THIS FILE COMBINES SUBMISSIONS TO THE BA-AA ANTITRUST CASE OST-2008-0252 MADE ON 15 Oct 2009 and 15 Jan 2010, 31 Jan 2010 and 4 Mar 2010
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DEPARTMENT OF TRANSPORTATION DOCKET OST-2008-0252
JOINT ANTITRUST IMMUNITY APPLICATION OF AMERICAN AIRLINES, BRITISH AIRWAYS, FINNAIR, IBERIA AND ROYAL JORDANIAN

COMMENTS OF HUBERT HORAN
ON THE JOINT APPLICANTS SUPPLEMENTAL COMMENTS OF 8 SEPTEMBER 2009
15 October 2009

My name is Hubert Horan. I am filing these comments in response to the Joint Applicants filing at OST-2008-0252-3357

During my 25-year aviation career I have done consulting work with over 30 airlines and held airline management positions with Northwest, America West, Swissair and Sabena. I have significant experience in international airline competition and the actual operation and economics of airline alliances. While at Northwest I was personally responsible for the original development of the KLM-Northwest Alliance network and introduced the intense hub-to-hub operations that allowed Northwest to become the most profitable US carrier on the North Atlantic, and established the template followed by all of the subsequent alliance networks. I spent four years at Swissair-Sabena, including the transition of Swissair's alliance from Delta to American, and thus have been involved in alliance management on both sides of the Atlantic. I have not only helped build highly successful alliances, I have helped shut down highly unprofitable ones, including the intra-European Qualiflyer alliance, and the domestic alliance between Continental and America West. Over the years I have written extensively on airline competition, global airline consolidation, and airpolitical treaty negotiations, and I also testified before Congress on the Delta-Northwest merger. I am based in Phoenix, Arizona. A full list of publications and further biographical information is available at my website, horanaviation.com.

I have no active business or financial interests with any of the parties to this case and am only commenting as a private citizen concerned about the issues raised by this case.

A. BACKGROUND

<u>The Joint Applicants' Supplemental Statement is a response to the extraordinary evidentiary weakness of the DOT's decision granting antitrust immunity to the expanded Star Alliance</u>

- On 10 July 2009,the Department of Transportation granted expanded antitrust immunity to the Star Alliance[1] without any legitimate, objective evidence supporting their claims that approval would generate significant public benefits, and that the reduced competition did not pose serious risks to consumers. The DOT's Show Cause Order[2] had repeated the Joint Applications assertions about public benefits and consumer risks without having made any independent effort to analyze or verify those claims.
- On 26 June 2009, the Department of Justice's Antitrust Division filed comments on the Show Cause Order that extensively documented the DOT's failure to meet the evidentiary standards of a legitimate Clayton Act review, and presented statistical analysis contradicting the DOT's assertion that immunity posed no threat of higher prices in nonstop and connecting markets. Across every one of the issues raised by the application, the DOJ Opinion identified findings that were either total unsupported by data, supported by analysis of past events under conditions totally dissimilar to the current case, or where the DOT accepted the applicants claimed benefits without any independent scrutiny. On 3 July 2009, I submitted comments arguing that the evidentiary shortcomings of the Show Cause Order were even greater than the DOJ had suggested. Using evidence from public data and my own experience managing these types of alliances, I documented much greater reductions in North Atlantic competition than the DOJ had identified and explained why actual public benefits would be much smaller than the Joint Applicants' anecdotal evidence suggested. I argued that the Show Cause Order demonstrated a clear DOT belief that consumers actually benefit from reduced international airline competition

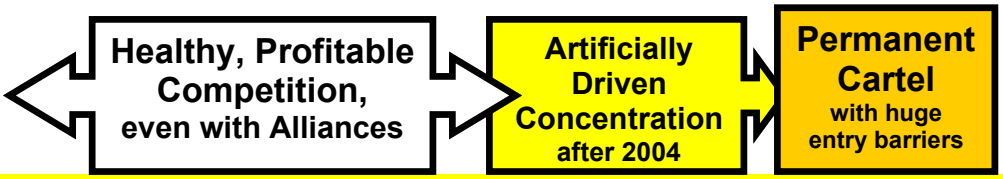
[1] DOT Final Order Docket 2008-0234, 10 July 2009
[2] DOT Show Cause Order Docket 2008-0234 7 April 2009

and suggested that the failure to document and justify these "policy" positions reflects a presumptive bias that would prevent the DOT from serving as a neutral, objective judge of airline antitrust issues.

- The DOT's Final Order made no effort to acknowledge the DOJ's evidentiary criticisms, or to demonstrate that its findings had been based on legitimate, objective data. The Final Order's section on Public Benefits made only one reference to supporting data, footnoting a study that focused on alliance gains achieved in the 1990s, and did not identify any evidence of benefits incremental to the current application. The DOT attacked the DOJ's interference with the DOT's authority over aviation "policy" and limited its direct response to the DOJ's Comments to narrow questions such as route carve-outs.[3]
- The extraordinary evidentiary deficiencies of the DOT's Star Alliance decision creates a dilemma for the Joint Applicants in the current case. The foundation of their case is a request for the same unfettered, rubber-stamp immunity approval granted to all other major North Atlantic airlines. Such a request would normally include a demonstration that their application met the same evidentiary standards, but since Star was granted immunity with any legitimate, objective evidence of the public benefits and lack of consumer risks required under the law, the current Joint Applications had no way to make such a demonstration. The Joint Applicants recognized the validity of the evidentiary issues first raised by the DOJ, and submitted Supplemental Comments on 8 September intended to present positive evidence about public benefits and the absence of consumer risks[4]. The critical portions of these Comments are Exhibit 1, a report the Joint Applicants had commissioned from Robert Willig and the consulting firm of Compass Lexecon (which I will refer to as the Willig/Compass Lexecon affidavit) and Exhibit 2, comments by American Airlines executive Don Casey (the Casey declaration).
- My purpose in submitting this Public Comment is to challenge all of the arguments put forward in the Supplemental Comments, to urge the DOT and other parties to completely reject all of the findings based on the Willig/Compass Lexecon regression analysis, and to recognize that the public benefits claims in the Casey declaration fail to meet the basic requirements of a proper antitrust review.

<u>The Importance of the current antitrust immunity applications</u>

- In 2003 there 9 major hub-network based North Atlantic competitors; overall concentration levels (top 3 carrier shares) was 65%, and the three immunized Collusive Alliance served only half of the market. Approval of the KLM-Air France merger and the current ATI applications (Skyteam, Star and BA/AA) will yield a market where only 3 competitors have market shares of at least 2%, and where these 3 competitors would control well over 90% of the largest international airline market in the world.

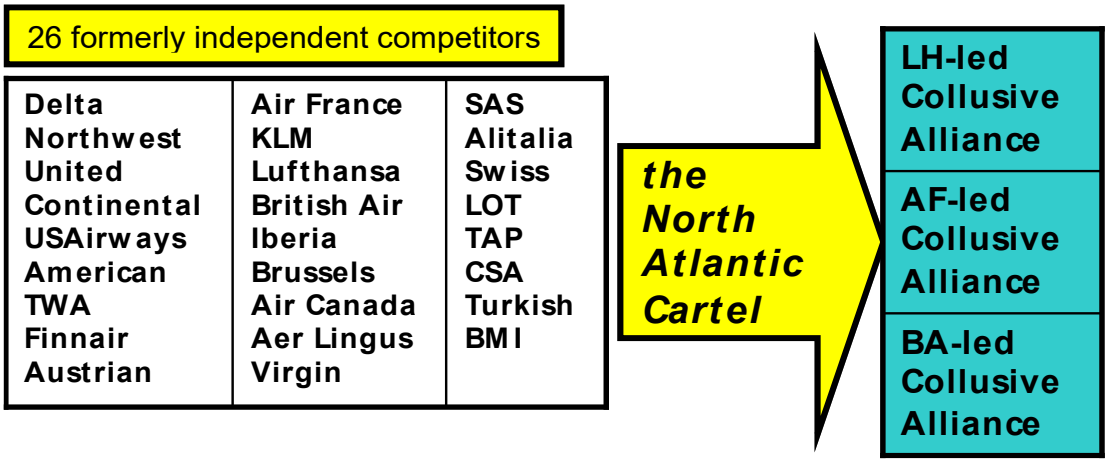


	1995	1997	1999	2001	2003	2005	2007	2009
Concentration levels of total North Atlantic market (55 million annual pax)								
top 2 share	29%	31%	35%	36%	41%	56%	54%	72%
top 3 share	**51%**	**53%**	**59%**	**58%**	**65%**	**79%**	**77%**	**98%**
Collusive Alliance%	7%	26%	42%	44%	49%	56%	54%	97%
number of US-Europe competitors with minimum departure share of 2%								
	13	**13**	**11**	**11**	**9**	**7**	**6**	**3**

- The increase from 65% to 95%+ market concentration on the North Atlantic will have been totally due to incumbent airlines petitioning governments to allow less concentration. None of this extreme concentration is explained by "market forces" such as the rapid growth of highly efficient carriers, or the market exit of failed carriers. Assuming that Virgin Atlantic, Aer Lingus and USAirways cannot survive independently and subsequently exit the market or join one of the three Collusive groups, 26 previously independent North Atlantic competitors will have

[3] The DOT's Final Order simply ignored all public comments (other than DOJ) that had criticized the Show Cause Order
[4] Joint Applicants' Supplemental Comments, 8 September 2009, p.1

consolidated into a cartel controlling 98% of the North Atlantic, a market with huge entry barriers, where no new entrant has survived long enough to achieve a 2% market share in 22 years[5]



- In CO/Star, the DOT said that its approval "does not materially alter the competitive landscape or increase overall market share to any significant degree" (Show Cause Order p.8, Final Order p.4). There is a massive disconnect between the DOT's competition findings and marketplace reality. The DOT has never presented and data or analysis supporting its claim that consumers faced no greater risks of pricing/service abuse with 3 competitors than they faced with 9 competitors or with 26 competitors—they have simply refused to examine the trend towards extreme concentration, and they have simply refused to undertake serious, objective analysis of the risks consumers might face under a permanent cartel-like oligopoly.
- The DOT has never undertaken a serious attempt to quantify public benefits, or to demonstrate that benefits are large enough to offset risks to consumers. This is in the apparent belief that any application consistent with the DOT's policy preference for reduced competition in international markets must be in the public interest. The question is not whether North Atlantic immunity applications are theoretically capable of producing public benefits and/or minimal consumer risks—these alliances date to the early 90s and operated profitably under market conditions with extremely low concentration. They initially created notable public benefits although the market conditions that generated those opportunities no longer exist. Studies citing benefits achieved by alliances ten years ago are irrelevant to this case. The question before the DOT is whether the current applications would generate large, objectively measurable incremental public benefits across the entire North Atlantic.
- The DOT's competition findings were predominately based on the general argument that consumers would benefit from merger-driven scale/scope improvements without any explicit acknowledgement that there might be tradeoffs between reduced competition and gains from scale/scope economies—a basic presumption that consolidation is not only a fundamentally a good thing for consumers, but the more consolidation the better. The DOT asserted that reduced competition actually gives "consumers a broader array of choices" of products and services.[6]

B. COMMENTS ON THE SUPPLEMENTAL COMMENTS—SUMMARY

It is noteworthy that the Joint Applicants have explicitly acknowledged the serious deficiencies of the evidentiary standards used by the DOT in prior airline immunity cases and submitted these Supplemental Comments in a proactive effort to establish evidence that might help meet the proper legal standards as demanded by the DOJ. The balance of my Comments will argue that all of the claims in the Supplemental Comments fail to meet these standards and should be rejected in their entirety. Nothing in the Supplemental Comments should be taken as the type of legitimate, objective evidence of public benefits or low consumer risks that might address the DOJ's concerns. The Supplemental Comments

[5] Horan Comments on the DOJ Comments, 3 July 2009, p11-13. The last successful new entrant on the North Atlantic was Piedmont (subsequently USAirways) in 1987

[6] DOT Star Alliance Final Order, p.10

offers no legitimate, objective evidence that the move from 60% to extreme 95%+ concentration would pose no serious risks to consumers and offers no legitimate, objective evidence that either the current or recent immunity applications would generate large enough public benefits to clearly offset competitive risks. The balance of this section of my comments is intended as a summary and overview of the detailed arguments presented in sections C and D.

<u>The Supplemental Comments' claim that antitrust immunity grants do not reduce competition (as a full merger or market exit would) is false and should be clearly rejected</u>

- The Supplemental Comments, the Willig/Compass Lexecon affidavit, and the Casey declaration each explicitly argue that the DOT's antitrust review should not treat reduced competition following a grant of antitrust immunity (where the currently separate American Airlines and British Airways services on Dallas-Ft.Worth-London would become a single competitor) as being at all similar to the reduced competition following a traditional merger or market exit.
- This claim, which is critical to most subsequent claims in the Supplemental Comments, is absolutely false and is designed to undermine the integrity of any antitrust review of consumer risks from reduced competition. All airline alliance immunity antitrust reviews dating back to KLM-Northwest in 1992 have clearly recognized the need to apply the same scrutiny to ATI cases that would be applied to a full merger. When separate KLM and Northwest aircraft operate Detroit-Amsterdam flights, consumers in that market are being served by only one competitor, with one integrated pricing function. The Joint Applicants in both Star and BA/AA are explicitly asking for the same, "metal-neutral" freedom to fully integrate pricing, capacity and financial management of their North Atlantic flights, and should not be granted substantially more generous antitrust standards.
- This entire justification for this anti-factual claim is that "carriers in an immunized relationship tend to increase capacity on the routes connecting their network"[7]. The Joint Applicants are attempting to improperly conflate the separate antitrust issues of consumer risks from reduced competition, and the possibility of offsetting public benefits. Instead of objectively quantifying both and evaluating whether the magnitude of benefits clearly offsets the competitive risks, as the law requires, the Joint Applicants are demanding an a priori assumption that ATI will not reduce competition on routes such as Dallas-Ft.Worth-London. The Joint Applicants are also making wholly unsubstantiated claims that that this specific ATI application will produce specific public benefits (increased capacity on Dallas-Ft. Worth-London), when (as they acknowledge) the historical record only shows a vague "tendency" and there is strong reason to believe that radically different market conditions would lead to different capacity decisions under extreme concentration in 2009 than might have been observed on Detroit-Amsterdam in the early 90s.

<u>The regression analysis supporting all of the Willig/Compass Lexecon affidavit's conclusions is fatally flawed and all findings based on this analysis must be rejected</u>

- The Willig/Compass Lexecon regression analysis is completely worthless. The nonstop market regressions, which are narrowly focused on the relationship between prices and the number of competitors serving a market, are based on data that does not correctly count the number of competitors in a market and does not correctly count quarter-to-quarter and year-over-year changes in the number of competitors. Variables such as "number of competitors=2" are a meaningless of mix of markets with two actual competitors (BA and Continental on Houston-London) and markets with one actual competitor (Delta and Air France on Atlanta-Paris). Thus, the Willig/Compass Lexecon claim that all of the observed changes in price levels can be explained by the independent "number of competitor" variables must be rejected out of hand because the data behind these variables grossly misrepresents marketplace reality. Garbage in, garbage out.
- Willig/Compass Lexecon demand that the DOJ's regression showing the possibility of pricing risks when competition is reduced on connecting routes be rejected is solely based on an alternate regression, where they added five "control variables" (such as "income of EU city"), none of which has any great relevance to North Atlantic pricing dynamics and three of which failed significance tests. Both the DOT and DOJ should clearly reject the Joint Applicants' argument that major antitrust decisions should be based solely on simplistic regressions and should emphatically reject the crude statistical gamesmanship presented by Willig/Compass Lexecon.

[7] Casey declaration, p. 2

- The core Joint Applicant arguments based on the Willig/Compass Lexecon regressions—that "there is no statistically significant fare effect from reducing the actual number of carriers on a route from two to one" and that "granting antitrust immunity has no significant effect on fares" and "carving-out from antitrust immunity the four oneworld overlap routes would impose harm on consumers equivalent to at least $55 million annually"[8] are not based on any legitimate analysis, and should be rejected out of hand. Furthermore, the DOT and DOJ should note the Joint Applicants' attempt to make inappropriately broad, totally unqualified arguments based on simplistic regressions---antitrust immunity has no impact on consumer prices in any situation, regardless of market conditions. Even if legitimate data had been used, a simplistic regression of prices against the number of competitors taken from time periods with low/moderate concentration cannot be used as evidence of what would happen to prices if competition is reduced under cartel-like conditions with 95%+ concentration and no possibility of meaningful new entry.

<u>No proper section 41309 competitive analysis of the risks to consumers from all of the current/recent applications that have led to extreme North Atlantic concentration has ever been undertaken, and nothing in the Supplemental Comments fills this void.</u>

- There was no legitimate, objective evidence supporting the DOT's finding that the Star/Continental case posed no risks to consumers. There is no legitimate, objective evidence in the Supplemental Comments that would support any finding that the current application would pose no risks to consumers. The DOT cannot approve the current application without a section 41309 review based on legitimate, objective evidence; nothing in the Supplemental Comments can assist that effort.
- There is nothing in the Supplemental Comments that counters any of the evidentiary concerns raised in public comments to the DOT's Star/ Continental Show Cause Order. It is fair, but misleading to note that no one that has objected to the DOT's making major antitrust decisions without the legitimate, objective evidence required by law have submitted alternative analysis that would fully meet section 41309 standards. Under the law it is the DOT's responsibility to undertake these analysis; neither the DOJ nor other outside parties have the responsibility or resources to do so. The Supplemental Comments suggestions that the DOJ's regression analysis do not constitute definitive evaluation of North Atlantic pricing issues are irrelevant. The DOJ was not attempting to present a definitive Clayton Act analysis; they were merely demonstrating the abundance of evidence contradicting the DOT's unsubstantiated assertion that extreme North Atlantic concentration poses no risks to consumers.
- The Casey declaration notes one of the keys to the competitive analysis that the DOT has steadfastly ignored--a large (or even monopoly) market share is not an automatic indication of "market power"; in order for consumers to face serious pricing risk "market share must be accompanied by conditions and incentives that would encourage airlines to contract supply"[9]. The current ATI applications cannot be approved because studies showed that alliances were pro-competitive in the 1990s, or regressions of price data from time periods when market concentration was 60% didn't raise concerns. The issue is whether the extreme levels of concentration that will directly result from the current applications would create "conditions and incentives that would encourage airlines to contract supply". This analysis has never been undertaken, and none of the recent/current ATI applications should have been approved without legitimate, objective evidence that these conditions and incentives did not exist.

<u>The potential for increased American Airlines-British Airways joint marketing cooperation cited in the Supplemental Comments does not constitute evidence of "Public Benefits" from BA/BA immunity</u>

- Nothing in the Supplemental Comments constitutes legitimate, objective evidence of public benefits that would be created if the current application is granted. Such evidence would need to be quantified in terms of their value to the consumer, and their magnitude relative to the market (a 0.00001% gain in consumer welfare with no benefits in terms of lower prices or increased service might not justify the lost competition); would need to be shown to be true net-market-wide gains (potential capacity increases on isolated routes might be offset by losses elsewhere) that were truly incremental to this transaction, and unachievable without immunity.
- None of the claimed "benefits" from increased BA/AA cooperation under immunity are properly defined as "public benefits"—they are benefits to these two companies and their shareholders, but there is no evidence of benefits

[8] Willig/Lexecon Compass affidavit p.6, 13, 18, 22
[9] Casey declaration, p.4

to North Atlantic consumers as a whole. The claim that an immunize BA/AA might adjust schedules to create new connection opportunities in isolated markets that already have significant service does not constitute evidence that the total level of service available to North Atlantic consumers would meaningfully increase. The claim that American frequent flyers could earn miles on a wider variety of routes does not constitute evidence that American frequent flyers (or North Atlantic frequent flyers in general) would enjoy richer frequent flyer programs as a result of ATI.

- The cited cooperation opportunities (frequent flyer reciprocity, joint corporate and agency incentive sales programs, increased codesharing and fare combinability) have always been possible without metal-neutral immunity, many airlines without metal-neutral immunity undertake such programs, and past BA/AA decisions not to undertake them clearly suggest that such programs would have not justified sufficient profits to justify the administrative costs. Any merger or immunity grant will lower the cost of joint marketing programs, but the Joint Applicant have not demonstrated that these hypothetical economies are large or that they will actually be passed on to consumers in terms of lower fares or increased services.

<u>Since it fails to provide any usable data or analysis, the argument in the Supplemental Comments boils down to "you gave our competitors huge gains from reduced competition without demanding any evidence of public benefits or low consumer risks, and it would be really unfair to our shareholders if you didn't give it to us too", which ignores the problem that "fairness" among megacarrier alliances might be hugely disadvantageous for consumers</u>

- The Joint Applicants explicitly argue that DOT should grant their application on the basis of competitive "fairness": "It is not clear how withholding antitrust immunity from one alliance, in effect leaving a duopoly for the remaining alliances, advances competition policy"; "oneworld in its current form simply cannot compete effectively with Star and Skyteam because the lack of antitrust immunity puts the Joint Applicants at a severe regulatory disadvantage."[10]
  - They even argue that the DOT has a legal obligation to ensure competitive "equity" and is not limited by its responsibilities to administer antitrust law: "The Department's mandate is far broader, and specifically includes 'strengthening the competitive position of air carriers to ensure at least equality with foreign air carriers, including the attainment of the opportunity for air carriers to maintain and increase their profitability in foreign air transportation'"[11]
- Thus in arguing that "there is no basis for the Department to abandon its established precedents in Skyteam II and Star II"[12], the Joint Applicants are arguing that the DOT's failure to conduct the required Clayton Act reviews of public benefits and consumer risks based on legitimate, objective evidence establishes a binding precedent that must be extended to all other companies in the market. Even if one can sympathize with the dilemma faced by American Airlines shareholders, the central issue is the DOT's abject failure to represent the interests of consumers and the public at large. The DOT has been totally unwilling to represent the public's interest in healthy marketplace competition, as it has aggressively rubber-stamped every move towards extreme North Atlantic consolidation, under a process where testimony has exclusively come from the large international airlines that will directly benefit from the elimination of competition.
- The Joint Applicants go beyond the basic "level playing field on the North Atlantic" argument, and point out that the past ATI approvals have given airlines such as Delta an unfair advantage in domestic competition as well: "The Department needs to consider the role that international alliances play in domestic competition…This gives these carriers (Delta, United) a distinct competitive advantage in operating a domestic network—something American would be denied absent approval and immunity for the proposed oneworld alliance on <u>equal</u> terms with Star and Skyteam"[13]. The obvious implication is that this massive reduction in competition, leading to cartel-like conditions on the North Atlantic, with no possibility of meaningful new entry, will generate supra-competitive profits that can be used to cross-subsidize domestic operations, where highly liberal, open-market competitive rules still apply. If American feels that it would be disadvantaged competing domestically with Delta and United without similar sources of artificial profits, the it is reasonable to be concerned that carriers like Airtran, Southwest, Jetblue and Spirit, whose operations are completely limited to highly liberal competitive markets, would face even greater

[10] Supplemental Comments, p. 3, 22
[11] Supplemental Comments, p. 3
[12] Supplemental Comments, p. 12
[13] Supplemental Comments, p. 22

disadvantages. As the Supplemental Comments explicitly acknowledge[14], the traditional Legacy carriers have significant competitive disadvantages versus the "low-cost" sector in many domestic markets, and the Legacy carriers have lost tens of billions of dollars competing unsuccessfully domestically. Artificial profits from artificially reduced international competition would further distort these domestic markets. The DOT's failure to even consider these issues as it enthusiastically rubber-stamped extreme international consolidation illustrates the extent to which they have failed to conduct the required section 41309 competitive analysis.

C. COMMENTS ON THE AFFIDAVIT SUBMITTED BY ROBERT WILLIG AND COMPASS LEXECON CONSULTANTS

<u>The regression analysis supporting all of the Willig/Compass Lexecon affidavit's conclusions is fatally flawed and must be rejected in its entirety.</u>

- In a study that purports to analyze relationships between price levels and the number of competitors, Willig/Compass Lexecon falsely assume that immunized alliance partners that jointly operate service on a nonstop route (such as Northwest and KLM on Detroit-Amsterdam) are independent price competitors.[15] In fact pricing and revenue management decisions on ATI routes like Detroit-Amsterdam are made by the same staff using the same IT systems and marketing criteria without regard to which partner operates a given flight. The affidavit makes the incredible claim that the "DOJ simply assumes that, without justification that granting antitrust immunity to two carriers on a given route has the same effect on fares as an actual reduction in the number of carriers, such as would occur following exit by a carrier".[16] The DOJ's assumption is not only fully supported by longstanding alliance practices (which this author personally participated in), but by the longstanding recognition of the DOT that granting ATI is the competitive equivalent of the elimination of an independent competitor and by the applicants in every recent ATI case (Skyteam, Continental/Star Alliance, BA/AA) that authority to conduct collude on pricing on a fully "metal neutral" basis is a critical aspect of their ATI application.[17]
  - ☐ This is the equivalent of an analysis of auto industry competition that assumed that wholly owned brands (i.e. Chevrolet and Buick; Toyota and Lexus) behaved as if they were fully independent.[18]
  - ☐ Willig/Compass Lexecon justify including ATI partners as independent price competitors in their regression, because ATI partners sometimes increase capacity on some routes. This claim is utterly meaningless in the context of a statistical analysis comparing price levels to the number of competitors. Airlines that fully merge sometimes increase capacity on some routes, but a regression that counted the pre-merger predecessors as independent price competitors would be worthless. All airlines make capacity adjustments over time; there is no basis for assuming that the price competitiveness of ATI capacity is wildly differently from all other capacity. Even if one postulates that AA/BA will make one-time capacity adjustments if their application is approved, there is no basis for double counting capacity that received ATI over ten years ago.
- All of the Willig/Compass Lexecon regression analysis considers price levels as dependent on the number of competitors in the market, with "nonstop competitors=1", "nonstop competitors=2", "nonstop competitors=3", and the presence of ATI between competitors defined as separate independent variables.[19] The affidavit claims that the "number of competitors" variables explain all observed price variations, and since the "ATI" variable does not improve the regression fit, it concludes that granting ATI has no impact on marketplace prices on nonstop routes, and thus granting ATI would never create risks to consumers on these nonstop routes. But the data within "nonstop competitors=2" is a random mix of routes with two true competitors (Continental and British Airways on Houston-London) and routes with one true competitor (Delta and Air France on Atlanta-Paris). If the data within each of the variables purported to explain all observed price variation falsely represents the fundamental relationship being analyzed, then the entire regression analysis must be rejected. The Willig/Compass Lexecon's

[14] Supplemental Comments, exhibit 3
[15] Willig/Lexecon Compass affidavit p. 3, 7-11.
[16] Willig/Lexecon Compass affidavit p. 3
[17] Joint Applications Motion, p.12-22.
[18] Since ATI partners North Atlantic pricing and revenue management is fully centralized and "metal neutral" the Willig/Lexecon Compass assumptions are actually worse than assuming Chevrolet and Buick are fully independent competitors, since these brands do maintain some separate tactical/short-term pricing autonomy and do not have the same level of market overlap as Delta and Air France do in the Atlanta-Paris market.
[19] Willig/Lexecon Compass affidavit p. 11,13

central conclusions, that "there is no statistically significant fare effect from reducing the actual number of carriers on a route from two to one" and that "granting antitrust immunity has no significant effect on fares"[20] are totally based on regression analysis that is fatally flawed.

- ☐ If an auto industry regression that assumed Chevrolet and Buick were separate competitors produced one result, but was contradicted by earlier regressions that recognized they were not independent, it would be ridiculous to base major antitrust decisions on the first regression. The joint applicants and Willig/Compass Lexecon are explicitly demanding that the DOT categorically reject the DOJ's evidence (based on regressions that treat Delta and Air France as a single competitor) and make a major industry structure decision (blanket approval for any ATI application because they have no impact on fares) based on its regression that assumes Delta and Air France are totally independent competitors.

■ In addition to misidentifying the number of competitors in nonstop markets at any point in time, the data used in the Willig/Compass Lexecon regression analysis fail to correctly identify changes in the number of competitors over time. The regressions are based on data tables showing the number of airlines operating nonstop service on 64 routes over 16 quarters (calendar 2005-08), showing quarter-by-quarter and year-over-year changes in the number of operators on each route, and a comparable of market prices for each of the 1024 route-quarters[21]

- ☐ The data tables identify 55 cases where the level of competition changed, but 41 of the claimed changes in carrier counts change were due to seasonal capacity adjustments where there was no true market entry or exit, or cases where flying on existing routes was shifted between ATI partners for operational convenience. There is absolutely no reason to expect any change in pricing behavior in these situations, and data largely driven by these events cannot possibly serve as the basis for any conclusions about the price versus number of competitor issue[22]
- ☐ Although the central focus of the affidavit is the impact of ATI grants on pricing, there is absolutely no data illustrating this relationship--none of the 64 routes during these 16 quarters experienced a change where previously independent competitors were granted antitrust immunity

■ Willig/Compass Lexecon argues that the antitrust determination of whether reduced competition poses risks to consumers on connecting North Atlantic routes should hinge totally on the presence of a control variable for "income of EU city" in the equation. It argues that the DOJ analysis showing the possibility of pricing risk should be rejected, because they reran the regressions adding five control variables, and although three failed to meet significance tests, the new results produced coefficients suggesting no pricing risks.[23] Willig/Compass Lexecon appear to have been manipulating regression equations in order to produce the results that the Joint Applicants wanted to hear. Regression results that can be manipulated this easily should not be presented as definitive evidence of critical economic relationships, and should not drive major antitrust decisions. Both the DOT and DOJ should clearly reject the Joint Applicants' argument that major antitrust decisions should be based solely on simplistic regressions, and should emphatically reject the crude statistical gamesmanship presented by Willig/Compass Lexecon.

■ Willig/Compass Lexecon's subsequent claim, that carving out nonstop routes from an immunity grant would cost consumers $55 million annually, is directly derived from the worthless original regressions, and must also be rejected.

<u>The Willig/Compass Lexecon's regression modeling bears little relationship to the actual antitrust issues posed by the Skyteam, Star Alliance and BA/AA applications, and willfully misrepresents the concerns raised by the Department of Justice in the Star Alliance/Continental case</u>

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[20] Willig/Lexecon Compass affidavit p. 6, 13, 18

[21] The carriers counts are shown in the Willig/Lexecon Compass affidavit as Table 2 on p.9; the price data was not published

[22] The analysis only considers pricing changes when the number of competitors shifts from 3 to 2 or 1; carrier counts above 3 and cases where nonstop counts move between 0 and 1 are ignored. The data distortion problem would exist even if the carrier count data used to drive the regressions had been corrected for the "ATI partners treated as independent competitors" problem described above. The year-over-year carrier changes are just as distorted as the quarter-to-quarter changes because of the irregular pattern by which summer-oriented service sometimes operate in shoulder seasons.

[23] Willig/Lexecon Compass p. 15-17. The other control variable reported as statistically significant was "market covered by Open Skies Treaty". Control variables for "income of US city", "population of US city" and "population of EU city" did not pass significance tests.

- Putting aside the fatal flaws in the data used in the Willig/Compass Lexecon regression analysis, their basic methodology is largely inappropriate to the current ATI applications, because any statistically estimated "price versus number of competitor" relationships would have only applied to marginal changes within the low/medium concentration market conditions that the input data reflected. Results from a hypothetical future regression analysis using legitimate data from the same (2005-2008) time period could not be used to predict the specific pricing impacts on nonstop North Atlantic routes following the extreme market concentration that would result from approval of the current ATI applications, and it are difficult to imagine that any regression analysis could provide such predictions.
  - Unlike so-called "LCC" or point-to-point airline networks, there is significant price inter-dependency on highly integrated hub-based networks, and the North Atlantic is perhaps the most extreme example of a hub-based network anywhere in the world. There are various substitution opportunities available to consumers (non-stop vs. connecting service; leisure passengers can shift destinations within a certain geographic range), and airlines want to limit the complexity of fare structures (fares from the US to different cities in Germany tend to be much more uniform than the underlying operational/competitive differences would suggest). In the past, the "pricing power" of carriers with dominant/monopoly positions in a given O&D market would have been limited somewhat by fare levels in nearby and overlapping markets. However, factors such as these that constrain supra-competitive pricing in isolated markets will likely vanish once highly concentrated, cartel-like condition are established with no serious threat of future entry.
- Willig/Compass Lexecon attack the DOJ's Comments in the Continental/Star Alliance case, because "the DOJ's study of non-stop fares is not, in fact, a study of the effect of alliances, but is in fact, a study of the effect of any change in the number of distinct carriers serving a route."[24] Willig/Compass Lexecon does not appear to understand that neither DOT nor DOJ were undertaking an isolated, theoretical analysis of alliance economics, but were responding to specific carrier applications that will reduce the number of independent competitors on the North Atlantic. Further Willig/Compass Lexecon comments in that same paragraph conflate the reduced competition issue with potential network effects that immunized alliances might create. This suggest that they also do not understand that DOT and DOJ are required to separately evaluate the ATI application for evidence of public benefits risks to consumers and quantify tradeoffs between them. Legitimate evidence of strong public benefits could be considered as a mitigating factor, but it would not change the need to initially consider whether increased market concentration would increase the risks of higher fares or reduced service.
  - The miscount of market competitors that rendered Willig/Compass Lexecon's regressions useless also reflects their improper conflation of consumer issues (price impacts of reduced numbers of competitors) and public benefits (would alliances add capacity or improve services)
- Willig/Compass Lexecon's argument that "the DOJ's econometric findings should not be relied upon for the formulation and support of policy towards airline alliances"[25] misrepresents the basic nature of the DOJ's Comments in the Continental/Star Alliance case. At no point did DOJ even remotely suggest that its (or anybody else's) regression results should be the primary driver of antitrust policy. The DOJ's Comments focused primarily on the DOT's clear failure to support its public benefits and competitive risk analysis with legitimate, objective data and analysis that were clearly tied to current market conditions and the facts raised by the current applications.[26] The burden of assembling evidence showing substantial public benefits and limited risks to consumers rests with the DOT, not with the DOJ or any other parties that might comment on the case. The DOT Show Cause Order North Atlantic competitive review was strictly limited to tables of historical carrier market shares; there was absolutely no analysis of potential pricing risks, entry barriers, or market contestability.[27] The DOJ's provided a simple analysis consistent with the literature and past cases showing the possibility of serious consumer risk, even under the low/medium market concentration levels of that time period.[28] The DOJ was not arguing that it had provided a definitive analysis that fully satisfied the requirements of Clayton Act section 41309, it was demonstrating why the DOT's unsupported assertions that the elimination of North Atlantic competition created zero risks to consumers needed to be rejected, and that a legitimate Section 41309 analysis needed to be undertaken before any application for antitrust immunity could be properly evaluated. Willig/Compass Lexecon is certainly welcome to

[24] Willig/Lexecon Compass affidavit p. 3
[25] Willig/Lexecon Compass affidavit p. 3
[26] The DOJ Comments on the DOT Show Cause Order, 26 June 2009 cites numerous examples; the key ones are summarized in Horan Comments on the DOJ Comments, 3 July 2009, p.1-2
[27] Competitive Analysis Pursuant to Section 41309, DOT Show Cause Order, 7 April 2009, p. 6-13
[28] DOJ Comments on the DOT Show Cause Order, p. 24 and Appendix B

offer a legitimate Section 41309 analysis but they clearly have not done so in this affidavit. Absolutely nothing in the Willig/Compass Lexecon affidavit challenges the conclusion that the DOT's grant of antitrust immunity in the Star Alliance/Continental case was not based on a legitimate Section 41309 analysis of the potential risks to consumers from reduced competition on the North Atlantic.

Willig/Compass Lexecon's states its conclusions in unacceptably sweeping, universal terms, and both DOT and DOJ should reject its basic approach to antitrust analysis

- The core Willig/Compass Lexecon conclusions—that "there is no statistically significant fare effect from reducing the actual number of carriers on a route from two to one" and that "granting antitrust immunity has no significant effect on fares"[29] are not based on any legitimate analysis. But these assertions would be highly objectionable even if Willig/Compass Lexecon had run defensible regressions based on data that bore some relationship to the actual issues raised by these ATI applications. The conclusions are stated as absolutes—they are claiming no grant of airline antitrust immunity would ever have a significant effect on passenger fares, regardless of entry barriers or other market conditions, regardless of the nature or scope of the ATI request, or regardless of its direct impact on market concentration. There is not a single sentence in the affidavit that qualifies these conclusions in any way.
- A legitimate antitrust review would consider a wide variety of evidence—not only price and production data, but analysis of the factors driving market demand, customer and product segmentation, operating scale and network scope economies, historical industry structure trends in comparable industries facing comparable pressures, and many others. Regressions might be a useful tool in testing certain relationships under certain conditions, but the results would need to be shown to be consistent with the full range of case evidence. Willig/Compass Lexecon claim that major antitrust decisions should be driven by regression results alone, without any need to demonstrate that the underlying data accurately reflected case conditions, and without any need to show that regression models were consistent with defined hypotheses about the drivers of consumer choice or airline pricing behavior. There is no need to understand complex customer or competitive dynamics—conclusions can be taken directly from equation coefficients, as long as the R-squared is reasonably high.
- The Willig/Compass Lexecon affidavit suggests that even major, counter-intuitive, potentially controversial antitrust findings, (such as the elimination of competition on nonstop routes having no impact on pricing) can be based on a single set of regressions from an isolated market/time period, without any need to ensure the robustness of the conclusions by showing comparable results from a wide range of comparable market analyses.[30]

D. COMMENTS ON THE PUBLIC DECLARATION OF DON CASEY OF AMERICAN AIRLINES

- Casey's declaration makes two central arguments, that immunized alliances would not raise fares in non-stop hub-to-hub markets such as Dallas-Ft. Worth-London or Miami-Madrid, and that the lack of antitrust immunity significantly reduces the benefits that the joint applicants can offer consumers

- I was responsible for the original network development of the Northwest-KLM alliance (ten years before American Airlines had any experience with these types of alliances) and subsequently managed international alliances at Swissair/Sabena, and can attest that Casey's observations about international network scheduling and pricing are fair and reasonable and accurately reflect current practices, and his New York-Zurich case example illustrates a typical way hub-to-hub flights might be scheduled under an immunized alliance with "metal neutral" financial arrangements

Casey's arguments do not support (and actually help refute) his view that ATI would not lead to higher prices in nonstop markets

- Casey correctly notes that a large (or even monopoly) market share on a nonstop transatlantic route is not an automatic indication of "market power", that pricing and revenue management decisions will be based on

[29] Willig/Lexecon Compass affidavit p.6, 13, 18

[30] Willig/Lexecon Compass fail to explain their counter-intitive finding that reducing the number of competitors on a nonstop route from 3 to 2 does have a significant impact on pricing, but that reducing the number of competitors from 2 to 1 has no impact whatsoever.

optimization of the entire network, not the maximization of revenue or prices in any individual O&D market, and that market prices are predominately a function of industry-wide supply/demand conditions. In order for consumers to face serious pricing risk "market share must be accompanied by conditions and incentives that would encourage airlines to contract supply"[31]

- Casey observes that the airlines' tendency to oversupply capacity on monopoly alliance transatlantic hub-to-hub routes such as Detroit-Amsterdam has led to reasonable fares for local passengers. However this historical tendency can be easily explained by conditions that are not likely to persist if all current ATI applications are approved and the three Collusive Alliances achieve a 95%+ share of the North Atlantic market.
  - The large network carriers have had significant overcapacity (aircraft and related infrastructure that could not earn the cost of its capital) since the late 90s, and are also highly sensitive to market share battles in key markets such as the North Atlantic. Carriers would tend to oversupply transatlantic hub capacity as excess aircraft would lose less money than on alternate domestic routes, and this would prevent competitors with even more excess capacity from capturing increased market share
  - Carriers now have much greater ability to shed excess capacity than they did ten years ago, and more importantly, the establishment of a 3-alliance cartel on the North Atlantic eliminates the pressure to maintain excess transatlantic capacity for competitive/market share purposes. The behavior Casey described occurred in a market with 60-70% concentration, and 7 or more serious competitors jockeying for position. If this market is replaced by one where the Air France and Lufthansa led Collusive Alliances control 97% of the US-Continental Europe market and the British Airways led Collusive Alliance dominating the US-UK market, none of the alliances would have any incentive to seriously challenge the markets of the other alliances—attacks would prompt quick retaliation, and there would be no prospect of seriously weakening anyone's overall position. In this environment, the "conditions and incentives that would encourage airlines to contract supply" would clearly be present.
  - As Casey notes, American and British Airways currently operate 27 weekly Dallas-Ft. Worth-London flights, capacity designed to support a strong overall position in the US-UK market. But once extreme North Atlantic concentration levels have been achieved, this could easily be cut back to 21 or fewer weekly flights, without any serious likelihood that members of the Lufthansa and Air France led alliances would enter the local DFW-LON market or aggressively cut prices in order to steal share on the overall US-UK market. This would support artificially high prices in the local market while still preserving the capacity needed to serve connecting markets.
  - Casey's claim that "shrinking critical trunk capacity in order to earn supra-competitive fares from a relatively small subset of passengers is simply not a viable long-term strategy for network carriers" is only true if there is robust competition on the North Atlantic, and/or serious industry-wide overcapacity. The current ATI applications will eliminate meaningful competition, so that supra-competitive pricing can be supported.
- Casey's claim that eliminating competition via ATI does not create the same problems for consumers as reducing competition via merger or market exit because "carriers in an immunized relationship tend to increase capacity"[32] is wholly unjustified in the context of the current ATI applications. Casey's New York-Zurich example illustrates how the normal response in most cases is not added capacity, but the reallocation of existing capacity to improve connecting opportunities. Casey presents absolutely no evidence that likely actions by BA/AA or Star Alliance/CO following ATI approval would increase aggregate North Atlantic capacity.
  - The original 90s Collusive Alliances (KLM-Northwest, Swissair-Delta) generated increases in aggregate North Atlantic capacity, and this is frequently cited as evidence that Collusive Alliances create public benefits; however these benefits were due to a one-time gain for consumers when new alliance "online" service provided improved schedules at lower fares versus previously available interline service in a large segment of North Atlantic that did not have single carrier service in 1990. These consumer gains had been fully realized by the late 90s, and there is no evidence that the current ATI applications are generating incremental public benefits.[33] The DOT's decision in the Star Alliance/Continental case merely asserted that approval would generate significant public benefits; there was no legitimate, objective analysis documenting the magnitude of the alleged benefits, or demonstrating that they were truly incremental market-wide gains (rather than zero-sum shifts between carriers or routes)

[31] all references in this section are to Casey Public Declaration, p.4-8
[32] Casey Public Declaration, p. 2
[33] Horan Comments on the DOJ Comments, p. 3-5

- ☐ Oneworld's four hub-to-hub routes are a small portion of their total transatlantic nonstop capacity; there is no basis for claiming that approval of their ATI application would lead to an increase in their overall capacity, and there is reason to suspect that approval would force competitive cutbacks on routes where they have a dominant position; one cannot simply assume that approval will automatically increase the level of service available to consumers

<u>Casey's attack on existing obstacles to American Airlines-British Airways cooperation is actually an attack on free-market competition</u>

- Despite ten years of common membership in the "oneworld" alliance, Casey notes that American Airlines and British Airways have failed to offer interline passengers a variety of services offered by other alliances groups, including fully integrated, reciprocal frequent flyer programs, combinable interline fares, comprehensive codesharing, and combined agency and corporate travel incentive programs[34]. But Casey's assertion that regulatory approval of metal neutral immunity is required to create these benefits is simply not true. All of these types of programs have been offered in the past that did not have antitrust immunity. Casey cites oneworld's competitive disadvantage versus the Star Alliance, but (until the recent Star/CO application) Star has never had metal neutral financial arrangements, and only a subset of members have antitrust immunity.
- As Casey's declaration clearly spells out, American and British Airways regularly evaluated whether to offer these programs, but on each occasion decided they were financially better off not offering them. At any point, they could have decided (to use the examples Casey cites) to allow American codesharing on BA's India or Philadelphia-London flights, to allow BA codesharing on AA's New Orleans flights, to publish combinable fares, or to allow frequent flyers to earn miles on each others' transatlantic flights, and to establish appropriate compensation arrangements. But in most cases they appear to have decided that the programs would not have been profitable for both parties. AA and BA presumably evaluated all of the financial impacts of these programs, and decided that benefits in some areas were outweighed by costs and disadvantages in others. If the net profits from these programs were so small that the incremental administrative costs couldn't be justified, then the efficient solution is not to offer them. Joint marketing programs between independent competitors occur throughout the business world, but they only survive when the incremental profits fully justify the programs.
- This is not a case of a competitive "market failure"—either these programs are not profitable, or the potential profits are so small that they could not possibly justify allowing full scale collusion. Casey has not presented any evidence that anti-collusion laws or any other form of government interference has blocked actions that would clearly enhance efficiency. Casey is simply arguing that these two companies would be better off (reduced "competitive disadvantage" versus the other alliances) if the antitrust laws were suspended.
  - ☐ A hypothetical merger between United, American and Delta would clearly lead to a wide range of joint marketing efforts that none of these carriers see fit to offer as independent competitors; that does not mean that reduced competition automatically increases public benefits, and in fact one cannot presume these joint marketing efforts increase consumer welfare (the new joint frequent flyer program might offer more stringent terms that the old, separate ones)

<u>Casey's claims of increased consumer benefits are meaningless in the context of the antitrust laws</u>

- In order to grant antitrust immunity, DOT must produce legitimate, objective evidence of significant public benefits that clearly outweigh any risks to consumers from reduced competition. Public benefits must be evaluated in terms of net gains across the entire market, recognizing that gains in one market may be easily offset by losses in others, and must be limited to gains that could not have been achieved without ATI. DOT granted immunity in the Star Alliance/Continental case without providing any legitimate evidence supporting their assertion that immunity would generate public benefits. There was no attempt to quantify the magnitude of benefits represented by the anecdotal evidence cited (increased frequencies, lower fares), to objectively evaluate the claims made by the applicants, to demonstrate true net gains across the entire market, or to provide any quantitative evidence that the total magnitude of gains clearly exceeded potential competitive risks.
- No one questions that airline mergers or immunity grants would create some public benefits. Casey's declaration cites the American frequent flyer who will now be able to earn miles on either the AA or BA flights to London, or

[34] all references in this section are to Casey Public Declaration, p.8-11.

the possibility (along the lines of the New York-Zurich example) that there will now be two codeshared connections to Berlin each day, instead of just one. But Casey provides absolutely no evidence of actual market-wide net benefits or whether the value of these benefits has any significance whatsoever relative to the size of the North Atlantic market. There is no evidence that aggregate market capacity will increase, or that any consumers will benefit from lower fares. There is no evidence that frequent flyer programs will become more generous to consumers. There is no evidence that the schedule changes to increase links between AA and BA hubs will not be offset by reduced capacity and reduced competitive options in other markets. In fact there is nothing in Casey's Declaration that suggests that North Atlantic consumers as a whole will benefit from BA/AA immunity—the only beneficiary cited are the BA/AA shareholders, who currently face a "competitive disadvantage" in selected markets. BA/AA immunity would merely shift tiny bits of traffic in markets like Berlin between carriers, without any meaningful net gains in consumer welfare.

- There is strong evidence that the public benefits from the current ATI applications (if the DOT ever undertook a serious attempt to measure them) would be miniscule, and would certainly be a tiny, tiny fraction of the public benefits created when the original alliances were immunized in the early 90s. As noted earlier, the original alliances had a huge competitive advantage (coordinated online schedules with a full rage of discount fares) in the 30% of the market where single carrier service was not available. These benefits were significant relative to the overall market, and readily measurable. The existing applications are merely adding additional frequencies in markets (like Dallas-Berlin) that have been well served for years. These changes will have no impact on capacity or prices, and the impact on competition will be much too small to measure.
  - The core "public benefits" question that the DOT has refused to address, is what is the evidence of net public benefits from the extremely concentrated North Atlantic (cartel-like oligopoly with 95%+ concentration with no likelihood of future entry) versus the low/medium concentration levels that existed five years ago, prior to the Air France-KLM merger and the current ATI applications?
- No one questions that carve-outs from immunity grants will limit the ability of an alliance to maximize joint network profitability. The issue is whether the risks to consumers from reduced competition in large nonstop markets is significant enough to justify some small limits on the scope of alliance collusion. Casey's Declaration notes the possibility that American Airlines would make a bit more money without any carve-outs, but provides no evidence as to why consumers as a whole would be better off if North Atlantic carriers had full freedom to collude on all nonstop routes.

Respectfully submitted,

Hubert Horan
15 October 2009

SUPPLEMENTAL COMMENTS OF HUBERT HORAN
AMERICAN AIRLINES-BRITISH AIRWAYS-IBERIA-FINNAIR-ROYAL JORDANIAN
JOINT APPLICATION FOR ANTITRUST IMMUNITY
DOCKET DOT-OST-2008-0252
8 January 2010

My name is Hubert Horan. I am filing these comments in response to the Department of Justice filing at DOT-OST-2008-0252-3374. These are supplemental to comments I originally filed on 15 October 2009 under DOT-OST-2008-0252-3362

During my 25 year aviation career I have done consulting work with over 30 airlines and held airline management positions with Northwest, America West, Swissair and Sabena. I have significant experience in international airline competition and the actual operation and economics of airline alliances. While at Northwest I was personally responsible for the original development of the KLM-Northwest Alliance network and introduced the intense hub-to-hub operations that allowed Northwest to become the most profitable US carrier on the North Atlantic, and established the template followed by all of the subsequent alliance networks. I spent four years at Swissair-Sabena, including the transition of Swissair's alliance from Delta to American, and thus have been involved in alliance management on both sides of the Atlantic. I have not only helped build highly successful alliances, I have helped shut down highly unprofitable ones, including the intra-European Qualiflyer alliance, and the domestic alliance between Continental and America West. Over the years I have written extensively on airline competition, global airline consolidation, and Open Skies treaty negotiations, and I also testified before Congress on the Delta-Northwest merger. I am based in Phoenix, Arizona. A full list of publications and further biographical information is available at my website, horanaviation.com.

I have no active business or financial interests with any of the parties to this case, and am only commenting as a private citizen concerned about the issues raised by this case.

A. RECENT SUBMISSIONS HAVE NOT ADDRESSED THE JOINT APPLICANTS' HIGHLY DEFICIENT CLAIM OF $92 MILLION IN ANNUAL PUBLIC BENEFITS FROM CONNECTING SERVICES

A1. DOT may not grant the requested immunity without evidence, meeting the standards of the *Horizontal Merger Guidelines* demonstrating consumer benefits in nonstop and connecting markets significantly greater than any risks of reduced competition in nonstop or connecting markets

- Applicants for antitrust immunity must prove that immunity "is necessary…to achieve important public benefits" that "cannot be achieved by reasonably available alternatives that are materially less anticompetitive."[35] Both the DOT and DOJ have recognized that airline antitrust immunity applications such as this one would directly eliminate competition in the same manner that a full merger would and applicants must prove that those public benefits outweigh the risk that it could harm competition by increasing the ability or incentive to raise price or reduce output in any relevant market.[36] The burden of proof for public benefits rests with the applicants, and the *Horizontal Merger Guidelines* defines the evidentiary standards that must be met:
  - "[the applicants] must substantiate efficiency claims so that the Agency can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so) how each would enhance the merged firm's ability and incentive to compete, and why each would be merger-specific. Efficiency claims will not be considered if they are vague or speculative or otherwise cannot be verified by reasonable means"[37]

- The Joint Applicants have made four substantive claims in support of their request for antitrust immunity: (1) that immunity would generate $92 million in annual public benefits in the form of capacity driven price reductions to

[35] 49 USC sections 41308, 41309(b)
[36] Federal Trade Commission, Department of Justice, Antitrust Guidelines for Collaborations Among Competitors (2000) sections 1.2, 3.3.
[37] Federal Trade Commission, Department of Justice, Horizontal Merger Guidelines (1997) p.31

North Atlantic passengers using connecting services[38] (2) that immunity would generate $45 million in annual public benefits from increased nonstop capacity added to hub-to-hub routes[39] (3) competition would not be reduced or eliminated in the overlapping nonstop markets served by the Applicants[40], and carve-outs of nonstop routes from any immunity grant would reduce consumer benefits by $55 million[41] (4) competition would not be reduced or eliminated in transatlantic connecting markets[42],

- ☐ Other claims made by the Joint Applicants (increased convenience, applicants better able to compete) are either derivative claims (the impact of increased convenience and competition are already reflected in the quantified public benefit claims) or are not supported by any of the types of evidence required by the *Horizontal Merger Guidelines.*

A2. Previous testimony has already fully refuted the Joint Applicants' claim that there is no risk to consumers from reduced nonstop competition

- ■ The only verifiable evidence presented by the Joint Applications in defense of claim (3), that competition in nonstop markets would not be reduced enough to increase ability or incentive to raise price or reduce output, and that carve-outs of nonstop routes would harm consumers, is included the Willig/Lexecon Compass affidavit. That affidavit claimed that its regression analysis demonstrated that risks from reduced competition were de minimis because "there is no statistically significant fare effect from reducing the actual number of carriers on a route from two to one" and that "granting antitrust immunity has no significant effect on fares" and "carving-out from antitrust immunity the four oneworld overlap routes would impose harm on consumers equivalent to at least $55 million annually"[43]
- ■ Previous testimony has already thoroughly refuted the Willig/Compass Lexecon claims, the only evidence supporting the Joint Applicants competition claims.
  - ☐ My October testimony[44] demonstrated that the key claims (allowing two competitors on a route to collude via immunity, and that reducing the number of competitors on a route from two to one did not affect prices), were entirely based on a regression that did not correctly count the number of competitors historically serving a route. The regression input data explicitly assumed that immunized partners, such as Northwest and KLM on Detroit-Amsterdam, were independent price competitors, and that results linking price levels to the number of competitors on a route were fundamentally invalid since the independent variables were improperly calculated ("routes with 2 competitors" were a mix of routes with 2 actual competitors, and routes such as Detroit-Amsterdam with 1 actual competitor).
  - ☐ The Department of Justice's December submission[45] provided a much more exhaustive attack on the methodological problems in the Willig/Compass Lexecon regressions, and the DOJ submitted independent regression analysis demonstrating serious risks that reduced competition on nonstop routes would lead to higher prices. The DOJ regressions, based on data reflecting current market conditions, showed an average 15% fare increase when competition on a route was reduced from 2 to 1, and 6% when competition was reduced from 3 to 2 carriers. When the DOJ corrected the statistical flaws in the Willig/Compass Lexecon regressions, results supported the DOJ findings of consumer risks, and no longer supported the Joint Applicants' claims. The DOJ submission also presented Herfindahl-Hirschman Index ("HHI") measures of competition showing that these nonstop markets are already highly concentrated, and that under the *Horizontal Merger Guidelines* further reductions in competition could be presumed to create additional market power.

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[38] Joint Application (DOT-OST-2008-0252-0001) p. 7. 24, exhibit JA-13, JA-19 (the Brattle affidavit) . All references to docket materials in this submissions refer to public versions ; pagination may vary slightly from confidential versions
[39] Joint Application op.cit., Joint Applicants Consolidated Reply (DOT-OST-2008-0252-3314) p.19.
[40] Joint Application p. 35-41, Joint Applicants Supplemental Comments (DOT-OST-2008-0252-3357) p.4-9, Exhibit 1 (the Willig/Lexecon Compass affidavit)
[41] Joint Application p. 41-57, Supplemental Comments p.11-19, the Willig/Lexecon Compass affidavit
[42] Joint Application p. 41-57, Supplemental Comments p.4-9
[43] Willig/Lexecon Compass affidavit p.6, 13, 18, 22
[44] Horan comments, DOT-OST-2008-0252-3362
[45] Department of Justice comments, DOT-OST-2008-0252-3374, appendix A and B

- ☐ The Joint Applicants' claim that immunity would lead to increased capacity in these markets does not meet *Horizontal Merger Guidelines* standards as it is purely speculative (the Joint Applicants say they would look seriously at capacity increases but have made no commitments), but the DOJ submission refuted the counter argument that added hub-to-hub flights would mitigate pricing risks since any added capacity would be dedicated to connecting markets.[46] More importantly, the DOJ submission specifically identifies the huge barriers to potential future entry in these markets, an issue that is critical to any evaluation under the *Horizontal Merger Guidelines.*

A3. The Joint Applicants' $92 million Public Benefit claims are the largest and most important claim in their application, but neither the Department of Justice's comments nor other recent submissions properly addressed the deficiencies in this claims

- The DOT cannot accept the Joint Applicant's claim of $92 million in annual public benefits in connecting markets without
  - ☐ proper, verifiable, non-speculative evidence supporting the specific efficiency benefits that the Joint Applicants claim will be created if immunity is granted
  - ☐ proper, verifiable, non-speculative evidence supporting that these specific consumer benefits are highly likely to be achieved in the Applicants' markets under current market conditions
  - ☐ clear evidence that the claimed public benefits could not be achieved by reasonably available alternatives that are materially less anticompetitive
- The Department of Justice's comments did not directly address the Joint Applicant's claim that immunity would create $92 million in public benefits, but argued more narrowly that these benefits could be achieved without immunity[47]
- The Joint Applicant's claim that immunity will generate $92 million in annual benefits in connecting markets is entirely based on two theoretical assumptions
  - ☐ Assumption 1--Interline fares on carriers with antitrust immunity are always lower than interline or codeshare fares on carriers that do not have antitrust immunity because carriers without immunity are always structurally bound to the higher costs of "double marginalization" (i.e. successive markups). This structural efficiency advantage would be observed in any market and occurs independently of any other factors (supply/demand, competition, etc.).
  - ☐ Assumption 2--Introducing antitrust immunity to existing itineraries operated on a non-immunized codesharing basis would lead directly to fare reductions of 17.45%; this magnitude of fare reduction would occur in any market, independent of any other factors. These price reductions can be assumed even in markets where there is no evidence than non-immunized passengers currently pay higher fares than passengers traveling on online or immunized alliance services. These fare reductions would stimulate new traffic growth based on a price elasticity measure of -1.7.[48]
  - ☐ The $92 million in annual public benefits is calculated by applying the 17.45% price reduction to all AA-BA/AA-IB interline passengers identified in the 2007 DB1A data, and further increasing traffic based on the price elasticity factor. These welfare gains are claimed to be "annual"--ongoing and permanent; and would never be eroded or competed away by the marketplace.
- The sole basis for these two assumptions are theoretical arguments made in papers published by J.K. Brueckner in 2003 and W.T, Whalen in 2007, derived from a single jointly-authored 2000 paper[49]. The later papers updated regression analysis from the original paper but made no significant changes to the original theoretical arguments or conclusions.

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[46] The Joint Application shows (Supplemental Comments p.5) that the Dallas-Ft.Worth-London market already has 8 times as many seats as required to serve the local market

[47] Department of Justice comments, p. 22-29

[48] Brattle affidavit p 1, 5-8; also restated in Joint Applicants Consolidated Reply "Brattle Group reply to Frontier Economics". Brattle would have applied larger (22%) price reduction in non-codesharing interline cases, but these could not be identified in the DB1A data, so the more conservative 17.45% factor was applied to all coupons.

[49] Jan K. Brueckner, currently on the Economics faculty at the University of California-Irvine and W. Tom Whalen, currently with the Antitrust Division of the Department of Justice. Both were at the University of Illinois-Urbana-Champaign at the time of the original paper

- This comment will argue that the DOT must completely reject the Joint Applicants' claim of $92 million in public benefits in connecting markets as it not only fails to meet the evidentiary standards of the *Horizontal Merger Guidelines* but is demonstratively false. The Joint Applicants' claims totally rely on the Brueckner and Whalen theoretical arguments; if those arguments meet the *Horizontal Merger Guidelines* standards, then the DOT should affirm the Joint Applicants' public benefits claim. If those arguments do not meet the *Horizontal Merger Guidelines* standards, then the DOT should reject the Joint Applicants' claim. As a result, this comment will:
  - Describe the Brueckner/Whalen analysis and arguments from their published papers, including their regression analysis of (largely) North Atlantic data from the 1990s, following the introduction of the original immunized alliances
  - Describe the actual North Atlantic competitive environment of the 1990s and the actual competitive and efficiency advantages of the original immunized alliances, based on DOT data and market studies, but also based on my experience as one of the key people responsible for the development of the original KLM-Northwest alliance network, my subsequent strategic and network alliance work at Swissair and other carriers, and other work throughout my 25 year career directly relevant to the competitive issues raised by this case, including hub network development, mergers and consolidation, and revenue management.
  - Evaluate Brueckner and Whalen's statistical analysis, which is used to estimate the Joint Applicant's projected public benefits, and their theoretical arguments about "double marginalization", which are central to the Joint Applicants' claim.
- It must be emphasized that, while these comments will focus heavily on the Brueckner/Whalen theories and papers, the issue at hand is claims made by the Joint Applicants, not by Brueckner or Whalen personally, neither of whom has submitted testimony in this case.

A4. The "Economics Literature" supporting the claim that immunized airline alliances generate consumer benefits consists of a single jointly-authored paper, plus two follow-up papers by the same authors that updated regressions without changing the original arguments or conclusions.

- The "economic literature" on the price effects of international alliances consists of one journal article published by Brueckner and Whalen in 2000[50], and several follow-up pieces by the same authors offering minor updates on the original paper. That original paper outlined the material that was repeated, with minor modifications, in all subsequent papers, including
  - A statement of the general hypothesis that the "cooperative pricing" lowers airfares in connecting markets; each paper specifically noted that consumer benefits from lower airfares in these connect markets could be offset by reduced competition in hub-to-hub nonstop markets, and that the analysis in the papers was focused on connect market impacts, and was not intended as an evaluation of the overall welfare impacts of alliances
  - A description of the authors' behavioral theories about how interline prices are set in alliance and non-alliance situations, which underlay the authors' assumptions of structural barriers to efficient non-alliance pricing, causing cooperative alliance interline fares to always be lower than non-cooperative interline fares
  - A discussion of the authors' mathematical models of how interline carriers, alliance and non-alliance, maximized the difference between marginal revenue and marginal costs, which were then applied to a simplified (4 to 8 leg) airline network where there economies of network density and either positive or constant scale economies. Since it was assumed that the structural barriers inherent in non-alliance pricing imposed an efficiency penalty that immunized airlines did not face, solving these equations (not surprisingly) demonstrated that non-alliance interlining was always less profitable than alliance interlining
  - A discussion of the DOT DB1A data and the regression results, which confirmed the general hypothesis that alliance interline fares were materially lower than non-alliance interline fares.
- None of Brueckner or Whalen's follow-up papers made any significant changes to the approach or conclusions of the 2000 paper, and should not be seen as separate from the original analysis
  - Brueckner-Whalen (2000) also attempted to estimate the net welfare impact of a British Airways-American Airlines immunized alliance. This was calculated by applying the regression alliance coefficients to all BA-AA interline traffic, and applying the average price detriment from those regressions due to reduced

[50] Brueckner, J. K. and Whalen, W. T., (2000), "The Price Effects of International Airline Alliances", *The Journal of Law and Economics* v43 n2, p. 503

competition to traffic on BA-AA hub-to-hub flights. The welfare losses from reduced hub-to-hub competition eliminated almost most gains in connection markets, although the exact tradeoff depended on price elasticity assumptions.

- ☐ Brueckner (2001)[51] did not undertake any regression analysis, but fleshed out the behavior pricing theories and mathematical profit maximization model a bit. The paper introduced the terms "double maximization" and "negative externalities" as descriptors for the alleged structural inability of non-alliance carriers to optimize interline revenues.
- ☐ Brueckner (2003a)[52] was the first paper to recognize multiple levels of alliance codesharing, and updated the original Brueckner-Whalen (2000) regressions using 1999 data, which separately identified the "marketing" and operating carriers. The results indicated greater price reductions for alliances with antitrust immunity than for codesharing within alliances that did not have antitrust immunity.
- ☐ Brueckner (2003b)[53] summarized Brueckner (2003a) results for a more general audience, and estimated the benefit of Star Alliance codesharing in connecting markets. Like the earlier BA-AA analysis, this involved a simple application of regression coefficients representing "price benefits of alliances in connecting markets" to all Star Alliance connecting traffic. Brueckner did not attempt to weigh the connecting market benefits (roughly $80 million) against detriments from lost competition in overlap markets, but acknowledged these existed.
- ☐ Whalen (2007)[54] briefly summarized Brueckner's general hypothesis and theories of pricing behavior, and presented new regressions using 11 year panel data instead of cross-section data from a single quarter as the input to his regression. Panel data minimizes errors or false correlations in cross-section analysis that are due to factors such as length of haul or local route characteristics, although panel data can introduce problems due to temporal factors. Whalen also extended the database to include online connecting trips. His results confirmed the general hypothesis but found smaller price differences than Brueckner's cross-section analysis. A separate analysis found that the existence of an "Open Skies" treaty was actually correlated with higher average connecting fares than found in non-"Open Skies" markets.

■ All quantitative evidence of alliance pricing benefits quoted in these antitrust immunity cases are based on two regressions of data from the 1990s—Brueckner's cross-section analysis of 1999 data, and Whalen's panel 1990-2000 data. These (and the original 2000 regressions that were superseded by the 2003 work) are summarized in the table below.

publication	data used in regression	author's key findings about price differences based on regressions
Brueckner-Whalen 2000	3Q 97 (cross section) international interline connect trips in DB1A 46,620 trips in 16,765 O&Ds	alliance vs. non-alliance interline 24% total database 15% total US behind gateway 15-18% Transatlantic+Central America 52% US-Canada (8%) US-South Pacific 0% US-South America/North Asia
Brueckner-2003	3Q 99 (cross section) international interline connect trips in DB1A 54,687 trips in	ATI vs non alliance interline 17-31% total database 21-23% Transatlantic 22% total US behind gateway

[51] Brueckner, J. K., (2001), "The Economics of International Codesharing: An Analysis of Airline Alliances", *International Journal of Industrial Organization* v19, p.1474

[52] Brueckner, J. K., (2003a), "International Airfares in the Age of Alliances: The Effects of Codesharing and Antitrust Immunity", *Review of Economics and Statistics* v85 n1, p105. The paper cites Whalen as an uncredited co-author, and was actually completed in 2001.

[53] Brueckner, J. K., (2003b), "The Benefits of Codesharing and Antitrust Immunity for International Passengers, with an Application to the Star Alliance", *Journal of Air Transport Management* v9 n2, p83

[54] Whalen, W. T., (2007) "A Panel Data Analysis of Code Sharing, Antitrust Immunity and Open Skies Treaties in International Aviation Markets", *Review of Industrial Organization* v30 2007; most analysis was conducted years before and earlier working paper versions included Whalen, W. T., (2003) "Constrained Contracting and Quasi-Mergers: Price Effects of Codesharing and Antitrust Immunity in International Airline Alliances" and Whalen, W. T., (2005) "A Panel Data Analysis of Code Sharing, Antitrust Immunity and Open Skies Treaties in International Aviation Markets"

	17,518 O&Ds	non-ATI codeshare vs interline 7-10% total database 7-9% Transatlantic 5% total US behind gateway
Whalen 2007	11 year panel data 1990-2000 (3Q each) all US-Europe connect trips in DB1A; 120,758 coupons	17-23% online vs non alliance interline 17-20% ATI vs non alliance interline 6-9% non-ATI codeshare vs interline (3%) Open Skies vs. non-Open Skies

- Brueckner, the primary author, has been a paid advocate for United Airlines and the Star Alliance throughout the period when these pieces have been published[55], and in addition to the Brueckner (2003b) paper estimating Star Alliance consumer benefits, has presented testimony on behalf of the Star Alliance in the recent antitrust immunity cases.[56]
- It should be noted while he has consistently claimed that immunity generates sizeable consumer benefits, each of Brueckner's papers also raised some concerns about possible consumer detriments when competition is reduced in overlapping markets, and Brueckner has argued that the merger of the previously independent KLM-Northwest and Delta-Air France groups into a single entity was anti-competitive. Thus while Brueckner's published opinions are extremely consistent with the public positions of United Airlines and the Star Alliance, they are not necessarily consistent with the positions of other parties advocating international airline consolidation.
- Brueckner's papers can and should be evaluated on their own merits. Nonetheless, there is no basis for the claim by the Joint Applicants and other consolidation advocates for the claim that alliance consumer benefits have been well documented by an independent "economic literature"[57]. The entire basis for the claim consists of one article plus statistical updates, and the principal author serves as a paid advocate for United Airlines and the Star Alliance. They should not be evaluated any differently than the Brattle affidavit in the current case (written by paid advocates for American Airlines), or similar paid testimony in other cases.

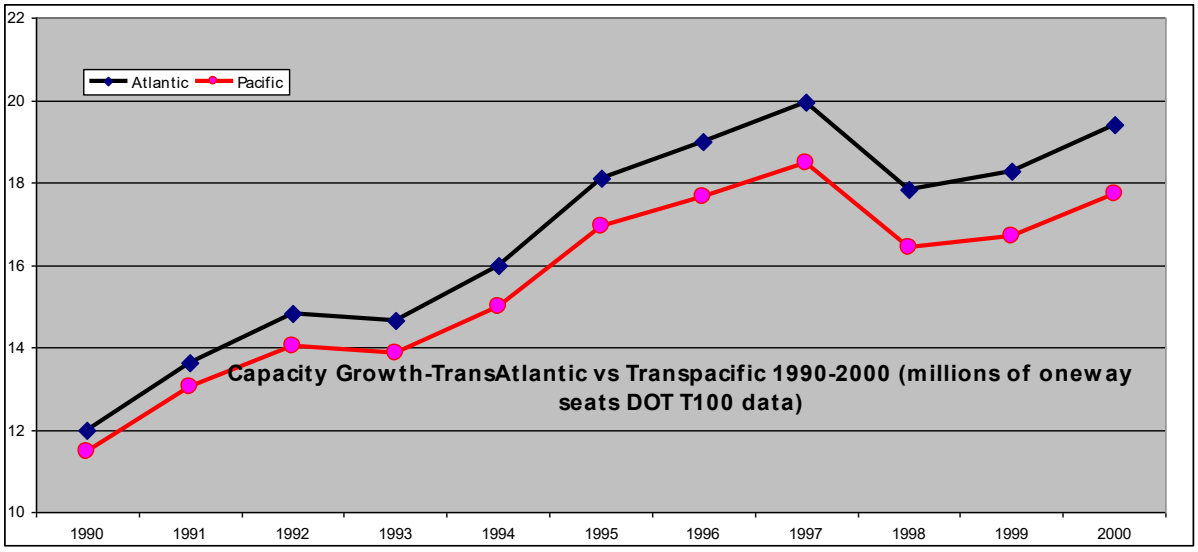
[55] Moorman, R. (2000) "United Turns to Academics to Show Alliances Aid Consumers", *Aviation Week and Space Technology* v153 n14 2 October 2000 p. 56 Brueckner's paid advocacy role was not disclosed in any of these papers.
[56] for example "An Evaluation of the Skyteam-Wings Antitrust Immunity Application" submitted in docket DOT-OST-2004-19214 and "An Evaluation of the Latest Star Alliance Application for Antitrust Immunity" submitted in docket DOT-OST 2005-22922. Since the AA-BA analysis in Brueckner-Whalen (2000), Whalen has not published any comments about any specific merger, consolidation or antitrust immunity proposal.
[57] The Brattle affidavit makes the "has been well documented in the economic literature" point at p.1. Another piece written by paid advocates for American Airlines claimed: "virtually every peer-reviewed academic study of immunized international alliances has concluded that, as a result of eliminating carriers' incentives to impose successive markups on fares for connecting tickets (the so called "double marginalization" problem), alliances have led to lower fares and expanded output", Kasper and Lee, "Why Antitrust Immunity Benefits Consumers" GCP Antitrust Journal, Sep. 2009;

B. THE ORIGINAL NORTH ATLANTIC ALLIANCES DID CREATE SIGNIFICANT CONSUMER WELFARE BENEFITS BUT WELFARE GAINS DUE TO ALLIANCE PRICING WERE VERY NARROW AND THESE WELFARE BENEFITS WERE FULLY EXHAUSTED BY THE LATE 90S

- The consumer benefits of the original North Atlantic immunized alliances (KLM-Northwest in 1992, Delta-Swissair-Sabena in 1995, United-Lufthansa-SAS in 1997) were driven by an efficiency enhancing network innovation—the use of codesharing and joint scheduling and pricing to create "quasi-online" service in a specific category of double connect O&Ds that prior to 1992 had only been served on interline services
  - Prior to alliances 70% of transatlantic demand had nonstop or true online connecting service via one of the many large network hubs, and these online carriers offered good schedules and a full range of discount fares; the other 30% of the market were required to use interline services where connections were often poor, and discount fares were more limited; the original alliances extended the schedule and pricing benefits that had always been enjoyed by passengers in 1-stop connect markets to passengers in the 2-stop double connect markets
  - The table below summarizes the competitive situation of the 1990s; certain carriers focused on the category (1) large nonstop O&Ds serving the largest markets (London, New York, Chicago); these nonstop services also provided capacity serving the category (2) 1-stop markets beyond their hubs; the new alliances had competitive advantage in the category (3) double connect markets where the non-aligned carriers could not compete and the only alternative was interline connections, but they also carried significant traffic in category (2) 1-stop markets

Mid 1990s Carrier Competitive Advantage by North Atlantic Market Category	% of total Trans-Atlantic market in these O&Ds in 1995	Did large non-aligned carriers (BA, CO,AA) have Competitive Advantage?	Did large immunized alliances (KL-NW, SR-DL) have Competitive Advantage?
(1) Nonstop O&Ds <gateway-gateway>	30%	**MAJOR ADVANTAGE**—major share of large nonstop O&Ds	**NO--UNCOMPETITIVE**
(2) Online 1-stop O&Ds not served by nonstops <beyond US-gateway EU> <gateway US-beyond EU>	40%	Could compete but no carrier had strong advantage	Could compete but no carrier had strong advantage
(3) Double Connect O&Ds with no online service <beyond US- beyond EU>	30%	**NO—UNCOMPETITIVE**	**MAJOR ADVANTAGE**—only alternative was interline service

- The consumer pricing benefits of the new alliances was significant but was strictly limited to the price reductions achieved in category (3) markets—the difference between interline prices and "online" alliance prices in these specific O&Ds that had been exclusively served on an interline basis
  - The new alliances served a significant amount of category (2) traffic, but these passengers in these markets already had online pricing, and thus the new alliances did not create any new pricing benefits for these passengers; the overall growth of these alliances would seriously overstate the size of the true pricing benefits
- Alliance pricing benefits were only a small part of the overall consumer benefits realized as a result of innovation and increased competition on the North Atlantic; evidence of consumer benefits (sustainable lower fares/increased service due to improved industry efficiency) is not always evidence of alliance benefits or pricing benefits
  - Consumers benefited whenever profitable new capacity added, as this growth put downward pressure on fares; most of this capacity growth of the 90s was due to favorable overall industry supply/conditions and was not alliance related. The graph below shows that seat capacity growth during the 90s on the North Atlantic (where alliances and codesharing were strong) tracks very closely to seat capacity growth on the North Pacific (where there was no antitrust immunity and codesharing was extremely rare); while alliance factors may explain the slightly faster growth on the Atlantic, it is clear that capacity growth was fundamentally driven by underlying market conditions, and those conditions explain a large portion of the pricing changes observed in the regressions.



- ☐ Consumer welfare was significantly increased by other non-pricing factors including increased market liberalization, the original Open Skies treaties, the growth of network hubs in the US (resulting from deregulation-based changes in the 80s), major improvements in European carrier efficiency (including the privatization of British Airways, and the consolidation of the Air France-UTA-Air Inter hub in Paris), major improvements in distribution and other information technologies, and the widespread introduction of 767 and A330 aircraft that made it possible to operate a much wider range of transatlantic flights profitably, and declining fuel prices. The "quasi-online" alliance network innovation was one of the benefits of increased transatlantic competition, but it was a small part of the overall picture.

■ The ability of the new alliances to generate significant consumer benefits depended on the convergence of three critical factors
  - ☐ Aggressive market-oriented, pro-competitive policies in both Washington and Brussels, including the Department of State's efforts use of ultra-liberal Open Skies treaties with countries like the Netherlands and Switzerland to encourage less liberal countries like Germany and France to remove traditional barriers to open entry and market pricing
  - ☐ The large, untapped, Category (3) double-connect market opportunity; prior to KLM-Northwest, no one had recognized the size of this segment (individual O&Ds were extremely small and highly fragmented); given the traffic potential, domination of this niche became the central focus of the KLM-Northwest's alliance.[58] The alliance's network coverage created significant marketing and distribution efficiencies, including strong market awareness in every US and European "beyond gateway" market that KLM-Northwest offered a full range of flights at competitive practices to every significant transatlantic destination. The success of KLM-Northwest and the other alliances in developing this category (3) niche was documented by several DOT studies at the end of the decade.[59]
  - ☐ The coincidental strongly favorable supply/demand conditions that made capacity growth profitable; the alliances' development of secondary connect markets would have been significantly riskier in an environment with low demand growth and overcapacity.

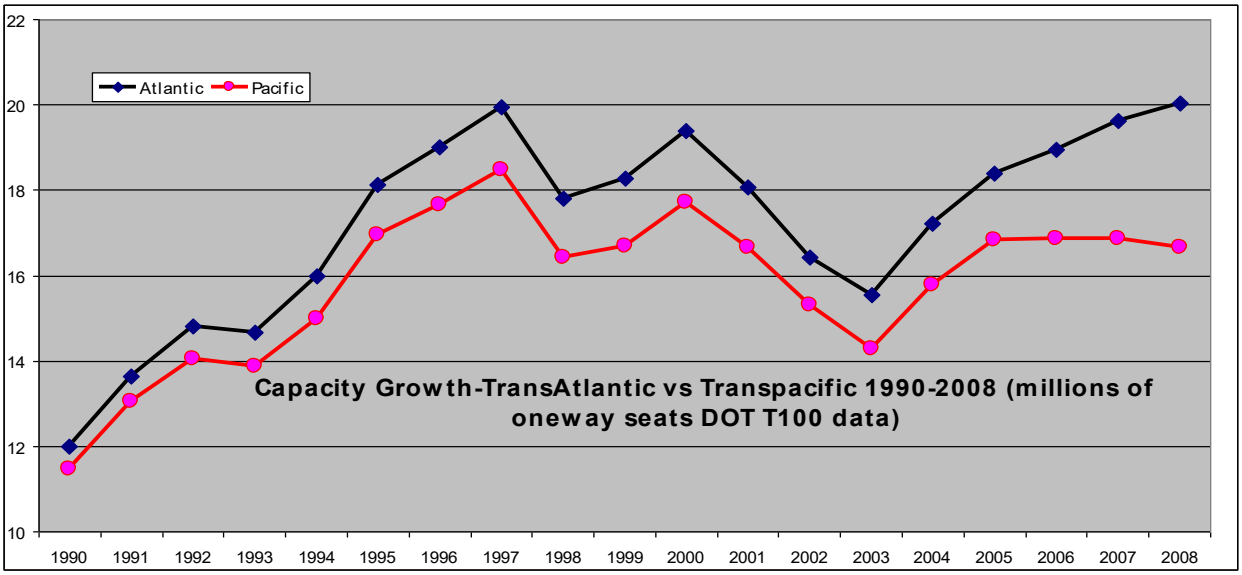
■ These incremental consumer benefits were fully exhausted by the end of the 90s; the alliances remained competitive, but were not introducing new efficiencies or reducing prices in any markets
  - ☐ As in any competitive market, the introduction of new efficiency enhancing innovation spurs some competitors to match the efficiency gains (via additional alliances or expanded direct services) and forces

[58] I was personally responsible for expanding alliance hub-to-hub flights from 3 to 10, all 747s and DC-10s, all of which were highly profitable, as part of a conscious strategy to exploit the alliance's first-mover advantage and establish a dominant position in this niche. The later Delta-Swissair-Sabena and Lufthansa-United alliances followed this exact network template, and rendered North Atlantic interline service almost completely obsolete.

[59] US Department of Transportation, Office of the Secretary, (1999) "International Aviation Developments: Global Deregulation Takes Off; US Department of Transportation, Office of the Secretary, (2000), "Transatlantic Deregulation: The Alliance Network Effect"

other capacity out of the market, and interline service had become totally irrelevant on the North Atlantic by 1999[60]. Alliances only create pricing benefits to the extent they introduce online pricing to a market previously only served by high fare interline services

- The category (3) double connect niche that drove all alliance pricing benefits also shrank dramatically with the major expansion of new nonstops, which shifted most category (3) O&Ds into online 1-stop category (2) O&Ds; many cities such as SLC, CLE, PDX, MEM, BCN, VCE, BHX received nonstop transatlantic service for the first time, as did major destinations in India, the Middle East and Africa that had previously required connections via European hubs
- Alliances are not generating any incremental consumer benefits in the low/negative growth environment of the last decade; transatlantic demand growth and profitability was halted by overexpansion in the late 90s, as carriers assumed growth driven by the one-time early-90s innovations and the dot-com bubble would be sustainable; capacity and traffic has only barely returned to peak 90s levels, and much of this may have been artificially supported by the recent financial bubble.



[60] While markets covering 30% of total demand were only served by interline services prior to 1992, interline trips accounted for 40-45% of total North Atlantic travel, since some passengers in category 2 markets used interline instead of available online markets. The Department of Justice's recent analysis of 2008 connecting travel showed only 7% of the coupons in its sample were interline trips, suggesting that interline travel probably accounts for less than 3% of the total North Atlantic. See Department of Justice, Comments on the Show Cause Order, DOT-OST-2008-0234-0239, p.49-51

C. THE BRUECKNER-WHALEN REGRESSIONS FUNDAMENTALLY MISREPRESENT THE HISTORICAL CONSUMER PRICING BENEFITS FROM ALLIANCE ANTITRUST IMMUNITY

C1. Almost all of the price reductions the authors attribute to "cooperative alliance interline pricing" can be better explained by improved supply/demand conditions and other changes in the marketplace

- Brueckner claims that antitrust immunity reduces fares by 17 to 30% and that his paper "measures the separate impacts of codesharing and antitrust immunity on the fares charged for interline trips".[61] He attributes all of the observed alliance benefits to pricing, specifically "the cooperative pricing of trips by the partners puts downward pressure on fares in the interline city-pair markets."[62] None of these papers are attempting to measure the overall benefits created by alliance expansion, they are specifically attempting to measure alliance pricing benefits. While there is no question that consumers benefited from lower fares in transatlantic markets in the 1990s, and these regressions show a clear correlation between "alliance presence" and "lower fares" in connecting markets, there is nothing in the data or analysis presented in these papers justifying the claim that "cooperative alliance interline pricing" behavior was the sole and exclusive cause of price shifts of this magnitude. This is an unsubstantiated theoretical argument based on claims of structural "double marginalization" barriers to efficient non-alliance pricing that will be discussed in section D, but the regressions provide absolutely no empirical data supporting the theoretical causation claim.
- The actual primary driver of the observed pricing changes was the highly favorable supply/demand and competitive conditions of the mid and late 90s. As shown in the graphs in the previous section, transatlantic capacity grew rapidly during this period (7.4% CAGR 1990-97, 4.9% CAGR 1990-2000[63]) with overall strong growth in international trade and travel. Some of this occurred in the hub-to-hub routes serving alliance connect markets, but the huge increases in nonstop and true online connect services would have had a much bigger impact on market price levels than the increased connecting service in markets that had no online service.
- As noted earlier, there were other important non-alliance factors that also contributed to the observed price changes, including pricing liberalization in Europe, carrier efficiency (the expansion of hubs serving intercontinental flights, marketing and distribution technology gains, 767 and A330 aircraft efficiencies), and declining fuel prices.

C2. The regression analysis seriously overstated the correlation attributed to "cooperative alliance interline pricing" by failing to restrict input data to the markets where these pricing benefits would have actually occurred

- Alliance connecting fares were in fact lower than pre-alliance interline fares, and alliance expansion did create legitimate consumer benefits, but Brueckner and Whalen seriously overstate this benefit by defining their data sets in a manner inconsistent with their own pricing hypotheses and inconsistent with the actual dynamics of these markets. As discussed in section B, alliance pricing benefits only occurred in category (3) double-connect markets that had only been served on an interline basis, and did not occur when alliances served category (2) connect markets that already had online service and prices. All of Brueckner and Whalen's papers explicitly assume that the "online" pricing the existed in category (2) markets prior to alliances was fully efficient. But their regressions overstate the benefit because the data includes a very large number of category (2) connect markets.[64] Category (2) is the most competitive category of markets on the North Atlantic since they can be served by every network carrier and all three alliances.[65] But "alliance price levels" in the regressions are being measured by the prices in a combination of category (2) and (3) markets, while they should have been measured solely based on the (higher) category (3) observations.
- Interline fares were also not properly restricted to category (3) markets, and "interline fares" were not defined in a way to show the actual pricing impacts. Most (if not nearly all) the interline coupons in Brueckner's 1999 sample

[61] Brueckner (2003a) p. 105. Whalen (2007) makes the narrower, more appropriate claims that "alliances are found to have significantly lower prices" or "are associated with" price benefits p.39.
[62] Brueckner (2001) p.1475
[63] DOT T-100 seat capacity data
[64] The regressions exclude category (2) traffic originating at US gateway cities served by European carrier nonstops (due to inherent limitations in the DB1A data), but include all other category (2) one-stop markets
[65] Category 3 markets can only be served by the three alliances, and category 1 market competition is a function of the number of carriers that choose to operate nonstops.

were incidental trips representing a tiny fraction of total demand in each O&D and wholly unrepresentative of any "market" price points. In 1999 almost every North Atlantic O&D would have had actual or alliance online service—any interline travel would have represented diversions due to flight cancellations or last minute emergencies or perhaps the occasional expense account traveler going out of his way to collect frequent flyer miles. By definition these tickets would show a high average fare, but they are meaningless in any evaluation of possible alliance price benefits. Brueckner's primary regressions includes interline prices worldwide, including markets where all prices are much higher than the North Atlantic. A legitimate attempt to estimate alliance price benefits would have been strictly limited to alliance versus interline coupons in the North Atlantic O&Ds that had no true online service, but none of these regressions were appropriately focused. These would have been included in Whalen's transatlantic panel data, but his data also included large quantities of unrelated non-category (2) market coupons.

- The analysis not only failed to limit the regression data to the appropriate markets, but the papers made no attempt to place their "17 to 30% lower price" type consumer welfare conclusions in any type of meaningful context. There is nothing in any of the papers that would help readers understand the magnitude of the alleged consumer benefits relative to the size of the overall market, or even to understand the scope of the markets in the regression relative to the size of the market. Despite an analytical scope specifically targeting "interline" traffic and markets, the authors made no attempt to show what portion of these markets actually use non-alliance interline ticket, or what percentage of the O&Ds in the regression were only served on an interline basis, and failed to show that these interline-only markets had almost completely disappeared by the end of the decade. An analysis appropriately targeted at category (3) interline markets might have found similar price reductions following the introduction of alliance online pricing, but from an economics and policy standpoint, it is much more important to understand what the actual historical consumer welfare gain from antitrust immunity had been, and whether there are opportunities for future gains in markets that could, but do not currently enjoy "online pricing".
- Any serious, carefully designed analysis of North Atlantic competition in the 1990s would show a clear correlation between the introduction and expansion of immunized alliance and growing consumer benefits (lower prices and increased capacity). But correlation does not equal causation. Not all of the observed consumer benefits would have been caused by alliances (most were caused by capacity growth, increasing liberalization, industry efficiency and other factors), and not all of the observed price reductions on alliance tickets were caused by efficiencies specifically related to antitrust immunity. A proper analysis of the North Atlantic would also show consumer benefits in general, and specific alliance pricing gains fully exhausted by the end of the decade.[66]

[66] See for example, Robyn, J., Reitzes,J. (2005) untitled paid analysis of the Skyteam antitrust immunity application prepared on behalf of American Airlines DOT-OST-2004-19214, Robyn, J., Reitzes,J. (2006) untitled paid analysis of the Star Alliance antitrust immunity application prepared on behalf of American Airlines DOT-OST-2005-22922

D. DOUBLE MARGINALIZATION DOES NOT EXIST, NEVER EXISTED, HAS ABSOLUTELY NOTHING TO DO WITH THE BENEFITS OF IMMUNIZED ALLIANCES, AND BRUECKNER AND WHALEN'S THEORIES ABOUT DOUBLE MARGINALIZATION ARE NOT SUPPORTED BY ANY DATA OR ANALYSIS

D1. Brueckner and Whalen specifically claim that all of their observed regression price correlations are due to the ability of cooperative pricing to eliminate "Double Marginalization" or "Double Markups" and that this is the primary consumer benefit created when antitrust immunity applications are approved

- Brueckner and Whalen's central "Double Marginalization" claim is repeated in each of their papers[67]. They believe that all of the price/alliance correlation in the regressions is caused by a "negative externality", a structural barrier that prevents non-alliance carriers from setting optimal interline fares, even when it would be in their joint economic interest to do so. The claimed structural barrier arises because non-aligned carriers allegedly establish "subfares" (prorates) for interline travel over their routes without any consideration of the prorate levels of connecting airlines, or any consideration of the joint interline fares that might result from the sum of these two prorates. This "noncooperative pricing of an interline trip leads to an excessively high fare which does not maximize joint profit"[68]. The two interline carriers are making "two separate markups" while immunized alliances and online carriers would only make one[69]. Because alliances can eliminate the "double marginalization", their interline fares are always lower than non-alliance interline fares[70]. Thus when Brueckner and Whalen solve profit maximization equations for alliance and non-alliance interline services, the non-alliance equation includes the efficiency penalty of the "double marginalization" and is always less profitable. The internalization of this "negative externality", is not just a useful feature, but is the primary benefit of immunized airline alliances.[71]
- The alleged efficiency penalty of non-alliance "double marginalization" is claimed to add $200 to the price of a round-trip ticket. Whalen cites an average non alliance fare of $929 in one of his regression sets versus an average immunized alliance fare of $727.[72] The idea that eliminating non-alliance "markups" would create a 25% efficiency gain is preposterous on the face of it; such an efficiency gain would be of the same order of magnitude of eliminating all wage and benefit expenses.[73] The Joint Applicants are claiming benefits of $257 per ticket in this case (applying the smaller regression gap between alliances and existing codeshares to higher 2007 fares). If $200-250 per ticket price reductions actually occurred in the market every time airlines received antitrust immunity, there would be ample evidence from multiple sources, and immunity advocates would not be relying exclusively on this academic paper.

D2. The entire "Double Marginalization" theory is based on unsubstantiated claims that normal competitive, rational, profit-maximizing behavioral assumptions do not apply to interline pricing, and the theory is fundamentally contradicted by actual airline pricing practices and systems

- Brueckner and Whalen's theory of "double marginalization" assumes physical barriers to optimal non-alliance interline pricing that do not exist and ignores the existence of revenue management. The assumed independent noncooperative processes with fixed (per route) mileage based prorates (derived from IATA practices) were

[67] Brueckner and Whalen (2000) p. 505-6, Brueckner (2001) p. 1477, Brueckner (2003a) p. 106, Brueckner (2003b) p.84-85, Whalen (2003) p. 2-4, Whalen (2005) p.2-4. Whalen (2007) omits the behavior explanation found in all previous papers, and simply notes that those papers identified a Double Marginalization problem, and that the regression analysis in those papers found a corresponding price difference p. 40

[68] Brueckner (2003a) ibid.

[69] Brueckner, J.K., Proost, S. (2009) "Carve-outs Under Airline Antitrust Immunity" CESIFO working paper

[70] Whalen (2005) p. 4 says that the double marginalization cost problem only exists when the two carriers have market power on their respective portions of the route, and can set price above marginal cost, but Whalen (2007) deletes all references to pricing power, but offers no alternate explanation for the alleged cost problem.

[71] Brueckner (2003b) ibid, Whalen (2007) ibid.

[72] Whalen (2003) p. 24. Other regression sets have slightly lower overall average fares, but average fares for key subgroups were not identified.

[73] According to its 10-K, wages, salaries and benefits accounted for 26% of American Airlines' total 2008 operating expenses.

abandoned decades ago[74]. Even carriers with limited automation were always fully capable of designing and adjusting interline fares to more profitable levels.[75]. Although interline fares were not easily handled by first generation yield management tools, interline fares are now easily linked to both carrier's inventory systems; prorates can vary by booking class, so that interline fares can be revenue managed just as effectively as online connecting fares.

- The "double marginalization" theory also assumes that fares are set with reference to the marginal cost of flight legs. This ignores overwhelming historical evidence that fares are set with respect to competitive "market prices" and not with respect to internal cost measures. The entire claim of "double marginalization" is based on "markups" above marginal cost, but the claim falls apart because real world airlines do not construct prices on a "cost plus markup" basis, and do not evaluate prices or prorates against marginal cost. If prices were set on a markup basis with respect to marginal cost-type measures, one would observe wild price fluctuations when fuel prices are volatile. If prices were set on a markup basis with respect to marginal cost-type measures, one would rarely observe price matching on competitive O&Ds, given underlying cost differences between carriers, aircraft and routings.
- Brueckner and Whalen's physical barrier theory explicitly assumes that alliance interline fares will always be lower than non-alliance interline fares, which would be irrational, and also ignores the basic "opportunity cost" logic behind inventory management at hubs, which focuses on revenue contribution/dilution[76]. Using "marginal cost" logic, Brueckner and Whalen falsely assume any "high" interline prorate suboptimizes joint revenue. Most KLM-Northwest alliance fares in the 90s might have been lower than most alternative interline fares, but rational, profit-maximizing airlines (alliance or other) will vary these levels based on specific opportunity costs and market conditions. Carriers with "high" prorates may be maximizing profits based on opportunity cost of connecting traffic from other routes. Connections over hubs with capacity limits and high local fares (London, Tokyo, New York) will have high prorates (to limit yield dilution) regardless of whether these are set on an immunized alliance arms-length codeshare or traditional interline basis. Connections over hubs with ample capacity and low local fares (Bangkok, Amsterdam, Los Angeles) are rationally set at lower levels. "High" prorates in very tiny interline markets may be entirely rational in the sense that the added pricing and revenue management costs needed to maximize joint traffic in each of the thousands of these markets could easily exceed the potential revenue gain. International codesharing and interline prorate arrangements have always been highly dynamic, as carriers adjust and cancel arrangements that are not profitable.
- The Brueckner/Whalen claim that there are behavioral barriers to optimal non-alliance prorate setting was never true, and is in fact a claim that market competition does not work. They claim that non-aligned carriers are incapable of improving or optimizing prorate levels even in the face of evidence that existing prorates do not maximize joint revenue. Thus the theory assumes that the classic models of dynamic competitive markets that apply well to every other category of airline pricing suddenly break down at the door of the interline pricing department.
  - This behavioral theory of competitive market failure rests upon the unsubstantiated assertion that at all non-alliance airlines, the process of establishing leg prorates is completely isolated from any consideration or publication of joint interline fares. "Neither carrier considers what effect setting a high prorate would have

[74] Brueckner (2001) claims that his noncooperative process is based on historical IATA practices, but then quotes Douganis (1985) *Flying Off Course*, saying that (even by 1985) major airlines almost never used IATA-derived prorate formulas. Brueckner (2003a) p. 108 also notes that most interline fares are in fact based on "special prorate agreements" that do not follow his model of separate leg prorates set in isolation of what interline partners are doing, and totally contradicts the "unavoidable externality" claim when he admits that those agreements "may produce fares not much higher than those observed under antitrust immunity".

[75] I worked extensively with SN Brussels Airlines, which between 2002 and 2009 was not a member of any alliance but had 35 different types of interline agreements with over 80 airlines, all administered manually. All agreements capable of generating significant traffic flows were carefully designed with respect of the competitive pricing situation in the interline O&Ds, and the local demand levels and patterns (time of day, day of week, seasonal) on each affected flight leg. Prorates were not fixed by route, but varied with the booking classes used, so that partners maintained full ability to limit interline sales that would dilute yields. "Default" prorates were used in low-volume cases, but these reflected the opportunity costs of capacity on individual SN flights, not distance based formulas.

[76] "Opportunity cost" is used in its revenue management context here; the opportunity cost of any potential new traffic flow is the revenue from the traffic it might displace; carriers would always set prorates higher than the "opportunity cost" level. With low load factors, this opportunity cost approaches zero. Actual evaluations would be based on a range of factors, including seasonality and how revenue management systems actually allot inventory to different fare categories.

on the other"[77] The authors explicitly assume that online fare setting is efficient, which implies they believe that online fare setting follows rational profit maximizing criteria, and is rapidly adjusted in the face of new information about the marketplace. However they offer no explanation of why rational, profit-maximizing logic cannot be applied to interline pricing

- ☐ Hub complexity cannot the source of the alleged structural problem; every large international carrier operates hubs, and its pricing staffs understand the process of prorating thru fares across connecting hubs, and how prorate formulas affect the profitability of the various long-haul and short-haul legs at the hub. Thus they would have a very strong understanding of how any given prorates or joint fares would affect the profitability of a potential interline partner, and could negotiate joint fares within ranges that would be profitable for both carriers. Information cannot be a serious issue; thanks to highly sophisticated yield management and route profitability systems, airline staffs have detailed information about leg contributions, can establish the "opportunity cost" of any potential new revenue flows, and can readily understand how other airlines would value these interline opportunities.[78]

- ■ Brueckner and Whalen's theory of structural barriers causing competitive market failure cannot be accepted without substantial real-world examples of carriers refusing to introduce or adjust prorates to levels that would increase total revenue contribution. As noted above, the existence of interline fares that are higher than online or alliance fares does not demonstrate suboptimality, as there could be many rational reasons for maintaining "high" prorates in these cases. The inability of airlines to agree on joint interline fares is also not evidence of irrational suboptimalilty, as there are many cases where there is no jointly beneficial solution.
  - ☐ Whalen's analysis illustrates that interline negotiations normally only have a limited set of jointly beneficial solutions. He presents a detailed comparison of hypothetical alliance and non-alliance interline negotiations, showing the full range of possible prorates that would be profitable for both carriers.[79] In Whalen's example there is a narrower range of solutions beneficial to both carriers in the non-alliance case because of the structural "double marginalization" costs he has assumed, but a similar result would hold if the assumed higher costs were due to higher "opportunity costs" of displacing high yield traffic, and there would certainly be cases where "opportunity cost" differentials lead to higher alliance versus non-alliance prorates. Irrational suboptimization would only occur if there was a consistent pattern where non-alliance carriers failed to achieve recognized opportunities beneficial to both carriers existed, consistently reducing their own profits. His example assumes price in the interline O&D is 3-4 times greater than cost, while in the real world airlines evaluate traffic options with only razor-thin margin. In that world the opportunities to improve joint profits via lower prorates would be rare, and it would be entirely rational to turn down most requests to lower prorates.

- ■ . There has been no research showing that any carriers currently set interline prorates or joint interline prices following the approaches theorized. None of the hundreds of non-aligned airlines in the world seem to think that "double marginalization" exists, since none of them have undertaken any efforts to minimize or overcome the huge ($200-250 per ticket) competitive pricing disadvantage it is alleged to create.

<u>D3. The market issues that Brueckner and Whalen have improperly attributed to structural barriers and "Double Marginalization" can be readily explained by factors unrelated to antitrust immunity</u>

[77] Whalen (2003) p.3. In certain situations, carriers might rationally set default prorates "in isolation", based on the opportunity costs on a route. USAirways might have a default prorate available for its midday Los Angeles-Las Vegas flight available to transpacific carriers with morning arrivals at Los Angeles interested in selling the connection, and given modern revenue management systems this default prorate might be very close to an optimal level. But the "double marginalization" theory specifically claims that USAirways would refuse to alter this prorate, even if a transpacific carrier proposed an alternative that would be more profitable for USAirways.

[78] The authors make passing reference to "double marginalization" in the literature on negotiation within vertical industries, but this is largely focused on firms that have very limited information about the costs, internal operations and profitability of competitors, conditions that do not apply to aviation. Ironically, the authors apply the low-competitive information concept of "double marginalization" to an analysis based on DB1A, a comprehensive database that provides competitors with near-perfect information about pricing in every significant market.

[79] Whalen (2003) p. 14-15 and Figures 1,2 p.35

- Brueckner and Whalen's papers have totally mischaracterized the actual nature of the efficiencies achieved by the original 90s North Atlantic alliances. As discussed in section B, real consumer-welfare enhancing benefits were created, but they were strictly of function of the unusual opportunity presented by the category (3) double-connect markets. There was not only the "online vs. interline" price benefit, but more importantly, there was the marketing/distribution efficiency opportunity created by the large size of the category (3) niche. The size of the market, combined with the size of the KLM-Northwest pricing advantage created the opportunity to quickly and cheaply establish powerful brand awareness among frequent travelers and travel agents in all of these many non-gateway cities. KLM-Northwest had no efficiencies allowing them to determine profit-maximizing levels of connecting fares any better than codesharing or non-aligned carriers. On initially entering the large set of category (3) double-connect markets, they did exploit brand marketing efficiencies, but these were the same efficiencies any hub network operator would enjoy against point-to-point competitors[80], and were not a unique function of antitrust immunity.
- To the extent that there was a historical obstacle limiting the spread of interline fares, it had nothing to do with alliances, but was due to the major economic differences between shorthaul and longhaul flights. Prorate formulas—the 1960's IATA formulas, the formulas currently used in every carrier's pricing and route profitability systems, and everything in between—all attempt to reflect the nonlinear relationship of operating costs and length of haul. Unit costs accelerate rapidly with shorter flights, more rapidly than unit revenues do in the vast majority of markets. Prior to deregulation, the CAB imposed pricing formulas that did not reflect the underlying cost curves, creating structural profitability problems for local service carriers, and artificial advantages for trunk carriers operating longhaul routes. The problem can be seen today within the route profitability reports of hub operators, most clearly at large European hubs like Amsterdam or Frankfurt that have a distinct mix of short 60-90 minute flights, and longhaul intercontinental flights, where shorthaul flights carrying significant connecting traffic will appear very unprofitable, while the longhaul connecting flights appear highly profitable.[81] The obstacle here is that it is extremely difficult to find jointly beneficial joint fares in longhaul-shorthaul situations, where the very low shorthaul prorate will rarely approach the opportunity cost of alternative local or short-haul connecting traffic. KLM-Northwest and the subsequent North Atlantic alliances did not break through this barrier because of an ability to internalize "double markups" as Brueckner and Whalen claim, but because the North Atlantic alliances, by pure happenstance, paired partners with highly parallel networks. In each case partners had equivalent longhaul operations and equivalent shorthaul feeding flights, so there was no "big prorate vs. small prorate" or other type of structural imbalance. Despite the proven success of the North Atlantic alliances, this model has not been duplicated in any other market, because the parallel markets needed to ensure mutual benefits and to facilitate cooperation between independent companies does not exist.[82]
  - In the environment of the 1990s, KLM-Northwest would have never been able to stumble onto and figure out how to exploit this market opportunity without antitrust immunity,[83] but effective, efficient prorate and

[80] The initial KLM-Northwest versus interline competition was analogous to a new hub entering markets previously served by fragmented point-to-point flights.

[81] In one of the first KLM-Northwest alliance network meetings I attended, we worked with our KLM counterparts to show them that the Amsterdam-Heathrow route was not the biggest money losing route on their system, and why the cutbacks they were planning would be highly damaging to profitability. Their Heathrow route P&L accounting data was accurate, but did not show the value of longhaul connecting revenue that would be lost if flights were cut. Several years later, after reviewing similar route P&L data, Sabena did eliminate its Brussels-Heathrow route, reducing profitability by tens of millions of US dollars.

[82] For example, a hypothetical immunized alliance between Lufthansa and Thai Airways would offer Thai nearly 100 important connecting destinations beyond Lufthansa's hub, but Thai only operates a handful of routes at its Bangkok hub where Lufthansa-Thai alliance connections would be meaningfully competitive. Under a KLM-Northwest revenue sharing approach, even with metal neutrality, Lufthansa would be saddled with a disproportionate share of low value shorthaul prorates, which might not only displace high-fare intra-European short haul passengers, but longhaul passengers that Lufthansa could have carried on its own longhaul flights. With today's systems, a jointly profit improving system could certainly be designed, but even in the absence of any regulatory or antitrust issues, the net gains might not justify the required investment.

[83] As with most efficiency enhancing innovations, the importance of luck and the lack of prior understanding of the true opportunity cannot be overstated.

revenue sharing approaches for these types of parallel alliances are now well understood, and could now be applied without immunity.[84]

- ☐ Codesharing at hubs between mainline and regional carriers further illustrates the longhaul-shorthaul prorate imbalance issues, and disproves the claim that productive international alliances are impossible without full antitrust immunity. No regional operator could exist without extensive revenue and network integration with the mainline partner. This can be solved with common ownership (as with American Airlines and American Eagle), but this approach has many disadvantages and is now exceptional, and airlines have devised a range of contract structures that can allocate market and financial risks in different ways.

D4. Anticipating the Joint Applicant's use of their regression results in the current case, Brueckner and Whalen use their regression coefficients to predict consumer benefits in other, unrelated markets, but do so in ways that violate the basic logic of their "Double Marginalization theory

- ■ Brueckner and Whalen's theory says that consumer benefits from collusive alliance prices will occur totally independent of market and competitive conditions, because every interline fare in every market suffers from the same structural "double marginalization" cost problem, and thus any immunity grant will internalize the problem, and will directly lead to lower fares. In line with the presumed universal truth of this "immunity always lower fares 17-30%" claim, their papers provide two examples using their regression coefficients to predict future price changes in other markets
  - ☐ The Brueckner-Whalen (2000) analysis of a potential British Airways-American Airlines alliance took the 25% price/alliance correlation found in the original regression and then simplistically claiming that the fare on every BA-AA interline itinerary would immediately fall 25% as soon as immunity was granted, creating a direct annual consumer welfare gain between $48 and $65 million[85].
  - ☐ Brueckner (2003b) applies the same simplistic approach in reverse, taking a 27% "benefit" rate from the later regressions, and then claiming that if the United-Lufthansa-SAS alliance suddenly lost its antitrust immunity, its interline fares would immediately rise 27%, leading (after knock-on effects) to a consumer welfare loss on the order of $80 million annually.
- ■ Applying coefficients from these regressions to future cases in different markets is only plausible if one accepts that none of the regression correlations were explained by 1990s market conditions and one accepts the full logic of the structural barriers/double marginalization theory, but even under these dubious conditions, the forecasting use of the coefficients in these papers violated the logic of that theory.
  - ☐ The BA-AA forecast erroneously assumes that every current BA-AA interline ticket is sold in a market that has no existing online or alliance interline service. In fact Brueckner and Whalen made no effort to determine what markets these passengers flew in, or whether they were even paying higher fares than passengers in other connecting markets were paying. Given the broad market coverage of the existing KLM-Northwest, Delta-Swissair-Sabena and United-Lufthansa-SAS alliances at the time this was written, it is safe to assume that the vast majority of this traffic, perhaps over 90% was in markets that already had the benefit on online or alliance pricing, and the claim that all these BA-AA interline tickets were sold at rates 25% higher than ones in comparable alliance and online markets is wildly implausible.
  - ☐ The Star Alliance calculations assume that if the alliance lost immunity, none of its current passengers could find equivalent fares on other alliances or online carriers, and that United, Lufthansa and SAS, after six years of immunized cooperation. They would not only be totally incapable of establishing any type of alternate codesharing arrangement, but since they would have reverted to "double maximization" practices, they would be establishing leg prorates with markups over marginal costs, would do in isolation of the pricing situation on any interline market, and would refuse to consider any proposals from their former partners to alter these prorates to levels that would increase joint profits. Brueckner also calculated transatlantic consumer impacts using the 27% factor from his worldwide regression, instead of the 21% factor from his

[84] For discussions of approaches see Gellman Research Associates (1994) A Study of International Airline Code Sharing. Department of Transportation Office of Aviation and International Economics

[85] The data presented in the paper is from the DOT DB1A ten percent sample, and must be multiplied by ten to produce the full estimated marketplace impact. None of Whalen's writings after the BA-AA analysis in the original joint 2000 paper use regression results as predictive of impacts in other markets

transatlantic regressions, suggesting this analysis may best be viewed as corporate advocacy, and not serious academic research.

D5. Brueckner and Whalen claim that "Double Marginalization" is a structural issue inherent to alliances, and that any and all new immunity grants would create similar consumer gains (due to the internalization of these barriers) is fundamentally false, and is contradicted by all available evidence

- The Joint Applicants' claim of public benefits in connecting markets totally depends on the claim that "double marginalization" not only exists, but would have the powerful effect on consumer prices (17-30% reductions, $200-250 per ticket) any and every time a new grant of immunity was made, regardless of supply or competitive conditions in the specifically affected markets at the time of the immunity grant. Neither the Joint Applications in this case, or any prior applicants for antitrust immunity, have submitted any proper, verifiable, non-speculative evidence of this alleged universal causal link between immunity and lower connecting fares except for citations of the Brueckner/Whalen articles discussed here. All other available evidence directly contradicts the Joint Applicants' claims.
- In order to claim that the Brueckner/Whalen regression coefficients can be used to predict price effects in other, unrelated, markets, one must demonstrate that their regressions were able to surgically isolate the "cooperative alliance pricing" impact on interline prices from all other marketplace factors influencing these fares, including supply levels, efficiency improvements, and the general level of fares in the 70-95% of all markets served by true online services. This would be an astounding statistical claim, but it is not supported by any analysis showing similar price effects in any post-1999 markets, and it is not supported by analysis putting the alliance impacts in the context of the broader North Atlantic consumer pricing gains that occurred during the mid 90s.
  - ☐ If one is to argue that these regression perfectly isolated the impact of "cooperative alliance pricing" from all other possible factors, then one must be willing to argue that the consumer benefits actually enjoyed by KLM-Northwest and Delta-Swissair passengers in the 90s, was not the 17-30%, or $200 per ticket identified here, but a substantially greater number. One must conclude either that these immunity grants were the single most economically beneficial decision in the history of aviation, or that the "double marginalization" coefficients cannot be used in forecasts.
  - ☐ If immunity grants really did drive these huge (17-30%, $200-250 per ticket) type of price reductions under any market condition, there would be ample evidence, in DB1A and other industry databases, that one could use to support the claim. Neither the Joint Applicants, nor anyone else, has produced any such evidence.
- Neither Brueckner, Whalen, or anyone else has replicated these "17-30%" type results in any regressions of any other markets. The analysis that has been conducted shows absolutely no evidence of "market-independent cooperative alliance pricing" consumer benefits, and tends to support the claim that consumer benefits, if they exist, are not large enough to offset the consumer welfare losses due to reduced competition.
  - ☐ James Reitzes and Dorothy Robyn of the Brattle Group, the authors of the Brattle affidavit in this Joint Application, also submitted analysis on behalf of American Airlines in the Star I and Skyteam I cases.[86] These affidavits updated analysis of transatlantic market growth since the initial introduction of antitrust immunity that had been performed by the DOT in 1999 and 2000.[87] The new analysis found that the pro-consumer pricing trends of the 1990s had been reversed, and that the greatest 1999-2005 price increased had come in the connect markets predominately served by carriers with antitrust immunity. Prices had increased 21% across the entire North Atlantic (CAGR 3.5%) and 23% in category 3 double connect markets, despite flat capacity. This suggested that whatever efficiency/consumer benefits had been generated by the original alliances had been short-lived, and had been fully offset by increased pricing power. It also suggested that the later Star Alliance immunity grants did not have the "17 to 30%" level effects that the earlier alliances were alleged to have, and had no impact after 1999.
  - ☐ In the Continental/Star Alliance case, The Department of Justice presented original statistical analysis of price differences in connecting North Atlantic markets based on DB1A data from 2005 through 2008.[88] The results directly contradicted claims of "double marginalization" and immunity efficiencies. Interline tickets only comprised 7% of the total sample, suggesting that interline only accounted for 3-4% of total North

[86] Robyn, J., Reitzes,J. (2005) and. (2006) op. cit.
[87] DOT, op.cit
[88] Department of Justice, Comments on the Show Cause Order, p.49-51

Atlantic travel. The analysis found that immunized alliance fares were 2.1% higher than online fares and 3.6% higher than non-immunized codeshare fares. This contradicted the claim that immunized fares would be lower than non-immunized codeshare fares because of "double marginalization" problems, and lent further support to concerns that the immunized alliances had developed market power and were not maximizing consumer welfare.

- ☐ In the current case the Department of Justice conducted further new analysis of connecting market fares based on 3Q2008 DB1A data, with results further broken down by alliance group.[89] This confirmed the earlier conclusion that current market data did not support claims about "double marginalization" and immunity efficiencies, and the DOJ specifically noted that they "make no representation that fare differences across tickets, as estimated by this type of work, are informative about causality between immunity grants and double marginalization". The results found that Oneworld codeshare fares were 1.6% less than Oneworld member online fares, undermining the Applicants claim that immunity is needed to reduce artificially high non-immunized fares. The results also found that Skyteam immunized fares were 7.2% higher than Skyteam non-immunized fares and that Star immunized fares were 11.7% higher than Star codeshare fares.

- ■ The argument "consumers benefit from international collusive pricing arrangements" is explicitly saying "consumers benefit whenever international competition is eliminated". If this were true, it would require rethinking a great deal of antitrust and industrial organization theory. But if each new immunized alliance actually generated price cuts on the order of 17-30%, or $200-250 a ticket, then the rethinking would undoubtedly be worthwhile.
- ■ All of the available evidence suggests that the two Brueckner/Whalen regressions failed to surgically isolate "cooperative alliance" pricing effects in connecting markets from the many other factors influencing these prices. The observed correlations between "17-30% price reductions" and "alliances" is not explained by "the internalization of double markups" which does not happen. The correlations are likely to be largely, if not fully explained by the marketplace changes described in section B, including strong, profitable capacity growth, market liberalization, and efficiency growth. The original antitrust immunity grants undoubtedly contributed to these overall effects in the mid 90s, but specific alliance pricing benefits would have been limited to one segment of the markets, and would have been fully exhausted by the late 90s, as "online" schedule and pricing options expanded from 60-70% to nearly 100% of the market.
- ■ Since there is no demonstrated "universal market-independent cooperative alliance pricing" impact, it is totally inappropriate to apply the coefficients of these two regressions to any other markets with different supply or competitive characteristics. The Joint Applicants are specifically claiming that regressions reflecting the highly competitive, strongly profitable, high demand growth 1990s North Atlantic can be used to predict price effects in 2010. This is the equivalent of saying that an analysis of the price impact of new low cost carrier entry onto markets solely served by Legacy carriers in the 1990s can be used to predict the price impact of the entry of a low cost carrier onto a market already served by other low cost carriers in 2010, when the pricing and efficiency gap between low cost and Legacy carriers was substantially smaller than it had been. This is the equivalent of saying that an analysis of the price appreciation of Las Vegas housing in the 1990s can be used to predict the exact level of housing appreciation in 2010. The Joint Applicants' use of these regressions to forecast future price reductions is completely indefensible and the consumer benefit claims based on those "predictions" must be rejected.

E. THE JOINT APPLICANTS' CLAIMS OF $92 MILLION IN ANNUAL PUBLIC BENEFITS IN CONNECT MARKETS MUST BE REJECTED. IT NOT ONLY FAILS TO MEET THE MINIMIMUM REQUIREMENTS OF THE HORIZONTAL MERGER GUIDELINES, BUT THE CLAIM IS DEMONSTRABLY FALSE.

<u>E1. The Joint Applicant's Claim of $92 million in annual public benefits in connect markets is entirely based on two demonstrably false assumptions, and thus must be rejected in its entirety.</u>

■ The Joint Applicant's public benefit claim depends on the false assumption that there are structural "Double Marginalization" barriers to efficient non-alliance pricing that would be found in any and all non-alliance cases as these barriers are independent of market or competitive conditions.

[89] Comments of the Department of Justice, p.22-4

- ☐ There have never been serious structural or behavior barriers preventing non-immunized carriers from setting rational, profit maximizing interline fare levels; carriers do not set prorates in total isolation of interline markets and partners as the "double marginalization" theory assumes, and do not refuse to consider more jointly beneficial alternative prorates
- ☐ "Double markups" never existed because airlines never price on a "cost plus markup" basis;
- ☐ The general claim that "high" interline prorates are evidence of structural barriers because they are inherently suboptimal is false; there are many examples of rationally higher prorates, and the theory is not based on any actual examples of irrationally suboptimal pricing;
- ☐ Efficient interline pricing can be managed at small airlines with limited automation, and is easily managed via fare mapping at any carrier using modern revenue management tools;
- ☐ The marketing efficiency of the original 1990s North Atlantic alliances had nothing to do with pricing; the actual brand awareness and distribution efficiencies achieved are found in any "hub network versus point-to-point" situation and were not uniquely caused by antitrust immunity
- ☐ Historical limitations to more widespread interline pricing had nothing to do with the lack of alliances or antitrust immunity but was due to the inherent difficulty of establishing jointly profitable interline fares between longhaul and shorthaul operators.
- ☐ None of the statistical analysis in the Brueckner and Whalen papers demonstrates the existence of "double marginalization" or any related structural barriers or supports the claim that it is the cause of higher non-alliance prices; there is absolutely no empirical evidence that the theorized structural barriers to efficient interline pricing actually exist.

■ The Joint Applicant's public benefit claim depends on the false assumption that non-immunized interline fares are always higher than immunized alliance and online connecting fares in all situations, regardless of market or competitive conditions, and that these higher non-immunized fares would immediately fall to the lower immunized/online level upon grant of immunity

- ☐ The only legitimate historical case of consumer pricing benefits from immunity occurred in the 1990s in a specific range of double-connect North Atlantic markets that had no online service, where new alliances prices were substantially lower than the previously available interline prices; this benefit is only possible in cases where new alliance service enters an O&D solely served on an online basis; "interline-only" O&Ds had been almost completely eliminated on the North Atlantic by 1999, and thus it would not be possible for any new alliance to achieve material pricing benefits from this source.
- ☐ Brueckner and Whalen's regression correlations between "alliances" and "lower prices" vastly overstate the claimed alliance pricing benefit, as their regressions were not properly restricted to the double-connect, interline-only markets and included many markets that already had online pricing. There were major consumer benefits realized on the North Atlantic following the introduction of alliances in the mid 90s, but most were due to non-alliance factors including profitable capacity growth and hub expansion, market liberalization, increased carrier efficiencies due to fleet and technology improvements, and lower fuel prices. The consumer benefits due to alliance pricing in previously interline-only markets had been fully exhausted by the end of the decade, and all of the available empirical evidence shows that the consumer welfare impact of antitrust immunity grants since 1999 has been negative.
- ☐ The Joint Applicant's' provided no evidence that their current non-immunized codeshare and interline fares in any given market are higher than competitive online and alliance fares, much less evidence showing that they are 17.45% higher as their testimony claims; Neither the Joint Application or the Brueckner and Whalen pricing theories are supported by any empirical evidence that non-immunized carriers publish higher fares than online and alliance carriers in any given market, and the claims of structurally higher non-immunized fares would contradict all historical evidence that airlines with comparable products cannot sustain higher than "market" fares in competitive O&Ds.
- ☐ The Joint Applicants' claim that non-alliance fares are structurally higher than alliance fares is based on the false assumption that all of these competitors set fares on a markup basis relative to a marginal cost-type measure; if this were true, airline fares would fluctuate wildly with volatile input costs such as fuel. If a given interline fare was rationally profit maximizing prior to an immunity grant, it would irrational to reduce it after an immunity grant. Since there is no evidence that current fares are irrationally set above profit-maximizing levels, there is no reason to believe that an immunity grant would systematically reduce fares.

- There is no empirical evidence of any fare reductions directly attributable to any antitrust immunity grant in the last decade, and certainly no evidence of fare reductions of the 17-30%, $200-250 per ticket magnitude suggested by the "double marginalization" theory and claimed by the Joint Applicants.
- Since the Brueckner and Whalen theories and regressions do not justify the "universal market-independent cooperative alliance pricing" impacts claimed by the Joint Applicants, there is no basis for using coefficients from those regressions as the basis of predicting such alliance pricing impacts in today's market.

E2. The Joint Applicant's Claim of $92 million in annual public benefits completely fails to meet the evidentiary standards of the Horizontal Merger Guidelines, and must be rejected in its entirety.

- The Joint Applicants have failed to provide proper, verifiable, non-speculative evidence that the claimed structural "double marginalization" barriers to efficiency actually exist
  - The cited Brueckner and Whalen "double marginalization" theories do not constitute legitimate evidence of actual barriers to airline efficiency
  - The cited Brueckner and Whalen "double marginalization" theories are not supported by their own empirical evidence or any other independent analysis showing systematic barriers to non-immunity pricing efficiency, all of the assumptions underlying the theory can be plausibly challenged, and there are highly plausible alternate explanations for all of the evidence they cite in support of their theory
  - The credibility of the theory must be questioned further given Brueckner's longstanding role as a paid advocate for another airline with similar interests in reduced competition among international airlines
  - The Joint Applicants' failed to provide any other evidence supporting their "double marginalization" claim.
- The Joint Applicants have failed to provide proper, verifiable, non-speculative evidence that the proposed immunity grant would lower prices in the specific markets served by the applicants, under current market conditions.
  - The Joint Applicants provided no evidence that the current interline pricing functions of British Airways, American Airlines, Finnair, Iberia or Royal Jordanian actually suffer from any of the structural inefficiencies implied by the "double marginalization" claim
  - The Joint Applicants provided no evidence that their current interline pricing is currently above online or alliance levels in the markets where it currently provides service
  - The Joint Applicants provided no evidence of any specific consumer-welfare enhancing price reductions it would make in any market it currently serves following a grant of immunity, and no evidence that these merger-specific changes would create $92 million in annual public benefits.
- As has already been shown in the comments of the Department of Justice[90], the Joint Applicants provide no proper, verifiable, non-speculative evidence that it would be unable to provide the alleged consumer pricing benefits in the absence of a grant of immunity, although this point is mooted by the lack of evidence for the alleged consumer pricing benefits.
- As the DOT has acknowledged on many occasions, the law places the burden of proof on the carriers requesting exemption from the antitrust laws; this burden has clearly not been met.

Respectfully submitted,

Hubert Horan
8 January 2010

[90] DOJ comments, DOT-OST-2008-0252-3374 p. 22-28

MOTION FOR LEAVE TO FILE AND
SUPPLEMENTAL COMMENTS OF HUBERT HORAN
AMERICAN AIRLINES-BRITISH AIRWAYS-IBERIA-FINNAIR-ROYAL JORDANIAN
JOINT APPLICATION FOR ANTITRUST IMMUNITY
DOCKET DOT-OST-2008-0252
31 January 2010

MOTION FOR LEAVE TO FILE

On January 10th, I filed public comments in response to the Department of Justice's December Comments.[91] These comments were filed during the public comment period established by the Department's order of 22 December.[92] My comments were filed via regulations.gov and have been available to the Department and the public since 11 January 2010.[93] My comments were largely focused on the Joint Applicants' claim that a grant of antitrust immunity would generate $92 million in annual public benefits due to lower fares in connecting markets—the largest and most important economic claim in their application. The Department of Justice took no position on the legitimacy of this claim, but argued that if any such consumer benefits existed, they could be largely achieved without a grant of immunity. My comments challenged the DOJ position that the possibility of benefits of this magnitude could be assumed without analysis or other scrutiny.

On 28 January, while discussing an unrelated matter on a separate case, a DOT staffer informed me that my public comments had been rejected by the Department, and the evidence I presented about the public benefit claims would be totally ignored. This was because I had failed to meet the requirements of 14 CFR 302.07 mandating email or physical distribution to all parties to the case, and inclusion of a signed "certificate of service" stating that such distribution has occurred. Although the Department actively encourages public comments via regulations.gov, and there is nothing in 14 CFR 302.07 specifically precluding the use of docket management systems such as regulations.gov as a means of distributing case filings, I was told that the Department interprets 14 CFR 302.07 to mean that evidence introduced by filings distributed solely via regulations.gov are wholly inadmissible. I had no knowledge of this issue prior to 28 January, as the Department had (and has) not provided me with any official communication indicating the deficiency or its intention to reject the comments. I have not received any informal communication about any deficiency other than the "certificate of service" issue.

I am filing this motion for leave to refile my original 10 January comments, including the missing certificate, that will bring my filing into compliance with the Department's interpretation of 14 CFR 302.07. The January 10th comments are completely unchanged from the version that has been available to the Department and the public since 11 January. I believe the Department should grant this motion, as

- The public comments are fully consistent with the reasons the Department established the supplemental comment period on 22 December
- The public comments provide objective evidence and substantive analysis of one of the most important aspects of this case
- I had made a sincere, good-faith effort to comply with the Department's public comment and filing requirements; there is no reasonable way that a member of the general public wishing to file a public comment on an important case such as this would have realized that the email and certificates were mandatory requirements; when I initially inquired about making public comments on cases such as this, staff at the DOT Dockets Office informed me that I simply had to follow the filing procedures at regulations.gov, and complete the filing within the designated public comment period, which I have done
  - ☐ There is no information at regulations.gov or any DOT website indicating that evidence introduced via public comments would be automatically rejected unless the distribution and certificate requirements had been met

[91] DOT-OST-2008-0252-3374
[92] DOT Order 2009-12-16
[93] DOT-OST-2008-0252-3379

- ☐ The public dockets on this and similar cases include many submissions that do not include certificates, thus a reasonable member of the general public would not assume this is a mandatory requirement
- ■ I have made a sincere, good-faith effort to remedy the distribution and certificate deficiency as soon as I discovered it was an issue, and would have done so sooner, had the Department made me aware of the issue sooner.
- ■ The distribution and certificate requirements of 14 CFR 302.07 serve legitimate, important purposes, but those purposes will have been met if this motion is granted. Granting this leave to refile after the end of the official comment period places no serious disadvantage on any party to this case, as the comments have been fully available for review by all parties since 11 January, and the Department had never issued any public statement disqualifying them; the initial omission of the certificate and this motion for late (re)filing is obviously not attempt to artificially disadvantage other parties to this case, who largely consist of large international airlines, represented by some of the top aviation counsel in Washington.
- ■ Granting this leave to refile after the end of the official comment period would be fully consistent with all past actions taken by the Department in this case, including the granting of all prior motions for leave to file late comments in its December Order. In all of these past decisions, the Department has properly given higher priority to establishing a complete case record, and allowing all parties full opportunity to review and comment on that record, than to producing a less complete decision on a tighter schedule.
- ■ For many years, the Department has actively encouraged public input into regulatory and administrative decisions, and was one of the pioneers of the user-friendly internet-based docket management systems that have evolved into regulations.gov. Granting this motion would indicate that the Department places greater weight on the importance of public access to and participation in its decision making, that it places on any unintended inconvenience caused to the airlines and law firms that have had access to these public comments since 11 January, but had not received a direct email with these comments until this filing.

The balance of this filing consists of a verbatim copy of my 10 January comments and the certificate of service. Following an introduction explaining my background, experience and interest in this case, the comments are divided into five sections

A. RECENT SUBMISSIONS HAVE NOT ADDRESSED THE JOINT APPLICANTS' HIGHLY DEFICIENT CLAIM OF $92 MILLION IN ANNUAL PUBLIC BENEFITS FROM CONNECTING SERVICES (pages 1-6)

B. THE ORIGINAL NORTH ATLANTIC ALLIANCES DID CREATE SIGNIFICANT CONSUMER WELFARE BENEFITS BUT WELFARE GAINS DUE TO ALLIANCE PRICING WERE VERY NARROW AND THESE WELFARE BENEFITS WERE FULLY EXHAUSTED BY THE LATE 90S (pages 7-9)

C. THE BRUECKNER-WHALEN REGRESSIONS FUNDAMENTALLY MISREPRESENT THE HISTORICAL CONSUMER PRICING BENEFITS FROM ALLIANCE ANTITRUST IMMUNITY (pages 10-11)

D. DOUBLE MARGINALIZATION DOES NOT EXIST, NEVER EXISTED, HAS ABSOLUTELY NOTHING TO DO WITH THE BENEFITS OF IMMUNIZED ALLIANCES, AND BRUECKNER AND WHALEN'S THEORIES ABOUT DOUBLE MARGINALIZATION ARE NOT SUPPORTED BY ANY DATA OR ANALYSIS (pages 12-18)

E. THE JOINT APPLICANTS' CLAIMS OF $92 MILLION IN ANNUAL PUBLIC BENEFITS IN CONNECT MARKETS MUST BE REJECTED. IT NOT ONLY FAILS TO MEET THE MINIMIMUM REQUIREMENTS OF THE HORIZONTAL MERGER GUIDELINES, BUT THE CLAIM IS DEMONSTRABLY FALSE. (pages 19-20)

CERTIFICATE OF SERVICE
I hereby certify that I have this date served the foregoing document on the persons identified below by causing a copy to be sent by electronic mail.

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COMMENTS OF HUBERT HORAN
AMERICAN AIRLINES-BRITISH AIRWAYS-IBERIA-FINNAIR-ROYAL JORDANIAN
JOINT APPLICATION FOR ANTITRUST IMMUNITY
DOCKET DOT-OST-2008-0252
4 March 2010

My name is Hubert Horan. I am filing these comments in response to the Show Cause Order of 13 February at DOT-OST-2008-0252-3390, which established a public comment period under order 2010-2-8. These make reference to comments I originally filed on 31 January under DOT-OST-2008-0252-3389.

A. SUMMARY OF COMMENTS

- DOT has failed to conduct a legitimate Clayton act market power test in this case, and the DOT has been willfully ignoring evidence of multi-billion dollar consumer welfare losses due to increasing market power in North Atlantic markets, welfare losses that would preclude approval under a legitimate Clayton Act test
- DOT uses false and illegitimate claims as the entire basis for its determination that immunity is required by the public interest; there is no valid evidence on the docket record supporting the claim that immunity will generate significant public benefits; the DOT's finding of public benefits in the Show Cause Order depended on DOT's willful rejection of the longstanding evidentiary standards established by the Horizontal Merger Guidelines
- DOT must reject the immunity application, on both market power and public benefits grounds, and must reaffirm Clayton act test and Horizontal Merger Guidelines evidentiary requirements for antitrust immunity applications

B. THE DOT HAS FAILED TO CONDUCT A LEGITIMATE CLAYTON ACT MARKET POWER TEST IN THIS CASE AND THE DOT HAS BEEN WILLFULLY IGNORING EVIDENCE OF MULTI-BILLION DOLLAR CONSUMER WELFARE LOSSES DUE TO MARKET POWER IN NORTH ATLANTIC MARKETS

B1. The legal requirements for a Clayton Act test of market power and market contestability are not in dispute

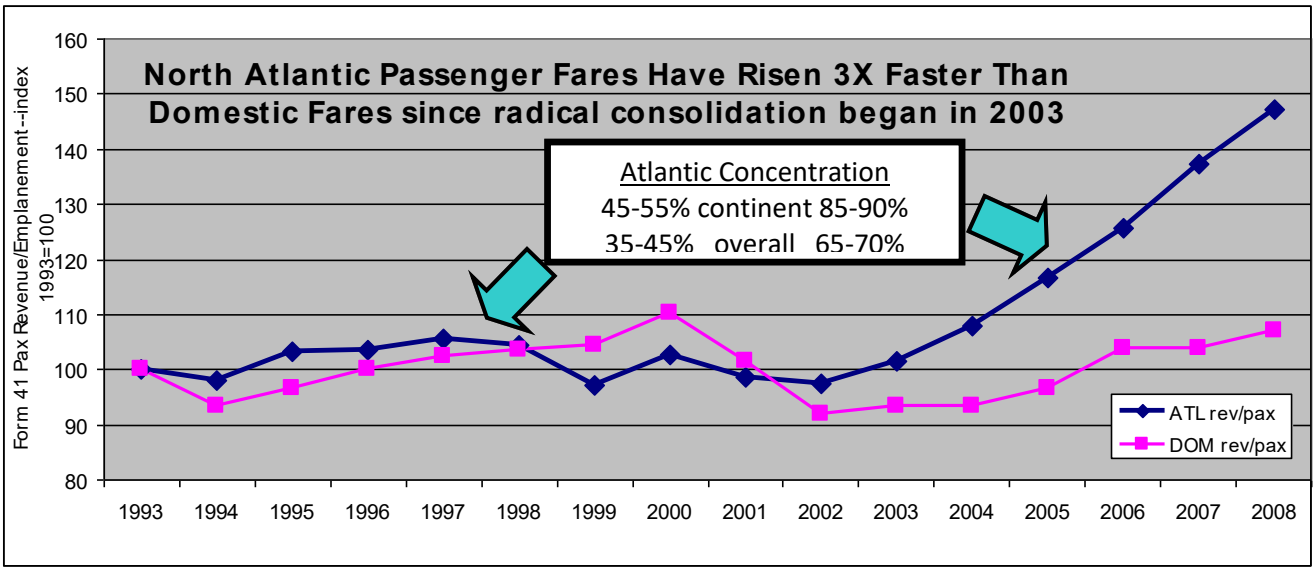
- Under the law, DOT cannot grant immunity from the antitrust laws without verifiable, case-specific evidence that the reduced competition would not create market power that would facilitate anti-competitive price increases and capacity cuts. The legal airline antitrust definition of market power focuses on the risk of oligopolistic price increases and capacity cuts. The primary indicators of "market power" are entry barriers and lack of "market contestability". High levels of market concentration are a necessary condition, but are not sufficient to demonstrate anti-competitive impacts unless evidence of entry barriers/non-contestability is also present.
- The Department laid out the legal requirements in the original Northwest/KLM case: "The Clayton Act test requires the Department to consider whether the alliance agreements are likely to substantively reduce competition so that any of the applicants would be able to charge supra-competitive prices or reduce service below competitive levels. To determine whether an alliance or comparable transaction is likely to violate the Clayton Act standard the department considers whether the transaction is likely to create or enhance "market power", defined as the ability to profitably maintain prices above competitive levels for a significant period of time or to reduce output and service quality below competitive levels. To determine whether a proposed alliance is likely to create or enhance market power, we primarily consider whether the alliance would significantly increase concentration in relevant markets, whether the alliance raises concern about potential anticompetitive effects in light of other factors, and whether entry into the market would be timely, likely, and sufficient either to deter or to counteract a proposed alliance's potential for harm."[94] The Department has confirmed this requirement in very subsequent immunity case, including the current Application.[95]

[94] Joint Application of Northwest Airlines and KLM Royal Dutch Airlines, 11 Jan 1993, DOT Docket 48342.
[95] Show Cause Order, p.11

- American Airlines, in the current case, correctly noted that concentration levels alone cannot be used as the basis for Clayton Act tests: "market share must be accompanied by conditions and incentives that would encourage airlines to contract supply"[96]

B2. DOT data shows that multi-billion dollar consumer welfare losses have already occurred on the North Atlantic due to supra-competitive prices sustained by market power

- Increased North Atlantic concentration has already increased prices towards supra-competitive levels. From deregulation until 2003, North Atlantic price trends closely tracked domestic price trends, give or take short-term 5-10% swings. From 2004 onward, a totally new pattern emerged, with North Atlantic fares rising three times faster than domestic fares.[97]

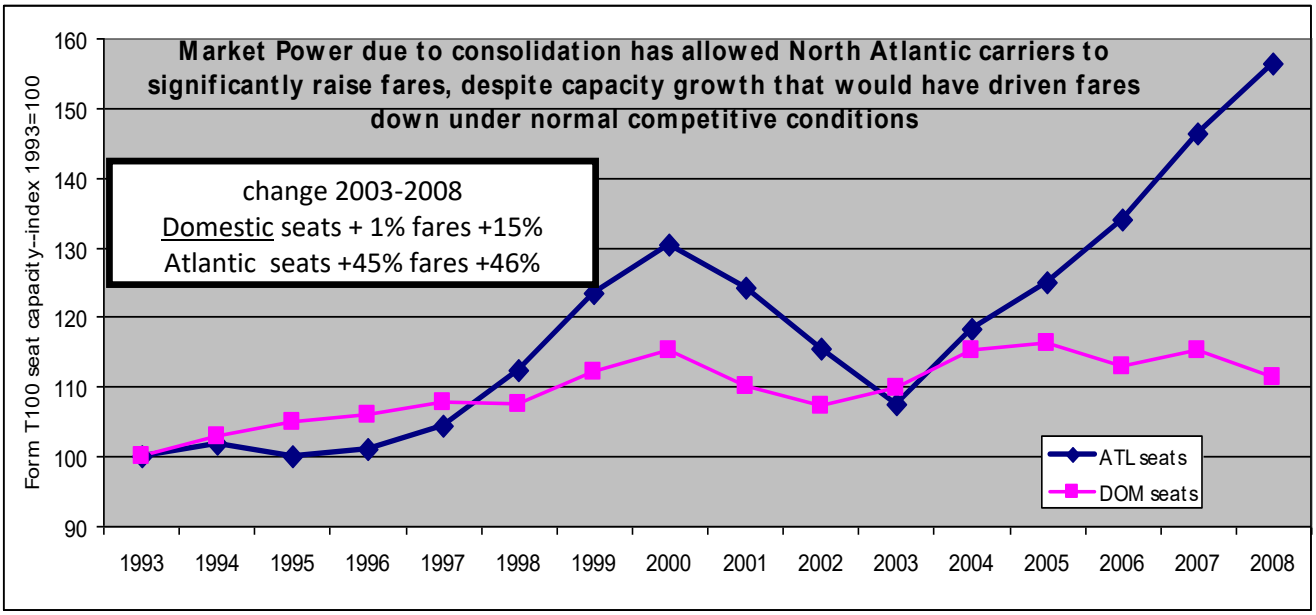


- The market power already created by consolidation is much worse than the simple Atlantic/Domestic fare comparison suggests. Under normal, healthy competitive conditions, airline fares are highly responsive to changes in capacity. Domestic fares increased 15% since 2003 because the industry did not add capacity. When Atlantic capacity spiked in the late 90s, average fares fell, even though this was the peak of the dot-com era. But the market power created on the Atlantic in recent years meant normal supply/demand relationships no longer held. Atlantic fares increased 46% since 2003, even through capacity also increased 45%[98]

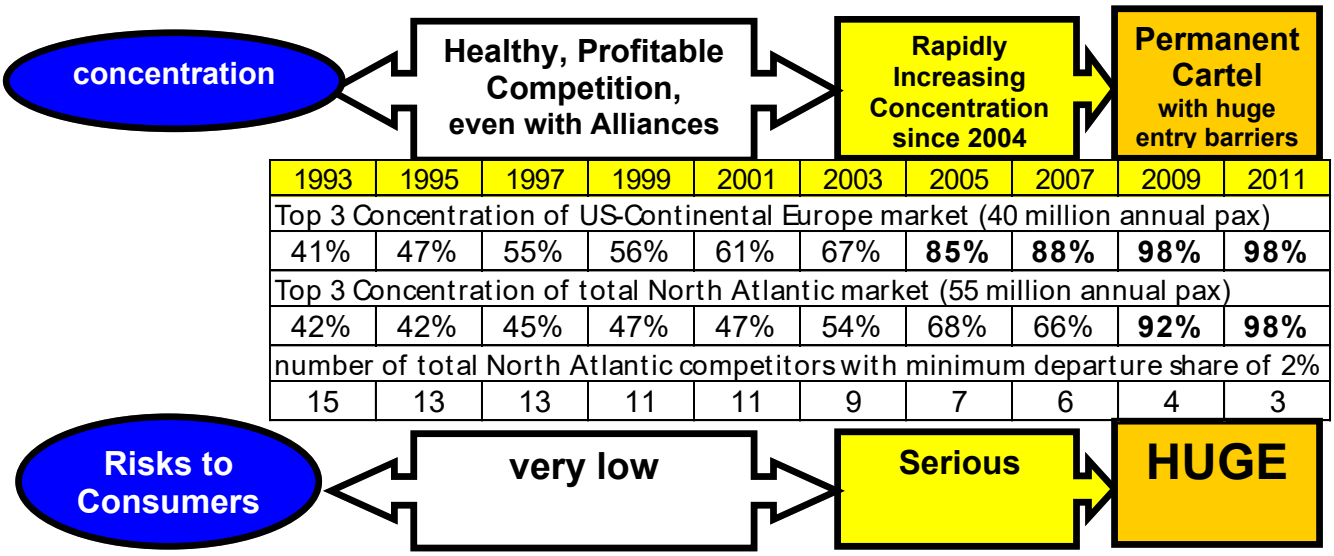
[96] Joint Applicants Supplemental Comments, DOT-OST-2008-0252-3357, 9 September 2009, p.13 and Exhibit 2 (Casey Declaration), p.4

[97] Data in the graph is US carriers' entity totals from DOT Form 41; passenger revenue data is from schedule P12, segment passengers from schedule T100. The aggregate US carrier Atlantic unit revenue data shown in the graph should very closely track aggregate market levels since US flag carriers serve the identical markets with comparable schedules and capacity. See Congressional testimony of Hubert Horan, "The Anti-Competitive Risks of a Delta-Northwest Merger and the Extreme Consolidation of Intercontinental Airlines", House Committee on Transportation and Infrastructure, 14 May 2008

[98] Data in the graph is total (US and non-US) carriers entity seat capacity from DOT Form 41 schedule T100.



■ This fundamental shift in pricing behavior exactly tracks the move towards extreme North Atlantic concentration, which started when Air France bought KLM, previously the largest single driver of price competition between European longhaul network markets. Underlying economic conditions in both markets are virtually identical; the only possible explanation of the dramatic post-03 shift is market power on the North Atlantic.



1993	1995	1997	1999	2001	2003	2005	2007	2009	2011
Top 3 Concentration of US-Continental Europe market (40 million annual pax)									
41%	47%	55%	56%	61%	67%	**85%**	**88%**	**98%**	**98%**
Top 3 Concentration of total North Atlantic market (55 million annual pax)									
42%	42%	45%	47%	47%	54%	68%	66%	**92%**	**98%**
number of total North Atlantic competitors with minimum departure share of 2%									
15	13	13	11	11	9	7	6	4	3

■ The observed consumer welfare loss is caused by extreme concentration in non-contestable markets, not by alliances per se. Alliances flourished in the 90s when robust competition still existed. Competition in isolated large nonstop O&Ds must be evaluated separately, but this table accurately reflects the concentration/cartel condition in connecting markets, which account for the vast majority of North Atlantic traffic. These connecting markets are predominately in Continental Europe, where concentration levels reached 85-90% levels five years ago[99]

[99] seat share using DOT Form 41 Schedule T100 data; 2009 shares assumes the approval of the current application (which was originally scheduled to be concluded during 2009); 2011 shares assumes other small network airlines based in "Open Skies" countries cannot survive as wholly independent competitors and are absorbed into the three large collusive groups.

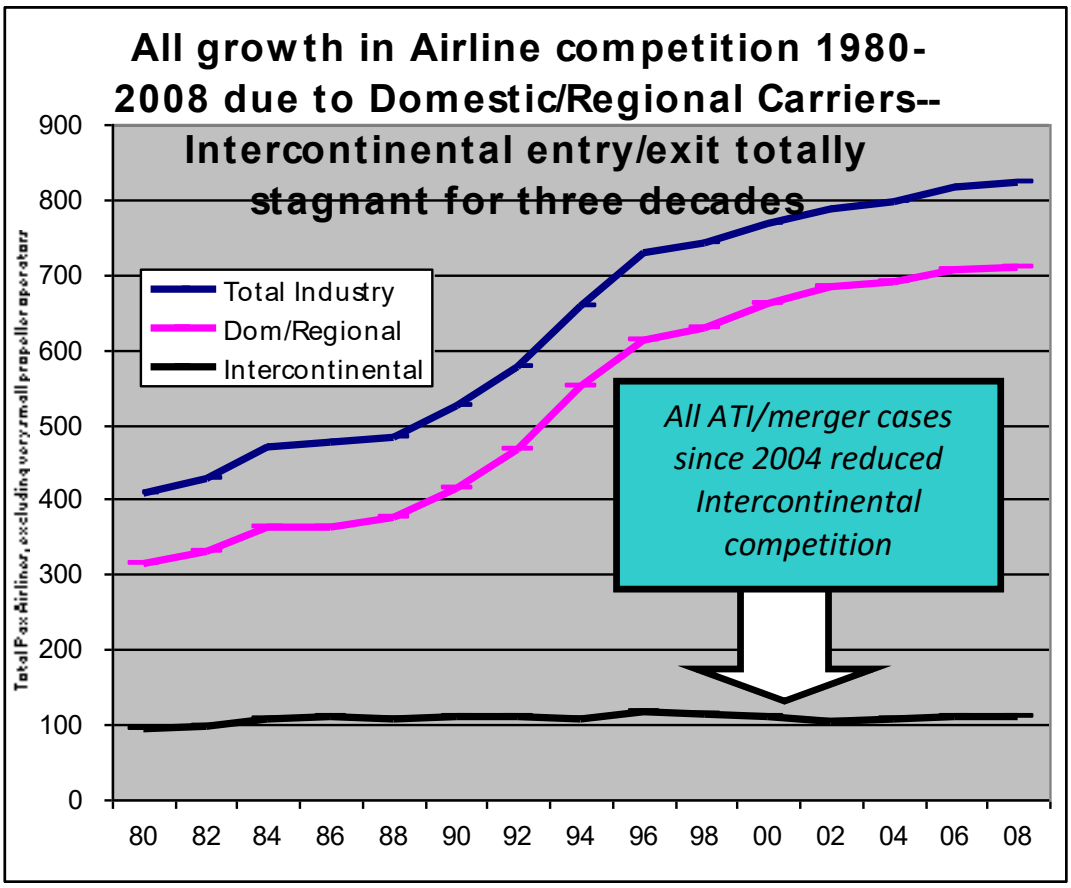
- The increase in concentration from the 65% levels in 2003 to the 90%+ levels that will result from this and the other recent applications is completely artificial. It is solely due to large incumbent airlines petitioning governments to reduce competition, and had nothing to do with highly efficient carriers displacing inefficient capacity or similar "market forces". All of the legitimate, verifiable efficiency benefits of immunized alliances had been fully realized in the decade prior to 2003.[100]
- Extreme concentration in these non-contestable markets not only establishes the "conditions and incentives that would encourage airlines to contract supply" but creates ideal conditions for cartel-type collusion. Because of the basic economics of network airlines none of the three large collusive alliances will have any ability to seriously challenge the other two; therefore risks to consumers will increase significantly following the current round of ATI grants. Competitors would have every incentive to match oligopoly capacity cuts and price increases because there is no possibility that more aggressive competition could displace existing hubs (Frankfurt, Paris, Amsterdam, Newark, Atlanta, etc) and capture significant market share. Carriers may compete for individual O&D markets isolated from these hubs and home markets, but these markets will be immaterial to overall market shares, and there is no possibility that aggressive price or schedule competition could in any way threaten any of the Star, Skyteam or oneworld strategic network positions.
- North Atlantic markets are not contestable. There is no possibility that future entry would be "timely, likely and sufficient either to deter or to counteract a proposed alliance's potential for harm." The last successful North Atlantic new entrant was 23 years ago[101]. Every carrier that has attempted to enter the North Atlantic on a niche market or other limited basis in the last 23 years has failed, and such limited entry would have no impact on anti-competitive behavior by the collusive alliance cartel. The new entry required to discipline anti-competitive abuses would require a major hub, tens of billions of dollars in new fleet investment and expensive access to highly constrained airports.

Although it has not been granted immunity, there is no evidence that USAirways competes aggressively on price with its Star Alliance partners, and the table explicitly assumed that with a 4% capacity share it would have neither the motivation nor ability to provide such competition, and would eventually be granted full immunity.

[100] Horan Comments, DOT-OST-2008-0252-3389, p.7-9.

[101] The last new entrant on the North Atlantic to successfully sustain a market position with at least 1% market share was Piedmont Airlines (now USAirways) which began Charlotte-London Gatwick service in 1987

- Intercontinental markets have always been non-contestable. There has been no growth in the number of intercontinental competitors in 30 years, even though this is the most profitable and fastest growing part of global aviation. Increased airline competition has been strictly limited to domestic and regional (narrowbody) markets[102]. The merger and immunity cases since 2003 are designed to consolidate the already non-contestable intercontinental markets into three globally collusive alliance groups.



- The market power that has already been created by increased consolidation reduces consumer welfare by billions of dollars a year, detriments which dwarf the $137 million consumer benefit claim made by the Joint Applicants.[103] North Atlantic carriers had $30 billion in passenger revenue in 2008.[104] If 2008 capacity levels were operated under pre-2003 competition levels, 2008 Atlantic unit revenues might well been 30-40% lower than observed, suggesting an annual consumer welfare loss due increased market power of $9-12 billion. Instead of increasing dramatically, Atlantic unit revenue would have fallen below the observed domestic unit revenue levels because of the sizeable growth in Atlantic capacity. Counterfactual historical analyses such as this are complicated and inherently imprecise; some marginal, higher-cost capacity would have been withdrawn in this environment, although stronger competition may have in turn driven productivity improvements, and shifted market share to more

[102] See "If Consolidation occurs, it would reverse decades of airline history", Airlines International, January 2009. Data in the graph is from a proprietary database of all historical passenger airlines operating under unique aircraft operator certificates. Data includes all airlines operating aircraft with at least 50 seats and all airline operating at least 15 smaller aircraft. Intercontinental airlines are those operating longhaul aircraft on routes of 3000 miles or more. The data does not reflect any reduced competition due to ATI; for example United and Lufthansa are counted as fully independent airlines

[103] $92 million of alleged "double marginalization" benefits in connecting markets and $45 million of alleged benefits from increased service in nonstop markets

[104] According to DOT Form 41, US carrier Atlantic passenger revenue was $15,058 million; US carriers operated 46% of combined EU-US flag available seat markets. This $30 billion estimate understates the North Atlantic market however, since it does not include non-passenger revenue, the portion of transatlantic ticket revenue flown on domestic US or intra-EU connecting flights that would not be categorized as Atlantic revenue in Form 41, and revenue on non-US/EU carriers.

efficient carriers. But even if one arbitrarily assumes that only half or less of these potential consumer pricing gains would have been possible, consumer welfare losses have already been staggeringly large[105].

Annual Consumer Welfare	5%	$1.5 billion
Loss if increased	10%	$3.0 billion
North Atlantic Market Power	15%	$4.5 billion
increases fares by:	20%	$6.0 billion

- The most important consumer welfare impact question here is not the precise estimation of 2008 welfare losses, but the likelihood of even larger losses as a result of this application and the recently granted Star/Continental immunity which are not reflected in the data in the graphs; given the cartel conditions noted above, this anti-competitive pricing behavior will worsen significantly as overall North Atlantic concentration increases from 65% levels to above 90%, and the already negligible possibility that future entry would be "timely, likely and sufficient either to deter or to counteract a proposed alliance's potential for harm" falls to zero.

<u>B3. DOT has systematically ignored these market power and market contestability issues, even though the Clayton Act does not permit ATI to be granted unless without legitimate, verifiable evidence that immunity will not create the anti-competitive risks associated with market power</u>

- At no point in this case or any of the previous Star/Skyteam cases is there any data showing the overall shift from 45% to 70% to 90+% concentration that these applications were designed to achieve, or the faster and more extreme concentration that has occurred in the extremely non-contestable connecting markets that account for the vast majority of North Atlantic traffic. In fact the DOT insisted that approval of Star/Continental "does not materially alter the competitive landscape or increase overall market share to any significant degree"[106]
- Neither this case nor any of the previous Star/Skyteam cases included any evidence or analysis of market contestability, nor (with the narrow exception of the isolated Heathrow nonstop O&Ds considered in this case[107]) any evidence or analysis of entry barriers. None of the cases included any evidence or empirically-based analysis of cartel risks due to the combination of extreme concentration and market non-contestability, or any other "conditions and incentives that would encourage airlines to contract supply"
- Neither this case nor any of the previous Star/Skyteam cases included any evidence or empirically-based analysis of pricing trends since the move to radical consolidation began in 2003. No ATI applicants has ever presented data or quoted any analysis of North Atlantic pricing trends since the introduction of the original alliances in the 1990s when supply/demand and competitive conditions were radically different. In violation of its legal obligations to base ATI decisions on case-specific evidence, the DOT has never evaluated price impacts under post-1999 market conditions.
- In the Show Cause Order, the DOT never defines a review methodology responsive to its Clayton Act market power test obligation, never positively states which evidence in this case demonstrates that granting immunity in the current case will not create or enhance the ability to profitably maintain prices above competitive levels for a significant period of time or to reduce output and service quality below competitive levels, and never positively states which evidence in this case demonstrates the high likelihood that that future entry into the market would

[105] A more sophisticated market power/consumer welfare analysis would segment the North Atlantic between market segments based on market contestability, however this requires carrier confidential data and the complex planning models used by the major carriers; while this would likely show greater consumer detriments in some segments (for example Continental European markets not served by nonstops, where concentration hit 85% levels five years ago) and smaller detriments in others, the overall multi-billion dollar consumer welfare problem would still remain. The pricing/capacity tradeoffs that would occur under more competitive conditions cannot be estimated without detailed historical data on both demand and supply elasticities.

[106] Star/Continental Show Cause Order, DOT-OST-2008-0234-0193, 7 April 2009, p.7-8

[107] Show Cause Order, p.20-25, discussing the eight overlap O&D nonstop routes (MAD-MIA and LHR-DFW/BOS/NYC/LAX/ORD/MIA and NYC-CDG). The issues raised in this section apply primarily to the tens of thousands of other O&D markets served by the Applicants, where the DOT did not even maintain the minimal pretense of a serious competitive analysis that would address its required Clayton Act review obligations.

be timely, likely, and sufficient either to deter or to counteract potential for harm from reduced competition. Implicitly, the DOT's Clayton Act test of market power and market contestability in this case appears to consist solely of applying wholly arbitrary "gut feel"-type criteria to simple snapshots of current market shares in the aggregate UK, French, Spanish and overall EU markets.

- ☐ In the dispute over competition in Heathrow O&D markets, both the Joint Applicants and Virgin Atlantic pose arguments that start with the reasonable premise that "you can't judge competition issues just by looking at market share"[108] The DOT ignores these warnings and conducts a analysis that "just looks at market share" while ignoring all other factors.
- ☐ In the dispute in this case over competitive impacts due to reduced competition in nonstop overlap markets, both the Joint Applicants and the Department of Justice agree that the issue cannot be resolved without careful, detailed analysis that can isolate the actual historical pricing impacts in comparable markets from other market activity. The DOT ignores this testimony and conducts a Clayton Act analysis that is willfully indifferent to actual historical pricing impacts in North Atlantic markets where competition has been reduced, and is willfully indifferent to the need to conduct a detailed analysis that carefully isolates competitive pricing impacts from other market activity.

C--DOT USES FALSE AND ILLEGITIMATE CLAIMS AS THE ENTIRE BASIS FOR ITS DETERMINATION THAT IMMUNITY IS REQUIRED BY THE PUBLIC INTEREST; THERE IS NO VALID EVIDENCE ON THE DOCKET RECORD SUPPORTING THE CLAIM THAT IMMUNITY WILL GENERATE SIGNIFICANT PUBLIC BENEFITS

C1. The legal requirements for determining that antitrust immunity is required by the public interest are not in dispute

- Applicants for antitrust immunity must prove that immunity "is necessary…to achieve important public benefits" that "cannot be achieved by reasonably available alternatives that are materially less anticompetitive."[109] Both the DOT and DOJ have recognized that airline antitrust immunity applications such as this one would directly eliminate competition in the same manner that a full merger would and applicants must prove that those public benefits outweigh the risk that it could harm competition by increasing the ability or incentive to raise price or reduce output in any relevant market.[110] Evidence of significant public benefits is critical since Section 41308(b) specifies that antitrust immunity can not be granted unless it is "required by the public interest"[111]
- The burden of proof for public benefits rests with the applicants[112], and the *Horizontal Merger Guidelines* defines the evidentiary standards that must be met: "[the applicants] must substantiate efficiency claims so that the Agency can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so) how each would enhance the merged firm's ability and incentive to compete, and why each would be merger-specific. Efficiency claims will not be considered if they are vague or speculative or otherwise cannot be verified by reasonable means"[113]

C2. The DOT has willfully refused to provide case-specific evidence that supports its finding that major public benefits will be created in connecting markets, and willfully refused to address docket evidence contradicting that finding

- The Joint Applicants claimed that antitrust immunity would create a $92 million annual consumer benefit in connecting markets, because immediately upon the grant of immunity, prices on all connecting AA/BA and AA/IB interline itineraries would fall by $257 per round trip because immunity would eliminate the "double marginalization" or "double markup" penalty that all airlines who sell interline tickets on a non-immunized basis

[108] The Joint Applicants argue that it would be unfair for DOT to take competitive concerns about Heathrow markets seriously when DOT ignored issues in Skyteam and Star markets that had much higher levels of concentration; Virgin Atlantic argued Heathrow competitive analysis needed to combine evidence on concentration and market contestability.
[109] 49 USC sections 41308, 41309(b)
[110] Federal Trade Commission, Department of Justice, Antitrust Guidelines for Collaborations Among Competitors (2000) sections 1.2, 3.3.
[111] 49 USC sections 41308(b)
[112] Show Cause Order, p.10
[113] Federal Trade Commission, Department of Justice, Horizontal Merger Guidelines (1997) p.31

are forced to apply to these fares.[114] This was the largest single claim made by the Joint Applicants in support of their immunity request.

- In my comments, I presented detailed evidence showing that the Joint Applicants' claim not only failed to meet the *Horizontal Merger Guidelines* requirements that applicants meet the burden of providing legitimate, case/market-specific evidence documenting their public benefit claims, but showing that "double marginalization" does not exist, never existed, and that the $92 million public benefit claim was demonstrably false. This included documentation of the flaws in the single academic paper on which this (and all other) "double marginalization" ATI claims are based[115], analysis explaining the actual sources of consumer benefits from the original 1990s alliances, evidence showing that pricing behavior noted in the paper could be fully explained by rational, revenue-maximizing airline behavior specific to unique market conditions, and that airline interline pricing had never suffered from the alleged structural inefficiencies, and quoting various sources of data and analysis that contradicted the Applicants' claim that consumers would benefit lower prices following any and every immunity grant, regardless of market or competitive conditions[116].
- The entire public benefit question boils down to an absolutely clear-cut, digital "double marginalization predicts every ATI grant in every situation will lower prices 15-25%: right or wrong?" There are no grey areas in this dispute; the answer is not "it depends on other conditions or factors". If "double marginalization" inefficiencies *always* exist, and ATI *always* drives 15-25% reductions in interline prices, just as night always follows day, the Joint Applicants' public benefit claims are valid and the DOT should grant their application since it will meet the section 41308(b) test that immunity will be required to generate these significant public benefits. If "double marginalization" is not a structural problem that artificially raises interline prices in any and all markets, regardless of demand or competitive conditions, and if there is no evidence supporting the Joint Applicants' claim that ATI will lower connecting fares by $92 million in the actual markets currently served on an interline basis, then the applicants have failed to demonstrate that immunity will generate significant DOT must deny the application for ATI, as it would fail the section 41308(b) test that immunity is *required* by the public interest.
- In the Show Cause Order, the DOT fully affirmed its belief that "double marginalization" exists and drives 15-25% connecting fare reductions each and every time ATI is granted as established, proven facts. It specifically said that "substantial public benefits are likely to be realized" due to "lower fares resulting from the reduction in "double marginalization" on multi-segment itineraries."[117] However the DOT refused to openly state that "double marginalization" was a legitimate fact-based theory that could withstand independent scrutiny, or to present any evidence showing it was a legitimate theory; it merely asserted the existence of the theorized benefits as self-evident truths that did not require logical explanation or verifiable evidence and rejected all of the evidence refuting the existence of "double marginalization". The arguments that the Show Cause Order accepted and ignored/rejected are summarized in the table below:

[114] Joint Application (DOT-OST-2008-0252-0001) p. 7. 24, exhibit JA-13, JA-19 (the Brattle affidavit)
[115] Brueckner, J. K. and Whalen, W. T., (2000), "The Price Effects of International Airline Alliances", The Journal of Law and Economics v43 n2, p. 503. Subsequent papers by Brueckner and/or Whalen merely repeat the "double marginalization" theory hypothesized in this original paper.
[116] Horan Comments, pp. 3-19
[117] Show Cause Order p. 30

DOT's Public Benefit finding is totally dependent on truth of the following arguments	**DOT's Public Benefit finding is based on ignoring/rejecting all of the evidence in this docket refuting those arguments:**
Double Marginalization Exists: Interline connecting prices—everywhere in the world—are artificially 15-25% higher than they would be if the identical connection was operated by a single carrier or an immunized alliance organized along Northwest/KLM lines; airline pricing departments using modern revenue management systems are incapable of rationally setting revenue-maximizing interline fares, and this 15-25% subobtimization occurs everywhere, regardless of market or competitive conditions; the existence of this structural barriers to rational, revenue-maximizing interline pricing was definitively proven by a single study of 1990s transatlantic pricing	■ No data/analysis in the original study supports the claim that "double marginalization" was the cause of any observed 1990s transatlantic pricing shifts ■ Vast majority of observed 1990s transatlantic consumer pricing gains are explained by other factors that original study ignored, including favorable supply/demand conditions, Open Skies/market liberalization efforts, improved aircraft economics and other carrier productivity gains ■ Actual gains achieved by original 1990s alliances are better explained by factors that the original study ignored, including competitive advantage versus traditional interline service in the specific markets targeted by the alliances ■ "Double Marginalization" theory falsely assumes that interline prices based on markups above segment marginal costs, and that airline pricing staff ignore market/competitive conditions when setting interline fares and are incapable of responding to market signals when interline prices are suboptimal or uncompetitive ■ Theory ignores the ability of revenue management systems to routinely optimize interline fares, and ignores evidence that actual interline practices are fully consistent with rational, profit maximizing behavior ■ No airlines have acknowledged "double marginalization" inefficiencies or taken any action to mitigate them
ATI Always Lowers Fares 15-25%: Every time previously independent airlines are granted antitrust immunity along Northwest/KLM lines, the prices of all the connecting tickets sold on an interline basis will immediately and automatically fall 15-25% (roughly $250-350 per intercontinental round trip ticket), and this same 15-25% price reduction will occur in every ATI case, regardless of market demand, competitive conditions, or carrier efficiency level; this permanent link between ATI and lower prices can be accepted as proven fact based on this one isolated study	■ Entire claim based on one study led by a paid advocate for United Airlines; no independent research has ever found evidence of a structural link between ATI and lower prices ■ Entire claim falsely assumes major price changes can occur totally independently of market/competitive conditions ■ No evidence that the traffic segments that recent ATI applicants claim will enjoy big price cuts have any of the characteristics of the traffic segments that benefited from the original ATI grants 15 years ago ■ The claimed automatic link between ATI and lower prices is contradicted by every post-1999 transatlantic pricing study and by the dramatic upward trend in overall prices ■ There is no evidence showing that any recent ATI grant actually led to lower connecting fares

■ The DOT willfully violated the longstanding rule that "the party seeking approval of the agreement or request must submit evidence establishing the transportation need or public benefits."[118] The Joint Applicants provided no such evidence that the $92 million in benefits would occur in these markets as a result of this specific immunity grant, and the DOT failed to refute any part of my "general skepticism that the applicants have submitted sufficient evidence showing that public benefits will be realized by the alliance"[119] and simply decreed that significant "public benefits" existed, whether or not the applicants had presented the evidence required to establish those benefits. The entire "evidence establishing the transportation need or public benefits" provided by the Applicants is a

[118] Show Cause Order, p.10
[119] Show Cause Order, p.32

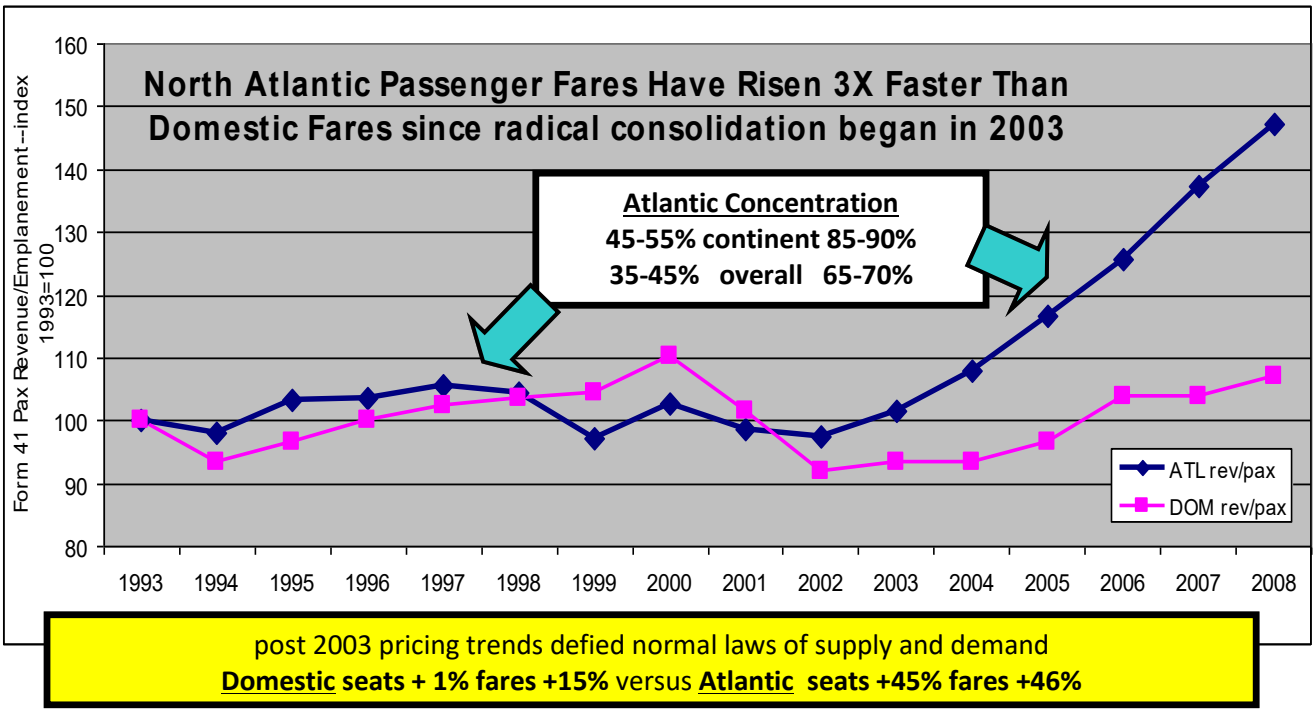
footnote reference to a regression coefficient in a single academic paper[120] that does not make any specific claims supporting the Applicants' argument that the 1990s pricing correlations observed in the regressions were caused by "double marginalization" and makes no specific claim that 1990s pricing correlations would occur in 2010 under the conditions presented by the Joint Application.

- The Show Cause Order disingenuously accepted the DOJ's observation there was an weak and totally unproven foundation beneath the public benefits claims, acknowledging that the links between "double marginalization" and consumer benefits had never been proven saying that "economic studies, including the Department's own studies of transatlantic competition, do not prove that airlines can only eliminate multiple markups by engaging in activity that raises antitrust concerns."[121] But DOT then published a finding that it could not legally reach unless those claims were based on solid, verifiable case-specific evidence, dismissing the DOJ's concerns with the counterfactual statement that "we do not expect the elimination of multiple markups to result from any anticompetitive conduct"[122]. DOT is explicitly arguing that it can grant immunity solely on the basis of its separate, unrelated (and equally dubious) competition analysis. If the Department's "gut feel" is that the application won't cause competition problems, then it can use false or totally unsubstantiated claims to make its section 41308 "required by the public benefits' determination.
- The Show Cause Order recognizes that my comments identified serious specific deficiencies in the Brueckner and Whalen "double marginalization" theory.[123] But instead of refuting any of the observed flaws, it simply asserts that since the theory has no deficiencies it can serve as the sole justification of the connect traffic public benefit finding. As noted earlier, the question is not about some parts or uses of the theory, the question is a simple, unambiguous "double marginalization predicts every ATI grant will lower prices 15-25%: right or wrong?" DOT said that "we disagree, however, with Mr. Horan's total rejection of the Brueckner and Whalen models, which demonstrate the important principle that alliances facilitate cooperative pricing that can reduce prices and enhance joint products and services that consumers value."[124] This is a false statement. Brueckner and Whalen's paper, as my original comments explain in detail, asserts that there is a relationship between "double marginalization" and observed 1990s pricing changes, but fails to provide evidence that "demonstrates" this link, and as the DOJ noted, fails to prove any causal relationship. And there is nothing in this paper that claims or demonstrates that the Applicants' central claim, that theorized relationship would hold under any and all market conditions. Again, DOT is unwilling to openly state that public benefit claims based on "double marginalization" are truthful, or demonstrate that the claims can be independently verified, or rebut any of the detailed counter-evidence that was presented. It simply asserts that these benefits are self-evident truths that do not require logical explanation or verifiable evidence, and then asserts that these self-evident theories justifying the self-evident truths cannot be challenged on the basis of factual or logical evidence.
- After making it clear that neither logic, evidence or analysis could shake its absolute faith in "double marginalization", The DOT added the gratuitous observation that "Mr. Horan does not recognize that antitrust immunity and the resulting integration of planning and pricing can fundamentally change the economics of connecting routes when each carrier participating in an itinerary shares equally in the benefits of cooperatively selling it."[125] I would repeat for the record that I was the person who developed the very first integrated alliance network, while at Northwest in the early 90s, a network that became the model for every subsequent North Atlantic alliance network. From the beginning of the Northwest/KLM alliance in 1992, the network was developed on a fully "metal neutral" basis, which is to say all fleet, schedule and marketing decisions were designed to maximize the financial and competitive performance of the overall joint-venture, without regard to which partner's "metal" operated any given flight, since overall gains were fully shared. Throughout the early development of the alliance, we conducted detailed market analysis identifying the competitive strengths and weaknesses of alliance services, so that we could better target alliance expansion on the most profitable market opportunities. While at Swissair between 1998 and the end of the Delta-Swissair-Sabena alliance in 2002, network decisions were also taken on a joint-venture maximizing, or "metal-neutral" basis, and were targeted at the same type of profitable market opportunities. I have also helped shut down alliance joint ventures, including Continental-America West and Qualiflyer that did not

[120] Whalen, W. T., (2007) "A Panel Data Analysis of Code Sharing, Antitrust Immunity and Open Skies Treaties in International Aviation Markets", Review of Industrial Organization v30 2007
[121] Department of Justice comments, DOT-OST-2008-0252-3374, p.26, Show Cause Order p. 30
[122] Ibid.
[123] Horan Comments, pp.10-19
[124] Ibid.
[125] Ibid.

produce positive financial and competitive benefits for their partners. The DOT staff responsible for the Show Cause Order apparently believe that their understanding of the economics of North Atlantic metal-neutral alliances is vastly superior to the people who actually developed them and spent many years running them, and believe that my written testimony demonstrates that I have not grasped either the basic concept of a joint venture, or the rudiments of network airline pricing. I presented testimony that I believe was solidly based on 30 years of direct management experience with large airline networks, global alliances, mergers and consolidation, and intercontinental competition although I am happy to have my data, logic and analysis challenged or refuted by better data, logic or analysis. The claim that these DOT officials have a vastly superior understanding of alliance economics would be a bit more credible if they did not base their entire public benefits jurisprudence on a theory that says that supply and demand, market liberalization and increasing carrier productivity had no impact on transatlantic prices in the 1990s. Their claim that I do not understand alliance economics would be a bit more credible if they could provide any evidence refuting the detailed evidence showing that the "double marginalization"-based claims contradict widely recognized airline practices, economic principles, and objective evidence of what has actually happened in the marketplace.

- The Show Cause Order's finding that immunity will generate massive connecting market price benefits because every ATI grant automatically generates massive connecting market price reductions must be rejected because there is no evidence that any recent grants reduced prices, and there is substantial evidence that immunity expansion since 2003 has significantly raise prices. In addition to the data below, which shows negative price impacts orders of magnitude greater than any positive benefits alleged by the applicants, the docket includes references to multiple studies showing that the "ATI automatically leads to lower prices" claim is false[126].



C3. The DOT's findings that immunity will create public benefits from increased nonstop service willfully violates *Horizontal Merger Guidelines* requirements that evidence cannot be vague or speculative

- The Joint Applicants claim that immunity will generate $45 million in annual public benefits from increased service in nonstop hub-to-hub routes[127]. This is the only source of public benefits quantified in the application other than the $92 million "double marginalization" benefits discussed in the previous section. The DOT explicitly includes

[126] data summarized at Horan comments, p 18
[127] Joint Application (DOT-OST-2008-0252-0001) p. 7. 24, exhibit JA-13, Joint Applicants Consolidated Reply (DOT-OST-2008-0252-3314) p.19.

increased nonstop service as a key basis for its finding that the application meets the section 41308 public benefits test.[128]

- As noted earlier the *Horizontal Merger Guidelines* clearly specifies that public benefit "claims will not be considered if they are vague or speculative or otherwise cannot be verified by reasonable means." Yet every time DOT mentions the public benefit of increased nonstop service, they directly acknowledge that such benefits are completely vague, speculative and unverifiable.
  - ☐ DOT comments when the core public benefits are summarized clearly indicate that increased nonstop service is a vague possibility, not a verifiable commitment: "we note the applicants' *intention* to introduce new nonstop service"[129]
  - ☐ DOT counters Virgin Atlantic objections that Heathrow constraints limit feasible gains from the development of connecting networks because of the possibility of added service, but immediately admits that this is purely speculative: "the participants will have the *option* to utilize the Madrid hub to boost traffic and work around the constraints at Heathrow"[130] but there is no evidence to suggest a high probability that they will actually do so.
  - ☐ DOT accepts the vague possibility of increased hub-to-hub nonstop service as a public benefit justifying the immunity grant, despite the lack of evidence that there would have been any actual increase in transatlantic service since new capacity on a route such as Chicago-London could have been funded by reduced capacity on other routes
  - ☐ DOT accepted increased Dallas Ft. Worth-Madrid service as a public benefit despite objections from both Virgin and DOJ that this route had been operated in the past, had been temporarily cancelled to the economic downturn, thus restoration of the flight could not be properly deemed a public benefit solely due to the grant of immunity. DOT justified this by vague references to capacity increases created by Northwest/KLM in the mid 90s, an even more dubious basis for claiming public benefits.[131]

C4. "Metal-Neutrality" is meaningless and irrelevant in any public benefits analysis, and cannot be used as a justification for refusing to carve-out collusion on nonstop routes from immunity grants

- The Show Cause Order falsely portrays "metal-neutral" alliance contract arrangements as an important, independent source of public benefits. It specifically says that these contracts are "pro-competitive" and the existence of these "efficiency-enhancing integration" arrangements were a key factor when DOT weighed the benefits of the alliance against the anti-competitive risks.[132] Because Northwest/KLM was always run on a "metal-neutral" basis the DOT links these contract arrangements with "lower fares, increased capacity and greater service for passengers."[133] The linkage is false because DOT can only cite evidence of Northwest/KLM public benefits in the 1990s, and cannot cite any evidence of incremental public benefits under Northwest/KLM "metal-neutrality" since 1999. The linkage is false because 1990s public benefits were created by specific network competitive advantages versus pure interline service in specific target markets, and were exhausted by 1999;[134] no public benefits were created by contract arrangements independently of the joint venture's prices and schedules in the marketplace .
- There is nothing wrong with Northwest/KLM-type joint venture contract arrangements; it is a perfectly sensible way to run an alliance. But these contract arrangements cannot be viewed any differently than accounting systems or revenue management software or line maintenance programs. Sensible joint venture contracts are only "efficiency enhancing" relative to bad joint-venture contracts, just as effective revenue management software and line maintenance programs are "efficiency enhancing" relative to badly-written software and unreliable maintenance programs. Antitrust reviews must assume that mergers and immunized alliances are run in ways that can sensibly achieve profit-maximizing objectives. The question here is whether a collusive alliance can be justified because of verifiable public benefits and the absence of market power risks, questions that must be judged in terms of prices, capacity, competition and other marketplace impacts. Alliance contractual arrangements, accounting systems,

[128] Show Cause Order p.30
[129] Ibid.
[130] Show Cause Order, p.32
[131] Show Cause Order, p.31
[132] Show Cause Order, pp.31-32
[133] Show Cause Order, p.22
[134] Horan Comments, p.7-9

revenue management software and line maintenance programs used to implement the collusive alliance do not have impacts separate from alliance price and capacity levels, and thus are irrelevant to the public benefits and market power questions.

- Every North Atlantic ATI case has presented a tradeoff between potential network synergies from new alliance services in connecting markets (markets the Joint Applicants currently serve on a codesharing basis) and reduced competition in overlapping nonstop markets such as Dallas-Ft. Worth-London. In the original Northwest/KLM and Delta-Swissair-Sabena alliances, the favorable ratio of passengers in connecting markets benefiting from service/capacity expansions to passengers in overlapping nonstop markets at risk because of reduced competition was huge, while in the current (and all recent) cases, the tradeoff is hugely negative. But the DOT has done away with the process of undertaking an objective, quantitative analysis of that tradeoff using case-specific evidence, by establishing an arbitrary rule that asserts that carveouts can never be justified in any ATI case because the needs of the connecting markets are always overwhelmingly more important. DOT bases this arbitrary rule on the combination of three willfully false claims:
  - ☐ ATI generates massive public benefits from "double marginalization" savings
  - ☐ The creation of an alliance joint-venture ("metal-neutral") contract creates incremental benefits and recent joint-venture contracts create greater incremental benefits than 1990s contracts
  - ☐ Joint-venture ("metal-neutral") contracts cannot function if any routes are excluded from the joint-venture; carve-outs would create such huge management inefficiencies as to destroy much of the basic gains from the alliance
- The only evidence DOT can cite to support its "carve outs would massively reduce consumer benefits claim" is a single working paper by Brueckner and Proost[135], based on paid advocacy work in support of Star Alliance's desire to be able to fully collude on overlapping nonstop hub-to-hub routes. That paper assumes all the core " because of double marginalization every future ATI grant will lower prices 15-25% regardless of market/competitive conditions" claim made in the 1990 Brueckner and Whalen paper. That claim relies on the DOT's insistence, discussed above, that "double marginalization always lowers prices" is established fact that not only does not require verifiable, case-specific evidentiary support, but is permanently immune from any challenge based on facts or evidence.
  - ☐ Recent joint-venture contracts create no benefits that were not possible under the original 1992 Northwest/KLM arrangements. Even the Brueckner and Proost paper clearly states that the only efficiency issue is "joint venture" versus "not joint venture". The DOT falsely claims that contract arrangements developed in the last few years create new public benefits never observed in past alliances, but it can't explain where those benefits come from, and it can't demonstrate where or how the "public" would actually achieve them.
- The DOT also has no evidence supporting its assertion that carve-outs would massively undermine the ability of joint-ventures to manage alliance networks, but more importantly the claim ignores the basic distinction between joint ventures and full mergers, and cannot possibly be true unless joint-venture alliances are fundamentally unmanageable. Every hypothetical airline alliance joint venture covers a limited scope of each partner's routes—some routes are included in the venture, others are excluded. Every hypothetical airline alliance partner is managing some routes and aircraft on a joint venture basis, and others on a traditional standalone basis, and each airline employs aircraft, staff and computer systems that interchangeably serve both networks. Thus every hypothetical airline alliance joint venture must address economic tradeoffs between the separate "joint venture" and "not joint venture" parts of their networks. Starting in 1992, Northwest and KLM routinely evaluated aircraft swaps that could improve profitability on Atlantic "joint venture" routes and but worsen the performance of other "not joint venture" routes (or vice versa) since both carriers' widebody fleets flowed freely between Atlantic and non-Atlantic routes. Northwest and KLM routinely evaluated shorthaul schedule changes that could increase feed onto the Atlantic "joint venture" but reduce competitiveness and yields in the local "not joint venture" routes. All of these questions were readily manageable in 1992 and they are readily manageable today. Other alliances can define broader or narrow joint venture scopes, as they see fit, but unless airlines pursue full mergers, there will always be a boundary between "joint venture" and "not joint venture", and airlines have always been capable of maximizing profitability across this boundary. In the Delta-Swissair-Sabena situation, many of Delta's transatlantic routes were outside the joint venture, even though they competed for some of the same traffic flows served by its joint venture flights. Airlines can optimize alliances where some nonstop routes are carved out, just as they can

[135] Brueckner, J. and Proost, S. (2009) "Carve-outs under antitrust immunity" CESIFO working paper 248

optimize alliances where not every transatlantic flight is part of the joint venture, or not every flight flown by its transatlantic fleet are part of the joint venture. DOT's assertion that carveouts will massively harm consumers has no evidentiary basis and is contradicted by over 15 years of alliance reality.

C5. Since all other components of the DOT's public benefit findings are either false or insignificant, the overall finding that immunity is required by the public interest must be rejected.

- The DOT's public benefit finding said: "Specifically, we tentatively find that the following public benefits are likely: (1) more options for travelers in numerous transatlantic city pairs, based on the applicants' ability to closely coordinate schedules and inventory and to achieve fare combinability; (2) lower fares resulting from the reduction in double marginalization on multi-segment itineraries; (3) volume discounting made possible when the alliance partners carry more passengers per flight and enjoy more efficient utilization of capacity; (4) expanded access to discounted fares resulting from coordinated inventory; (5) reduced costs through shared sales, marketing, distribution, procurement, fleet assignment, and frequent-flyer program management; and (6) expanded opportunities to earn and redeem miles due to the airline partners' ability to share risks. Additionally, we note the applicants' intentions to introduce new nonstop services and facilitate long-term operational changes, product enhancements, and investment in infrastructure"[136]
- Thus the public benefits DOT uses to justify immunity here fall into several categories;
  - (a) the false claims of lower prices in connecting markets due to "double marginalization" (item 2) and (b) the vague and speculative claims of expanded nonstop service (unnumbered item 7) the only two quantified claims in the application, both of which have already been discussed;
  - (c) the claim that consumers will get more generous frequent flyer benefits as a result of ATI (item 6), a claim that must be dismissed because it is not supported by any evidence on the record and is refuted by decades of worldwide evidence that frequent flyer programs are becoming steadily less generous
  - (d) cost-reduction claims (item 5) and (e) claimed efficiencies resulting from higher levels of low-yield connecting traffic generated via new alliance connecting schedules (items 1,3 and 4) that must be dismissed as they do not meet the *Horizontal Merger Guidelines* requirement that efficiencies must be significant and properly documented. Both claims are unquantified (and in fact wholly unsubstantiated), and thus "the likelihood and magnitude of each asserted efficiency" cannot be verified, and it cannot be shown that they are material enough to "enhance the merged firm's ability and incentive to compete"[137]
- The DOT explicitly used the alliance connecting schedules claim (items 1,3,4) of as justification for dismissing the evidence that "double marginalization" does not exist. After claiming "Mr. Horan does not recognize that antitrust immunity and the resulting integration of planning and pricing can fundamentally change the economics of connecting routes" DOT explains "When carriers are metal-neutral, they price, market, and revenue manage accordingly, opening availability of more seats and fares throughout the cabin on more itineraries in a given city pair."[138] But this "benefits from more connecting seats and fares available" claim is not only unsubstantiated (and has nothing to do with "metal neutral" contracts) but is demonstrably false. No significant public benefits have been created—overall market prices are not being reduced because overall seat capacity has not been increased. If American Airlines moves aircraft from the St.Louis-Chicago route to Kansas City-Chicago, it will sensibly adjust its revenue management allocation of discount fare availabilities on connecting Chicago routes, but the increased Kansas City discount seats simply offset the decreased St. Louis seats; no public benefits were created unless American increased its total Chicago hub seat capacity, or the average fares across the entire Chicago hub declined. If this alliance is approved, American and British Airways will sensibly adjust revenue management allocations on their Chicago-London flights, but seats allocated to new alliance connecting routings are simply offsetting decreased allocations to existing online routings. Alliances can create public benefits in connecting markets, when they provide superior schedules and lower prices than existing alternatives, and when those competitive advantages allow carriers to profitably sustain more capacity. But the DOT is falsely asserting that benefits can be created without competitive advantages, increased capacity, aggregate fare reductions or large efficiency gains.
- The DOT's findings eliminate the "public" part of public benefits. It accepts connecting traffic gains on the applicant's airplanes as a "public" benefit without any consideration as to whether there was an overall market

[136] Show Cause Order p. 30
[137] Horizontal Merger Guideline, p. 31
[138] Show Cause Order, p.32

gain or whether this simply shifted pre-existing traffic from other carriers. It accepts increased seat availability for one connecting itinerary without considering the reduced seat availability on other itineraries that it displaced. It accepts the possibility of cost reductions as a "public" benefit without any consideration of whether the alleged gains would be passed on to consumers. It accepts the possibility that certain platinum status Aadvantage program members might have improved frequent flyer redemption options without considering whether frequent flyers across the North Atlantic (or even across the Aadvantage program) would have improved benefits as a direct result of immunity.

- The DOT's public benefit finding renders the section 41308 public benefit requirement completely meaningless by establishing a standard that each any and every plausible ATI application would meet. Every conceivable ATI application between network airlines with some degree of network overlap could claim the exact same "public benefits", since DOT has eliminated the longstanding requirements that benefits must be quantified using verifiable, case-specific evidence, must have a significant impact on pricing, productivity or competitiveness, and cannot be vague and speculative.
  - Even totally implausible ATI applications would fully meet these eviscerated public benefits standards. Even a full merger of the Star and Skyteam immunized alliances would generate huge benefits from "the elimination of double marginalization," the possibility of new flights on new hub-to-hub links, potential savings from consolidation of lounges, check-in facilities, sales programs and frequent-flyer administration, and more routing and upgrade options for platinum status frequent flyers. Even a full merger of the United and American hubs at Chicago would allow the carriers to "closely coordinate schedules and inventory and to achieve fare combinability," "volume discounting made possible when the alliance partners carry more passengers per flight and enjoy more efficient utilization of capacity" and would result in "opening availability of more seats and fares throughout the cabin on more itineraries in a given city pair."

D. DOT MUST REJECT THE IMMUNITY APPLICATION, ON BOTH MARKET POWER AND PUBLIC BENEFITS GROUNDS, AND MUST REAFFIRM CLAYTON ACT TEST AND HORIZONTAL MERGER GUIDELINES EVIDENTIARY REQUIREMENTS FOR ATI APPLICATIONS

D1. The Immunity Application must be rejected as it creates serious risk of creating market power, and the DOT has failed to undertake a legitimate Clayton Act test proving otherwise, and immunity is also not required by the public interest, as there is no legitimate, verifiable evidence of significant public benefits

- The Show Cause Order approved the application without the legally required Clayton Act market power test. The DOT's finding that immunity did not create competitive risk did not consider evidence of entry barriers across the tens of thousands of connecting transatlantic markets that have not witnessed successful entry in 23 years. The DOT failed to undertake the analysis of market contestability that would be required to determine whether there was any possibility that future entry would be "timely, likely and sufficient either to deter or to counteract a proposed alliance's potential for harm." The DOT's findings are not based on any evidence as to whether recent increases in North Atlantic concentration had created pricing power that had reduced consumer welfare, even though such data is readily available, and shows that multi-billion dollar annual consumer losses due to anti-competitive pricing are occurring at concentration levels much lower than the current and recent applications will create. The DOT's findings are not based on any analysis as to whether the combination of non-contestable markets and even higher levels of concentration would establish "conditions and incentives that would encourage airlines to contract supply" and create even larger consumer welfare losses than have been observed to date.
- The Show Cause Order's finding that the application would generate $92 million in annual public benefits in connecting markets, the Joint Applicants' biggest and most important claim, willfully violated the *Horizontal Merger Guidelines* requirement that efficiency claims must be based on legitimate, verifiable, case-specific evidence. This finding is not only based on evidence that fails to meet the evidentiary requirements needed to justify a section 41308 finding that immunity is *required* by the public interest, but is based on evidence that is demonstrably false and could not survive any objective scrutiny, and the DOT willfully ignored substantial evidence on this docket contradicting the applicant's claim. "Double marginalization", the underlying theory that airlines are physically incapable of setting rational, revenue-maximizing interline fares, and instead establish interline prices 15-25% higher than online or alliance carriers would set, is false. Based on this false theory, the DOT has held that every ATI grant, anywhere in the world, will lead to an immediate and automatic 15-25% reduction in connecting fares, regardless of market or competitive conditions. There is no evidence whatsoever supporting the claim that "double marginalization" is a structural problem that increases interline fares worldwide, or the claim that ATI grants will automatically lead to 15-25% fare reductions in each and every possible case. All "double marginalization" benefit claims, in this and all previous ATI cases, rest on a single paper that used data from 15 years ago, and whose lead author was (and is) a paid advocate for the Star Alliance. No airline or researcher independent of the ATI applicants have ever found any evidence of "double marginalization." No study of post-1999 transatlantic pricing has found any evidence that ATI grants have led to lower fares for consumers, and there is no evidence that any recent ATI grant actually reduced any connecting fares.
- The DOT also failed to enforce the *Horizontal Merger Guidelines* requirements that public benefits must be proven by the applicants, and that the significance of public benefit claims must be properly documented and claims cannot be vague or speculative. The sole basis of the applicants' claim of $92 million in connecting market benefits was a footnote reference to the original 1990 paper that theorized the existence of "double marginalization". The applicants' separate claim of $45 million in nonstop market benefits was wholly speculative. Claimed cost-reductions were not quantified, wholly unsubstantiated, and there was no evidence demonstrating that any savings would be passed on to consumers. Claimed benefits from more generous frequent flyer awards and increased discount seat availability were not quantified, wholly unsubstantiated, and are demonstrably false.
- The DOT's refusal to consider route carveouts that could mitigate competitive losses in overlapping nonstop markets was based on three claims that are wholly unsubstantiated in the Show Cause Order and are demonstrably false: the claim (noted above) that ATI automatically generates massive consumer benefits in connecting markets, the claim that joint-venture partnership contracts create public benefits incremental to any network benefits, and that airlines cannot manage alliance joint ventures that have any carveouts or other scope limitations because these would undermine the entire economics of the alliance.

D2. The Immunity Application must be rejected, as affirmation of the Show Cause Order would sustain the DOT's efforts to eviscerate the Clayton Act test, the Section 41308 public interest requirement, and longstanding antitrust evidentiary requirements under the Horizontal Merger Guidelines, and would eliminate the possibility of a legitimate antitrust review of any future airline ATI request

- DOT is attempting to eliminate the need to examine each antitrust application based on case-specific facts about competition, market conditions and potential efficiencies by establishing arbitrary "rules" so that
  - the need for evidence about actual public benefits has been replaced by a "rule" asserting that any and every ATI application along Northwest/KLM lines will automatically generate significant connecting price reductions by eliminating "double marginalization"
  - the need for evidence about actual market contestability and entry barriers has been replaced by a rule asserting that the existence of a treaty with the words "open skies" in it automatically establishes that markets are fully contestable
  - the need for evidence about actual evidence about risks of anti-competitive pricing or oligopoly capacity reductions has been replaced by a rule asserting that if, after scanning a simple snapshot of current market shares, the DOT's "gut feel" is that those risks do not exist, then those risks do not exist
  - the need for evidence about actual competitive risks where alliances eliminate competition on overlapping nonstop routes has been replaced by a rule asserting that "metal-neutral" joint venture revenue sharing contract create huge benefits that would be destroyed by any scope limitations, and that those benefits always outweigh any consumer welfare losses in the nonstop markets
- These rules create the superficial appearance that then DOT only grants ATI when applications meet the requirements of sections 41308 and 41309, while it is actually flouting the substance of those antitrust rules and directly attacking the consumer welfare and industry efficiency principles they are based on
  - since almost any plausible ATI application the industry might propose along Northwest/KLM lines would automatically be found to produce significant public benefits, and would automatically be found to pose no danger of creating market power, these DOT rules fully eviscerate the laws they are obligated to enforce, and make a mockery of DOT claims that ATI cases are evaluated on their individual merits
  - the new rules reduce the transparency of the airline antitrust review process and give the DOT vastly more power and discretion to decide industry structure and competition as they see fit; if the DOT's power to eviscerate legal standards is upheld, one presumes they would be able to modify these rules or create new rules in the future
  - Unlike the rules in most legal and regulatory setting, which codify longstanding, well-documented evidence and practices, the DOT's rules are deliberately designed to undermine longstanding practices and evidentiary standards.
- These rules are clearly designed to accelerate the process of rubber-stamping ATI requests. Accelerating the reduction of competition in international aviation markets will accelerate increases in the supra-competitive fares already seen in international markets, and will accelerate increases in the multi-billion dollar annual welfare losses consumers have already suffered in those markets
  - the rules should vastly reduce the effort airlines need to make to document ATI applications, and should dramatically reduce the time DOT requires to review them
  - The DOT's willful indifference to substantial docket evidence contradicting the applicants' public benefit claims clearly suggests the DOT's strong predisposal to granting ATI, and entrenching these rules makes it extremely difficult for opponents to challenge ATI applications on the basis of case and market specific evidence
  - DOT's actions flout its own longstanding principle that exemptions from the antitrust laws should only occur under special conditions: "[b]ecause the antitrust laws represent a fundamental national economic policy, one that serves consumers and travelers well, . . . immunity from the antitrust laws should be the exception, not the rule."[139]

D3. The DOT's Final Order must specifically reject claims based on "Double Marginalization" and reaffirm Horizontal Merger Guidelines evidentiary standards and the need for a legitimate Clayton Act test

[139] SkyTeam I Show Cause Order, DOT-OST-2004-19214-0195 p.33.

- The DOT's final decision must clearly reject the Joint Applicants' presumption that any ATI application can be automatically assumed to drive 15-25% price reductions in connecting markets, and that future applications must show verifiable, case/market-specific evidence supporting any such pricing claims
- The DOT's final decision must clearly affirm that this and subsequent ATI cases must meet Horizontal Merger Guideline evidentiary standards, requiring applicants to demonstrate significant, verifiable, case-specific data supporting public benefit claims
- If the DOT does not immediately reject the application on the basis that it is not "required by the public interest", but keeps the docket open and permits the applicants to submit new evidence, DOT must separately undertake a legitimate Clayton Act review before making any final decision on the case. That review must address market power issues based on detailed analysis of pricing trends, and the market contestability of all major transatlantic traffic segments, especially the tens of thousands of markets served predominately on a connecting basis.

Respectfully submitted,

Hubert Horan
4 March 2010