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BEFORE THE  
DEPARTMENT OF TRANSPORTATION  
WASHINGTON, D.C.

DEPT. OF TRANSPORTATION  
DISPATCH UNIT  
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Joint Application of )  
 )  
Delta Air Lines, Inc. )  
Swissair; Swiss Air Transport Company, Ltd. )  
Sabena, S.A., Sabena Belgian World )  
Airlines, and )  
Austrian Airlines, Osterreichische )  
Luftverkehrs AG )  
 )  
for approval of and antitrust immunity for )  
Alliance Agreements pursuant to 49 U.S.C. )  
Sections 41308 and 41309 )

Docket OST-95-618 - 34

ANSWER OF UNITED AIR LINES, INC.

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DATED: November 13, 1995

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ANSWER OF UNITED AIR LINES, INC.

United Airlines offers the following comments on the Application jointly filed by Delta Air Lines, Swissair, Sabena and Austrian Airlines (the "Joint Applicants") for approval of, and antitrust immunity for, a series of cooperation agreements.

The proposed alliance among the Joint Applicants is an effort to develop a global route network built upon hub-and-spoke operating systems. Since deregulation, the majority of U.S. airlines have reorganized their domestic route structures into hub-and-spoke operating systems in order to respond better to consumers' demand for an online, seamless transportation product. Because hub-and-spoke networks enable carriers to respond more efficiently to such consumer **demand**,<sup>1</sup> carriers are attempting to

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<sup>1</sup> Route networks built upon hub-and-spoke systems offer important advantages to both consumers and carriers. By combining local traffic to and from the hub with traffic connecting at the hub to and from the spoke cities, carriers can

structure their international operations as networks following the domestic hub-and-spoke model.

Carriers are following the hub-and-spoke model to expand globally because passengers prefer a seamless, online transportation product whether traveling from Muncie, Indiana to San Francisco, or from Muncie to Zurich. What passengers want is the ability to travel by air from Muncie to Zurich with the same ease and convenience with which they can place a telephone call or send a fax to Zurich, or have a package delivered there virtually "overnight." In the telecommunications industry, consumers can pick up a telephone in Muncie (or virtually anywhere else in the world), dial a set of numbers, and almost instantly be connected with someone in Zurich (or anywhere else). In the air cargo industry, with one telephone call, consumers can arrange to have a package picked up by Federal Express, UPS, DHL or numerous other air cargo companies in Muncie and delivered in one or two days in Zurich or almost anywhere else in the world. In these industries, consumers generally are not bothered with having to coordinate connecting service over the intervening operating systems of different service providers.

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offer consumers in both the hub and spoke cities online service to a much wider range of destinations than is justified by local O&D demand alone, while obtaining the efficiency gains associated with operating larger aircraft and higher load factors.

In the air passenger industry, on the other hand, carriers are still striving to develop the type of coordinated global networks that can provide passengers the type of seamless, online service networks that are already widely available in telecommunications and air cargo. The carrier (or carrier alliance) that can best provide passengers the benefits of online service on a global basis -- one stop check-in, single carrier responsibility, convenient connections, through baggage handling, and a generally seamless transportation experience -- will be in the best position to compete successfully in today's increasingly competitive air transportation industry.

As the Department noted in its recently adopted International Policy Statement:

Just as U.S. carriers developed hub-and-spoke systems to tap the broad traffic pool in the domestic market and to provide the most cost efficient service for hundreds of communities that could not support direct service, international air carriers are developing world-wide hub-and-spoke systems to tap the substantial pool of international city pairs.

U.S. International Air Transportation Policy Statement, April 1995, at 3.

Cooperation and code sharing agreements between international airlines have become key ingredients in carriers' efforts to build such global route networks. There are several reasons. As the Department noted in its International Policy Statement, "**an** even larger portion of traffic moving over

[international] hub-and-spoke systems **require[s]** the use of at least two-hubs (e.g., a hub in both the U.S. and Europe for a passenger moving from an interior U.S. point to a point beyond the European hub) ." Id.

For a carrier to develop such a multi-hub network using its own services alone requires authority to operate not only to key hub cities overseas, but the right to operate through and beyond them to numerous points, mostly in third countries. This type of broad route authority with extensive fifth-freedom rights is not readily obtainable through the bilateral system upon which international air transportation is currently based. In addition, while carriers have been able to build their domestic networks, in part, by acquiring strategic assets from others, the ownership and nationality limitations imposed in civil aviation agreements, the proscriptions on **cabotage** sanctioned by the Chicago Convention, and the foreign investment laws widely in force around the world, limit carriers' ability to use mergers and acquisitions to build global **networks**.<sup>2/</sup> With the use of mergers and acquisitions limited, with essential route rights frequently unavailable, and with the investment costs associated with the development of a hub system in a foreign country often prohibitively high, carriers have turned to global alliances and

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<sup>2/</sup> In the air cargo sector, by comparison, many of these limitations have been overcome because of the high degree of surface transportation involved, where acquisitions and joint ventures are less constrained.

code sharing as the most efficient way to develop a global network.

As the Joint Applicants note, U.S. International Aviation Policy endorses both the development of international hub-and-spoke networks and the use of code sharing to overcome the obstacles that exist to the building of such global networks. See, e.g., Joint Application at 17-20. In United's view, antitrust immunity can play an important role in furthering this process.

Code sharing is more than an end in itself, it is also a means to the development of an integrated global route network that makes available to the traveling public high quality, low price service throughout the world. In the U.S., carriers are able fully to achieve the economies of scope and scale made possible by hub-and-spoke networks and to pass those economies on to consumers in the form of lower prices and improved service. Internationally, while code sharing permits a carrier to extend the reach of its global network, concern about potential antitrust liability can limit the ability of carriers participating in a contractually-based code share relationship jointly to plan, price, sell, advertise, and coordinate their code shared services to the same degree as if they were a single firm. In appropriate cases, antitrust immunity can remove this antitrust liability risk, enhancing the partners' ability to

achieve the full range of efficiency benefits that are available from an integrated hub-and-spoke network.

Antitrust immunity can also be a vehicle to secure the acceptance of open skies bilateral agreements by more of the United States' major trading partners. Because antitrust immunity can facilitate the ability of alliance partners to achieve all of the efficiency gains possible from a hub-and-spoke operating system, an alliance that has been granted antitrust immunity should be able to achieve greater cost efficiencies than competing alliances that do not enjoy such immunity. For that reason, by making antitrust immunity available to carriers from countries that have open skies bilateral agreements with the U.S., the Department can provide a strong incentive for countries that are interested in securing the maximum benefits for their flag carriers from participation in code share alliances with U.S. airlines to enter into open skies agreements with the U.S.

This was the Department's principal objective when it decided to grant antitrust immunity to the Northwest/KLM alliance despite misgivings about the potential impact of such immunity on competition in several city pairs where both Northwest and KLM held out overlapping **service**.<sup>3/</sup> The Department concluded that the benefits of the agreement outweighed any possible loss of

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<sup>3/</sup> Northwest and KLM both held out service between Minneapolis-St. Paul-Amsterdam and Detroit-Amsterdam through a blocked space agreement. **See** Order 92-11-27 at 16.

competition. See, Order 92-11-27 at 16. **Key** among these benefits was the Department's expectation that the "Open Skies accord with the Netherlands and our approval of and grant of antitrust immunity to the Agreement . . . [would] encourage other European countries to agree to liberalize their aviation services so that comparable opportunities may become available to other U.S. carriers." Id. at 13-14 (emphasis added).

Further, because antitrust immunity can have a direct bearing on alliance partners' ability to maximize the efficiency gains available from their alliance, a selective policy of granting such immunity would distort competition among the various alliances that now exist or that may be agreed to in the future. Those alliances that have immunity would be completely free to plan jointly the expansion of the partners' services, price jointly the alliance's products, advertise jointly the partners' flights, agree jointly on the partners' commission policies and sales promotion activities, and generally would be able to carry on business as if the partners were a single firm without the risk of being sued for alleged antitrust violations. Alliances without immunity, on the other hand, could not engage in many of these coordinated activities without such litigation risk. Thus, to the extent these coordinated activities can reduce costs, improve service and enhance the partners' competitive position in the marketplace, the Department's grant

of antitrust immunity furthers inter-alliance and inter-carrier competition.

The issue for the Department in responding to applications for antitrust immunity is to ensure that a decision to grant such immunity advances the applicants' ability to respond efficiently to consumers' demand for an integrated, online travel product, and that "**the** overall net effect of . . . [the] transaction . . . is procompetitive and **proconsumer**...." Statement of Secretary Peña before the Committee on Commerce, Science and Transportation, July 11, 1995 at 13-14. When Northwest and KLM first sought antitrust immunity for their alliance, United and Delta opposed the application. The Department, nonetheless, approved the application, basing its approval, in part, on its expectation that its willingness to approve the alliance "**might** well encourage" the formation of competing alliances under other bilateral agreements. Order 92-11-27 at 11-12. The Department observed:

... other U.S. carriers already have the ability to obtain many of the same service advantages and efficiencies that Northwest and KLM will gain through the Agreement. Other U.S. carriers can use such means as code-sharing agreements to coordinate their services with foreign carriers.

Id. at

Consistent with this advice, United, Delta and other U.S. airlines have proceeded to enter into a series of alliances that

expand the reach of their global networks and increase both inter-carrier and inter-alliance competition. The Department's International Policy Statement recognizes that code sharing alliances are an important and innovative competitive tool that produces valuable benefits for passengers, carriers, and communities, **as** well as for the U.S. economy as a whole:

Increased international code-sharing and other cooperative arrangements can benefit consumers by increasing international service options and enhancing competition between carriers, particularly for traffic to or from cities behind major gateways. By stimulating traffic, the increased competition and service options should expand the overall international market and increase overall opportunities for the aviation industry. U.S. airlines should be major beneficiaries of this expansion and the concomitant increased service opportunities, given their competitive advantages.

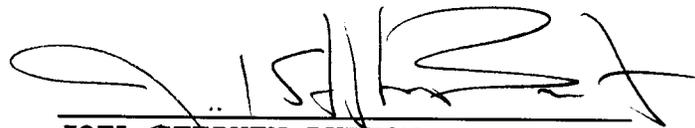
Moreover, code-sharing should also enhance domestic competition. Many international passengers traveling to or from U.S. interior cities use domestic service for some portion of their international journey. Code-sharing should increase competition among domestic carriers to carry those passengers on the domestic segment of their international journey.

Policy Statement at 5-6.

Having encouraged carriers to respond to the increased competition made possible by global alliances and code sharing through the formation of competing alliances, the Department should continue to encourage and promote the expansion of these alliances whenever they further the Department's consumer and competition objectives.

Because antitrust immunity can both improve the ability of carriers participating in a code sharing alliance to maximize the efficiencies gains available from operating a global hub-and-spoke network and enhance the attractiveness of open skies agreements to the United States' major trading partners, United encourages the Department to grant immunity to those alliances where the overall net effect is to improve the alliance partners' ability to respond to consumer demand and to increase competition. While United supports the grant of antitrust immunity in such cases, United expresses no view on whether the alliance among the Joint Applicants meets those criteria.

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DATED: November 13, 1995

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**CERTIFICATE OF SERVICE**

I hereby certify that I have this date served a copy of the foregoing Answer of United Air Lines, Inc. on all persons listed on the attached Service List by causing a copy to be sent via facsimile to those persons noted with an asterisk on the attached Service List and by first class mail, postage prepaid to all other persons listed.

  
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Kathryn D. North

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