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BEFORE THE
DEPARTMENT OF TRANSPORTATION
WASHINGTON, D.C.

DEPT. OF TRANSPORTATION
DOCKET SECTION

96 JUN -4 PH 4: 19

Joint Application of)
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AMERICAN AIRLINES, INC. and)
EXECUTIVE AIRLINES, INC., FLAGSHIP)
AIRLINES, INC., SIMMONS AIRLINES, INC,)
and WINGS WEST AIRLINES, INC.)
(d/b/a AMERICAN EAGLE))

and)
)

CANADIAN AIRLINES INTERNATIONAL LTD.)
and ONTARIO EXPRESS LTD. and TIME AIR INC.)
(d/b/a CANADIAN REGIONAL) and)
INTER-CANADIAN (1991) INC.)

under 49 USC §§ 41308 and 41309 for approval of and)
antitrust immunity for commercial alliance agreement)
)

Docket OST-95792 - 29

**ANSWER OF AIR CANADA
TO ORDER TO SHOW CAUSE**

Communications with respect to this document should be addressed to:

Morris R. Garfinkle
Anita M. Mosner
Michael P. Fleming
GALLAND, KHARASCH, MORSE & GARFINKLE, P.C.
1054 Thirty-first Street, N.W.
Washington, D.C. 20007

L. Cameron DesBois, Q.C.
Vice President and General Counsel
Geoffrey N. Pratt
Senior Solicitor
AIR CANADA
Law Branch 276, CP 14000
Saint-Laurent, Quebec H4Y 1 H4
Canada

Attorneys for
AIR CANADA

Dated: June 4, 1996

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Docket OST-95-792

**ANSWER OF AIR CANADA
TO ORDER TO SHOW CAUSE**

On May 29, 1996, the Department of Transportation ("DOT" or "Department") issued Order 96-5-38 ("Order") tentatively deciding to grant, with certain specified exceptions, approval of and antitrust immunity for a commercial alliance between American Airlines, Inc. and its regional commuter **affiliates** ("American") and Canadian Airlines International, Ltd. and its regional affiliates ("**CAI**"). The Department invited interested parties to comment on the tentative findings and conclusions contained in the Order by June 4, 1996. Air Canada hereby submits its comments on Order 96-5-38 and the tentative findings and conclusions therein.

INTRODUCTION

Air Canada obviously is an interested party concerning the actions which the Department takes with respect to both the **American/CAI** alliance and the aviation relationship between the United States and Canada that has resulted from the February 24, 1995 Air Transport Agreement between these two governments ("U.S.-Canada Agreement"). The Departments final actions in this proceeding will impact significantly on the nature of the U.S.-Canada commercial and trading relationships, and especially the aviation relationship under the U.S.-Canada Agreement; it will impact significantly on the competitive landscape in the U.S.-Canada aviation market; and it will impact significantly on the evolution, development, and maturation of global alliances throughout the international aviation community.

As an airline which has a direct and substantial interest in each of these three areas -the U.S.-Canada market, the competitive landscape of the U.S.-Canada aviation market, and the evolution of global alliances -- Air Canada has much at stake in the Departments final findings and conclusions in this proceeding. What is at issue in this proceeding is not confined simply to adjudicating the merits of a single alliance's request for antitrust immunity, but, rather, the scope of future competition in what DOT itself called the "largest international passenger market in the **world,**"^{1/} and the ability of global alliances, particularly alliances involving Canadian airlines, to compete, on even terms, with one another.

^{1/} Order 96-5-38, page 10.

Air Canada opposed the November 3, 1995 application filed by American and CAI, which sought approval of and antitrust immunity for their commercial alliance, on the basis that the U.S.-Canada Agreement was not an open skies agreement under the traditional views of the United States Government and DOT, and, therefore, did not qualify under principles often articulated and clearly espoused by the Department for consideration for a grant of antitrust immunity. Order 96-5-38 holds true to that view, but examines the **U.S.-Canada** market and relationship from a new, and different, **perspective.**^{2/} Specifically, the Department states in the Order that it is “prepared to go forward in the absence of full, open-skies provisions [in the U.S.-Canada Agreement] . . . because the U.S.-Canada market presents unique circumstances that justify special considerations.@’ The Department then goes on to identify these unique circumstances:

- Canada and the United States share the longest border in the world;
- There are vast and various networks of land transportation alternatives between the two countries;
- The vast majority of Canadians live within an hours flight of the **U.S.-Canadian** border;
- The resulting transborder market is relatively short-haul compared to the transatlantic, transpacific and Latin America markets; and
- The volume for goods and services in the U.S.-Canada market out paces every other international market.”

^{2/} **Id.**

^{3/} **Id.**

^{4/} **Id.** at pages 10 and 16.

Air Canada is heartened by the Department's recognition of the breadth, depth, and intensity of competition in the transborder market subsequent to, and as a result of, the U.S.-Canada Agreement. As the Department points out in the Order:

"The new U.S.-Canada aviation agreement has resulted in large growth of new transborder service. As of December 1995, U.S. and Canadian carriers had initiated scheduled nonstop service in 45 previously unserved markets (12 by U.S. carriers, 27 by Canadian carriers, and six by both U.S. and Canadian carriers), and new competitive scheduled service was instituted in another 14 nonstop markets. Fourteen new U.S. cities and one new Canadian city now receive scheduled nonstop transborder service. Altogether, in December 1995, there were 90 transborder markets receiving scheduled service, compared to only 53 a year earlier, a 70 percent increase. As a consequence of these new services, transborder traffic and capacity skyrocketed. U.S.-Canada nonstop passengers in December 1995 grew 28 percent from December 1994, while nonstop flights grew by 45 percent." Order 96-5-38 at pages 18-19.

Similarly, in a speech delivered by DOT Assistant Secretary for Aviation and International Affairs, Charles Hunnicutt, before the Aero Club of Washington, D.C. on May 28, 1996 -- the day before the Order was issued -- Assistant Secretary Hunnicutt declared:

"Our new transborder aviation agreement with Canada has opened the largest single bilateral aviation market in the world. The new agreement is tailored to special circumstances, including the overriding importance of the third and fourth freedom markets. It has led to an avalanche of applications both from U.S. and Canadian airlines, who are now going all-out to stimulate business and tourism by aggressively expanding transborder service. Nearly fifty city-pair markets have received first-time scheduled service and another 14 city-pair markets have received additional airline competition. The market grew by more than one million passengers during the first year of the new regime, providing huge public benefits for both countries." Order 96-5-38 at 7.

As an active participant in the U.S.-Canada market both before and after the **U.S.-Canada Agreement**, Air Canada can confirm, without a doubt, the new sense of competition

which has been brought to the U.S.-Canada market and which, in Air Canada's opinion, will only increase as market protection provisions are lifted at Montreal, Vancouver, and Toronto.

Moreover, Air Canada appreciates the fact that the Department is not reviewing the **American/CAI** application for antitrust immunity, or that alliance, in a vacuum. When the Department stated in Order 96-5-38 that its "proposed action will be consistent with [its] policy of facilitating competition among emerging multinational airline networks" and allow U.S. airlines "to become significant players in the globalization of the airline industry,"^{5/} the Department fully recognized that competition in international aviation has evolved (in large part due to the prodding by and encouragement of the United States and DOT) from **airline-**to-airline and city-pair-to-city-pair competition to alliance-to-alliance and network-to-network competition. Air Canada believes that this is the only way in which airlines and competition can be viewed and analyzed today.

After considering the Department's perspective and reviewing Order 96-5-38 in light of that perspective, as well as the bustling competition in the U.S.-Canada market, Air Canada fully agrees with the Department's conviction that the U.S.-Canada market is special, unique, and sui aeneris, and, thus, warrants consideration different from that accorded to other aviation relationships enjoyed by the United States. Given that the Department has indeed accepted the fact that the U.S.-Canada market is different and that the uniqueness of the relationship between the United States and Canada allows airline alliances of the two countries to apply for, and receive, antitrust immunity, Air Canada now

^{5/} **Id.** at page 2.

fully supports the basis and rationale for the tentative findings and conclusions of Order 96-5-38.

In light of the Departments findings and conclusions with respect to the sui aeneris nature of the U.S.-Canada market, and the fact that the special circumstances of the U.S.-Canada relationship do not require all of the provisions of a traditional open skies agreement to be in place for U.S.-Canada airline alliances to receive antitrust immunity, Air Canada and United Air Lines, Inc., too, are free to apply for, and receive, antitrust treatment similar to that which ultimately may be accorded American and CAI. Accordingly, Air Canada and United are today filing a joint application for approval of and antitrust immunity for their commercial alliance activities. Indeed, contemporaneous consideration of the Air Canada/United and **American/CAI** applications may be required by the Ashbacker doctrine (Ashbacker Radio Co. v. F.C.C., 326 U.S. 327 (1945)).^{6/} The Air Canada/United alliance

^{6/} If the Departments (and the Department of Justice's) analysis of the competitive effects of a possible Air Canada/United alliance and grant of antitrust immunity will be viewed in any different context than the **American/CAI** application was viewed, then Ashbacker must apply. If, for example, the analysis of the competitive effects of the **American/CAI** application examined the market conditions which existed before that alliance were granted antitrust immunity, and the analysis of the competitive effects of the Air Canada/United application were to examine the market conditions then in existence, including the existence of the **American/CAI** alliance with antitrust immunity, and that analysis were to conclude that the **American/CAI** alliance was permissible, but antitrust immunity for the Air Canada/United alliance was not (in part because market concentrations had changed after the **American/CAI** grant of antitrust immunity), then the Department would be required to consider the **American/CAI** and Air Canada/United application simultaneously because they would be mutually exclusive; the grant of one application -- the **American/CAI** application -- would "effectively preclude realistic consideration and grant of the other" -- the Air Canada/United application. (See Order 95-2-28). This would be true in any event, but all the more so here, where the Department, by its own admission, is deviating carefully from its previously-articulated policy of not granting antitrust immunity in the absence of an open skies agreement. At the very least, if the Department could grant only one antitrust immunity application -- and Air Canada does not believe that that is the case -- then it would have been required to put all interested parties on notice, to give
(continued.. .)

will provide the same benefits to consumers and competition which the Department identified in Order 96538 with respect to the **American/CAI** alliance, and Air Canada and United will accept the same conditions and limitations to be imposed on **American/CAI**.

Having indicated that Air Canada supports the basis and rationale for the tentative findings and conclusions of Order 96-5-38, and having indicated that that rationale enables Air Canada and United to apply for and receive equivalent consideration of their joint application for and approval of antitrust immunity, Air Canada is, however, concerned and troubled by some of the references in that Order to Air Canada's so-called and alleged "dominance."

Air Canada's concern is based on several factors. The Department has quite correctly pointed out that the U.S.-Canada market has become greatly more competitive as a result of the U.S.-Canada Agreement. Assistant Secretary Hunnicutt reiterated this point in his May 28 speech. However, the analysis of services in the U.S.-Canada market offered by U.S. and Canadian airlines referred to in the Order (e.g., page 19) includes only services through December 1995. This is less than one year of experience, and more than five months old. While Air Canada concurs with the conclusions reached in Order 96-5-38

^{6/} (...continued)
them all a chance to apply, and to consider each of those competing applications contemporaneously.

Air Canada does not want to be misunderstood on this point. It is not advocating such a policy. A "one immunity per country" result would have severe adverse policy implications for the United States not only with respect to Canada -- where, as stated in the Joint Application of Air Canada and United Air Lines, Inc. filed today, the Canadian Government expectation is that all of its airlines will be treated evenhandedly -- but also as it tries to pursue other open skies agreements with, inter alia, the United Kingdom, Japan, Brazil, Korea, and Taiwan -- all of which have two major airlines that are involved in, or undoubtedly will seek, alliance relationships.

^{7/} See, for example, Order 96-5-38 at pages 15 and 19 (n. 43).

as to the large increases in service, the underlying theme -- the growth and extent of competition in the U.S.-Canada market -- would be corroborated by what also happened in the last five months, and what has been announced for the next several months.^{8/}

While the limited scope of the levels of service in the U.S.-Canada market tend to portray that market in outdated fashion, the traffic figures utilized by the Department in Order 96-5-38 are even less reflective of the current market. This is because some of the traffic data cited by the Department is for the twelve months ended September 30, 1995 -- just over one-half year's experience under the U.S.-Canada Agreement -- and some are for the calendar year 1995. Air Canada recognizes that DOT was under limitations outside

^{8/} The new jet services which have been inaugurated in the U.S.-Canada market since January 1996 are:

U.S. CARRIER SERVICES		CANADIAN CARRIER SERVICES	
Alaska:	San Diego-Vancouver	Air Canada:	Nashville-Toronto Philadelphia-Toronto
American:	JFK-Vancouver Miami-Vancouver San Jose-Vancouver		
Delta:	Atlanta-Vancouver Cincinnati-Montreal Cincinnati-Vancouver Las Vegas-Calgary		
Continental:	Newark-Toronto*		
Comair: (Delta Affiliate)	Nashville-Toronto Boston-Montreal		
Northwest:	Detroit-Vancouver		
TWA:	St. Louis-Vancouver		
United:	Denver-Vancouver Los Angeles-Vancouver		

• Not started; recently awarded.

of its control on its ability to review and analyze “real time” data, but Air Canada also recognizes, as it is sure the Department does as well, that, given a market as dynamic and growing as the U.S.-Canada market, using even three-month-old data can lead to outdated results, especially where services are being added on an almost weekly basis.

The lack of “real time” data is compounded by the fact that the Department’s views of the market are retrospective, or historical, not prospective. There is no doubt that the U.S.-Canada market will continue to grow dynamically -- perhaps not at the pace experienced in the first few years after the U.S.-Canada Agreement, but it will continue to grow nevertheless. Much of the growth will be by U.S. airlines at Vancouver and Toronto after the market protection provisions at those gateways expire. DOT’s description of Air Canada as the “dominant” airline is, thus, a conclusion based on an historical structure.

Given the enormous growth which has occurred in the U.S.-Canada market since the signing of the U.S.-Canada Agreement and the future growth which DOT itself acknowledges will occur in this market, the structure of this market is forever changed. It would not be accurate to look at the U.S.-Canada market on an historical basis, or even on the basis of a “snapshot” today. This is a dynamic market, and any view of this market must consider future growth, as well. And, in the future, Air Canada will continue to be subject to increased competition in the U.S.-Canada markets, not only from the **American/CAI** alliance, but also from several other U.S. airlines.^{9/} Thus, any analysis of the U.S.-Canada market, of the **American/CAI** alliance, or the Air Canada/United alliance must

^{9/} Indeed, as the March 5, 1996 edition of The Wall Street Journal pointed out, many of the new services which have been inaugurated since the U.S.-Canada Agreement was signed have been by airlines other than Air Canada. Indeed, Northwest Airlines has been declared a large winner.

reflect the fact that Air Canada's share of the U.S.-Canada market, and the U.S.-Toronto market, surely will decrease. Air Canada is concerned that Order 96-5-38 did not take these factors into account in examining Air Canada's prospective participation in the **U.S.-Canada** market.

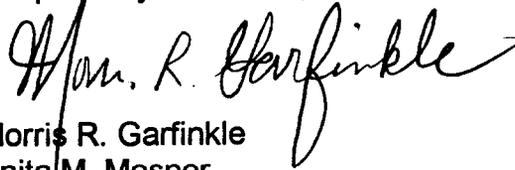
Finally, while Air Canada may be the largest airline at some of the gateways mentioned in Order 96-5-38, it is certainly far, far less a "dominant" carrier at those gateways and in those markets than other airlines which have received antitrust immunity in markets in which they participate. **See** Attachment. Indeed, of all the airlines which have received, or are being considered or have applied for, antitrust immunity, Air Canada's market share in every city-pair, city-to-country and country-pair is among the lowest.

CONCLUSION

Air Canada fully supports the manner in which the Department has determined to view the U.S.-Canada market. This market, as the Department found, is unique, and is a bilateral market that is "in a class by itself." Air Canada also fully supports the decision that airlines of Canada and the United States are eligible to apply for and receive approval of and antitrust immunity for their commercial alliance agreements. Finally, Air Canada would

support a grant of immunity to the **American/CAI** alliance provided that the Air Canada/United application, filed today, received similar treatment and authority.

Respectfully submitted,



Morris R. Garfinkle
Anita M. Mosner
Michael P. Fleming

GALLAND, KHARASCH, MORSE & GARFINKLE, P.C.

L. Cameron **DesBois**, Q.C.
Vice President and General Counsel
Geoffrey N. Pratt
Senior Solicitor

AIR CANADA

Attorneys for
AIR CANADA

Dated: June 4, 1996

CARRIER MARKET SHARES IN SELECTED COUNTRY, CITY, AND CITY-PAIR MARKETS
(Ranked by Seat Share)

1. BETWEEN U.S. AND SELECTED COUNTRIES:

<u>RANK</u>	<u>CARRIER</u>	<u>COUNTRY</u>	<u>SEAT SHARE (%)</u>	<u>DEPARTURE SHARE (%)</u>
1	SAS	Norway	100.0	100.0
2	SAS	Denmark	77.2	78.1
3	Swissair	Switzerland	67.0	58.5
4	Austrian	Austria	55.2	58.8
5	SAS	Sweden	49.1	50.0
6	Sabena	Belgium	38.6	35.2
7	KLM	Netherlands	38.4	37.9
8	Lufthansa	Germany	36.8	32.6
9	Air Canada	Canada	29.8	33.9

<u>RANK</u>	<u>ALLIANCE</u>	<u>COUNTRY</u>	<u>SEAT SHARE (%)</u>	<u>DEPARTURE SHARE (%)</u>
1	UA/SAS	Norway	100.0	100.0
1	DL/SR/SN/OS	Austria	100.0	100.0
3	UA/SAS	Denmark	77.2	78.1
4	DL/SR/SN/OS	Switzerland	75.0	67.0
5	KLM/NW*	Netherlands	66.8	62.0
6	DL/SR/SN/OS	Belgium	66.1	61.0
7	UAISAS	Sweden	49.1	50.0
8	LH/UA	Germany	42.7	38.0
9	AC/UA	Canada	36.1	37.9

• Excludes Martinair Holland, which is majority owned by KLM. If Martinair is added, the departure and seat shares increase to 75.1% and 79.8%, respectively.

2. BETWEEN U.S. AND SELECTED CITIES:

<u>RANK</u>	<u>CARRIER</u>	<u>CITY</u>	<u>SEAT SHARE (%)</u>	<u>DEPARTURE SHARE (%)</u>
1	SAS	Oslo	100.0	100.0
2	SAS	Copenhagen	77.2	78.1
3	Swissair	Zurich	67.1	58.2
4	Austrian	Vienna	55.2	58.8
5	SAS	Stockholm	49.1	50.0
6	Air Canada	Toronto	43.3	49.9
7	Lufthansa	Frankfurt	39.2	34.2
8	Sabena	Brussels	38.6	35.2
9	KLM	Amsterdam	38.4	37.9
10	Air Canada	Montreal	25.0	31.7
11	Air Canada	Vancouver	15.7	25.0

<u>RANK</u>	<u>ALLIANCE</u>	<u>CITY</u>	<u>SEAT SHARE (%)</u>	<u>DEPARTURE SHARE (%)</u>
1	DL/SR/SN/OS	Vienna	100.0	100.0
1	UAJSAS	Oslo	100.0	100.0
3	UA/SAS	Copenhagen	77.2	78.1
4	DL/SR/SN/OS	Zurich	76.6	69.2
5	KLM/NW*	Amsterdam	66.8	62.0
6	DL/SR/SN/OS	Brussels	66.1	61.1
7	UA/SAS	Stockholm	49.1	50.0
7	ACNA	Toronto	49.1	53.5
9	LH/UA	Frankfurt	46.0	40.2
10	AC/UA	Vancouver	31.5	37.7
11	AA/CP	Vancouver	26.0	21.6
12	AA/CP	Montreal	25.0	14.3
13	AA/CP	Toronto	23.5	17.3
14	AC/UA	Montreal	12.6	31.7

- Excludes Martinair Holland, which is majority owned by KLM. If Martinair is added, the departure and seat shares increase to 75.1% and 79.8%, respectively.

3. BETWEEN U.S. AND SELECTED CITY-PAIRS:

<u>RANK</u>	<u>CARRIER</u>	<u>CITY-PAIR</u>	<u>SEAT SHARE (%)</u>	<u>DEPARTURE SHARE (%)</u>
1	Delta	ATL-BRU	100.0	100.0
1	Delta	ATL-ZRH	100.0	100.0
1	Delta	CVG-ZRH	100.0	100.0
1	Swissair	JFK-GVA	100.0	100.0
1	Austrian	JFK-VIE	100.0	100.0
6	Swissair	JFK-ZRH	66.1	50.0
7	Air Canada	LGA-WZ	47.2	49.0
8	Lufthansa	ORD-FRA	41.6	33.3
9	Lufthansa	IAD-FRA	40.4	33.3
10	Delta	JFK-BRU	39.9	33.3
11	Canadian	LAX-WR	39.1	44.4
12	United	ORD-FRA	35.3	33.3
13	American	ORD-WZ	34.0	30.3
14	Air Canada	ORD-WZ	24.8	31.1

<u>RANK</u>	<u>ALLIANCE</u>	<u>CITY-PAIR</u>	<u>SEAT SHARE (%)</u>	<u>DEPARTURE SHARE (%)</u>
1	DL/SN	ATL-BRU	100.0	100.0
1	DL/SR	ATL-ZRH	100.0	100.0
1	DL/SR	CVG-ZRH	100.0	100.0
1	DL/SR	JFK-GVA	100.0	100.0
1	DUOS	JFK-VIE	100.0	100.0
6	LHNA	ORD-FRA	76.9	66.6
7	LH/JA	IAD-FRA	74.1	66.6
8	DUSN	JFK-BRU	73.9	66.6
9	DUSR	JFK-ZRH	66.1	50.0
10	AC/JA	ORD-YYZ	53.2	57.6
11	AA/CP	LGA-WZ	52.7	50.9
12	AA/CP	ORD-WZ	42.5	40.9
13	AA/CP	LAX-WR	39.1	44.4
14	AC/JA	LAX-YVR	36.9	33.3

Source: Official Airline Guide, June edition, Weekly Seats, June 1 to 7, 1996.

CERTIFICATE OF SERVICE

I hereby certify that on this 4th day of June, 1996, I served a copy of the foregoing document, entitled "Answer of Air Canada to Order to Show Cause," on the following individuals by first class mail, postage prepaid.

Kenneth H. Abbe
Rogers & Wells
607 14th Street, N.W.
Washington, D.C. 20005

David B. Armstrong
Ginsburg, Feldman & Bress, Chartered
1250 Connecticut Avenue, N.W.
Suite 800
Washington, D.C. 20036

Gerard J. Arpey
American Airlines, Inc.
P.O. Box 619616, MD 5621
DFW Airport, Texas 75261

Kevin J. Arquit
Rogers & Wells
607 14th Street, N.W.
Washington, D.C. 20005

Lynn Bonde
Ginsburg, Feldman & Bress, Chartered
1250 Connecticut Avenue, N. W.
Suite 800
Washington, D.C. 20036

Joel Stephen Burton
Ginsburg, Feldman & Bress, Chartered
1250 Connecticut Avenue, N.W.
Suite 800
Washington, D.C. 20036

Donald B. Casey
Canadian Airlines International Ltd.
700 - 2nd Street, S.W., Suite 2800
Calgary, Alberta, Canada
T2P 2W2

Gary R. Doernhoefer
American Airlines, Inc.
P.O. Box 619616, MD 5675
DFW Airport, Texas 75261

Alfred J. Eichenlaub
Ginsburg, Feldman & Bress, Chartered
1250 Connecticut Avenue, N.W.
Suite 800
Washington, D.C. 20036

Kenneth J. Fredeen
Canadian Airlines International Ltd.
700 - 2nd Street, S.W., Suite 2800
Calgary, Alberta, Canada
T2P 2W2

Arnold J. Grossman
American Airlines, Inc.
P.O. Box 619616, MD 5635
DFW Airport, Texas 75261

James M. Lynch
Rogers & Wells
607 14th Street, N.W.
Washington, D.C. 20005

Jeffrey A. Manley
Ginsburg, Feldman & Bress, Chartered
1250 Connecticut Avenue, N.W.
Suite 800
Washington, D.C. 20036

Steven A. Newborn
Rogers & Wells
607 14th Street, N.W.
Washington, D.C. 20005

David B. Ortman
Counsel for Canadian Airlines
International, Ltd.
61 G Street, S.W.
Washington, D.C. 20024

Megan Rae Poldy
Northwest Airlines, Inc.
901 15th Street, N.W., Suite 310
Washington, D.C. 20005

Bruce H. Rabinovitz
Ginsburg, Feldman & Bress, Chartered
1250 Connecticut Avenue, N. W.
Suite 700
Washington, D.C. 20036

Yvonne L. Ramos
United Air Lines, Inc.
1707 L Street, N.W., Suite 300
Washington, D.C. 20036

Gregg A. Saretsky
Canadian Airlines International Ltd.
700 - 2nd Street, S.W., Suite 2800
Calgary, Alberta, Canada
T2P 2W2

Elliott M. Seiden
Northwest Airlines, Inc.
901 15th Street, **N.W.**, Suite 310
Washington, D.C. 20005

Stephen P. **Sibold**
Canadian Airlines International Ltd.
700 - 2nd Street, S.W., Suite 2800
Calgary, Alberta, Canada
T2P 2W2

Clifford A. **Westfall**
Ginsburg, Feldman & Bress, Chartered
1250 Connecticut Avenue, N.W.
Suite 800
Washington, D.C. 20036

Michael G. Whitaker
United Air Lines, Inc.
P.O. Box 66100
Chicago, IL 60666

Kelly P. Wilson
Rogers & Wells
607 14th Street, N.W.
Washington, D.C. 20005

Marshall S. Sinick
Squire, Sanders & Dempsey
1201 Pennsylvania Avenue, N. W.
Suite 500
Washington, D.C. 20004

John E. **Gillick**
Winthrop, Stimson, Putnam & Roberts
1133 Connecticut Avenue, N.W.
Suite 1200
Washington, D.C. 20036

R. Bruce Keiner
Crowell & Moring
1001 Pennsylvania Avenue, N. W.
Suite 1100
Washington, D.C. 20004

Robert E. Cohn
Shaw, **Pittman**, Potts & Trowbridge
2300 N Street, N.W.
Washington, D. C. 20037

Steve H. Lachter
2300 N Street, N.W.
Suite 725
Washington, D.C. 20037

Richard J. Fahy, Jr.
1800 Diagonal Road
Suite 600
Alexandria, VA 22314

Frank Cotter
Assistant General Counsel
USAir, Inc.
Crystal Park Four
2345 Crystal Drive
Arlington, VA 22227

Richard D. Mathias
Cathleen P. Peterson
Zuckert, **Scoutt** & Rasenberger
888 17th Street, N.W., Suite 600
Washington, D.C. 20036

Patrick P. Salisbury
Salisbury & Ryan
1325 Avenue of the Americas
New York, NY 10019

John R. DeGregorio
Senior Attorney-Transportation
Midwest Express Airlines, Inc.
700 11 th Street, N.W., Suite 600
Washington, D.C. 20001

Vance Fort
Senior V.P. - Government & Legal
Affairs
World Airways, Inc.
13873 Park Center Road, Suite 490
Herndon, VA 22071

Richard P. Taylor
Stephoe & Johnson
1330 Connecticut Avenue, N.W.
Washington, D.C. 20036

John L. Richardson
Seeger, Potter & Richardson
2121 K Street, N.W., Suite 700
Washington, D.C. 20037

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

Thomas C. Accardi
Director, Flight Standards
Federal Aviation Administration
800 Independence Avenue, S. W.
Room 821
Washington, D.C. 20591

James R. Weiss
Preston Gates Ellis & Rouvelas Meeds
1735 New York Avenue, N.W.
Suite 500
Washington, D.C. 20006

Department of Defense
U.S. **Transcom/TCJ5**
Attention: Air Mobility Analysis
508 Scott Drive
Scott AFB, IL 62225-5357

Stephen L. Gelband
Hewes, Morella, **Gelband & Lamberton**
1000 Potomac Street, N.W.
Suite 300
Washington, D.C. 20007

William Karas
Stephoe & Johnson
1330 Connecticut Avenue, N.W.
Washington, D.C. 20036

R. Tenney Johnson
2300 N Street, N.W.
Suite 600
Washington, D.C. 20037

J.E. **Murdock III**
Shaw, **Pittman**, Potts & Trowbridge
2300 N Street, N.W.
Washington, D.C. 20037

John J. Varley
Law Department
Delta Air Lines, Inc.
1030 Delta Boulevard
Atlanta, GA 30320

D. Scott Yohe
Vice President, Government Affairs
Delta Air Lines, Inc.
1629 K Street, N.W., Suite 501
Washington, D.C. 20006

Craig Denny
Vice President
Big Sky Airlines
P.O. Box 31397
Logan International Airport
Billings, MT 59107

Jonathan B. Hill
Dow Lohnes & Albertson
1255 23rd Street, N.W.
Washington, D.C. 20037

William C. Evans
Verner, Liipfert, Bernhard, McPherson
& Hand, Chartered
901 15th Street, N.W., Suite 700
Washington, D.C. 20005

Nathaniel P. Breed, Jr.
Shaw, Pittman, Potts & Trowbridge
2300 N Street, N.W.
Washington, D.C. 20037

Russell E. Pommer
Verner, Liipfert, Bernhard, McPherson &
Hand, Chartered
901 15th Street, N.W., Suite 700
Washington, D.C. 20005

Berl Bernhard
Verner, Liipfert, Bernhard, McPherson &
Hand, Chartered
901 15th Street, N.W., Suite 700
Washington, D.C. 20005

Steven A. Alterman
Meyers & Alterman
1220 19th Street, N.W., Suite 400
Washington, D.C. 20036

Aaron A. Goerlich
Boros & Garofalo, P.C.
1201 Connecticut Ave., N.W.
Suite 700
Washington, D.C. 20036

Roger W. Fones
Antitrust Division
Department of Justice
555 Fourth Street, N.W.
Room 9104
Washington, D.C. 20001

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



Georgia E. Holliday