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Commissioner of Competition

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Projet-Project: N3061

December 21, 1999

Mr. Lawson A.W. Hunter, Q.C.
Stikeman, Elliott
Barristers & Solicitors
50 O'Connor Street, Suite 914
Ottawa, Ontario
K1P 6L2

Dear Mr. Hunter:

Re: **Proposed Acquisition by Air Canada and 853350 Alberta Ltd. (the "Offeror") of Canadian Airlines Corporation**

I am writing in regard to your long-form prenotification filing dated November 19, 1999, pursuant to section 122 of the *Competition Act* ("Act") with respect to the above-noted transaction.

As you are aware, I forwarded on October 22, 1999, a detailed letter to the Minister of Transport setting out my views regarding competition issues arising from a potential restructuring of the Canadian airline industry. The Bureau concluded in that letter that the emergence of a single dominant Canadian air carrier, whether achieved through merger or as a result of the financial failure of Canadian Airlines Corporation ("Canadian"), would raise very significant competition concerns in the Canadian airline industry.

Based on the most recently available information, the Bureau continues to believe that the emergence of Air Canada as a single dominant Canadian airline would raise very significant competition concerns. In particular, a merged Air Canada and Canadian would account for close to 90% of domestic passenger revenues and in excess of 80% of domestic passengers carried. The various barriers to entry identified in my October 22, 1999, letter continue to be of concern.

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Canada

Notwithstanding the foregoing, the key question under the merger provisions of the *Competition Act* is whether there is a competitively preferable alternative, under the existing regulatory framework, to the proposed transaction. In considering this question, due regard must be given both to Canadian's financial situation and to undertakings provided by Air Canada and the Offeror (the "Undertakings" - see attached Annex A).

The Bureau has concluded that Canadian is facing imminent insolvency, necessitating the need for urgent action. The Bureau also acknowledges that there is not likely to be a competitively preferable purchaser of Canadian in the absence of the proposed transaction. Given this situation, and on the basis of the Undertakings provided by Air Canada and the Offeror, the Bureau does not consider that there is a competitively preferable alternative to the proposed transaction. In other words, the proposed transaction with the Undertakings is preferable to the liquidation of Canadian.

In coming to this conclusion, I wish to stress that the Bureau continues to be of the view that significant competition concerns would remain in the Canadian airline industry following completion of the proposed transaction. In my letter of October 22, 1999, I identified four categories of recommendations designed to address competition problems. Only the first category, entitled "Possible Terms of Restructuring", involves matters within the control of Air Canada and Canadian. As such, the Undertakings are designed to address only those matters. The remaining three categories involve recommendations for policy, regulatory and legislative changes which the Bureau believes are important to protect and promote competition in Canada's airline industry. I will continue to advocate the need for such changes.

Based on the foregoing considerations, I am of the view that there are not, at this time, sufficient grounds to initiate proceedings before the Competition Tribunal under the merger provisions of the Act with respect to the proposed transaction. This conclusion is based on our mutual understanding that the Undertakings are legally enforceable, ultimately pursuant to legislation to be introduced before the Parliament of Canada, and in the interim, if necessary, before the Competition Tribunal as a consent order.

Please advise the Prenotification Unit in the Mergers Branch, in writing, of the actual closing date of the transaction.

Yours very truly,



Konrad von Finckenstein, Q.C.

Attachment

ANNEX A

TO: THE COMMISSIONER OF COMPETITION

FROM: AIR CANADA AND 853350 ALBERTA LTD.

WHEREAS,

1. The Offeror and Air Canada have proposed a Transaction whereby Air Canada will acquire control of Canadian Airlines Corporation;
2. Air Canada's acquisition of control of Canadian Airlines Corporation will result in a large concentration of domestic air carrier capacity in Canada; and
3. Air Canada and the Offeror have agreed to take certain steps and to accept certain conditions in order to promote and maintain airline competition in Canada,

THEREFORE, Air Canada and the Offeror hereby undertake the following:

1. Definitions

In this undertaking:

- (a) "Act" means the *Competition Act* (Canada);
- (b) "affiliate" has the same meaning as in the *Competition Act* (Canada);
- (c) "Air Canada" means Air Canada and its affiliates;
- (d) "CAC" means Canadian Airlines Corporation and its affiliates;
- (e) "Canadian Air Carrier" means an air carrier other than Air Canada or CAC operating a domestic service or holding a licence to operate a domestic service within the meaning of the Canada Transportation Act;
- (f) "Chicago Formula" means the airport services cost allocation formula whereby the initial twenty (20) percent of the applicable cost is shared equally among carriers and the remaining eighty (80) percent of said cost is allocated on a passenger volume basis;
- (g) "Commissioner" means the Commissioner of Competition appointed under the *Competition Act* (Canada);
- (h) "CRAL" means Canadian Regional Airlines (1998) Ltd.;
- (i) "IATA" means the International Air Transport Association;
- (j) "Offeror" means 853350 Alberta Ltd. and its affiliates;
- (k) "Transaction" means the series of steps, commencing when the Offeror acquires at least a majority of the voting shares of CAC and including any subsequent steps whereby
 - (i) the Offeror acquires any other securities of CAC or Canadian Airlines International Limited ("CAIL");
 - (ii) Air Canada acquires, directly or indirectly, any or all of the securities of the Offeror, CAC or CAIL; or
 - (iii) Air Canada acquires, directly or indirectly, assets, rights or privileges of CAC, CAIL or their subsidiaries;

such that Air Canada or the Offeror, directly or indirectly, acquires the business of CAC, whether through the acquisition of shares or of all substantially all of the assets of CAC, or CAIL;

- (l) "Transaction Date" means the date on which the Offeror takes up at least a majority of the shares of CAC;

2. Scope and Duration of Undertakings

- (a) Unless otherwise provided herein, these undertakings come into force immediately on the Transaction Date.
- (b) Unless otherwise provided herein, these undertakings expire on the seventh anniversary of the Transaction Date.
- (c) Air Canada and the Offeror agree that except as specifically provided herein, they shall both be bound by all of the undertakings herein.

3. **Majority in Interest Rights**

Air Canada and the Offeror shall not exercise any majority in interest rights related to the collection of airport improvement fees at any airport in Canada other than at Lester B. Pearson International Airport, Vancouver International Airport, Montreal Dorval International Airport, Montreal Mirabel International Airport, and Calgary International Airport, unless air carriers including Air Canada representing at least eighty (80) percent of enplanements at that airport desire to exercise their majority in interest rights.

4. Change to Chicago Formula

Air Canada and the Offeror shall use their best efforts to convert the cost allocation formula for those airport services that are subject to the Chicago Formula to a formula which allocates 100% of costs on a passenger volume basis, at all airports in Canada, with the exception of the following airports: Lester B. Pearson International Airport, Vancouver International Airport, Dorval International Airport, Mirabel International Airport, Calgary International Airport, Edmonton International Airport, MacDonal-Cartier Ottawa International Airport, Halifax International Airport, and Winnipeg International Airport.

5. **Transfer of Surplus Aircraft**

- (a) For a period of three years following the Transaction Date, Air Canada or the Offeror, as the case may be, shall make all aircraft that are surplus to Air Canada's or CAC's reasonable operating requirements available for purchase by Canadian Air Carriers at prices equal to the value of the aircraft as determined by a qualified appraiser selected by Air Canada.
- (b) If Air Canada or the Offeror wishes to accept an offer to acquire an aircraft from persons other than Canadian Air Carriers, Air Canada or the Offeror shall first give Canadian Air Carriers seven (7) business days to match such offer, and shall sell the aircraft that are subject to the offer to a Canadian Air Carrier who matches or betters such offer in all material respects. If no Canadian Air Carrier matches or betters such offer within the seven (7) business day period, Air Canada or the Offeror may dispose of the aircraft that are subject to the offer to the non-Canadian Air Carrier offeror. Dispositions of leased aircraft pursuant to this article are subject to the concurrence of any third-party aircraft owner or lessor. Neither Air Canada nor CAC shall be obliged to assume any ongoing liabilities to such third-party aircraft owners or lessors.

6. Travel Agent Commission Overrides

- (a) The trigger mechanism for all travel agents who qualify for incentive override commissions offered by Air Canada and CAC shall not be based on revenue performance for domestic services, but solely on Transborder/U.S.A. and International route revenues.
- (b) Incentive override commissions paid by Air Canada and CAC in respect of their domestic services, shall be on a straight-line percentage basis applied to the travel agent's domestic revenue volumes and not on market share targets.
- (c) This undertaking comes into effect on June 1, 2000, and remains in effect for five years from that date.

7. Access to Aeroplan

Commencing as soon as reasonably possible and in any event not later than October 1, 2000, and continuing for a period of 5 years from the date of its first sale of frequent flyer plan ("FFP") points pursuant to this undertaking, Air Canada shall sell its FFP points to eligible Canadian Air Carriers, subject to the following conditions:

- (a) Air Canada shall sell its FFP points on commercially reasonable terms taking into account prices charged by Air Canada on the sale of such points to third parties and, in particular, other air carriers;
- (b) Air Canada shall sell its FFP points in accordance with the accumulation program then applicable to its FFP;
- (c) In its agreements to sell FFP points entered into pursuant to this undertaking, Air Canada shall be entitled to an implementation period of up to three (3) months before selling any FFP points.
- (d) Purchasers of FFP points from Air Canada may not resell such points;
- (e) Air Canada may not impose any restrictions on the ability of such purchasers of FFP points to participate in other reward programs;
- (f) An eligible Canadian Air Carrier shall be any Canadian Air Carrier which has annual revenues from domestic passenger services of less than \$250 million, which is not owned or affiliated with a foreign air carrier, and which meets reasonable industry standards related to safety, service and quality;
- (g) Air Canada FFP points awarded by an eligible Canadian Air Carrier shall be redeemable on all flights operated by Air Canada or any of its affiliated regional carriers, but not on flights operated by any of its codeshare or alliance partners.
- (h) Subject to paragraph (i), after one year following the time when an eligible Canadian Air Carrier ceases to be eligible to purchase FFP points from Air Canada, Air Canada shall not be obliged to continue selling FFP points to that carrier. Air Canada shall honour all FFP points sold to that carrier.
- (i) If Air Canada determines that an eligible Canadian Air Carrier has ceased to meet reasonable industry standards related to safety, service and quality, Air Canada shall provide specific notice of its concerns to such Canadian Air Carrier who will have a period of thirty days from

such notification to meet reasonable industry standards related to safety, service and quality. If such Canadian Air Carrier fails to meet reasonable industry standards within that period, Air Canada shall not be obliged to continue to sell FFP points to such Canadian Air Carrier. Air Canada shall honour all FFP points sold to that carrier.

8. Surrender of Airport Facilities

- (a) For all airports where Air Canada and CAC collectively have exclusive or preferred use of more than 60% of ticketing/check-in positions (including those airports listed in Schedule A), other than Lester B. Pearson International Airport, Air Canada or the Offeror shall offer for sale to the relevant airport authority or Transport Canada, as the case may be, or otherwise make available for common use at least 25% of the ticket counters and check-in counters currently held by CAC. Fractions shall be rounded up to the nearest integer.
- (b) At Montreal Dorval International Airport, Air Canada or the Offeror shall offer for sale to Aéroports de Montréal, or otherwise make available for common use, gates 37, 38, and 39, including the loading bridges and other facilities associated with those gates or such three (3) loading bridges, gates and related facilities as are acceptable to the Commissioner.
- (c) At Winnipeg International Airport, Air Canada or the Offeror shall offer to sell to the Winnipeg Airports Authority, or otherwise make available for common use, one (1) gate including the loading bridge and other facilities associated with that gate.
- (d) At Halifax International Airport, Air Canada or the Offeror shall offer to sell to Transport Canada or the airport authority, as the case may be, or otherwise make available for common use, one (1) gate including the loading bridge and other facilities associated with that gate.
- (e) At Lester B. Pearson International Airport, Air Canada or the Offeror shall offer to sell to the Greater Toronto Airports Authority, or otherwise make available for common use, four gates at Terminal 3 currently used by CAC or American Airlines, including the loading bridges and other facilities associated with such gates. In no circumstances shall the number of gates to be made available hereunder be less than four (4).
- (f) These offers shall remain open for one (1) year, and for those airports which have not yet transferred to an airport authority, for at least 6 months following transfer. Subject to paragraph (b), the designation of facilities to be made available for common usage shall be at Air Canada's or the Offeror's discretion.

9. Interlining and Joint Fare Agreements

(a) Air Canada shall:

- (i) enter into interlining agreements in accordance with IATA standards; and
- (ii) in good faith, negotiate Joint Fare Agreements on commercially reasonable terms, in connection with such interlining agreements

with any Canadian Air Carrier that so requests, provided that such carrier is an IATA member who settles interline payments through the IATA clearing house system and meets reasonable industry standards related to safety, commercial reasonableness and level of service.

(b) Joint Fare Agreements negotiated pursuant to this undertaking shall provide for the following:

- (i) the establishment of joint through fares and division of revenues (prorates);
- (ii) the entitlement of a travel agent or carrier to sell the combined services of the participating carriers to the agreement;
- (iii) the display of joint through fares on computer reservation systems; and
- (iv) the right to file joint through fares with Air Tariff Publishing Company or other recognized tariff publisher.

10. Eastern Canadian Discount Carrier

- (a) Air Canada shall not directly or indirectly commence any discount air carrier operations which offer any domestic service flights originating or terminating in Eastern Canada, including points in Ontario, prior to September 30, 2000.
- (b) If another Canadian Air Carrier (other than WestJet) commences a bona fide discount air carrier operation offering domestic service flights in Eastern Canada including points in Ontario prior to September 30, 2000, the prohibition in paragraph (a) shall continue until September 30, 2001. If no other Canadian Air Carrier (other than WestJet) commences a bona fide discount air carrier operation offering domestic flights in Eastern Canada including points in Ontario prior to September 30, 2000, the prohibition in paragraph (a) shall terminate on September 30, 2000.
- (c) Air Canada further undertakes that it will, at the option of any discount air carrier offering or planning to offer domestic service flights in Eastern Canada, release, assign or sublease facilities it has leased at John C. Munro Hamilton International Airport, to such discount air carriers which require facilities at John C. Munro Hamilton International Airport, including WestJet, at a price, if applicable, equal to Air Canada's cost, to allow such discount air carriers to commence and maintain operations at John C. Munro Hamilton International Airport. Air Canada undertakes to waive any right of first refusal it may have on additional space at John C. Munro Hamilton International Airport, if such other discount air carriers require such additional space.
- (d) For greater certainty, and subject to Air Canada's obligation in paragraph (c), it is understood that nothing in this undertaking prevents Air Canada from commencing a transborder only discount service at any time.
- (e) In this undertaking, Eastern Canada means all points in Canada east of the Manitoba-Ontario border.

11. Slots

Air Canada shall make slots at Lester B. Pearson International Airport available to the slot co-ordinator for assignment to other Canadian Air Carriers in accordance with the following terms:

- (a) If CRAL is sold, the number of slots to be made available is 8 slots in total during the two hour period between 7:00 and 9:00 a.m., and 20 slots in total during the five hour period between 3:00 and 8:00 p.m., provided that at least 2 slots shall be made available in each hour.
- (b) If CRAL is not sold, the number of slots to be made available is 12 slots in total during the two hour period between 7:00 and 9:00 a.m., and 30 slots in total during the five hour period between 3:00 and 8:00 p.m., provided that at least 3 slots shall be made available in each hour.
- (c) Air Canada shall make these slots available according to the following procedure:
 - (i) A Canadian Air Carrier that is unable to obtain a slot from the slot co-ordinator within 45 minutes on either side of its desired time for a domestic flight may request that the slot co-ordinator obtain a slot from Air Canada.
 - (ii) Such requests may be made at either the June 2000 or the November 2000 IATA slot allocation meetings.
 - (iii) Upon being informed by the slot co-ordinator of a request for a slot, Air Canada shall make a slot available within 45 minutes on either side of the time requested by the requesting Canadian Air Carrier.

12. CRAL Divestiture

Air Canada and the Offeror shall offer CRAL for sale in accordance with the process set out below and shall use their best efforts to sell CRAL on the following terms:

- (a) within ten (10) days following the Transaction Date, Air Canada and the Commissioner shall each designate a person to value CRAL and oversee its sale;
- (b) if, within a further twenty (20) days, the designated persons chosen by Air Canada and the Commissioner have not reached agreement on the appropriate structure and fair market value for CRAL, they shall choose a third designated person within an additional five (5) days;
- (c) within a further fifteen (15) days, the third designated person, in consultation with the other designated persons, shall determine the appropriate structure and fair market value for CRAL;
- (d) CRAL shall then be offered for sale in accordance with the structure as determined above, for a period of sixty (60) days (the "offer period");
- (e) Air Canada and the Offeror shall sell CRAL to the person who offers the highest price at or above the fair market value of CRAL as determined above, within the offer period;
- (f) in the event that there are no offers received during the offer period at or higher than the fair market value of CRAL as determined above, Air Canada and the Offeror shall have no further obligation to sell CRAL;
- (g) during the sale process set out above, and for a transition period of twelve months following the sale of CRAL, Air Canada and the Offeror shall continue to provide or cause CAIL to provide business, operational and marketing support services to CRAL at current levels on existing terms during the sale process and on commercially reasonable terms during the transition period;
- (h) pending the outcome of the sale process described above, and subject to paragraph (i) below, Air Canada and the Offeror shall not sell or transfer any of CRAL's rights or assets as they existed on December 18, 1999 or encumber CRAL with any liabilities other than those incurred in the normal course of business;
- (i) the sale of CRAL shall not include the slots currently held by CRAL at Lester B. Pearson International Airport during the two hour period

between 7:00 and 9:00 a.m., and the five hour period between 3:00 and 8:00 p.m., which Air Canada shall be entitled to assume from CRAL. Air Canada shall not oppose the acquisition by CRAL of other slots at Lester B. Pearson International Airport at other hours, and

- (j) it shall be a condition of the sale of CRAL that the purchaser assume any commitments that Air Canada or the Offeror has made to the Government of Canada to continue to provide service to small communities served only by CRAL as of December 18, 1999.

13. Review

- (a) Air Canada and the Offeror make these undertakings on the understanding that they and the Commissioner will review these undertakings three (3) years after the Transaction Date to determine whether Air Canada or the Offeror, as the case may be, should be relieved of any or all of the undertakings herein, or whether any undertaking should be changed or altered, due to a change in circumstances or otherwise.

14. Arbitration

- (a) Air Canada and the Offeror agree that either of them or the Commissioner may submit arbitrable issues to arbitration before a single arbitrator.
- (b) Arbitrable issues are those related to airline industry standards, commercial reasonableness and other similar issues, together with any other issue that Air Canada or the Offeror, as the case may be, and the Commissioner agree to submit to the arbitrator, including, without limiting the generality of the foregoing,
 - (i) issues concerning whether terms sought by Air Canada in negotiating for the sale of FFP points pursuant to undertaking 7 are commercially reasonable;
 - (ii) issues concerning whether a Canadian Air Carrier is an eligible Canadian Air Carrier pursuant to undertaking 7, and, in particular, whether a Canadian Air Carrier does not meet reasonable industry standards related to safety, service and quality;
 - (iii) issues concerning whether another Canadian Air Carrier has commenced a bona fide discount air carrier operation within the meaning of undertaking 10(b);
 - (iv) issues concerning whether terms sought by Air Canada in negotiating interlining agreements are in accordance with IATA standards;
 - (v) issues concerning whether terms sought by Air Canada in negotiating Joint Fare Agreements pursuant to undertaking 9 are commercially reasonable or in good faith;
 - (vi) issues concerning whether a Canadian Air Carrier that requests that Air Canada enter into an interlining agreement or Joint Fare Agreement with it pursuant to undertaking 9 meets reasonable industry standards related to safety, commercial reasonableness and level of service; and
 - (vii) issues concerning business, operational and marketing support services provided to CRAL during the sale period and transition period provided for in undertaking 12 (g).

- (c) The arbitrator shall be appointed by agreement of the Commissioner and Air Canada prior to the Transaction Date. In the absence of an agreement to appoint the arbitrator by the Transaction Date, Air Canada and the Commissioner shall each designate a person to appoint the arbitrator, within three (3) days of the Transaction Date. These two designated persons shall appoint the arbitrator within three (3) days thereafter. In the absence of an appointment within that three (3) day period, the Commissioner, Air Canada or the Offeror may apply to have the arbitrator appointed by the Institut d'Arbitrage et de Médiation du Québec, which appointment shall be accepted by the Commissioner, the Offeror and Air Canada.
- (d) In the event of the death, resignation or permanent incapacity of the arbitrator, Air Canada shall come to an agreement with the Commissioner appointing a new arbitrator as soon as possible. If the arbitrator has proposed a successor, that person shall be nominated the arbitrator unless both Air Canada and the Commissioner agree to appoint someone else.
- (e) The arbitrator shall determine the procedure to be used in conducting any arbitration.
- (f) Air Canada and the Commissioner shall each pay one half of the costs of any arbitration.

15. Formal Restructuring or Liquidation of CAC

Unless a court of competent jurisdiction otherwise determines, the undertakings made herein by Air Canada and the Offeror shall survive any bankruptcy or court supervised restructuring of CAC provided that Air Canada directly or indirectly acquires the majority of the assets of CAC or CAIL through such bankruptcy, court supervised restructuring or otherwise. Air Canada, the Offeror and the Commissioner reserve the right to make representations respecting the status of the undertakings to the court supervising the bankruptcy or restructuring.

16. Enforcement


- (a) Air Canada and the Offeror understand that the Government of Canada intends to seek legislation which will provide for the enforcement of these undertakings.
- (b) Air Canada and the Offeror further agree that if they fail to meet or fulfil any of these undertakings prior to or in the absence of the legislation referred to in paragraph (a) being enacted, the Commissioner may apply to the Competition Tribunal for an order enforcing these undertakings, to which Air Canada and the Offeror irrevocably consent.
- (c) Air Canada and the Offeror agree that in any application to the Competition Tribunal for an order to enforce these undertakings, they and the Commissioner shall be bound by any prior relevant determinations by the arbitrator.

17. General


- (a) Nothing in these undertakings shall be taken as an admission now or in the future of any facts, or shall prevent Air Canada or the Offeror from making any submissions or legal arguments, for any purposes other than the enforcement of these undertakings, including any other application or enforcement action taken by the Commissioner or the Attorney-General of Canada under the Act, or any other Act of Parliament or otherwise.
- (b) Except as provided for in undertakings 16(b) and (c) above, nothing in these undertakings shall derogate from any rights or defences of Air Canada under the Act, or any other Act of Parliament or otherwise.
- (c) Air Canada acknowledges that the acceptance of these undertakings by the Commissioner does not derogate from the Commissioner's authority to take enforcement action under the Act except as provided for in undertaking 16 (c) above.

DATED at Montreal, Quebec, the 20th day of December, 1999

AIR CANADA

Per: 
ROBERT A. MILTON
PRESIDENT + C.E.O.

853350 ALBERTA LTD.

Per: 
ROBERT A. MILTON
CHAIRMAN

SCHEDULE A

**List of Communities with Airports
where the combined share in total airport ticketing/check-in counters
of Air Canada, CAC, and owned affiliates exceeds 60%**

Campbell River
Castlegar
Comox
Cranbrook
Dawson Creek
Ft. Nelson
Ft. St. John
Grande Prairie
Kamloops
Kelowna
Lethbridge
Moncton
Ottawa
Penticton
Prince George
Rainbow Lake
Regina
St. John
Terrace
Winnipeg

The above list is based on currently available information. Other airports that meet the criteria may be added.