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BEFORE THE

DEPARTMENT OF TRANSPORTATION

WASHINGTON, D.C.

Joint Application of UNITED AIRLINES, INC. and AIR CANADA under 49 U.S.C. §§ 41308 and 41309 for approval of and antitrust immunity for an expanded alliance agreement	Docket OST-96-1434 -11

ANSWER OF CONTINENTAL AIRLINES, INC.

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August 2, 1996

16 pgs

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Air Canada[1] and United have applied for antitrust immunity for a comprehensive alliance for U.S.-Canada service. Granting approval for such an alliance would be diametrically opposed to the Department's principles in awarding U.S.-Toronto routes to strengthen competition with Canadian carriers, approving the American/Canadian alliance to enhance competition with Air Canada and insisting on "Open Skies" agreements before granting antitrust immunity to a dominant foreign carrier serving a market. If the United/Air

[1] Common names of carriers are used.

August 2, 1996

Canada application were approved, immunized alliances would control 99% of the traffic in the two largest U.S.-Canada markets, Chicago-Toronto and New York/Newark-Toronto, and nearly 60% of the total U.S.-Canada market.[2] Entry into those Toronto markets (and any other Toronto markets) will be severely restricted for nearly two more years. Moreover, these transborder alliances would lock up peak-period slots and facilities at Toronto before the transborder skies are open and develop formidable market presences which would make it extremely difficult for other U.S. carriers to compete effectively in Toronto-U.S. markets. Under these circumstances, the Department should deny approval for the Air Canada/United agreement or, at the very least, defer action on it until Canada agrees to far more open access between the U.S. and Toronto.

Continental states as follows in support of its position.

1. When the Department approved the American/Canadian alliance it justified its decision by citing American's enhanced ability to compete in the U.S.-Toronto market dominated by Air Canada. The Department noted that Canadian had only a five percent market share in the U.S.-Toronto market, "while Air Canada has the largest share, 40 percent" and "Air Canada, not [Canadian], has a hub at Toronto." (Order 96-7-21 at 21) Adding Air Canada's 40 percent market share and hub strength at Toronto to United's share of the Toronto-U.S. market

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[2] See Order 96-5-38 at 18-19.

will surely inhibit expanded competition by other U.S. carriers.[3] With both American/Canadian (26% of the Toronto-U.S. market combined) and Air Canada/United (more than 40% of the Toronto-U.S. market combined), transborder traffic at the largest Canadian city will be dominated by two antitrust-immunized alliances, both of which will also be immunized from substantial new competition at least until February of 1998. Immunizing these giant alliances so they can secure a nearly two-year head start on U.S. competitors establishes the patterns of service for years to come, particularly since facilities and slots at peak-hour periods will be unavailable for expansion by the time Toronto's skies are opened.[4] Since Toronto traffic represents nearly 43% of U.S.-Toronto passengers, the U.S.-Canada market is nowhere near "open" without means that additional Toronto access. Air Canada and United stress the importance of "competitive parity" between the American/Canadian and Air Canada/United alliances, ignoring altogether the need for some "competitive parity" between the alliances and other

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[3] Without access to current T-100 data, Continental is unable to compute United's Toronto-U.S. market share.

[4] When the Department approved American/Canadian, it said Continental had not "demonstrated that it has been prevented from offering services it is authorized to provide" at Toronto. (Order 96-7-21) Although Continental has indeed been prevented from operating Houston-Toronto services at economically-viable times, it has had so few opportunities to institute Toronto services that the outer limits of Toronto access have not been tested. No immunity should be given to Air Canada for services at its Toronto hub until U.S. carriers have an opportunity to institute all the services the marketplace demands.

airlines serving the market. Since both alliances have access -- through their Canadian participants -- to unlimited transborder route opportunities in all markets, their ability to join forces, eliminate competition between themselves and expand their competition with other carriers means that additional competitive access for unaligned carriers must be required as a matter of simple fairness. The three-year head start for Canadian carriers at Toronto was premised on the notion that those carriers were smaller and weaker than U.S. carriers. With alliances between Canadian and American and Air Canada and United, however, that premise would no longer be valid. Instead, U.S. carriers such as Continental will be smaller and weaker than either of the alliances in Toronto-U.S. markets, and greater Toronto access now is critical to Continental's ability to compete with the alliances both today and in the future.

2. The Department has consistently implemented a policy of granting rights to U.S. carriers which could best enhance competition with Air Canada. Since Air Canada dominates both the U.S.-Canada market and, in particular, the heavily-restricted Toronto market where it has its hub, this policy has been procompetitive. Air Canada and United now ask the Department to turn that policy on its head. Each of the Department's decisions awarding U.S.-Toronto authority since 1995 has emphasized a single key decisional factor: enhancing competition with Air Canada. Thus, in awarding Delta authority at Atlanta -- where Air Canada was the only Canadian carrier serving the market -- the

Department concluded that Delta would "offer the strongest head-to-head competition with Canadian carriers in the Toronto market." (Order 95-11-1 at 2) The Department further explained its decision this way,

> In the interim [to open skies] the substantial limitations on U.S. carriers in the U.S.-Toronto market, combined with the unlimited opportunity for Canadian carriers to enter all U.S.-Toronto markets immediately, make it in the public interest for the U.S. carriers selected in this proceeding to be able to enhance competition among U.S. and Canadian carriers at a large number of the major U.S.-Toronto traffic points.

(Order 95-11-1 at 3)

The Department's policy became even firmer a year later when it tentatively selected TWA and USAir and said,

> As we stressed in the first-year Toronto Service Proceeding, the enormous relative size of the Toronto market, with nearly five million nonstop segment passengers per year to and from U.S. gateways, and the advantage accruing to Canadian carriers in the years before full liberalization, make it imperative that the U.S. select the carriers that will offer the strongest head-to-head competition with Canadian carriers. This primary goal has become especially urgent over the past year because of the need for U.S. carriers to develop U.S.-Toronto city-pair markets that have been targeted by Canadian flag carriers in the first year of the phase-in period.

(Order 96-2-45 at 6) TWA and USAir were tentatively selected because Air Canada had introduced substantial new service between Toronto and TWA's St. Louis hub and between Toronto and USAir's Washington (National) base.

(Order 96-2-45 at 7-8) When TWA received backup authority for the St. Louis-Toronto route, making a new route available, the Department selected Continental for new Toronto authority. Why? Because the proposal of Continental "will offer the strongest competition to foreign-flag carriers in the U.S.-Toronto market, especially in the largest single U.S.-Toronto market, which is also the market where Canadian flag carriers operate their largest number of Toronto frequencies." (Order 96-5-21 at 8) All of the Department's efforts to expand competition with Air Canada would be wiped out by granting antitrust immunity for an alliance between Air Canada and United combining the largest Canadian carrier with one of the two largest U.S. carriers in a de facto merger.[5] De facto end-on mergers between smaller carriers strengthen them to compete with the world's largest carriers, but alliances involving one of the world's largest airlines and the dominant carrier in a foreign country with overlapping routes in the largest markets are particularly insidious in countries without true "open skies" agreements.

As DOT Deputy Assistant Secretary Patrick V. Murphy said in June, "An alliance with antitrust immunity is a powerful competitive force. Any airline

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[5] For the first quarter of 1996, American and United each carried 16% of the major carriers' systemwide traffic. (Aviation Daily, August 1, 1996, at 183.

which would choose to compete with it must be free to do so in an unfettered way."[6] The applicants falsely claim that "other carriers and carrier alliances can respond to any service improvements United and Air Canada might make." (Application at 39) Unless the skies are opened to Continental between Newark and Cleveland, on the one hand, and Toronto, on the other hand, Continental will not be free to compete with either the American/Canadian alliance or the Air Canada/United alliance.[7]

If entry were open at Toronto and slots at critical times were available readily, Continental could compete with the American/Canadian and Air Canada/United combines. Continental would offer at least six daily roundtrip flights in the New York/Newark-Toronto market, five daily Cleveland-Toronto flights and two daily Houston-Toronto flights. These new Continental flights would provide far more consumer and competitive benefits than pooling the resources of the largest carriers in the U.S. and Canadian markets on restricted

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[6] Speech of Patrick V. Murphy before the 68th Annual American Association of Airport Executives Annual Conference and Exposition at Las Vegas, Nevada, June 11, 1996 at 8.

[7] Without Cleveland-Toronto authority Continental cannot compete with either alliance for Toronto-west traffic both alliances will route through the American and United hubs at Chicago, where the alliances will control 100% of the Toronto traffic.

U.S.-Toronto routes could ever provide.[8] The impenetrable duopoly which would be created by approval of both the American/Canadian and Air Canada/United alliances must be disciplined by competition from Continental and other carriers before approval can be justified.

3. Even if the Departments of Justice and Transportation were to impose "carve-out" conditions on the Chicago-Toronto and New York/Newark-Toronto markets and other Toronto markets, those conditions would not significantly ameliorate the anticompetitive results of the duopoly. Adding United's substantial marketing presence at New York/Newark to Air Canada's dominant presence at Toronto would further exacerbate the anticompetitive effect of the American/Canadian alliance in that market as well as in the Chicago-Toronto market. The restrictions imposed on American/Canadian give them free rein -- immune from antitrust laws -- to pool their resources on most of the traffic moving between Toronto and New York. Conditions limiting antitrust immunity for the American/Canadian alliance do not apply to Canadian-origin sales at all, so roughly half of the traffic is immunized at the beginning. Extending the immunity to traffic moving on corporate discounts, consolidator/wholesaler fares,

[8] Although the applicants claim huge benefits from seamless connections, connecting traffic on code-share flights is limited by the terms of the U.S.-Canada agreement and will continue to be limited on flights serving Toronto. Since Toronto is far and away the largest transborder market and Air Canada's hub, any public benefits will be constrained until the Toronto market is open to additional U.S.-flag competition.

group fares, government fares and promotional fares offered directly to the general public for a limited time leaves very little traffic not exempt from the antitrust laws.[9] If similar restrictions were placed on Air Canada/United in markets they dominate, the impact of their immunized alliance, combined with the impact of the American/Canadian alliance, would nonetheless be extremely detrimental to both present and prospective competition for U.S.-Toronto traffic.

4. Air Canada has been the primary beneficiary of the 1995 U.S.-Canada agreement. Air Canada has opened more routes, and added more flights, than any other carrier serving transborder U.S.-Canada markets. As a result, Air Canada's earnings have seen "a dramatic improvement over the same period a year ago" due in large measure to "increased international passenger revenues" resulting from a "29% increase in international traffic." (See Aviation Daily, August 1, 1996 at 181) Air Canada's success has been achieved despite the introduction of new U.S.-flag services in Canada's three major markets (Vancouver, Toronto and Montreal) because of the limitations on U.S.-flag services in those markets. Significantly, Air Canada's Toronto hub has been the most severely restricted market for U.S.-flag carriers, and those restrictions will continue until February of 1998. If

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[9] Continental recognizes that the immunized carriers must offer their group and corporate fares in other markets as well to secure immunity for their actions on such fares in the New York-Toronto market. Such restrictions are effective only to avoid targeting the New York-Toronto market with low fares separately from other markets where more competitive forces are at work anyway.

Secretary Peña can convince Canada that "the economic pie gets bigger when you open markets, not smaller" (Application at 16) and if Canada is serious about finding an "appropriate context" for considering antitrust immunity applications and urging the U.S. to give them "favorable consideration" (Application at 8), the U.S. should be able to negotiate greater entry at Toronto before awarding any further antitrust immunity. Since opportunities for Air Canada and United to carry connecting passengers on code-share flights serving Toronto will continue to be limited by the number of flights operated by U.S.-flag carriers at Toronto, the alliance partners will themselves benefit by an expansion of U.S.-flag opportunities at Toronto. To the extent additional "seamless" connections benefit the public, the public would also benefit from the new U.S.-flag services and from expanding the alliance services. If Air Canada's alliance with United and antitrust immunity for that alliance are important to Air Canada it should be able to persuade Canada to permit additional U.S.-flag competition at Toronto. The U.S. should insist on no less. Unless Air Canada and Canada are willing to offer additional opportunities to U.S. carriers at Toronto, the Department should deny the Air Canada/United application or defer approval of any immunized Air Canada/United alliance until February of 1998.[10]

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August 2, 1996
[1291889]

[10] Although the Department concluded that such a deferral would not have served the public interest in the case of American/Canadian, that alliance dominated only limited markets, while Air Canada/United will dominate Toronto and have a far larger combined market share in the overall U.S.-Canada market.

CERTIFICATE OF SERVICE

I certify that I have this date served a copy of the foregoing answer upon United and Air Canada and persons served with their application in accordance with the Department's Rules of Practice.

R. Bruce Keiner

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August 2, 1996

[1291889]

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