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BEFORE THE
DEPARTMENT OF TRANSPORTATION
WASHINGTON, D.C.

Joint Application of

AMERICAN AIRLINES, INC. and
LINEA AERA NACIONAL CHILE, S.A. (LAN CHILE)

Docket OST-97-3285 - 31

under 49 U.S.C. Sections 41308 and 41309 for approval
of antitrust immunity for alliance agreement

Application of

LINEA AERA NACIONAL CHILE, S.A. (LAN CHILE)

Docket OST-97-2982 - 20

for an exemption under 49 U.S.C. Section 40109

Joint Application of

AMERICAN AIRLINES, INC. and
LINEA AERA NACIONAL CHILE, S.A. (LAN CHILE)

Undocketed

for a statement of authorization under 14 C.F.R.
Parts 207 and 212 (reciprocal code-share services)

CONTINENTAL AIRLINES, INC.
ANSWER TO MOTION,
CONSOLIDATED SURREPLY
AND MOTION FOR LEAVE TO FILE AN
UNAUTHORIZED DOCUMENT OUT OF TIME

Communications with respect to this document should be sent to:

Rebecca G. Cox
Vice President, Government Affairs
CONTINENTAL AIRLINES, INC.
1350 I Street, N.W.
Washington, DC 20005

R. Bruce Keiner, Jr.
Lorraine B. Halloway
CROWELL & MORING LLP
1001 Pennsylvania Avenue, N.W.
Washington, DC 20004.2595
(202) 624.2500

April 7, 1998

Counsel for
Continental Airlines, Inc

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The Joint Applicants' claims about the "pro-competitive implications of U.S.-Chile open skies" and the public benefit of an immunized American/Lan Chile¹ alliance are simply not credible. They are directly contradicted by the complaints of

¹ Common names of carriers are used.

American's Chairman and CEO to Congress (and by American to the Department) about the anticompetitive effects of immunized U.S.-European alliances as well as by the conclusion of the Department of Justice ("DOJ") that, even without antitrust immunity, the similar American/TACA Group alliance brings "high" risk to competition and "low" procompetitive efficiencies.² As Aeromexico and the Regional Business Partnership (Newark) showed in their replies, an American/Lan Chile alliance will preempt development of competing airline networks on U.S.-Chile and U.S.-Latin America routes while also preventing growth on new U.S. gateways for Chile.

Continental states as follows in opposition to American's motion to strike Aeromexico's reply and in response to the replies filed by Aeromexico, American/Lan Chile and the Regional Business Partnership (Newark):

I. AMERICANS POSITION IN THIS CASE CANNOT BE
RECONCILED WITH RECENT STATEMENTS OF ITS TOP
EXECUTIVE OR AMERICANS OPPOSITION TO LUFTHANSA'S
O'HARE SLOT EXEMPTION APPLICATION

The Joint Applicants' pie-in-the sky description of open skies and their attempt to cast Continental, Delta and United as villains do not withstand scrutiny. While American and Lan Chile continue to advance the absurd argument that a de facto merger of the two carriers controlling 70% of the U.S.-Chile seats is in the

² January 18, 1998 Comments of the Department of Justice ("DOJ") in Docket OST-96-1700 at 6.

public interest, American's Chairman and CEO is showing exactly why an American/Lan Chile combination is bad for consumers and bad for competition.

Here the Joint Applicants claim that "[t]he Lan Chile/American alliance provides the impetus for the opening of the currently restricted U.S.-Chile market, just as the United-Lufthansa alliance was the driving force behind the opening of the U.S.-Germany market." (Joint Applicants' Reply at 7) Less than a week earlier, however, American's Chairman and CEO complained to a Senate Committee that "American has been driven out of three U.S.-European city-pairs because of the tremendous advantages immunized alliances possess over unaffiliated carriers."³

With respect to Germany, Mr. Crandall said:

In March 1997, we had to cancel American service between Miami and Frankfurt, due to the United/Lufthansa alliance. We had suffered millions of dollars of losses and had no prospect of turning a profit.

(Crandall Testimony at 8) In a similar vein, American argued to the Department last month that it should not grant Lufthansa an additional O'Hare slot because

Since the grant of antitrust immunity to United/Lufthansa two years ago, American's service between the U.S. and Germany in general, and between Chicago and Frankfurt in particular, has become increasingly marginal, with low load factors and low yields. Last Fall, American ceased operations altogether between Miami and Frankfurt, despite Miami's position

³ Written Testimony of R. L. Crandall, Chairman and Chief Executive Officer, AMR Corporation, Before the Subcommittee on Antitrust, Business Rights and Competition, Senate Committee on the Judiciary at 2 (March 19, 1998) ("Crandall Testimony").

as an American hub, because of American's inability to compete effectively for beyond Frankfurt traffic in light of the United/Lufthansa alliance.

(March 11, 1998 Answer of American in Docket OST-98-3552 at 6 ("American Answer"))

Continental agrees with the Regional Business Partnership that if American has been unable to compete in an open skies environment as an independent carrier on its well-established U.S. hub-Europe routes against immunized European alliances with combined U.S.-Europe shares below 20%, it will be impossible for any U.S. carrier to compete with immunized alliances between dominant American and its Latin American partners, even under open skies, because American and its partners control more than 53% of the nonstop U.S. seats on U.S.-Latin America routes. (See Regional Business Partnership Reply at 4-5) American's cited difficulties on U.S.-Germany routes, where there are six U.S. competitors⁴ and United/Lufthansa have only a 50% share of all nonstop U.S.-Germany seats prove beyond a doubt that no U.S. carrier would be able to compete effectively with an American/Lan Chile monolith controlling 70% of the U.S.-Chile nonstop seats.

⁴ Service on U.S.-Germany routes is provided by American, Continental, Delta, Northwest, United and US Airways.

Moreover, “there are dramatic differences between the European and South American markets” that show why “control over Santiago has a far greater impact on a carrier’s total market power than control over a major European city.”

Aeromexico Reply at 15) As Aeromexico demonstrates, “[h]ubs in Latin America are not interchangeable, and while other Latin American cities may also be very important to U.S. interests, it is not possible to conveniently substitute one market for another in the region, especially if one carrier is clearly working to control the majority of major markets region-wide” (II. at 15-16) as American is. As a result, it is especially important to maximize competitive travel options on Latin America routes so “the growing numbers of U.S. travelers [are] able to reach destinations as effectively and competitively as possible.” (Id. at 9) Without those options, both competition and consumer choice will suffer.

II. AMERICANS CLAIMS OF PUBLIC BENEFIT ARE REFUTED BY THE CONCLUSION OF THE DEPARTMENT OF JUSTICE THAT HORIZONTAL ALLIANCES ARE ANTICOMPETITIVE AND LACK PUBLIC BENEFIT

American and Lan Chile are right about one thing: the Department’s decision in this proceeding will determine the course of “open skies” negotiations and competition throughout South America. If the Department were to approve the American-Lan Chile relationship, it would be telling governments throughout South America that signing an “open skies” agreement will allow them to convert “de jure” protective restrictions into a “de facto” monopoly by combining their principal flag airline with the dominant U.S. carrier in the region and allowing the two airlines to

share the monopoly rents which would result. Unless the intention of U.S. policy is securing “open skies” agreements to create monopolies, the Department should deny the American/Lan Chile applications to make clear that its goal is increased access for all airlines,

The Joint Applicants claim their alliance “will offer a myriad of benefits” (Joint Applicants’ Reply at 3), and they assert that approval of their applications is supported by “developments since Lan Chile and American signed their agreement in September 1997.” (Joint Applicants’ Reply at 3) Just the opposite is true.

The Joint Applicants’ chronology omits two key developments: On December 31, 1997, the Department tentatively approved the American/TACA Group alliance, and on January 28, 1998 the Department of Justice (“DOJ”) filed comments strongly counseling against final approval of that alliance. Aeromexico correctly points out that the guidance provided by DOJ in the American/TACA Group case leads to the inescapable conclusion that an American/Lan Chile combination “would do great harm to competition region-wide in Latin America, as well as to the choices and options available to the growing numbers of U.S. interests which rely on the existence of such competition.” (Aeromexico Reply at 22)

As the Department of Justice recognized:

- . By any measure the proposed American/TACA Code-Sharing Agreement is largely horizontal rather than end-to-end. As noted in the Department’s Show Cause Order, American and TACA carrier operate overlapping nonstop flights on virtually all routes between Miami, the principal Latin American hub in the United

States, and Central American gateway cities. (DOJ Comments at 7)

- The “almost exclusively horizontal American/TACA agreement stood in stark contrast to the largely end-to-end agreements that the Department has approved in the past.”⁵
- It appears that the code-share agreement cannot possibly extend the reach of American’s existing network to new on-line services for single-connect city pairs in which one end point is a Central American point beyond American’s Central American gateways. (DOJ Comments at 9)

DOJ warned the Department that the American/TACA agreement “does not offer significant pro-competitive efficiencies” and the threats to competition that inevitably persist despite the best efforts to eliminate them through conditions should be a matter of concern.” (DOJ Comments at 12) American’s proposal to merge with Lan Chile raises the same dangers which DOJ cautioned the Department about in the American/TACA Group case, and the dominance and overlap between American and Lan Chile is even greater than it is between American and the TACA Group.⁶

⁵ The end-to-end agreements cited by DOJ were those for which the Department has granted antitrust immunity: Delta/Swissair/Sabena/Austrian Airlines, United/Lufthansa, American/Canada and United /Air Canada, which DOJ found “involved fewer problematic overlapping city pairs, and significantly greater opportunities for the code-share partners to extend the reach of their networks beyond foreign “gateways.” (DOJ Comment at 10)

⁶ Significantly, the Joint Applicants fail to address the merits of Continental’s argument that DOJ’s American/TACA Group analysis leads logically to denial of the American/Lan Chile alliance. Since the reasoning of DOJ in the American/TACA Group case applies equally here, it should be considered by the Department.

The Joint Applicants tout the same benefits claimed in the American/TACA case, and Aeromexico's reply shows why they are just as illusory here. First, unlike an alliance between Lan Chile and another U.S. airline, "the proposed alliance. .would extend neither of the major online networks of American and Lan Chile, and it would add no new nonstop destinations or services that do not already exist for U.S. and international passengers." (Aeromexico Reply at 23-24) Second, the so-called new online city-pairs the Joint Applicants may create "are characterized by the fact that they feature extremely remote areas where there is likely to be very little demand." (Id. at 24) Third, "the proposed alliance offers few, if any, consumer benefits" since passengers will gain no new direct flights, will have little need for "new service" to remote areas and gain no new flight times. (Aeromexico Reply at 25) Indeed, the only "consumer" benefits from the proposed alliance would be the listing of American and Lan Chile connections under a single code, allowing agents to see them more easily. (Id. at 25) And, that benefit will have the negative effect of pushing other connections off the screen.

Aeromexico is correct that an American/Lan Chile alliance will "first, reduce (if not eliminate) regional competition; second, empower the alliance possibly to reduce flights and raise prices, and third, increase the prospects for anticompetitive practices throughout Latin America." (Aeromexico Reply at 9) The only beneficiaries would be American, Lan Chile and their other partners. (Id.)

III. AN AMERICAN/LAN CHILE ALLIANCE WILL PREEMPT
NETWORK COMPETITION

Among the most far-fetched claims of the Joint Applicants is their assertion that a U.S.-Chile “open skies accord, in combination with the American-Lan Chile alliance, will accelerate South American carriers’ and governments’ participation in the emerging global alliance networks.” (Joint Reply at 3) The replies of both Aeromexico and the Regional Business Partnership rebut this preposterous proposition.

As the Regional Business Partnership says, “the only plausible reason for American’s interrelated investments in and code-shares with Latin American carriers is to preserve its already-dominant position on U.S.-Latin America routes and to deny its U.S. competitors the positive benefits and network efficiencies that result from such alliances.” (Regional Business Partnership Reply at 6-7) American’s Chairman and CEO says that alliances between U.S. and foreign airlines, particularly those with antitrust immunity, are anticompetitive and harmful, and he justified American’s proposed mega-alliance with British Airways “solely for the purpose of enabling [American] to remain a competitor between the United States and Europe in a world where all our major competitors already enjoy extremely powerful alliances.” (Crandall Testimony at 28) This rationale has no application to American in Chile, where American already operates 75% of the U.S. carrier nonstop flights between the U.S. and Chile, dominates the key Miami-

Santiago routes and competes with no other U.S.-carrier alliance on U.S.-Chile routes. (See Regional Business Partnership Reply at 6)

Aeromexico's exhibits confirm that American and its affiliates would have substantial control of important U.S.-Latin America routes, including New York-Santiago, Los Angeles-Santiago and Miami-Santiago (Aeromexico Reply at Appendix 3) as well as Bogota-Santiago, Buenos Aires-Santiago, Mexico City-Santiago, Montevideo-Santiago and Caracas-Santiago. (Aeromexico Reply at Appendix 4) Aeromexico's finding that American and its affiliates control more than 80 percent of the market share in half of the "78 major city-pair routes between and among Mexico, Central America and South America" (Id. at 27-29) should truly alarm the Department,

As Aeromexico shows, approving the American/Lan Chile alliance "would create not only dominance in key regional city-pairs (New York-Santiago; Lima Santiago), but also would extend between the United States and Latin America, and throughout the Latin American market, which is distinct as a region in that its geography does not support a large number of competitive alternative hubs and service options, and in that there are not multiple alliance groups in competition in the market," in contrast to Europe and Asia. (Aeromexico Reply at 30-31) Thus, an American/Lan Chile alliance would "not only exclude small and new market entrants from key markets in Latin America, it will also ensure that they will not

be able to do competitive business within entire regional route systems.” (Id. at 31, emphasis in original)

The Department’s International Air Transportation Policy recognizes the “need to watch for harmful effect [of global alliances] on competition,”⁷ and application of that policy requires the Department to disapprove the preemptive, anticompetitive and anticonsumer American/Lan Chile alliance.

IV. AMERICANS PREEMPTIVE, ANTICOMPETITIVE AND ANTICONSUMER ALLIANCE WITH ITS CHIEF COMPETITOR ON U.S.-CHILE ROUTES BEARS NO RESEMBLANCE TO THE PRO-COMPETITIVE CONTINENTAL/NORTHWEST ALLIANCE

As American did in the American/TACA Group proceeding, the Joint Applicants make the mistake of comparing the procompetitive, end-to-end Continental/Northwest alliance with the preemptive, horizontal American/Lan Chile combination. American should have discovered by now that comparing its overlapping Latin American alliances to the beneficial Continental/Northwest alliance only underscores the anticompetitive and anticonsumer nature of American’s Latin American alliances.

⁷ Statement of United States International Air Transportation Policy, 60 Fed. Reg. at 21843 (May 3, 1995).

The Joint Applicants' suggestion that disapproval of the American/Lan Chile alliance would require rejection of the Continental/Northwest alliance is pure grandstanding. The two alliances are vastly different. Neither Continental nor Northwest dominates any broad international region as American dominates the U.S.-Latin American region, and Continental's alliance with Northwest is not horizontal as the American/Lan Chile alliance is. Indeed, "Industry observers see tremendous synergies between [Continental and Northwest] and little overlap."*

The proposed Continental/Northwest alliance simply "makes Northwest and Continental the same size as United, American and Delta and allows them to compete on a more level footing in some international markets." Delta's Chief Executive Office recognizes that the Continental/Northwest alliance should be "approved because it increases competition and benefits consumers."¹⁰

As DOJ said, "the potential for consumer and pro-competitive benefits occurs in those markets where the code-share partners gain the ability to offer on-line service beyond their existing individual route systems." (DOJ Comments at 5)

With "largely end-to-end combinations, the number of markets where

⁸ Aviation Daily at 141 (January 27, 1998).

⁹ Id., quoting David Ulmer, Senior Vice President of Roberts, Roach & Associates.

¹⁰ "Delta CEO: NW-CO Does Not Change 'Uneasy Balance of Power,'" World Airline News at 8 (Feb. 20, 1998).

pro-competitive benefits may be created is larger” and public benefits are “higher.”

(Id.) Continental/Northwest falls into this category.

- Continental and Northwest do not operate hubs at the same airports and their joint geographic scope is enhanced by hubs in different regions.
- Although Continental and Northwest both operate transatlantic routes, they have no overlapping nonstop transatlantic routes.
- Northwest barely serves Latin America, while Continental is attempting to compete with American’s dominance on U.S.-Latin American routes.
- A Continental/Northwest combination will give passengers vast new on-line service opportunities.

Although no approval is required for domestic code shares between U.S. carriers, the Joint Applicants complain that Continental and Northwest operate 100% of the nonstop frequencies in six domestic city-pair markets (Cleveland-Detroit, Cleveland-Minneapolis/St. Paul, Detroit-Houston, Houston-Memphis, Houston-Minneapolis/St. Paul, and Minneapolis/St. Paul-New York) and 86% of the nonstop flights in another (Detroit-New York). The Joint Applicants are truly grasping at straws with this argument. As noted above, none of Continental’s U.S. hubs overlap with Northwest’s. Moreover, these seven city-pairs represent only 1.3% of the domestic city-pairs on which the two carriers operate, and neither point in any city-pair named is a gateway for the other in the same way that Miami is the

key U.S. gateway for service to Latin America by both American and its TACA Group partners.”

In short, the Continental/Northwest alliance is a prime example of pro-competitive and pro-consumer end-to-end code-sharing with “high” public interest benefits and “smaller risk to competition,” while the American/Lan Chile alliance is a prime example of horizontal code-sharing with “low” consumer benefits and “high risk to competition. (DOJ Comments at 6)

V. THE DEPARTMENT SHOULD ACCEPT AEROMEXICO’S REPLY

American has moved to strike the reply submitted in this proceeding by Aeromexico, claiming that the reply is really an objection and that Aeromexico lacks standing to submit comments to the Department on the American-Lan Chile attempt to create a U.S.-Chile monopoly. Aeromexico’s answer is clearly a reply to comments submitted by Continental, Delta and United, the addition of a foreign carrier’s perspective should provide the Department with additional insights into the issues raised by the joint applications and American is free to seek leave to file a surreply if it really has any response to make to Aeromexico. The Department should accept comments from any parties which will elucidate the issues before it,

¹¹ Additionally, Continental and Northwest serve different Houston airports in the city-pairs mentioned.

but if standing were truly an issue Continental would adopt Aeromexico's comments as its own.

VI. THE DEPARTMENT SHOULD ACCEPT CONTINENTAL'S SURREPLY

Continental moves the Department pursuant to Rule 4(f) of the Department's Rules of Practice for leave to late-file this unauthorized surreply three days late. Continental's surreply responds to inaccuracies and arguments contained in the Joint Applicants' reply. Acceptance of the surreply will provide a more complete record on which the Department can base its decision in this case. Acceptance of the surreply will not prejudice any party, especially because the surreply is being filed on the date for answers to American's motion to strike.

Conclusion

The record shows that an American/Lan Chile alliance is bad for competition, U.S. cities and consumers. In fact, the only beneficiaries of the alliance are American and Lan Chile. The Department should deny American's motion to strike Aeromexico's reply and disapprove the American/Lan Chile applications without delay.

Respectfully submitted,

CROWELL & MORING LLP

By: R. Bruce Keiner, Jr.
R. Bruce Keiner, Jr.
rbkeiner@cromor.com *lan*

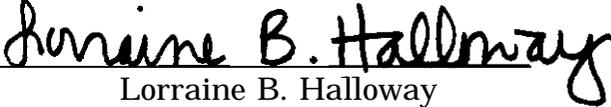
Lorraine B. Hallway
Lorraine B. Hallway
lhalloway@cromor.com

Counsel for
Continental Airlines, Inc.

April 7, 1998

CERTIFICATE OF SERVICE

I certify that I have this date served the foregoing document on counsel for American and Lan Chile and all parties served with their applications in accordance with the Department's Rules of Practice.


Lorraine B. Halloway

April 7, 1998

Peter Reaveley
Dade County Aviation Department
Miami International Airport
P.O. Box 592075
Miami, FL 33159

Director of Aviation
Port Authority of New York
and New Jersey
One World Trade Center
65N
New York, NY 10048

Joel S. Spiro
Deputy Assistant Secretary
Department of State
2201 C Street, N.W.
Room 5820
Washington, D.C. 20520

Roger F. Fones
Chief, Transportation, Energy &
Agriculture Section
Antitrust Division
Department of Justice
325 7th Street, N.W.
Room 500
Washington, D.C. 20530

Irwin P. Altschuler
Donald S. Stein
Keven O'Connell
Stephanie E. Silverman, Senior
Advisor
Manatt, Phelps & Phillips
1501 M Street, N.W.
Suite 700
Washington, D.C. 2005-1702
(for Aerovias de Mexico, S.A.
de C.V.)

William C. Evans
John R. Mietus, Jr.
Verner, Liipfert, Bernhard,
McPherson and Hand
901 15th Street, N.W.
Suite 700
Washington, D.C. 20005
(for Aerovias de Mexico, S.A.
de C.V.)

Marshall S. Sinick
Squire, Sanders & Dempsey
1201 Pennsylvania Avenue, N.W.
Suite 400
Washington, D.C. 20004
(for Alaska)

Carl B. Nelson, Jr.
American Airlines, Inc.
1101 17th Street, N.W.
Suite 600
Washington, D.C. 20036

John L. Richardson
Seeger, Potter, Richardson, Luxton,
Joselow & Brooks
2121 K Street, N.W.
Suite 700
Washington, D.C. 20037
(for Amerijet)

Allan W. Markham
Arrow Air, Inc.
2733 36th Street, N.W.
Washington, D.C. 20007-1422

Aaron A. Goerlich
Boros & Garofalo, P.C.
1201 Connecticut Avenue, N.W.
Suite 700
Washington, D.C. 20036
(for Carnival)

William H. Callaway, Jr.
Zuckert, Scoutt & Rasenberger, LLP
888 17th Street, N.W.
Washington, D.C. 20006
(for Challenge)

Lorraine B. Halloway
R. Bruce Keiner, Jr.
Crowell & Moring LLP
1001 Pennsylvania Avenue, N.W.
Washington, DC 20004
(for Continental)

Robert E. Cohn
Shaw, Pittman, Potts & Trowbridge
2300 N Street, N.W.
Washington, D.C. 20037
(for Delta)

D. Scott Yohe
Senior Vice President -
Government Affairs
Delta Air Lines, Inc.
1275 K Street, N.W.
Washington, D.C. 20006

R. Tenney Johnson
2300 N Street, N.W.
Suite 600
Washington, D.C. 20037
(for DHL)

Richard P. Taylor
Steptoe & Johnson LLP
1330 Connecticut Avenue, N.W.
Washington, D.C. 20036
(for Evergreen)

Nathaniel P. Breed, Jr.
Shaw, Pittman, Potts & Trowbridge
2300 N Street, N.W.
Washington, D.C. 20037
(for Federal Express)

Charles J. Simpson, Jr.
Zuckert, Scoutt & Rasenberger, L.L.P.
888 Seventeenth Street, N.W.
Suite 600
Washington, D.C. 20006
(for Lan Chile)

Suzette Matthews
Bernstein & Matthews
5649 John Barton Payne Road
Marshall, VA 22115
(for Millon Air)

Elliott M. Seiden
Vice President, Law and
Government Affairs
Northwest Airlines, Inc.
901 15th Street, N.W.
Suite 301
Washington, D.C. 20005

Alfred J. Eichenlaub
Polar Air Cargo
1215 17th Street, N.W.
Suite 300
Washington, D.C. 20036

Pierre Murphy
2445 M Street, N.W.
Suite 260
Washington, D.C. 20037
(for Southern Air Transport)

Michael F. Goldman
Bagileo, Silverberg & Goldman
1101 30th Street, N.W.
Washington, D.C. 20037
(for TAM-Mercosur)

Shelley A. Longmuir
Vice President - Government
Affairs
United Air Lines, Inc.
1707 L Street, N.W.
Suite 300
Washington, D.C. 20036

David L. Vaughan
Kelley, Drye & Warren
1200 19th Street, N.W.
Suite 500
Washington, D.C. 20036
(for UPS)

Stephen L. Gelband
Hewes, Morella & Gelband
1000 Potomac Street, N.W.
Suite 300
Washington, D.C. 20007
(for Tower)

Richard J. Fahy, Jr.
Consulting Attorney
900 19th Street, N.W.
Suite 350
Washington, D.C. 20006
(for TWA)

Joel Stephen Burton
Ginsburg, Feldman & Bress
1250 Connecticut Avenue, N.W.
Washington, D.C. 20036
(for United)

Lawrence M. Nagin
Executive Vice President -
Corporate Affairs
US Airways
Crystal Park Four
2345 Crystal Drive
Arlington, VA 22227