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BEFORE THE
DEPARTMENT OF TRANSPORTATION
WASHINGTON, D.C.

DEPT. OF TRANSPORTATION
DOCKET SECTION

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Joint Application)
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 UNITED AIR LINES, INC.)
 and)
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 AIR CANADA)
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 for Approval of and Antitrust)
 Immunity for an Alliance)
 Expansion Agreement under 49)
 U.S.C. §§41308 and 41309)

Docket OST-96-1434 -15

CONSOLIDATED JOINT REPLY OF
UNITED AIR LINES, INC. AND AIR CANADA

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DATED: August 13, 1996

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DATED: August 13, 1996

**CONSOLIDATED JOINT REPLY OF
UNITED AIR LINES, INC. AND AIR CANADA**

Pursuant to Order 96-7-16, United Air Lines, Inc. ("United") and Air Canada jointly submit the following consolidated reply to the answers of Continental Airlines, Inc. ("Continental"), Delta Air Lines, Inc. ("Delta") and Northwest Airlines, Inc. ("Northwest") in the above-referenced proceeding:^{1/}

I. No Party Disputes the Extensive Public Benefits Which the United/Air Canada Alliance Would Bring.

In its recent approval and antitrust immunization of the American/Canadian Airlines International ("CAI") alliance, the Department recognized the important public benefits that the

^{1/} American Airlines, Inc. ("American") filed a pleading denominated "Comments" in which it attacked positions taken by United in other proceedings but did not oppose the instant joint application. United is responding to those "Comments" in a separate response.

increased cooperation between these alliance partners would bring to the U.S.-Canada transborder market. These were summarized as follows:

Our analysis indicates that this alliance will have a strong pro-competitive impact, bringing on-line service to nearly 20,000 transborder city-pair markets with an estimated traffic of over 9 million passengers. In particular, the alliance will significantly increase competition and service opportunities for many of the 4 million U.S.-Canada passengers in behind-U.S. gateway and beyond-Canadian gateway markets. This analysis further supports our belief that these alliances will benefit consumers by increasing U.S.-Canada service options and enhancing competition between airlines, particularly for traffic to or from the cities behind or beyond major gateways for transborder service. U.S. consumers and airlines should be major beneficiaries of this expansion and the associated increase in service opportunities.

Order 96-5-38 at 17.

In their Joint Application, United and Air Canada have described how their alliance will produce similar benefits. No party filing answers has in any way challenged the expanded on-line benefits that the United/Air Canada alliance would produce. Rather, the parties filing answers have chosen to use this application as a forum to pursue other agendas. The parochial issues raised in the various answers fail to meet the respondents' burden of proving that the alliance would substantially reduce or eliminate competition in any relevant market. United and Air Canada, therefore, respectfully request that their instant application be approved without further delay.

This will permit them to offer the extensive new on-line services they have described in their Joint Application and, equally important, to compete with the American/CAI alliance for transborder traffic.

II. The Department Has Already Considered And Rejected The Opposing Parties' Principal Argument Relating To The Nature Of The U.S.-Canada Bilateral Agreement.

Continental, Delta, and Northwest each oppose the United/Air Canada request for antitrust immunity for the same reasons. Essentially, these carriers argue that the grant of antitrust immunity is not warranted because the U.S.-Canada bilateral air services agreement does not provide for open skies to the same extent as bilaterals with other countries where antitrust immunity has been granted.

Each of these carriers raised the same arguments in opposition to the approval and immunization of the American/CAI alliance. In fact, United raised similar concerns. See, e.g., United's Petition for Reconsideration, dated August 5, 1996, in Docket OST-95-792. The Department, however, overrode these objections in approving the American/CAI alliance. While agreeing that "open skies" is a prerequisite for approval and immunization of alliance agreements, the Department found that the circumstances of the U.S.-Canada market were unique:

In arriving at our tentative decision here, we weighed the objections of both Northwest and Delta to a grant

of antitrust immunity based on the fact that the underlying U.S.-Canada relationship lacks some attributes of a full comprehensive open-skies agreement...

While we agree with the arguments of both Northwest and Delta as a matter of principle, we view this application as a unique exception to that principle, given the very distinct character of the U.S.-Canada market. The U.S.-Canada transborder market supports more U.S. gateways, nonstop city-pairs, diverse airlines, and competitive routings and service options than any other international market. Perhaps most important, at the conclusion of the brief phase-in of entry and capacity at Montreal, Toronto, and Vancouver, the underlying air transport agreement between the United States and Canada will have created an open environment for transborder passenger and belly cargo services and prices. Against this background, we tentatively find that the U.S.-Canada aviation relationship justifies positive action on the application before us...*

* No other bilateral market resembles the U.S.-Canada market and, accordingly, we intend to continue to insist upon full open-skies agreements as a prerequisite to our consideration of applications for antitrust immunity.

Order 96-5-38 at 10.

The same carriers objecting here continued to press their objections in the American/CAI case after the Department tentatively found the U.S.-Canada agreement to qualify for alliance approval. For example, they sought to distinguish the competitive characteristics of the U.S.-Canada market from the transatlantic markets at issue in previous proceedings involving requests for antitrust immunity where alliances had been approved and immunized. Northwest takes this position a step further and

argues that the exception which the Department made to its "open skies" principles when it approved the American/CAI alliance was intended to be unique to that alliance, and would not necessarily apply to the U.S.-Canada market generally. The arguments advanced by the objectors have been rejected by the Department. In its final order, the Department articulated quite clearly the reasons why the U.S.-Canada market is entirely different from other international markets. The basis for this distinction drawn by the Department applies to the United/Air Canada application as well as to American/CAI:

Although Continental and Delta may be correct that connecting service provides less competitive discipline in the relatively short-haul U.S.-Canada market than in transatlantic markets, owing to the proportionately greater elapsed time difference between connecting and nonstop service, we do not find this to be sufficient grounds to withhold approval and immunity here. Unlike transatlantic markets, U.S.-Canada markets are characterized by high-frequency nonstop services from multiple gateways. In addition, travelers in these markets have more options than transatlantic travelers, including surface transportation (by car, bus, or rail). In the relatively few major, longer-range markets with limited nonstops, connecting services offer further competition. Accordingly, we continue to view the differences between the U.S.-Canada market and other bilateral aviation markets as favorable to the grant of immunity here.

Order 96-7-21 at 19. (Emphasis supplied.)

As they did before, the objecting carriers also continue to complain here that making an exception for the U.S.-Canada agreement would discourage other countries from entering

into "open skies" agreements. The Department similarly considered and rejected these arguments in the American/CAI case:

... we see little similarity between the U.S.-Canada relationship and those with our other trading partners. Accordingly, we reiterate our declaration in the show-cause order that grant of immunity in this case should not be interpreted to suggest any relaxation of our policy regarding antitrust immunity. Rather, our decision is premised on the uniqueness of the Canadian case. Absent all of the special circumstances of our relationship with Canada, the Department would not provide immunity in the absence of full, immediate open skies. There is no present or potential situation in Europe or elsewhere that presents the many extraordinary factors in the Canadian case that support our decision to grant immunity here.

Order 96-7-21 at 19.

The Department's decision in the American/CAI proceeding definitively settled the issue of whether approval and immunization of alliances between U.S. and Canadian carriers is justified under the terms of the U.S.-Canada agreement. The Department held that approval and immunity is justified, and that conclusion is determinative in this proceeding.

III. The Department Has Already Concluded That All Transborder Markets Except Toronto Are De Facto Open To Competitive Entry.

As they did in the American/CAI case, the objecting carriers claim here that it would be unfair to them competitively to allow a U.S. and Canadian carrier alliance to have antitrust immunity in those transborder markets where U.S. carrier

competition is limited for an interim period: Montreal, Vancouver and Toronto. The Department considered and rejected these same arguments in the American/CAI case.

Indeed, with respect to the Vancouver and Montreal markets, the Department concluded that, given the relatively short time remaining for the interim operating restraints, these markets were essentially open for U.S. carriers and raised no special competitive concerns:

As a practical matter, even if the United States were to negotiate with the Canadian government for an immediate lifting of all entry and frequency limitations at Montreal and Vancouver, at this point it is unlikely that any U.S. carriers could undertake major expansions of service to these cities before autumn (or even early winter). Except for winter leisure markets such as Florida and Hawaii, therefore, the best time this year to begin new expanded U.S.-Canada service has already passed; we therefore believe that the competitive need for significant further U.S.-carrier expansion at Montreal and Vancouver is small before the spring of 1997, after all restrictions on transborder services to these two cities expire.

For similar reasons, while Continental correctly notes that new entrants are currently limited to two daily round trips, we do not view these temporary limitations on frequencies to be significant in this case, particularly at Montreal and Vancouver. In fact, in view of the imminent expiration of any limitations on transborder operations at Montreal and Vancouver, we consider the remaining bilateral limitations on U.S.-flag operations to be *de minimis*. We conclude, therefore, that the U.S.-Montreal/Vancouver markets, which become *de jure* open in February 1997, will be open before the proposed expansion of the alliance can have an impact on competition, and that, as a consequence, the Montreal and Vancouver markets are already open *de facto*, and the remaining nominal limitations there do not justify our withholding of

approval and immunity for the short period until all
restrictions are removed.

Order 96-7-21 at 20-21. (Emphasis supplied.)

These conclusions apply with even greater strength to the United/Air Canada alliance. The Department found in American/CAI that the restrictions on U.S.-flag operations at Montreal and Vancouver were de minimis, and especially so because of the limited time during which they will remain in force. Given the passage of time between consideration of the American/CAI and United/Air Canada applications, this determination is even more compelling here.

Moreover, there are other factors which serve to mitigate any potential claims. For example, United does not operate its own service at Montreal. The Department noted a similar lack of transborder service by CAI at Montreal as a factor in concluding that immunization of the American/CAI service at that point raised no competitive concerns. Order 96-7-21 at 21, n.60. United is a competitive factor at Montreal, if at all, only as a result of its code share on Air Canada, which is operated subject to restrictions on the carriage of connecting code-share traffic for the same period that the U.S. carrier frequency limits apply. The Department concluded that these limits on connecting code-share traffic substantially mitigated the concerns of the objecting carriers with respect to the

alleged advantage of alliance carriers at the restricted entry points. Order 96-7-21 at 21-22.

With respect to Vancouver, CAI is the dominant carrier and operates a hub at that point. Notwithstanding this fact, the Department concluded that the benefits of the alliance outweighed the concerns of the objecting carriers to the elimination of U.S.-Vancouver competition between American and CAI:

While CAI has a large market share at Vancouver -- almost 25 percent -- the additional route rights made available by the new air services agreement for U.S. airlines at Vancouver were sufficient to satisfy all U.S. carriers' wishes for new Vancouver routes, and the remaining limitations at Vancouver will end in seven months.

Order 96-7-21 at 21, n.60.

Air Canada does not operate a hub at Vancouver and has a market share of less than four percent. Order 96-5-38 at 15, n.31. There should, therefore, be no regulatory concern with respect to operations by United and Air Canada between the U.S. and Vancouver because there are no overlapping hub-to-hub routes.

To the extent that Continental, Delta and Northwest are complaining about elimination of competition in Montreal and Vancouver markets, those complaints have already been fully considered and rejected in the American/CAI case for reasons that are equally applicable here. The objecting carriers, which have the burden of proof on this issue, have cited no factor that would require a different result in this case.

IV. The United/Air Canada Alliance Will Not Significantly Reduce or Eliminate Competition In Any Relevant Toronto Markets.

Most of the rhetoric of the objecting carriers is directed at the Toronto market. As they did in the American/CAI case, these carriers again complain of their lack of ability to compete with the alliance for services to Toronto due to the three-year restrictions on U.S. carrier access to that point.

Not coincidentally, each of the objecting carriers is an applicant for U.S. operating authority in the U.S.-Toronto Third Year Service Proceeding, Docket OST-96-1538. The arguments raised by Continental, Northwest and Delta appear to be more applicable to the Third Year Toronto proceeding than they are to this case.

In the American/CAI case, the Department found Toronto to be the "only potentially troublesome market at issue." Order 96-7-21 at 21. Nevertheless, the Department was prepared to allow American and CAI to have antitrust immunity for nearly all of their Toronto services. This approval was given notwithstanding the facts that American had the largest share of any U.S. carrier at Toronto and that the alliance partners had overlapping services to Toronto from major U.S. hubs, such as Chicago.

The objecting carriers seek to distinguish the United/Air Canada alliance on the basis that Air Canada has a

larger presence at Toronto than does CAI. They fail to note, however, that this is counterbalanced by United's relatively smaller share at that point than American. Thus, United has a 6.8 percent market share of the U.S.-Toronto market based on ASM's compared to American's 16.4 percent, and United is the 5th largest carrier. American also serves more U.S. points from Toronto than any other U.S. carrier: five compared to United's two.

The only Toronto city-pair in which the Department withheld its full approval for the American/CAI alliance is New York-Toronto where a temporary carve out was imposed pending the elimination of operating restraints. Continental (Answer at 8) suggests that the Department should apply even stricter "carve outs" in any approval of the United/Air Canada alliance for services in the New York-Toronto and Chicago-Toronto city-pairs.^{2/} Continental asserts that United's "substantial marketing presence

^{2/} Continental suggests, without analysis, that even subject to the same carve outs as have been applied to American/CAI, the impact of the United/Air Canada alliance would "nonetheless be extremely detrimental" to U.S.-Toronto competition and seems to suggest that stricter carve outs are necessary. Continental fails to address, however, the unfairness this would work on the United/Air Canada alliance in circumstances where the competitive American/CAI alliance is operating subject to the standard carve out in the New York-Toronto market and subject to no carve out at all in Chicago-Toronto. In any event, Continental has failed to demonstrate that the Department's carve out remedy is not sufficient to protect consumers in the New York-Toronto city-pair.

at New York/Newark" would, in conjunction with Air Canada's Toronto service from that point, reduce competition between New York/Newark and Toronto. It is far from clear why Continental is even discussing a New York-Toronto carve out in this proceeding since it would be wholly inappropriate to apply such a carve out to that city-pair in circumstances where United does not even serve it. Moreover, the "substantial" United New York/Newark competitive presence alleged by Continental comes as something of a surprise to United. The last time United looked, it was the number 4 carrier at New York/Newark, with a market share of less than 8 percent. The factors underlying the New York-Toronto "carve out" in the American/CAI case simply do not apply here, given United's relatively small presence at both New York and Toronto and its lack of any nonstop service between those points. Again, Continental's comments seem aimed more at bolstering its Newark-Toronto application than at providing substantive comment in this docket.

In the Chicago-Toronto market, where United and Air Canada operate overlapping nonstop service, the Department chose not to impose any restriction on American/CAI despite the fact that their nonstop services also overlapped in that city-pair and gave them a combined nonstop market share of nearly 50 percent. Order 96-5-38 at 14-15. In these circumstances, it would be fundamentally unfair to United and Air Canada to restrict their

ability to cooperate in order to compete on an equal basis with American/CAI for Chicago-Toronto local traffic. Such a result would require United and Air Canada to compete with American and CAI with one hand tied behind the United/Air Canada alliance's back when American and CAI would have no similar impediment. In any event, approval of the United/Air Canada alliance would result in at least two carriers competing vigorously on this route, with unlimited opportunity for new entry in the near future. Moreover, as United has pointed out in its Petition for Reconsideration of Order 96-7-21, dated August 5, 1996, in Docket OST-95-792, the Department cannot lawfully grant unrestricted approval and immunity to one alliance but not the other without adjudication of the issues in a contemporaneous carrier selection proceeding.^{3/}

The only other Toronto city-pair where United and Air Canada have overlapping nonstop service is San Francisco-Toronto. As indicated in their joint application, there are alternative competitive services available in this relatively long-haul transborder market. Thus, there are at least five other carriers

^{3/} Both Delta (p. 7) and Continental (p. 8) seem to suggest that changes in market shares brought about by approval of the American/CAI alliance could be used with prejudice against approval of the United/Air Canada alliance. As United has demonstrated in its Petition for Reconsideration, such a result would violate United's due process rights and cannot be applied without at least resort to a comparative hearing. Neither Delta nor Continental has addressed these legal issues.

offering one-stop services between San Francisco and Toronto. See Joint Application, dated June 4, 1996, Exhibit JA-6. Such services substantially ameliorate the competitive concerns that might be applicable in shorter haul markets. Order 96-7-21 at 19 (quoted supra at p.5.) Moreover, under the U.S.-Canada agreement, there will be at least 8 more U.S. carrier frequencies allocated next year to add services to Toronto, and possibly more.^{4/} This acceleration of the Toronto phase-in will go a considerable way toward addressing the objecting carriers' demands.

The objecting carriers are, in fact, more concerned about increasing their own services between Toronto and their U.S. hubs than they are about the effect the United/Air Canada alliance would have on them or on consumers in the particular Toronto markets they serve or propose to serve. Approval of this alliance will not result in the loss of a competitor on any of the Toronto routes that Continental, Delta and Northwest have identified as their primary concern: Atlanta, Cincinnati,

^{4/} It should be noted that USAir has announced that it will discontinue Boston-Toronto service on September 5, 1996. Based on that action, the Department may be able to allow a U.S. carrier to move that Toronto right to another city under an extrabilateral authorization. If that is possible, the Department may be able to grant all five of the pending U.S. carrier requests for new U.S.-Toronto services in the Third Year Toronto proceeding (including those of Continental, Delta and Northwest), without the need to engage in carrier selection.

Detroit, Houston, Minneapolis and New York/Newark. The antitrust laws exist to protect competition, not competitors. The proposed alliance will not affect consumers on the routes identified by the objecting carriers, and will not upset the present competitive balance in these Toronto markets during the relatively short time remaining before interim restrictions on Toronto services expire.

V. Conclusion.

In short, the objecting carriers have expended a considerable effort to show how important it is for them to increase their U.S.-Toronto services to their respective hubs. This was intended primarily to impress the Department with the relative merits of their arguments in the Third Year Toronto case, supra. They have failed by a large margin, however, to show how the United/Air Canada alliance would affect their competitive presence in the Toronto city-pairs of concern to them any more than the American/CAI alliance would have done. There is no more basis to deprive the public of the benefits of the United/Air Canada alliance in any Toronto markets, or in any Montreal or Vancouver markets, than there was in the case of American/CAI.

In these circumstances, United and Air Canada respectfully urge the Department to approve without further delay their instant request for approval and antitrust immunity.

Respectfully submitted,



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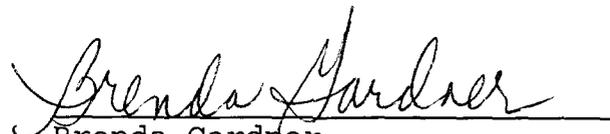
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DATED: August 13, 1996

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CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Consolidated Joint Reply of United Air Lines, Inc. and Air Canada on all persons named on the attached Service List by causing a copy to be sent via first-class mail, postage prepaid.


Brenda Gardner

DATED: August 13, 1996

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