

BEFORE THE  
DEPARTMENT OF TRANSPORTATION  
WASHINGTON, D.C.

Joint Application of )  
)  
AIR CANADA )  
THE AUSTRIAN GROUP )  
BRITISH MIDLAND AIRWAYS LTD )  
CONTINENTAL AIRLINES, INC. )  
DEUTSCHE LUFTHANSA AG )  
POLSKIE LINIE LOTNIECZE LOT S.A. )  
SCANDINAVIAN AIRLINES SYSTEM )  
SWISS INTERNATIONAL AIR LINES LTD. )  
TAP AIR PORTUGAL )  
UNITED AIR LINES, INC. )  
)  
to Amend Order 2007-2-16 under 49 U.S.C. §§ )  
41308 and 41309 so as to Approve and Confer )  
Antitrust Immunity )

Docket OST-2008-0234

**PUBLIC VERSION**  
**COMMENTS OF THE DEPARTMENT OF JUSTICE ON THE SHOW CAUSE ORDER**

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June 26, 2009

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## **COMMENTS OF THE DEPARTMENT OF JUSTICE ON THE SHOW CAUSE ORDER**

The United States Department of Justice (“DOJ”) hereby submits its comments to the Department of Transportation’s (“DOT”) Show Cause Order (“Order”) in the matter of the Joint Application of Air Canada, the Austrian Group (“Austrian”), British Midland Airways Ltd (“BMI”), Continental Airlines, Inc. (“Continental”), Deutsche Lufthansa AG (“Lufthansa”), Polskie Linie Lotnicze Lot S.A. (“LOT”), Scandinavian Airlines System (“SAS”), Swiss International Air Lines Ltd (“Swiss”), TAP Air Portugal (“TAP”) and United Air Lines, Inc. (“United”) (collectively, the “Joint Applicants” or “Applicants”) to Amend Order 2007-2-16 under 49 U.S.C. §§ 41308 and 41309 so as to Approve and Confer Antitrust Immunity (the “Joint Application” or “J.A.”).

### **I. Summary of Comments**

Antitrust enforcement has played a vital role in bringing increased competition and consumer benefits to the deregulated airline industry. Accordingly, any exemptions from the antitrust laws should be strongly disfavored. To overcome the presumption against antitrust immunity, applicants must demonstrate that their collaboration will generate significant public benefits that outweigh any harm to competition, that they cannot achieve those benefits without immunity, and that they have narrowly tailored the requested immunity to achieve the benefits claimed.

For many past applications, the principal public interest benefit furthered by DOT’s grant of immunity has been the negotiation of open skies agreements with the home country of the U.S. carriers’ alliance partners. In the present matter, open skies agreements have been signed with the home countries of all the foreign applicants, and those foreign carriers will continue to

be members of the immunized alliances whatever DOT decides here. Granting immunity for Continental to coordinate with Star ATI Alliance<sup>1</sup> members on U.S. to Latin American or Pacific routes is not likely to result in further liberalization discussions between the U.S. and countries with which we have not yet negotiated open skies, such as China or Brazil. Therefore, an expansion of immunity offers no open skies benefits for U.S. consumers.

Where an application does not directly promote open skies with its attendant consumer benefits, applicants bear a heavy burden to prove benefits specific to their alliance agreements that justify immunity. Where an application involves the presence of two major domestic competitors, the request for immunity warrants particularly close scrutiny.

DOJ believes the Joint Applicants have failed to demonstrate the required elements for the broad immunity sought – immunity encompassing transborder, transatlantic and transpacific markets without regard to the planned level of integration among Applicants – and that DOT should deny the broad requested immunity and instead grant a more limited immunity. In considering the Joint Applicants’ immunity request, we urge DOT to take into account the following DOJ conclusions:

- The Applicants’ proposed elimination of competition between United and Continental for transpacific and Latin American service threatens competitive harm in markets where entry is limited by restrictive bilateral agreements. It will, for example, substantially lessen competition in city pairs between the U.S. and Beijing, where United and

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<sup>1</sup> As described in greater detail below, the Star Alliance is an alliance of more than 20 U.S. and international airlines that interact together at many levels without antitrust immunity. The Star ATI Alliance is a subset of nine Star Alliance members that have received authority from DOT to coordinate on an immunized basis. Two of the Star ATI members – United and Lufthansa – have yet another alliance agreement, proscribing a greater level of integration than found in the arrangements between the Star ATI members at large, for which DOT has also granted antitrust immunity. United and Lufthansa refer to that alliance as the “Atlantic Plus” or “A+” agreement.

Continental provide substantial connecting service. The Applicants have provided no concrete plans for cooperation in non-transatlantic markets, let alone established that immunity is necessary to achieve specific benefits. A DOT grant of immunity for two U.S. carriers to coordinate their international operations outside of an explicit joint venture with foreign carriers would be unprecedented.

- The Applicants' proposed elimination of competition between Continental and Air Canada on U.S.-Canada routes ("transborder routes") will substantially limit competitive alternatives on certain transborder routes where entry is unlikely. Applicants have provided no plans detailing any future integration between the parties and hence no justification for this immunity request.
- The Applicants' proposed elimination of competition between Continental and SAS, Swiss and TAP (as a function of Continental joining the Star ATI Alliance) will likely result in competitive harm for consumers in several transatlantic markets, including New York - Stockholm, New York-Copenhagen, New York-Geneva, New York-Zurich, and New York-Lisbon. The Applicants have offered little, if any, evidence to show that immunity between Continental and the nine Star ATI alliance members is necessary to achieve any benefits, or to support their failure to carve out these particular markets from their immunity request.
- The Applicants' proposed elimination of competition between United and Lufthansa in the Dulles-Frankfurt and Chicago-Frankfurt markets (by removing the existing carve outs to immunity) will likely lead to higher fares. Applicants have offered no evidence showing (1) that they need to remove the carve outs to achieve specific benefits and (2) that the value to consumers of those benefits outweighs the likely competitive harm.
- Because the Applicants include two large, domestic competitors, a sweeping grant of immunity raises significant concerns about harm to domestic competition, a risk that cannot be completely mitigated through confidentiality guidelines. Thus, the request for immunity should be viewed with enhanced skepticism.

## **II. Background**

### **A. The Star Alliance and its immunized components**

The member airlines of the Star Alliance together operate flights to over 900 destinations worldwide. Its founding – and principal members – include:

- *United*: United, the third largest U.S. airline with over \$20 billion in annual revenue, has hubs in Chicago, Denver, San Francisco, Los Angeles and Washington, D.C. United offers international service to Canada, Europe, Asia, and Latin America. In addition to its immunized participation in the Star ATI

Alliance (described below) and its longstanding immunized cooperation with Lufthansa, United also has bilateral immunized relationships with Asiana and Air New Zealand that exist independent of United's relationships with the other Star participants.

- *Lufthansa*: Lufthansa is one of the world's largest airlines, with hubs in Frankfurt and Munich and over \$35 billion in annual revenue. Lufthansa owns 100% of Swiss, and has significant ownership interests in BMI and JetBlue. Lufthansa provides extensive service to the United States.
- *Air Canada*: Air Canada is the largest provider of scheduled passenger service in the Canadian market, the Canada-U.S. transborder markets, and in the international markets to and from Canada. Air Canada has hubs in Toronto, Montreal, Vancouver and Calgary, and provides service directly to numerous destinations in the United States and cities in Europe, Asia, and Latin America.

The Star Alliance includes eighteen additional members,<sup>2</sup> all of which have agreed to provide Alliance customers certain joint services such as codesharing, coordinated processes for reservations and baggage transfer, through-ticketing, frequent flyer reciprocity, and lounge sharing. [REDACTED]

Star members interact with one another with varying degrees of integration and across various sets of markets. The full group of twenty-one members operates without antitrust immunity. [REDACTED]

[REDACTED] For example, US Airways' participation in the Star Alliance is not subject to antitrust immunity; therefore, the

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<sup>2</sup> The current members of the Star Alliance are United, Lufthansa, Air Canada, Air China, Air New Zealand, ANA, Asiana Airlines, Austrian, BMI, Egyptair, LOT, SAS, Shanghai Airlines, Singapore Airlines, South African Airways, Spanair, Swiss, TAP, Turkish Airways, THAI and US Airways. Star also has three regional members: Adria Airways, Blue1 and Croatia Airlines.

<sup>3</sup> [REDACTED]

<sup>4</sup> [REDACTED]

antitrust laws fully apply to its collaboration with other Star members – including that with its domestic rival United.

Certain Star members, however, have entered into more extensive agreements with one another for which they have requested – and received – antitrust immunity from DOT:

- *The United/Lufthansa Joint Venture*: In 1996, United and Lufthansa received antitrust immunity to coordinate pricing, scheduling and other activities as part of their alliance agreement. DOT imposed carve outs from the immunity for the Frankfurt to Chicago/Washington routes – the only routes then served by both airlines on a nonstop basis. The carve outs remained following each subsequent renewal of the United/Lufthansa immunity grant and each expansion of the membership of the Star ATI Alliance. The two carriers instituted revenue sharing in 2003, when they changed the name of the venture to the Atlantic Plus (“A+”) Alliance.
- *The Star ATI Alliance*: United, Air Canada, Lufthansa and six other Star members<sup>5</sup> have entered into a coordination agreement to “promote global cooperation, while maintaining their distinct corporate identities.”<sup>6</sup> DOT granted this group global antitrust immunity but excluded routes between Frankfurt and Chicago/Washington (discussed above) and between Toronto and San Francisco/Chicago. DOT had previously carved out these routes from bilateral agreements between United/Lufthansa and United/Air Canada<sup>7</sup> due to competitive concerns and then ordered these carve outs continued under the Star ATI Alliance; accordingly, the antitrust laws continue to apply to operations on those routes.

#### **B. Continental’s request to join Star and receive antitrust immunity**

Continental, the fourth largest U.S. airline with hubs in Newark, Houston and Cleveland, has an extensive international network, including significant transatlantic, transpacific and Latin American operations. It currently is a non-immunized member of the SkyTeam Alliance and

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<sup>5</sup> United, Air Canada, Lufthansa, Austrian, BMI, LOT, SAS, Swiss and TAP are the current members of the Star ATI Alliance.

<sup>6</sup> Docket 2005-22922, Joint Application Ex. 2.

<sup>7</sup> DOT first granted United and Air Canada immunity in 1997. That order exempted from immunity Toronto to Chicago/San Francisco routes – two of the five routes where United and Air Canada each offered nonstop service between the U.S. and Canada at the time.

also participates in a domestic alliance with Northwest and Delta. Continental competes with United on numerous domestic routes; the airlines also provide competing service to Europe, Canada, Asia and Latin America.

Continental now seeks to exit SkyTeam and join United in the Star Alliance.<sup>8</sup> In addition to becoming a member of the full, non-immunized alliance, the Applicants request that DOT provide antitrust immunity for Continental's inclusion in the Star ATI Alliance agreement, with the result that Continental will have global immunity to cooperate with the existing Star ATI participants.<sup>9</sup>

The Applicants also propose an integrated joint venture among Continental, United, Air Canada, and Lufthansa patterned after the immunized A+ alliance. The venture – named A++ – provides for the four parties to engage in joint pricing, sales and marketing, and revenue sharing for the transatlantic routes encompassed by the agreement. The Applicants contend that revenue sharing will promote “sales without preference” or “metal neutrality,” and allow the parties to focus on jointly tailoring their service to serve customers better, rather than diverting passengers from one another. [REDACTED]

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<sup>8</sup> Due to contractual obligations, Continental cannot transition from SkyTeam to the Star Alliance, or any of the other coordination agreements set forth in the Joint Application, until October 24, 2009.

<sup>9</sup> Continental proposes to enter into bilateral agreements with each of the existing members to facilitate this coordination.

<sup>10</sup> [REDACTED]

[REDACTED]

In support of their overall request, the Applicants claim that Continental's inclusion in the immunized Star ATI Alliance will provide significant consumer benefits, which include expansion of service, prevention of service cuts, cost efficiencies, and more vigorous competition among the three major international alliances (Star, SkyTeam and largely non-immunized oneworld). They place significant emphasis on the "common bottom line" of the A++ agreement, which they claim will allow significant integration and operational efficiencies. They assert that antitrust immunity is required to achieve these consumer benefits because a grant of immunity would negate the "threat of costly and burdensome private antitrust litigation;" satisfy "due process" and "equitable" considerations by providing the Star ATI Alliance, plus Continental, immunity to match the immunity currently in place for the SkyTeam Alliance; and further the goals of the U.S.-E.U. open skies agreement.<sup>12</sup>

The Applicants assert that the benefits justify global, unrestricted immunity; *i.e.*, that DOT should not impose carve outs on new overlap routes and that DOT should rescind the carve outs that apply to the Star ATI members' existing grants of immunity.<sup>13</sup> The Applicants claim that they will not carry out the joint activities contemplated by the proposed alliance agreements without immunity.<sup>14</sup>

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<sup>11</sup> The agreement does not specifically provide for expansion of the venture to other international routes. The Applicants have stated that they intend to pursue similar integrated joint ventures to cover Latin America and Asia, but no such contractual obligation exists.

<sup>12</sup> J.A. at 97, 13, and 9.

<sup>13</sup> J.A. at 85.

<sup>14</sup> J.A. at 97.

Continental and United also contemplate forming a domestic alliance spanning their entire U.S. networks.<sup>15</sup> Continental and United assert that they will maintain their separate domestic networks and make independent pricing, scheduling and sales decision for the domestic entities.

**C. The Show Cause Order**

DOT conducted an analysis of the competitive effects and claimed benefits of the proposed agreements. DOT explains that its competitive analysis treats the agreements as a merger and that the appropriate framework is an application of Clayton Act standards.<sup>16</sup> Under its review process, DOT analyzes the potential effects of the proposed agreements on competition in “regional,” “country-pair,” and “city-pair” markets, and the Order finds the combination to be pro-competitive or neutral with respect to regional and country-pair markets.<sup>17</sup> With respect to city-pair markets, the Order notes that there are fourteen city pairs in which Continental and a Star ATI carrier compete on a nonstop basis. DOT states that “each of the nonstop overlap markets will continue to have adequate competition on a nonstop or connecting basis” but does not discuss the specific facts of each. The Order also states that even “[w]here the transaction materially reduces the number of competitors . . . the particular facts and circumstances of this

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<sup>15</sup> Continental and United hope eventually to codeshare on nearly all of their domestic flight segments, combine customer lounges, consolidate their operations at common airports, provide frequent flyer reciprocity, cooperate on ticketing, reservations and check-in, and perform joint procurement.

<sup>16</sup> Order at 7-13.

<sup>17</sup> The Order does not explain how DOT determined that regional and country-pair markets are relevant markets under the Clayton Act. In its analysis of country-pair markets, DOT focuses on the predicted effect of the transaction on “inter-alliance competition.” As discussed *infra*, when DOJ analyzes the competitive effects of transactions involving air transportation service, DOJ considers travel between city pairs, or nonstop travel between city pairs, to be the appropriate relevant markets for review.

case indicate that consumers will not be harmed.’’<sup>18</sup>

DOT also explains its view that carving out service on transatlantic overlap city-pair routes from immunity would interfere with the expected integration efficiencies from the A++ venture and would disadvantage the smaller Star carriers SAS, Swiss, and TAP, which compete on certain of the overlap routes but are not A++ members.<sup>19</sup> In addition, the Order states that entry is easy in U.S.-Canada markets, and thus DOT does not impose carve outs of overlaps between Continental and the Star ATI members.<sup>20</sup> The Order does not address competitive issues in any other non-transatlantic international city pairs (such as routes from the U.S. to Asia or Latin America). The Order notes that, although there is some risk that immunized coordination between Continental and United will have spillover effects on competition in domestic markets, that risk is small and outweighed by the benefits of integration. The Order states that the adoption of antitrust protocols by United and Continental is critical to this finding.

The Order concludes that the extensive integration contemplated in the A++ joint venture might create a risk of antitrust litigation for the four participants.<sup>21</sup> The Order does not expressly analyze why immunity is necessary for Continental to join the broader, less integrated Star ATI alliance. The Order states that restricting the scope of the alliance agreements at this juncture would “primarily serve to disadvantage Continental and its customers.”<sup>22</sup>

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<sup>18</sup> Order at 12.

<sup>19</sup> Order at 13.

<sup>20</sup> *Id.* The Order maintains existing transborder carve outs between Star ATI members United and Air Canada. Order at 13, 27.

<sup>21</sup> Order at 17-18.

<sup>22</sup> Order at 20.

The Order grants global immunity for Continental to coordinate with the Star ATI members and for the A++ joint venture.<sup>23</sup> The Applicants are required to submit evidence showing that the A++ joint venture has been implemented – *i.e.*, the parties must negotiate a revenue sharing formula – within 18 months. If they do so, the existing carve-outs on the Washington-Frankfurt and Chicago-Frankfurt markets will be removed. If they fail to do so, “the grant of antitrust immunity shall be automatically withdrawn.”<sup>24</sup>

### **III. The Statutory Scheme Disfavors Immunity and Places a Significant Burden on the Applicants to Justify Their Request**

Under the applicable statute, DOT must disapprove a proposed agreement if it “substantially reduces or eliminates competition” unless DOT finds that the agreement “is necessary to meet a serious transportation need or to achieve important public benefits” and there is no less anticompetitive alternative. 49 U.S.C. §41309(b). If DOT approves an anticompetitive agreement on those grounds, it must exempt it from the antitrust laws. 49 U.S.C. §41308(c).

If DOT finds that an agreement does not reduce or eliminate competition and is consistent with the public interest, DOT must approve it, but exemption from the antitrust laws is authorized only if it is *required* by the public interest; even then immunity is authorized only “to the extent necessary to allow the person to proceed with the transaction specifically approved by the order and with any transaction necessarily contemplated by the order.” 49 U.S.C. §§41309(b) and

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<sup>23</sup> The immunity grant is subject to the adoption of antitrust guidelines by United, Continental, and Lufthansa, and does not extend to any market solely within the United States. Order at 27, Appendix A. The Applicants also must submit for prior approval any agreements materially altering their cooperation agreements and must resubmit the alliance agreements five years after issuance of the Final Order. Order at 27.

<sup>24</sup> Order at 26-27.

41308(b). In such a case, the burden is on the Applicants to make “a strong showing on the record that antitrust immunity is required by the public interest, and that the parties will not proceed with the transaction without the antitrust immunity.”<sup>25</sup>

**A. Antitrust enforcement plays a central role in the deregulated airline industry**

Antitrust enforcement protects U.S. consumers. The antitrust laws rest on “the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress.”<sup>26</sup> Accordingly, the Supreme Court has consistently held that exemptions from the antitrust laws are to be narrowly construed.<sup>27</sup>

An important goal of airline deregulation was to “make the airline industry subject to the same competitive and antitrust standards applicable to other industries, as far as is practicable.”<sup>28</sup> As the Civil Aeronautics Board (“CAB”) itself recognized, regulatory protection from antitrust enforcement may have unanticipated consequences:

Congress intended the Board to be circumspect in its use of 414 [the antitrust exemption for airlines], both because the threat of antitrust liability is a valuable regulator of business conduct and because the consequences of the grant of immunity can be difficult to predict.<sup>29</sup>

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<sup>25</sup> Order 93-1-11 (Northwest/KLM) at 10.

<sup>26</sup> *N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 4 (1958).

<sup>27</sup> *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 126 (1982); *FMC v. Seatrain Lines, Inc.*, 411 U.S. 726, 732-33 (1973). This doctrine applies with equal force to both implicit and express statutory exemptions. *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 231 (1979); *United States v. McKesson & Robbins, Inc.*, 351 U.S. 305, 316 (1956).

<sup>28</sup> Air Carrier Agreements Affecting Interstate and Overseas Air Transportation, Order 88-12-11 at 1 (1988).

<sup>29</sup> National Airlines, Acquisition, 84 C.A.B. 408, 415 (1979).

The CAB and DOT have in the past exercised their authority to grant immunity mindful of competitive consequences:

In enacting the ADA, Congress directed that control of the air transportation system be returned to the marketplace. We have consistently held that a part of the return to market control is exposure of participants to the antitrust laws, as that exposure exists in unregulated industries.<sup>30</sup>

**B. Applicants must show that immunity is required by the public interest**

The burden is on the Applicants to make “a strong showing on the record that antitrust immunity is required by the public interest, and that the parties will not proceed with the transaction without the antitrust immunity.”<sup>31</sup> DOT has “determined that it will grant antitrust immunity only if it is necessary to enable a transaction that will provide significant public benefits to go forward.”<sup>32</sup> Previous decisions have described the “high standard” or exceptional showing required.<sup>33</sup> The courts have upheld this approach. For example, in affirming a CAB denial of antitrust immunity, the Eighth Circuit explained that “[e]xamination of [the approval and immunity provisions] and their legislative history clearly reveals that antitrust immunity for

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<sup>30</sup> Competitive Marketing of Air Transportation, Order 82-12-85, 99 C.A.B. 1, 131 (1982). “ADA” refers to the Airline Deregulation Act of 1978, Pub. L. No. 95-504, 92 Stat. 1705, codified as amended at 49 U.S.C. §§ 40101-46501 (2005).

<sup>31</sup> Order 93-1-11 (Northwest/KLM) at 10.

<sup>32</sup> DOT Report to Congress: Administration of Aviation Antitrust Functions, at 16 (May 1987). *See also* 49 U.S.C. § 41308(b) (stating the “necessary” requirement).

<sup>33</sup> *See, e.g.*, UATP-1976 Agreements, Order 80-6-66, 85 C.A.B. 2481, 2512-14 (1980) (“[F]ull exposure to antitrust liability is consistent with the marketplace orientation of [the Airline Deregulation Act]”); Airline Fuel Corporation Case, Order 79-9-120, 83 C.A.B. 1358, 1363-64 (1979) (holding that Board’s continuing jurisdiction over agreements was not sufficient substitute for antitrust exposure and noting that the threat of unwarranted litigation is “simply one of the risks of doing business”); *see also*, Competitive Marketing of Air Transportation, Order 82-12-85, 99 C.A.B.1, 13 (1982) (recognizing that “full antitrust exposure is consistent with deregulation” and setting a “high standard for granting antitrust immunity”).

airline agreements is intended to be the exception and not the rule.”<sup>34</sup>

All prudent businesses devote some concern to antitrust liability; this level of awareness is normal and, from a consumer standpoint, healthy. Subjective fears of antitrust litigation are an insufficient basis for granting immunity:

Petitioners seem to read the [Federal Aviation Act] as authorizing immunity on demand for any agreement which produces public benefits. Neither the text nor the legislative history of the statute supports such a reading, which would make the grant of antitrust immunity turn on the subjective desire of the parties to avoid antitrust litigation. This desire is one shared by all businesses subject to the Sherman Act, and we do not believe that it is relevant to the Board’s task. Petitioners are entitled to immunity on the basis of an *objective* demonstration that the statutory requirements for such immunity have been met.<sup>35</sup>

An application for immunity must therefore make a “strong showing” that, from the standpoint of the public interest, the predicted value of antitrust immunity is greater than the proven value of the normal antitrust regime.

#### **IV. DOT Should Deny the Broad Application for Immunity**

Over the last sixteen years, DOT has exercised its authority to grant antitrust immunity to more than twenty alliance agreements.<sup>36</sup> During this time most of the largest airlines in the world have become members of one of three large alliances and, in many cases, have been granted immunity from the antitrust laws by DOT.

Many of the immunity grants DOT has issued were intended, in large part, to further the foreign policy goal of inducing the governments of the foreign alliance partners’ home countries

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<sup>34</sup> *Republic Airlines, Inc. v. C.A.B.*, 756 F.2d 1304, 1317 (8<sup>th</sup> Cir. 1985).

<sup>35</sup> *Id.* (emphasis in original).

<sup>36</sup> DOT has published lists of open skies agreements and immunized alliances at [http://ostpxweb.dot.gov/aviation/X-40%20Role\\_Files/bilatogramreement.htm](http://ostpxweb.dot.gov/aviation/X-40%20Role_Files/bilatogramreement.htm) and at [http://ostpxweb.dot.gov/aviation/X-50%20Role\\_files/immunizedalliances.htm](http://ostpxweb.dot.gov/aviation/X-50%20Role_files/immunizedalliances.htm).

to enter into open skies agreements with the United States. Indeed, DOT asked Congress to retain the authority to approve and immunize agreements as a tool to be used in the conduct of U.S. international aviation policy.<sup>37</sup> For example, in granting immunity to the Northwest/KLM alliance, foreign policy considerations led DOT to overcome its normal reluctance to grant antitrust immunity:

We have rarely been willing to grant antitrust immunity to carrier agreements because immunity is usually inconsistent with airline deregulation and the promotion of airline competition. In this case, however, the grant of immunity should promote competition by furthering our efforts to obtain less restrictive aviation agreements with other European countries.<sup>38</sup>

The agreements facilitated by earlier grants of immunity have removed entry restrictions and pricing regulation in most large international markets. In this case, however, open skies agreements are in place with all of the relevant governments<sup>39</sup> and an immunity grant to Continental does not advance this important goal.<sup>40</sup>

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<sup>37</sup> Report to Congress: Administration of Aviation Antitrust Functions, May 1987, at 24.

<sup>38</sup> Order 93-1-11 at 11-12.

<sup>39</sup> Although in some previous cases, DOT granted immunity to a new alliance after open skies were achieved, these decisions occurred where the foreign carrier's original alliance with a U.S. carrier had terminated or where the citizen airline of the open skies partner was newly joining an alliance with a single U.S. carrier. As DOT has explained, "the existence of an open-skies relationship in no way guarantees any grant of immunity. To the contrary, it is possible that immunity will not be found to be pro-competitive or pro-consumer in particular cases, notwithstanding an open national market, depending on such factors as relevant market concentration, potential future barriers, overall dominance and size of the applicants, among other things[;] . . . an Open-Skies agreement is a necessary, but not automatically sufficient, basis for the grant of antitrust immunity." Order 2001-12-18 (Delta/Air France/Alitalia/Czech) at 2.

<sup>40</sup> The EU and the U.S. have negotiated and implemented a first stage open skies agreement and are negotiating an expansion of that agreement. There has been no claim here that granting expanded immunity to Star would lead to success in those negotiations.

DOT has also based its prior decisions to grant immunity to alliances on the assumption that immunity would allow the partner airlines to coordinate in ways that create large public benefits, and that such coordination would not occur without immunity. The primary benefit asserted by the Applicants is that, like other international alliances, immunity here will allow the partner airlines to extend their networks to provide passengers with online service in a large number of city pair markets that no partner serves on its own. They further argue that immunity will benefit passengers by creating broader frequent flyer programs, improved access to airport lounges, and more efficient service through shared airport facilities and passenger handling. Time has shown, however, that non-immunized alliances (including some involving the Applicants) routinely provide these same public benefits through code-sharing, joint marketing programs, and operational cooperation. *See infra* Section VI. A. The Applicants also argue that immunity would lead to reduced fares through the elimination of double marginalization. Comparison of immunized and non-immunized alliances, however, shows that immunity is not necessary to achieve this benefit. *See infra* Section VI. E. Finally, the Applicants claim that they would not engage in the proposed coordination without immunity due to fear of frivolous antitrust litigation. This fear is without substantial foundation, and long experience shows that airlines routinely engage in profitable and beneficial coordination without antitrust immunity. *See infra* Section VI.

**V. Immunizing an Alliance that Includes Continental and the Other Star ATI Members Risks Significant Competitive Harm in Certain Markets**

DOJ's analysis shows that the addition of Continental to the immunized Star ATI Alliance is likely to result in harm to certain international routes, including routes between the U.S. and China, routes spanning the U.S. and Canadian border, and routes between the U.S. and Denmark,

Portugal, Sweden, and Switzerland. The proposed agreements also pose harm to domestic competition.

**A. Analyzing the competitive effects of the Joint Application agreements**

To determine the competitive effect of adding Continental to the immunized Star ATI Alliance, DOJ undertakes an analysis based on the antitrust agencies' *Antitrust Guidelines for Collaborations Among Competitors* (hereinafter "Joint Venture Guidelines").<sup>41</sup> The central question is whether the joint venture is likely to harm competition in any relevant markets by increasing the participants' ability or incentive to raise price or reduce output.<sup>42</sup> The first part of this analysis asks whether the venture may reduce competition in the markets within which the venture operates. The second asks whether the joint venture may reduce competition in other markets where the joint venturers remain competitors.

The likelihood of any harm to competition depends on, among other things, "the nature of the collaboration, its organization and governance, and safeguards implemented to prevent or minimize such disclosure."<sup>43</sup> A joint venture may facilitate collusion by providing the participants with opportunities to discuss and agree on anticompetitive terms or enhancing their ability to detect and punish deviations from a collusive agreement.<sup>44</sup> Evaluating the competitive effects requires a detailed and fact-intensive analysis of the specifics of the joint venture structure

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<sup>41</sup> These guidelines, prepared by DOJ and the Federal Trade Commission and available at <http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf>, explain the framework for analysis of the competitive effects of joint ventures.

<sup>42</sup> Joint Venture Guidelines at 1.2; 3.3.

<sup>43</sup> See Joint Venture Guidelines at 3.34(e).

<sup>44</sup> *Id.* at 3.31(b).

and proposed operations in the relevant markets. DOJ uses the principles contained in the 1992 *Horizontal Merger Guidelines* to analyze the likely competitive effects of agreements such as those in the Joint Application,<sup>45</sup> and DOT has adopted this *Merger Guidelines* approach.<sup>46</sup> The analysis identifies the relevant markets and the firms that compete in those markets, and considers whether entry into the market is so easy that the market participants, after the transaction, would not be able profitably to maintain a price increase above pre-merger levels.<sup>47</sup>

In analyzing airline matters, the relevant markets are no larger than city pairs. However, there are often narrower markets for nonstop service because a significant number of travelers may not consider onestop service to be a reasonable substitute for nonstop in a given city-pair market.

In principle, a transaction may not increase market power, notwithstanding a significant increase in concentration, if entry were so easy that profitable price increases could not be sustained after the transaction. Here, the Applicants have made no showing that such entry would be timely, likely or sufficient on the routes of greatest concern. Moreover, experience shows that entry on certain routes, in particular routes connecting two hubs of an airline, can be difficult for a

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<sup>45</sup> For a more detailed description of DOJ's approach to analyzing airline mergers, see Statement of James J. O'Connell before the Subcommittee of Aviation, Committee on Transportation and Infrastructure, U.S. House of Representatives (May 14, 2008) at 7-10.

<sup>46</sup> "[W]e primarily consider whether the alliance would significantly increase market concentration, whether the alliance raises concerns about potential anticompetitive effects in light of other factors, and whether new entry into the market would be timely, likely, and sufficient either to deter or counteract a proposed alliance's potential for harm." Order at 7.

<sup>47</sup> "Entry is that easy if entry would be timely, likely, and sufficient in its magnitude, character and scope to deter and counteract the competitive effects of concern." *Merger Guidelines* § 3.0.

non-hub carrier.<sup>48</sup>

**B. Competition on non-transatlantic routes**

If global antitrust immunity is granted, United and Continental will be free to cease competing in non-transatlantic international markets. Although the two carriers have no nonstop overlaps on non-transatlantic city pairs, they are nevertheless important competitors in non-transatlantic regions. Pacific and Latin American markets tend to have significantly less service from the U.S. than European markets, both because the markets are thinner and because service to several countries is still subject to limited entry bilaterals.<sup>49</sup> The Order contains no analysis of the competitive effects of immunizing the non-transatlantic international operations of Continental and United.<sup>50</sup>

The most serious competitive concerns raised by a grant of global immunity involve China. U.S. airlines must receive DOT authorization to serve between specific cities in the U.S. and China, and such authorization has strict frequency limits. United and Continental are currently the only two U.S. carriers offering nonstop service to Beijing from the U.S. mainland. Together, they account for 57% of the available nonstop seats to Beijing, while (non-immunized)

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<sup>48</sup> Entry by non-hub carriers in transatlantic hub routes where only a few airlines offer nonstop flights is extremely unlikely. For the 46 transatlantic hub routes studied in Appendix B that had nonstop service from only one or two carriers, there was only one instance in the past three years of a non-hub carrier entering a route with regular service. *See* Appendix B, fn. 119. *See also, infra* notes 67 and 122.

<sup>49</sup> Countries that still have restricted bilaterals include Brazil, Mexico, China, and Japan.

<sup>50</sup> The Order notes Delta Air Lines' objection to extending immunity to limited entry countries, but merely states that DOT is unwilling to "jeopardize the network benefits of the proposed alliance by limiting the points that be served without stronger evidence of competitive harm." Order at 20. The Order does not describe which limited entry markets DOT examined for competitive effects or which evidence DOT would have found sufficient.

Star member Air China accounts for another 41%.<sup>51</sup> United and Continental are also the only U.S. carriers providing nonstop service from U.S. gateways to Hong Kong; those nonstop flights accounted for 28% of all nonstop seats offered from the U.S. to Hong Kong in 2008.<sup>52</sup>

United and Continental currently do not provide nonstop service between the same U.S.-China city pairs (*e.g.*, United has authority to provide some service between Beijing and Chicago/San Francisco/Washington, while Continental is authorized to offer some service between Beijing and Newark). However, because DOT can authorize service to China from only a handful of U.S. cities,<sup>53</sup> customers in many U.S. cities must use connect service when traveling to/from China. Thus, Continental and United today compete for connecting traffic between numerous non-gateway U.S. cities and Beijing. That competition would be lost under the terms of the Order.

Under current service patterns, post-application the Star Alliance would provide a dominant share of the onestop connecting service available to U.S. consumers, with immunized Star ATI members Continental and United accounting for many of the onestop options involving Eastern U.S. points. Although significant new U.S.-China service has been negotiated and awarded,<sup>54</sup> most of that new service has been deferred by the recipient airlines for at least a year.<sup>55</sup>

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<sup>51</sup> OAG data for 2008.

<sup>52</sup> *Id.*

<sup>53</sup> *See* Order 2007-9-25, Docket OST-2007-28567, at 2-3 (discussing limits on DOT's ability to award service to China).

<sup>54</sup> *See* Order 2007-9-25, Docket OST-2007-28567.

<sup>55</sup> *See, e.g.*, Docket OST-2007-28567, Motion of United Airlines, March 20, 2009, at 2-3.

Even if all the authorized service were implemented eventually, the combination of the Continental and United frequencies will leave the Star ATI alliance with over half of the authorized U.S. carrier frequencies from the U.S. to Beijing.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

**C. Competition on transatlantic routes**

Continental has extensive transatlantic operations – with flights to 25 destinations in Europe – primarily from its hub in Newark and more limited service from Houston and Cleveland. Continental competes on a nonstop basis with the Star ATI carriers in certain U.S.-Europe city-pair markets, as discussed in Section V. C. 2 below.<sup>58</sup> Granting Continental authority to join the immunized Star ATI Alliance will likely harm nonstop competition in these markets.

1. Nonstop service is a separate product market

In transatlantic routes covered by this Application, nonstop service is a separate product

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<sup>56</sup> See Appendix A.

[REDACTED]

<sup>57</sup>

[REDACTED]

<sup>58</sup> With respect to transatlantic city-pair markets in which Continental today provides only connecting service, the proposed immunity grant does not raise competitive concerns for passengers.

market.

Empirical analyses (discussed in more detail below) show that the number of nonstop carriers competing in a market has a significant impact on the average fares paid by customers in the market. That finding strongly supports the conclusion that nonstop service is a separate market.<sup>59</sup>

The evidence shows that for a large group of passengers, connecting service is not a reasonable substitute and airlines can target this group for higher fares.<sup>60</sup> These travelers generally have fewer options on the timing of trips, tend to purchase tickets closer to the time of travel, are able to pay more for better service and flexibility, and are less likely to accept the delays attendant to connecting service when nonstop service is available. In other words, for many passengers, connecting service is not a reasonable substitute for nonstop service.

The existence of a separate market for nonstop service is supported by the airlines' own documents and actions. The airlines structure restrictions on their tickets to segment time-sensitive from non-time-sensitive demand, thereby encouraging passengers to self-select into either lower priced tickets with more restrictions purchased in advance of travel, or less restricted

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<sup>59</sup> Moreover, on transatlantic hub routes the vast majority of coach passengers fly nonstop when it is available even though average connect fares are 10% lower than average nonstop fares (see Appendix B). Such evidence is consistent with the existence of a separate non-stop market.

<sup>60</sup> See, e.g., Armantier, O., and Richard, O., 2008, "Domestic Airline Alliances and Consumer Welfare," 39 *RAND Journal of Economics* 875-904, and Berry, S., Carnall, M., and Spiller, P., 2006, "Airline Hubs: Costs, Markups and the Implications of Customer Heterogeneity," 1 *Advances in Airlines Economics* (Darin Lee, Elsevier B.V., ed.).

tickets purchased within a few days of travel at relatively high prices.<sup>61</sup> To similar effect, the airlines' QSI ("quality of service index") models award nonstop service a significantly higher projected share than connect service when predicting the market share a carrier should receive based upon its level or quality of service in a market.<sup>62</sup>

Finally, business travelers' conduct supports the existence of a nonstop market.<sup>63</sup> Many corporations have explicit guidelines governing when their employees are required to take onestop alternatives due to lower price. Those guidelines require a significant fare difference before the onestop option is mandated – generally at least 10% and in some cases 25% or more. Some corporations actually *require* passengers to take nonstop service if available. This is not surprising given the value of employees' time, especially the types of employees likely to be dispatched on international travel.

## 2. Nonstop overlap on specific transatlantic routes

Continental currently competes against other Star ATI members on five nonstop transatlantic routes: New York-Stockholm, New York-Copenhagen, New York-Geneva, New

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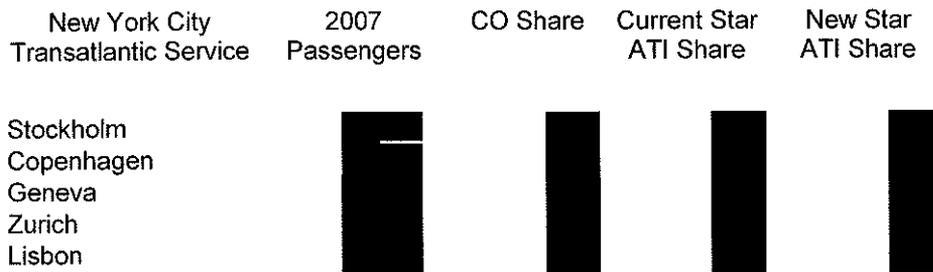
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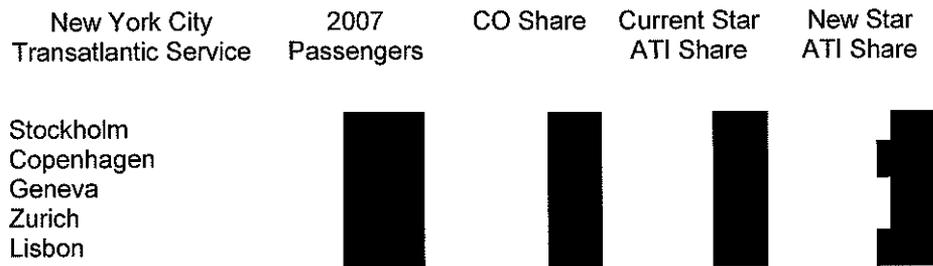
<sup>63</sup> DOJ interviewed numerous corporate travel managers about their companies' travel policies during the course of investigating the Joint Applicants' proposals and other airline transactions.

York-Lisbon, and New York-Zurich.<sup>64</sup> The two charts below show Continental and the Star ATI carriers' shares on these five routes of all passengers (nonstop and connecting) and nonstop passengers.<sup>65</sup>

**Total Passenger Shares (Nonstop and Connecting) in Selected N.Y.C. Overlap Routes**



**Total Nonstop Passenger Shares in Selected N.Y.C. Overlap Routes**



On each of these routes, Continental and its potential immunized partner account for at least [Redacted] of the passenger traffic. Thus, even if the relevant market is more broadly defined to include nonstop and connecting service, the proposed Application would substantially increase market concentration in each of the above-referenced markets. On four of the routes (New York to Copenhagen, Geneva, Lisbon, and Stockholm) they offer the only daily nonstop service on the

<sup>64</sup>SAS serves New York-Copenhagen/Stockholm, Swiss serves New York-Geneva/Zurich, and TAP serves New York-Lisbon.

<sup>65</sup> Source: MIDT data (2007). [Redacted]

route, and on the fifth (New York to Zurich) they are two of three nonstop competitors. The proposed immunity order would thus significantly reduce – and in some cases completely eliminate – nonstop competition on these routes.

As the table below shows, the vast majority of passengers traveling in these markets fly nonstop, and the percentage of business passengers (identified by fare class) flying nonstop is generally even higher.<sup>66</sup>

New York City Transatlantic Service	<u>Business Class Share</u>		<u>Coach Class Share</u>	
	Nonstop Carriers	Connecting Carriers	Nonstop Carriers	Connecting Carriers
Stockholm	■	■	■	■
Copenhagen	■	■	■	■
Geneva	■	■	■	■
Zurich	■	■	■	■
Lisbon	■	■	■	■

3. The loss of a nonstop competitor is likely to result in significant fare increases

The immunity grant will substantially reduce competition on routes where the Star ATI members offer nonstop service in competition with Continental. Numerous economic studies of the domestic U.S. airline industry since deregulation have shown that reducing the number of nonstop competitors, particularly from three to two, or from two to one, results in significant fare increases.<sup>67</sup> Recent work by DOJ, using cross-sectional analysis of third quarter 2008 fare data

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<sup>66</sup> Source: MIDT data (2007). Includes all carriers with at least 500 passengers in the calendar year.

<sup>67</sup> See, e.g., Kamita, “Analyzing the Effects of Temporary Antitrust Immunity: The Aloha-Hawaiian Immunity Agreement,” *Journal of Law and Economics* (forthcoming 2009);

for U.S. carriers on transatlantic routes, shows that fares paid by nonstop passengers increase by 15% when the number of nonstop carriers goes from two to one (as would be the result in a number of the nonstop overlap markets at issue here if immunity is granted) and increase by 6.6% when the number of nonstop carriers goes from three to two.<sup>68</sup>

4. Nonstop entry is unlikely

The Applicants have failed to show that nonstop entry would prevent fare increases by Continental and its immunized Star ATI partners in overlap transatlantic markets. If Continental has immunity to coordinate with the Star ATI members, the Star ATI Alliance will, in essence, operate hubs at both ends of the overlap city pairs. It is very difficult to enter the hub-hub market of another carrier because the entrant does not have access to feed traffic and because the hub carrier has significant marketing advantages.<sup>69</sup> New York-Copenhagen and New York-Stockholm

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Peters, "Evaluating the Performance of Merger Simulation: Evidence from the U.S. Airline Industry," 49 *Journal of Law and Economics* 627 (2006); Joskow, Werden & Johnson, "Entry, Exit and Performance in Airline Markets, 12 *International Journal of Industrial Organization* 457 (1994); Borenstein, "The Evolution of U.S. Airline Competition," 6 *Journal of Economic Perspectives* 45 (1992); Borenstein, "Hubs and High Fares: Airport Dominance and Market Power in the U.S. Airline Industry," 20 *Rand Journal of Economics* 344 (1989); Brueckner, Dyer & Spiller, "Fare Determination in Hub and Spoke Networks," 23 *Rand Journal of Economics* 309 (1992); Morrison & Winston, "Enhancing Performance in the Deregulated Air Transportation System," 1989 *Brookings Papers: Microeconomics* 61 (1989). Recent DOJ empirical work on domestic markets also confirms that going from three to two nonstop carriers increases fares.

<sup>68</sup> The fare change findings for two to one routes are statistically significant. See Appendix B, Section I, for further description of the analysis performed.

<sup>69</sup> The hub carrier's strong frequent flyer base and its relationships with local travel agents make it difficult for an entrant to attract local passengers. [REDACTED]

[REDACTED] See also, Gurrea, "International Airline Code Sharing and Entry Deterrence," 1 *Competition Policy and Antitrust* 109 (2006); Lijesen, Nijkamp, Pels & Rietveld, "The Home Carrier Advantage in Civil Aviation," 1 *Competition Policy and Antitrust* 215 (2006).

each have less than [REDACTED] local passengers per year, making those routes particularly unattractive for entry by a non-hub carrier.

Constraints on service at New York airports are another factor that makes entry in these overlap markets unlikely. All Continental transatlantic nonstop overlaps with the Star carriers involve New York as an endpoint. Long-term, ongoing congestion problems in the New York area airspace have resulted in actions by the FAA to limit scheduled operations at both JFK and Newark Liberty.<sup>70</sup> Currently, it would be difficult for a competitor to gain additional operating authority to begin service in the event fares increased on the overlap markets.

#### **D. Competition on transborder routes**

Continental and Air Canada are the only, or two of only three, airlines providing nonstop service on five transborder routes.<sup>71</sup> As is the case on the transatlantic overlaps, the vast majority of passengers on these routes travel nonstop.<sup>72</sup> The charts below show shares of all passengers (nonstop and connecting) and nonstop passengers on five of the Continental/Air Canada nonstop overlaps:<sup>73</sup>

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<sup>70</sup> Order Limiting Scheduled Operations at John F. Kennedy International Airport, Docket FAA-2007-29320 (Jan.15, 2008); Order Limiting Scheduled Operations at Newark Liberty International Airport, Docket FAA-2008-0221 (May 15, 2008).

<sup>71</sup> Continental and Air Canada also each offer nonstop service in New York-Vancouver; however, Continental only serves this market on a seasonal basis (summer). The New York-Montreal/Toronto markets are currently served by four carriers on a nonstop basis – American, Delta, and the two Applicants. These are large local markets (over [REDACTED] passengers per year in the case of New York-Toronto); thus, nonhub carriers are able to profitably to provide service even without access to feed traffic. Continental and United have no transborder nonstop overlaps, but do compete for connecting traffic over their various hubs.

<sup>72</sup> The nonstop carriers have well over [REDACTED] of the coach Y fare, business and first-class traffic on all of the transborder overlaps.

<sup>73</sup> Source: MIDT data (2007).

**Total Passenger Shares (Nonstop and Connecting) in Selected U.S-Canada Overlap Routes**

Transborder Market	2007 Passengers	CO Share	AC + UA Share	CO+AC+UA Share
Houston-Calgary	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Houston-Toronto	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Cleveland-Toronto	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
New York-Ottawa	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
New York-Halifax	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

**Total Nonstop Passenger Shares in Selected U.S-Canada Overlap Routes**

Transborder Market	2007 Passengers	CO Share	AC + UA Share	CO+AC+UA Share
Houston-Calgary	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Houston-Toronto	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Cleveland-Toronto	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
New York-Ottawa	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
New York-Halifax	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

As detailed in our analysis of transatlantic nonstop overlaps, a grant of immunity will harm passengers in the above markets unless the characteristics of these particular markets indicate that entry is likely to counteract the anticompetitive effects. DOJ agrees with the Order that the competitive structure of transborder routes is very similar to U.S. domestic routes.<sup>74</sup> As discussed above in Section V. C. 3., however, there is substantial evidence that a reduction in the number of nonstop competitors from three to two, or two to one, in domestic markets leads to significant fare increases. There is no persuasive evidence in the record that entry will occur on these routes. Entry is particularly unlikely in Houston-Calgary, Houston-Toronto, and Cleveland-Toronto because Continental and Air Canada each operate a hub at one end of these routes.<sup>75</sup>

<sup>74</sup> Order at 13.

<sup>75</sup> The Applicants argue that low cost carriers, such as Westjet and Porter Airlines, are potential entrants on the transborder overlaps. Consolidated Reply of the Joint Applicants at 30-

**E. Competition on domestic routes**

United and Continental are the third and fourth largest domestic carriers; if merged, the combined carrier would be the largest airline in the world.<sup>76</sup> Domestically, United and Continental offer competing nonstop service between United's hubs (Chicago, Washington, Denver, San Francisco, and Los Angeles) and Continental's hubs (Newark, Houston and Cleveland). In some cases they are the only carriers offering nonstop service. In addition, the two carriers compete on a very large number of domestic connecting routes.

As DOT recognizes, immunized cooperation between two U.S. carriers on international routes carries with it the risk of competitive harm in domestic markets.<sup>77</sup> United and Continental have adopted antitrust guidelines designed to lessen the risk of domestic spillover.<sup>78</sup> These guidelines have been reviewed by DOJ and revised to some extent in light of our concerns.

It is important to understand, however, that no guidelines can completely eliminate the risk of domestic spillover. An airline's domestic and international operations are closely

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31. Service offered by Westjet (an airline that has traditionally targeted leisure passengers) via its potential codeshare with Southwest would likely be connecting, which as discussed above, is unattractive to time-sensitive passengers. Porter's fleet choice – modern turboprops – makes entry into routes like Houston to Calgary or Toronto extremely unlikely. Even if Westjet or Porter were to enter the overlap transborder routes on a nonstop basis, they would still have to overcome the advantage an immunized Air Canada/Continental relationship would have by way of operating hubs at each end. *See, e.g.*, [REDACTED]

<sup>76</sup> *See, e.g.*, [REDACTED]

<sup>77</sup> Order at 14.

<sup>78</sup> Exhibit JA-2 (revised).

integrated, as DOT also recognizes.<sup>79</sup> Within the context of their international alliance, United and Continental will be discussing the most sensitive competitive subjects, including pricing, yield management, capacity planning, entry and exit decisions, and aircraft deployment. The opportunities and incentives to extend coordination to non-immunized domestic operations are clear.

Moreover, this risk increases as the scope of international cooperation between the two domestic carriers increases. [REDACTED]

[REDACTED].<sup>80</sup> If the international cooperation is broad but undefined, however – as is the case for the overall Star ATI Alliance – the opportunities for domestic spillover increase significantly.<sup>81</sup>

**VI. The Applicants Make No Showing Why Immunity Is Required to Achieve the Claimed Public Benefits Arising from the Joint Application Agreements**

The Applicants have the burden of showing immunity is required by the public interest. In assessing whether they have met their burden, DOT considers the likely benefits of the proposed coordination and whether the Applicants could obtain those benefits without immunity. The Applicants claim, and DOT has tentatively found, that the agreements will result in public benefits. DOT cites the Applicants' assertion that the A++ "integrated" venture will enable its participants to "pool resources to achieve substantial efficiency and cost savings." Order at 19. In DOJ's view, it is not sufficient, however, merely to point toward claimed benefits; rather, the

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<sup>79</sup> See Order at 13-14.

<sup>80</sup> J.A. Ex. 2 (revised).

<sup>81</sup> For example, we understand that U.S.-Canada pricing is typically handled by the domestic pricing staff.

Applicants need to demonstrate that immunity is *necessary* to achieve them.<sup>82</sup> In this regard, the Applicants fall short.

It is likely that Continental's entry into the Star Alliance (or the smaller Star ATI Alliance) will reduce travel times for some connecting passengers and increase the number of itineraries available from which to select. The Applicants present no evidence, however, that customers will receive quantitatively or qualitatively different service if Continental receives antitrust immunity to coordinate with the Star ATI members compared to what would be provided if Continental merely interacted with the level of cooperation expected of any member of the broader, non-immunized Star Alliance.<sup>83</sup>

The Applicants do not describe which specific "important" consumer benefits will be lost if DOT does not grant the requested immunity. Nor do the Applicants make any attempt to quantify how much smaller the benefits enuring to the traveling public would be if Continental merely engaged with the Star ATI members, without antitrust immunity, in such standard alliance cooperation practices as codesharing, through-ticketing, frequent flyer reciprocity and lounge sharing – in short, the type of interaction Continental currently has with immunized SkyTeam members, or that US Airways has with the Star ATI members, including United. Rather, the

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<sup>82</sup> See, e.g., Joint Venture Guidelines at 3.36 (the proponents of a potentially anticompetitive collaborative agreement have the burden of showing the agreement is reasonably necessary to achieve cognizable benefits and there is no less restrictive means of achieving those benefits).

<sup>83</sup>



Applicants proffer unsubstantiated assertions about why they must have immunity. The Applicants' documents also indicate that cost savings of any significance are unlikely,<sup>84</sup> and, more importantly, none of the evidence shows that cost savings are likely to be passed on to passengers.

**A. The Applicants' assertion that they will not move forward without immunity is not convincing**

The Applicants insist that they would not enter into the proposed alliance agreements without a grant of immunity. While it may be true that the Applicants would not enter into alliances exactly as set forth in the Joint Application, we do not find it credible for the Applicants to assert that they would not engage in some sort of cooperation that would provide nearly identical benefits to consumers as those likely to result from the application agreements. Carriers routinely enter into commercial relationships with each other and make significant long term investments in such relationships, without immunity from the antitrust laws.<sup>85</sup> [REDACTED]

[REDACTED]

[REDACTED]

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<sup>84</sup> See, e.g., [REDACTED]

[REDACTED]

[REDACTED] In addition, the precipitous drop in fuel prices since the parties filed their application in July 2008, negates the Applicants' already less than compelling argument that immunized coordination was necessary to combat fuel costs.

<sup>85</sup> [REDACTED]

[REDACTED]

[REDACTED]

Both United and Continental have invested significant effort into furthering their respective domestic alliances (United with US Airways, and Continental with Northwest and Delta) to the benefit of both the airlines and their customers, but the airlines remain fully accountable to the antitrust laws. Parties to domestic codeshare agreements regularly endeavor to consolidate their operations at airports, independently modify their capacity to facilitate connections between each other, and take other steps to extend their network offerings. In *SkyTeam I*, United urged DOT to prohibit immunity “as a matter of policy between domestic U.S. carriers, absent compelling evidence that [granting immunity] would achieve important public benefits not otherwise obtainable.” It explained:

Absent a grant of immunity, Northwest and Delta have . . . possible alternatives available that will allow them to gain significant benefits from participation in the SkyTeam alliance. [E]ither Delta or Northwest may forego immunity with the foreign members of the SkyTeam alliance (and with each other), but remain a member of the alliance and engage in cooperative activities that do not raise a meaningful antitrust risk. This is precisely the situation with US Airways and members of the Star Alliance; while US Airways has no immunity with the other Star members, it participates in Star and generates benefits by code sharing with each of the foreign members (and United), allowing it to gain behind and beyond benefits, network expansions and integrated scheduling, ticketing and passenger handling that goes with such codesharing. It can also participate in joint alliance discount offers to corporate customers, subject to certain conditions designed to preserve competition, and participate in many joint purchasing programs and other joint activities that do not touch on competitively sensitive behavior.<sup>87</sup>

**B. The Applicants exaggerate their claim that “significant litigation risks” exist absent immunity**

The Applicants argue that they will not attempt to achieve the claimed benefits of any of

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<sup>86</sup> [REDACTED]

<sup>87</sup> Reply of United Air Lines, Inc., Docket OST-2004-19214.

the Joint Application agreements without the protection of antitrust immunity due to the risk of litigation. In particular, the Applicants state that because this particular venture “contemplates joint sales, route and schedule coordination, revenue pooling and joint pricing decisions,” it carries with it the threat of legal challenge.<sup>88</sup>

As courts have recognized, however, a grant of antitrust immunity does not turn on “the subjective desire of the parties to avoid antitrust litigation,” and “[i]t is not realistic to expect a flood of antitrust lawsuits attacking a substantially procompetitive agreement.”<sup>89</sup> If the Applicants’ claims of significant benefits arising from the agreements are accurate, the Applicants will have the incentive to pursue further integration, which they can accomplish in ways consistent with the antitrust laws. DOJ is aware of no legal challenge to the actions taken by carriers within and in furtherance of a legitimate airline alliance.<sup>90</sup>

**C. The Applicants inflate the importance of inter-alliance competition**

The Applicants maintain that immunity is necessary to allow Star to achieve parity with the SkyTeam alliance, which received immunity. The Applicants also suggest, without evidentiary support, that consumers benefit from competition between alliances, particularly immunized alliances.

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<sup>88</sup> J.A. at 98.

<sup>89</sup> *Republic Airlines, Inc. v. C.A.B.*, 756 F.2d 1304, 1317 (8th Cir. 1985).

<sup>90</sup> The cases cited by the Applicants regarding their “continuing risk of legal challenge by third parties” (J.A. at 98, fn. 190) are inapposite. First, those cases do not demonstrate that airlines were sued because they were acting pursuant to a joint venture. The airline defendants may have been members of various alliances, but the causes of action were not based on activities undertaken only because of the joint venture. Second, granting antitrust immunity to the Applicants will not provide them with immunity from suit for coordination with carriers that are not members of the joint venture, as was the case in the multi-defendant travel agent commission litigation.

First, achieving balance in the market success of differing alliances is not a legitimate goal of sound competition policy, in DOJ's view. Alliances should compete against each other, and the market should determine the outcome of that competition.

Second, those assertions are not supported by any party evidence and are inconsistent with the evidence DOJ has gathered, which shows that immunity is not necessary for effective alliance competition. Few, if any, corporate travel managers we interviewed during our investigation of this application and in the course of other airline investigations have stated a desire for increased inter-alliance competition. Even when a particular corporation had negotiated a contract with an alliance, that contract seldom encompassed all members of the alliance or had resulted in lower fares than if the corporation had negotiated separate contracts with the carriers.<sup>91</sup> Moreover, the Order ignores the competition between Star and oneworld, whose two largest members – American and British Airways – today function effectively without immunity between each other.

**D. Immunity will not advance open skies**

Recognizing that granting the immunity application will not itself lead to new open skies agreements, the Applicants assert that immunity is warranted because their proposed agreements will help achieve the “goals” of the U.S.-E.U. open skies agreement.<sup>92</sup> They claim that the Memorandum of Consultations accompanying the U.S.-E.U. Agreement “underscores the strategic and economic importance of antitrust-immunized alliances as a matter of aviation policy.”<sup>93</sup> But the Memorandum provides only that U.S. authorities will give a procedural

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<sup>91</sup> None of the Applicants' corporate customers filed letters in support of the Joint Application.

<sup>92</sup> J.A. at 9.

<sup>93</sup> J.A. at 10.

guaranty of “fair and expeditious consideration” of immunity applications.<sup>94</sup>

**E. The Applicants overemphasize the likelihood that immunity for the proposed alliance will substantially reduce double marginalization**

The Order cites the elimination of double marginalization as a significant benefit of the proposed immunity grant, as do the Applicants in the Joint Application.<sup>95</sup> Although alliances can lead to lower fares by reducing incentives for each carrier to impose an additional markup on connecting traffic, immunity is not necessary to realize that result.

It is true that economic studies of the fares offered by international airline alliances in the 1990s found that immunized alliance carriers charged interline fares that were lower than the interline fares charged by non-immunized alliance carriers.<sup>96</sup> These studies, however, never proved that the airlines needed immunity to provide the lower fares, *i.e.*, that the airlines could eliminate double marginalization only by engaging in activity that raised antitrust concerns.

The 1990s were a time of flux for airline alliances as the airlines experimented with different partner alignments and degrees of coordination and integration. Indeed, most of the immunized alliance relationships included in these earlier studies featured only minimal levels of revenue sharing, in most cases, no more than dictated by a special prorate agreement.<sup>97</sup> Since

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<sup>94</sup> See J.A. at 10 (quoting Memorandum of Consultations).

<sup>95</sup> Order at 19; J.A. at 37-39.

<sup>96</sup> See Brueckner, J., and Whalen, T., 2000, “The Price Effects of International Airline Alliances.” *Journal of Law and Economics*, Vol. 43, pp.503-545. Brueckner, J, 2003, “International Airfares in the Age of Alliances,” *Review of Economics and Statistics*, Vol. 85, pp.105-118. Whalen, T., 2007, “A Panel Data Analysis of Code-Sharing, Antitrust Immunity, and Open Skies Treaties in International Aviation Markets.” *Review of Industrial Organization*, Vol. 30, pp.39-61.

<sup>97</sup> With the exception of Northwest/KLM, the immunized alliances operating during the time period covered by these studies did not engage in the sort of revenue sharing DOT

then, most airlines have grouped into three major alliances, and more recent empirical work by DOJ strongly suggests that over the past ten years (after the period studied in those earlier papers), airlines participating in alliances, whether immunized or not, have made strides toward managing their inventory and pricing activities to provide more competitive fares when forming a connection with another airline.<sup>98</sup> In fact, using 2005-2008 data, DOJ has found that connecting fares offered by non-immunized alliances for transatlantic routes are no more expensive than fares offered by immunized alliances.<sup>99</sup>

**VII. Any Grant of Antitrust Immunity Should Include Restrictions to Limit Potential Anticompetitive Effects**

Approval of the Applicants' request for global immunity for the Joint Application agreements will likely reduce competition in specific city pairs and increases the risk of harm to domestic competition, all with scant evidence or quantification of any consumer benefits to which such a broad grant of immunity is inextricably linked. Thus, the final Order should carve out the transatlantic and transborder markets where competitive harm is most likely to occur, maintain existing carve outs, and limit immunity to transatlantic markets.

**A. Carve out nonstop overlap routes**

As discussed above, the immunity DOT previously granted to the Star ATI Alliance carves

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apparently believes results in "metal neutrality."

<sup>98</sup>



<sup>99</sup> See Appendix B, Section 2, for further description of this DOJ empirical analysis.

out nonstop service between Frankfurt and Chicago/Washington (maintaining the carve outs first mandated in the 1996 United/Lufthansa immunity authorization) and between Toronto and Chicago/San Francisco (maintaining the carve outs first mandated in the 1997 United/Air Canada immunity authorization).<sup>100</sup> The carve outs do not prohibit the carriers from engaging in cooperative conduct, but merely make that conduct subject to the antitrust laws. In the present Order, DOT has tentatively concluded that the Applicants:

- must maintain the carve outs for Toronto to Chicago/San Francisco,
- may remove the Frankfurt-Chicago/Washington carve outs, provided the Applicants present evidence within 18 months that they have implemented the A++ alliance,
- need not carve out any additional routes from the scope of immunity held by Star ATI after Continental joins.

The analysis underlying DOT's conclusions on carve outs is unclear. The Order declines to carve out any of the overlap transborder routes in which Continental and the Star ATI members currently compete on a nonstop basis, without citing evidence from the record describing the public benefits likely to result from coordination on these routes. At the same time, the Order requires the Applicants to maintain the existing carve outs in Toronto-Chicago/San Francisco because the Applicants did not demonstrate "integrative benefits in the subject markets."<sup>101</sup> The reason for the differing treatment of these routes is not stated.

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<sup>100</sup> See Order 2007-2-16. Over time, DOT has varied the scope of the carve outs it has imposed. In some cases all local traffic except for bulk fares and corporate fares was carved out, in other cases only restricted business-type fares were carved out. Compare Order 96-5-27 at App. A (United/Lufthansa)(carving out "local U.S. point of sale passengers flying nonstop") with Order 2002-1-6 (Delta/Air France)(carving-out "unrestricted coach-class fares or any business or first-class fares for local U.S. point of sale passengers flying nonstop").

<sup>101</sup> Order at 13.

The Order declines to carve out the six transatlantic overlap routes where Continental and the Star ATI members provide competing nonstop service: New York to Copenhagen/Frankfurt/Geneva/Lisbon/Stockholm/Zurich. The Order defends this decision by noting that these city pairs “are subject to close cooperation under [A++]” and relies heavily on the alleged integration efficiencies the Applicants state they will realize on transatlantic routes through the A++ joint venture – including the Applicants’ claim that these efficiencies will be passed on to consumers.<sup>102</sup> But, as the Order recognizes, only one new nonstop overlap route actually involves parties to the A++ agreement – New York-Frankfurt. Each of the other overlap transatlantic routes at issue (New York–Copenhagen, Geneva, Lisbon, Stockholm and Zurich) involves Continental and a Star airline – SAS, Swiss or TAP – that is not one of the A++ partners; the purported A++ integrative efficiencies thus would not apply to SAS, Swiss, or TAP’s operations on these routes. The only explanation for DOT’s decision is that carve outs would prevent the alliance members from improving connections on these “bridge” routes – *i.e.*, the links between Continental’s extensive U.S. network and the European networks of SAS, Swiss and TAP – thereby “disadvantaging the smaller carriers and jeopardizing potential benefits for consumers.” Order at 13. DOT, however, does not cite to evidence that carve outs in these markets would foreclose efficiency-enhancing network improvements.<sup>103</sup>

DOT also states that it will remove the existing carve outs in Frankfurt-

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<sup>102</sup> Order at 12.

<sup>103</sup> The Applicants state that carve outs are not needed on these routes because, even though SAS, Swiss, and TAP are not parties to the A++ Agreement, the specific transatlantic city pairs are “within the geographical scope of the A++ Agreement.” J.A. at 92, n.181. They do not – and cannot – explain how the purported integrative efficiencies of A++ could apply on routes where the overlap airlines are not both A++ members.

Chicago/Washington – provided the Applicants submit proof within 18 months that the A++ agreement has been executed and implemented – because the “proposed alliance is pro-competitive.”<sup>104</sup> Other than the fact that these two routes fall within the scope of A++, the Order cites no evidence to support revoking the carve outs beyond the Applicants’ own self-serving statements. The Applicants do not provide specific evidence or quantification of diminished efficiencies or consumer value, even though Star members have long operated under carve outs imposed as part of prior immunity grants.

DOJ recommendation on carve outs

Absent a showing of substantial efficiencies that would be imperiled by a narrower grant of immunity – which the Applicants have not made – we believe that the competitive harm likely to be suffered by consumers in these transborder and transatlantic markets is not offset by public benefits. Therefore, the immunity grant should be more narrowly tailored to minimize anticompetitive effects. In the case of the current application, we recommend that any grant of antitrust immunity not apply to travel on the following routes: Houston-Calgary, Houston-Toronto, Cleveland-Toronto, NYC-Halifax, NYC-Ottawa, NYC-Stockholm, NYC-Copenhagen, NYC-Lisbon, NYC-Geneva, and NYC-Zurich. These routes are concentrated and entry would likely be difficult due to the existence of a Star ATI Alliance carrier hub at either one end or both.<sup>105</sup> DOT should also maintain the existing Frankfurt to Chicago/Dulles carve outs.

When DOT imposed carve outs in the original United/Lufthansa immunity request, it

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<sup>104</sup> Order at 13.

<sup>105</sup> As discussed above, it would be very difficult for a non-hub carrier to offer sufficient frequencies to attract local customers or to garner the connecting feed traffic necessary to sustain nonstop service in thin markets.

provided that antitrust immunity would not extend to coordinated activity “with respect to local U.S.-point-of-sale passengers flying nonstop” on the listed routes.<sup>106</sup> In subsequent grants of immunity, however, DOT has limited the carve out to coordinated activity “with respect to unrestricted coach-class fares or any business or first-class fares for local U.S.-point-of-sale passengers flying nonstop” in the specified city-pair markets.<sup>107</sup> Such a narrow exemption applies at most to a very small number of coach tickets and does not include many tickets with modest restrictions commonly sold to business passengers at a discount to full Y fares. Our analysis of coach fares on international routes indicates that the narrow carve-out language is insufficient to protect competition on overlapping hub-hub routes operated by alliance partners because decreasing the number of nonstop competitors increases all nonstop coach prices, not just the prices charged for unrestricted coach-class, business or first-class nonstop fares.<sup>108</sup> To be effective, carve outs should not be restricted to such a limited range of fare classes; instead, DOJ recommends a return to the more expansive carve out language used in the 1996 United/Lufthansa order.

#### **B. Deny global immunity**

The Applicants seek, and the Order to Show Cause tentatively grants, immunity for Continental and the Star ATI members to coordinate on a global basis, despite the lack of any concrete plans for integration outside the transatlantic venture. The Applicants present no

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<sup>106</sup> Order 96-5-27, App. 4.

<sup>107</sup> *See, e.g.*, Order 2000-5-13 (American/Swissair), Appendix 1.

<sup>108</sup> *See* Appendix B, Section I, which estimates that fares that are paid by nonstop coach passengers increase, on average, when the number of nonstop competitors decreases. The carve out language proposed by DOJ would protect these passengers; the carve out language in more recent DOT orders would not.

evidence that immunity for non-transatlantic operations is required by the public interest: they do not describe how they will integrate their operations in these markets, what new routes they will serve, or what public benefits will flow from non-transatlantic immunity.<sup>109</sup> The Applicants allege that they plan in the future to enter into ventures modeled upon A++ covering areas outside of the transatlantic. The record, however, is devoid of details as to where these additional joint ventures will operate, who the parties to the ventures will be, what form their integration will take, or when the ventures will be implemented.<sup>110</sup> A public interest determination cannot be based on entirely hypothetical agreements.

Moreover, the evidence in the record shows that current non-transatlantic cooperation is minimal *even among the currently immunized Star members*. Asked by DOT to describe the current state of non-transatlantic cooperation, the best example the Applicants could provide was the consolidation of airport facilities at Beijing and Tokyo.<sup>111</sup> While such cooperation may constitute an efficiency, it does not require antitrust immunity; in fact, the highlighted

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<sup>109</sup> DOT dismisses concerns about the scope of the immunity on the grounds that the other Star partners have global immunity with each other for many years. Therefore DOT concludes that it “has enough information to analyze the alliance plans” and that restricting the scope here would unfairly disadvantage Continental. Order at 20. DOT does not cite the “other information” it relies upon to analyze the alliance plans, nor does it explain how Continental, or more significantly, consumers, would be harmed by the lack of global immunity.

<sup>110</sup> The Order directs the Applicants to show that the A++ joint venture has been implemented as described in the Joint Application within 18 months to retain immunity. Order at 26. There is no requirement that the Applicants demonstrate, at any point during the 5-year period covered by the Order, that they have implemented similar integration agreements that cover non-transatlantic markets or that include Star ATI members not parties to the existing A++ agreement.

<sup>111</sup> Responses of Joint Applicants to Clarification Questions at 4-5.

consolidation effort included a number of non-immunized Asian Star Alliance carriers.<sup>112</sup> The documents cited by the Applicants as providing additional examples of non-transatlantic cooperation requiring antitrust immunity contain similar examples of operational and marketing coordination such as lounge sharing, frequent flyer cooperation, and joint baggage handling.<sup>113</sup> Such coordination is a common feature of non-immunized alliances, and the non-immunized members of Star routinely engage in such conduct.

A grant of global immunity between Continental and United would eliminate competition in non-transatlantic international markets where they currently compete and would increase the risk of spillover effects in domestic markets. The Applicants have not shown that global immunity between United and Continental is necessary to the public interest; in the absence of such a showing there is no justification for accepting the risk of harm to passengers in both international and domestic markets. Accordingly, we recommend limiting the grant of immunity between Continental and the other Star ATI members to transatlantic operations.

### **VIII. Conclusion**

The immunity requested by the Joint Applicants is unprecedented in scope and breadth, sanctioning collusion by United and Continental on all international service, eliminating or significantly reducing competition between certain Star alliance members on routes where they provide the only – or almost all of – the competitive alternatives, and removing previously

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<sup>112</sup> At Narita, the immunized Star airlines are located in the South Wing along with non-immunized Star members ANA, Shanghai, Thai and US Airways.

<sup>113</sup>



imposed protections designed to preserve competition on overlap routes.

The result is likely to be substantial consumer harm. Our empirical work indicates that fares are likely to increase by roughly 15% on routes where the number of nonstop competitors decreases from two to one, and by roughly 6% on routes where the number of nonstop competitors decreases from three to two. Competition will be significantly diminished in limited entry markets such as China, where United and Continental today present the best, and in some cases, only service alternatives. Domestic competition between United and Continental may also be affected. The Joint Applicants have offered little in the way of consumer benefits arising from the application to counter the likely harm; in contrast, DOJ empirical work shows that carriers in non-immunized alliances offer lower prices than those in immunized ones.

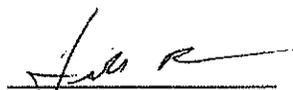
In short, the Joint Applicants have not justified their extraordinary immunity request. Thus, for these and all the foregoing reasons, the DOJ believes the DOT should amend its Order granting the Joint Application.

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Dated: June 26, 2009

### Appendix A: China/Beijing

**U.S. to Beijing Passenger Shares for One and Two Stop Passengers, 2007Q4 - 2008Q3.**

U.S. Origin City to Beijing	CO Pass	CO Share	UA Pass	UA Share	NW Pass	NW Share	All Other Airlines	All Others Share	Interline Pass	Interline Share	CO+UA Share	Total Pass
New Orleans												
Syracuse												
Manchester												
Tulsa												
Cleveland												
Rochester												
Richmond												
W Palm Beach												
Buffalo												
Boston												
Tampa												
Pittsburgh												
Orlando												
Columbus												
Fort Lauderdale												
Jacksonville												
Raleigh												
Kansas City												
Nashville												
Indianapolis												
Austin												
Charlotte												
Atlanta												
Birmingham												
St. Louis												
Houston												
Miami												
Baltimore												

Data: OD1B passengers with one or two stops for 2007 Q4 - 2008Q3, adjusted for sampling by multiplying by 10. Routes must have at least 200 passengers for each of CO and UA to be included, and a combined CO + UA share of at least 50% of all passengers.

Interline passengers have different marketing carriers on different segments of their trip.

## Appendix A: China/Hong Kong

**U.S. to Hong Kong Passenger Shares for One and Two Stop Passengers, 2007Q4 - 2008Q3.**

U.S. Origin City to Hong Kong	CO Pass	CO Share	UA Pass	UA Share	NW Pass	NW Share	All Other Airlines	All Others Share	Interline Pass	Interline Share	CO+UA Share	Total Pass
W Palm Beach												
Rochester												
Columbus												
Richmond												
Cleveland												
Fort Lauderdale												
Greensboro												
Birmingham												
Wash Dulles												
Providence												
Orlando												
Kansas City												
Baltimore												
Hartford												
New Orleans												
Tampa												
San Antonio												
Pittsburgh												
Boston												
Houston												
Jacksonville												
Raleigh												
Wash National												
Nashville												
St. Louis												
Cincinnati												

Data: OD1B passengers with one or two stops for 2007 Q4 - 2008Q3, adjusted for sampling by multiplying by 10. Routes must have at least 200 passengers for each of CO and UA to be included, and a combined CO + UA share of at least 50% of all passengers. Interline passengers have different marketing carriers on different segments of their trip.

## Appendix B: Empirical Addendum

The empirical analyses in this Addendum use the publicly-available DB1B ticket database maintained by the U.S. Department of Transportation. The DB1B data are a 10% random sample of tickets either ticketed by a U.S. carrier or where a U.S. carrier operated at least one flight in the ticket's itinerary. The data are compiled quarterly. The only information provided by a ticket in DB1B is the purchased price (in dollars), number of coupons in the ticket's itinerary,<sup>114</sup> number of sampled passengers traveling the itinerary at the particular fare, and, for each coupon, the fare class,<sup>115</sup> origin and destination airports as well as the operating and marketing carriers. Tickets ticketed by foreign carriers that include no flights operated by U.S. carriers are not reported in DB1B.

### I. Price Effects from the Loss of Nonstop Competition in Transatlantic Routes.

Our empirical evidence shows that a reduction in the number of competing airlines offering nonstop transatlantic flights may result in large, statistically significant price increases.

To determine the effects from changes in the number of competing airlines offering nonstop transatlantic flights, we analyze the DB1B data for the 3<sup>rd</sup> quarter of 2008. We define a route as a non-directional city pair with one endpoint in the U.S. and the other endpoint in Europe (that is, transatlantic routes). We extract from DB1B 1-coupon coach-class tickets (one-way tickets) and 2-coupon coach-class round-trip tickets that have the same starting and ending city.<sup>116</sup> We split the round-trip tickets into one-way tickets and divide the fare by two, so that the data are on a one-way basis. Following Brueckner and Whalen (2000),<sup>117</sup> we drop tickets with one-way fares below \$50 since these may represent trips purchased with frequent-flyer miles or made by airline employees at significantly reduced fares. We then compute the passenger-weighted average fare for each route.

The object of the empirical analysis is to analyze how the average fare varies across transatlantic routes based on the number of airlines offering nonstop flights in a route, controlling for other factors that may affect fares. In the hub-and-spoke networks that the major transatlantic carriers operate, the majority of nonstop service that an airline offers radiates from its hubs, and the airline relies on connections through its hubs to serve thousands of other routes. Given this structure, the major network carriers provide overlapping transatlantic nonstop service on routes between their hubs or from the same hub airport if they share a hub airport. To control for the economics of hubs, we focus our attention on routes between two hubs of an immunized alliance and routes served by multiple carriers with a hub airport in the route. Our sample data include 65 routes (see the Attachment for a list).

To identify the number of nonstop competitors in these routes, we use flight listing data from the

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<sup>114</sup> A coupon may denote a nonstop flight or a direct flight. A direct flight is a connecting flight (that is, a flight with a stop at an intermediate transit airport) with no change of aircraft or flight number.

<sup>115</sup> The DB1B data reports the generic fare class for each coupon in a ticket. The most common fare classes are C, D, X, and Y, where C and D are business fare classes, X is the main coach cabin fare class, and Y typically stands for full-fare coach fare. DB1B provides no other data on passenger mix.

<sup>116</sup> We focus on tickets in which all coupons have coach fare class X. These tickets represent 90% of all tickets in our data. Our results are not affected if we also include tickets with Y fare class coupons (only 1.5% of tickets have coupons with Y fare classes).

<sup>117</sup> Brueckner, J., and Whalen, T., 2000, "The Price Effects of International Alliances," *Journal of Law and Economics*, 43, 503-454. These authors analyze the price effects of immunity grants in transatlantic routes with nonstop service using 1997 quarter three data from DOT. They estimate that average fares rise by about 5% when immunity is granted to two previously competitive carriers.

Official Airline Guide. An airline is counted as serving a route nonstop if it offers at least 60 flights in each direction during the quarter. Different airlines serving the route nonstop are counted as competing unless they were immunized members of the same alliance during the quarter, in which case they count as a single competitor.<sup>118</sup> We define dummy variables to denote the number of competitors in a route. Monopoly routes are the reference group. The competitive variables equal one when there are, respectively, 2, 3, 4, or 5 or more nonstop competitors in the route and zero otherwise. Eighteen of the 65 routes in our data are nonstop monopolies, 28 have 2 nonstop competitors, 13 have 3 nonstop competitors, 4 have 4 nonstop competitors, and 2 have 6 nonstop competitors.<sup>119</sup> Having already controlled for hub effects, following Brueckner and Whalen (2000), we include as additional control variables the mileage of the route and the route's population potential, which is computed as the geometric mean of the population at the two endpoint cities in the route.<sup>120</sup> Lastly, the airports in our transatlantic routes are major U.S. and European airports, at which, to begin with, members of all of the major airline alliances have flight operations. These alliances include multiple members that make available a large number of single-connect and double-connect travel itineraries to passengers across the sample routes.<sup>121</sup> That is, there is significant connecting service offered across all of our routes.

We use the ordinary least squares method to estimate how average fares vary across routes based on the number of nonstop competitors in a route. In particular, we estimate how the natural logarithm transformation of the average fare varies as a function of the dummy variables denoting the number of nonstop competitors, the natural logarithm transformation of the mileage distance, and the population potential.<sup>122</sup> Results are listed in Table 1. The model explains 59% of the variation in average fares across

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<sup>118</sup> This assumes that non-immunized members of the same alliance remain vigorous competitors. If not, then the price effects we estimate from the loss of a nonstop competitor may underscore the magnitude of the true price effects.

<sup>119</sup> In seven routes, an airline, such as Air India, Eurofly, Malaysia, Kuwait or Pakistan International Airlines, offers less than 60 nonstop flights in each direction (it typically offers 30 to 40 flights during the quarter). Dropping these routes from our data does not affect our findings: the estimated price effects are statistically significant and, if anything, slightly larger in magnitude than those reported in Table 1. We note that, over the past three years, there is only one instance of a non-hub carrier beginning to serve any of the 46 transatlantic hub routes that have one or two nonstop competitors in quarter three 2008. Chicago-Frankfurt had two nonstop competitors in quarter three 2008; during quarter four 2008, Air India increased its Chicago-Frankfurt service (part of its longer haul service to India) to about 90 flights.

<sup>120</sup> The mileage is the great circle distance mileage between the endpoints of the route. We use the 2008 U.S. metropolitan area population data at <http://www.census.gov/popest/metro/metro.html>. European population data is from European Spatial Planning Observation Network, Study on Urban Functions (Project 1.4.3), Final Report, Chapter 3, (ESPON, 2007), located at [http://www.espon.eu/mmp/online/website/content/projects/261/420/index\\_EN.html](http://www.espon.eu/mmp/online/website/content/projects/261/420/index_EN.html).

<sup>121</sup> Additional connecting travel itineraries are also available as a result of traditional interline agreements or bilateral arrangements between airlines not in alliances or across different alliances.

<sup>122</sup> We assume that the number of airlines offering nonstop flights in a transatlantic route is determined prior to these airlines' pricing decisions. This assumption is reasonable at several levels. First, given that airline demand is revealed over time, and the high costs associated with establishing transatlantic nonstop service, airlines who enter a transatlantic route will publish their flight schedule and advertise their new service well-ahead of actual departure dates. Second, the number of airlines with nonstop flights in our hub routes is quite stable over time, and almost exclusively made of airlines with a hub at an endpoint of the route. Moreover, across our sample routes, over the period 2005-2008, the number of nonstop airlines during quarter three equals that in quarter two 99% of the time. We also note

routes ( $R^2=0.59$ ), which means that the model fits the data well.

We estimate that reducing the number of nonstop competitors in a route from 2 to 1 raises average nonstop fares in the route by 15.0%, all else equal.<sup>123</sup> This effect is statistically significant at the 1% level. In addition, we estimate that reducing the number of nonstop competitors in a route from 3 to 2 (4 to 3, respectively) raises average nonstop fares by 6.6% (6.3%, respectively), all else equal.<sup>124</sup> These findings are consistent with both previously published work and internal DOJ analyses on the price effects from the loss of a nonstop carrier in domestic hub routes.<sup>125</sup> Moreover, across our routes, the vast majority of coach-class passengers (73%) fly nonstop, even though average connecting fares are 10% lower than average nonstop fares. Hence, even if connecting service is in the relevant market, the loss of nonstop competition significantly increases concentration levels in the market, and we have evidence of large, statistically significant price effects from the loss of nonstop competition on the fares paid by the vast majority of passengers.

## II. Price Differences across Tickets within a Route.

The parties claim that immunity grants to airline alliances are necessary to reduce a double marginalization problem, which otherwise arises from the uncoordinated choice of alliance fares in the absence of immunity. To support their claim, they cite empirical evidence in the economics literature that finds that immunized alliance fares for connecting travel itineraries were lower in the 1990s than non-immunized alliance fares.<sup>126</sup> Since the 1990s, however, the airline industry has undergone major global changes, including, but not limited to, an increase in the global demand for travel and consolidation in Europe. Airlines have also grouped into three major global alliances (Oneworld, Skyteam, Star) and, within these alliances, non-immunized carriers appear to have made significant strides towards managing more efficiently their yield management and capacity. In this Section, using quarter three DB1B data for 2005 through 2008, we provide newer empirical evidence on pricing. Our evidence, which shows that immunized alliance fares are higher than non-immunized ones, does not support the parties' claims on immunity grants and double marginalization.

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that if we delete from the data routes with entry or exit in other quarters in 2008, we obtain similar, statistically significant effects.

<sup>123</sup> We obtain similar results running the model on quartile fares (25<sup>th</sup>, 50<sup>th</sup>, or 75<sup>th</sup> percentile fare) rather than on the average fare. We also obtain similar results if we expand the sample to include all 129 transatlantic nonstop routes for which we have data (adding to the model a dummy variable to control for the presence of dual hubs on the 65 routes of focus in the text). The itinerary in a DB1B ticket is reported in terms of coupons, and the estimated effects apply to passengers in nonstop and, if any, direct flights. In only 7 of the 65 routes, there are 1-stop direct flights reported in the Official Airline Guide data. In the text, for parsimony, we discuss the estimates in terms of their effect on the fares paid by nonstop passengers.

<sup>124</sup> There are few routes in our data with 3 or more competitors, and the 3-to-2 and 4-to-3 effects are not statistically significant.

<sup>125</sup> See, e.g., Peters, C., 2006, "Airline Merger Simulation," *Journal of Law and Economics*, 49, pp.627-649. He computes actual price increases of between 7.2% and 29.4% following the loss of nonstop competition in overlap domestic routes involved in mergers.

<sup>126</sup> See, e.g., Brueckner and Whalen (2000), Brueckner, J., 2003, "International Airfares in the Age of Alliances," *Review of Economics and Statistics*, 85, pp.105-118, and Whalen, T., 2007, "A Panel Data Analysis of Code-Sharing, Antitrust Immunity, and Open Skies Treaties in International Aviation Markets," *Review of Industrial Organization*, 30, 39-61.

We define a route as a city-pair in a quarter, with origin in the U.S. and destination in Europe. As in Brueckner and Whalen (2000), Brueckner (2003) and Whalen (2007), we drop from the data (i) routes from U.S. cities where foreign carriers offer at least one nonstop flight per business day to Europe, because the DB1B data do not report tickets ticketed by foreign carriers, and (ii) routes that have nonstop flights between their endpoints, to focus on routes where service by domestic and foreign airlines is complementary.<sup>127</sup> We extract from DB1B tickets with itineraries that represent round-trip travel with same starting and ending city. Itineraries may have up to 6 coupons, but no more than 3 coupons one-way and no surface transfers. Tickets with round-trip fares below \$100 (in 2008 quarter three dollars) are dropped, since these may represent trips purchased with frequent-flyer miles or made by airline employees at significantly reduced fares. We then differentiate between tickets that are either *online tickets*, *immunized alliance tickets*, *non-immunized alliance tickets*, or *interline tickets*. A ticket is an online ticket if all of the coupons in the ticket are operated and marketed by a single airline (including its regional affiliates).<sup>128</sup> An immunized alliance ticket is a ticket that lists two or more airlines as operating or marketing carriers and all of the airlines listed on the ticket are immunized members of the same alliance. A non-immunized alliance ticket is a ticket that lists two or more airlines, and all listed airlines are members of the same alliance, and at least one of the airlines is not an immunized alliance member. Lastly, a ticket is an interline ticket if it is none of the above.<sup>129</sup> Using these definitions, 67.8% of all tickets in the sample are online, 7.4% are non-immunized alliance tickets, 17.4% are immunized alliance tickets, and the other 7.4% are interline tickets.

We use ordinary least-squares regression to analyze how prices vary across tickets based on the type of ticket, the major U.S. airline reporting the ticket<sup>130</sup>, and the mileage and number of coupons in the ticket's itinerary. We use dummy variables to denote each of the type of ticket (online, immunized alliance, non-immunized alliance, or interline ticket) and carriers. Online tickets are the reference group. We also include in the model route fixed effects to control for all of the factors that are invariant in a route, including, but not limited to, the level of competition in the route. We estimate the model using: (i) all of the tickets in the data, and (ii) coach-class tickets only.<sup>131</sup> Results for both data are reported in Table 2. We discuss below the results based on the coach class tickets; the estimated fare differentials

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<sup>127</sup> Within the U.S., we exclude Hawaii. Within Europe, we focus on destinations in the European Union, Switzerland, Norway, and Croatia. Our data include approximately 23,000 routes.

<sup>128</sup> A coupon in a ticket is online if the operating carrier is the marketing carrier on the coupon. If the carriers do not match, the coupon may yet be online since the operating carrier may be a regional affiliate of the marketing carrier. We use the flight listing data in the Official Airline Guide to identify regional carrier affiliations for major airlines on an individual coupon basis. If all of the coupons in a ticket are online coupons from the same carrier, then the ticket is online.

<sup>129</sup> These tickets include traditional interline tickets and tickets that obtain from bilateral arrangements between airlines not in alliances or in different alliances.

<sup>130</sup> To be included in the DB1B data, a ticket must be either ticketed by a U.S. airline or include at least one flight operated by a U.S. airline. We identify the major U.S. airline listed as marketing or operating carrier across the coupons in the ticket. For tractability, we drop the few tickets (5% of tickets) that list two or more major U.S. carriers.

<sup>131</sup> The coach class tickets are tickets in which all coupons have coach fare class X. In this Section, these tickets represent 93% of all tickets sold. We note that Brueckner and Whalen (2000), Brueckner (2003), and Whalen (2007) estimate a model similar to ours using all of the tickets in the DOT data, but for first-class tickets. First-class tickets account for only 0.2% of all the tickets in our data. Dropping these tickets is inconsequential for the results in Table 2 that use all of the tickets in the data.

are slightly larger if we look at the results based on all of the tickets.

We estimate that interline tickets have the highest sales prices. Interline fares are, for instance, 6.3% higher than online fares, all else equal. We also find that non-immunized alliance fares are 1.5% lower than online fares. This difference is not statistically significant. More importantly, controlling for other factors, we estimate that immunized alliance fares are 2.1% higher than online fares and 3.6% *higher* than non-immunized alliance fares. Both of these fare differentials are statistically significant at the 1% level.

**Table 1**  
**Price Effects from Loss of Nonstop Competition on Transatlantic Routes.**

The Dependent Variable is ln (Average Fare)

Explanatory Variables		Estimate (Standard error)	Change in # of nonstop competitors	Estimated price effect in percentages
Number of Nonstop Competitors	1	---	---	---
	2	-.140* (.043)	2 to 1 <sup>#</sup>	+15.0% *
	3	-.204* (.044)	3 to 2 <sup>##</sup>	+6.6%
	4	-.265* (.064)	4 to 3 <sup>###</sup>	+6.3%
	5 or more	-.422* (.081)		
ln(Mileage of the Route)		.638* (.114)		
Mean of City Populations in the Route		.948 (.731)		
Constant term		1.218* (.953)		

R<sup>2</sup> = 0.59. Number of observations (routes) = 65.

Standard errors computed with White heteroskedasticity correction.

The population variable is divided by 100 million, for scaling purposes.

\* Indicates statistical significance at a 1% level.

<sup>#</sup> The 2 to 1 percentage effect equals  $\exp(.140) - 1 = 15.0\%$ .

<sup>##</sup> The 3 to 2 percentage effect equals  $\exp(-.140+.204) - 1 = 6.6\%$ .

<sup>###</sup> The 4 to 3 percentage effect equals  $\exp(-.204+.265) - 1 = 6.3\%$

**Table 2**  
**Price Differences Across Tickets based upon the Type of Ticket.**

The Dependent Variable is ln( Ticket Fare )

	All Tickets	Coach Class Tickets	Coach Class Tickets	
Explanatory variables:	Estimate (Standard error)	Estimate (Standard error)	Estimated Price Differentials	
<i>Type of ticket:</i>				
Online tickets (reference group)	---		---	---
Non-immunized alliance tickets	-.017 (0.010)	-.015 (0.009)	relative to online tickets	-1.5%
Immunized alliance tickets	.035* (0.008)	.021* (0.007)	relative to online tickets	+2.1%*
Interline tickets	.070* (0.009)	.061* (0.007)	relative to online tickets #	+6.3%*
Mileage of itinerary in ticket	-.046 (0.044)	-0.096* (0.036)		
Number of coupons in itinerary	-.054* (0.005)	-0.046* (0.004)		
R <sup>2</sup>	0.25	0.30		
Number of tickets	126,520	117,494		

Standard errors computed with White heteroskedasticity correction.

Estimates for route and carrier fixed effects not shown in the Table.

\* Indicates statistical significance at a 1% level.

# The percentage effect is computed as  $\exp(0.061) - 1 = 6.3\%$

**Attachment**

<b>Price Effects from Loss of Nonstop Competition on Transatlantic Routes.</b>			
List of Transatlantic Routes in the Sample Data.			
<b>U.S. endpoint</b>	<b>European endpoint</b>	<b>U.S. endpoint</b>	<b>European endpoint</b>
Atlanta	Amsterdam	New York City	Stockholm
Atlanta	Paris	New York City	Athens
Atlanta	Rome	New York City	Barcelona
Atlanta	Frankfurt	New York City	Brussels
Atlanta	London	New York City	Budapest
Cincinnati	Amsterdam	New York City	Paris
Cincinnati	Paris	New York City	Copenhagen
Cincinnati	Rome	New York City	Dublin
Denver	London	New York City	Edinburgh
Detroit	Frankfurt	New York City	Rome
Detroit	London	New York City	Frankfurt
Detroit	Amsterdam	New York City	Lisbon
Detroit	Paris	New York City	London
Detroit	Frankfurt	New York City	Madrid
Washington	Amsterdam	New York City	Manchester
Washington	Paris	New York City	Milan
Washington	Frankfurt	New York City	Shannon
Washington	London	New York City	Berlin
Washington	Munich	New York City	Zurich
Washington	Zurich		
Houston	Amsterdam	Chicago	Amsterdam
Houston	Paris	Chicago	Paris
Houston	London	Chicago	Dublin
Houston	London	Chicago	Rome
Los Angeles	Frankfurt	Chicago	Frankfurt
Los Angeles	London	Chicago	London
Memphis	Amsterdam	Chicago	Manchester
Miami	Paris	Chicago	Munich
Miami	London	Philadelphia	Paris
Miami	Madrid	Philadelphia	Frankfurt
Minneapolis - St Paul	Amsterdam	Philadelphia	London
Minneapolis - St Paul	Paris	San Francisco	Frankfurt
New York City	Amsterdam	San Francisco	London
		Salt Lake City	Paris

## CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing COMMENTS OF THE DEPARTMENT OF JUSTICE have been served this day by e-mail upon each of the following addresses:

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June 26, 2009

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