of those provisions. Sections 1(a) and (b) refer to "operating [or increasing] *capacity on a* route or routes at fares that do not cover the avoidable cost of providing the service" [emphasis added]. Since the Airlines Regulations refer to "capacity on a route" and not simply to the route, something less than the route as a whole is the unit of reference for the purposes of the *Airline Regulations*.

15. Operating a flight on a route constitutes operating "capacity on a route" within the meaning of section 1(a) of the *Airline Regulations*. Adding a flight on a route, or increasing the size of aircraft on a flight constitutes "increasing capacity on a route" within the meaning of section 1(b).

16. Operating a flight below avoidable cost constitutes an anti-competitive act within the meaning of the *Airline Regulations.* In addition, an increase in capacity on a route constitutes an anti-competitive act where the additional revenues, if any, generated by that increase do not cover the incremental costs associated with that increase.

17. An approach which would permit Air Canada to operate flights below avoidable cost so long as its operations on the entire route are above cost, would effectively defeat the purpose of sections 1(a) and (b) of the *Airline Regulations*.

(2) Relevant time periods/avoidable costs

18. The Commissioner disputes Air Canada's argument, at paragraph 55 of its Response, that the appropriate time period for consideration of whether a cost is avoidable by Air Canada is at least one year.

19. Air Canada is able to quickly determine whether a flight is operating profitably, and to avoid the costs associated with that flight in a short time when it chooses to do so, as pleaded in paragraphs 88-91 of the Notice of Application.

20. Air Canada itself effects two major schedule changes per year, in the fall and in the spring, and makes ongoing adjustments to capacity on its routes, including on the Affected Routes, as Air Canada acknowledges at paragraph 61 of its Response.

21. Air Canada's chief executive officer, Mr. Milton has publicly stated that Air Canada has "a lot of flexibility to park or return planes", "good leeway in adjusting [its] labour costs" and "virtually unlimited flexibility to direct capacity to geographic markets where strength exists". Mr. Milton attributed "part of this flexibility [to] the fact that with the acquisition of Canadian [Air Canada] is no longer constrained in its capacity decision making by fears of market share loss to a similarly-sized full service competitor" (February 6, 2001).

22. In this case, Air Canada had ample time to determine that it was operating flights below avoidable costs on the Affected Routes and to make the necessary adjustments to rectify that situation. It chose not to.

23. An approach which would allow Air Canada to offer flights below avoidable costs for an entire year would enable Air Canada to eliminate many competitors, as evidenced by the case of CanJet. It would be contrary to the plain words and the purpose of the *Airline Regulations*.

(3) "Beyond contribution"

24. At paragraph 7(g) Air Canada chastises the Commissioner for not taking into account "the economic contribution which a flight makes to Air Canada's network", also referred to by Air Canada as "beyond contribution".

25. What Air Canada apparently means by this statement is that in determining whether Air Canada has operated flights below avoidable costs, the Commissioner and the Tribunal should artificially increase Air Canada's revenues on flights on the Affected Routes by adding revenues from other flight segments. The Commissioner disagrees with that approach.

26. Revenues from other operations should not be included in calculating revenues from flights on the Affected Routes for the purpose of determining whether Air Canada has operated those flights below avoidable costs for at least the following reasons:

a) Air Canada's dominant position in Canada undermines the basis for including beyond contribution;

b) Including such revenues represents double counting; and

c) There is no accepted way to measure beyond contribution.

F. Fare Matching

27. The Commissioner does not accept Air Canada's argument at paragraph 31 of its Response that matching a competitor's price cannot constitute an anti-competitive act. This position is contrary to the plain words and the purpose of the *Airline Regulations.*

28. Further, as set out at paragraphs 49, 106 and 124 of the Notice of Application, when Air Canada purportedly matches the price set by one of its low cost competitors, it is effectively offering a lower price than that competitor.

G. Effects on CanJet and Royal/Substantial lessening of competition

29. The inability of CanJet and Royal to operate profitably on the Affected Halifax Routes in the face of Air Canada's Response to CanJet is evidence of the effects of Air Canada's anti-competitive acts on these carriers, and on competition.

H. Undertakings to the Minister of Transport

30. Air Canada refers in its Response to the Undertakings it gave to the Minister of Transport in December, 1999, as a condition of the Minister's approval of its acquisition of Canadian Airlines. However, Air Canada has not pleaded that these Undertakings in any way contributed to its pricing or capacity decisions on the Affected Routes. As such, they are not relevant to this Application.

DATED at Toronto, this 19th day of April, 2001

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