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**BEFORE THE
DEPARTMENT OF TRANSPORTATION
WASHINGTON, D. C.**

DEPT. OF TRANSPORTATION
DOCKET SECTION

96 APR -3 AM 10:48

Joint Application of

UNITED AIRLINES, INC.

and

DEUTSCHE LUFTHANSA, A.G.
(LUFTHANSA GERMAN AIRLINES)

for approval of and Antitrust Immunity for an
expanded alliance agreement pursuant to 49 U. S.C.
§§ 41308 and 41309

Docket OST-96- 1116 - 9

ANSWER OF TRANS WORLD AIRLINES, INC.

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Docket OST-96- 1116

ANSWER OF TRANS WORLD AIRLINES, INC.

By an application, dated February 29, 1996, United and Lufthansa have requested antitrust immunity for an expanded alliance agreement under which they would jointly dominate the U.S.-Germany market. TWA hereby answers and requests that the application be denied. If, nevertheless, the Department determines to approve the agreement, it should impose strict conditions that would limit the ability of the applicants to restrict their competitors from distributing their travel services and scheduling their flights in Germany. In support of its answer, TWA states as follows:

INTRODUCTION

At the outset, TWA must state that it fully supports the concept of Open Skies with Germany, as well as code sharing alliances. TWA believes that it is unfortunate that the German government has tied implementation of the open skies agreement to approval of this application for antitrust immunity. The German position invalidly assumes that an open skies agreement justifies antitrust immunity. While open skies should certainly be a prerequisite, it does not follow that open skies justifies antitrust immunity. There may be significant barriers to entry, as there are in the U.S.-Germany market, which can create market power even in an open skies environment. While the U.S. has clearly indicated that its consideration of this application will be an independent matter from the bilateral, it is only natural that it feels pressure to approve the agreement. TWA urges the Department to apply strict scrutiny to this agreement and, in particular, to carefully analyze the applicants' claims that the network benefits they seek to achieve cannot be accomplished without immunity.

This application follows upon, and is quite similar to the application filed in Docket OST-95-618 for antitrust immunity for the alliance agreement between Delta, Swissair, Sabena, and Austrian Airlines. This agreement is not quite so anticompetitive as that one because it involves only two carriers and a country that receives a fair amount of service from other U.S. airlines. In contrast, that agreement combined the largest U.S. flag carrier with the national carriers of three countries European countries. Nevertheless, the United/Lufthansa agreement contains all the anticompetitive elements that were present in the Delta alliance application -- the parties propose to fix prices, pool revenue, and deal jointly with travel agents. Like the Delta

alliance carriers, United and Lufthansa allege that immunity will allow them to provide benefits in beyond markets, but fail to explain why these benefits could not be achieved without immunity. TWA filed extensive comments in that proceeding, and will not repeat its arguments in detail here. In this pleading, we will focus upon market statistics and demonstrate that, even under the applicants' proposed use of Clayton Act criteria, there is no basis for approval of this agreement.

I. THE APPLICANTS CANNOT RELY ON THE PRECEDENT OF NORTHWEST/KLM TO SUPPORT THEIR REQUEST FOR IMMUNITY.

Like the Delta alliance carriers, the applicants have structured their case to be as similar as possible to that presented by Northwest and KLM, to whom the Department granted antitrust immunity in January 1993. Thus, they claim that the objectives of the United/Lufthansa agreement are the same as those of KLM and Northwest, and that, like those carriers, United and Lufthansa have a modest share of the transatlantic service (pp. 27, 29). However, the Northwest/KLM agreement had substantially less market impact than United and Lufthansa.

Northwest/KLM accounted for only 8 percent of total US-Europe seats, making them the 8th and 9th largest carriers. Even combined, they would have been the 5th largest carrier (Order 92-1 1-37, p.32). In contrast, United and Lufthansa are the third and fourth largest transatlantic carriers, with a combined share of 14.1 percent of all transatlantic departures and 13.4 percent of all transatlantic seats (Exhibit JA-6). Thus, even in the transatlantic market as a whole, the

United/Lufthansa agreement will have substantially more impact than KLM and Northwest. Moreover, the two city pairs in which Northwest and KLM competed were substantially smaller than the major markets of Washington and Chicago-Frankfurt, in which United and Lufthansa would combine their service.

The approval under different circumstances by a previous Administration of the Northwest/KLM agreement does not bind the Department in this proceeding. This Administration has injected new vigor into antitrust enforcement, and has been more sensitive to the competitive impact of agreements in numerous industries. In Northwest/KLM, the two parties actually competed in only two secondary city pairs, and the potential benefit in beyond markets far outweighed the limited effect of the agreement on existing competition. This case would involve service between the United States and the most populous country in Europe, and would have a substantially greater impact on transatlantic air transportation.

II. A MERGER AMONG THESE CARRIERS WOULD NOT BE APPROVED.

The applicants argue that the proposed alliance should be judged as if it were a merger under Section 7 of the Clayton Act because the carriers intend to operate as if they were a single carrier'. This claim is simply a device to bring the application within the ambit of Northwest/KLM -- there is absolutely no evidence that these carriers would merge if they could.

¹ Application, p. 27

However, even if the Clayton Act were applied to the Agreement, there would no basis for the grant of antitrust immunity. Under those standards, a merger would not be approved if it would substantially reduce competition in any relevant market (Order 92-1 1-27, p.29). The proposed agreement fails to meet this standard.

In Northwest/KLM, the Department found that there were three relevant markets: U.S. - Europe, U.S. - Netherlands, and two specific city pairs in which the carriers competed (Order 92-1 1-27, p. 32). Applicants have provided appropriate market share data for the U.S.-Europe market, but have failed to provide comparable information for the U.S.-Germany market or for the individual city pairs. TWA has filled this gap by providing HHI calculations for the U.S. Germany market (Appendices A and B). There is no need for formal HHI calculations of the city-pair markets -- in both the markets the applicants allege as relevant, they provide more than two-thirds of the capacity. TWA's HHI calculations show that this agreement would not be approved if it involved a merger of the two applicants.

U.S. - Germany - The Department of Justice and DOT have measured the reduction in competition by applying the Herfindahl-Hirshman (HHI) index of market concentration². Under the 1992 Merger Guidelines, a merger in which the post-merger HHI is above 1800, and where the merger produces an increase in the HHI of more than 50 points, raises significant competitive concerns. Where the increase exceeds 100 points, it is presumed to create or enhance market

² Department of Justice and Federal Trade Commissions Horizontal Merger Guidelines, Issued April 2, 1992, Section 1.5.

power or facilitate its exercise. In the case of the U.S. - Germany market, the HHI is almost off the charts. As shown in Appendix B, the U.S. - Germany base HHI is 2262. When Lufthansa's market share of 36.5 percent is combined with United's 6.3 percent, this produces an HHI of 2,721, and an increase of 459.

TWA has based its HHI calculation on the number of nonstop seats offered between the U.S. and Germany. Unfortunately, adequate traffic data is not available because foreign carriers do not provide O&D data, but seats are a reasonable proxy because they reflect the comparative strength of each carrier in the market. If anything, they understate the share of United and Lufthansa by giving full weight to the fifth freedom services of Air New Zealand, Singapore, and Pakistan International, even though those carriers' capacity is primarily devoted to their homeland passengers.

United and Lufthansa will undoubtedly argue that measurement of HHI on the basis of nonstop seats is flawed because it does not include connecting service. That objection is invalid for two reasons:

1. The HHI methodology includes all traffic connecting within the United States because it incorporates all U.S. -Germany transatlantic sectors. Inclusion of traffic connecting over foreign countries would have a negligible impact on the HHI. Except possibly for British Airways, it is unlikely that any third country carrier achieves more than a 1% market share of

U.S.-German traffic. Under HHI methodology, which squares market shares, these small participations cannot cause any significant change in the HHI figures.

2. United and Lufthansa exaggerate the value of connecting service. In theory, U.S.-Germany traffic may move via alternative European gateways. In practice, connecting service via other gateways is not attractive because of longer elapsed times. Moreover, because the capacity of such flights must be shared with passengers traveling to the other gateway and beyond the gateway to other countries, there may not be sufficient capacity, particularly during peak season, to materially affect market shares or discipline the market in any meaningful way. Thus, the availability of connecting service over other European gateways will not, as applicants contend, eliminate the ability of applicants to raise prices above competitive levels or reduce the quality of service below that expected in a competitive market³.

Individual City Pairs - United and Lufthansa have claimed that the only relevant city pair markets are Chicago-Frankfurt and Washington-Frankfurt, in which both carriers provide nonstop service and code share on each other's flights. In those city pairs, the HHI calculations would show the markets to be highly concentrated. The applicants have not presented the data, but it is clear that the joint operation raises serious competitive concerns .

³ Business passengers in particular, simply will not take connecting routings that are substantially longer than the nonstop service.

TWA also suggests that there are other city pairs in which the proposed Alliance will limit competition. These are markets which United could logically be expected to enter, but on which it code shares with Lufthansa's existing service. For example, United code shares on Lufthansa's San Francisco-Frankfurt service, and, because of its San Francisco hub, would be the only logical entrant into that market. Immunity for the United/Lufthansa agreement will eliminate the threat of potential competition in that market. Another city pair in this category is Chicago-Munich. In addition, in several city pairs, United is a potential entrant, even though there is other U.S. flag service. The alliance agreement eliminates the threat of United entry from markets such as Los Angeles, Miami, and Boston-Frankfurt.

Barriers to Entry - The applicants argue that, even if they increase market concentration, they will not be able to raise prices above competitive levels because of the threat of potential competition. They claim "upon the entry into force of the new aviation agreement, other carriers will have unlimited opportunities to enter the market if United and Lufthansa were to attempt to raise fares or reduce service".⁴ However, the existence of an abstract legal right does not validate the claim that entry into U.S. - Germany markets is easy as a matter of fact

In effect, applicants are relying on the contestability theory used in the early days of deregulation, and long since discredited. For example, a recent economics textbook states:

⁴ Application, p. 32.

The theory of contestable markets (Baumol et al., 1982) argues that even in very concentrated markets, firms will not be able to hold the price above marginal cost -- will not have the power to control price -- if entry and exit are costless and can occur very rapidly. If these conditions are met, the force of potential competition alone will be sufficient to yield optimal market performance. This is, of course, essentially the same prediction that emerges from the static limit price model.

The commercial airline industry was long touted as one of the markets most likely to meet the assumptions of the theory of contestable markets. Airplanes can easily be shifted from one route to another if profits make it attractive to do so. There are some problems with obtaining gates at major airports, but the point that assets are not sunk in particular routes seems valid enough. However, empirical studies have conclusively rejected the hypothesis that the airline industry is contestable. [Discussion of studies]

No real world industry has as yet been shown to be contestable. The analysis of contestable markets has been a useful exercise to the extent that it has clarified the way market performance departs from the optimal in imperfectly contestable markets. It does not provide a tool that can be used to analyze the determinants of performance in real-world markets.⁵

In fact, while these markets may be contestable, there are significant barriers to entry. The marketplace dominance of Lufthansa, combined with the beyond traffic flow over its European hub, makes new entry extremely difficult.

In particular, Lufthansa exercises control over travel agents both through its CRS dominance, and through commissions and override payments. In Germany, where it controls the

⁵ Martin, Industrial Economics: Economic Analysis and Public Policy. Second Edition, 1994, pp. 223 -224.

national marketing company for Amadeus, its CRS has an 82% market share⁶. A recent report to the European Union states that the German CRS market has “yet to become highly competitive”⁷.

In addition, Lufthansa’s control over travel agents through payment or withholding of override commissions is quite significant. Because the national carrier generally carries substantially more traffic from its home country than any individual competitor, travel agents earn substantially more in overrides by booking on the national airline. Conversely, if they fail to reach the goals established by the national carrier for payment of the override, they are severely damaged. The combination of Lufthansa and United will increase the volume on which the allied carriers can pay overrides, and correspondingly reduce the ability of competitors to compete for Germany-originating traffic.

The proposed antitrust immunity would allow the carriers to establish override goals based upon bookings on both United and Lufthansa. For example, Lufthansa may now pay a transatlantic override on an assumption that it will carry 50% of all transatlantic traffic out of its country. It may require agents to book half of all passengers on Lufthansa in order to gain the override. However, with the United alliance, the joint carriers can establish a goal requiring the agent to book a much higher percentage on them. Thus, the alliance will substantially raise the barriers to entry into these markets.

⁶ SH&E, Study on CRS Charging Principles for European Commission, August 1995, p. 15.

⁷ *Id.*, p. 5.

A final barrier to entry will be the connecting hubs that applicants propose to create with antitrust immunity. In the United States, the applicants will have online connections through United's hubs at both Washington and Chicago equal to the connections available to any U.S. flag new entrant. At the European end of the route, Lufthansa also has a major connecting hub that the new entrant will be unable to match. At Frankfurt, a significant portion of the traffic carried on transatlantic service is Sixth Freedom traffic, originating and or destined to points behind the gateway. In order to capture that traffic, the new entrant would have to establish a connecting hub at Frankfurt, the European gateway. This is a clearly impossible task since Lufthansa is the only non-U. S. hub carrier and since most other carriers offering service from Frankfurt to beyond points already offer transatlantic service of their own and are unwilling to partner with a U.S. carrier. Even if the new entrant could obtain Fifth Freedom traffic rights to beyond-gateway points, establishment of such a hub would be precluded by the lack of sufficient takeoff and landing slots.

Thus, even under the Clayton Act standard proposed by applicants, the expanded alliance agreement must be denied immunity. The HHI data creates a presumption that the proposed agreement is anticompetitive, which the applicants cannot overcome on the basis of the record in this proceeding.

III. IF THE DEPARTMENT APPROVES THE AGREEMENT, IT SHOULD IMPOSE CONDITIONS THAT WOULD IMPROVE THE ABILITY OF U.S. FLAG CARRIERS TO COMPETE IN GERMANY.

TWA recognizes that the German open skies agreement places pressure upon the Department to grant antitrust immunity to the United/Lufthansa agreement despite its anticompetitive nature. If the Department determines that it must approve the agreement, it should impose conditions that will improve the ability of other U.S. flag carriers to compete in the U.S.-Germany market, recognizing that no condition DOT can propose will completely eliminate such barriers. TWA believes that two conditions are particularly important to preserve some semblance of a competitive market -- the Department should require Lufthansa and its CRS partners to participate fully in all U.S. CRS's, and Lufthansa should be required to make slots available at German airports for U.S. flag carriers that desire to enter or expand in the market. In addition, the Department should condition approval on the elimination of a contract provision that restricts code shares by either party with third party carriers.

1. In order to be competitive in Germany, U.S. CRS's and airlines must overcome Lufthansa's monopoly CRS position. In order to ensure that American carriers can compete on a level playing field, the Department should require Lufthansa and its partners in START, the German marketing company for Amadeus, to offer full functionality through U.S. CRS's.

Amadeus is marketed in Germany by START, which is owned by Lufthansa, Deutsche Bahn, the German national railroad, and TUI, a German tour company, which TWA understands

is part-owned by Lufthansa. Deutsche Bahn, which accounts for nearly one-third of a typical travel agency's business in Germany, is available only through Amadeus. Deutsche Bahn recently resolved a complaint filed against it by SABRE before the German competition tribunal by agreeing to participate in SABRE. Although it has not yet agreed to participate in WORLDSPAN, the same competitive principles should apply. Lufthansa has been slow to participate in WORLDSPAN enhanced products, such as WorldGroup, which would allow travel agency subscribers to process PNRs and gain access to Lufthansa special fares available via Amadeus. Lufthansa has discussed participation, but has not yet joined. The special treatment by Lufthansa offered to Amadeus subscribers has placed WORLDSPAN at a serious competitive disadvantage. If it is to approve this agreement, the Department should impose on all owners of START the same obligations imposed on U.S. airline CRS owners under the U.S. rules. They should be required to offer the same fare and schedule information and the same functionality to U.S. CRS's that they provide to Amadeus.

2. Lufthansa should be required to make slots available, at the times requested, to U.S. flag carriers desiring to enter the U.S. - Germany market or expand service. The status of airport slot coordination in Germany was recently described in a report to the European Union'. The seven major airports in Germany are fully coordinated by a coordinating committee, appointed by the government, and run by an individual employee of Lufthansa. The staff of the coordinating committee consists of 19 Lufthansa employees and one from the Frankfurt Airport. The Report

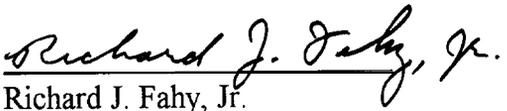
⁸ Coopers & Lybrand, The Application and Possible Modification of Council Regulation 95/93 on Common Rules for the Allocation of Slots at Community Airports, Final Report, 17 October 1995.

recommends “considering change of the coordinator’s status to give greater independence from Lufthansa” (Report, Table 5.1). Under these circumstances, Lufthansa should be the guarantor of entry by U.S. carriers if it receives antitrust immunity.

3. Finally, the Department should condition antitrust immunity on elimination of Article 6.2 of the Alliance Expansion Agreement, which locks the parties into each other, and eliminates, as a practical matter, the potential for any other carrier to code share in the U.S. - Germany market with either United or Lufthansa. In the past, code share alliances have been quite fluid and have responded to changes in the marketplace. For example, one of the first major alliances was between United and British Airways, which disappeared within a few years. Such flexibility should not be hampered by a requirement that each party consult with the other about any future alliance (as the paragraph is written it applies to any alliance anywhere in the world). Moreover, the provision that the parties will try to ally with the same third party carriers is a backdoor way of excluding potential code shares with either party unless a carrier is willing to code share with the other. TWA has already had one potential transatlantic code share thwarted because the partner carrier also wanted to code share with partners of Delta in markets in continental Europe. It was told that, to gain such code shares, the only acceptable code share partner for that carrier across the Atlantic was Delta. The Department should not allow United and Lufthansa to use their market power for such anticompetitive activities.

WHEREFORE, TWA respectfully requests that the application of United and Lufthansa for antitrust immunity for their expanded Alliance Agreement be denied. If it is approved, the Department should impose the conditions proposed above.

Respectfully submitted,



Richard J. Fahy, Jr.

Attorney for
Trans World Airlines, Inc.

April 3, 1996

MARCH, 1996 USA-GERMANY ONE WAY NON-STOP SERVICE BY CARRIER

<u>Carrier</u>	<u>City Pair</u>	<u>Equipment</u>	<u>Seats</u>	<u>Days/Wk.</u>	<u>Total/Wk.</u>	<u>Carrier % of Total</u>
AA	CHI-FRA	763	215	7	1505	
	DFW-FRA	763	215	7	1505	
	MIA-FRA	763	215	7	<u>1505</u>	
					4515	7.0
CO	NYC-FRA	D10	242	7	1694	2.6
DL	ATL-FRA	M11	245	7	1715	
	ATL-FRA	L15	221	7	1547	
	CVG-FRA	MI1	245	7	1715	
	LAX-FRA	MI1	245	6	1470	
	NYC-FRA	L15	221	7	1547	
	NYC-FRA	763	252	7	1764	
	MCO-FRA	L15	221	7	1547	
	WAS-FRA	L15	221	6	1348	
	NYC-BER	763	252	7	1764	
	ATL-MUC	763	252	7	1764	
	NYC-MUC	763	252	7	<u>1764</u>	
						17943
KU	NYC-FRA	340	258	1	258	0.4
LH (Code share with UA)						
	ATL-FRA	340	258	6	1548	
	BOS-FRA	340	258	7	1806	
	CHI-FRA	747	369	4	1476	
	DFW-FRA	340	258	5	1290	
	LAX-FRA	747	369	7	2583	
	MIA-FRA	747	369	7	2583	
	NYC-FRA	340	258	19	4902	
	SFO-FRA	340	258	7	1806	
	WAS-FRA	747	369	7	2583	
	NYC-DUS	310	169	7	1183	
	CHI-MUC	340	258	7	<u>1806</u>	
					23566	36.5

LT	LAX-DUS	MI1	245	1	245	
	MIA-DUS	L15	221	1	221	
	MCO-DUS	M11	245	1	245	
	TPA-DUS	M11	245	1	245	
	RSW-FRA	767	216	1	<u>216</u>	
					1172	1.8
NG - Lauda Air (Code share with LH)						
	MIA-MUC	767	215	3	645	1.0
NW	DTW-FRA	D10	288	10	2880	4.5
NZ	LAX-FRA	747	318	4	954	1.5
PK	NYC-FRA	74M	350	3	1050	1.6
SQ	NYC-FRA	744	393	4	1572	2.4
TW	NYC-FRA	767	183	7	1281	2.0
UA (Code share with/LH)						
	CHI-FRA	777	292	7	2044	
	WAS-FRA	777	292	7	<u>2044</u>	
					4088	6.3
US	BOS-FRA	767	216	7	1512	
	PHL-FRA	767	216	7	<u>1512</u>	
					3024	4.7
GRAND TOTAL					64542	

HHI Calculation

March, 1996 Carrier Share of USA-Germany Market

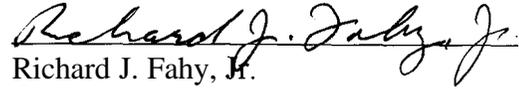
Carrier	Carrier % of Total	Square
AA	7.0	49.00
c o	2.6	6.76
DL	27.8	772.84
KU	0.4	.16
LH	36.5	1332.25
LT	1.8	3.24
NG	1.0	1.00
NW	4.5	20.25
NZ	1.5	2.25
PK	1.6	2.56
SQ	2.4	5.76
TW	2.0	4.00
UA	6.3	39.69
US	4.7	22.09
Total:		2,261.85

HHI Increase

With UA/LH Consolidation	
HHI after consolidating UA/LH	2,721.75
Increase:	459.90

CERTIFICATE OF SERVICE

I hereby certify that I have on this day served a copy of the foregoing document upon all persons named on the attached service list by causing copies thereof, postage prepaid, to be mailed to each of them.


Richard J. Fahy, Jr.

April 3, 1996

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