

II. THE CURRENT SITUATION

At present, under the current scheduled air services agreement and the RLCS agreement, transborder services are provided on 83 city pairs. Canadian carriers operate exclusively on 26 of these routes while U.S. carriers have exclusivity on 39. Carriers from both countries are designated to operate on 18 of these city pairs. Currently, there are more than 13 million passenger trips annually between the two countries, generating approximately \$2.3 billion in revenue. American carriers handle over 60% of the transborder traffic and earn approximately \$500 million more annually than do Canadian carriers from this market. Furthermore, U.S. carriers have direct access to 90% of Canada's population while Canadian carriers can only reach 30% of the U.S. market.

Obviously, one of the reasons for the current imbalance in market shares is the imbalance in the number of bilateral routes awarded to the airlines of each country. Apart from this, certain structural competitive advantages have enabled American carriers to maintain their dominance and improve their market share. This has occurred through the development, since deregulation, of the "hub-and-spoke" system in the United States and preclearance of transborder passengers in Canada.

Because of the size of the U.S. population and its relatively even distribution, large U.S. carriers have been able to establish major hubs. These airlines channel their traffic into these hubs, consolidate it and then distribute it to numerous points within their networks. As a result of consolidation and competition, several "mega" American carriers have emerged. Through their sheer size, their computer reservation systems, control of feeder airlines, control of gates and slots, and frequent flyer programs, they have managed to create "fortress hubs" which can effectively block the entry of potential competitors.

Some of these major hubs, such as Chicago, are designated gateways for transborder traffic originating in Canada. Once the traffic has arrived in Chicago, it is consolidated with domestic American traffic and then distributed by the American carrier to all of its domestic and international destinations "behind/beyond" the gateway hub. For example, this enables an American carrier in the Toronto—Chicago market to mount more daily frequencies because a substantial portion of the traffic is not destined to Chicago but beyond to the many points within its extensive network. Another form this phenomenon takes is through the creation of "fictitious" hubs. On the Toronto—Rochester route, for example, although only a small segment of the traffic is actually destined for Rochester, the American carrier mounts several frequencies a day because the vast majority of the traffic is dispersed to other destinations. In contrast, a Canadian carrier can only carry traffic to Chicago or Rochester and not beyond. This can only be done by interlining or connecting with a U.S. carrier at the hub. Therefore, there is a strong incentive for the behind-the-gateway traffic to use a U.S. carrier to avoid interlining with the attendant delays, greater risk of baggage loss, etc.