BEFORE THE
FEDERAL AVIATION ADMINISTRATION
DEPARTMENT OF TRANSPORTATION

NOTICE OF PETITION FOR WAIVER OF THE TERMS OF THE ORDER LIMITING SCHEDULED OPERATIONS AT LAGUARDIA AIRPORT AND SOLICITATION OF COMMENTS ON GRANT OF PETITION WITH CONDITIONS

Docket No. FAA-2010-0109

REPLY COMMENTS OF THE UNITED STATES DEPARTMENT OF JUSTICE

PUBLIC VERSION

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I. INTRODUCTION

In a Notice dated February 18, 2010, the Federal Aviation Administration ("FAA") sought comments on its tentative decision to grant, subject to certain conditions, a request by Delta Air Lines ("Delta") and US Airways (collectively, "the parties") for a waiver from the prohibition on permanent transfer of operating authorizations ("slots" or "slot interests") at LaGuardia Airport ("LGA").[1] The Department of Justice ("DOJ"), Southwest Airlines, Virgin America, and others filed comments generally supporting the FAA's tentative decision.[2] The parties, as well as several legacy airlines with substantial slot holdings at the two airports, filed

[1]Petition for Waiver of the Terms of the Order Limiting Scheduled Operations at LaGuardia Airport, 75 Fed. Reg. 7,306 (proposed Feb. 18, 2010) ("Notice"). The parties proposed a permanent exchange of slots in which US Airways would transfer 140 pairs of slots at LGA to Delta and Delta would transfer 42 pairs of slots to US Airways at DCA ("the transaction"). The FAA's tentative decision allows the transaction to proceed on the condition that the airlines sell 14 slot pairs at DCA and 20 pairs at LGA.

[2]Docket No. FAA-2010-0109: Comments of the United States Department of Justice (March 25, 2010) ("DOJ Comments"); Comments of Southwest Airlines Co. (March 22, 2010); Comments of Virgin America Inc. (March 22, 2010); Comments of Congresswoman Louise M. Slaughter (March 22, 2010).

comments challenging the FAA's statutory, factual, and analytical bases for imposing the proposed conditions.[3]

In addition to comments responding to the initial waiver petition and FAA's tentative decision, the parties filed joint comments with four other airlines in support of a proposed modified transaction under which the parties would divest 15 LGA and 4.5 DCA slot pairs to these airlines if, and only if, FAA approved the parties' proposed transaction (the "Modification Proposal"). Specifically, the parties would transfer a total of 15 LGA slot pairs (in three groups of five) to Spirit Airlines, Inc. ("Spirit"), Westjet, An Alberta Partnership, ("Westjet"), and Air Tran Airways, Inc. ("AirTran") and 4.5 DCA slot pairs to JetBlue Airways Corporation ("JetBlue").[4]

DOJ offers these reply comments in support of the FAA's tentative decision. As explained in our initial Comments and in the tentative decision itself, the FAA has sufficient statutory authority and factual bases upon which to conclude that waiver of its prohibition on permanent slot transfers to facilitate the parties' transaction without conditions would not be in the "public interest." Below, we offer comments on some of the parties' key arguments.

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[3]Docket No. FAA-2010-0109: Comments of Delta Air Lines, Inc. and US Airways, Inc. (March 22, 2010)("Parties' Comments"); Comments of Continental Airlines, Inc. (March 22, 2010)("Continental Comments"); Comments of United Airlines, Inc. (March 22, 2010)("United Comments"); Comments of American Airlines, Inc. (March 22, 2010)("American Comments"). The Port Authority of New York and New Jersey questions FAA's analysis but supports the proposed remedy, Comments of the Port Authority of New York and New Jersey (March 22, 2010).

[4]Docket No. FAA-2010-0109: Joint Comments of Air Tran Airways, Inc., Spirit Airlines, Inc., JetBlue Airways Corporation, WestJet, An Alberta Partnership, Delta Air Lines, Inc., and US Airways, Inc. in Support of Waiver Petition of Delta and US Airways (March 22, 2010).

II. FAA DIVESTITURES OFFSET HARM WHILE PRESERVING PURPORTED EFFICIENCIES

The parties claim that the slot divestitures proposed by the FAA would seriously undermine the purported benefits of the transaction and that these lost benefits would "swamp" the gains from divesting the slots to new entrants.[5] Logic, the parties' own analysis, and their Modification Proposal strongly suggest the opposite -- the proposed FAA divestitures would offset the transaction's harm to consumers while allowing the parties to achieve nearly all the transaction's purported benefits.

The parties submit that the 14-slot divestiture at DCA could cause US Airways to drop the least profitable new flights from its transaction-related expansion plans [redacted] The parties base their claim of substantial harm from the divestiture by focusing primarily on "passenger counts" – *i.e.*, comparing the number of passengers they assume would have flown US Airways on the proposed DCA routes most likely to be "dropped" from the plan as a result of the divestiture, compared to those passengers Delta currently flies on the overlap routes most likely to be harmed as a result of the transaction: [redacted] They use the passengers US Airways predicts it would carry on the dropped flights as a proxy for the lost consumer benefits resulting from the divestiture, and they use the passengers Delta currently

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[5]Parties' Comments at 28-29; *Id.* at Confidential Appendix A, at 25.

[6]Parties' Comments, Appendix A at 25-27. [redacted]

carries in the DCA overlap routes where competition will be lost as a result of the proposed transaction as the proxy for the benefits that can be expected from divestiture and reassignment of the slots to entrants.

Such a comparison, though, tells us little about overall consumer benefits and harms from the divestiture of slots, which under the DOT/FAA Order will go to LCCs. By using Delta's pre-transaction use of the slots as a proxy for the benefits of a divestiture, the parties' analysis ignores the significant impact of LCCs on prices and passenger volumes relative to legacy carriers.

Although the parties' comparison does not assign a value to the customer switching they assume would occur between these two scenarios, their overall benefits methodology does try to quantify the value of consumer switching.[7] When applied to the divestiture proposal, however, such an exercise actually confirms that the proposed divestitures would substantially benefit consumers. [redacted]

[7]However, as noted in the DOJ Comments, at 16-18, the parties' benefits estimations use incorrect baselines, or "but-for world" against which to compare their promised capacity and traffic gains. Further, the parties' claim that they used a benefit methodology "adopted by the [DOJ]," to assess the benefits of the transaction. Parties' Comments at 26. In fact, DOJ has not "adopted" any particular methodology to measure benefits for every airline-related transaction, and in any event the methodology referred to captures only one aspect of what would have to be a multifaceted analysis of costs and benefits.

[redacted]

DOJ used the same frequency reduction scenario advanced by the parties, but took account of the LCC factor in conducting its analysis of the proposed divestiture. Not surprisingly, DOJ reached a very different conclusion -- the aggregate impact on consumers from the proposed divestiture would be strongly positive.[9]

Delta's planning and model results regarding its LGA plans were not at all transparent, and we have consequently been unable to evaluate in detail the parties' assertions about their traffic predictions for LGA routes that would be affected by divestitures. However, their arguments about the net effect of LGA divestitures are based on the same logic, and suffer from the same methodological biases and faulty assumptions as their arguments about the DCA divestitures.

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[8] [redacted]

[9] *See* DOJ Comments, at 19 and Appendix A, Section D ("Effects of Proposed Divestiture on Parties' Route Choices").

The Modification Proposal further undermines the parties' assertions with respect to the damaging effects of divestitures. The parties have repeatedly suggested to both DOJ and FAA that the transaction as originally proposed was so complex and carefully calibrated that they would abandon the deal rather than make any changes to accommodate divestiture conditions.[10] In its Comments, the DOJ argued that such divestitures likely were feasible, and the parties' Modification Proposal confirms this. The proposed divestitures illustrate that, even after divestitures to offset competitive harm, the parties believe they would achieve enough of the transaction's purported benefits to make it worth pursuing. The FAA should therefore view the parties' suggestions that no further divestitures are possible with some skepticism.

III. THE MODIFICATON PROPOSAL WARRANTS CAREFUL EXAMINATION

Although the Modification Proposal should, in principle, introduce additional competition at LGA and DCA, the structure and terms of the slot sales to AirTran, Spirit, WestJet, and JetBlue raise concerns that the sales were designed by the parties to minimize the sales' effect on competition. The joint comments do not provide many details concerning the proposed transactions, but they do state that the transfers to AirTran and Spirit could be delayed for as long as two years (at the recipients' request) and that the transfer to WestJet could be postponed by as many as 28 months.

We recognize that the proposed recipients of these divested slots are low-cost competitors, and that their use of the slots would most likely be more efficient, from a consumer

[10] *See* Parties' Comments at 27-29; Letter from Richard B. Hirst to Susan Kurland, Robert Rivkin and J. David Grizzle (January 29, 2010) ("Hirst Letter"), at 5.

benefit standpoint, than the use to which the slots would be put by the parties under the transaction as originally proposed. However, the circumstances and limited disclosed terms of the proposed transfers strongly suggest that the divestitures were structured to minimize the potential competitive effect on Delta and US Airways, and consequently the potential benefits for consumers. The FAA may wish to examine the details of the proposals, including the agreements themselves and surrounding circumstances, to evaluate their likely effects.[11]

The proposed divestitures raise a number of concerns. First, the size of the proposed divestiture, 15 LGA slot pairs and 4.5 DCA slot pairs, is significantly smaller than that originally proposed by the FAA, 20 LGA slot pairs and 14 DCA slot pairs. Even under the FAA's tentative decision, the number of divested slots was somewhat small relative to the size of the transaction and the magnitude of the concentration increase. One justification for this may be the significantly greater effect that LCC entry has relative to legacy entry. Numerous studies, including Appendix A, Section A to DOJ's initial Comments, have shown that even a relatively small level of LCC entry can have a very large effect on prices and demand in a market.[12] However, the FAA needs to consider carefully whether the net benefits promised by such a substantially reduced divestiture package are sufficiently large to offset anticipated harms from the underlying transaction. As the size of the divestiture decreases, it becomes even more

[11]In merger investigations where parties propose divestiture to address competitive problems with a transaction, DOJ finds it relevant and useful to examine issues such as alternatives proposed and considered, plans of the acquirer for the divested assets, and the rationale for the parties' decision to contract with the proffered recipients.

[12] [redacted]

important to ensure that the divested slots go to uses that maximize efficiency and consumer benefit.

Moreover, some of the terms and circumstances of these proposals, particularly those involving LGA, raise concerns that the parties may have structured their divestitures to minimize competitive threats to themselves and undercut the benefits of divestitures for consumers. To begin with, each of the three proffered recipients of LGA slots has requested a delay of up to two years or more to acquire and begin using their slots.[13] Such a delay significantly reduces the potential benefits of the divestiture, as each month of delay is a month without the new LCC service. The recipients' requests for such delays also suggest that none of them has very thoroughly evaluated market opportunities, let alone made any concrete plans for use of the slots.

[redacted]

[13]By way of comparison, FAA has granted a use or lose grace period of 3 months to accommodate service start-up for slots awarded through lotteries under the High Density Rule since 1992. See 14 C.F.R. § 93.227 (West 2005) (new entrants are given a 90 day grace period, while limited and other incumbents are given 60 days).

[14] [redacted]

[redacted]

DOJ believes that the blind, cash-only sales process proposed in the FAA's tentative decision, with the modifications previously suggested by DOJ, would better ensure that the slots are divested to carriers likely to generate the greatest consumer benefit from the use of the slots.

IV. COMPETITION FROM NEARBY AIRPORTS WILL NOT COMPLETELY OFFSET LOST COMPETITION BETWEEN US AND DELTA AT DCA AND LGA

The parties argue that the three Washington area airports and the three New York area airports are "competitively linked" and that they serve as a constraint on one another, citing unpublished research that purports to show that fares at a given airport are constrained by LCC service at an adjacent airport.[16] While it is true that some passengers, leisure passengers in particular, may view adjacent airports as substitutes to some degree, nothing in the parties' various submissions refutes the notion that flights out of DCA (or LGA) provide closer competition to other flights out of DCA (or LGA) than do flights out of IAD and BWI (or JFK and EWR), and thus that market power can be exercised at DCA (or LGA) against some

[15]*See*, DOJ Comments at 8-9.

[16]Parties' Comments at 34, *citing* Darin Lee, Jan Brueckner, and Ethan Singer, "Airline Competition and Domestic US Airfares: A Comprehensive Reappraisal," 2010 Hamburg Aviation Conference, *available at* http://www.hamburg-aviation-conference.de/pdf/present2010/Session-V-Darin-Lee.pdf.

passengers despite of the presence of competition from the other two nearby airports.[17] In fact, the unpublished study on which the parties rely finds that LCCs at the same airport provide much greater competition than LCCs at adjacent airports.[18] Such a finding, if applicable to LGA and DCA, would appear to support FAA's conclusion that service at those airports is significantly differentiated from service at nearby airports. This conclusion is also buttressed by the fact that JetBlue has agreed [redacted] when it already offers significant service from both IAD and BWI.

The Compass Lexecon price correlation study presented by the parties purports to demonstrate economic linkages between the three Washington and the three New York airports through correlation in the prices between the sets of airports. This evidence also is unconvincing on the basic questions relevant to the FAA's analysis. One major flaw in the Compass Lexecon approach is that the parties do not define the level of correlation in fares that would place the airports in the same relevant market, such that market power could not be exercised at DCA (or

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[17]Contrary to the parties' assertions, these conclusions are entirely consistent with the DOJ's approach to market definition in prior airline investigations. *See, e.g.*, United States v. AMR Corp., 140 F. Supp. 2d 1141 (D. Kan. 2001), aff'd, 335 F.3d 1109 (10th Cir. 2003)(alleging that airport pairs, including DFW-DCA, DFW-IAD, and DFW-BWI, were distinct markets). As explained by a former Assistant Attorney General, "'. . . while some travelers may be indifferent as to which of several airports in a city they use, others might not switch to a flight using an alternative airport even if the fares on flights using the most convenient airport were to increase significantly. As a result, there can be instances in which the relevant market is limited . . . to the flights using a specific airport in a large city." Anne Bingaman, Consolidation and Code Sharing: Antitrust Enforcement in the Airline Industry, available at http://www.justice.gov/atr/public/speeches/speech.akb.htm (January 25, 1996).

[18]Lee, Brueckner, and Singer, *supra* (reporting fare impacts from LCC presence within an airport pair that are roughly twice the magnitude of impacts from LCC presence in adjacent airport pairs). The details of this study are not available, and its reported results do not provide a reliable basis for reaching any conclusions on this or other issues. We cite these results here simply to point out that the parties' own cited sources appear to contradict some of their key arguments.

LGA) independently of BWI and IAD (or JFK and EWR). It is not surprising that there is some correlation among fares at nearby airports, and more correlation than one would find among three random airports. That fact alone does not, however, show whether fares at DCA or LGA are constrained by fares at nearby airports.[19]

V. DOT REVIEW OF COMPETITION EFFECTS DOES NOT INTERFERE WITH DOJ AUTHORITY

The parties and others argue that DOT/FAA has no statutory authority to consider competition-related issues in deciding whether the waiver request is in the public interest.[20] As part of this argument, the parties claim that if the FAA assesses effects of the transaction on competition, it will usurp DOJ's exclusive authority to review the transaction under Section 7.[21] With respect to the broader argument, we defer to the agency's interpretation of its public interest standard and note that parties' contentions are contradicted by literally decades of FAA actions that have invoked competitive considerations in connection with ensuring the safe and efficient use of airspace.[22] The parties' claims are particularly ironic here given that the specific

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[19]Another problem with testing price correlations is that correlation between airport prices can be caused by many factors other than demand-side substitution by consumers between products at those markets, which is the relevant question for market definition. Though Compass Lexecon purports to control for common demand and supply factors across their airports, their controls are weak, and would not, for example, remove the correlation in fares caused by a marketing campaign for a particular vacation destination across the entire DC region. Thus whatever correlation they do find is not necessarily a result of passenger substitution between airports, which is the relevant question for determining how much of a price constraint the airports offer to one another.

[20]Parties' Comments at 7-18; Continental Comments at 2-7; United Comments at 3-11.

[21]*See* Parties' Comments at 12-15.

[22]*See, e.g.*, High Density Traffic Airports; Slot Allocation and Transfer Methods, 51 Fed. Reg. (continued...)

restriction from which the parties now seek a waiver has been opposed by the parties on the grounds that the FAA should have adopted alternatives that would better promote competition.[23] Interestingly, before the Notice was issued in this matter, Delta was urging DOT/FAA to undertake a broad analysis of the competitive effects of this transaction as part of its "independent obligation to evaluate the application under its broader transportation policy mandates [...]."[24]

As to the more narrow exclusive jurisdiction argument, DOJ's participation in this proceeding should demonstrate that DOJ does not believe that there is any conflict between DOT/FAA's consideration of competition policy in its public interest inquiry and the DOJ's

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[22](...continued)
52,180 (Dec. 20, 1985) (discussing competitive considerations and entry issues at length in connection with institution of "buy-sell" rule); High Density Traffic Airports; Slot Allocation and Transfer Methods, 57 Fed. Reg. 37,308 (August 18, 1992) (citing Congressional mandates to consider competition and market entry issues in connection with amending the minimum use rule and creating procedures for slot lotteries); High Density Airports; Notice of Lottery of Slot Exemptions at LaGuardia Airport, 65 Fed. Reg. 69,126 (November 15, 2000) (citing need to balance congestion management with promoting entry and access in lottery of AIR 21 slots); Notice of Alternative Policy Options for Managing Capacity at LaGuardia Airport and Proposed Extension of the Lottery Allocation, 66 Fed. Reg. 31,731 (June 12, 2001) (citing need to develop comprehensive congestion management rules that enhance competition); Congestion and Delay Reduction Rule at Chicago O'Hare International Airport, 71 Fed. Reg. 51,382 (Aug. 29, 2006) (citing pro-competitive policies in connection with O'Hare Rule).

[23] *See, e.g.,* Comments of Delta Air Lines at 3, Docket No. FAA-2006-25755 (July 14, 2009) (urging the FAA to eliminate the "permanent transfer" restriction at LGA and re-institute the "buy-sell" rule because "[t]he FAA's buy-sell rule is a proven and effective market-based mechanism *that has worked to promote new entry and enhance competition* at 'capped airports' for more than two decades") (emphasis added). In fact, in its comments, Delta went so far as to direct the FAA to its prior findings that the buy-sell rule promoted "the elimination of barriers to entry" and "the optimal operation of a competitive market" and was "fully consistent with its statutory mandate," *id.* – a far cry from its claim here that "Congress has not conferred any authority on the FAA to consider effects on competition," DL/US Comments at 7.

[24]Hirst Letter, at 5.

jurisdiction to review transactions under Section 7.[25] The parties' application for a waiver from a properly instituted FAA administrative rule does not implicate the merger review authority that Congress eliminated under the Civil Aeronautics Board Sunset Act of 1984, nor does the FAA in any way purport to invoke or apply Section 7 in its tentative decision. The FAA's proposed decision therefore does not usurp the DOJ's authority to investigate whether the transaction would likely substantially lessen competition and if it would, to file suit to enjoin it under Section 7. Again, Delta apparently agreed with this conclusion – until it saw the results of FAA's competitive analysis. In urging DOT to conduct its broad competitive analysis, Delta stressed that DOT "should not view itself as constrained by the Antitrust Division's limited analysis of the competitive effects of the transaction."[26]

VI. CONCLUSION

FAA has sufficient statutory, analytical and factual basis to impose the conditions proposed in its Notice. In addition, FAA should subject the transaction modification proposed by the parties to close scrutiny.

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[25] *E.g.*, Bowman Transp., Inc. v. Arkansas-Best Freight System, Inc., 419 U.S. 281, 298-99 (1974) ("A policy in favor of competition embodied in the laws has application in a variety of economic affairs.").

[26] Hirst Letter, at 5-6.

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