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BEFORE THE
UNITED STATES DEPARTMENT OF TRANSPORTATION
WASHINGTON, D.C.

DEPT. OF TRANSPORTATION
DOCKET SECTION
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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, ÖSTERREICHISCHE)
LUFTVERKEHRS AG)
for approval of and Antitrust Immunity for)
Alliance Agreements pursuant to 49 U.S.C. §§)
41308 and 41309)

Docket OST-95-618 - 39

COMMENTS OF THE DEPARTMENT OF JUSTICE ON ORDER TO SHOW CAUSE

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Docket OST-95-6 13

COMMENTS OF THE DEPARTMENT OF JUSTICE ON ORDER TO SHOW CAUSE

The United States Department of Justice ("DOJ") hereby submits these comments on the Department of Transportation's ("DOT") Order to Show Cause (Order 96-5-26). For the reasons stated below, DOJ recommends that DOT modify the proposed Order to withhold unlimited antitrust immunity for coordination activities on four New York city pairs.

Introduction

The Department of Transportation, in its Show Cause Order, has tentatively determined to grant approval of and antitrust immunity for three separate Cooperation Agreements and a Coordination Agreement (collectively, the "Alliance Agreements") among Delta Air Lines, Inc. ("Delta"), Swiss Air, Swiss Air Transport Company, Ltd. ("Swissair"), Sabena S.A., Sabena Belgian World Airlines, ("Sabena") and Austrian Airlines, dsterreichische Luftverkehrs AG ("Austrian"). These Alliance Agreements

would permit the parties to substantially broaden their existing code-share arrangements on transatlantic services by jointly coordinating routes and schedules, marketing, pricing, inventory and yield management, strategic planning, and numerous other activities.

As a condition of approval, DOT has tentatively determined not to extend antitrust immunity to certain activities; i.e., pricing, inventory or yield management coordination, and the pooling of revenues with respect to local United States point-of-sale passengers flying nonstop in certain fare categories in the Atlanta-Brussels, Atlanta-Zurich, and Cincinnati-Zurich markets. DOT further proposes as a condition to require the parties to withdraw from all International Air Transport Association ("IATA") tariff coordination activities affecting through prices between the United States and Austria, Belgium, or Switzerland, and in certain other markets described in the Order. In addition, DOT has tentatively decided to impose certain other requirements on the parties, including the requirement that Swissair, Sabena, and Austrian report full-itinerary Origin-Destination Survey of Airline Passenger Traffic ("O & D Survey") data for all passengers to and from the United States.

The Department of Justice strongly supports DOT's tentative determination to condition and limit its grant of antitrust immunity in the Atlanta-Brussels, Atlanta-Zurich, and Cincinnati-Zurich markets. By carving out these markets the proposed Order will preserve existing competition for time-sensitive local nonstop passengers on these routes. DOJ also agrees that any limitations imposed on IATA tariff coordination activities are surely in the public interest, for IATA, by its very nature, undermines

competition. The O & D Survey reporting requirements are also desirable because these data are very useful for evaluating the competitive consequences of the Alliance Agreements.

The Department of Justice is concerned, however, with the tentative determination by DOT to grant full antitrust immunity without an appropriate carve-out for the New York-Brussels, New York-Geneva, New York-Vienna, and New York-Zurich markets. Full immunity would reduce the level of competition that exists today for time-sensitive local passengers who travel these routes. The Show Cause Order indicates that full antitrust immunity for the New York markets is appropriate for two reasons: (1) there remain a number of “competitive” one-stop and connecting services in all four of the New York markets and (2) the potential for new entry in these markets will counteract any loss of competition. Order at 16. In reviewing its tentative conclusion, however, we urge DOT to consider the evidence we present in these comments, explained more fully below, that time-sensitive travelers do not have good substitutes for nonstop scheduled airline service. Moreover, the prospects for entry by additional airlines into the New York markets that is sufficient and timely enough to deter or counteract the potential anticompetitive effects of the Alliance Agreements in these markets are remote.

In the light of these circumstances, the Department of Justice believes it would be prudent for DOT to reconsider its position and order a carve-out of the New York city pairs to preserve competition in these markets. An appropriate carve-out order should

contain the same terms and conditions set forth in the carve-out that already applies to the Atlanta and Cincinnati city pairs.

I. General Standards and Methodology.

The Department of Justice concurs with DOT's conclusion that the appropriate framework for assessing the competitive effects of these agreements is merger analysis. While the joint venture at issue here is not the equivalent of a merger, it would consolidate operations of competing firms and it does offer the potential for meaningful efficiency gains in numerous beyond-gateway (connecting) markets. Our analysis of such transactions focuses solely on their likely effects in properly defined relevant markets. The central issue is whether the proposed transaction is likely to result in increased prices to consumers by creating, enhancing, or facilitating the exercise of market power by the joint venture partners in any relevant markets.

In analyzing the likely competitive effects of such transactions, the Department of Justice uses the principles contained in the 1992 Horizontal Merger Guidelines. The Guidelines are widely accepted by economists and the courts as an analytical approach to assessing the effects of a transaction on competition and consumers, and the Show Cause Order adopts them as well. Order at 18. The starting point for that analysis is identifying the relevant markets in which the merging firms compete, identifying the firms that compete in those markets, and measuring concentration.

In analyzing airline mergers, the relevant markets are at least as small as city pairs. However, as discussed in more detail below, there are often even smaller markets. For example, a significant number of travelers who are time-sensitive may not

consider one-stop service to be a reasonable substitute for the nonstop service in a given city-pair market.’ In such cases, it is necessary to assess separately the impact of the transaction on time-sensitive passengers that require nonstop service.

Where a transaction results in high concentration in the relevant market, the Department of Justice proceeds to examine other factors to determine whether the remaining competitors will likely be able to increase prices or reduce the quality of service they provide. One factor DOJ considers is whether entry into the market is so easy that market participants, after the transaction, could not profitably maintain a price increase above premerger levels. It is not enough that entry be possible, that is, that others “can” enter (Order at 20) -- rather, the inquiry under the Guidelines is whether entry would occur if there were a small but significant anticompetitive price increase. “Entry is that easy if entry would be timely, likely, and sufficient in its magnitude, character and scope to deter or counteract the competitive effects of concern.” Merger Guidelines, § 3.0.

II. **The Alliance Will Reduce Nonstop Competition In the Overlap City Pairs.**

A. Current Competition.

Delta and an Alliance carrier currently compete on ten nonstop routes between the U.S. and Europe: Atlanta-Brussels, Atlanta-Zurich, Cincinnati-Zurich, New York-

¹ As discussed at Section 1.12 of the Merger Guidelines, the Department of Justice considers a product (such as non-stop service) to be a separate product market if the sellers of that product can price discriminate between the buyers that require that product and the buyers that are willing to buy other products (here, one-stop or connecting service). Airlines not only can charge different fares for nonstop and one-stop routings, they have also become very adept at using fare restrictions such as minimum stay requirements to target time-sensitive travelers using nonstop service.

Brussels, New York-Geneva, New York-Zurich, New York-Vienna, **Washington-** Geneva, Boston-Brussels, and Chicago-Brussels. These Comments will focus primarily on the four New York markets, since the Show Cause Order proposes to take action that will address our competitive concerns with three of the other markets (Cincinnati-Zurich and Atlanta-Zurich and Brussels), and since the remaining three markets (Washington-Geneva, Boston-Brussels and Chicago-Brussels) are not supported at the US. end by an Alliance hub of any magnitude.

The current competition among Alliance carriers in these markets is between carriers that own separate capacity in single aircraft -- so-called block seat arrangements. This block seat competition resulted when Delta undertook a program to lower costs and improve profitability by among other things, withdrawing service from certain relatively thin transatlantic routes. On each of the four New York routes, Delta withdrew its own independently operated service (which in each case had been operating at a loss) and replaced it with code-share/blocked space arrangements with its major European competitor in the market. Delta and its competitors each benefitted from these arrangements by removing capacity from the markets, while retaining a competitive presence.

Under the parties' code share/blocked space agreements, the marketing carriers purchase a block of seats at wholesale on aircraft operated by their code-share partners, and independently sell them at retail to their passengers in competition with the operating carrier. Although sharing the same aircraft limits the carriers' ability to compete vigorously on overall service quality, our review of internal carrier documents

provided in the course of our investigation in this case shows that this type of codesharing arrangement does result in meaningful competition between the carriers since each party bears the risk of unsold seats, and each party is able to control its own inventory. Even where, as is often the case, competing carriers have identical fares for comparable fare classes, price competition occurs as the airlines make different (and secret) decisions about how many cheaper seats to make available on each flight. A traveler may today, for example, find an advance purchase discount fare sold out on Swissair, but available on Delta because Delta had allocated more total seats to discount “buckets.” Now, however, the carriers seek by agreement to eliminate this competition.

B. Nonstop Service is a Relevant Product Market for Time-Sensitive Travelers.

The Show Cause Order properly concludes that city pairs are relevant markets requiring analysis. The issue here is whether, in the city pairs at issue here, nonstop service is a separate product market from one-stop and connecting service. The Show Cause Order tentatively concludes that one-stop competitors are in the same product market because they can discipline supracompetitive price increases in the overlap city pair markets. Order at 16, 25. However, there exists a large group of passengers for whom one-stop service is not a reasonable substitute for nonstop service. By charging higher average fares for nonstop service, and using certain fare restrictions and conditions, an airline can target time-sensitive passengers. Allowing the Alliance carriers to eliminate competition on the New York routes threatens these time-sensitive

(largely business) passengers with the possibility of anticompetitive price increases. The existence of a separate market for nonstop service is supported by the data on traffic patterns for long distance hub routings in the US. domestic market, by recent econometric work that shows that time-sensitive, business type consumers have a strong preference for nonstop versus one-stop travel, and by evidence regarding corporate travel policies.

An examination of many longer-haul domestic routes to hubs within the U.S. supports the existence of a separate market for time-sensitive travelers, and that those travelers are unlikely to take one-stop alternatives, absent large fare differentials. Consider, for example, the market between Delta's hubs in Atlanta and Salt Lake City. Data from the O & D Survey² for the 2nd Quarter of 1995 shows that although Delta carries much of the traffic in this city-pair market, the distribution of fares between Delta's nonstop passengers and the one-stop connecting passengers is very different at the high and low ends of the distribution.³ Chart I tracks how many passengers were traveling in either direction between Atlanta and Salt Lake City. The number of

² Comparable data for international travel are not collected from foreign carriers, but the data for long haul domestic markets are instructive. An important advantage of DOT's proposed data condition is that some comparable information on the precise city pairs at issue here will become available, at least from these parties.

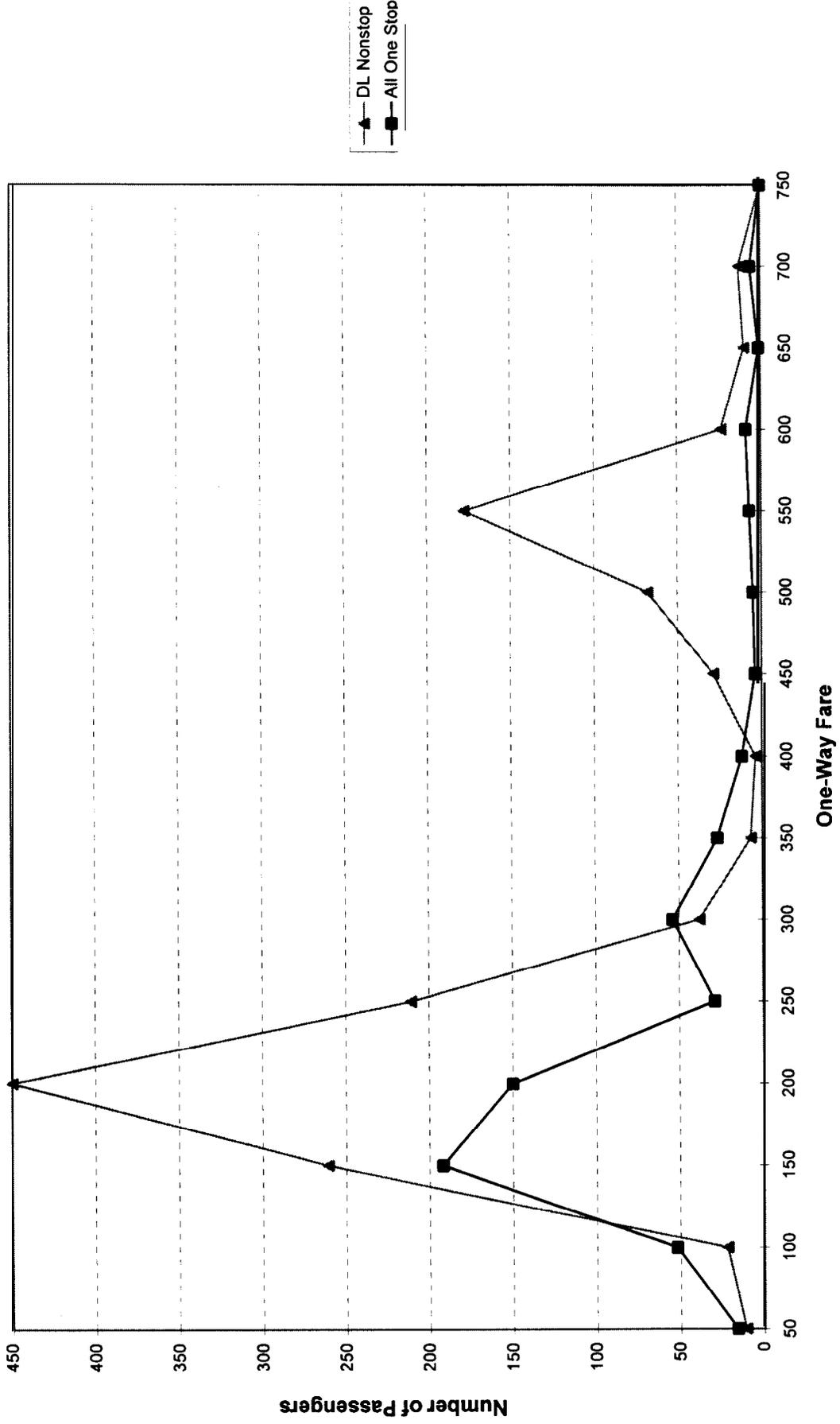
³ The O & D Survey classifies passengers by the number of ticket coupons they use, and cannot distinguish between passengers traveling nonstop on a route and those passengers traveling on a direct flight that do not change planes. In constructing the tables used below, all one coupon passengers are treated as nonstop passengers if they fly on the airline providing nonstop service. All other passengers on other airlines are treated as one stop passengers. Passengers buying round trip tickets will be counted twice (once in each direction), and their total ticket price is divided in half to allow comparison of all fares on a one way basis.

passengers at each fare level are grouped into categories ranging from \$50-\$99 up to \$750-\$799.⁴ Table I, attached, presents the same information in a tabular format.

⁴ Since these numbers are taken from the O & D Survey, they represent a 10% sample of all traffic on this route. The approximate number of actual passengers traveling in each category can be calculated by multiplying the observed number of passengers in Table I by ten.

CHART I

O&D Passenger Totals by Fare Category in Atlanta - Salt Lake City



As Chart I demonstrates, there are two distinct peaks in the data. These peaks correspond to two general groups of consumers. At the low end, leisure travelers with a greater willingness to change planes are evident. Most of the fares sold at the lower dollar amounts are sold with minimum stay or other requirements that often do not appeal to time-sensitive travelers. For fares at the low end of the scale, the number of passengers peaks for connecting traffic between \$150 and \$199. Although Delta still carries more total passengers in this group than the connecting carriers (58% on Delta's nonstop versus 42% on connecting carriers), a large proportion are clearly willing to incur the time penalty involved in changing planes to get a lower fare. Even so, there appears to be a measurable nonstop "premium" for leisure passengers. The larger proportion of passengers traveling nonstop on Delta in the next two highest groups (\$200-\$249 and \$250-\$299 groups) suggests that many leisure travelers are willing to pay significantly more for a nonstop instead of a connecting flight.

The second peak in the data occurs at the \$550 fare level, where minimum stay restrictions are not likely to apply. Here, Delta's nonstop service carries 96% of all the traffic on the city pair. Almost none of these passengers are interested in traveling on one-stop alternatives, and this group is probably composed almost entirely of time-sensitive passengers who are buying essentially unrestricted tickets. Looking more broadly at the distribution, Delta carries 82% of all passengers paying \$350 or more on a nonstop basis in Atlanta-Salt Lake City, while for passengers paying less than \$350, Delta carries only 67% of the passengers. Although these data do not precisely

answer the question of what would happen if Delta were to raise prices by 10% at the upper end of the distribution, it does show that at existing prices, time-sensitive consumers do not find one-stop carriers an attractive option. The table also demonstrates quite clearly how effectively airlines can price discriminate to target the time-sensitive travelers.

Similar results can be obtained by looking at fare distributions in other longer distance markets with a hub carrier at one or both ends of the route where only the hub carrier offers nonstop service compared to connecting service on other airlines. A more rigorous econometric study addressing the distinction between types of passengers was recently performed by Berry, Carnall, and Spiller (1996). Their study covered a large number of markets in the U.S. and demonstrates that airlines appeal to two distinct groups of passengers, a tourist type passenger and a business type passenger. They found that hubbing airlines were able to extract a 5% premium from tourist type customers, but that hubbing carriers were able to raise their premium to business travelers on nonstop flights by an average of 20% relative to a non-hub competitor's price.⁵

During the course of its investigation into the Delta Alliance agreements, the Department of Justice interviewed numerous corporate travel agencies and travel managers. Many corporations have explicit guidelines governing when their employees are required to take a one-stop alternative for European travel due to its

⁵ Steven Berry, Michael Carnall, and Pablo Spiller, "Airline Hubs: Costs, Markups and the Implications of Customer Heterogeneity," *NBER Working Paper 5561*, May 1996, hereinafter Berry, Carnall and Spiller (1996), p. 26.

lower price. Those guidelines consistently require a difference in fare well in excess of 10% before the one-stop alternative is preferred, with many corporations requiring up to 25% or more. This is not surprising given the value of employees' time, especially those that are dispatched to Europe, and suggests that for many time-sensitive passengers, an increase in price due to an absence of competition will not induce such travelers to substitute one-stop routings for the nonstop routings available from the Alliance.

If antitrust immunity is approved without conditions in the New York markets, as DOT has proposed in its draft order, the independent pricing on blocked space seats will disappear. As a result, the number of carriers offering nonstop service that is priced independently will drop from three to two in New York-Brussels and New York-Zurich, where American Airlines will be the only remaining nonstop competition. In New York-Geneva and New York-Vienna, the Delta Alliance carriers will cease competing and will become monopolists on the nonstop routing. On each of these routings, the Alliance non-stop flight generally has approximately a two hour advantage in elapsed time over the alternative one-stop routings. Local passengers on each of these hub-hub routings will see less competition. This loss of competition is going to be most acute for time-sensitive local travelers, such as business travelers. Many local tourist travelers with a lower value of time probably are willing to reroute over some one-stop alternatives, and they may not be adversely affected.

C. The Potential for New Entry in the New York Markets Will Not Deter or Counteract any Anticompetitive Effects of the Alliance Aareements.

The Show Cause Order, although expressing some concern about the loss of competition on these routings, on balance concludes that “sufficient potential market response,” particularly new entry, will discipline any price increase. Order 96-5-26 at 16. The Department of Justice questions this predictive judgment.

The prospect of entry could mitigate concerns about lost competition in the New York markets, but only if entry is so easy that the parties could not profitably maintain prices above competitive levels. Entry is that easy under the Meraer Guidelines if it would be “timely, likely, and sufficient in its magnitude . . . to deter or counteract the competitive effects of concern.” Meraer Guidelines § 3.0. The standard for assessing entry is thus not an abstract concept that can be satisfied simply because entry is possible -- to the contrary, the Guidelines require one to examine closely the market facts and then determine whether timely entry likely will occur in order to deter or prevent any anticompetitive effects. See Kevin J. Arquit, Perspectives on the 1992 U.S. Government Horizontal Meraer Guidelines, 61 Antitrust Law Journal 121, 129-131 (1992). To meet this standard, a new entrant must, among other things, be able to operate profitably at current price levels.⁶

Entry by new nonstop competitors, although permitted under recent open skies agreements, appears unlikely in many hub-hub transatlantic routings such as the four

⁶ Although the Alliance can raise fares, a new entrant will assume that fares will fall back to former levels (or below) once it enters. If fares do not fall back to pre-alliance levels, then the new entry is not “sufficient in magnitude” to prevent the anticompetitive price increase.

New York routes. Unlike many domestic routes that have seen entry by low-cost carriers in recent years, most transatlantic routes are unlikely to see the type of low-cost entry that has emerged in many domestic markets. Low-cost airlines such as Valujet and Southwest have succeeded largely by choosing shorthaul markets with large amounts of local traffic where they can provide reasonably frequent point to point service. By turning their aircraft around more frequently than major airlines constrained by requirements for meeting banking flights at hubs, these airlines are able to keep their costs low and compete with incumbent hub carriers. Economic studies have shown that these shorthaul routes do not have the economies of density that give a hub carrier significant cost advantages over a new entrant.⁷ Transatlantic routes, by contrast, are exactly the types of routes where hub carriers have a significant cost advantage over other potential entrants. The larger planes required on transatlantic flights require a hub system to concentrate many passengers from diverse origins on the same aircraft in order to be competitive.

Entering a transatlantic market without significant feed from a hub is even less likely when the routes involved have only a relatively small number of local passengers.⁸ In the four New York routes at issue, the Department of Justice estimates

⁷ See Berry, Carnall, and Spiller (1996).

⁸ The Show Cause Order points out that New York accounts for more originating traffic than other gateways, Order 96-5-26 at 25. However, while the volume of local traffic in a city pair is clearly relevant, the issue is whether entry is easy in the New York city pairs. The fact that other city pairs are more difficult than New York city pairs to enter does not answer the question whether entry is feasible in the city pairs at issue.

that no more than one-third to a little over one-half of the passengers currently carried by the nonstop competitors are local passengers on the New York to European hub city-pair. A fare increase targeted at well under half of the passengers on the Alliance planes would be unlikely to induce entry if the entrant could not fill the remainder of its own plane with other connecting passengers. Even in New York-Zurich, the largest of the four New York city pairs, the total number of local passengers flying this route on a daily basis would barely fill one plane, even assuming that the entrant could, by charging current fares, attract every local passenger away from the existing incumbent carriers.⁹ And if there existed a carrier that could operate profitably by attracting enough local passengers with lower fares than exist now, it would have entered once the open skies agreement became effective.

To profitably operate on any of these New York routes, therefore, an entrant must be able to find enough connecting traffic to fill the remaining seats.” To provide a reasonable connection to the international flight, that connecting traffic would have to be timed to meet the arriving and departing international flights, which are often grouped at certain times of day to provide convenient arrival and departure times for

⁹ The difficulty of attracting local passengers, particularly time-sensitive business passengers, is exacerbated by the advantage of national carriers in their home markets where distribution systems and frequent flyer programs make it difficult for U.S.-based carriers to attract this type of customer. Comments of Trans World Airlines, Inc., November 13, 1995, at 25-27.

¹⁰ The relevant issue is not whether Delta or any other carrier “dominates” traffic at JFK. See Order 96-5-36 at 25. Rather, the important question is whether possible entrants have or can be expected to develop in a timely fashion the necessary connecting “feed” traffic that hubs are designed to generate.

passengers. One measure of which carriers are well-suited to enter international routes at New York, therefore, is the existing number of international passengers they already have connecting at John F. Kennedy International Airport ("JFK").¹¹ Using both O & D Survey data and INS T-100 traffic statistics for 1994, DOJ has estimated the amount of feed traffic for each of the major U.S. carriers with significant international connecting traffic at JFK. They are:

<u>Carrier</u>	<u>Average Number of International Connecting Passengers Per Day</u>
TWA	2,900
Delta	2,700
American	1,900
United	800

The difficulty in attracting a profitable mix of local and connecting traffic on the particular New York routes at issue here is underscored by the recent history of unprofitable operations on those routes. TWA, which had the largest number of passengers connecting to international flights at JFK in 1994, withdrew from three out of the four New York routes during 1994 and 1995. Delta, which had the second highest number of passengers connecting to international flights at JFK in 1994, also lost money on these routes prior to its earlier applications for code share authority with its Alliance partners. This history of exit by carriers with significant feed at New York is strong evidence that new entry at current price levels is unlikely. The only other airline with significant amounts of international feed at JFK that could be used to support

¹¹ Delta has characterized its New York operation as one of its "primary transatlantic hubs." Letter from counsel for Delta to DOJ counsel dated July 17, 1995.

flights in these city-pairs is American Airlines, American currently operates two of the New York routes, but it has not entered either of the other routes since the open skies agreements became effective. Continental with its hub at Newark airport is another possible entrant, but it too has not entered any of the four markets since the bilaterals were signed despite the withdrawal of TWA from these markets and the capacity drawdown by Delta and its partners.

Finally, in analyzing the likelihood of entry on any of the New York city pairs, the potential profitability of that entry is relevant. A ten percent price increase targeted at time-sensitive passengers, while significant for those passengers, probably is not sufficient to induce entry because high pre-entry prices do not necessarily mean that an entrant can expect similar high prices after entry. Since the incumbent airline can adjust prices more quickly than an entrant can enter, the entrant would not be able to expect to charge above average fares after entry because of the likelihood of a competitive response by the Alliance partners. This point has been illustrated repeatedly in econometric studies of the domestic U.S. airline industry designed to test whether airline markets are contestable. In a contestable market, prices would not rise even under a monopolist because the threat of entry would restrain price increases. Studies of the airline industry have repeatedly rejected this hypothesis, finding instead that price is largely dependent upon the number of actual competitors in a market.*

¹² See Severin Borenstein, "The Evolution of U.S. Airline Competition," *Journal of Economic Perspectives*, Vol. 6 (Spring 1992).

D. The Loss of Actual Competition Is Important.

The antitrust laws of the United States are based on the premise that competition matters. For consumers, the tangible payoff of that competition is in the form of lower prices than they would otherwise pay. The airline industry has been the subject of a number of studies, and the conclusion that almost all of those studies have reached is that actual competition affects fares, and that actual competition affects fares far more than potential competition. After the Northwest/Republic merger, for example, fares rose significantly on routes where the two airlines had competed for passengers flying to the Minneapolis/St. Paul area.¹³ Fare premiums at Minneapolis/St. Paul and other concentrated airports have persisted over many years despite the theoretical possibility of entry by other carriers on many routes.¹⁴ Numerous studies have also shown that the number of actual competitors matters in determining fares, and in particular that going from three competitors to two competitors or from a duopoly to a monopoly causes a significant increase in fares.¹⁵

¹³ See Severin Borenstein, "Airline Mergers, Airport Dominance, and Market Power," *American Economic Review*, Volume 80, (May 1990), pp. 400-04, and Greg Werden, Andrew Joskow, and Richard Johnson, "The Effects of Mergers on Price and Output: Two Case Studies from the Airline Industry," *Managerial and Decision Economics*, Vol. 12 (1991), pp. 1-12.

¹⁴ See U.S. General Accounting Office, "Airline Competition: Higher Fares and Less Competition Continue at Concentrated Airports," July 1993.

¹⁵ For example, Joskow, Werden and Johnson (1994) find that entry and exit decisions by one airline can lead to changes in fares of between 9% and 10% in a number of routes where there are only a small number of incumbents. See Andrew Joskow, Greg Werden, and Richard Johnson, "Entry, Exit and Performance in Airline Markets," *International Journal of Industrial Organization*, Vol. 12 (1994), pp. 457-471.

(continued...)

Due to the restructuring of the domestic airline system into a hub and spoke system, there are a number long haul routes in major markets where only one or two carriers provide nonstop competition. The cost advantage of hub carriers on these routes means that on many long haul routes in the U.S., there is going to be very little competition for time-sensitive travelers. Since one of the most likely sources of nonstop competition on many of these longer distance routes is from another carrier hubbing at either the origin or destination city, structural changes that eliminate competition between hubbing carriers can have a large impact on fares. There is no reason to expect that the international consequences of eliminating competition between competing hub carriers will be any different than the U.S. domestic experience. If they receive unlimited antitrust immunity on routes connecting Delta's hub in New York with the hubs of its European partners, Delta and its partners will be able to raise fares on these routes, and restrict the availability of discounts.

Antitrust immunity in this context has the same effect on prices as a merger between two hub carriers, and the effect is likely. As an example, consider the

¹⁵(. ..continued)

Borenstein (1992) finds that on average, prices on routes with two active competitors averaged about 8% lower than on monopoly routes, and a third active competitor caused fares to drop by an additional 8%. See Severin Borenstein, "The Evolution of U.S. Airline Competition," *Journal of Economic Perspectives*, Vol. 6 (Spring 1992), pp. 45-73. Other studies with similar findings include: Severin Borenstein, "Hubs and High Fares: Airport Dominance and Market Power in the U.S. Airline Industry," *Rand Journal of Economics*, Vol. 20 (Autumn 1989), pp. 344-65. Jan Brueckner, Nichola Dyer, and Pablo Spiller, "Fare Determination in Hub and Spoke Networks," *Rand Journal of Economics*, Vol. 23 (Autumn 1992), pp. 309-333. Steven Morrison and Clifford Winston, "Enhancing the Performance of the Deregulated Air Transportation System," *Brookings Papers: Microeconomics* 1989, pp. 61-121.

differences observable between Boston-Houston and Boston-Dallas. In the Boston-Houston market, Continental operates a hub at Houston and offered 437 departures from Boston to Houston during the second quarter of 1995. Like Delta in Atlanta-Salt Lake, Continental is the only carrier offering nonstop service in this market. In Boston-Dallas, however, both American Airlines and Delta offer frequent nonstop service, with Delta offering 365 departures from Boston to Dallas during the quarter, and American offering 968 departures during the same time period. Chart II (and Table II, attached) present the number of nonstop passengers flying on Continental in the O & D Survey during the second quarter of 1995, while Chart III (and Table III) present similar information for the combined number of nonstop passengers carried by American and Delta in Boston-Dallas.

CHART II

O&D Passenger Totals by Fare Category in Boston - Houston

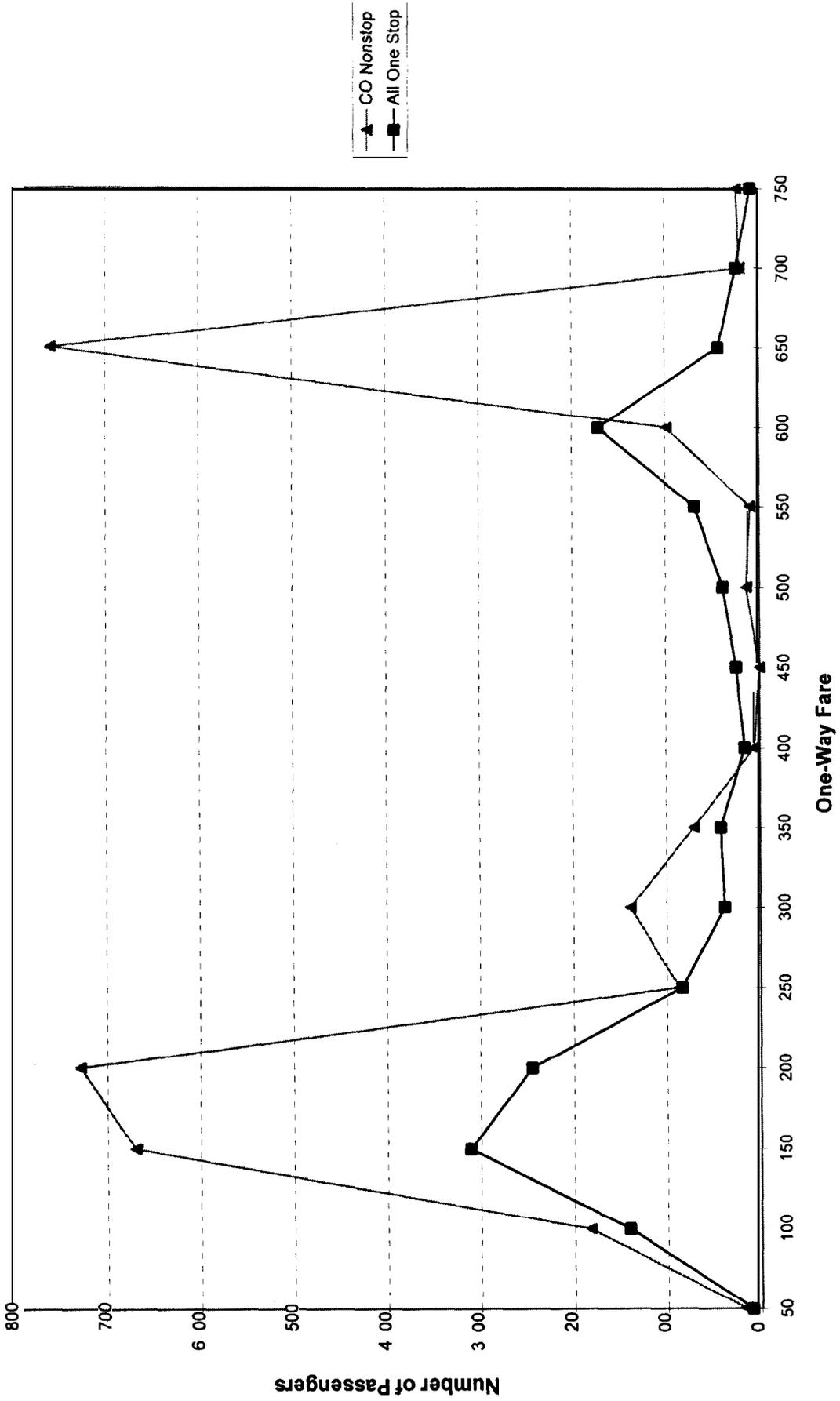
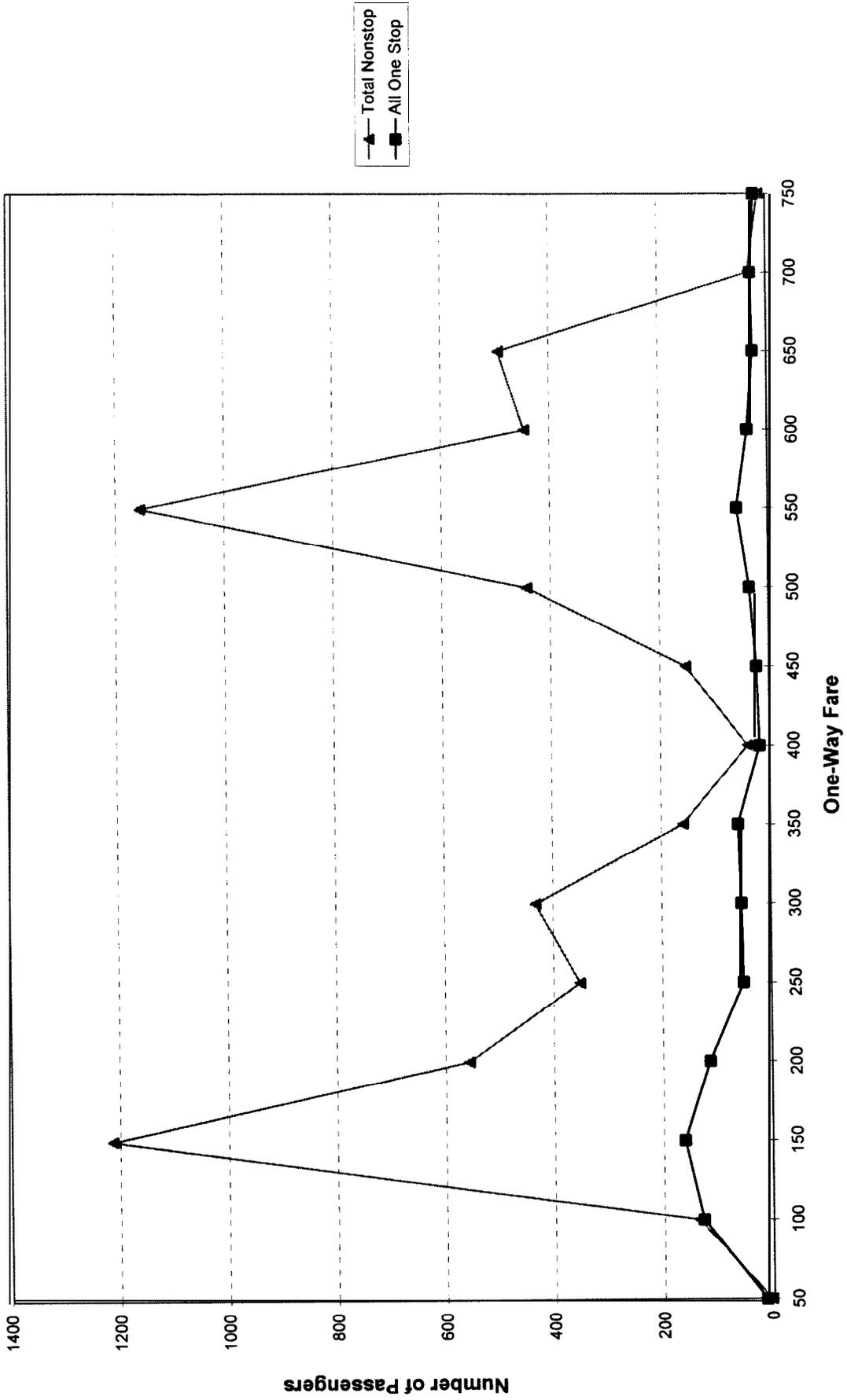


CHART III

O&D Passenger Totals by Fare Category in Boston - Dallas



As in Atlanta-Salt Lake City, the Continental nonstop traffic in Boston to Houston displays two distinct peaks in the number of passengers. The first peak occurs in the \$150-\$249 range, where Continental carries 72% of the total traffic, The second peak occurs between \$600 and \$699, where Continental carries 80% of all the traffic nonstop despite the competition for a few passengers by other airlines in the \$600-\$649 range.

The sharply defined peaks in Continental's business level nonstop fares in Boston-Houston contrast with a lower and much more dispersed fare distribution in Boston - Dallas for business level nonstop fares. In Boston-Houston, almost all of Continental's business passengers paid between \$650-\$699. In Boston-Dallas, by contrast, where there are two major nonstop competitors, there is evidence of greater competition for business fares. Rather than having just one selling business fare that is purchased by almost all business customers, a significant percentage of time sensitive passengers are spread across every category between \$500 and \$699 in Boston-Dallas. Although comparing absolute fare levels between two different cities can be somewhat misleading if demand conditions vary dramatically, it is nevertheless probative that for two similar markets, the business peak occurs at a level \$100 lower in the market with competing nonstop service, and the distribution is more dispersed, showing that the majority of time-sensitive business type passengers paid much less than passengers paid for similar nonstop service in Boston-Houston. The basic point that this comparison illustrates is the same point that many studies of the airline

industry has shown: competition matters. With more competitors, lower fares and greater varieties of fare levels are more likely as each airline tries to compete to attract more customers.

With the limited data available on transatlantic routes, determining the number of local passengers in the affected hub-hub markets is imprecise. However, the number of passengers and the amount of commerce that could be subject to increased prices is not insignificant. Our lower bound estimate of time-sensitive local passengers who would be subject to a price increase as a result of this transaction is about 72,000 annually. We arrived at that estimate by constructing from confidential 1994 data an estimate of the number of local passengers who traveled in the four overlap markets. In addition, Delta supplied DOJ with information on the percentage of their ticketed passengers in Atlanta-Brussels, Atlanta-Zurich, and Cincinnati-Zurich who travel in either first class, business class, or on an unrestricted full coach (Y type) ticket. It is likely that time-sensitive travelers also travel in other fare classes with somewhat greater restrictions, such as advance purchase with no minimum stay. But DOJ conservatively used Delta's percentage number to estimate a lower bound for the number of time-sensitive travelers.

While the Department of Justice is of course willing to work with DOT in monitoring the performance of the affected markets in the future, our preference would be to first assure that the consuming public is protected. This could be done by including the New York markets in the carve out, and reconsidering at a later date if in fact new entry occurs, or if fare distribution charts similar to those included with these

comments are constructed for the New York city pairs with the data DOT proposes to require, and show a fare distribution quite unlike those that exist in comparable domestic markets.

III. The Proposed Condition Limiting Participation in IATA by Immunized Alliance Carriers is an Appropriate Exercise of DOT's Discretion.

The Show Cause Order proposes to condition its grant of antitrust immunity by requiring the alliance participants to withdraw from participation in IATA tariff conference activities that discuss prices applicable between the U.S. and countries whose carriers participate in immunized agreements like the one at issue here. In effect, DOT proposed to have the applicants choose between immunized participation in the alliance and immunized participation in IATA price fixing. DOT has ample basis for imposing such a condition. Indeed, U.S. consumers would benefit from enhanced airline competition if DOT were to broaden the condition to block participation in tariff coordination by alliance carriers for all U.S.-third country routes.

First, a condition limiting IATA participation by the alliance partners is justified by DOT's desire to maximize the potential public benefits underlying this order. DOT's tentative decision to grant the parties immunity here is based on its conclusion that the Alliance Agreements will provide benefits in the form of better, more efficient airline service. DOT has properly concluded that it is prudent to adopt every feasible measure to ensure that the efficiencies realized by the Alliance participants are passed on to consumers. Unfettered competition is the most effective means to accomplish this. In this context, the proposed IATA condition is justified even given a finding (with which

we are in partial disagreement) that the underlying agreement is not likely substantially to reduce competition. **IATA** price fixing is clearly **anticompetitive**.¹⁶ Even though **IATA** tariff coordination does not eliminate all competition in these markets, and even if existing levels of competition will not be substantially lessened by this transaction, the fact remains that “a greater degree of price competition, and hence, a more competitive environment would exist in the absence of [**IATA** tariff coordination].” Order 81-5-27 at 10. The public benefit sought by DOT’s in approving this alliance is to increase competitive service, and it is only prudent to condition this transaction to limit the clear threat that **IATA** price fixing poses to the public interest benefits of the transaction.

Second, DOT’s action to facilitate this and other joint ventures is a key element in the U.S. government’s plan to foster the development of a true open skies environment -- one where entry, exit and pricing will take place in a fully competitive environment, unfettered by governmental or other constraints. Allowing carriers in the market to engage in government-sanctioned price fixing is, to say the least, fundamentally at odds with any notion of an open competitive marketplace. While DOJ

¹⁶ **IATA** has criticized the identical condition imposed on United and Lufthansa in Docket OST-96-1116 arguing, among other things, that “there is not a shred of evidence to establish that tariff coordination has or will ‘undermine [price competition between the Alliance carriers and other carriers].” Docket OST-96-1116. Response of The International Air Transport Association to Order to Show Cause, 1996 WL 16, 1996 WL 16 at p. 3. Of course, the anticompetitive nature of **IATA** price fixing is well-established. DOT and its predecessor agency found in 1985 that **IATA** tariff coordination “substantially reduces competition in the provision of foreign air transportation.” Order 85-5-32 at 5. Those findings remain valid regardless of whether DOT is currently reviewing the grant of antitrust immunity that was made in those orders. Moreover, the pendency of that broader proceeding does not render DOT powerless to address specific public interest issues relating to **IATA** in this proceeding.

would prefer to see the elimination of all tariff coordination, the steps DOT has taken in this and other alliance proceedings are clearly in the public interest and within the Secretary's authority.¹⁷

IV. The Proposed Condition Requiring the Submission of Traffic Data Is Well-Advised.

The Department of Justice fully supports the Show Cause Order's proposed requirement that the European carriers in the Delta Alliance be required to report Origin and Destination survey data. This requirement, similar to the one imposed upon Lufthansa in Docket OST-96-1116, is essential if current and future codesharing arrangements are to be examined effectively in the future. In examining both the Delta Alliance and similar codesharing arrangements in the past, the Justice Department has been substantially hindered by the lack of consistent, accurate data on foreign carriers flying between the U.S. and Europe. Although U.S. carriers routinely report this information for their transatlantic passengers when they fly on the U.S. carrier's aircraft, information on foreign carriers is necessary for a complete analysis of the market. As this reporting requirement becomes more common among foreign carriers, the O&D Survey will become a useful tool for analyzing transatlantic markets in much the same way it has already become the primary data source for analyzing city-pair markets within the U.S.

¹⁷ The Department of Justice recommended in Docket 46928 that DOT should consider immunity for IATA tariff coordination on a country-by-country basis. Docket 46928, Comments of the Department of Justice, August 7, 1990 at 21-22. Under such an approach, an international comity analysis would likely conclude that our open skies bilateral trading partners would not have an overriding interest in preserving IATA price fixing at the expense of U.S. antitrust principles.

Conclusion.

While the Alliance promises significant benefits to many passengers traveling in most city pairs in the partners' global network, these benefits do not have to come at the expense of local, time-sensitive passengers in the markets where the partners currently compete. The benefits of integration and the protection of the local passengers can both be achieved by the extension of appropriate immunity limitations to the New York-Brussels, Geneva, Vienna and Zurich city pairs.

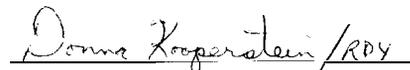
Respectfully submitted,

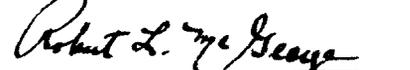
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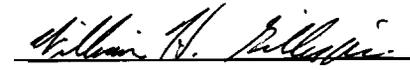
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Dated: May 28, 1996

Table I

O&D Passenger Totals by Fare Category in
Atlanta - Salt Lake City

Fare Category	Delta Nonstop Passengers	All One Stop Passengers
\$50 - \$99	11	16
\$100 - \$149	22	52
\$150 - \$199	261	192
\$200 - \$249	450	150
\$250 - \$299	211	29
\$300 - \$349	38	54
\$350 - \$399	7	27
\$400 - \$449	4	12
\$450 - \$499	29	4
\$500 - \$549	68	5
\$550 - \$599	178	7
\$600 - \$649	24	9
\$650 - \$699	10	1
\$700 - \$749	13	6
\$750 - \$799	0	0

Table II

O&D Passenger Totals by Fare Category in
Boston - Houston

Fare Category	Continental Nonstop Passengers	All One Stop Passengers
\$50 - \$99	17	10
\$100 - \$149	183	141
\$150 - \$199	670	311
\$200 - \$249	729	245
\$250 - \$299	87	84
\$300 - \$349	139	38
\$350 - \$399	71	42
\$400 - \$449	6	16
\$450 - \$499	0	25
\$500 - \$549	14	39
\$550 - \$599	10	69
\$600 - \$649	99	172
\$650 - \$699	759	43
\$700 - \$749	20	24
\$750 - \$799	23	8

Table III

O&D Passenger Totals by Fare Category in
Boston - Dallas

Fare Category	Total Nonstop Passengers	All One Stop Passengers
\$50 - \$99	4	13
\$100 - \$149	137	128
\$150 - \$199	1214	161
\$200 - \$249	557	114
\$250 - \$299	352	51
\$300 - \$349	433	54
\$350 - \$399	160	59
\$400 - \$449	40	18
\$450 - \$499	153	23
\$500 - \$549	444	35
\$550 - \$599	1156	57
\$600 - \$649	447	37
\$650 - \$699	494	26
\$700 - \$749	34	29
\$750 - \$799	14	22

CERTIFICATE OF SERVICE

I hereby certify that on this 28th day of May, 1996, I served a copy of the foregoing Comments of the Department of Justice on the following individuals by first class mail, postage prepaid.

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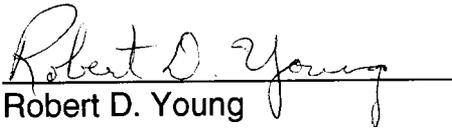
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