

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

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

**PLAINTIFF UNITED STATES OF AMERICA’S MEMORANDUM IN
OPPOSITION TO NORTHWEST AIRLINES’ MOTION FOR PARTIAL
SUMMARY JUDGMENT REGARDING THE EQUITY-ALLIANCE LINKAGE**

Plaintiff United States of America submits this Memorandum in Opposition to Northwest Airlines’ Motion for Partial Summary Judgment Regarding the Equity-Alliance Link filed May 12, 2000 (hereinafter “Northwest Motion.”).¹

I. PRELIMINARY STATEMENT

Faced with the very real prospect of an adverse decision on the government’s Motion To Strike Defendants’ Efficiencies Defense (hereinafter “Motion To Strike”), defendant Northwest

¹This memorandum is accompanied and supported by the United States’ Counterstatement of Material Facts Beyond Genuine Dispute (hereinafter “CMF”), which sets forth the factual record that not only requires that Northwest’s instant motion be denied, but further establishes the basis for the United States’ Motion To Strike Defendants’ Efficiencies Defense.

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Airlines Corp. (“Northwest”) adopted the age old strategy that “the best defense is a good offense.” Northwest accordingly filed a procedurally improper motion,² which it mislabels a motion for “partial summary judgment,” asking the Court to deem two facts “proven” for purposes of this litigation:

- That it was “necessary” for Northwest to buy control of Continental in order to form the alliance; and
- That it is “necessary” for Northwest to retain control of Continental in order for Northwest to give its “full and continuing commitment” to the alliance.

In support of these “facts” Northwest offers only the conclusory testimony of its executives, **REDACTED MATERIAL**

Nowhere in its lengthy papers does

Northwest deny any of the following objective facts which show that the alliance benefits are achievable without the controlling equity and which, at minimum, create a genuine issue of material fact precluding Northwest’s requested relief:

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- Only a small minority of past and present airline marketing alliances involve any equity ownership between partners at all and almost none involves control;
- The Northwest/KLM alliance is very successful and its history demonstrates that Northwest strongly believes that as little as 19% ownership of one alliance partner by another was not only unnecessary, but enough to be counterproductive; and

²Northwest asks the Court to find facts under Fed. R. Civ. P. 56(d), but has not requested (and has no grounds) to move for summary judgment on any “claim” in this case. Rule 56(d) does not authorize fact-finding under these circumstances. See Part III, infra.

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- Continental does not consider Northwest’s ownership of Continental equity necessary for the success of the alliance, and is currently seeking to repurchase its stock from Northwest.

Given these undisputed facts, the Court should deny Northwest’s improper and unfounded motion, and grant our Motion to Strike Northwest’s efficiencies defense, excluding all evidence pertaining to any benefits of the alliance at trial -- evidence that will only serve to needlessly burden the record and substantially prolong the trial.

II. NORTHWEST HAS NO BASIS TO ASSERT AN EFFICIENCIES DEFENSE PREMISED ON AN ALLEGED LINKAGE BETWEEN THE BENEFITS OF THE ALLIANCE AND NORTHWEST’S EQUITY STAKE IN CONTINENTAL

The Clayton Act and the efficiencies defense are concerned with the public interest -- not a private party’s parochial interests.³ The efficiencies defense recognizes that even though a merger might reduce competition, it may provide the public with meaningful benefits by, for example, lowering costs, improving quality, or enhancing service. However, before the merging firms can claim a “credit” for such benefits, they must show (among other stringent requirements) that the

³As discussed in the Motion To Strike, the role of an efficiencies defense in a Section 7 case is quite carefully confined. As a starting point, courts typically view such a defense with a healthy dose of skepticism given the substantial and undeniable public interests in preserving competition that underlie the antitrust laws. See, e.g., United States v. Philadelphia Nat’l Bank, 374 U.S. 321, 371 (1963); see also FTC v. Proctor & Gamble Co., 386 U.S. 568, 580 (1967). Second, courts reject any consideration of alleged efficiencies that can be achieved through less anticompetitive means. See, e.g., FTC v. University Health, Inc., 938 F.2d 1206, 1222 n.30 (11th Cir. 1991); United States v. Rockford Mem. Corp., 717 F. Supp. 1251, 1289 (N.D. Ill. 1989). Finally, courts demand exacting proof of any alleged efficiencies before such benefits will even be considered in the context of an acquisition challenged under the Clayton Act. See, e.g., University Health, 938 F.2d at 1223; FTC v. Staples, Inc., 970 F. Supp. 1066, 1088 (D.D.C. 1997).

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efficiencies cannot be achieved through other means that pose a lesser risk to competition. Thus, the key question here is whether alliance benefits can be achieved without Northwest holding a controlling equity stake in its competitor. The answer does not depend, as Northwest contends, on whether Northwest thinks controlling equity is advantageous to it or whether it “feels” more committed to the alliance as a result of its continued ownership of the controlling equity. Rather, the answer depends on objective evidence of reasonable less anticompetitive alternatives. The uncontroverted evidence set forth below establishes that any efficiency benefits of the alliance are achievable without the controlling equity.

A. Northwest Does Not Dispute The Objective Facts Underlying The United States’ Motion To Strike

Rather than attempting to dispute the factual basis presented in the government’s Motion To Strike, Northwest claims that these uncontroverted facts are immaterial, irrelevant, or somehow distinguishable from the situation at hand. Defendant Northwest Airlines’ Memorandum In Support Of Motion For Partial Summary Judgment Regarding The Equity-Alliance Linkage, at 10, 12 (hereinafter “Northwest Mem.”). They are not. In fact, they are highly probative of the lack of necessity for equity and show that Northwest has not met its substantial burden of establishing the absence of any reasonable, alternatives for consumers to achieve the alliance benefits, and certainly can not provide a basis for summary relief under Fed. R. Civ. P. 56.

1. The Alliance Agreement Is Not Contingent On Northwest’s Ownership Of Control Over Continental

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Northwest never disputes the simple fact that the

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(CMF ¶ 3). **REDACTED MATERIAL**

(CMF ¶ 4).

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(CMF ¶ 5).

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2. The History of Airline Alliances

Over the last decade marketing or codeshare alliances have become common in the airline industry. (CMF ¶ 6). These alliances are typically contractual arrangements which rarely involve equity investments between the parties to the alliance. (CMF ¶ 9). For example, while the six largest airlines in the United States had 81 alliances in 1999, only 9 of those involved equity holdings. (CMF ¶ 9). Moreover, virtually none of the few alliances with equity holdings involve one carrier holding voting control over its partner, or give the partner with equity the absolute ability to reject potential mergers or acquisitions by its alliance partner. (CMF ¶ 9). Again,

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objective facts support the government's contention that equity is not essential to the continuation or success of an airline alliance.

3. Northwest's Experience With The KLM Alliance

There is perhaps no better evidence to support the Government's contentions than Northwest's own actions when KLM held an 18.8% voting stake in the company – considerably below the 51% voting stake Northwest now owns in Continental. (CMF ¶ 10). When confronted with this situation, Northwest's leadership concluded that:

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(CMF ¶ 14).

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(CMF ¶ 14). Both of these alternatives seemed more than reasonable to Northwest at the time as means of resolving KLM's ownership of equity in Northwest and the problems caused by that stock ownership for the carriers' ongoing alliance. (CMF ¶ 14).

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(CMF ¶ 20). Only after KLM's divestiture did the alliance expand and become heralded by Northwest as the "Alliance for Life." (CMF ¶ 19). Since KLM's divestiture, KLM and Northwest have continued to make investments in their alliance, and Northwest has offered no evidence that either carrier's commitment to the success of that alliance has been compromised. (CMF ¶ 19).

The implications of this Northwest/KLM episode for the current controversy are striking and direct. By contrast, Northwest's attempt to distinguish its experience with KLM is facile at best. (Northwest Mem. at 5). Certainly, the existence of a governance agreement fails to distinguish this compelling evidence. **REDACTED MATERIAL**

(CMF ¶ 16).

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(CMF ¶ 11).

Northwest also cites the profit sharing and antitrust immunity features of the KLM alliance as distinguishing features, but provides no explanation for why profit sharing or antitrust immunity are the "functional equivalent" of voting control, and thus satisfy its current pretext for continuing to hold the Continental stock -- that another carrier might take over Continental. There is no

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apparent reason why KLM would view Northwest as less vulnerable to takeover because of profit sharing or antitrust immunity. Indeed, these factors might reasonably make Northwest more attractive as a takeover target.

Northwest's argument that the alliance with Continental is far more important than its alliance with KLM and that this distinction justifies its need for equity is also baseless. Northwest utterly fails to demonstrate that it will "suffer a severe, perhaps fatal competitive injury" as a result of the failure of the Northwest/Continental alliance. (Northwest Mem. at 13). Notably, Continental holds no Northwest equity; but if Northwest's apocalyptic statements are to be believed, Continental presumably would suffer the same "fatal" competitive injury should the alliance end. (CMF ¶ 39).

4. Continental's Offer To Repurchase The Equity

There is absolutely no doubt about Continental's position on the so-called equity-alliance "linkage." Continental has consistently shown, by deeds as well as words, that it does not consider equity to be necessary for an alliance to succeed. Continental has a successful and ongoing alliance with America West Airlines ("America West") despite having divested all but a very small equity holding in that carrier,⁴ and Continental has repeatedly offered to buy back its equity and continue the alliance with Northwest.

⁴Continental has participated in a marketing alliance with America West since 1994. Initially there were significant equity links between the two carriers. Currently, however, Continental has only about 1% equity (and approximately 7% voting power) in America West; America West holds no equity in Continental, and there are no significant common shareholders. Nonetheless, the alliance has continued with no discernible change on its operations or performance. (CMF ¶¶ 23-24).

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Gordon Bethune, Chairman and CEO of Continental, testified as follows:

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(CMF ¶ 25)(emphasis added). Greg Brenneman, Continental's President and Chief Operating Officer, confirmed this view with regard to the Northwest/Continental alliance in his deposition:

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(CMF ¶ 25).

Northwest misportrays the background to this transaction in a manner designed to suggest that originally, Continental actually wanted Northwest to acquire the Air Partners block of supervoting Continental stock, but has now changed its mind. This is not true.

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As Greg Brenneman testified,

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(CMF ¶ 26).

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(CMF ¶ 29).

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(CMF ¶ 36).

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(CMF ¶ 36). **REDACTED MATERIAL**

(CMF ¶ 37).

Continental's concerns about the existence of this controlling block of supervoting stock have not ceased, and Continental has once again embarked on an effort to convince Northwest to sell the stock back to Continental. In January 2000, Continental publicly disclosed that it had offered to buy back the shares from Northwest. (CMF ¶ 38). In addition, Continental made it clear that "[t]he alliance between Continental and Northwest is beneficial to both carriers, and any [stock repurchase] transaction would be designed to *preserve and strengthen the benefits of the alliance.*" (CMF ¶ 38)(emphasis added). Thus, contrary to Northwest's professed fears, Continental believes that the sale of Northwest's equity stake back to Continental would not threaten the future of the alliance, but rather enhance the benefits of the alliance relationship for both carriers. In this case, Continental is prepared to back up its beliefs with its actions and its bank account – it is offering to repurchase the equity from Northwest.

- Q. There Exist Reasonable and Practical Less Anticompetitive Alternatives To Northwest's Ownership of Control Over Continental

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As the preceding undisputed facts demonstrate, there are several reasonable alternatives, all of which were available to Northwest at the time of the transaction (and are still available today) for Northwest to continue in its alliance with Continental without owning equity. In particular, **REDACTED MATERIAL**

Either option could also involve contractual amendments to the alliance agreement designed to further strengthen the carriers' relationship. For example, Northwest and Continental could agree to include an appropriate "break up" fee in the agreement to provide both parties with the confidence to invest fully in their alliance relationship, **REDACTED MATERIAL** (CMF ¶ 17).

Nothing in 1998 prevented Northwest from acquiring the stock from Air Partners and then immediately selling it back to Continental, and nothing stands in the way of such a resolution of this case today; indeed, Continental wholeheartedly supports such a solution. Continental's desire to enter into an alliance with Northwest was in no way dependent on Northwest's ownership of the Air Partners stock. While Northwest might prefer to continue to hold the stock for reasons beyond the need to "stabilize" the alliance, the fact of the matter is, selling the stock back to Continental was and is a viable option.

R. Northwest's Criticisms of the Less Anticompetitive Alternatives Are Subjective, Speculative and Unpersuasive

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Northwest asks the Court to reject these less anticompetitive alternatives because they are merely “theoretical.” (Northwest Mem. at 8). But the only reason they are “too theoretical” is because, **REDACTED MATERIAL**

(Northwest Mem. at 8). There is no case law supporting this position, and the Court should not adopt it. Northwest would essentially write the “reasonable, less anticompetitive alternative” prong out of the test for the efficiencies defense. Northwest’s proposed rule of law would discount objective evidence about alternatives (including alternatives pursued by the parties in prior transactions), and simply accept as dispositive the testimony of their executives stating their belief that there were no alternatives. Thus, Northwest’s position would give firms a blank check to enter anticompetitive transactions – all they would need do is concurrently enter a side deal that benefits some consumers and then claim they would never have done that beneficial deal independent of the anticompetitive transaction.

Northwest also argues that but for its continued ownership of the Continental stock, it would have no absolute guarantee against a potential takeover of Continental that might result in the loss of the alliance benefits. (Northwest Mem. at 10). But firms enter into contractual arrangements all the time that are structured to protect their legitimate business interests to the maximum degree possible, but which must be consistent with all applicable laws, including the antitrust laws. Northwest assumes it is entitled to achieve a unique, extra measure of protection for its alliance relationship with Continental even if that extra measure -- its ownership of the Air Partners control block -- is anticompetitive and harms the public. Neither the Clayton Act nor the

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efficiencies defense permits a special exception for Northwest. If there is a reasonable, practical alternative for achieving alliance efficiencies, Northwest must take it.

Northwest suggests that ownership of the equity stake in Continental “remains central to its commitment to the Alliance.” (Northwest Mem. at 12). In other words, Northwest rejects the notion of a non-equity alliance because it prefers owning the equity.

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(CMF ¶¶ 40,44). What is beyond dispute are the substantial revenues generated to date by the alliance for both carriers – **REDACTED MATERIAL**

(CMF ¶ 41). In effect, Northwest asks this Court to suspend disbelief and assume that Northwest would voluntarily terminate the alliance if forced to divest its equity stake, when practical business realities suggest Northwest would never choose to walk away from the substantial and ongoing revenues provided by its alliance relationship with Continental.

In his testimony during Northwest’s litigation with KLM, Al Checchi, Northwest’s Co-Chairman of the Board at the time, **REDACTED MATERIAL**

(CMF ¶ 15) (emphasis added).

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In sum, Northwest's arguments are based predominantly, if not entirely, on the subjective assertions of Northwest executives made in the context of this litigation in contrast to that in the KLM litigation), and can not provide a sufficient basis for the Court to conclude that the equity is a necessary precondition for the public to secure the benefits of the alliance. The ability of defendants to manipulate evidence of this sort for the litigation at hand has long been recognized by the courts. See, e.g., United States v. Falstaff Brewing Corp., 410 U.S. 526, 563-570 (1973) (Marshall, J., concurring) (subjective evidence of management's post-acquisition intentions is inherently self-serving and not worthy of credit in the usual Section 7 case); United States v.

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Phillips Petroleum Co., 367 F. Supp. 1226, 1234-39 (C.D. Cal. 1973), aff'd, 418 U.S. 906 (1974).

Accordingly, Northwest's instant motion must be denied. In light of the objective evidence presented by the United States showing that non-equity alliances are common, practical, and, from Continental's viewpoint, even desirable in this case, the Court should grant the government's motion to strike and exclude any efficiencies defense based on the alliance.

S. Northwest's Other "Defenses" Lack Factual or Legal Support

In an attempt to cover up its failure to contest the objective facts in the government's motion, Northwest clutters its papers with a number of sweeping and ill-supported defenses, arguing that even if Northwest's ownership of voting control over Continental is otherwise illegal, it should be allowed in this case. First, Northwest argues that without its equity ownership, Continental would have merged with Delta instead of allying with Northwest. But it is no defense to an illegal acquisition that other bidders were interested – this is often the case in mergers and acquisitions.

Second, Northwest maintains that it has granted Continental a contractual "decade of independence," suggesting that private governance agreements constitute an absolute defense to an illegal acquisition. But Northwest does not cite any case or any legal support for this proposition, and indeed there is none. While the United States vigorously disputes the notion that the so-called "governance" agreements in this case prevent Northwest from exercising significant influence over Continental, this issue is not relevant to the motion at hand.⁵

⁵The United States will respond to Northwest's governance arguments at the appropriate time when those issues are properly before the Court.

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Finally, Northwest implies that Continental's independent directors voted to approve the Northwest equity transaction, suggesting that approval of an illegal acquisition by independent directors constitutes an absolute defense.⁶ This too is a completely unfounded defense, and Northwest can not possibly cite any legal precedent in support of its contention in this regard. Such a defense would completely vitiate Section 7 of the Clayton Act – after all, the more anticompetitive a transaction is, the more likely it will produce monopoly profits for the firms involved and their shareholders. Independent directors are not obligated, and do not even purport, to protect the interests of consumers in vigorous competition.

III. NORTHWEST'S MOTION FOR RELIEF UNDER RULE 56(d) IS PROCEDURALLY IMPROPER AND SHOULD BE DENIED

Northwest seeks an order from this Court “establishing [certain] facts as proven for purposes of this litigation” under Fed. R. Civ. P. 56(d). (Northwest Motion at 1). But there is no such thing as a standalone motion under Rule 56(d) to find facts. Rather, Rule 56(d) is designed to be ancillary to a proper motion for summary judgment under Rule 56(b). Nowhere in Northwest's motion, memorandum, or proposed order, however, is there any reference to a claim for summary judgment under Rule 56(b) for dismissal of any “claim, counterclaim, or cross-claim.” See Fed. R. Civ. P. 56(b). The reason for this omission is clear. The only “claims” in the case are brought under Section 7 of the Clayton Act, 15 U.S.C. § 18, and Section 1 of the Sherman Act,

⁶ **REDACTED MATERIAL**

(CMF ¶ 36).

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15 U.S.C. § 1. The so-called “equity/alliance link” solely relates to Northwest’s defense that the purported benefits of the Northwest/Continental alliance should justify the anticompetitive effects of Northwest’s ownership of voting control over Continental.

It is well established that Rule 56(d) does not provide a basis to find facts where the Court is not first presented with a proper motion for summary judgment. See, e.g., Sears, Roebuck & Co. v. Sears Realty Co., 932 F. Supp. 392, 410 n.5 (N.D.N.Y. 1996); 10B Charles A. Wright et al., Federal Practice and Procedure § 2737 (1998 & Supp. 2000) (Rule 56(d) is “designed to be *ancillary* to a motion for summary judgment”). Rule 56(d) “does not authorize the initiation of motions the sole object of which is to adjudicate issues of fact which are not dispositive of any claim or part thereof.” Yale Transp. Corp. v. Yellow Truck & Coach Mfg. Co., 3 F.R.D. 440, 441 (S.D.N.Y. 1944). Rule 56(d) performs a function of narrowing the issues only in the wake of an unsuccessful but proper motion for summary judgment under Rule 56(a) or 56(b) in order to salvage whatever constructive results have come from the judicial effort to resolve a full-fledged motion. See Arado v. General Fire Extinguisher Corp., 626 F. Supp. 506, 508-09 (N.D. Ill. 1985); Capitol Records, Inc. v. Progress Record Distributing, Inc., 106 F.R.D. 25, 29-30 (N.D. Ill. 1985).

Northwest erroneously cites the decision in France Stone Co. v. Charter Township of Monroe, 790 F. Supp. 707 (E.D. Mich. 1992), in support of its motion. In that case the plaintiff moved under Rule 56(a) and (d) for summary judgment on one element of its legal claim against the defendant. Id. at 709-10. Here, by contrast, Northwest has relied solely upon Rule 56(d) – since as noted above there is no basis to seek summary disposition under Rule 56(a) or (b) – and further asks this Court to find facts pertaining not to a claim in the case, but rather to one of its

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own defenses. The ruling in France Stone thus provides no support for Northwest's application of Rule 56(d) or its unfounded request for relief thereunder.⁸

IV. CONCLUSION

Northwest's instant motion is nothing more than an effort to divert the Court's attention from the issues presented in the United States' Motion to Strike Defendants' Efficiencies Defense. Northwest asks the Court to engage in fact finding unrelated to any proper request for summary judgment on a claim. The motion is procedurally defective and should be rejected on that ground alone. However, even assuming the motion were proper, Northwest's requested relief lacks factual and legal foundation. While the government has come forward with objective, uncontroverted facts that Northwest's equity ownership in Continental is not necessary for the alliance to provide consumer benefits, Northwest relies entirely on the speculative and self-serving statements of its own executives and diversionary defenses to carry its burden.

For all of these reasons, Northwest's motion for partial summary judgment should be denied.

DATED: June 9, 2000

⁸The only other case cited by Northwest, Central States, Southeast and Southwest Areas Pension and Health and Welfare Funds v. McNamara Motor Express, Inc., 503 F. Supp. 96 (W.D. Mich. 1980), likewise provides no support. That decision addresses the issue of whether a motion for partial summary judgment can properly result in a final, enforceable judgment, an issue which is clearly not relevant here.

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Respectfully submitted,

“/s/”

James R. Wade
Jill A. Ptacek
Michael D. Billiel
John R. Read
Tracey D. Chambers
Salvatore Massa
Trial Attorneys
Antitrust Division
Department of Justice
325 Seventh Street, N.W., Suite 500
Washington, D.C. 20530
(202) 353-8730

**COUNSEL FOR PLAINTIFF
UNITED STATES OF AMERICA**

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing PLAINTIFF UNITED STATES OF AMERICA'S MEMORANDUM IN OPPOSITION TO NORTHWEST AIRLINES' MOTION FOR PARTIAL SUMMARY JUDGMENT REGARDING THE EQUITY-ALLIANCE LINKAGE, COUNTERSTATEMENT OF MATERIAL FACTS BEYOND DISPUTE, and RESPONSE TO DEFENDANT NORTHWEST AIRLINES' STATEMENT OF MATERIAL FACTS BEYOND GENUINE DISPUTE were served by hand and/or first-class U.S. mail, postage prepaid, this 9th day of June, 2000 upon each of the parties listed below:

Donald L. Flexner (By Hand)
James P. Denvir
BOIES, SCHILLER & FLEXNER PLLC
5301 Wisconsin Avenue, N.W.
Suite 570
Washington, D.C. 20015
(202) 237-2727

John L. Murchison, Jr. (By U.S. Mail)
VINSON & ELKINS, LLP
2300 First City Tower
Houston, TX 77002-6720
(713) 758-2338

Alexandre de Gramont (By Hand)
CROWELL & MORING LLP
1001 Pennsylvania Avenue, N.W.
Washington, D.C. 20004
(202) 624-2500

Paul L. Yde (By Hand)
VINSON & ELKINS
1455 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-1008
(202) 639-6685

Lawrence G. Campbell (By U.S. Mail)
DICKENSON, WRIGHT, MOON
VAN DUREN & FREEMAN
500 Woodward Avenue
Suite 4000
Detroit, MI 48226
(313) 223-3500

Eugene Driker (By U.S. Mail)
BARRIS, SOTT, DENN & DRIKER, PLLC
211 West Fort Street, 15th Floor
Detroit, MI 48226-3281
(313) 965-9725

"/s/

James R. Wade
Counsel for Plaintiff
United States of America