**UNITED STATES DISTRICT COURT FOR THE**
**EASTERN DISTRICT OF MICHIGAN**
**SOUTHERN DIVISION**

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| UNITED STATES OF AMERICA, *Plaintiff,* v. NORTHWEST AIRLINES CORP. and CONTINENTAL AIRLINES, INC., *Defendants.* | ) | Civil Action No. 98-74611<br>Judge Denise Page Hood<br>Magistrate Judge Scheer |

**PRETRIAL ORDER**

Plaintiff United States of America (hereafter "the United States" or "the Government") and Defendants Northwest Airlines Corporation (hereafter "Northwest") and Continental Airlines, Inc. (hereafter "Continental") hereby jointly set forth various matters required by Local Rule 16.2 in anticipation of the pretrial conference scheduled for October 16, 2000, and trial of this action, currently scheduled to commence on October 24, 2000, before the Honorable Denise Page Hood.

I. Jurisdiction

This action is brought by the United States pursuant to Section 15 of the Clayton Act, as amended, 15 U.S.C. § 25, to prevent and restrain alleged violations of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18. Defendants do not contest subject matter jurisdiction, except that Northwest has asserted that the statutory exemption to Section 7 immunizes the acquisition of equity, which is the subject of this action.

II. Plaintiff's Claims

The United States will prove at trial that Northwest violated Section 7 of the Clayton Act, 15 U.S.C. § 18, which prohibits stock acquisitions whose effect "may be substantially to lessen competition, or tend to create a monopoly." The act is intended to arrest monopolistic tendencies "in their incipiency," *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586, 589 (1957). Northwest violated Section 7 by acquiring stock giving it voting control over its competitor, Continental.

Northwest and Continental are the fourth and fifth largest U.S. airlines, respectively, accounting for a combined $10 billion in domestic passenger revenues annually. Even counting defendants as separate and independent entities, on a nationwide basis the domestic airline industry is substantially concentrated, with the seven largest carriers accounting for more than 80% of overall airline market, while many individual city-pair routes are extraordinarily concentrated. If left unchecked, Northwest's ownership of over 51% of the voting stock and 14% of the equity of its competitor, Continental, will further lessen competition in an airline industry that is already characterized by high prices and poor service in many markets.

The United States will show Northwest's ownership of the Continental stock has a reasonable probability of substantially reducing competition throughout the airline industry in a variety of ways:

*Hub-To-Hub Markets*. Both defendant airlines are "hub and spoke" carriers. That means they concentrate passengers from many points at "hub" airports (such as Detroit Metro) and then provide service from that hub airport to a large number of "spoke" destinations. Northwest operates domestic hubs at airports in Detroit, Minneapolis, and Memphis; Continental operates hubs in Houston, Newark and Cleveland. There are nine routes that connect one of Northwest's hubs to one of Continental's hub.[1] In most of those, Northwest and Continental are the only providers of non-stop service, have the dominant market share, and are each other's most significant competition. In most of those routes, Northwest's ownership and control of Continental will "tend to create a monopoly" in those routes, and, over time, result in higher prices and worse service (e.g., fewer frequencies).

*Systemwide Effects*. Both Northwest and Continental have domestic networks that span the United States. They both offer service between most major U.S. cities. Only a limited number of other airlines have such expansive networks. The airlines with such broad networks (the "major airlines") will frequently adjust their prices systemwide (*e.g.*, raise their business fares by 5% to all the cities they fly in the United States). A successful systemwide price increase of as little as 1% will cost domestic passengers more than half a billion dollars annually. However, the major airlines have found that it is unprofitable to raise their prices if one or more of the other major airlines decides not to follow. Thus, if one carrier raises its fares systemwide, it will withdraw that fare increase within a few days unless the other major airlines have decided to raise their fares to match the increase. There are many reasons why one airline may not want to raise prices, even though the rest of the industry does, including, for example, the fact that the one airline is facing (or just coming out of) a labor strike, is experiencing lower systemwide demand for its flights, or has short-term cash-flow problems. At differing times in the past, Northwest and Continental have each prevented price increases that the rest of the industry has tried to push through by refusing to match the increase. However, as a result of Northwest's ownership of the

[1] They are: Detroit-Houston, Detroit-Newark, Detroit-Cleveland, Minneapolis-Houston, Minneapolis-Newark, Minneapolis-Cleveland, Memphis-Houston, Memphis-Newark and Memphis-Cleveland.

Continental stock, the two carriers' interests will be more closely aligned, and it will be less likely that either of those two will be the one "spoiler" that blocks a nationwide price increase. Fewer potential spoilers will lead to higher prices for consumers.

*Hub expansion (Cleveland)*. Third, Northwest's Detroit hub and Continental's Cleveland hub compete for passengers throughout the northern midwest United States. If Continental were independent, competition between these hubs would grow and intensify as Continental implements its plans to expand the number of flights originating from their Cleveland hub. Northwest's ownership of a controlling equity stake in Continental will reduce competition between these two hubs to the detriment of consumers.

Northwest maintains that these competitive harms should be tolerated because Northwest's continued ownership of control over Continental is necessary for Northwest to maintain a separate marketing ("alliance") agreement with Continental. This "alliance" defense fails to meet the well-settled legal standards for an efficiency defense under Section 7, which require Northwest to carry the burden of verifying the existence of any alleged efficiencies and proving that the efficiencies are not obtainable through less anticompetitive means. *See FTC v. University Health, Inc.*, 938 F.2d 1206, 1222 n. 30 (11th Cir. 1991); *United States v. Ivaco, Inc.*, 704 F. Supp. 1409, 1425-27 (W.D. Mich. 1989). Northwest's defense is based on the subjective and unverifiable pronouncements of Northwest's executives that absent Northwest's ownership of voting control over Continental, Northwest would choose to simply abandon the alliance. These pronouncements are inconsistent not only with the rest of the industry's practices regarding marketing alliances, but with Northwest's own prior conduct and sworn testimony. Indeed, all of the objective evidence at trial will prove that there are reasonable alternatives other than Northwest's ownership of voting control over Continental by which the public can receive equivalent or greater alliance efficiencies that, unlike Northwest's acquisition of control over Continental, pose no risk to competition. Northwest will thus fail to prove that the benefits of the alliance are relevant to the competitive issue at the heart of this case.

The competitive harms caused by Northwest's stake in Continental will not be solved by new entry. Entry is unlikely to replace the loss of non-stop competition in the hub-to-hub routes served by defendants. No other major carrier is likely to enter any route that is not a spoke from its own hub; entry by non-major carriers is exceedingly rare, and subject to an extremely low survival rate. The increased probability of successful systemwide price increases likely to result from this transaction similarly will not be counteracted by entry. Entry on a nationwide scale comparable to that of the major carriers is a massive undertaking which, in addition to being highly unlikely, could only be accomplished over a significant period of time. Once Continental is lost as an independent major network carrier, it is highly unlikely that any new entrant will take its place.

Northwest's claim that the so-called "governance" arrangements it entered into with Continental on how it would vote its stock is an adequate remedy for a violation of Section 7 has been fully briefed. Northwest retains significant rights to influence Continental's actions even during the terms of these agreements, and will increasingly have the ability to directly control Continental as a result of its ownership of 51% of Continental's voting power. Those governance arrangements do not eliminate the competitive harm and thus are an inappropriate and inadequate remedy to an otherwise illegal stock purchase. *See United States v. E. I. du Pont de Nemours & Co.*, 366 U.S. 316 (1961). The appropriate remedy, and the one the United States seeks in this action, is for this Court to order Northwest to divest its stockholdings in Continental.

## III. Defendants' Claims

### A. Northwest's Claims

The government will not be able meet its burden to prove that Northwest's equity investment in Continental is likely to "substantially . . . lessen competition, or tend to create a monopoly."

Northwest lacks the present or imminent ability to exercise influence or control over Continental. Continental's CEO has admitted that the Governance Agreement has rendered Northwest a "passive investor" (Bethune Dep. at 208-09), that it "absolutely " insulates Continental from "any influence by Northwest" (*Id*. at 187) and, that, combined with the Supplemental Agreement, it "give[s] Continental a decade of independence" (Continental Airlines, Inc., Form 8-K, Ex. 99.2 (Nov. 20, 1998)). The law is clear that absent present or imminent ability to exercise influence or control, no Section 7 violation is possible.

For the same reasons, Northwest's equity investment meets the two-part test required to satisfy the investment exception to Section 7. The governance agreements themselves establish that the stock was not "purchased for the purpose of taking over active management and control of" Continental. Further, Continental's CEO has admitted that Northwest is "scrupulous[ly]" adhering to the Governance Agreement (Bethune Dep. at 231) and the stock, therefore, is not "being used by voting or otherwise to bring about a substantial lessening of competition." *United States v. Tracinda Investment Corp.*, 477 F. Supp. 1093, 1099 (C.D. Cal. 1979). The extent and duration of the governance agreements between Northwest and Continental far exceed those found to justify application of the investment exemption in *Tracinda*.

The government's contention that such governance arrangements are put forth as a remedy for a Section 7 violation is misleading. The purpose and effect of such agreements is the precise opposite; namely to *avoid* influence and control, just as in *Tracinda*. For the same reason, none of the circumstances here are remotely like those that justified a finding of a violation and order of divestiture in *du Pont* – namely actual, long-standing use of the acquired stock to foreclose competition. The evidence shows there has been no such use and that Continental is guaranteed a "decade of independence."

Moreover, even if the government could overcome these threshold obstacles to its Section 7 claim, it cannot make out a *prima facie* case of probable harm to competition on either "hub-to-hub" routes or "systemwide" where the government claims that competition will suffer. Continental and Northwest remain separate and independent competitors and the government's mere assertions that Northwest's equity investment will reduce competition between them cannot suffice to establish a *prima facie* violation of Section 7. Unlike in the typical Section 7 case to which the government is accustomed, there is no loss of a competitor here. That is why the government has been forced to rest its case on "changed incentives" theories advocated by its experts. No case, however, has found a Section 7 violation based on such theories. Nor is there any authority that would support such a finding based on unsubstantiated hearsay concerning the psychological impact of Northwest's investment on anonymous lower level Continental employees.

The government's theory that Continental will pull its competitive punches for fear of alienating Northwest is not only based on fatally speculative and remote scenarios conjured up by its expert (*United States v. Marine Bancorp., Inc.*, 418 U.S. 602, 622-23 (1974) ("Section 7 deals in 'probabilities' not 'ephemeral possibilities'")) and disproved by the testimony of Continental witnesses deposed by the government, but is contradicted by actual marketplace evidence. Contrary to the government's explicit prediction, Continental has entered new routes in competition with Northwest and has remained an aggressive competitor in every other respect, including from its Cleveland hub. The government's theories concerning Northwest's "changed incentives" are equally flawed. Northwest also has continued to compete as aggressively, if not more so, against Continental since the equity investment. Indeed, Northwest' capacity increases in Continental's Houston hub were so dramatic that Continental's CEO was prompted to remark: "[I]t looked like the skies got dark with Northwest airplanes in Houston. Did you ever see so many guys come in at once?" Bethune Dep. at 230. In the "hub-to-hub markets," where the government predicts "higher prices and worse service (*e.g*., fewer frequencies))," prices have fallen and capacity has dramatically increased. This is hardly surprising, since to realize the increased traffic flows over Northwest's and Continental's networks that the carriers expected the equity-Alliance transaction to produce, requires expanding, rather than contracting these inter-network conduits. As the evidence will show, these benefits provide a value to consumers and competition of hundreds of million of dollars per year. Finally, the government is wrong about the effects of entry. Entry by non-major carriers, to use the government's term, is neither rare nor ineffective. To the contrary, so-called non-major carriers have a significant effect on competition in all areas, including hubs.

Nor can the government carry its burden with predictions about what might happen in four years or eight years when certain provisions of the governance agreements are currently set to expire. Such speculation has no part in Section 7 analysis (*see BOC Int'l, Ltd. v.FTC*, 557 F.2d 24, 29 (2d Cir. 1977) ("uncabined speculation [as to future competitive impact] cannot be the basis of a finding that Section 7 has been violated")), and was specifically rejected by the court in *Tracinda,* 477 F. Supp. at 1100 ("The fact that this contract will last three years, as opposed to ten, twenty, or fifty years, bears very little weight upon the ultimate determination . . . although the Court does take it into consideration"). And it is particularly unwarranted here where there is considerable uncertainty concerning whether Continental's independent status can or will change, given the need for Northwest to obtain further concessions from its pilots union and Northwest's and Continental's commitment to give the Justice Department 6 months advance notice of the expiration of the agreements so it can seek to obtain relief if it believes there is an imminent threat to competition. *Cf.*

*United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586, 597 (1957) (Section 7 "contemplates an action at any time the stock is used to bring about or in attempting to bring about, the substantial lessening of competition").

In the event that the government carries its burden to prove a likelihood of a "substantial" lessening of competition, Northwest is entitled to rebut that showing through evidence that competition has not been harmed, but enhanced by the equity-Alliance transaction and through evidence that the equity-Alliance transaction has produced consumer benefits that outweigh any potential harms – all of which the government mislabels "an efficiencies defense."

Even if viewed as an efficiency defense, however, the Alliance benefits are entitled to full weight. *See FTC v. Butterworth Health Corp.*, 946 F. Supp. 1285 (W.D. Mich. 1996) (finding *prima facie* violation rebutted by efficiencies that benefit consumers), *aff'd*, 121 F.3d 708 (6th Cir. 1997); *United States v. Long Island Jewish Med. Ctr.*, 983 F. Supp. 121 (E.D.N.Y. 1997) (same). If the government establishes a *prima facie* Section 7 violation, Northwest is entitled to introduce evidence of "efficiencies" so long as the transaction was "reasonably necessary" to the achievement of such efficiencies. *Polk Bros. v. Forest City Ent., Inc.*, 776 F.2d 185, 189 (7th Cir. 1985) (Easterbrook, J.); *see also* Revision to Horizontal Merger Guidelines, 1997 WL 166999 § 4 (FTC, Dep't Justice Apr. 8, 1997); Antitrust Guidelines for Collaborations Among Competitors, 1999 WL 959640 §§ 3.36, *et seq.* (FTC Oct. 1999) And the time for making the "reasonably necessary" assessment is at the time of the transaction's formation. *Polk Bros.*, 776 F.2d at 189 (stating, in deciding whether to apply *per se* or rule of reason analysis under Illinois antitrust law, "[a] court must ask whether an agreement promoted enterprise and productivity at the time it was adopted"). In that regard, the evidence is entirely one-sided. To quote Continental's February 1999 10-K: "Continental believes that because of agreements restricting Northwest's right to exercise control over Continental, the companies remain independent competitors; Northwest's stock acquisition was made solely for investment purposes and thus is expressly exempt under Section 7 of the Clayton Act; and Northwest's stock acquisition was necessary in order for Northwest and Continental to enter into an alliance agreement that is highly pro-competitive." Continental Airlines, Inc., Form 10-K (Feb. 17, 1999).

Further, in assessing whether Northwest's investment was "reasonably necessary" to achieve consumer benefits, there is no requirement in this Circuit that the Court search for alternatives – under the law, the transaction must be evaluated as is. *See White Consol. Indus., Inc. v. Whirlpool Corp.*, 781 F.2d 1224 (6th Cir. 1986); *Butterworth*, No. 96-2440, 1997 WL 420543 at **2 (6th Cir. July 8, 1997). And even if such a search were appropriate, the government's own guidelines provide that "the Agencies consider only alternatives that are *practical* in the business situation faced by the participants; the Agencies do not search for a theoretically less restrictive alternative that is not realistic given business realities." Antitrust Guidelines for Collaborations Among Competitors § 3.36(b).

There is no question, for reasons already fully briefed, that Northwest's investment in Continental was not only "reasonably necessary" to the formation of the Alliance and the competitive and consumer benefits it produces, but absolutely essential – if Northwest had not purchased the Air Partners' stock, Continental would have been sold to Delta and there would have been no Continental and no Northwest/Continental Alliance. Nor is there any question about the existence of alternatives "practical in the business situation faced by the participants" – as Continental's own Board minutes disclose, there were *no* other alternatives. And the investment in Continental remains as necessary to the Alliance today as at the time of the transaction – indeed, Northwest only recently received, and rejected, an overture by Delta to purchase the Air Partners' shares. As Gordon Bethune testified: "So you can't deny their concerns that they needed to have some armor to stop a competitor . . . to try to break [the Alliance] up." Bethune Dep. at 229.

Finally, a defendant's burden in rebutting the government's *prima facie* case is no different when the defendant's evidence is offered in the form of consumer benefits than when it is offered to prove the absence of likely competitive harm. *See FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1087 (D.D.C. 1997); *Butterworth*, No. 96-2440, 1997 WL 420543 at **2 (6th Cir. July 8, 1997).

When the evidence is viewed in its entirety, it will show that equity acquisition was necessary to establish a procompetitive alliance with Continental, that the Alliance has produced benefits to consumers, which on an annual basis amount to hundreds of millions of dollars in consumer value, and that such concrete benefits are achieved while at the same time Continental's competitive independence is preserved.

B. Continental's Claims

1. <u>The Governance and Supplemental Agreements Do Not Prevent Northwest from Influencing Continental.</u>

If the United States is able to prove that Northwest's ownership of a controlling share of Continental is a violation of Section 7 of the Clayton Act, then the Governance Agreement and the Supplemental Agreement do not remedy an otherwise illegal stock acquisition. Notwithstanding the contractual limitations placed upon Northwest's use of the stock until 2004, Northwest retains the ability to control very significant aspects of Continental's existence. Once the Governance Agreement expires in 2004, Northwest will be free to exercise very significant control over Continental's operations. The Supplemental Agreement permits Northwest to vote 20% of Continental's total outstanding voting power. Thus, Northwest will be the largest single voter of Continental stock in November 2004. Furthermore, in 2004, Northwest also may elect its own representatives to Continental's Board of Directors, solicit proxies, and conduct proxy fights to oust Continental's independent directors. Northwest will be free to exert influence on all of Continental's management decisions, including those that directly affect competition between Northwest and Continental. It is highly unlikely that competition between Continental and Northwest (the basis for the government's Complaint) will be less important or less significant in November 2004 than it is now.

After November 2008, Northwest will have complete and unfettered operational control of Continental. There will be no substantive restrictions on Northwest's ability to control every facet of Continental's operations, including decisions affecting routes and pricing. Northwest also will be free to hire managers who will carry out Northwest's commands to the detriment of Continental's other shareholders and -- more importantly -- consumers.

Northwest's acquisition of a controlling block of Continental stock does not satisfy the "solely for investment" exemption. Section 7 provides an exemption from antitrust scrutiny for otherwise illegal acquisitions that are made solely for the purpose of passive investment. Northwest's actions in this case do not satisfy that standard. Northwest has admitted that it purchased the stock for two related strategic purposes: (1) to ensure that it could obtain an alliance with Continental that Northwest believes is crucial to its long-term survival against United, American, and Delta; and (2) to prevent another airline from acquiring Continental. In addition to having these strategic purposes for the acquisition, it is undisputed that Northwest also fully intends to assume and exercise influence and control over Continental after 2004. Therefore, Northwest's acquisition is not "solely for the purpose of investment" and is not immunized from Section 7.

2. <u>Northwest's Ownership of a Controlling Share of Continental's Stock is not Necessary to Formation, Stability, or Consumer Benefits of the Alliance.</u>

Acquiring control of Continental was not necessary to formation of the Alliance. Air Partners, the former owners of the shares at issue in this case, had three options for disposing of their investment: (1) sale to Continental; (2) sale to Delta; and (3) sale to Northwest. Continental was ready, willing, and able to purchase the Air Partners shares. Purchase of the stock by Continental (either from Air Partners or Northwest) would have provided Continental with the independence that Northwest argues was a condition precedent for entering into the Master Alliance. Continental's ownership of its own stock would have provided a stable ownership structure that is indistinguishable from Northwest's other alliance partners. Entering into an alliance with an independent Continental would have produced the same procompetitive benefits that exist today.

Retaining control of Continental is not necessary for the continuation of the Alliance. Continental remains ready, willing, and able to purchase the shares currently owned by Northwest. Continental remains highly committed to the Alliance because the Alliance is quite profitable for both parties and benefits consumers. Moreover, if equity were necessary to stabilize this specific alliance, then logic dictates that Continental also would own equity in Northwest. But that is not the case. Continental is confident that Northwest will not abandon the Alliance because the Alliance is highly profitable. Furthermore, all objective evidence demonstrates that equity is not necessary to successful codesharing alliances. Most alliances do not involve any equity, and this is the only airline alliance that involves a controlling equity interest. Alliances that involve equity have survived or failed for business reasons that are completely independent of the existence of the equity investment.

There are other, less troubling methods for ensuring Continental's continued participation in the Alliance. The profits derived from the Alliance and the consumer benefits created by the Alliance are sufficient in themselves to secure the full participation of both Northwest and Continental. Nevertheless, Continental is ready and willing to enter into other arrangements that can assure Northwest of Continental's participation and allay the competitive concerns of the United States. Continental repeatedly has made its willingness to enter such arrangements known to both the United States and Northwest. Northwest refuses to sell its stock to Continental despite Continental's willingness to enter into arrangements that guarantee the continued success of the Alliance.

The efficiencies generated by the Alliance are irrelevant to the competitive impact of the stock ownership. Continental, Northwest, and consumers derive benefits from the Alliance. Nevertheless, if the United States can prove that Northwest's ownership of a controlling interest in one of its direct competitors violates Section 7, then the efficiencies generated by the Alliance do not constitute a defense. *See United States v. Philadelphia National Bank*, 374 U.S. 321 (1963). In that case, the Court held that procompetitive efforts generated by a merger in one market are no defense to the anticompetitive effects of the merger in other markets.

## IV. Stipulation of Facts

The parties have agreed that the following statements of fact are true and correct and the Court may consider such facts as conclusively established, without further proof, for the purposes of this action only:

1. Defendant Northwest Airlines Corporation is a corporation incorporated under the laws of the State of Delaware, with its principal places of business in St. Paul, Minnesota.

2. Northwest Airlines Corporation is the indirect parent corporation of Northwest Airlines, Inc.

3. Defendant Continental Airlines, Inc. is a corporation incorporated under the laws of the State of Delaware, with its principal places of business in Houston, Texas.

4. A substantial portion of each defendant's revenues is derived from the sale and provision of scheduled airline passenger service between different states. Defendants are engaged in interstate commerce and in activities that substantially affect interstate commerce.

5. The Court has personal jurisdiction over Northwest Airlines Corporation and Continental Airlines, Inc., and venue is proper under 15 U.S.C. § 22.

6. The Court has subject matter jurisdiction over the claims brought against the

defendants under Section 7 of the Clayton Act, 15 U.S.C. § 18, provided that Northwest has asserted that the statutory exemption to Section 7 immunizes the acquisition of equity, which is the subject of this action.

7. Northwest operates domestic hubs at airports in Detroit, Michigan, Minneapolis/St. Paul, Minnesota, and Memphis, Tennessee.

8. Continental operates domestic hubs at airports in Houston, Texas, Newark, New Jersey, and Cleveland, Ohio.

## V. Issues of Fact to Be Litigated

### A. The Government's Statement of Issues of Fact to be Litigated

1. Whether Northwest's acquisition and ownership of a 51% voting control and 14% equity share in Continental may substantially lessen competition or tend to create a monopoly in any line of commerce in any section of the country?

2. Assuming, *arguendo*, that Northwest's ownership of a controlling 51% voting interest in Continental would violate Section 7 of the Clayton Act, does the existence of contractual agreements temporarily restricting certain aspects of Northwest's ability to exercise its rights to vote its shares alter that conclusion?

3. Whether the alleged consumer benefits that flow from Northwest's marketing alliance with Continental (and that Northwest claims justify the competitive harm caused by its purchase of a controlling equity stake in its competitor) could reasonably be achieved absent Northwest's purchase and ownership of the controlling voting stake?

4. Assuming, *arguendo*, that Northwest can carry its burden to demonstrate the absence of alternatives for achieving alliance efficiencies that pose a lesser risk to competition, whether Northwest has met its burden of proving that the additional consumer benefits from its marketing agreement with Continental that are produced by its continued ownership of the 51% voting control and 14% equity share in Continental outweigh the competitive harm of that ownership?

### B. Continental's Statement of Issues Of Fact To Be Litigated

Continental agrees with the issues listed by the Government. Continental understands that issue 3 is actually a statement of two issues. First, whether Northwest's purchase of control of Continental was necessary in order for Northwest to enter into a marketing Alliance with Continental. A second question is whether Northwest's continued ownership of the controlling voting stock is necessary to a continuation of the Alliance between Northwest and Continental.

C. Northwest's Statement of Issues of Fact to be Litigated

1. Whether governance agreements protect Continental Airlines from significant influence or control by Northwest, and thus maintain Continental's competitive independence for a substantial period of time.

2. Whether, given the governance agreements, Northwest's ownership of stock in Continental is likely "substantially to lessen competition or tend to create a monopoly."

3. Assuming that the government carries its initial burden to prove a "substantial" lessening of competition with a reasonable probability, whether that *prima facie* showing is nonetheless rebutted by expert testimony and factual evidence which Northwest contends will show the absence of harm to competition and substantial benefits to consumers and competition.

4. Assuming that evidence of consumer benefits produced by the Alliance is properly characterized as an "efficiencies defense," whether Northwest's acquisition of stock in Continental was "reasonably necessary" to achieve the consumer and competitive benefits Northwest contends are produced by the Alliance.

Northwest objects to Continental's demand to insert changes to the Statement of Issues of Fact and Law, as well as its changes to Section III.B.1. on October 9, 2000, in clear violation of the Stipulation of the parties filed with the Court on August 28, 2000 and reserves the right to object to evidence or argument offered by the government or Continental with respect to such changes.

VI. Issues of Law to Be Litigated

A. The Government's Statement of Issues of Law to be Litigated

1. Whether scheduled airline passenger service between city-pairs is an appropriate "line of commerce" in "any section of the country" (*i.e.*, a relevant product and geographic market) in which to evaluate the competitive consequences of Northwest's purchase of a 51% voting control and 14% equity share in Continental? *See* 15 U.S.C. § 18.

2. Whether the United States is entitled to a legal presumption of competitive harm from Northwest's purchase of a 51% voting control and 14% equity share in its competitor under *United States v. Philadelphia Nat'l Bank,* 374 U.S. 321 (1963)?

3. Whether, contrary to *Denver & Rio Grande Western R.R. v. United States*, 387 U.S. 485 (1967), section 7 of the Clayton Act requires as a threshold matter that the acquiring company be able to directly influence or control the acquired company?

4. Whether Northwest can remedy what would otherwise be an antitrust violation by entering into private agreements that temporarily restrict the circumstances and extent to which Northwest can exercise voting control over its competitor Continental? *See United States v. E. I. du Pont de Nemours & Co.*, 366 U.S. 316 (1961).

5. Whether Northwest's purchase of a 51% voting control and 14% equity share in Continental was "solely for investment" and thus is exempt from Section 7 of the Clayton Act?

B. Continental's Statement of Issues of Law to be Litigated

Continental agrees with the Government's Statement of Issues of Law to be Litigated but would add the following.

1. Whether contrary to *United States v. Philadelphia National Bank*, anticompetitive effects of a merger in one or more markets in violation of §7 can be offset by procompetitive effects in other markets.

C. Northwest's Statement of Issues of Law to be Litigated

1. Whether a Section 7 violation is reasonably probable, if the governance agreements deprive Northwest of the present or imminent ability to exercise influence or control over Continental's management and Board of Directors.

2. Whether the investment exception to Section 7 applies if the governance agreements deprive Northwest of the present or imminent ability to exercise influence or control over Continental's management and Board of Directors.

3. Whether the government can establish a prima facie violation with reasonable probability where governance agreements deprive Northwest of the present or imminent ability to exercise influence or control over Continental's management and Board of Directors.

4. Whether the equity acquisition was reasonably necessary to create an alliance between Northwest and Continental.

5. Whether the Northwest-Continental Alliance is reasonably likely to produce benefits to consumers and competition that outweigh any harms the government proves are the reasonably probable result of Northwest owning Continental stock

6. Whether the government can prove that as a result of the equity acquisition by Northwest, "consumers likely will pay higher prices and receive lower quality service" and that Northwest's holding of the equity "will deter Continental from offering new service in competition with Northwest," "will reduce Continental's incentive to compete aggressively against Northwest," and "will reduce Northwest's incentive to compete aggressively against Continental" with reasonable probability in any relevant market.

Northwest objects to Continental's demand to insert changes to the Statement of Issues of Fact and Law, as well as its changes to Section III.B.1. on October 9, 2000, in clear violation of the Stipulation of the parties filed with the Court on August 28, 2000 and reserves the right to object to evidence or argument offered by the government or Continental with respect to such changes.

VII. Evidence Problems Likely to Arise at Trial

The following motions in limine are pending:

1. Plaintiff's Motion In Limine To Exclude The Expert Testimony Of Dr. Almarin Phillips;

2. Plaintiff's Motion In Limine To Exclude Evidence Of Defendants' Governance Agreements As A Defense To This Section 7 Stock Acquisition;

3. Plaintiff's Motion In Limine To Exclude Evidence Of Professor Ordover's Late Study;

4. Northwest's Motion In Limine To Exclude The Testimony Of The Government's Experts;

5. Northwest's Motion In Limine To Exclude Evidence Relating To Allegations Of Possible Collusion, Including Those Made By The Government In U.S. v. Airline tariff Publishing Co.;

6. Northwest's Motion In Limine To Exclude Deposition Testimony From Prior Cases;

7. Northwest's Motion In Limine To Exclude Evidence Relating To Alliances Other Than The Transaction At Issue;

8. Northwest's Motion In Limine To Exclude Evidence Relating To The Operating And Competitive Experience Of Six Airline Carriers Competitor Witnesses.

There may be other issues relating to the admissibility of exhibits, testimony, or deposition testimony that are pending as of the time of the pretrial conference.

VIII. Witnesses

Exhibits A through C list those witnesses each party intends to call live in their case in chief. Exhibits A through C further identify those witnesses the parties "may" call as opposed to "will" call, and those witnesses the parties intend to call for expert testimony as opposed to lay testimony.

Exhibits D through F list each parties' designations and counter-designations by page and line number of deposition testimony, which may be offered at trial.

IX. Exhibits

Exhibits G through I list those exhibits each party may offer at trial.

X. Damages

The United States is seeking no monetary damages, only appropriate injunctive relief and the costs of this action.

XI. Trial

This case is to be tried by the Court without a jury. The government believes that the estimated length of trial for plaintiff's case in chief (assuming the cross-examination is roughly commensurate with the direct examination) is two weeks. Continental estimates that the length of Continental's case in chief is one week. Northwest believes that, assuming that Northwest's in limine motions are granted and that the Government's case includes Continental's evidence, the estimated length of trial for Northwest's case in chief is three weeks.

XII. Settlement

The last time the United States discussed settlement directly with defendants was in November, 1998. The United States has advised defendants that the case could be resolved if Northwest sold the equity stake it holds in Continental to Continental or other independent purchaser which would not raise competitive concerns. Northwest is unwilling to settle this case on these terms.

DATED this 10th day of October, 2000.

"/s/"
Judge Denise Page Hood

Approved as to Form and Content:

"/s/"

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