

**IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF KANSAS**

UNITED STATES OF AMERICA,)	
)	
Plaintiff,)	
)	
v.)	Civil Action No. 99-1180-JTM
)	
AMR CORPORATION,)	
AMERICAN AIRLINES, INC, and)	
AMERICAN EAGLE HOLDING)	
CORPORATION,)	
)	
Defendants.)	
)	

**DECLARATION OF HERBERT HOVENKAMP IN SUPPORT
OF PLAINTIFF’S MOTION FOR RECONSIDERATION
OF THE COURT’S SEPTEMBER 28, 2000, ORDER
GRANTING DEFENDANTS’ MOTION TO REVIEW**

I, Herbert Hovenkamp, hereby declare the following to be true and correct, based on my personal knowledge, unless otherwise indicated:

1. I am the Ben V. & Dorothy Willie Distinguished Professor of Law at the University of Iowa, College of Law, and have held that position since 1987. I am co-author, with the late P. Areeda and the late D. Turner, of *ANTITRUST LAW: An Analysis of Antitrust Principles and Their Application* and its annual supplements (referenced in the Court’s September 28 Order as “*Antitrust Law*”).

2. In my capacity as a litigative consultant for the United States Department of Justice, I wrote a letter to Joel Klein dated October 2, 1998. In that letter, I expressed my view that when considering an allegation of predation by a dominant air passenger carrier in response

to new entry at its hub, the definition of average variable cost “must take into account all costs that could be avoided if the airline chose not to make those flights in that hub during the alleged predation period.” That position was consistent with my long-held views on average variable costs.

3. I understand that a dispute has arisen regarding the status of that letter, and I have reviewed: (1) Magistrate Judge Humphreys’ June 12, 2000, Memorandum and Order; (2) American’s Reply Memorandum in Support of American’s Motion to Review; and (3) this Court’s September 28, 2000, Order Granting Defendants’ Motion to Review Magistrate Judge Humphreys’ June 13, 2000, Memorandum and Order.

4. The purpose of this declaration is to address American’s allegation that I added a footnote to my 1999 Supplement “that for the first time asserts that the ownership cost or cost of aircraft capital should be considered to be variable” and the statement in the September 28, 2000, Order “that after writing the letter and consulting with the government, Hovenkamp revised the treatise, adding a footnote which suggested for the first time that the entire cost of an airplane (in addition to depreciation and obsolescence) should be considered a variable cost.”

5. The view I expressed in the 1999 Supplement concerning the appropriate characterization of aircraft costs is consistent with the view that Professor Areeda and I expressed as early as 1986. *See* note 46 to ¶714.6 of the 1986 Supplement to *Antitrust Law*:

As another example in which a superficial definition of the relevant variable costs would be wrong, suppose that an airline shifts planes to a route on which a rival complains of predatory pricing. To what extent should the investment in the shifted aircraft be included for predatory pricing purposes in the defendant’s costs on that route? Firstly, planes depreciate with use and that depreciation is a variable cost. Secondly, planes become obsolete with time and replacement is anticipated. That factor should also be counted. *See* ¶712.1. Thirdly, the shifted plane has an opportunity cost in the form of the revenues that it would have generated on the route out of which it was shifted. That also seems a

short-run cost of the challenged service. Put another way, the defendant expanded capacity on the route in question in order to lower his price there; the cost of doing so -- in the form of additional capacity -- is relevant to the appraisal of his price there.

6. The footnote quoted above addresses whether the cost of additional capacity should be included in an average variable cost test. The examples I cited in the footnote (depreciation, obsolescence, and opportunity costs) were intended to explain why investment in shifted aircraft is variable. I retained this footnote, albeit with changing numbers, through my 1996 supplement, where it can be found at note 51.

7. In revising Volume III of *Antitrust Law*, I faced difficult decisions concerning which portions of previous supplements to include, given the many developments in the field of antitrust law. Although space limitations led me to edit the above-quoted footnote out of the 1996 Revised Edition of *Antitrust Law*, Volume III, the text noting that the incremental cost of new capacity may, in some circumstances, be relevant to a predation analysis remains.

8. The 1997 and 1998 Supplements to the predatory pricing sections of *Antitrust Law* contained few updates because there were few developments in that area of the law.

9. In 1998, the Department of Transportation proposed Airline Pricing Guidelines and the United States Court of Appeals for the Ninth Circuit decided *Rebel Oil Co. v. Atlantic Richfield Co. (Rebel Oil II)*, 146 F.3d 1088. These developments in the area of predatory pricing prompted me to restore and enlarge upon my previous discussion concerning circumstances in which costs sometimes characterized as fixed should be considered variable in my 1999 Supplement to *Antitrust Law*. I returned to my earlier example of aircraft costs, adding the following paragraph to the text of ¶740:

Now consider a claim that an airline with an established position in a certain hub airport has reduced its price dramatically in response to entry by a new carrier. In speaking of

predatory pricing in air passenger services, many of the cases have referred to the incremental cost of supplying a single seat on an already scheduled airline. But in those cases the claim was that the airline was selling individual discounted seats at below-relevant costs, while presumably continuing to earn positive returns overall. When the question is whether the airline's rate structure as a whole is below relevant costs, then the airplane itself must be considered a variable cost item. First, it is subject to use depreciation in proportion to the number of hours it flies. Second, its cost is avoidable because it can readily be transferred to another market if not needed in the market in question.

10. In the 1999 Supplement, I used the fact that aircraft can be shifted or transferred from one route to another to explain why in some circumstances aircraft cost should be defined as variable; just as in my earlier statements I referenced depreciation and opportunity costs to explain why investment in shifted aircraft is variable. I employed the term "*avoidable*" in 1999 because it was used in an article by Professor William Baumol, *Predation and the Logic of the Average Variable Cost Test*, 39 *Journal of Law and Economics* 49 (1996).

I declare under penalty of perjury under the laws of the United States that the foregoing is true and correct. Executed this 20th day of October, 2000.

/ "s"/

Herbert Hovenkamp