

**Air Canada
and
Canadian Airlines Corporation**

A report on the merger situations



COMPETITION COMMISSION

Air Canada and Canadian Airlines Corporation

A report on the merger situations

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Trade and Industry by Command of Her Majesty
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¹These members formed the Group which was responsible for this report under the chairmanship of Mr D Jenkins.

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The omissions are indicated by a note in the text or, where space does not permit, by the symbol ✂.

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Part I

Summary and Conclusions

1 Summary

1.1. On 2 May 2000, the Secretary of State for Trade and Industry asked us to investigate the merger between Air Canada and Canadian Airlines Corporation (CAC)—see Appendix 1.1. At the time of the reference to us, Air Canada was able materially to influence CAC. During the course of our inquiry Air Canada acquired full control of CAC, technically a second merger situation which we were asked to examine by an amendment to the terms of reference on 27 June.

1.2. Air Canada is a Canadian public company with its headquarters in Montreal, Quebec. It operates domestic air services within Canada, and international air services to and from Canada. CAC is also a Canadian public company, and also operated domestic and international air services, mainly through a subsidiary Canadian Airlines International Ltd (Canadian Airlines). Both Air Canada and Canadian Airlines operated air services to and from the UK, overlapping on routes between London Heathrow and Toronto, Vancouver, Calgary and Ottawa. Air Canada is a member of the Star Alliance of airlines and Canadian Airlines was a member of the Oneworld Alliance, which also includes British Airways plc (BA). Before the merger, Canadian Airlines and BA had a code-sharing agreement on all their Canada–UK services, and shared revenue on the Heathrow–Toronto service, with little effective competition between them.

1.3. CAC had been making substantial losses and was experiencing serious cash flow problems. The Canadian Government told us that if CAC failed, it would have caused considerable disruption in a country where some communities were reliant on air transport. It saw little prospect of CAC’s future viability and believed it was necessary to foster a merger between CAC and Air Canada. As a condition of the merger a number of undertakings were given by Air Canada, reinforced by legislative measures, but focused on the provision of domestic services within Canada.

1.4. We analyse the markets affected by reference to the origin and destination of passengers (that is, where they start and finish their air journeys) and by their requirements (namely, the distinction between time-sensitive and price-sensitive passengers). We use the term OD passengers to refer to passengers having their origin and destination for their air journey at the places specified, for example London–Toronto OD passengers refers to a passenger with an origin and destination of London and Toronto.

1.5. As regards OD passengers, it is appropriate in our view first to distinguish passengers with origins and destinations in the UK and Canada from those with other origins and destinations; and then further to distinguish passengers with origins and destinations at particular airports in the UK and Canada. It is also appropriate to distinguish time-sensitive passengers (primarily people travelling for business purposes) from price-sensitive (primarily leisure) passengers, since time-sensitive passengers require greater frequency of services and almost exclusively use scheduled services. Almost 95 per cent of UK–Canada scheduled services operate between London and Canada, and previously only between Heathrow and Canada, although some operators which have recently changed status from charter to scheduled airlines operate from Gatwick and Stansted. There are significant advantages to time-sensitive travellers from using Heathrow because of the greater frequency of flights available there. It is,

however, more difficult for new entrants to acquire slots to operate from Heathrow. Price-sensitive passengers give less weight to factors such as frequency, and are more prepared to use charter carriers, and London airports other than Heathrow.

1.6. The major route with which we are concerned is that between London and Toronto. Following the merger, there has been an increase in concentration on that route even after taking account of the previous arrangements between BA and Canadian Airlines, and Air Canada would now account for about 40 per cent of London–Toronto OD passengers. In the case of price-sensitive passengers, we believe there is effective competition on this route from the redesignated scheduled airlines and from other charter operators, and the prospect of expansion or entry from airlines at Heathrow, Gatwick or Stansted. Air Canada, however, would account for some 71 per cent of time-sensitive passengers between Heathrow and Toronto after the merger. Although there is less competition for such passengers, we believe that there are few constraints on BA expanding its services at Heathrow and that it is able to provide effective competition, as may other operators at Heathrow.

1.7. There has been a more significant increase in concentration on the London–Calgary route. Although there are a number of other services operated between Gatwick and Calgary, competition has been eliminated for time-sensitive passengers between Heathrow and Calgary. On the London–Ottawa route, Air Canada now has a share of almost 90 per cent of OD passengers, and competition has been almost eliminated for time-sensitive passengers. Given the limited number of passengers in these markets, prospects of entry in the market for time-sensitive passengers on these routes are poor.

1.8. An increase by Air Canada in the prorated fares charged to other airlines for through journeys on Air Canada flights has significantly affected competition for such journeys beyond the Canadian gateways. Air Canada's commission override system, which links payments to Canada-based travel agents on the sale of domestic tickets within Canada to their performance in selling international tickets, has also made competition on UK–Canada routes more difficult.

1.9. However, in assessing the effects of this merger, we have to consider what would have happened in the absence of the merger. The only meaningful scenario against which to judge the effects of the merger is the financial failure of Canadian Airlines and its break-up, an alternative regarded as unacceptable by the Canadian Government. Within such a scenario, we see little evidence that other operators would have been able or willing to take on Canadian Airlines' services on the Heathrow–Calgary or Heathrow–Ottawa routes, or to any significant extent the domestic services in Canada which provide flights connecting to the Heathrow–Canada routes. The possible detriments arising from such a lack of competition, as well as Air Canada's increase in its prorated fares and the introduction of its new commission override system, arise as a result of the failure of Canadian Airlines to sustain competition in the Canadian market and on the Canada–UK routes, and irrespective of the merger situations we have to consider.

1.10. We conclude that the merger situations we have investigated do not operate and may not be expected to operate against the public interest.