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

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U.S.-U.K. Alliance Case

Docket OST-2001-11029 - 30

**ANSWER OF THE CITY OF HOUSTON
AND THE GREATER HOUSTON PARTNERSHIP**

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Dated: December 17, 2001

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The City of Houston and the Greater Houston Partnership (collectively, the "Houston Parties") respectfully submit this answer to the consolidated applications of American Airlines and British Airways, and of United Airlines and BMI British Midland, for antitrust immunity and code-sharing authority. This answer supplements the answer the Houston Parties previously filed to the applications of American Airlines and British Airways, Dockets OST-10387 and OST-10388, on November 2, 2001.

In their previous answer, the Houston Parties urged the Department to deny the AA/BA applications on the grounds that: (1) an immunized AA/BA alliance would reduce competition in the U.S.-U.K. market, and (2) an immunized AA/BA alliance would preclude the entry of any meaningful new competition at London Heathrow. The United/BMI applications are closely related to, and should be considered in tandem with, the AA/BA applications, as the Department has directed. However, the United/BMI applications do not present precisely the same issues for review. The Houston Parties therefore file this answer in order to address the additional issues that the Department should take into consideration in deciding the consolidated U.S.-U.K. Alliance Case.

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1. Competition. As has been noted by the Houston Parties and numerous other parties, an AA/BA alliance would involve significant horizontal overlapping services in the U.S.-U.K. market. Most notably, six U.S. gateways would, in effect, lose a U.S.-U.K. competitor – among them Dallas/Ft. Worth, at which there is already the least prospect of new entry. In contrast, United/BMI would primarily be an end-to-end alliance, linking United's transatlantic services to the U.K. and European services of BMI British Midland and the other European Star alliance carriers. The Houston Parties do note that United is one of the four U.S./U.K. carriers that Bermuda II authorizes to operate transatlantic services to and from Heathrow. It is also true that BMI British Midland might be a new entrant to the U.S.-Heathrow market under a U.S.-U.K. Open Skies agreement, joining existing smaller carriers in the market such as fifth freedom carriers Air India and Kuwait Airways. However, the impact of a United/BMI alliance on U.S.-U.K. competition would be relatively limited in comparison with the impact of an AA/BA alliance. In sum, the Houston Parties do not believe that the direct competitive effects of a United/BMI alliance, standing alone, require the denial of those carriers' anti-trust immunity and code-sharing applications.

2. New Entry. However, the Houston Parties are concerned that the approval of United/BMI could indirectly inflict major damage on competition in the U.S.-U.K. market. The approval of a United/BMI alliance in tandem with the approval of an AA/BA alliance would preclude the entry of any meaningful new competition at London Heathrow. BMI British Midland now controls approximately 14% of the slots at Heathrow, second only to British Airways. A United/BMI alliance, along with their Star alliance partners, would control approximately 27% of the slots at Heathrow. Standing alone, this percentage of

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the slots, while significant, probably would not permit United/BMI to dominate the U.S.-Heathrow market. However, it must be recognized that AA/BA and their Oneworld partners would at the same time control an additional 47% of the slots at Heathrow. The approval of both alliances would create a duopoly which by its mere existence would result in the exclusion of any meaningful new competition from Heathrow.

No Star or Oneworld carrier reasonably can be expected to sell or trade slots with an unaligned competitor, such as Continental Airlines. No carrier unaffiliated with Star or Oneworld has more than 3% of the slots at Heathrow. These remaining slots are divided among carriers that (i) possess too few slots to fund new entry; (ii) require all of their existing slots to compete with British Airways, BMI British Midland, or an allied carrier in providing service to their homeland markets; and/or (iii) are themselves competitors in the U.S.-U.K. or overall transatlantic market, and are unlikely to sell or trade slots with a new entrant. As noted in the Houston Parties' previous answer, the handful of new entrants at Heathrow since 1997 mostly have operated off-peak services, including charter and cargo, and many have ceased services at Heathrow or even have transferred their slots on undisclosed terms to British Airways. See Answer of the City of Houston and the Greater Houston Partnership (Nov. 2, 2001), at 3-4.

Nor can meaningful new competition at Heathrow be funded through the creation of new slots. The U.K. Government in November announced that Heathrow operations will be capped at 480,000 annual flights, or approximately an additional 55 daily slots. See Terminal 5 Gets the Green Light with Conditions, News Release, Nov. 20, 2001 <<http://www.press.dtlr.gov.uk/0111/0498.htm>>. Even in the unlikely event that these slots were all immediately and exclusively available at times and with ground facilities

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appropriate for new entrant U.S.-U.K. services, they would be insufficient to fund the minimum of 32 new daily services that non-incumbent U.S. carriers, such as Continental Airlines, have stated they would need to operate to Heathrow in order to compete with the services already operated to Heathrow by the incumbent U.S./U.K. carriers.¹

The Houston Parties anticipate that the U.S.-U.K. Alliance Case ultimately will be decided based largely on the merits of the AA/BA applications. For this reason, the Houston Parties do not take a position on whether the indirect competitive effects of a United/BMI alliance require the denial of those carriers' anti-trust immunity and code-sharing applications. However, the Houston Parties respectfully remind the Department of the reasons that it established the U.S.-U.K. Alliance Case. The competitive effects of an AA/BA alliance cannot be evaluated in a vacuum, but must instead acknowledge that the approval of AA/BA would almost certainly be accompanied by the approval of a United/BMI alliance. The Department's analysis should be tailored accordingly.²

Recommendations. The Houston Parties re-emphasize the recommendations set forth in their previous answer. The Department should concentrate on negotiating a U.S.-U.K. Open Skies agreement which ensures meaningful competition in the market,

¹ United/BMI have asserted that their ability to compete with AA/BA likewise will be constrained because most of the ground facilities associated with BMI's Heathrow slots are not suitable for wide-body aircraft. However, because the U.K. now has approved the construction of Heathrow Terminal 5, it appears likely that in the future BMI will be more easily able to obtain additional ground facilities suitable for wide-body aircraft than new entrants will be able to obtain any runway slots suitable for the operation of U.S.-U.K. services.

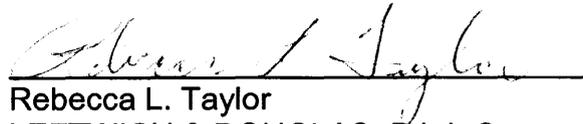
² The Houston Parties are also concerned that, in light of the accelerated timeframe for this proceeding, errors of basic fact in the applications before the Department may pass unnoticed. For example, in the AA/BA Answer dated November 2, 2001, the carriers analyze competition in the Boston-London market based on an assumption that United entered the market in April 2000. See id. at 46-47. In reality, United entered that market in April 1999.

and which specifically prevents incumbents from leveraging their existing advantages to prevent new entry in the U.S.-U.K. market. Such an agreement should, in particular:

- (1) Ensure that non-incumbent carriers have a meaningful opportunity to establish services to Heathrow – i.e., through AA/BA slot divestment – from gateways currently deprived of such services, such as Houston.
- (2) Provide for a transition period during which alliances such as AA/BA are not permitted to implement an alliance or to operate code-share services at U.S.-London gateways served by no other carrier, such as Dallas-Ft. Worth.
- (3) Provide that alliances such as AA/BA may not subsequently implement an alliance or operate code-share services at U.S.-London gateways served by no other carrier, such as Dallas-Ft. Worth, unless equal opportunities are available for non-incumbent carriers serving the same market or region, such as Houston.

Only once an Open Skies agreement has been signed which incorporates these principles should the DOT consider whether anti-trust and code-sharing applications by the applicants in this proceeding are in the interest of U.S. gateways, carriers, and the public as a whole. The applications in the U.S.-U.K. Alliance Case, like those in the consolidated AA/BA proceeding, are based on a set of unproven assumptions, most notably that Open Skies alone would open Heathrow to new competition, as well as that a rushed U.S.-U.K. Open Skies agreement is better than none at all, on the basis that a pending European Court of Justice decision might prevent the signing of further Open Skies agreements by EU countries in the immediate future, but might grandfather Open Skies agreements already completed. The Houston Parties agree that the U.S.-U.K. aviation market should be liberalized. But the approval of an immunized AA/BA alliance, without any corresponding obligation by the U.K. to make slots and other resources available to new entrants, continues to be much too high a cost to expect U.S. gateways, carriers, and the public as a whole to pay.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Rebecca L. Taylor", is written over a solid horizontal line.

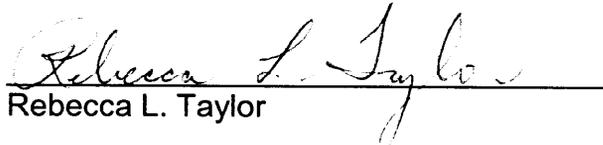
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Dated: December 17, 2001

CERTIFICATE OF SERVICE

I hereby certify that on this 17th day of December, 2001, a copy of the foregoing Answer of the City of Houston and the Greater Houston Partnership was served by hand or by mail on the parties named below:


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