STATEMENT OF HUBERT HORAN

THE ANTI-COMPETITIVE IMPACTS OF A UNITED-CONTINENTAL MERGER AND THE CONSOLIDATION OF 80% OF THE US AVIATION MARKET INTO JUST THREE COMPETITORS

HOUSE COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
AVIATION SUBCOMMITTEE HEARINGS 16 JUNE 2010

Executive Summary—United/Continental and Industry Consolidation Create Four Major Problems

1. Multi-billion dollar consumer welfare losses due to anti-competitive pricing in international markets that will steadily increase in the coming years
2. Extreme levels of consolidation where a cartel of three Collusive Alliances will permanently control 80% of the entire US aviation market and 100% of trans-Atlantic and trans-Pacific markets
3. Seriously new distortions to domestic competition, including risks of major oligopoly service cuts in thousands of smaller cities where Low Cost Carriers (LCCs) do not compete. Just as the KLM-Air France merger destroyed Northwest Airlines as an independent competitor and destroyed almost all of its corporate value, this merger is designed to cripple or destroy USAirways' ability to survive as an independent competitor. This reduced competition will not be addressed by new LCC expansion or by future competitive entry. It is highly unlikely that consolidation will produce stable competition; given the weaknesses of American and USAirways it is much more likely competition will be imbalanced in favor of just two competitors (United and Delta)
4. This merger cannot be justified by synergy or efficiency gains, and can only be explained by United's pursuit of increased anti-competitive market power. The merger does not do anything to solve the industry's many problems, and the distortions created by this merger will actually make those problems worse.

Executive Summary—The Committee Needs to Address the Root Cause of These Problems, The DOT's Nullification of Longstanding Antitrust Law and Evidentiary Requirements

None of the extreme concentration and consumer welfare losses would have occurred without the DOT's willful refusal to enforce longstanding antitrust law, including its failure to conduct required market power tests and its use of fraudulent evidence of public benefits. The Committee and Congress must ensure that the United/Continental review and all future airline antitrust cases are based on verifiable, factual, case-specific evidentiary standards consistent with the Horizontal Merger Guidelines and reject the DOT's use of non-factual, non-evidentiary "rules" to eliminate the need to evaluate the actual market power and public benefits impacts of consolidation. The Committee and Congress must ensure that the United/Continental review and all future airline antitrust cases include the rigorous, independent review of synergy, efficiency and public benefits claims that are required under the law, but have been missing in every prior airline consolidation case.

Hubert Horan has been in aviation for over 25 years, and his consulting practice is based in Phoenix. The testimony presented here is based on his personal experience with over a dozen major airline mergers, alliances and restructurings. He was responsible for the original development of the Northwest-KLM alliance network, which served as the template for all subsequent immunized airline alliances. He also managed Northwest's Tokyo-based trans-Pacific network, developed and implemented the business and fleet plan America West used to successfully emerge from bankruptcy in the mid 90s, held strategic planning and network management positions at Swissair and Sabena, and worked on the bankruptcy reorganization plans for Hawaiian and United.

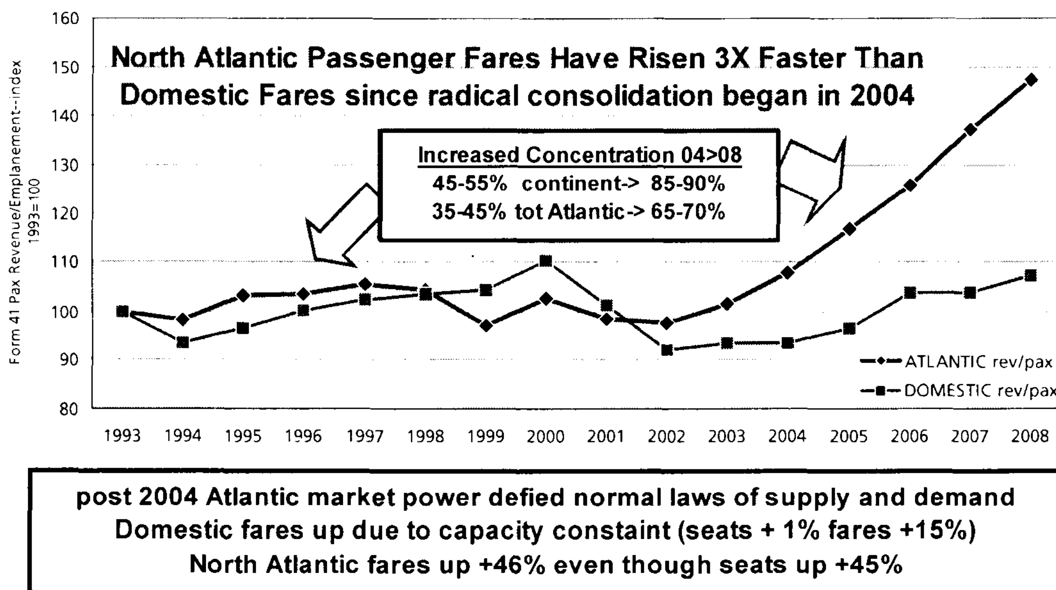
As with his 2008 Congressional testimony on the Delta/Northwest merger, this testimony is based on his concern that extreme airline consolidation will undermine the benefits of liberal, market-based competition and will damage long-term industry efficiency. He has no financial relationship with any of the current merger or antitrust immunity applications. He has published extensively on airline competition and consolidation issues, the restructuring of Legacy airlines in both America and Europe, and the negotiations leading to the recent US-EU Open Skies treaty. A full publication list and professional biography is available at his website, horanaviation.com. He is a graduate of Wesleyan University and the Yale University School of Management and is based in Phoenix, Arizona.

Mr. Chairman, the United/Continental merger and the ongoing airline consolidation process creates four major problems for consumers and industry efficiency. I would like to open with a brief overview of these four problems, (which are fully documented in my written testimony). The heart of my testimony is that all four problems have a common and very simple cause, and I believe a very simple solution.

Problem #1. Consumer Welfare Losses From Anti-Competitive Pricing Power Already $5+ Billion and Rising

- Problem #1 is that the anti-competitive market power created by trans-Atlantic consolidation has already created consumer welfare losses in excess of $5 billion per year. These consumer welfare losses will be much worse in a few years—the historical evidence doesn't reflect the recent consolidation due to ATI grants for United/Continental and American/British Airways/Iberia. The evidence is overwhelming and shows that the growth of anti-competitive pricing on the North Atlantic exactly tracks the movement to extremely high levels of North Atlantic concentration that started in 2004, with the KLM-Air France merger, continued with the three major ATI cases creating the current situation where meaningful competition has been eliminated in favor of a permanent Cartel of three Collusive Alliances. What has developed on the North Atlantic is the exact type of artificial pricing power that is specifically forbidden by the antitrust laws--extreme concentration levels, in completely non-contestable markets. There hasn't been successful new entry on the North Atlantic in 23 years, so there is no possibility that future competition could ever discipline the growing anti-competitive behavior that has been documented
  - For decades, pricing trends in the domestic and trans-Atlantic markets tracked closely, because the factors driving market demand and airline efficiency in both markets were virtually identical. But as exhibit 1 below clearly shows, artificial trans-Atlantic pricing power emerged after 2004, and ever since Atlantic prices have been rising three times faster than domestic fares.

exhibit 1



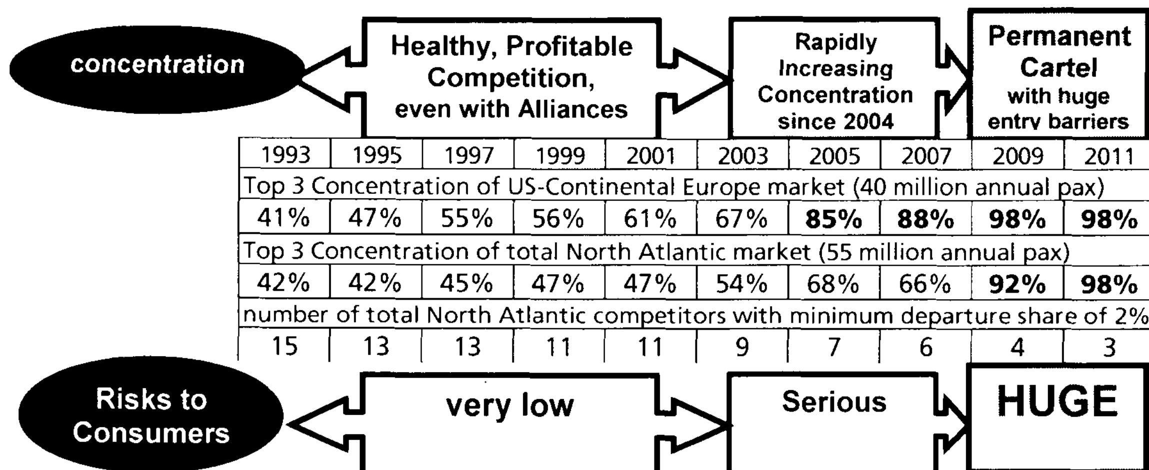
  - The pricing gap in exhibit 1 actually understates the market power problem; the trans-Atlantic carriers have developed sufficient pricing power to raise fares despite huge capacity increases that would depress yields in any competitive market. Despite robust (dot-com era) demand conditions, North Atlantic prices fell after 1998 in response to 10% capacity growth because carriers had no artificial pricing power. In the domestic market carriers, recent unit revenue growth was made possible by strong capacity discipline--fares increased 15% in four years

because capacity only grew 1%. But North Atlantic carriers have been able to raise prices 46% in the same period, despite 45% increases in seat capacity.[1]

- Exhibit 1 reflects actual 2008 North Atlantic fares $10-12 billion higher than they would have been if fares had continued to track domestic fare trends, as they always had when both markets were fully competitive. A detailed analysis (such as the Clayton Act market power test required in cases such as these) would need to adjust this raw comparison upward for the additional market power demonstrated by the industry's ability to significantly increase prices in the face of rapid capacity growth, and downward to recognize that less capacity would be provided in a lower revenue environment. $5-8 billion is a (conservative) estimate of the true consumer welfare loss due to anti-competitive pricing after these adjustments. That analysis would likely find that the greatest 2008 consumer welfare losses were in Continental European markets where concentration levels and entry barriers are highest.

- Exhibit 2 documents the movement from modest North Atlantic concentration prior to 2004, to the imminent situation where a permanent Cartel of three Collusive Alliances controls the entire market. The KLM-Air France merger (announced in 2003 and finalized in 2004) eliminated the strongest price competitor in European longhaul markets, immediately pushed top 3 concentration levels in the US-Continental Europe markets from 60-65% to 85%+ and ensured that it would be a permanent Air France/Lufthansa-controlled duopoly. The US-UK market and the overall North Atlantic market will reach similar concentration levels once the recent United/Continental and British Airways/American antitrust immunity grants have been implemented.[2].

exhibit 2



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

[1] 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. Capacity growth rates are total (US and non-US) carriers entity seat capacity from DOT Form 41 schedule T100. 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, and testimony in the "Oneworld" (British Airways-American Airlines) ATI case at docket DOT-OST-2008-0252-3394 p.2-3

[2] The three Collusive Alliances are controlled by Air France/Delta ("Skyteam"), Lufthansa/United ("Star") and British Airways/American ("oneworld"). Alliance members with ATI are free to collude on all pricing, capacity and product decisions. Concentration levels based on 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. 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 or merge with another immunized carrier

- The antitrust issue here is not Collusive Alliances, per se, but the market power needed to sustain anti-competitive behavior. ATI grants since 2004 have helped create this market power although Collusive Alliances produced strong consumer benefits when they were first introduced in the mid 90s. The original Alliances created tangible, readily-measurable pricing and service advantages across a large range of markets, and consumers received maximum benefit because they were introduced in a highly robust competitive environment. These incremental gains were fully exhausted by the late 90s as the inferior interline connecting service that had been supplanted by the new alliance connections had been driven out of the market, and large increases in nonstop and online one-stop service supplanted much of the value created by the initial alliance connections. There are no legitimate independent studies showing any material consumer benefits created by Collusive Alliances in the last decade[3]

- Anti-competitive pricing supported by the combination of extreme concentration, cartel conditions and high entry barriers is the only possible explanation of the pricing shifts shown in exhibit 1. Neither fuel or GDP shifts nor any other economic factor except artificial market power could possibly explain multi-billion dollar shifts in the economics of one market since 2004, but not the other. Factors such as fuel, exchange rates, and GDP shifts can explain the smaller variances observed before 2004 (and small portions of subsequent variations), but not the huge, steady post-2004 shift.

- The critical issues are not the precise estimate of consumer welfare losses in past years, but that the DOT enthusiastically supported the increase in trans-Atlantic concentration from 40% levels to 90% levels while ignoring powerful evidence of multi-billion dollar reductions in consumer welfare, and the risk that the current phase of industry consolidation, including this merger and the Japan ATI cases are likely to proceed without a rigorous analysis of market power issues.

<u>Problem #2. United/Continental is Part of a Well-Planned, Ongoing Process to Consolidate Virtually All Legacy Network Airlines Into Just Three Competitors That Will Control 80% of US Airline Traffic</u>

- Problem #2 is that United/Continental is part of a well-planned, coordinated, ongoing process to consolidate the Legacy Network sector so that three competitors control roughly 80% of the US aviation market. Phase 1 of this process was the North Atlantic consolidation between 2004 and 2010 that created the growing anti-competitive pricing power and artificially handed exclusive control of all Intercontinental traffic to three companies. In Phase 2 those three companies use that power to artificially force the other three Legacy airlines out of business. Phase 3 began last year with the Japan ATI cases that are designed to eliminate competition and give the three Collusive Alliances control of the trans-Pacific market, and create the same type of multi-billion dollar consumer pricing impacts already seen on the North Atlantic. United/Continental is key to all three phases of radical industry consolidation, and cannot evaluated as an isolated event. The central antitrust issues is not what will happen to prices the day after this merger closes, but whether the process whereby a Cartel of three "too-big-to-fail" competitors end up with control 80% of the overall US aviation market and nearly 100% of the trans-Atlantic and trans-Pacific markets is justified by efficiency gains that clearly offset any competitive detriments.

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[3] The original mid-90s North Atlantic Collusive Alliances (KLM-Northwest in 1992, Swissair/Delta in 1995 and United/Lufthansa in 1997) not only provided offering superior schedules and a wider range of discount fares in thousands of small connecting markets, but traffic growth stimulated by these lower fares led to capacity growth and further consumer benefits. For a more detailed discussion of Collusive Alliance economics see Comments of Hubert Horan in the "Oneworld" case, 31 January 2010, DOT Docket OST-2008-0252-3389, pp.7-9, based on my experience developing the original Northwest/KLM alliance network (that has served as the template for all subsequent North Atlantic alliances), and my subsequent work on Swissair-Sabena-Delta alliance. The DOT documented the schedule and price benefits of the original 90s alliances in studies conducted in 1999/2000, although they overstated the benefits attributable to antitrust immunity by including some of the consumer pricing gains stimulated by non-alliance capacity growth. See US Department of Transportation, Office of the Secretary (1999) "International Aviation Developments: Global Deregulation Takes Off" and (2000) "Transatlantic Deregulation: The Alliance Network Effect." But neither DOT nor any other public agency has conducted similar analysis of the consumer and competitive impacts of immunized airline alliances since 2000.

- Each phase was driven by a small set of directly linked transactions, each making the same basic economic claims. The sequence and timing of applications was fully coordinated by Air France and Lufthansa on the European side and by Delta and United on the US side. Phase 1 consolidation was driven by the 2004 Air France-KLM merger and the coordinated antitrust immunity (ATI) petitions that increased concentration above 90%. Phase 2 consolidation, shrinking six domestic Legacy carriers to three, is being driven by the Delta/Northwest merger, the inevitable follow-on United/Continental application, and whatever deal USAirways is forced to make. The phase 3 process began last year with the coordinated ATI petitions that will reduce US-Japan competition by 50%.

PHASE 1-ATLANTIC **Replace competition with permanent Cartel of 3 Collusive Alliances** --KLM-Air France merger --Skyteam/Star/Oneworld ATI	**PHASE 2-DOMESTIC** **Consolidate 6 Network carriers into just 3** --Delta-NWA merger --United-CAL merger --USAirways merger???	**PHASE 3-PACIFIC** **Replace competition with permanent Cartel of 3 Collusive Alliances** --Japan ATI cases --future ATI cases
Top 3 Concentration rises from 47% to 95+% 13 large competitors (02) consolidated into just 3	Destroy value of most efficient Legacies (NWA, USAirways) Enhance, entrench power of least efficient legacies (Delta, United)	(2008) 26 independent competitors, low concentration (future) 3 Alliances control entire market

Exhibit 3

- The Domestic and Pacific consolidation that will occur in phases 2 and 3 would not have been possible without the market power created by the phase 1 Atlantic consolidation. Phase 1 not only created a growing multi-billion dollar pool of supra-competitive profits, but it created artificial market power based on the three alliances' control of all longhaul connecting traffic to/from the North America and Europe. This control of these huge traffic flows allows the three alliances can block or distort competition since no other longhaul Network airline can provide meaningful service to North America or Europe unless they agree to whatever terms the three alliances might choose to set.[4]

- The industry consolidation that occurred after 2004 versus is fundamentally different from the consolidation that occurred prior to 2004. Pre-2004 consolidation was entirely market driven, post 2004 consolidation was strictly the result of large incumbent carriers petitioning DOT and other government agencies for reduced competition, and the willingness of DOT and those government agencies to engineer changes to industry structure that free-market competition would have never created[5]. Most pre-2004 consolidation was due to smaller carriers with uncompetitive networks shrinking operations or exiting markets, allowing more efficient carriers with stronger networks to grow more rapidly. Mergers were very rare, but none had any expectation of producing high market concentration or pricing power. In contrast, none of the post-2004 consolidation had anything to do with competitive "market forces" (highly efficient carriers displacing the capacity of

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[4] Carriers from Brazil or China or India or other countries can serve the US and Europe with direct nonstop flights, but this limits them to a small number of very large gateway markets (New York, Los Angeles, London). Traditionally, these carriers could serve interior markets via interline connecting agreements with local network carriers, and healthy competition among US and EU network carriers ensured reasonable access to these connecting opportunities. But the Cartelization of US/EU network carriers creates new market power so that the three alliances can simply refuse to interchange connecting passengers (in the hope of driving the foreign carrier out of the market completely) or by imposing punitive terms for alliance membership or interline agreements.

[5] The one post-2004 exception involving US airlines was the 2005 USAirways-America West combination, which occurred as part of the court-supervised chapter 11 reorganizations of both carriers. It not only met the longstanding "failing company" antitrust test, but the chapter 11 context allowed the merger plan to incorporate a much greater magnitude of efficiency improvements that would be possible with United/Continental or any other non-chapter 11 merger. While employees and other creditors suffered painful losses, it is likely that both airlines would have liquidated without a merger, and thus significant employment, service and competition was preserved.

carriers with higher costs and poorer service). Post-2004 North Atlantic consolidation reflects a totally artificial, governmentally driven process whereby DOT and the EU drove massive changes to industry structure designed to massively reduce competition on behalf of the interests of a small handful of politically powerful companies.

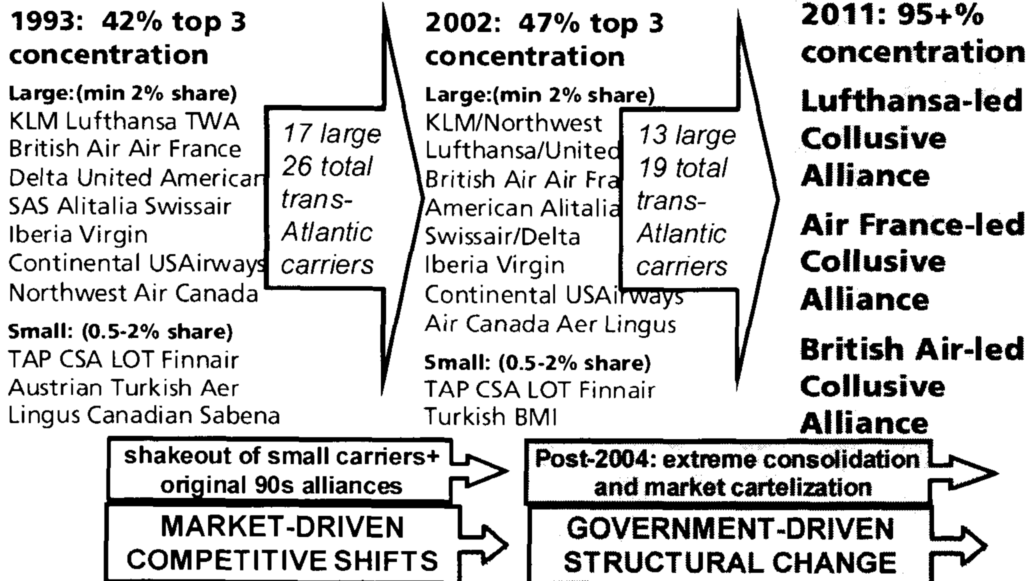
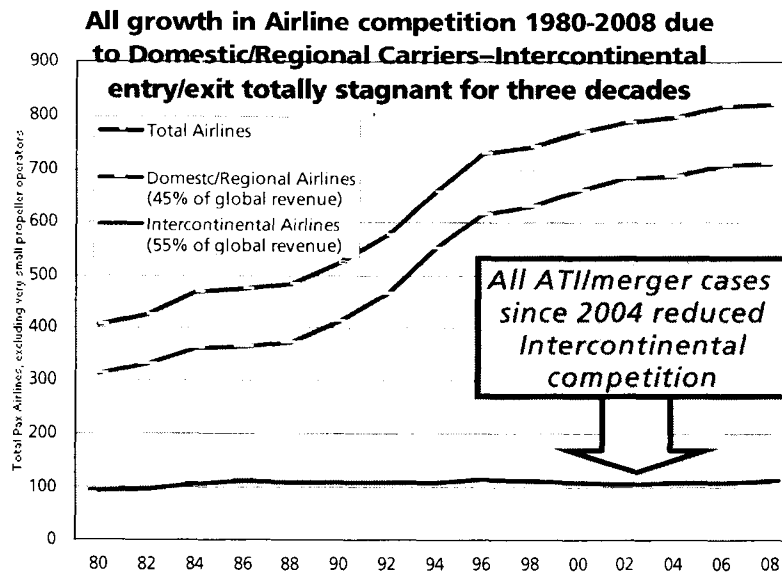


exhibit 4

- The consolidation process started and is largely focused on Intercontinental markets because those markets have always been highly competitively deficient, and because market power is easily created through the combination of high entry barriers and government market interference. Exhibit 5 demonstrates that Intercontinental competition has been completely stagnant for three decades, and contrasts the highly non-contestable intercontinental (longhaul) sector with the highly dynamic domestic/regional (short/medium-haul) sector[6].

exhibit 5



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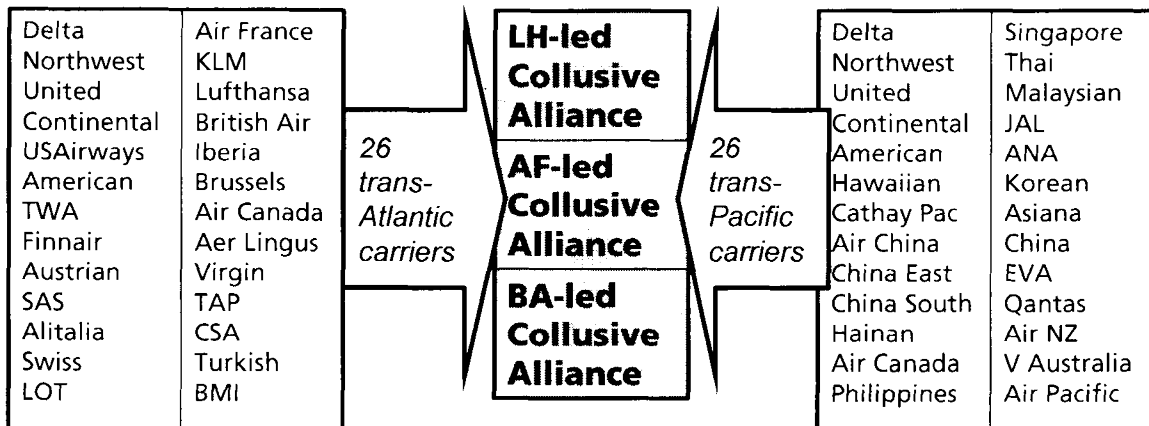
[6] See "If Consolidation occurs, it would reverse decades of airline history", Airlines International, January 2009. The graph includes all airlines operating regularly scheduled passenger services with aircraft of 30 seats or more, and all airlines that operated more than 15 aircraft of 30 seats or less. Airlines included as domestic/regional carriers operate exclusively on short/medium haul routes, while any airline operating longhaul aircraft on routes 3000 miles or longer are considered intercontinental carriers even if they also operate in short/medium haul markets. The graph does not reflect any of the reduced competition in intercontinental markets due to recent alliance antitrust immunity grants.

- ☐ The number of passenger airlines has more than doubled in this period, but 100% of this industry expansion occurred in the domestic/regional sector, while there has not been any competitive growth in the intercontinental sector for the past three decades. Over 800 airlines fight over the 45% of global aviation revenue earned in domestic/regional markets while huge entry barriers have limited share the 55% of global aviation revenue earned in intercontinental markets to a stagnant group of roughly 100 companies.
- ☐ Consolidation advocates falsely claim that recent consolidation is a rational response to the chronic losses caused by "too many airlines", and the ease by which new entrants can create excess capacity, when in fact consolidation is only occurring among the intercontinental carriers, who always enjoyed huge entry barriers, the strongest demand growth, and the least excess capacity.

■ The greatest threat to consumer welfare going forward is the program to cartelize trans-Pacific airline service that began with the recently opened US-Japan Alliance ATI case, and is designed to create the same anti-competitive pricing power illustrated in exhibit 1. Pacific market power will be even easier to develop than it was on the Atlantic because of much greater governmental interference, and much higher competitive barriers (such as Japanese airport slot limitations). Most Pacific carriers (including Singapore, Thai, Cathay Pacific, Qantas and JAL) had long resisted North Atlantic-style alliance network integration because they felt that the added costs and strategic risks greatly outweighed the limited connecting revenue benefits. But due to the artificial market power created by the alliances control of all North American and European longhaul connecting traffic, these carriers will soon face the choice of accepting full integration on whatever terms the alliances might offer, or being almost entirely shut out of access to both the huge United States and European Union markets. Cartelization of the US-Japan market already has the enthusiastic support of both governments; it serves the DOT's desire to limit international markets to just two or three competitors, and the Japanese Ministry of Transport sees the pricing power that reduced trans-Pacific competition would create as critical to the bankruptcy restructuring of Japan Air Lines. Once all of the US and Asian carriers that had served the Pacific via the Tokyo and Seoul hubs have full collusive immunity, and competition between the Tokyo and Seoul hubs has been neutralized, then other carriers serving smaller or less-developed markets will be forced to join the Collusive Alliances as well.

exhibit 5



<u>Problem #3. Domestic Consumers Are Threatened by Weakened, Distorted Competition that Low Cost Carriers Will Not Address; United/Continental Directly Threatens the Independent Survival of USAirways</u>

■ Problem #3 is the domestic market power threat. The United/Continental merger will not cause immediate price increases in the Chicago-Houston market, and the antitrust issues are different from those already documented in international markets, but broad categories of US consumers are at risk. Until recently there had been six (or more) competitive Legacy Network Carriers[7], each with

[7] The national Legacy network carriers are American, United, Delta, Continental, Northwest and USAirways and their regional airline partners; the three national LCCs are Southwest, Airtran and Jetblue. The two largest of the carriers that do

strong international operations; in fact Legacy Network carriers cannot survive without a strong, secure source of international traffic. The domestic market power problem was created when the DOT's ATI decisions granted the three Collusive Alliances exclusive control over the lucrative intercontinental traffic that is the heart of Legacy Network business model. When the DOT gave three Legacy companies exclusive control over this international traffic, they issued a de facto death warrant for Legacy companies #4, 5 and 6. The Delta/Northwest merger eliminated competitor #4, the current merger will eliminate competitor #5, and is designed to cripple or kill USAirways, carrier #6. The artificial competitive distortions that will cause harm in the marketplace fall into four major categories

1. Distortions already caused by the artificial destruction of corporate value of Northwest, and the threat to the corporate value of USAirways created by this merger. Although USAirways is the most efficient Legacy carrier, it has no hope of independent survival, solely due to DOT actions designed to help Delta and United. The destruction of competitors and forced mergers where companies can be acquired for pennies on the dollar are market power abuses every bit as serious as cartel pricing behavior.
2. Distortions caused by consolidation of the 82% of the domestic market currently served by Legacy Network Carriers from six to three carriers, that will primarily occur in the form of oligopoly service reductions in smaller cities, and will not be addressed or mitigated by Low Cost Airline (LCC) expansion
3. Further risks that the consequent impacts of this merger on USAirways and American don't just shrink the Legacy sector from six to three, but produce a highly imbalanced situation with only two-and-a-half, and eventually only two companies controlling the Legacy 80% of the overall market
4. Distortions in the large city markets where direct Legacy-LCC competition remains, where the Legacy carriers will be able to cross-subsidize competition against the much more efficient LCCs using supra-competitive gains from international markets

- Domestic consumers and investors have already suffered as a result of reduced competition due to this artificial alliance market power. Regulatory approval of the Air France-KLM merger destroyed Northwest Airlines' corporate viability, even though Northwest was one of the lowest cost Legacy carriers and operated highly competitive hubs in Minneapolis and Detroit. That merger meant the end of its alliance with KLM, which rendered Northwest's highly profitable North Atlantic operations unsustainable, effectively destroying Northwest's going-concern value. Those regulatory actions also gave Delta (Air France's exclusive US alliance partner) market power over Northwest's future access to North Atlantic, market power that it exercised by dictating punitive terms for Northwest's subsequent merger into Delta, where Northwest's shareholders were paid nothing for all of Northwest's physical, network and brand assets[8]. Northwest was a much more efficient airline than Delta, but Delta survived while Northwest's corporate value was totally destroyed because Delta had artificial market power thanks to its control of the Air France alliance "franchise position", and because DOT had ignored these competitive risks when it approved the Skyteam ATI deals that had created this market power.

- United/Continental similarly threatens the viability of USAirways, the most efficient of the six Legacy carriers. USAirways' survival depends the large North Atlantic revenue base that depends on connections with Star Alliance's European members. Despite public claims that status quo

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not operate national networks (Alaska/Horizon and Hawaiian) also follow the "Legacy Network" business model. Any competitive analysis must consider the Legacy regional carriers (such as ASA, American Eagle and Air Wisconsin) as integral parts of the "mainline" Legacy carriers, and none of these regional airline companies could survive independently of the Legacy companies. Intercontinental traffic is critical to legacy carriers as this is the one market where they have significant competitive advantage and LCCs like Southwest and Airtran cannot compete. Legacy Network carriers also serve the vast majority of cross-border North American traffic (Canada/Mexico/Caribbean) as their hub networks and marketing infrastructure gives them advantages that the LCCs have been unable to match. No Legacy Network airline could survive as a predominately domestic carrier as they could not compete with the large cost advantage of the LCCs or the revenue advantage Legacy carriers with large international networks would have

[8] The Delta-Northwest merger was structured as a stock swap; Northwest shareholders got Delta stock equivalent in value to the Northwest's cash and liquid assets, thus Delta paid nothing for Northwest's routes, brand equity, hub networks, computer systems or other non-liquid assets.

arrangements are secure, United/Continental has every motivation to cripple or destroy USAirways' current Star Alliance position, because any trans-Atlantic traffic USAirways carries over Philadelphia directly reduces United/Continental revenue over Newark and Washington,[9] and reduces the network synergies used to justify the UA/CO combination. Since USAirways does not have a secure international traffic base, and no longer provides unique value to the Star Alliance network, it has no hope of independent survival[10]. USAirways entered merger negotiations with United because it fully recognized its vulnerability; United exercised its alliance market power by pitting USAirways and Continental in a bidding war against each other, and getting Continental to agree to a merger that it had said for many years that it didn't want.

- USAirways' corporate value has thus been seriously compromised (if not destroyed) by DOT's actions giving United control over the Star Alliance US traffic base. The inevitable loss of USAirways' Star Alliance traffic does not mean that it would immediately collapse and shut down, but that (like Northwest) its corporate value would be now limited to whatever United, American or Delta are willing to offer, which might be extremely limited given USAirways weak bargaining position and the problematic nature of all three options. The trans-Atlantic network advantages of an American/USAirways merger would not be large enough to offset major integration obstacles and American's much weaker cost structure. Merger with United or Delta would likely require liquidation of significant USAirways capacity given the larger network redundancy. USAirways is only at risk because DOT ignored the risk that the Star ATI deals they approved could be used to destroy viable competitors. Under healthy competitive market conditions, there was no possibility that Delta and United could have driven more efficient carriers such as Northwest and USAirways out of business, or forced them to accept highly unfavorable merger terms.
- A full merger of USAirways with United/Continental would allow all current Star Alliance links to remain in place, but would be one of the most anti-competitive scenarios imaginable. It would give United an overwhelming advantage in the North Atlantic market since it would control of the three strongest North Atlantic hubs in the Eastern US (Newark, Philadelphia and Washington Dulles). Over half of all trans-Atlantic traffic originates in this region[11] and neither of the other two alliances have profitable, competitive hubs anywhere north of Atlanta (Delta) or east of Detroit and Chicago (Delta and American). This would also allow United to control the combined Washington National/Dulles markets.

- Legacy Network Airlines currently provide 82% of all capacity in the US aviation market; the forced consolidation of domestic Legacy carriers due to the DOT's ATI decisions simply means that three companies will control this 82% of the US aviation market instead of six carriers. This reduced competition will not mitigated by Low Cost Carrier expansion. Some modest LCC growth is possible—from today's 18% market share to perhaps 20-21% but growth to 25% or more would require more dramatic industry shifts than have ever occurred before. More importantly for consumers, these small shifts would have almost no impact on price competition, as LCC expansion would only occur in the high volume markets where LCCs already compete. Legacy competitive behavior will always be limited in these markets that LCCs can readily contest. The risks to consumers are in the 50-60% of the domestic market where LCCs do not meaningfully compete, and will never meaningfully compete—most shorthaul transborder markets, most markets at slot constrained airports and Legacy hub cities (LaGuardia, Newark, Dallas-Ft. Worth, Philadelphia, Minneapolis-St. Paul, etc.) and thousands of smaller volume/smaller city markets. The question is

[9] Lufthansa brought USAirways into the Star Alliance and acquired an equity position in JetBlue during United's bankruptcy, as insurance against the possibility of a major United downsizing, and to add incremental Eastern US feed that United could not provide. The United risk no longer exists, and Continental renders the USAirways/Jetblue feed role completely redundant. Jetblue has already shifted North Atlantic alliance cooperation from Lufthansa to American.

[10] News that USAirways' role in Star Alliance was being minimized or terminated would undoubtedly cause a major collapse in its stock price. A weakened USAirways would quickly become unsustainable because they would rapidly face a larger unit revenue gap (less international and corporate traffic) and a shrinking cost advantage (due to scale effects). **The** status quo is also untenable because USAirways is the only Star trans-Atlantic partner without ATI. USAirways currently earns lower unit revenues than other Legacy carriers (due to less international and very high yield domestic business traffic) but remains competitive because they also have lower unit costs than other Legacy carriers.

[11] In a recent note Bob McAdoo of Avondale Partners noted that "over half the U.S. traffic to Europe is still originating in the eastern 1/3 of the U.S., in an area generally north of the Carolinas and east of Michigan".

whether United and Continental are merging in the expectation that the elimination of Northwest, USAirways and other competitors will create increased domestic market power over the next 3-5 years in the 50-60% of the domestic market where LCCs do not compete, just as it took 3-5 years from the beginning of radical North Atlantic consolidation for multi-billion dollar consumer welfare losses to develop.

- Appendix A describes the current and historical Legacy/LCC breakdown of the US aviation market. Share shift from Legacy to LCCs has slowed to almost zero since 2007, as the cost advantage that fueled price competition in the past has diminished significantly. Rapid LCC growth has only occurred during periods of major bankruptcy-driven capacity retrenchment, or when Legacy carriers have abandoned hubs in major markets (Baltimore, Nashville, Milwaukee) well suited to the LCC business model. Neither situation is likely to occur in the near future, and all of the three large LCCs have adopted very slow/zero growth strategies.

- The greatest risk to consumers from reduced domestic competition is the likelihood of oligopoly service reductions in the thousands of smaller cities where LCCs will never have a significant presence. Some service reductions would occur in these markets even under highly competitive conditions, since not all of today's capacity can be financially justified. The danger is supra-competitive service cuts in these markets, as the three carrier Cartel terminates all air service at many cities and attempts to drive fares and yields as high as possible in the remaining regional cities. This oligopoly behavior would place huge burdens on these communities, and the local businesses that depend on airline service[12].

- Consolidation will also weaken the direct Legacy-LCC competition that remains, although LCC price competition will never be completely neutralized. At Atlanta, Delta can use supra-competitive international revenues to cross-subsidize competition against Airtran, which is a much more efficient provider of domestic service. The Legacy carriers could subsidize below market corporate travel programs to capture traffic that LCCs and other smaller carriers could serve more efficiently, and then raise prices once those smaller carriers are forced to reduce service.

- These domestic competitive problems will become even worse if USAirways and American are unable to merge and successfully compete with United and Delta, although it is difficult to imagine a successful merger given American's current cost competitiveness problems. Under any other scenario competition between the surviving Legacy carriers would be imbalanced and unstable, so only two (or two-and-a-half) carriers were competing for the Legacy 80% of the US market. Since Delta and United would enjoy both size/scope advantages and much greater supra-competitive international profits, they would be able to steadily weaken American's ability to compete.

<u>Problem #4. Mergers such as UA/CO and DL/NW Cannot Be Justified on Efficiency/Synergy Grounds and are Strictly Motivated by the Potential for Increased Anti-Competitive Market Power</u>

- Problem #4 is that Mergers such as UA/CO and DL/NW cannot be justified on efficiency/synergy grounds and are strictly motivated by the potential for increased anti-competitive market power. No previous merger between large airlines (outside of bankruptcy) has ever produced a material reduction in unit operating costs and no previous merger between large airlines has ever produced large enough overall synergies to justify the enormous acquisition and implementation risks, and the vast majority of US airline mergers since deregulation have been dismal financial failures. There is no evidence that the Delta/Northwest merger produced the multi-billion dollar efficiency benefits claimed at the time. There is no broad-based merger movement in aviation because these synergies do not exist, and megamergers make no sense unless they can establish anti-competitive market

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[12] This concern about future Legacy oligopoly behavior in these smaller cities was echoed by former American Airlines CEO Robert Crandall: "It is beyond me why a network carrier that does not need feed for an international network would operate service to smaller destinations that will not support fares high enough to make the feeder flights profitable in their own right. Across time, if consolidation continues, the network guys will simply withdraw from more small cities. Then where will we be? Consolidation will doubtless go on, but I am dead sure we will be sorry in the long run" See National Journal Transportation Expert Blogs "Should United and Continental Be Allowed to Merge?". May. 17, 2010

power. Absent compelling evidence that United/Continental will generate massive efficiencies that no prior merger has been able to achieve, the only rational explanations for the merger are the pursuit of anti-competitive pricing power in international markets, the expectation that they could cripple or kill USAirways and establish oligopoly power in large portions of the domestic market.

- All of these past mergers are listed in Appendix B; the rare successful mergers were either involved bankruptcy financial restructuring (such as America West-USAirways), hub consolidation immediately following deregulation (such as TWA-Ozark and Northwest-Republic), fixing network inefficiencies that had been mandated by the CAB, or involved the acquisition of very small, easy to integrate carriers (Southwest-Muse, Southwest-Morris).
- If this merger could be justified by efficiencies absent market power, it would have been pursued years ago when the cost and network synergies would have been even greater; Continental refused merger overtures for many years because the conditions for anti-competitive market power were not ripe, but is pursuing this merger today, because conditions supporting artificial market power are now secure.

- The claim that the UA/CO merger is needed to "solve the industry's financial problems" is false and completely inappropriate in any antitrust context. United and Continental are not proposing this merger out of an altruistic desire to help improve the profitability of other airlines. The industry does have financial problems, but those problems will not be solved by suspending the antitrust laws so that mediocre airlines clinging to obsolete business strategies can exercise artificial market power at the expense of consumers and more efficiently run airlines. This merger is designed to artificially transfer wealth from the more efficient to the less efficient, and that will actually make the industry's long-term problems even worse.

- This merger will not produce any material reductions in unit costs, and United's own public statements acknowledge that the merger will not reduce its cost disadvantage versus LCCs or the more efficient Legacy competitors. Mergers between airlines as large as United and Continental cannot exploit scale economies as these carriers already have extremely low overhead rates due their already huge scale and years of draconian cost cutting. Any merger between network airlines will produce modest connecting revenue gains, but without major growth or hub development, significant, sustainable revenue synergies are impossible. Most importantly, potential long-range synergies will be dwarfed by the up-front, multi-billion negative cash flow impacts of combining the two companies maintenance programs, IT systems, and other work processes.
  - United' immediate press release claims were that the UA/CO merger would achieve net savings equal to only sixth-tenths of one percent of current operating expenses; actual savings would most likely be negative since the multi-billion dollar costs of systems/airport/fleet/employee integration would be huge, absolutely certain, and would be incurred immediately following merger approval, while most offsetting synergies would be far less certain, and would only be realized well into the future. United's PR cost synergy claims were not based on detailed operational analysis and could have easily been inflated by savings that could have been achieved without merging
  - The same press release predicted annual revenue increases of $800 million (2.5% of current revenue levels) indefinitely into the future even though the merger will not lead to capacity growth and any revenue from new routes is merely replacing revenue from cancelled routes. The claimed increases are merely zero-sum shifts from other airlines that do nothing to improve overall industry efficiency, and these gains will not be maintained indefinitely since competitors will rapidly respond to new network challenges. United/Continental's revenue synergy claims were publicly question by Don Carty, who as CEO of American Airlines was responsible for the unsuccessful American-TWA merger in 2001. "Revenue is a zero sum game. You can't count on revenue synergies because implicitly you are taking revenues from someone and they will have a strategy to take them back."[13]
  - The efficiency/synergy claims made in support of the Delta/Northwest merger were never independently scrutinized by any objective outsiders, and Delta's financial performance in the two years since the merger does not support the claim of huge merger efficiencies

[13]See Jeremy Lemer, "Airlines try to get merger off the ground" Financial Times, 28 May 2010.

- ☐ As with every other carrier, a sizeable portion of both United and Continental's fleet and network is fundamentally unprofitable, part of what is commonly referred to as the industry's "excess capacity" problem. The merger will not make these unprofitable assets profitable, since it will not materially reduce unit operating costs. Contrary to claims made by many financial analysts, the merger will not improve profitability by eliminating these unprofitable assets. Such capacity cuts could improve unit revenues by strengthening supply/demand relationships that depress industry-wide yields, but United and Continental management have explicitly ruled out such merger-driven capacity cuts.

The Root Cause of All of the Growing Consumer Welfare Losses is the DOT's Willful Refusal to Enforce Longstanding Antitrust Law and its Nullification of Verifiable, Factual Evidentiary Standards

- Full enforcement of the antitrust laws is not only central to liberal, free-market airline competition but the Airline Deregulation Act specifically intended that airlines have the same exposure to antitrust laws as every other unregulated industry[14]. But free market competition would not have created the billions in anti-competitive consumer welfare losses documented here if the antitrust laws had been enforced. Free market competition would not have created the market power to wipe out competition and destroy the corporate value of Northwest and USAirways if the antitrust laws were being enforced. Free markets with antitrust enforcement would not have produced the sudden post-2004 shift from robust trans-Atlantic competition with 47% concentration to a permanent Collusive Alliance Cartel with over 90% concentration, and would not have created the current process to eliminate trans-Pacific competition and to give three (or fewer) companies control of 80% of the entire US aviation market. The single root cause of these anti-free market changes is the DOT's willful refusal to obey or enforce longstanding antitrust law. Antitrust law is not a barrier to any airline consolidation proposals that can demonstrate public benefits (such as efficiency gains, service expansion or lower prices) and that do not create or enhance artificial market power. The industry consolidation since 2004 completely fails to meet these consumer welfare/industry efficiency based standards. The DOT's failure to obey the antitrust laws means airline competition is no longer being determined by consumers and investors in the marketplace in accordance with the Airline Deregulation Act, it is being determined by bureaucrats in the Department of Transportation at the behest of politically powerful incumbent companies.

- The DOT refused to conduct the legally required Clayton Act market power test in any ATI case. The DOT has not only willfully ignored the evidence of the growing anti-competitive pricing problem documented here, but they failed to collect any evidence whatsoever pertaining to pricing, entry barriers or market contestability[15]. The DOT simply made the false assertion that the North Atlantic was a fully contestable market, even though there has not been successful new entry in 23 years.

- Every DOT ATI decision is based on completely fraudulent public benefits evidence, directly violating the Horizontal Merger Guidelines requirement that applicants must demonstrate public benefits on the basis of verifiable, case-specific evidence that is neither vague or speculative. The public benefits findings in each case rely on the completely false claim that eliminating competition via ATI automatically reduces prices 15-25% in certain markets regardless of market or competitive conditions[16]. The DOT has actually established this "prices always fall when competition is reduced"

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[14] "In enacting the Airline Deregulation Act, Congress directed that control of the air transportation system be returned to the marketplace. We have consistently held that a part of the return to market control is exposure of participants to the antitrust laws, as that exposure exists in unregulated industries" Competitive Marketing of Air Transportation, Order 82-5-106, 99 CAB 1, 131

[15] With the narrow exception of entry barriers on four Heathrow nonstop routes in the Oneworld case, an issue that is irrelevant to the market power issues discussed here.

[16] This claim, known as "double marginalization" is entirely based on a paper by a United Airlines consultant, based on market data that is over ten years old. There is nothing in the paper (or any other analysis) supporting the public benefits findings DOT actually made in any ATI case. The applicants in the Oneworld case claimed that ATI would generate $137 million in annual public benefits; $92 million of their claim is solely based on the DOT's "rule" that reductions in competition via ATI automatically reduce fares in any and all cases, regardless of market and competitive conditions. For a

claim as an established rule, so that future ATI applicants do not have to provide any objective evidence showing that its customers will actually receive price cuts. In the BA-AA case DOT rejected the evidence of rapidly increasing prices in alliance markets shown in exhibit 1 solely on the grounds that its since its rule "proves" that alliance immunity always reduces prices it is not required to consider pricing evidence that contradicts its rule. The applications in the Japan ATI case present no evidence about public benefits in the US-Japan market whatsoever, but merely assert that their applications must be approved because of the DOT rule that prices fall whenever competition is reduced.

- The DOT also violated the Horizontal Merger Guidelines by using non-public benefits to satisfy public benefits requirements, in particular, claims of benefits that the applicants or some of its customers might enjoy, without any evidence that consumers in general, or the industry in general will be any better off.

- All previous cases ignored consequential downstream events and the overall consolidation process, in order to misrepresent the actual market power issues. Earlier cases only considered market shares the day after implementation and ignored the near-certainty that consolidation would spur further consolidation, even ignoring cases that had already been filed, or the industry-wide public statements about the need for further consolidation. Even though every case made directly comparable economic claims, DOT evaluated later cases without making any effort to see whether the claims from earlier cases had actually been realized. At no point in any ATI case did DOT ever consider the market concentration impacts of the overall consolidation process, such as those shown in exhibit 2.

- DOT's ATI decisions are based on the wholly unsubstantiated assertion that airline consumers are fully protected as long as there are two or three competitors. The major airlines believe this is now an established DOT "rule;"one of the US-Japan ATI petitioners explicitly states "The Department has found that as long as two or more nonstop competitors will remain in a city-pair following a grant of ATI, there is no risk of a substantial reduction in competition"[17]. This claim is not based on any objective analysis of actual airline competition and falsely assumes that the Legacy business model, based on the economics of a complex network of low volume connecting routes across hubs, has the same competitive characteristics of isolated large volume point-to-point nonstop markets.

- The DOT's nullification of factual evidence-based antitrust enforcement has created an irreconcilable split between the DOT and DOJ. Both agencies play a role in airline antitrust enforcement, but their basic approach to antitrust jurisprudence are nearly 180 degrees apart, and are not amenable to compromise. This conflict surfaced publicly during the United/Continental ATI case last year when the DOJ filed detailed comments demonstrating that the DOT had not only failed to meet the Horizontal Merger Guidelines requirement for verifiable, case-specific evidence, but the DOT had done nothing more than "copy/paste" the applicant's unsubstantiated public benefits claims. The DOT's Final Order completely rejected all of the DOJ's evidentiary objections out of hand, and affirmed DOT's nullification of antitrust standards based on verifiable factual evidence. The DOJ position was based on the view that the law required a neutral judge to weigh case-specific evidence against the consumer welfare and industry efficiency standards of antitrust law, and that antitrust regulators do not have the legal authority to use merger cases as the basis for reengineering overall industry structure. The DOT argued that DOJ was interfering with their prerogative to base antitrust decisions on their desire to reengineering airline competition in favor of 2-3 politically powerful companies.[18] These are basic black-and-white questions that the Committee and Congress must resolve before the antitrust review of this merger can proceed.

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more detailed discussion of the DOT's fraudulent regulatory use of the "double marginalization" claim see Oneworld ATI testimony at docket DOT-OST-2008-0252-3389 pp.3-19.

[17] Joint Response of American Airlines and Japan Air Lines to Order 2010-4-9, DOT-OST-2010-0059-020, p. 4, citing the DOT's Skyteam ATI final decision.

[18] See Comments of the Department of Justice on the Show Cause Order (Public Version), 26 June 2009, Docket DOT-OST-2008-0234-0239 and the DOT Final Order Docket DOT-OST-2008-0234-0253, 10 July 2009. For an overview of the ensuing interagency dispute see Stephen Labaton, "Antitrust Chief Hits Resistance in Crackdown", *New York Times*, July 26, 2009. For a detailed explanation of the DOT's "policy advocate" approach see Dean, Warren, L. and Shane, Jeffrey N.

- The DOT has clearly signaled that they have no intention of enforcing the law in the upcoming US-Japan ATI case, and plans to rubber-stamp the two alliances' request to massively reduce trans-Pacific competition. North Atlantic carriers have had some form of ATI since 1992; the recent North Atlantic consolidation cases have been active since 2004, and the BA-AA case has been pending for 20 months. Yet the DOT agreed to complete its review of the two new Japan ATI cases by September, even though these markets are subject to huge governmental interference and have much greater competitive deficiencies than any transatlantic market, DOT has never conducted a major transpacific competitive analysis, and the cases will be subject to huge uncertainty due to Japan Air Lines' bankruptcy reorganization and political instability within Japan. One must assume that DOT has no intention of conducting legitimate market power or public benefits analysis, since it would be impossible to conduct any analysis using evidence that met Clayton Act and Horizontal Merger Guidelines standards within this unrealistic deadline.
  - The Japanese bilateral treaty and the Japan ATI cases are explicitly designed to weaken US carrier competitive positions and force consumers to pay high prices in order to protect the incumbent Japanese carriers, two of the highest cost carriers in the world. Under healthy competitive conditions US carriers (who are much more efficient) would have a much larger share of the US-Japan market and Japan Air Lines would most likely be forced to liquidate.
  - The DOT sees "antitrust enforcement" as an inseparable part of its "bilateral treaty negotiation" role; thus having negotiated a new Japanese bilateral treaty that promised the Japanese a massive reduction in market competition needed to protect Japan Air Lines from market forces, it plans to violate all existing antitrust requirements and rubber-stamp the Japan ATI applications as part of the process of "honoring" its treaty commitment. But the DOT's "bilateral treaty negotiation" role is primarily responsive to the narrow interests of the big incumbent carriers and protectionist foreign governments, just as it was in the days of Pan Am and BOAC. By making antitrust enforcement a secondary adjunct of treaty negotiation, the DOT is explicitly making consumer welfare and overall industry efficiency a secondary adjunct to the short-term interests of a small number of private companies.

- While it has had only a limited role in the consolidation that has occurred to date, and certainly has a stronger appreciation of the consumer welfare/industry efficiency objectives of antitrust law, the DOJ's past track record does not inspire confidence that its upcoming United/Continental review will fully address these competitive issues.
  - While the DOJ correctly objected to the DOT's willful refusal to decide the United/Continental ATI case in accordance with the law, it has taken no substantive actions since then to deal with the DOT's adamant rejection of Horizontal Merger Guidelines based evidentiary standards
  - The DOJ's Delta/Northwest merger review was not based on a serious review or understanding of the industry and market economics critical to the case. DOJ failed to meaningfully scrutinize the synergy/efficiency claims, failed to evaluate any of the market power issues that had destroyed Northwest's corporate value, failed to consider the merger in the context of the ongoing industry consolidation process, failed to consider likely follow-on impacts (such as this case), and its focus on competition in large nonstop O&Ds was not appropriate for hub-based economics of the Legacy Network business model.

<u>Congress Cannot Allow United/Continental, Japan ATI and Industry Consolidation To Proceed Without Clearly Rejecting the DOT's Nullification of Longstanding Antitrust Law and Evidentiary Requirements</u>

- The Committee and Congress must ensure that the United/Continental review and all future airline antitrust cases are based on verifiable, factual, case-specific evidentiary standards consistent with

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(2010), "Alliances, Immunity and the Future of Aviation", *Air and Space Lawyer*, v22 n4 p.1. Although Dean and Shane are highly supportive of the DOT's "policy based" airline antitrust jurisprudence. their paper offers no post-1999 evidence that the public or the industry have benefited from this approach. The DOT "policies" that Dean and Shane support are not based on any published analysis, and are not explained in any publicly disclosed policy papers.

the Horizontal Merger Guidelines and reject the DOT's use of non-factual, non-evidentiary "rules" to eliminate the need to evaluate the actual market power and public benefits impacts of consolidation. The Committee and Congress must ensure that all future merger and ATI cases are based on the actual market power and public benefits impacts of individual transactions based on US law, and that applications are not evaluated in terms of agreements negotiated with foreign governments, or DOT desires to reengineer a different industry structure than free market competition would produce. The Committee and Congress must either align DOT and DOJ antitrust jurisprudence under a consistent approach using verifiable case-specific evidence or reallocate airline antitrust review responsibilities between the agencies.

- The Committee must ensure that the United/Continental review considers all consequent downstream impacts, based on all of the factors shaping the economics of industry competition. These should include risks to USAirways international revenue base, corporate value and independent survival; the possibility of a consequent USAirways/American merger giving three companies control of 80% of the US aviation market; mergers between a highly weakened/downsized USAirways and either United or Delta (producing much more imbalanced competition between the three surviving Legacy carriers); the risks of oligopoly service cuts in smaller cities where LCCs do not compete, and whether Legacy consolidation would undermine price competition with LCCs, or stimulate increased competition from LCCs

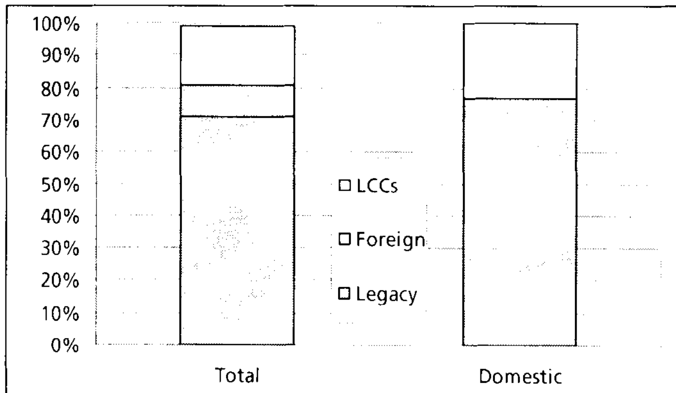
- The Committee must ensure that the United/Continental review includes a rigorous independent review of all efficiency/synergy claims, based on evidence of the actual efficiency/synergy gains achieved by Delta/Northwest and other prior mergers. The Committee must ensure that the United/Continental market power review is based on the actual economics of the internationally focused Legacy Network business model, and considers the market power impacts of the three alliances control of North American and European longhaul connecting traffic.

- The Committee and Congress must ensure that the DOT does not rubber-stamp the Japan ATI applications based on fraudulent, non-evidentiary claims of network synergies and price reductions, must ensure that the DOT is not limited by an September deadline and takes whatever time is required to conduct a review consistent with Horizontal Merger Guideline standards, and must ensure that its decisions do not reduce consumer welfare or reduce the competitiveness of US carriers in order to subsidize or protect Japan Air Lines.

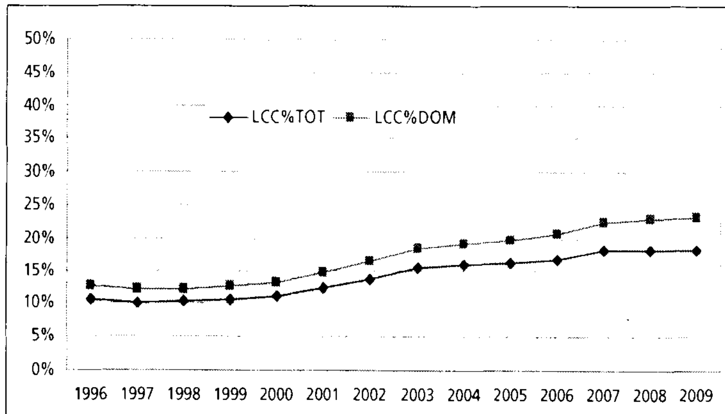
- The Committee and Congress must ensure that DOT initiates rigorous economic analysis of the actual consumer and industry efficiency impacts of the North Atlantic consolidation that has occurred since it last analyzed the impact of immunized alliances in 1999/2000.

Appendix A—Consolidation would give three companies control over 80% of the US aviation market; Low Cost Carriers are unlikely to ever serve more than 20% of the total market (or 30% of the purely domestic market) and they will never compete in Regional or Intercontinental markets

- Legacy Network Airlines currently provide 82% of all capacity (ASMs) in the US aviation market and 77% of all capacity in purely domestic markets. Low Cost Airlines currently provide 18% of total capacity and 23% of domestic capacity. The LCC share of industry capacity increased modestly until 2007 but has been flat in the last three years.[19]
  - 77% of industry ASMs serve domestic markets; 23% serve international markets; 55% of the capacity in international markets is operated by US flag carriers, 45% by foreign carriers



exhibits 6,7



- Legacy Network carriers will continue to control 75% or more of the US aviation market for the foreseeable future; further increases in LCC share are possible, but are likely to be modest
  - Legacy carriers will continue to completely dominate Intercontinental markets (where they have insurmountable competitive advantage) and have an overwhelmingly strong share of shorthaul international markets (Canada, Mexico, Caribbean)
  - Legacy carriers will continue to dominate domestic markets served by the highly efficient megahubs (Chicago, Atlanta, Dallas-Ft. Worth, Newark, etc), and will completely control low volume domestic O&D markets served via regional aircraft, where LCCs are uncompetitive
  - Larger share shifts from Legacy to LCC carriers are not impossible, but would require the types of major Legacy capacity cuts that occurred after multiple bankruptcies in the 2002-05 period

- Airline consolidation would give three competitors control over the vast majority of this huge market; meaningful price competition would be limited to high volume O&Ds where LCCs have already established a strong market presence. There is no possibility that LCC competition would discipline anti-competitive behavior in international markets, regional airline markets or most megahub markets.

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[19] DOT Form 41 Schedule T-1 and T100 data. 2009 data is year ending November.

Appendix B--No Large US Airline Merger Has Ever Been Economically Justified by Cost Efficiencies or Network Synergies and Almost All Mergers Since Deregulation Have Been Dismal Financial Failures

There were 18 mergers of major airlines in the years between deregulation and the 2008 Delta/Northwest merger. In almost every case, airline mergers failed to generate positive returns for shareholders, which is to say profit improvements (above and beyond what the carriers would have earned absent the merger) that fully justified the financial costs and implementation risks. Mergers that cannot earn positive returns for shareholders cannot possibly justify the risks (from reduced competition) imposed on consumers.

All ten of the "Synergy/Scope" mergers that had been justified on the basis of scale economies and revenue synergies from combining existing networks, were complete economic failures. In many cases the acquired network was quickly liquidated and/or the merged carrier went bankrupt.

Mergers such as Delta/Northwest and United/Continental have none of the characteristics of the four successful cases. The recent USAirways/America West merger justified its costs and risks because it occurred as part of a Chapter 11 bankruptcy restructuring, which allowed asset shifts that are impossible in non-bankruptcy cases. The 1994 Morris merger allowed Southwest to acquire a very small set of aircraft and routes that were very easily integrated into Southwest's network and operation. And two mergers in the mid 80s, TWA-Ozark and Northwest-Republic, led to the integration of operations at large hubs (Detroit, Minneapolis and St. Louis) that had been artificially segregated by CAB route regulations.

Exhibit 9

Large Airline Mergers	Category	**Were merger acquisition and implementation costs fully justified by improved profitability?**
80: Pan Am/National	Post Deregulation	**FAILURE**—NA network largely liquidated
82: Texas Intl/Continental	Post Deregulation	**FAILURE**—carrier quickly went bankrupt
85: Southwest/Muse	Small Acquisition	**FAILURE** —MC assets quickly liquidated
85: People Exp/Frontier	Synergy/Scope	**FAILURE**— carrier quickly went bankrupt
86: TWA/Ozark	Post Deregulation	Profitable—Restructured STL into a competitive hub
86: Northwest/Republic	Post Deregulation	Profitable—Restructured DTW/MSP into competitive hubs
86: American/Aircal	Synergy/Scope	**FAILURE**—OC network totally liquidated
87: Continental/PE/NY/FL	Synergy/Scope	**FAILURE**—carrier soon bankrupt, FL/NY networks liquidated
87: Delta/Western	Synergy/Scope	**FAILURE**—WA network largely liquidated
87: Continental/Eastern	Synergy/Scope	**FAILURE**—CO soon bankrupt, EA network liquidated
88: USAir/PSA	Synergy/Scope	**FAILURE**—PS network largely liquidated
88: USAir/Piedmont	Synergy/Scope	**FAILURE**—US soon bankrupt, PI partially liquidated
94: Southwest/Morris	Small Acquisition	Profitable—easy fit with SWA network/operations
99: American/Reno	Synergy/Scope	**FAILURE**—QQ network largely liquidated
00: American/TWA	Synergy/Scope	**FAILURE**—TW network largely liquidated
00: United/USAir (plan)	Synergy/Scope	**FAILURE**—both carriers went quickly bankrupt
05: America West/USAir	Chapter 11 reorg	Profitable—helped avert liquidation, but profits still weak
07: Northwest/Midwest	Small Acquisition	**FAILURE**—YX soon bankrupt, NW had massively overpaid

Note: 2000 United/USAir merger reached regulatory review process but was never implemented
All Canadian airline mergers during this time frame were also failures