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IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF MICHIGAN

UNITED STATES OF AMERICA, Plaintiff, v. NORTHWEST AIRLINES CORP., and CONTINENTAL AIRLINES, INC., Defendants.	Civil Action No. 98-74611 Judge Hood Magistrate Scheer

CONSOLIDATED OPPOSITION OF THE UNITED STATES TO DEFENDANT NORTHWEST AIRLINES' MOTIONS IN LIMINE

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October 17, 2000

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CONTROLLING OR MOST APPROPRIATE AUTHORITY

I. Motion Regarding Other Alliances

A. Cases

United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963)

FTC v. Proctor & Gamble Co,, 386 U.S. 568 (1967)

United States v. Rockford Mem. Corp., 717 F. Supp, 1251 (N.D. Ill. 1989), *aff'd on other grounds*, 898 F.2d 1278 (7th Cir.), *cert. denied*, 498 U.S. 920 (1990)

FTC v. University Health, Inc., 938 F.2d 1206 (11th Cir. 1991)

United States v. Mercy Health Svcs., 902 F. Supp. 968 (N.D. Iowa 1995), *vacated as moot*, 107 F.3d 632 (8th Cir. 1997)

FTC v. Staples, Inc., 970 F. Supp. 1066 (D.D.C. 1997)

FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34 (D.D.C. 1998)

B. Other Authority

U.S. Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines § 4, at 31 (rev. Apr. 8, 1997)

II. Motion Regarding Prior Sworn Testimony

C. **Cases**

Fullerform Continuous Pipe Corp. v. Am. Pipe & Constr. Co., 44 F.R.D. 453 (D. Ariz. 1968)

Ikerd v. Lapworth, 435 F.2d 197 (7th Cir. 1970)

B-W Acceptance Corp. v. Porter, 568 F.2d 1179 (5th Cir. 1978)

Rule v. Int'l Ass'n of Bridge, Structural & Ornamental Ironworkers, 568 F.2d 558 (8th Cir. 1978)

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In re Japanese Elec. Prods. Antitrust Litig., 723 F.2d 238 (3rd Cir. 1983)

United States v. Smith Grading & Paving, Inc., 760 F.2d 527 (4th Cir. 1984), *cert. denied*, 474 U.S. 1005 (1985)

United States v. Estabrook, 774 F.2d 284 (8th Cir. 1985)

United States v. Mendez-Ortiz, 810 F.2d 76 (6th Cir. 1986), *cert. denied*, 480 U.S. 922 (1987)

United States v. Airline Tariff Publ'g Co., et al., No 92-2858 (SSH) (D.D.C. 1992)

United States v. Southwest Bus Sales, Inc., 20 F.3d 1449 (8th Cir. 1994)

United States v. Merriweather, 78 F.3d 1070 (6th Cir. 1996)

United States v. Andreas, 216 F.3d 645 (7th Cir. 2000)

B. **Other Authority**

Clayton Act § 7, 15 U.S.C. § 18 (1950)

FED. R. EVID. 104(b)

FED. R. EVID. 401

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FED. R. EVID. 403

FED. R. EVID. 403, Advisory Committee's Note

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FED. R. EVID. 804

MOORE'S FEDERAL PRACTICE, 1990 rules Pamphlet § 403.4 (1990)

M. Martin, *Significant Evidence Problems in Complex Litigation*, C829 ALI-ABA 257 (1993)

WRIGHT & GRAHAM, FEDERAL PRACTICE AND PROCEDURE: EVIDENCE § 5162 (1978)

V. **Motion Regarding Expert Testimony**

A. **Cases**

Times-Picayune Publ'g Co. v. United States, 345 U.S. 594 (1953)

United States v. E. E. du Pont de Nemours, 353 U.S. 586 (1957)

United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1961)

FTC v. Proctor & Gamble Co., 386 U.S. 558 (1967)

United States v. Gen. Dynamics Corp., 415 U.S. 486 (1974)

Exxon Corp. v. Governor of Md., 437 U.S. 117 (1978)

Calif. v. Am. Stores Co., 495 U.S. 271 (1990)

Brooke Group, Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993)

Daubert v. Merrell Dow Pharms., 509 U.S. 579 (1993)

Turner Broad. Sys., Inc. v. FCC, 520 U.S. 180 (1997)

Gen. Elec. Co. v. Joiner, 522 U.S. 136 (1997)

Kumho Tire Co. v. Carmichael, 526 U.S. 137 (1999)

Berry v. City of Detroit, 25 F.3d 1342 (6th Cir. 1994)

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Cincinnati Bell Tel. Co. v. FCC, 69 F.3d 752 (6th Cir. 1995)

Pomella v. Regency Coach Lines, Ltd., 899 F. Supp. 335 (E.D. Mich. 1995)

Guillory v. Domtar Indus., Inc., 95 F.3d 1320 (5th Cir. 1996)

PSI Repair Servs., Inc. v. Honeywell, Inc., 104 F.3d 811 (6th Cir. 1997)

Smelser v. Norfolk S. Ry. Co., 105 F.3d 299 (6th Cir. 1997)

FCC v. Staples, Inc., 970 F. Supp. 1066 (D.D.C. 1997)

In re Brand Name Prescription Drugs Antitrust Litig., 186 F.3d 781 (7th Cir. 1999)

Pride v. BIC Corp., 218 F.3d 566 (6th Cir. 2000)

Berry v. Crown Equip. Corp., 108 F. Supp. 2d 743 (E.D. Mich. 2000)

In re Visa Check/MasterMoney Antitrust Litig., 192 F.R.D. 68 (E.D.N.Y. 2000)

B. **Other Authority**

Clayton Act § 7, 15 U.S.C. § 18 (1950)

FED. R. EVID. 702

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Statements of Issues

I. Should the Court consider evidence that other alliances between major airlines, including the successful alliance between Northwest and KLM, do not involve an equity interest by one partner in the other.

II. Should the Court consider prior sworn testimony of Northwest directors and executives that contradicts Northwest's position in this case.

III. Should the Court consider evidence of the significant barriers to entry faced by non-major airlines.

IV. Should the Court consider evidence of possible collusion in the airline industry in its section 7 analysis.

V. Should the Court consider the evidence offered by the government's highly-creditionaled experts regarding the consequences of Northwest's ownership of voting control of Continental.

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I. Introduction

On October 23, 1998, the United States filed a complaint alleging that the acquisition by Northwest Airlines Corp. (Northwest) of stock representing voting control of Continental Airlines, Inc. (Continental) is likely to substantially reduce competition in the airline industry in violation of section 7 of the Clayton Act, 15 U.S.C. §18 and seeking divestiture of that stock. The United States did not challenge a separate joint marketing alliance the carriers entered at about the same time.

At the trial, scheduled to begin shortly, we will offer testimony from executives of competing airlines, experts and Northwest's own officers and directors showing that, among other things, Northwest and Continental are each other's most significant competitors for airline service between the cities where they operate their hubs, that entry by other airlines, including smaller low cost carriers, is unlikely in the cities where competition between Continental and Northwest will be lost or reduced, and that consequently prices will increase and service will decline if Northwest retains ownership and control of Continental. We will also offer evidence refuting Northwest's two defenses -- that its retention and ultimate exercise of full voting control over Continental is justified by the alleged consumer benefits of the contemporaneous but contractually separate marketing alliance (the "efficiencies defense") and that its interim governance agreements, which were designed to protect minority shareholders, by happy coincidence also fully protect consumers' interest in competition (the "governance defense"). Our evidence will include expert

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analysis and, more importantly, Northwest's own conduct, experience and prior statements showing that any alliance efficiencies can be achieved without Northwest owning control of Continental and that the temporary, governance agreements are an inadequate substitute for true structural independence between these important competitors.

Northwest would rather that the Court not hear any of the government's evidence. On October 2, Northwest filed in essence seven motions in limine that taken together would exclude virtually all of the government's evidence. Northwest asks the Court to bar (1) testimony from other airline executives explaining why they are unlikely to enter or expand in the hub-to-hub markets at issue, even if fares increase and service deteriorates, including the importance of the incumbent airline's reactions to entry, (2) evidence on prior anticompetitive conduct by Northwest and other major airlines, (3) prior sworn testimony from Northwest's then executive vice president on airline markets and airline competition; (4) prior sworn testimony of Northwest's own officers and directors from its litigation with KLM, its international "alliance for life" airline partner, that equity ownership by an alliance partner is not only unnecessary but is also destructive to an alliance relationship; (5) evidence of the success of the Northwest/KLM alliance after Northwest repurchased its equity from KLM; (6) evidence of the dozens of alliances involving major U.S. airlines that do not include equity, let alone controlling equity; and (7) for good measure, all testimony offered by any of three government experts on any topic, including market definition, market structure, entry, competitive effects, corporate governance and marketing alliances. According to Northwest, virtually all of the government's evidence is fanciful, irrelevant, prejudicial, nonprobative, unreliable, confusing, or speculative unless Northwest chooses to offer it to the Court. Northwest does not want the Court to consider Northwest's prior statements, Northwest's prior testimony under oath or Northwest's prior

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conduct when Northwest motivations were different than they are today. Northwest does not want the Court to consider any evidence on Northwest's alliance with KLM even though Northwest told the government there were many "strong analogies between NW/KLM and NW/CO." Northwest does not want the Court to hear from other airline executives on whether they are likely to enter Northwest/Continental monopoly and duopoly markets, even though Northwest told the Court in the pretrial order that entry in these markets is likely. Northwest does not want the Court to hear prior testimony from its executives on shareholder influence and control, even though Northwest tells the Court these are key issues in this proceeding. In short, Northwest rejects the fundamental principle of American jurisprudence that the Court's role is to evaluate conflicting testimony, weigh the bias and credibility of witnesses, assess the probative value of different types of evidence and reach a reasoned conclusion.

As we demonstrate below, Northwest's motions are without basis in the law and should be denied.

II. Evidence Regarding Other Successful Alliances That Do Not Include Equity Is Highly Probative And Should Not Be Excluded

As the first day of trial approaches, Northwest realizes that it has no viable legal theory or credible independent evidence to corroborate the ipse dixits of its executives that it is "absolutely necessary" that Northwest maintain control of Continental in order for the alliance to survive. Northwest has therefore chosen to ask the Court to bar the Government from introducing any probative evidence refuting Northwest's defense that the harm to competition caused by its control of Continental is justified by the alliance. What Northwest refers to as "fanciful" alternatives and "sweeping generalizations" are actually a well-documented history of prior conduct that directly contradicts the story Northwest executives would now like to tell the Court.

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The basic facts are:

- Both Northwest and Continental have had successful alliances involving little or no equity.
- Other major domestic airlines routinely enter similar marketing alliances without equity ownership.
- KLM held equity in Northwest for several years.
- Even though KLM's equity holding was well below the 51% equity holding that Northwest has in Continental, significant governance problems arose between Northwest and KLM, problems that interfered with the Northwest-KLM alliance.
- After the commencement of litigation between the two parties, Northwest repurchased its stock from KLM.
- Northwest and KLM now have a long-term, stable and successful alliance involving no equity.

Northwest cannot raise its alliance with Continental as an efficiencies defense and then protest when the Government presents alliance evidence Northwest does not like.[1]

A. The Court Should Not Relieve Northwest Of Its Burden To Prove An Efficiencies Defense

The Government's complaint in this case did not seek to prevent Northwest and Continental from forming an alliance. In fact, the Government has taken no position as to the competitive benefits or harm of that alliance. This case is, and always has been, about the

[1] Northwest's motion also claims that "it is beyond genuine dispute" that Northwest's acquisition of control of Continental was "absolutely" necessary. This issue is, of course, vigorously disputed by the Government, and indeed the Court has already rejected Northwest's motion for partial summary judgment on this issue. See Hearing Transcript, August 30, 2000 at 73.

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competitive harm caused by Northwest's ownership of a controlling interest in Continental. Northwest has decided to try to make an issue of the separate alliance transaction. If the Court permits this defense to go forward at trial,[2] the Government anticipates that Northwest will produce evidence of allegedly procompetitive benefits of the alliance and ask the Court to weigh those benefits against the anticompetitive harm caused by Northwest's holding a controlling interest in Continental. Such evidence constitutes an efficiencies defense, and, if it is to be accepted at all, it is a defendant's burden to prove.[3] *No Court has ever ruled that a transaction that otherwise violates Section 7 was saved by an efficiency defense.*

There are good reasons why efficiencies defenses have never succeeded. Contrary to Northwest's assertion (NW Motion at 4), an efficiencies defense cannot be raised as a justification for an anticompetitive transaction if those efficiencies could be achieved through less competitively harmful means. *See FTC v. University Health, Inc.,* 938 F.2d at 1222 n.30 (stating that courts should require "proof that the efficiencies to be gained by the acquisition cannot be secured by means that inflict less damage to competition"); *FTC v. Cardinal Health, Inc.,* 12 F.

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[2] The Supreme Court rejected an efficiencies defense in *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 371 (1963) stating that an otherwise anticompetitive merger would not be saved because, "on some ultimate reckoning of social or economic debits and credits, it may be deemed beneficial." *See also, FTC v. Proctor & Gamble Co.*, 386 U.S. 568, 580 (1967).

[3] *FTC v. University Health, Inc.*, 938 F.2d 1206, 1223 (11th Cir. 1991), (holding that a defendant must prove the efficiencies); *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1088 (D.D.C. 1997) (holding that defendants have the burden of proof); *United States v. Rockford Mem. Corp.*, 717 F. Supp, 1251, 1289 (N.D. Ill. 1989) (stating that the efficiencies defense is subject to a "very rigorous standard"; it must be proved with "clear and convincing evidence"), *aff'd on other grounds*, 898 F.2d 1278 (7th Cir. 1990), *cert. denied*, 498 U.S. 920 (1990); U.S. Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines § 4, at 31 (rev. Apr. 8, 1997) ("merging firms must substantiate efficiency claims so that the Agency can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), how each would enhance the merged firms' ability and incentives to compete, and why each would be merger-specific.").

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Supp. 2d 34, 61-62 (D.D.C. 1998) ("efficiencies, no matter how great, should not be considered if they could also be accomplished without a merger"); *United States v. IVACO, Inc*., 704 F. Supp. 1409, 1425-26 (W.D. Mich 1989) (finding the efficiency argument unpersuasive because defendants failed to consider a number of alternative transactions, and failed to explain why such alternatives were impractical); *Rockford Mem. Corp.*, 717 F. Supp. at 1289 ("Efficiencies benefitting the [combined] entity, but obtainable by means independent of the [combination], are not relevant for § 7 purposes."), *aff'd on other grounds*, 898 F.2d 1278 (7th Cir.); *Staples, Inc.*, 970 F. Supp. at 1088-90 (holding that many of the claimed cost savings were not specific to the combination since they could have been achieved if the firms remained independent); *United States v. Mercy Health Svcs.*, 902 F. Supp. 968, 987-88 (N.D. Iowa 1995) (rejecting many of the claimed efficiencies on the grounds they could be realized without the combination), *vacated as moot*, 107 F.3d 632 (8th Cir. 1997); *Philadelphia Nat'l Bank*, 374 U.S. at 370-71 (holding that the advantages of an acquisition did not justify the acquisition where an alternative -- internal expansion -- was available).

The cases cited by Northwest do not suggest that the Sixth Circuit has departed from this well-settled rule as Northwest implies. In *White Consol. Indus., Inc. v. Whirlpool Corp.*, 781 F. 2d 1224 (6th Cir. 1986), efficiencies were not even an issue. Rather, the issue was whether a proposed divestiture remedy was sufficient. *See* id. at 1227. Once the Court concluded that the remedy was sufficient to cure the competitive harm, it properly declined to look for "better" remedies urged by plaintiff that went beyond redressing the violation. *See* id. at 1227-28. Northwest's reliance on *FTC v. Butterworth Health Corp.*, 946 F. Supp. 1285 (W.D. Mich. 1996), *aff'd* 121 F.3d 708 (6th Cir. 1997) is also misplaced. There the FTC challenged only the magnitude of defendants' efficiencies, but did not claim that the defendants' efficiencies could be

achieved by less anticompetitive alternatives. Thus, the issue of alternatives was never reached by the court. *See Butterworth Health Corp.*, 946 F. Supp at 1295-96.

There is a further reason why an efficiencies defense has never saved an otherwise anticompetitive acquisition, and it is particularly instructive in this case: self-serving statements by defendants' executives alone (Northwest's key evidence regarding the link between equity and the alliance) are insufficient to carry the defendant's burden of proof. *University Health*, 938 F.2d at 1222-23 (a defendant cannot carry its burden "based solely on speculative, self-serving assertions.").

Aware that it is unable to meet its burden because it has no objective or credible independent evidence that its alleged "link" exists, Northwest has asked the Court to exclude the government's evidence as well. In effect, Northwest is saying, "just take our word for it--there is a link." Such a request is untenable. If Northwest truly wants to relieve the Court of the need to review evidence regarding other alliances, Northwest should agree not to offer any evidence regarding the alleged benefits of the Northwest alliance with Continental, and the Government will then have no need to show that those benefits are achievable without equity.

B. The Court Should Admit and Consider The Most Probative Evidence That Equity Is Not Necessary To A Successful Alliance -- Northwest's Own Prior Conduct And Statements

Northwest patronizingly claims that evidence of other alliances, including its alliance with KLM will "confuse" the Court (NW Motion at 5-6). In reality, Northwest is understandably concerned that this objective evidence that none of Northwest's other alliances involve controlling equity, that none of the dozens of major alliances of U.S. airlines involve controlling equity, and that few of the alliances of U.S. carriers involve any equity at all, will persuade the Court.

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Northwest is particularly concerned that evidence of its prior words and deeds in its KLM alliance (when the shoe was on the other foot) will persuade the Court that an equity holding is not necessary to a successful alliance between Northwest and Continental.

Now that it is in its interest to say so, Northwest tells this Court that the KLM experience is "not comparable" and "of no probative value with respect to the transaction at issue."(NW Motion at 5,6). The probative value of the evidence is ultimately for the Court to decide, but Northwest previously found evidence from its NW/KLM experience to be highly probative, telling the Government that [**REDACTED**

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Indeed, the similarities of the NW/KLM alliance to the present situation are striking:

- Northwest is a party to both alliances.
- KLM is also a large network carrier..
- KLM's equity holding in Northwest was even less than the control block involved here.
- The Government's evidence includes prior statements, including sworn testimony, by Northwest executives on Northwest's current witness list.
- The Government's evidence contains instances of corporate governance problems between the two parties to the NW/KLM alliance similar to those predicted by Government witnesses in the present case.
- Just as Continental has asked to purchase its stock from Northwest, Northwest proposed to buy its stock from KLM, but KLM was at first unwilling until litigation forced its hand.

Northwest is understandably concerned that the Court may find another "analogy" between the

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two -- just as the NW/KLM alliance was more successful than ever after Northwest bought its stock back, so too would be the Northwest/Continental alliance if Continental bought its stock back.

The product liability jury trial cases cited by Northwest, *Brock v. Caterpillar Tractor, Inc.*, 94 F.3d 220 (6th Cir. 1996), and *In re Aircrash Disaster,* 86 F. 3d 498 (6th Cir. 1996) have little bearing on the value and relevance of the alliance evidence. Both of those cases involved evidence of design changes made by defendant manufacturers that were offered by plaintiff as evidence of liability. The government is not using the alliance evidence to prove antitrust liability against Northwest. Rather the evidence will be used to rebut Northwest's arguments that holding the equity in Continental is necessary to maintain the alliance. Only by comparing the actual choices and conduct of Northwest and other airlines in analogous situations can the credibility of Northwest's current "linkage" claims be assessed. Thus, its probative value is high, while the likelihood of unfair prejudice is low.

C. Continental Witnesses May Indeed Have A Basis For Testimony Regarding Northwest's Alliances With Other Carriers

Northwest asks for a blanket exclusion of any Continental witnesses offering any testimony about the Northwest-KLM alliance. The admissibility of any such testimony will depend on the foundation for the testimony and the purpose for which it is offered. Fed. R. Evid. 602 requires only that a proper foundation be laid before a witness testifies. There is an extensive public record on the Northwest-KLM alliance, including many statements from Northwest itself. Any objections Northwest has to the competence of any witness to testify on any subject should await trial.

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III. Prior Sworn Testimony Of Northwest's Officers and Directors Are Admissions Of A Party Opponent

Northwest seeks to exclude deposition testimony *of its own executives* from other cases[4], claiming it is irrelevant, barred by Federal Rule of Civil Procedure 32 and would be misleading and confusing to the Court. Although it is understandable that Northwest would rather the Court not hear the prior sworn testimony of its own executives, those prior depositions are highly relevant to issues in this case and clearly admissible under Fed. R. Evid. 801.

In this case, Northwest urges the Court to find that its retention of voting control of Continental is lawful under the antitrust laws. It claims that despite its continuing ownership of voting control, the "governance agreements" will keep Continental independent from Northwest for the next ten years. Its experts and executives maintain, among other things, that Northwest's ability to vote 20% of Continental's stock in four years is essentially meaningless and that Northwest's commitment to have independent directors on Continental's board will ensure that Continental will compete with Northwest. Simultaneously, Northwest claims that it must continue to hold voting control of Continental to assure Continental will continue to cooperate with Northwest in their marketing alliance. Northwest also contends that, in any event, the loss of competition between Continental and Northwest is not very important because other airlines, including Southwest Airlines, will prevent any fare increases.

But Northwest did not always feel that way on these issues. In fact, the testimony it seeks to exclude directly undercuts the evidence it now wants to offer this Court.

A. <u>The KLM Litigation</u>

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[4]See attached appendix, tab 1.

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In 1995, KLM Royal Dutch Airlines owned approximately 19% of Northwest's outstanding voting stock, had an option for an additional 4.6%, and had the right to appoint three of Northwest's fourteen directors. Northwest and KLM were also partners in a alliance which included extensive code sharing on their routes. In November 1995, Northwest's board became concerned about the size of KLM's voting stake in Northwest and the interference of KLM's equity holdings of the alliance. Northwest adopted a poison pill to stem KLM's ability to control the company.

KLM sued Northwest over the poison pill. When asked about what level of voting shares could control a company, Frederic Malek, a board member of Northwest Airlines, testified that [**REDACTED**

]Another board member, George Vojta, testified that [**REDACTED**

] Others testified similarly.[5] According to Northwest, three years ago, [**REDACTED** **]** ; now it does not.

Northwest's directors did not place much faith in [**REDACTED**

] When Duane Woerth, a Northwest board member, was asked about this issue in the KLM matter, he testified that [**REDACTED**

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[5] *See also* Dasburg **[REDACTED**

]; Wilson [**REDACTED**

]; Woerth [**REDACTED**

].

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] [6] Three years ago, [**REDACTED**] now they do.

Northwest also rejected KLM's claim that it needed the equity to maintain their alliance. Al Checchi, a co-chairman of the Northwest board, swore:

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Checchi Dep., 7/24/97, at 223-24. Checchi's view that not only [**REDACTED**

] was consistent with the sworn testimony of other Northwest board members.[7] Indeed, Gary Wilson, the other co-chairman of the Northwest board, testified that **[REDACTED**

] Wilson Dep., 7/1/97, at 251. Only *after* KLM divested its voting shares did the alliance truly flourish. Three years ago, equity wasn't necessary to an alliance; now it is.

B. The Litigation Against American Airlines

Northwest sued American Airlines in 1992 for monopolization, claiming that it engaged in

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[6] Woerth Dep., 5/20/97, at 139.

[7] *See* Malek [**REDACTED**] ; Wilson [**REDACTED**

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predatory conduct. Michael Levine, then the executive vice president of marketing at Northwest, testified about [**REDACTED**

] didn't matter then; it does now.

C. Legal Argument

The Sixth Circuit has recognized that admissions made by a party opponent in a deposition are "not hearsay" under Fed. R. Evid. 801(d)(2). *Trepel v. Roadway Express, Inc.*, 194 F.3d 708, 718 (6th Cir. 1999). Rule 801(d)(2) allows the admission of a statement against a party when made by "a person authorized by the party to make a statement" or by "the party's agent or servant." The deposition statements Northwest seeks to exclude are sworn depositions of Northwest board members and high ranking executives. Thus, the prior sworn statements of Northwest executives and directors are clearly admissible by the United States against Northwest, its party-opponent.[8]

Northwest ignores this fundamental rule of evidence and argues that this sworn

[8] Rule 801(d)(2) has been used to admit far less reliable statements than the sworn testimony of Northwest's own board of directors and executives. *See, e.g., Astra Pharmaceutical Prod., Inc. v. OSHRC*, 681 F.2d 69, 73 n.8 (1st Cir. 1982) (health inspector's re-counting of the statements of two employees of plaintiff admissible); *B-W Acceptance Corp. v. Porter*, 568 F.2d 1179, 1183 (5th Cir. 1978) (co-defendant could testify as to what plaintiff's branch manager said at a prior trial).

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testimony should not be admitted because of Fed. R. Civ. P. 32(a)(4).[9] But, Rule 32(a)(4) does not override Rule 801(d)(2) or any of the other rules of evidence; indeed the last sentence of Rule 32(a)(4) specifically provides: "*A deposition previously taken may also be used as permitted by the Federal Rules of Evidence.*" Thus, courts properly look to Rule 32(a)(4) when analyzing the admissibility of testimony that is not otherwise admissible under the Rules of Evidence, testimony that usually involves third party witnesses. But Rule 32 does not repeal the Federal Rules of Evidence.[10] *See, e.g.*, *Budden v. United States*, 748 F. Supp. 1374, 1378 (D. Neb. 1990), *judgment vacated and remanded on other grounds*, 963 F.2d 188 (8th Cir. 1992) (Rule 801, not Rule 32, governed admissibility of admissions by a party opponent). As one court stated:

> This Court is satisfied that its fellow members on the Advisory Committee on the

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[9] The Rule states in relevant part:

> Substitution of parties pursuant to Rule 25 does not affect the right to use depositions previously taken; and, when an action has been brought in any court of the United States or of any State and afterward brought between the same parties or their representatives or successors in interest, all depositions lawfully taken and duly filed in the former action may be used in the latter as if originally taken therefor. *A deposition previously taken may also be used as permitted by the Federal Rules of Evidence.*

Fed. R. Civ. P. 32(a)(4) (emphasis added). "The final sentence [of Rule 32(a)(4)] is added to *reflect the fact that the Federal Rules of Evidence permit a broader use of depositions previously taken under certain circumstances.*" Fed. R. Civ. P. 32 (Advisory Committee Notes to the 1980 Amendment) (emphasis added).

[10] The Advisory Committee Notes on Rule 32 state: "For example, Rule 804(b)(1) of the Federal Rules of Evidence provides that if a witness is unavailable, as that term is defined by the rule, his deposition in *any* earlier proceeding can be used against a party to the prior proceeding who had an opportunity and similar motive to develop the testimony of the witness." (Notes to the 1980 Amendment). Indeed, in *Kondakjian v. Port Authority of New York and New Jersey*, 1996 WL 280799 *1 (S.D.N.Y., May 24, 1996), the court admitted deposition testimony that satisfied Rule 804(b)(1), but *not* Rule 32(a)(4).

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> Rules of Evidence would be just as surprised as this Court by the notion. . . that Rule 32 somehow trumps the Evidence Rules. Under the Evidence Rules, once an item of evidence qualifies as nonhearsay under Evidence Rule 801(d) its admissibility is governed by the broad-brush statement in Evidence Rule 402 that, subject to specified exceptions: All relevant evidence is admissible.[11]

In urging the Court to ignore Rule 801(d)(2) and instead apply Rule 32(a)(4) to the prior depositions of its own executives and directors, Northwest relies on *Rule v. International Association of Bridge, Structural & Ornamental Ironworkers*, 568 F.2d 558, 568-69 (8th Cir. 1978), an Eighth Circuit case decided prior to 1980.[12] But in that case, the Court admitted all of the prior depositions against all defendant parties, finding that the depositions were admissions of a party opponent and that they also satisfied the requirements of Rule 32(a)(4), even though the parties in the prior action were not identical.[13]

In this case, the Government is not seeking to offer in evidence deposition testimony from other parties as an admission against Northwest; rather, the Government is seeking to use prior statements given under oath by Northwest's own high-ranking executives and board members. In both prior matters, Northwest executives had every interest in developing fully for the record the testimony that the government now wishes to use as admissions because that testimony was

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[11] *Aircraft Gear Corp. v. Kaman Aerospace Corp.*, 1996 WL 65990 *1 (N.D. Ill. Feb. 12, 1996). Other Courts have reached the same conclusion, *See, e.g., Angelo v. Armstrong World Indus., Inc.*, 11 F.3d 957, 963 (10th Cir. 1993); *Wyatt v. Security Inn Food & Beverage, Inc.*, 819 F.2d 69, 70-71. (4th Cir. 1987). *See* also 7 Moore's Federal Practice § 32.63[3] at 32-77.

[12] That year is significant because Rule 32(a)(4) was amended in 1980, adding the very last sentence that allows "[a] deposition previously taken . . . [to be admitted] as permitted by the Federal Rules of Evidence." Thus, *Rule* was decided before the relationship between Rule 32 and the Federal Rules of Evidence was clarified.

[13] The *Rule* court and others have followed a liberal construction of the requirements of Rule 32(a)(4). *See, e.g., Ikerd v. Lapworth*, 435 F.2d 197, 205-06 (7th Cir. 1970); *Fullerform Continuous Pipe Corp. v. American Pipe & Construction Co.*, 44 F.R.D. 453 (D. Ariz. 1968).

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important to Northwest's position in those lawsuits. KLM's control and influence of Northwest was Northwest's key defense in a lawsuit by KLM challenging Northwest's decision to adopt a poison pill. And, in the antitrust litigation between Northwest and American Airlines, Northwest vigorously disputed American's characterization of Southwest Airlines' pricing practices and its competitive significance.

Finally, Northwest disingenuously suggests that live testimony is superior to the "stale" sworn testimony of its executives and board members while providing the court with deposition designations of literally hundreds of pages of Continental executives who *will* testify at trial, as well as other Continental employees who Northwest could have easily subpoenaed to testify. *See* Dep. Designations of Northwest Airlines, 9/15/00. The only consistency in Northwest's position is that it only wants this Court to hear testimony, stale or otherwise, that supports Northwest's litigation positions.

IV. Evidence Regarding Entry Barriers Faced By Low Cost Carriers Is Crucial To A Proper Section 7 Analysis In This Case

Both the United States and Northwest have asserted that the issue of entry is relevant and material to this case. In the Pretrial Order, the United States' claims section states:

> 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 countered by new 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. At trial, the United

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> States will offer evidence of the formidable barriers to entry in the airline industry that will prevent other airlines from entering the adversely affected routes and driving prices down to pre-transaction levels.

Pretrial Order at 3.

In its statement of claims section, Northwest adopts the opposite position on the entry issue: It states that:

> 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.

Pretrial Order at 5.

Now, Northwest proposes that the Court exclude evidence from six executives of non-major airlines "relating to barriers to entry and alleged predatory behavior" (Motion to Exclude at 2), characterizing this evidence as a "sideshow." Read broadly, Northwest seeks to exclude all evidence that barriers to entry will make new entry unlikely. Read more narrowly, it seeks to exclude evidence of the effect of its prior aggressive responses to entry on the likelihood of new entry, if those responses have been or could be characterized as predatory conduct. Under either reading of its motion, however, Northwest seeks to exclude relevant evidence that is clearly admissible under Federal Rules of Evidence 401, 402 and 403.

A. Evidence on the Entry Issue is Relevant under Rule 401

Rule 401 defines "relevant evidence" as "evidence having any tendency to make the existence of any fact that is consequential to the determination of the action more probable or less probable than it would be without the evidence." As noted by the Supreme Court, Rule 401 adopts a "liberal" standard of relevance. *Daubert v. Merrell Dow Pharmaceuticals*, 509 U.S. 579, 587 (1993). In describing its relevance standard, the Sixth Circuit stated:

> The standard for determining whether evidence is relevant is extremely liberal. . . We note

> that in determining whether evidence is relevant, the district court must not consider the weight or sufficiency of the evidence. . . (citations omitted) Even if a district court believes the evidence is insufficient to prove the ultimate point for which it is offered, it may not exclude the evidence if it has even the slightest probative worth.

Douglass v. Eaton Corp., 956 F.2d 1339, 1343-44 (6th Cir. 1992) (abuse of discretion to exclude fired employee's evidence of prior physical altercations).[14]

The Government will have no difficulty satisfying this relevance standard for the testimony that it will elicit from the Sun Country, Pro Air, Southwest, Frontier, Midwest Express, and JetBlue executives on its witness list. We anticipate that some of those witnesses will testify that establishing new hubs at existing Northwest or Continental hub airports or initiating new point-to-point services on Northwest/Continental hub-to-hub routes is not compatible with their business strategies. Some of their testimony will tend to prove that barriers to entry that are common in the airline industry make entry by non-major airlines difficult and rare; other testimony will tend to prove that Northwest's reputation for aggressively responding to new entrants makes new entry on its routes particularly unattractive to would-be entrants. All of the expected testimony will tend to make the existence of substantial barriers to entry on Northwest or Continental routes more probable and thereby tend to disprove Northwest's argument that new entry will cure any competitive harm from the transaction.

B. The Relevant Evidence on the Existence of Barriers to Entry is Admissible under Rules 402 and 403

[14]The ruling in *United States v. W. Fountain*, 2 F.3d 656, 667 (6th Cir. 1993), which Northwest cites as authority for injecting a materiality standard into Rule 401, does not change the Sixth Circuit's liberal relevance standard, or provide a basis for excluding testimony concerning the existence of barriers to entry. The entry issue is material to the outcome of this case. If Northwest proves that new entry in all of the affected city pair markets is so easy and likely that it would solve all of the competitive problems caused by its acquisition of a majority voting interest in Continental, Northwest wins.

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Rule 402 provides that "all relevant evidence is admissible, except as otherwise provided by the Constitution of the United States, by Act of Congress, by these rules, or by other statutory authority." In order to exclude evidence on entry and barriers to entry, therefore, Northwest must find some exception to the liberal general rule favoring admission. Northwest appears to focus primarily on the prospect that other airlines may testify about its reputation for aggressively responding to entry (arguably to the point of engaging in unlawful predatory activities), and it contends that the prejudicial impact of this evidence would outweigh its probative value.

Northwest may be overly sensitive about its conduct. It is not the Government's intention to argue that any of its evidence proves that Northwest's responses to new entrants meet the standard for unlawful monopolization conduct. But we do expect, as noted above, that the airline executives may testify about their knowledge of Northwest's aggressive conduct in response to entry, their knowledge of law suits filed against Northwest accusing it of unlawful conduct, and ultimately, the effect Northwest's reputation has on their state of mind in making decisions about entry into Northwest's routes -- evidence highly probative to the issue of whether new entry is likely.

Although this reputation evidence may not be consistent with the public image Northwest would like to promote, it is not nearly as prejudicial as the negative reputation evidence that courts routinely allow juries to hear for the purpose of proving the state of mind of persons whose actions are affected by those reputations. For example, the Sixth Circuit ruled that the defendant's reputed membership in the Mafia was properly admitted to show the victim's fear of bodily harm in a Hobbs Act case (*United States v. Russo,* 708 F.2d 209 (6th Cir. 1983). *See also, United States v. Gigante,* 729 F.2d 78 (2nd Cir. 1984) (proper to admit evidence that the defendant was a reputed "capo" in the Genovese crime family in a loansharking case). Similarly,

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in an antitrust case, *Forro Precision v. International Business Machines Corp.*, 673 F.2d 1045 (9th Cir. 1982), the court of appeals ruled that the trial court properly admitted hearsay evidence relating to the plaintiff's alleged leaks of trade secrets, arrests, indictments and convictions for the purpose of showing IBM's state of mind when it induced the police to raid the plaintiff's business premises.[15]

In any event, unfair prejudice from otherwise relevant and admissible evidence is of little concern in bench trials.[16] The trial judge can cure any conceivable hearsay or prejudice problems by keeping in mind the limited purpose for which the evidence is presented -- to prove that Northwest's reputation for aggressively responding to new entrants in the past makes it less likely that new entrants will enter Northwest's markets in the future.

Finally, the introduction of evidence on Northwest's reputation for aggressively responding to new entrants should not waste the Court's time -- the United States anticipates that all six airline executives' direct testimony combined will require less than a day of trial time -- nor should it create a contentious side show -- the Court can prevent such tactics.

Northwest can, if it chooses, avoid the presentation of evidence on barriers to entry. It can eliminate that issue and streamline the trial by signing a stipulation[17] conceding that new entry

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[15]In these cases, the trial court resolved hearsay objections, and cured any prejudicial inferences, by instructing the jury that the reputation evidence was not admitted to establish the truth of the matter, but only to show the state of mind of persons who took that reputation into account when engaging in actions relevant to the disposition of the case.

[16]Moore's Federal Practice, 1990 Rules Pamphlet § 403.4 at 89 (1990); see also M. Martin, "Significant Evidence Problems in Complex Litigation," C829 ALI-ABA 257, 274 (1993); *In re Japanese Elec. Prods. Antitrust Litig.*, 723 F.2d 270 (3rd Cir. 1983); *Gulf States Utils. Co. v. Ecodyne Corp.*, 635 F.2d 517 (5th Cir. 1981).

[17]See attached appendix, tab 2, for suggested stipulation.

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is not likely to solve any competitive problems caused by Northwest's purchase of a voting majority of Continental's stock.

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V. Evidence of Possible Collusion in the Airline Industry is Highly Probative in this Case and Should Not be Excluded

Defendant Northwest has moved for the Court to bar introduction of evidence relating to collusion in the airline industry, including evidence related to the Airline Tariff Publishing Co. case.[18] The ease and likelihood of anticompetitive collusion or coordination among competitors in the relevant market(s) is always an issue in a section 7 case, and evidence of whether a particular market structure is conducive to collusion is clearly relevant and admissible in such cases.[19] Therefore, the Court should deny defendant Northwest's motion to exclude *in limine* all evidence relating to collusion in the airline industry.

Defendant Northwest contends that evidence relating to collusion in the airline industry is inadmissible as irrelevant under Federal Rules of Evidence 401, 402, and 403. Northwest is mistaken. The likelihood of anticompetitive coordination among competitors in the relevant industry is a central factor in any case brought under section 7 of the Clayton Act, and evidence of the history of competition in that industry is routinely admitted. *See, U. S. v. Standard Oil Co.*, 253 F.Supp. 196 (D.C.N.J. 1966) (history of competition in the industry is an important factor in a section 7 analysis); *U. S. v. Manufacturers Hanover Trust Co.*, 240 F.Supp. 867 (S.D.N.Y. 1965) (section 7 analysis is assessed within the structure and history of the whole relevant market); *Kaplan & Sons, Inc. v. F. T. C.*, 347 F.2d 785 (D.C. Cir. 1965) (noting that the analysis involves many factors, including the "competitive history of one accused of violations, including

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[18] *United States v. Airline Tariff Publishing Co.*, et al., No 92-2858 (SSH) (D.D.C. 1992).

[19] 15 U.S.C.A. § 18; Wright & Graham, Federal Practice and Procedure: Evidence § 5162 (1978). See also *United States v. Hall*, 653 F.2d 1002, 1005 (5th Cir. 1981) (noting that whether a proposition is relevant is a question that is governed by the substantive law).

evidence of past violations"). None of the cases cited by Northwest involved exclusion of prior collusion evidence as irrelevant in an antitrust case.

Northwest also claims that evidence of past collusion in the airline industry should be excluded under Federal Rule of Evidence 404(b). However, evidence of past acts is generally admissible when offered for any reason other than to "prove the character of a person in order to show action in conformity therewith." Fed. R. Evid. 404(b).[20] Hence, evidence of prior acts of collusion is commonly admitted as relevant in federal antitrust litigation for many purposes other than to prove conformity to the prior acts or propensity to engage in those acts.[21] Thus, it is improper for Northwest to request that the Court exclude prior act evidence without regard to the nature of the evidence offered or what it is being offered to prove.[22] Because Northwest cannot

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[20]Rule 404(b) expressly permits prior acts to be introduced to show motive, opportunity, intent, preparation, plan, knowledge, identity or absence of mistake. The list of purposes for which evidence of other acts is admissible was not meant to be an exclusive or exhaustive list. *See, e.g., United States v. Mendez-Ortiz*, 810 F.2d 76 (6th Cir. 1986), cert. denied 480 U.S. 922 (1987).

[21]*See, e.g., United States v. Southwest Bus Sales, Inc.*, 20 F.3d 1449 (8th Cir. 1994) (evidence of prior conspiracy to allocate sales and fix prices was admissible and relevant in subsequent prosecution for antitrust conspiracy); *United States v. Andreas*, 216 F.3d 645 (7th Cir. 2000) (evidence of other conspiracy to control supply and fix prices was admissible under exception to prohibition against "other crimes" evidence); *United States v. Smith Grading & Paving, Inc.*, 760 F.2d 527 (4th Cir. 1984) (finding evidence of prior bid rigging admissible). That a defendant was acquitted of the other acts, or a fortiori settled a case relating to the acts, does not bar use of such evidence under Rule 404(b). *Dowling v. United States*, 493 U.S. 342, 350 (1990). A decision to admit evidence under Rule 404(b) will not be overturned unless "the evidence in question clearly had no bearing upon any of the issues involved." *United States v. Estabrook*, 774 F.2d 284, 287 (8th Cir. 1985).

[22]The admissibility of other acts evidence is a question of conditional relevancy under Federal Rule of Evidence 104(b). *Huddleston v. United States*, 485 U.S. 681 (1988). Determining admissibility requires the proponent and the court to focus on the purpose for which particular evidence is offered. *See, e.g. United States v. Merriweather*, 78 F.3d 1070 (6th Cir. 1996).

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presume that the government intends to use prior acts evidence only to prove a proclivity to collude, a motion *in limine* seeking blanket exclusion under Rule 404(b) is unwarranted. Finally, Northwest's reliance on Rule 403 is misplaced, since Rule 403 only excludes evidence that is "*unfairly*" prejudicial,[23] and in any event unfair prejudice from otherwise relevant and admissible evidence is of little concern in bench trials.[24]

Northwest also argues that any evidence of past collusion in the airline industry that the Government might offer will inevitably be inadmissible hearsay under Federal Rules of Evidence 801 and 802. Northwest cannot presume that all potential evidence of past collusion in the airline industry will be hearsay, particularly if it comes in the testimony of Northwest, Continental or other industry witnesses at trial. (See NW Motion at 1.) Moreover, evidence relating to allegations of collusion in the airline industry may be admissible as nonhearsay where it is not offered for the truth of the allegation, or because it is an admission of a party opponent, or because it falls within an exception to the hearsay rule. See Fed. R. E. 801, 803, 804. It is premature for Northwest to make a blanket hearsay objection before Northwest knows the nature of the evidence and what it is being offered to prove.[25]

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[23]Fed. R. Evid. 403, Advisory Committee's Note (the rule "does not offer protection against evidence that is merely ... detrimental to a party's case").

[24]Moore's Federal Practice, 1990 Rules Pamphlet § 403.4, at 89 (1990); See also M. Martin, "Significant Evidence Problems in Complex Litigation", C829 ALI-ABA 257, 274 (1993); *In re Japanese Elec. Prods. Antitrust Litig.*, 723 F.2d , 270 (3rd Cir. 1983); *Gulf States Utils. Co. v. Ecodyne Corp.*, 635 F.2d 517 (5th Cir. 1981).

[25]See also United States v. Batts, 558 F.2d 513, 517 (9th Cir. 1977), cert. denied 439 U.S. 859 (1978) (citing rule 102 in declining to construe Rule 608(b) to require exclusion of prior specific act evidence that it regarded as highly probative in the circumstances of the case.)

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VI. Evidence By The Government's Expert Witnesses of the Consequences of Northwest's Ownership of Voting Control of Continental Should Not Be Excluded

A. Introduction

Northwest seeks to exclude all testimony of all three of the government's experts. It is predictable of course that Northwest disagrees with our experts. But that neither makes their testimony unreliable nor irrelevant. Northwest's motion is just the latest reflection of its overarching trial strategy -- to make this case about their defenses -- the governance and alliance agreements -- rather than the inescapable competitive consequences of Northwest's ownership of voting control over Continental and to make sure the Court hears only one side of the story. Northwest's motion should be denied.

In seeking to exclude the testimony, Northwest mischaracterizes the role of each of the government's experts and the nature of their anticipated testimony, while at the same time ignoring the proper focus and substance of their expert opinions. In addition, Northwest takes particular issues out of context and then misstates the government's experts' opinions on those issues. Finally, Northwest improperly asks this Court to issue a blanket exclusion order precluding any and all expert testimony by the government's expert witnesses.

The government's experts are, as their resumes demonstrate, skilled and accomplished professionals who have not only studied the record in this case, including the documents and deposition testimony produced by parties and non-parties alike, but have also gathered and considered the types of materials relied on by other experts in their disciplines that bear on the issues they address. Prof. Baker, a highly credentialed economist, analyzes the likely competitive effects of Northwest's acquisition and ownership of 51% voting control and a 14% equity interest in Continental. Prof. Rock, an expert in corporate governance, analyzes the complex governance

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agreements between Northwest and Continental and assesses their affect on Northwest's influence and control over Continental. And Prof. Oster, an expert on transportation and the airline industry, analyzes whether equity control or ownership is necessary for the alliance. The testimony of all three experts flow logically and clearly from the evidence, and all three experts drafted reports that set forth in extensive detail the bases for their opinions and the evidence supporting them. The opinions of the government's experts meet the *Daubert* criteria and will greatly assist the Court in conducting a proper analysis under Section 7 of the Clayton Act.

B. Argument

To qualify as an expert under Rule 702 of the Federal Rules of Evidence, a witness must meet three basic criteria:

(1) the witness must establish his expertise by reference to "knowledge, skill, experience, training, or education." Fed. R. Evid. 702; *Pride v. BIC Corp.*, 218 F.3d 566, 577 (6th Cir. 2000);

(2) the proffered expert's testimony must be "reliable;" in the sense that it is based on "scientific, technical or other specialized knowledge." Fed. R. Evid. 702; *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579, 591 (1993); and

(3) the expert's testimony must assist the trier of facts in understanding and disposing of the issues relevant to the case; that is, the testimony must "fit" the facts of the case. *Daubert*, 509 U.S. at 592; *Pride*, 218 F. 3d at 578.

In applying these standards, the Court has considerable discretion "to avoid unnecessary 'reliability' proceedings in ordinary cases where the reliability of an expert's methods is properly taken for granted." *Kuhmo Tire Co. v. Carmichael*, 526 U.S. 137, 152 (1999).

Each of the government's expert witnesses clearly meets these criteria. Their testimony, based on the factual record and well-accepted analysis in their disciplines "employs ... the same

level of intellectual rigor that characterizes the practice of an expert in the[ir] .... field" (*Kuhmo* 526 U.S. at 137). Their testimony will assist the Court in assessing key issues in the case -- the competitive effects of Northwest's acquisition and Northwest's alliance and governance defenses. The testimony of Professors Baker, Rock and Oster should be admitted.

C. Professor Jonathan Baker

The government's first expert is Professor Jonathan Baker. Prof. Baker is an economist specializing in antitrust issues who currently is a professor at The American University. Economists such as Prof. Baker routinely testify in antitrust cases, and their testimony is often cited by Courts in reaching their decision. *See, Brooke Group, Ltd. v. Brown & Williamson Tobacco Corp*, 509 U.S. 209 (1993); *PSI Repair Servs., Inc. v. Honeywell, Inc.,* 104 F. 3d 811 (6th Cir. 1997). *See also Cincinnati Bell Telephone Co. v. FCC*, 69 F. 3d 752 (6th Cir. 1995) (the parties did not use an economist expert witness, and the court noted that it would have been helpful if they had).[26]

Prof. Baker is particularly well qualified to assist the Court in this case. He was recently among a handful of industry experts who were asked to serve on a Congressionally commissioned panel analyzing competitive problems in the airline industry. Before that he was the head

[26]Few of the cases that Northwest cites in support of its *Daubert* arguments are antitrust cases involving expert testimony of economists. *See, e.g., Pride v. BIC Corp.,* 218 F. 3d 566 (6th Cir. 2000) (expert in cigarette lighters); *Berry v. Crown Equip. Corp.,* 108 F. Supp. 2d 743 (E.D. Mich. 2000) (self-employed accident prevention and safety expert with only an undergraduate degree in speech); *Berry v. City of Detroit,* 25 F.3d 1342 (6th Cir. 1994) (sociologist police discipline expert); *Guillory v. Domtar Indus., Inc.,* 95 F. 3d 1320 (5th Cir. 1996) (mechanical engineer as a forklift accident expert); *Pomella v. Regency Coach Lines, Ltd.,* 899 F. Supp. 335 (E.D. Mich. 1995) (mathematician, retired police officer, and bus driver as bus accident experts); *General Electric Co. v. Joiner,* 522 U.S. 136 (1997) (oncologist expert); *Smelser v. Norfolk S. Ry. Co.,* 105 F. 3d 299 (6th Cir. 1997) (biomechanics expert admitting to testifying outside of area of expertise).

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economist at the Federal Trade Commission ("FTC"). In that capacity he supervised a staff of more than 60 Ph.D. economists, and advised the FTC on a variety of antitrust matters, including questions pertaining to merger enforcement activities. Prior to serving at the FTC, Professor Baker worked on airline and other matters in the Clinton White House as a senior economist for the Council of Economic Advisers. Among other degrees, he has a Ph.D. in economics from Stanford and a J.D. from Harvard. He has previously examined competitive issues in numerous industries, including the domestic airline industry. His resume lists more than 40 published antitrust articles, working papers, and manuscripts. Thus, he is well qualified under *Daubert-Kumho* to testify on competition and pricing in airline markets.

Professor Baker's framework for his economic analysis is the same as that used by economic experts in antitrust cases, including defendants' own experts. He applies that framework to the fact of this case.[27] Indeed, his analysis is based on a painstaking review of the factual record in this case, a point made more than evident by Prof. Baker's initial report, which contains 114 endnotes citing to more than 100 separate evidentiary sources.[28]

The first step in the analytical framework is referred to as "market definition." The Supreme Court requires trial courts to define the "relevant markets" in which to analyze whether

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[27]*See Baker's Report at ¶¶ 27-37.*

[28]Perhaps not wanting the Court to compare the well-supported nature of the opinions set forth by the government's experts with those of its own Professor Phillips (who cited almost nothing), Northwest did not even bother to provide the Court with a copy of the expert reports of the government's experts. Northwest's failure to give the Court the full record of the opinions of these experts is clearly inappropriate where Northwest is asking the Court to exclude all of their opinions. For the Court's convience, the Government herewith attaches the reports and rebuttal reports of all three experts. See attached appendix, tab 3.

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a transaction lessens competition.[29] Through his expert opinions, Professor Baker will lay the groundwork for the Court to conclude that the relevant markets in this case are (1) scheduled airline service between pairs of cities and (2) scheduled airline service for business travelers between pairs of cities. Such markets would include airline service between Northwest's and Continental's hub cities ("hub-to-hub" markets).

The second step in the analytical framework is to measure and assess whether the relevant markets are "concentrated" (have very few competitors) and analyze the effect of the transaction on concentration.[30] Professor Baker's expert report demonstrates, and Professor Baker's trial testimony will confirm, that each of the nine hub-hub routes at issue in this case are currently dominated by Northwest and Continental. Professor Baker then explains in detail, with reference to defendants' own deposition testimony, documents, and historical incidents, how airlines set their prices and how the number of airlines present in a market affects the price level -- fares are higher when there are fewer airlines competing on a route.[31] Professor Baker shows how Northwest's ownership of the controlling stock in Continental will likely result in increased prices in the dominated hub-to-hub markets.[32] He further explains how airlines set prices across their networks and how "systemwide" price increases do not occur unless all the major airlines, including both Northwest and Continental, raise their fares around the same time. Prof. Baker

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[29]*Times-Picayune Publishing Co. v. United States*, 345 U.S. 594, 612 (1953).

[30]The Supreme Court also requires trial courts to presume future harm to competition when a combination of companies significantly increases concentration in an already concentrated relevant market. *United States v. Philadelphia National Bank*, 374 U.S. 321, 363 (1961)

[31]See Baker's Report at ¶¶ at 40-47 & 73.

[32]See Baker's Report at ¶¶ 48-54.

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then demonstrates how Northwest's ownership of the stock in Continental will lead to both Northwest and Continental going along with systemwide increases more often, resulting in higher fares across all routes nationwide.[33] Finally, in his expert report Prof. Baker explains why the competitive harms he predicts will not be solved by the entry of new airlines.[34] He examines the historical record of entry by major airlines into "competitor's" hub-to-hub routes (almost none), the experience, costs, and likelihood of success of non-major airlines onto these routes (successful on only a very small scale, if at all) and the likelihood of new entry systemwide (virtually nil).

Northwest's motion does not even mention any of this testimony by Prof. Baker -- not his testimony on the appropriate economic framework, not his testimony on market definition, not his testimony on airline pricing, not his testimony explaining why fares are likely to increase, not his testimony on new entry. Nor does Northwest suggest it has any valid criticism of Prof. Baker's testimony with regard to the issues.[35] Rather, Northwest advances two isolated and unfounded attacks on Professor Baker.

First, Northwest contends that Prof. Baker relies on, but misinterprets Professor Rock's opinion. Northwest's Brief at 17. It is Northwest, however, that misinterprets or, perhaps intentionally, mischaracterizes the relationship between Professor Baker's and Rock's testimony.

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[33]See Baker's Report at ¶¶ 55-61.

[34]As Continental's counsel, Eugene Driker, described this issue at the summary judgment oral argument -- "Airlines don't pop up like ice cream stores. And if in a highly concentrated industry, if an airline is eliminated, this Court has to ask itself what are the consequences for competition?"

[35]Indeed, while critical of Prof. Baker, Northwest's expert conceded that Prof. Baker's opinion that [**REDACTED**

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As discussed above, Prof. Baker analyzed the likely competitive effects of Northwest's acquisition and ownership of 51% voting control and a 14% equity interest in Continental. Because of the existence of complex governance arrangements between Northwest and Continental, which Northwest proffers as a remedy to any competitive concerns, the United States retained Prof. Edward Rock, an expert in corporate governance, to analyze how this governance structure affects the nature of the relationship between Northwest and Continental. Prof. Rock was specifically asked to determine to what degree these agreements limited Northwest's ability to exercise control or influence over Continental by virtue of its stock ownership. Prof. Baker then reasonably relied on Prof. Rock's analysis in rendering his expert opinion.[36] Testimony of multiple expert witnesses in antitrust litigation, such as the use of separate experts to analyze efficiencies and competitive effects, is not uncommon. *See, e.g., In re Brand Name Prescription Drugs Antitrust Litig.,* 186 F. 3d 781 (7th Cir. 1999); *F.C.C. v. Staples, Inc.,* 970 F. Supp. 1066 (D.D.C. 1997); *Turner Broadcasting System, Inc. v. F.C.C.,* 520 U.S. 180 (1997); *Exxon Corp. v. Governor of Maryland,* 437 U.S. 117 (1978). The government is not aware of any cases in which a court has excluded expert testimony because it refers to other experts' testimony.

Second, Northwest argues that Prof. Baker has not identified any harm to date. But that criticism rests on a false premise -- that the government must prove that prices have already gone up, or that other competitive harm has already occurred. In the first place, the Clayton Act is an

[36]Prof. Baker does not address the impact of the governance arrangements because an understanding and interpretation of those contracts is not generally within the realm of an economist. For the very same reasons, Northwest has retained its own corporate governance expert, Prof. Merritt Fox, and Northwest's primary economic experts rely on Prof. Fox for their analysis of the operation of the governance agreements.

incipiency statute, concerned with the probable future effects of mergers.[37] And in any event, as the Supreme Court has recognized, a trial court should *expect* defendants to keep their noses clean and forebear from raising prices while an antitrust challenge is pending before the courts. "Postacquisition evidence tending to diminish the probability or impact of anticompetitive effects' in a § 7 case is 'extremely limited.' The need for such a limitation is obvious. 'If a demonstration that no anticompetitive effects had occurred at the time of trial or of judgment constituted a permissible defense to a § 7 divestiture suit, violators could stave off such actions merely by refraining from aggressive or anticompetitive behavior when such a suit was threatened or pending." *United States v. General Dynamics Corp.*, 415 U.S. 486, 504-05 (1974). (citations omitted). This Supreme Court principle is especially appropriate here where Northwest documents confirm that they have discussed how business decisions will "play" before this Court.[38] Prof. Baker's testimony will help the Court answer the relevant question -- whether a substantial lessening of competition may occur in the future as a result of Northwest's control stock acquisition. *FTC v. Proctor & Gamble Co.*, 386 U.S. 558, 577 (1967); *California v. American Stores Co.*, 495 U.S. 271, 284 (1990).[39]

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[37]*See United States v. E.I. du Pont de Nemours*, 353 U.S. 586, 592-93 (1957).

[38]See attached appendix, tab 5.

[39]In addition to claiming wrongly that Prof. Baker must show harm today, Northwest also claims that he must do so empirically. That too is wrong. In *In re Visa Check/MasterMoney Antitrust Litigation*, 192 F.R.D. 68 (E.D.N.Y. 2000), the court declined to exclude Dennis Carlton's expert testimony: "The fact that his report is based principally on economic theory, not exhaustive empirical or quantitative analysis, is no bar to its admission at this stage; if it were, [opposing counsel's] opinion would be inadmissible as well." 192 F.R.D. at 78. Prof. Baker's methodologies have been widely accepted and tested in the economic and industrial organization literatures regarding airlines in particular, (see e.g., Baker's report endnotes 89-91), and his conclusions that prices are likely to rise is thus well-supported.

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Prof. Baker's testimony will assist the Court in deciding whether Northwest's continued holding of Continental's controlling stock in a competitor will likely lead to higher prices in violation of Section 7. It should be admitted.

D. Professor Edward Rock

The government's second expert, Professor Edward Rock, is a professor at the University of Pennsylvania Law School. He teaches a variety of classes involving corporate law, securities regulation, and corporate governance, and is co-director of a research institute that sponsors and organizes conferences on corporate governance and other issues. He graduated *magna cum laude* from the University of Pennsylvania Law School; received a B.A. degree with first class honors from Oxford; and graduated *cum laude* from Yale. Like Prof. Baker, Prof. Rock has amassed a substantial body of published articles, working papers, manuscripts, and invited presentations relating to corporate governance issues.

Professor Rock is qualified to render an expert opinion that goes to one of Northwest's two main defenses -- whether the corporate governance arrangements between Northwest and Continental preclude Northwest from influencing or controlling Continental. Professor Rock analyzes the numerous governance contracts at issue in detail, and examines the corporate structure and shareholder composition of both companies. In addition, Prof. Rock brings his comprehensive knowledge of general corporate law and governance to bear on the nature of the relationship established by the various governance arrangements. Prof. Rock can and will explain to the Court the various "real world" methods by which Northwest, if it so chooses, can influence Continental, notwithstanding the governance agreements. Prof. Rock's testimony will be invaluable to the Court in assessing the validity of Northwest's claim that the governance

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arrangements prevent or remedy all of the competitive harm identified by Prof. Baker -- prevent the harm by completely and forever insulating Continental from any influence by Northwest.

Professor Rock offers a number of opinions that Northwest does not appear to contest in its motion. First, Professor Rock explains the fundamental principles needed to understand corporate governance issues such as the powers of shareholders, the nature of fiduciary duties, the limited role of independent directors, and the controlling rights that come with a 51% or more voting interest in a company.[40] This information from our expert in the field will greatly help the Court understand the limits of the governance agreements. Second, Professor Rock explains why, after the governance agreements end, Northwest will have the unfettered ability to control Continental.[41] Third, Professor Rock demonstrates that even as soon as the first governance contract ends in 2004, Northwest will be able to directly influence Continental's management if it is not happy with their performance.[42] Northwest's criticisms of Prof. Rock do not even address these aspects of his expert opinions, which comprise 30 pages of his 34 page report.[43]

Northwest's attacks are focused almost entirely on the period of the initial governance agreement, during which Northwest's influence must be exercised more indirectly. Northwest

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[40]Rock Report at ¶¶ 17-51.

[41]Rock Report at ¶¶ 107-111.

[42]Rock Report at ¶ 163.

[43]Prof. Rock also offers the opinion that the equity is not a necessary element to the alliance. Rock shows through record evidence, examples of other corporate deals, and historical airline alliances that Northwest does not need to hold equity in Continental for the Northwest/Continental alliance to function. He identifies a number of alternative mechanisms besides the equity holding that are commonly used in the corporate world to resolve concerns of the type that Northwest has proffered. *See* Rebuttal Report at ¶¶ 30-60. Northwest does not even attempt to challenge this aspect of his opinion.

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complains that Prof. Rock cannot assign any probability of competitive harm or any probability to Northwest acting in certain ways to influence Continental. But, as noted above, Prof. Baker is testifying on competitive harm, not Prof. Rock. And Northwest completely ignores Prof. Rock's testimony that, starting in just 2004, Northwest will have the direct ability to control or influence Continental by voting 20% of its stock. Indeed, Northwest's criticisms suffer from a fundamental misunderstanding of his opinion. Prof. Rock's basic premise is that the mere threat of Northwest exercising its power to influence Continental will be enough to cause Continental's executives to act more cooperatively towards Northwest. Thus, while the "probability" of particular Northwest actions occurring in the next four years -- or even the next eight -- may be low, the probability that Northwest's ownership will have its natural intended consequences is high.

Northwest also complains that Prof. Rock disregards "behavioral restraints" such as fiduciary duty and the antitrust laws. But Prof Rock's report and deposition do not "disregard" them, rather he explains how Northwest can influence Continental consistent with various fiduciary duties and makes no assumption that such conduct would violate the antitrust laws. Northwest's real grievance is that Prof. Rock does not reach the same conclusion as Northwest's corporate governance witness, Prof. Fox, that fiduciary duties and the Sherman Act prohibition on agreements in restraint of trade will prevent any harm to consumers from one competitor owning control of another. Finally, while complaining that Prof. Rock "ignores" certain evidence it offers, Northwest itself ignores evidence from its own alliance with KLM (which it also is seeking to exclude from this Court's consideration), where Northwest was concerned that KLM's ownership of less than 20% of Northwest's stock could lead to control by KLM.

Northwest's motion is little more than a thinly disguised effort to argue its evidence and its theories. It provides no basis for excluding Prof. Rock's testimony

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E. Professor Clinton Oster

Professor Clinton Oster, a professor at Indiana University, has focussed his academic work on transportation and the airline industry. He has authored four books and more than 100 articles on those subjects. He has served as President of the Transportation Research Forum and on six aviation study committees for the National Academy of Science. He earned a Ph.D. in economics from Harvard and degrees from Carnegie-Mellon and Princeton. His analysis and experience is highly valued by the Department of Transportation and the Federal Aviation Administration where he has served as a frequent consultant on airline matters. He has testified several times before Congress on various matters pertaining to the airline industry.

Given his unique qualifications, Prof. Oster was asked to analyze the validity of the second of Northwest's defenses – whether Northwest needs to hold the Continental stock in order for the two companies to have a successful alliance. After examining the nature of the Northwest/Continental alliance, the history of alliances in the industry, Northwest's and Continental's particular history with alliances, the types of contract terms used in alliances, the minimal investment needed to make this alliance work, and the large financial payout to making it work, Professor Oster concluded that Northwest does not need to continue holding the equity in order for Northwest and Continental to continue in their alliance. Northwest obviously does not want the Court to hear that directly relevant and probative evidence.

Prof. Oster explains a number of reasons why Northwest's holding of the control equity is not a necessary element of the alliance. He shows that the costs to Northwest and Continental of implementing the alliance are quite small compared to the additional profits the alliance generates for both parties. Indeed, Prof. Oster shows that the parties have already earned back more than

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they invested.[44] These large profits are the real "glue" in any commercial relationship. As long as the parties can make money, they will stay in the venture. The quick payoff period also means that this alliance is not a particularly risky investment.

Prof. Oster also analyzes Northwest's history with alliances. He examines in detail the Northwest/KLM experience where KLM at one time held an equity stake in Northwest, but later sold that stake off, only to see the alliance between them grow and prosper as never before. Prof. Oster emphasizes the statement by Northwest's own CEO in reference to that alliance:

[**REDACTED**

] [45]

Prof. Oster did not stop there, but also analyzed Continental's alliance history. He found that Continental also owned a stake in an alliance partner, America West. Continental has reduced that holding over time to where it now owns an insignificant stake. Prof. Oster cites the deposition testimony of Continental's CEO, Gordon Bethune, that [**REDACTED**

]. He additionally quoted Mr. Bethune's deposition that [**REDACTED**

].[46]

Finally, Prof. Oster continued beyond the alliance histories of Northwest and Continental to examine the underpinnings of more than 80 other alliances involving the major domestic airlines. He found that it is uncommon for alliance partners to hold equity in one other, especially

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[44]Oster Rebuttal Report at ¶ 8.

[45]Oster Rebuttal Report at 9.

[46]Oster Rebuttal Report at 9.

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controlling equity, concluding that other airline alliance partners resolve the various "stability" concerns that Northwest claims to have through traditional contracts. Prof. Oster thus will testify that the reasons Northwest gives for needing the equity can be achieved simply by extending the terms of the alliance agreement, by contractually limiting the ability of Continental to terminate the alliance agreement early, or by making the alliance agreement exclusive.[47]

Northwest focuses its motion on Prof. Oster's examination of these other alliances, belittling his testimony by calling it a "head count." This pejorative attack, however, does not even address most of Prof. Oster's analysis. Nor does it negate the results of Prof. Oster's survey of airline alliances -- almost no alliances have equity; the percent of alliances with equity has been decreasing over time; and the biggest, most enduring alliances do not have equity. Prof. Oster's testimony should not be stricken simply because Northwest fears the logical conclusion the Court will draw from his analysis -- controlling equity is not necessary for the alliance.

F. Conclusion

Prof. Oster's analysis and his opinions are clearly based on record evidence and will assist the Court in evaluating one of the critical issues in this case. The Court should not countenance Northwest's efforts to keep that testimony out of the record, and should deny its motion.

VII. Conclusion

For the aforementioned reasons, the Court should deny Northwest's sweeping set of motions to exclude evidence relating to alliances other than the one at issue; prior testimony by Northwest's directors and executives; evidence of barriers to entry in the airline industry; evidence of possible collusion in the airline industry; and evidence put forth by the government's expert

[47]Oster Rebuttal Report at 10-13.

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witnesses.

DATED: October 17, 2000

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing Redacted Version of the CONSOLIDATED OPPOSITION OF THE UNITED STATES TO NORTHWEST'S MOTIONS IN LIMINE were served by hand and/or first-class U.S. mail, postage prepaid, this 17th day of October, 2000 upon each of the parties listed below:

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