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THE UNITED/CONTINENTAL AIRLINES MERGER: HOW WILL CONSUMERS FARE?

HEARING

BEFORE THE

SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS

OF THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

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THE UNITED/CONTINENTAL AIRLINES MERGER: HOW WILL CONSUMERS FARE?

THURSDAY, MAY 27, 2010

U.S. SENATE,
SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY,
AND CONSUMER RIGHTS,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:15 p.m., in room SD–226, Dirksen Senate Office Building, Hon. Herb Kohl, Chairman of the Subcommittee, presiding.

Present: Senators Kohl, Klobuchar, Hatch, and Cornyn.

OPENING STATEMENT OF HON. HERB KOHL, A U.S. SENATOR FROM THE STATE OF WISCONSIN

Chairman KOHL. Good afternoon to one and all. We welcome you here today. Our hearing today will examine the latest salvo in the recent wave of airline mergers, the merger between United and Continental Airlines. This merger will combine the two airlines that rank No. 4 and 6 in terms of domestic revenue into one of the world's largest airlines.

The two airlines' CEOs claim that the deal was "built to pass" antitrust scrutiny because the two airlines' routes do not overlap substantially and the low-cost carriers will constrain their ability to raise prices. However, fundamentally this merger will reduce the number of national network airlines.

Two years ago we had six. After this merger we will have four. So we need to ask the question: At what point do we reach "a tipping point" for competition?

At the outset, I should stress that we consider this merger with an open mind and do not reflexively oppose or support the merger. We are mindful of the difficulties faced by the airline industry today. In the last decade, the airline industry has faced unprecedented challenges from the devastating tragedy of 9/11 and crippling increases in fuel prices to bankruptcies and a drop in travel due to the economic downturn.

We all have an interest in seeing a profitable airline industry so that hundreds of communities all across America can continue to see frequent and reliable air service so essential to economic growth.

At the same time, we must recognize the problems also faced by air travelers today. Consumers are understandably frustrated by crowded flights, disappearing leg room, frequent delays, and puzzling prices. Once free services that passengers took for granted,

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like checked bags, telephone reservations, and blankets and pillows, today are available only for a fee on most carriers. Is this decline in service an inevitable consequence of the industry's need for profitability?

So we must ask critical questions: How will the loss of competition between these two national systems impact airfares and service? Will a combined United/Continental be a stronger competitor to the previously merged Delta/Northwest? Or will the large network airlines remain dominant in the airline industry today across the country and internationally? Will the low-cost carriers be able to step in and fill the competitive void? Or will they feel less competitive pressures to keep fares low or compete by offering things like free checked bags? And how will small and medium-size cities fare after this merger at the very time that they most need frequent and inexpensive air service for their economic health?

So at this point, we recognize that both you, Mr. Tilton, and you, Mr. Smisek, have a special duty to your shareholders to create the most viable and the most robust airline possible. This is the foundation of our free market economy. On this Subcommittee, however, we also have an additional responsibility, which is to the public: to protect consumers and to ensure that travelers are protected by true competition among airlines.

We need to be sure that the announcement that we have all heard flight attendants say at the end of a flight, "We know that you have a choice among airlines," does not become as obsolete as airlines like Northwest, TWA, PanAm, America West, and now perhaps Continental.

Before asking Senator Cornyn for his remarks, I would like, without objection, to enter into the record the statement of Representative Sheila Jackson Lee of Texas.

[The prepared statement of Ms. Jackson Lee appears as a submission for the record.]

Chairman KOHL. Senator Cornyn.

STATEMENT OF HON. JOHN CORNYN, A U.S. SENATOR FROM THE STATE OF TEXAS

Senator CORNYN. Thank you, Mr. Chairman, for convening this important hearing. Last year, when I talked to Continental Airlines representatives about the possibility of a merger with United, we were told that it would not be good for Houston and that Houston and Cleveland would be some of the biggest losers in terms of jobs.

Of course, at that time there was a different objective in sight. It was the Star Alliance which Continental pitched as an alternative to a merger. A merger, Continental explained then, was not in the best interest of its shareholders, employees, or the communities it serves. An alliance was an alternative, we were told, that would provide much of the benefit of a merger without the labor, integration, and financial risks. In arguing for membership in Star Alliance, Continental's representatives told us that a merger would have a very negative impact on jobs in Houston where, of course, Continental is headquartered.

Now we are hearing a different point of view. Continental wants to merge with United. Now Continental argues that a merger with United would benefit Houston in the long run because Houston will

be the largest hub for the largest airline in the world. I hope over time this forecast of long-term benefits to Houston comes true. But right now, three things appear to be clear. The 3,000 Texans who work for Continental in Houston are in jeopardy of losing their jobs. This risk extends further to the many contract workers and support personnel whose jobs depend on Continental's Houston offices. Even if the hub expands, these headquarters jobs may well be gone.

Second, the merger will have an impact—and I would like to hear from the witnesses on this topic, and the others that I have mentioned—on competition, especially with regard to routes to and from Houston. Mr. Smisek was kind enough to meet with me yesterday, and we talked a little bit about the issues I have just raised, as well as this one. But my information is—and certainly the witnesses are free to correct me if I am wrong—that the new United will be the only airline flying nonstop from Houston's Bush Intercontinental Airport to Washington, D.C., Los Angeles, and San Francisco. On each of these routes, the merger eliminates a competitor and leaves Houston-based travelers with fewer choices.

And I cannot help but ask—and I would love to hear the witnesses' testimony—why the decision was made to move the corporate headquarters to Chicago. There is a certain well-known Chicagoan who now lives and works in Washington, D.C., down at the other end of downtown. But I look at Houston, and Houston has a lower tax rate, lower commercial real estate costs, lower costs of living, and certainly a business-friendly environment. And so I would be interested to hear the considerations that were in play in determining that the corporate headquarters of a merged United and Continental would leave Houston and go to Chicago.

Of course, Continental has a proud history as a Houston-based airline, and I hope the airline's deep ties to Houston survive this merger. I look forward to working with my colleagues to minimize any harm that this merger does to airline competition and, thus, the consumer in terms of the price they pay for tickets. We will look to ameliorate and minimize the impact on the airlines' employees if at all possible. I would be interested in your proposals to do that from your perspective. And certainly I am interested in avoiding and minimizing any harm this may do to the Texas economy.

Our unemployment rate in Texas is 8.2 percent. We are grateful that it is not as high as the national average, but the prospect of seeing Texans unemployed as a result of this merger is not a happy one.

Thank you, Mr. Chairman.

Chairman KOHL. Thank you very much, Mr. Cornyn.

We would like now to introduce our panel of distinguished witnesses. Our first witness to testify will be Glenn Tilton. Mr. Tilton is chairman, president, and chief executive officer of United Airlines. Before joining United in September of 2002, Mr. Tilton was vice chairman of the board of directors of Chevron Texaco.

Next we will be hearing from Jeffery Smisek. Mr. Smisek is chairman, president, and chief executive officer of Continental Airlines. In 1995, he left private practice at Vincent and Elkins and joined Continental Airline as senior vice president and general counsel.

Next we will be hearing from Professor Darren Bush. Professor Bush is an associate professor of law at the University of Houston Law School, and he has written and consulted extensively on issues concerning the intersection of antitrust and regulated industry.

Finally, we will be hearing from Bill McGee. Mr. McGee is a consultant on travel investigations for Consumer Reports and other Consumers Union publications. He is former editor-in-chief of Consumer Reports' travel letter and has received numerous awards for his journalism work.

Let me ask all of our witnesses now to stand, raise your right hand as I administer the oath of office. Do you affirm that the testimony you are about to give before this Committee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. TILTON. I do.

Mr. SMISEK. I do.

Mr. BUSH. I do.

Mr. MCGEE. I do.

Chairman KOHL. Thank you.

First we will be hearing from Mr. Tilton.

STATEMENT OF GLENN F. TILTON, CHAIRMAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, UNITED AIRLINES, CHICAGO, ILLINOIS

Mr. TILTON. Thank you very much, Chairman Kohl, Senator Cornyn, members of the Subcommittee. I appreciate the opportunity to testify today on the merger of my company, United Airlines, and Continental Airlines.

Our merger creates a more viable and sustainable enterprise at a time when the status quo for this industry is clearly unacceptable. Strong U.S. commercial aviation will be a key enabler of our country's economic recovery. As leaders, we know well the role that aviation plays nationally and in the communities that you represent in creating and driving commerce and tourism, jobs and contributing to the national economy.

That said, for an industry that plays such an important role, we are, nevertheless, an industry with losses of some $60 billion and 150,000 jobs in the last 10 years, delivering the worst financial performance of any major industry in the United States over the last 30 years.

Both before and after deregulation, the industry has been systemically incapable of earning even a modest profit, let alone a reasonable return on the significant investment we have made in aircraft, facilities, and technology. In this 30-year period, the industry has suffered 186 bankruptcies, with devastating impact on employees, investors, and suppliers, and the communities we serve.

One thing upon which we can likely agree regardless of our differing perspectives, serial bankruptcies is not an acceptable industry strategy. We must create economic sustainability for this industry through the business cycle. Our objective at United has been consistent: to put our company on a path to sustained profitability. Without profitability, we cannot provide a stable environment for employees. Without profitability, we cannot grow or maintain service to communities, large or small. We cannot invest in customer service, nor can we create value for shareholders. To be profitable,

we must successfully compete in the global marketplace of today, not the market of 10 years ago, not the market of 20 years ago, and certainly not the market of 30 years ago.

Domestic competition has intensified, and low-cost carriers are today very well established. Southwest Airlines will continue to be the country's largest airline in terms of passengers after our merger. Consumers will continue to benefit from the prevalence of low-cost carriers and fare transparency that ensures intense, fierce competition across this industry.

International competitors have merged, and powerful new entrants continue to gain ground. Just 10 years ago, the world's two largest airlines measured by revenue were American and my company, United. Using that same measure, the largest airlines today are Lufthansa and Air France/KLM, with more than half of all trans-Atlantic capacity and more than two-thirds of all trans-Pacific capacity being served by foreign carriers.

Our two companies, United and Continental, have taken significant action to improve our performance in this highly competitive environment. As network carriers, we provide service and compete in both the international and the domestic market, and at the same time connect small communities into our route networks. We are realigning our base businesses to better match current and future market realities, using every opportunity at our disposal to strengthen our companies by maximizing our existing alliance and our international joint ventures.

Our proposed merger is an important and, indeed, a logical next step toward profitability. Building on our improved base businesses, our combined airline will continue to operate more efficiently, better manage costs, and realize market opportunities by fully optimizing our nearly 700 aircraft across our combined network.

Carriers compete vigorously on both price and on service, and our merger does not change this reality. Over the last decade, ticket prices have declined, adjusted for inflation, by some 30 percent, with fares to small communities also declining. The revenue synergies we expect to achieve from this merger are driven by better service and our combined expanded network. They are not based on fare increases. This is excellent value for consumers who now have more access to more destinations across the globe.

Importantly, our merger enhances and strengthens service to nearly 148 small communities and metropolitan areas. The expanded network will provide collateral economic benefit for those communities and will result in better travel options for consumers who rely on our networks. Low-cost carriers have not traditionally served these important communities.

The global commercial aviation business has fundamentally changed, and that means that we must evolve to continue to be globally relevant and provide connectivity for the many customers in the communities that we serve.

When Jeff and I announced our merger earlier this month, perhaps Chicago's Mayor Daley said it best when he endorsed our transaction by saying, and I quote, "That is what this merger is all about. You respect the past, you understand the present, but you always look to the future."

Thank you very much for the opportunity to testify, Mr. Chairman.

[The prepared statement of Mr. Tilton appears as a submission for the record.]

Chairman KOHL. Thanks a lot, Mr. Tilton.

Mr. Smisek.

STATEMENT OF JEFFERY SMISEK, CHAIRMAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CONTINENTAL AIRLINES, HOUSTON, TEXAS

Mr. SMISEK. Thank you, Chairman Kohl and Senator Cornyn. I want to also thank this Committee for the opportunity to discuss this merger.

I want to make four basic points. This merger is good for employees, it is good for communities, it is good for consumers, and it is good for competition. Let me start by talking about employees first.

The volatility and instability of the airline industry have had harsh effects on employment. Before 9/11, Continental had over 54,000 employees. Despite being the only carrier to have grown, the only network carrier to have grown since 9/11, we have less than 41,000 employees today, and we have lost over $1 billion. And United, United had over 100,000 employees before 9/11 and has about 46,000 employees today.

After we merge, our employees will be part of a larger, financially stronger, and more geographically diverse carrier. This carrier will be better able to compete in the global marketplace and better able to withstand the external shocks that hit our industry with disappointing regularity.

Because of how little we overlap, the merger will have minimal effects on the jobs of our front-line employees. We are committed to continuing our cooperative labor relations and to integrating our workforces in a fair and equitable manner and negotiating contracts with our unions that are fair to the employees and fair to the company.

United has two union members on its board of directors, and the board seats allocated those unions will remain when we combine the companies.

The merger will also enable us to continue to provide service to small communities—communities that you represent.

The turmoil in our industry has been devastating to many small and medium-size communities. As you know, low-cost carriers have not and will not serve small communities as such service is inconsistent with their point-to-point business models that rely largely on local traffic. As a result, over 200 small communities are served only by network carriers. As a merged carrier, we plan to continue to provide service to all of the communities we currently serve, including 148 small communities.

This merger will be good for consumers as well. The combined airline will offer consumers an unparalleled integrated global network and the industry's leading frequent-flyer program. It will have the financial wherewithal to invest in technology, acquire new aircraft, invest in its people, and invest in its product. We will have a young and fuel-efficient fleet, and our new aircraft orders will permit us to retire older, less fuel efficient aircraft.

Continental brings to the merger its "working together" culture of dignity and respect and direct, open, and honest communication. This culture creates a workplace where people enjoy coming to work every day and, therefore, deliver great service. United brings to the merger talented employees who are delivering industry-leading on-time performance.

The merger will also enhance competition. Continental and United have highly complementary networks, creating over 1,000 new domestic connecting city pairs, expanding integrated network service to hundreds of destinations, and improving access and services to millions of consumers. Our networks are so complementary that we have only minimal nonstop overlaps, each of which faces significant competition after the merger. Additionally, over 85 percent of passengers traveling nonstop on either Continental or United in the U.S. today have a direct low-cost carrier alternative. Moreover, low-cost carriers compete at all of our hubs and at airports adjacent to our hubs, like Hobby and Midway.

As a result of the robust competition in the U.S., airline fares have declined by more than 30 percent over the past 10 years on an inflation-adjusted basis. We also face significant competition from foreign air carriers, which themselves have merged to create attractive global networks, such as Air France/KLM, the Lufthansa group of companies, and British Airways/Iberia.

The merged Continental/United will enable us as a U.S. carrier to provide enhanced competition against these large foreign airlines. In sum, the merger will create a strong, financially viable airline that can offer good-paying careers and secure retirement to our co-workers, great customer service and an unparalleled network to consumers, and reliable service to communities. The merger will provide us with a platform for sustainable profitability and position us to succeed in the highly competitive domestic and global aviation industry, better positioned than either airline could be alone or as members of an alliance.

Thank you very much.

[The prepared statement of Mr. Smisek appears as a submission for the record.]

Chairman KOHL. Thank you very much, Mr. Smisek.

Mr. Bush.

STATEMENT OF DARREN BUSH, ASSOCIATE PROFESSOR OF LAW, UNIVERSITY OF HOUSTON LAW CENTER, HOUSTON, TEXAS, ON BEHALF OF THE AMERICAN ANTITRUST INSTITUTE

Mr. BUSH. Thank you, Mr. Chairman, Senator Cornyn from the great State of Texas in which I reside, and other distinguished members of the Committee. I want to thank you for giving me the opportunity today to speak about the potential anticompetitive of the proposed merger of United and Continental. I speak today on my behalf and on behalf of the American Antitrust Institute, but not on behalf of the University of Houston. And I speak in my capacity as a former trial attorney at the Antitrust Division of the Department of Justice, as an economist, and as a law professor who has studied this industry extensively.

It has been approximately 2 years since the Committee held a similar hearing on the merger of Delta Air Lines and Northwest Airlines. Since that hearing, little has changed for the better in this industry, except that the pressure to consolidate has increased in the wake of this previous merger, and the pending transaction reflects what I believe to be the start of yet another merger wave.

Rather than rehash my written testimony, I want to signal to you not the things that might be problematic with the merger specifically, but also more broadly things that are problematic in bringing an antitrust case against any transaction, any merger before a court.

With any merger, the ultimate question posed by the Department of Justice or the Federal Trade Commission is whether the proposed merger will harm consumers. The analysis is far more complex, but the gist is to determine whether there is anticompetitive harm and whether or not anything about the transaction or the nature of the industry mitigates that harm.

With respect to the anticompetitive harms in the airline industry, we typically examine nonstop city-pair markets, typically routes between the hubs of the merging airlines. Here you will see reductions in service from three to two and in many instances two to one. In those instances, consumers face a monopoly, no choice, restricted output, increased fares.

I understand the notion taken from the great antitrust case, *U.S.* v. *Philadelphia National Bank*, that speculative benefits in international markets do not cure domestic anticompetitive conduct.

There is also an effect of the merger on competition in connection markets. For example, connections from origins or destinations east of Colorado in the Midwest to east coast destinations may only have as reasonable connection options the hubs of the merging firms and the hubs of Northwest and Delta. This means that the connection markets in the Midwest are already constrained or are increasingly going to be constrained.

In many instances, United will be—or is currently a potential competitor to Continental. One example might be the nonstop service from Intercontinental to LAX, which United currently does not serve. However, United serves as an important disciplinary mechanism even if it does not currently service that route because it could potentially serve that route, therefore disciplining fares within the market.

Air passenger service may also be diminished. Northwest's merger with Delta already served to reduce the number of systems from which customers can choose. This merger may create or enhance dominance at many cities throughout the United States, including Newark, Houston, Chicago, L.A., Washington, Denver, and Cleveland. Competition for millions of passengers traveling to and from these cities may decrease, resulting in higher fares or reduced service. In many instances, low-cost carrier competition does not reduce that concentration or mitigate it in any way. As we have seen from many instances in the airline industry, there is a potential for retaliatory strikes against low-cost carriers when they enter major hubs.

These issues, at least as raised in the DOJ's excellent press release in the U.S. Airways investigation, are fully understood by

agency staff. I reserve judgment as to whether such issues are fully understood by the current administration. It is not clear whether the prior administrations understood them given the free pass received by the Northwest/Delta merger. In its press release in Northwest/Delta, the DOJ stated that "two airlines currently compete with a number of other legacy and low-cost airlines in the provision of scheduled air passenger service on the vast majority of nonstop and connecting routes where they compete with each other." The implication of this statement was that in some markets there would be a substantial loss of competition, but the DOJ statement never identified how many or which markets were to be sacrificed for the sake of these proclaimed efficiencies.

The press release continued: "In addition, the merger likely will result in efficiencies such as cost savings in airport operations, information technology, supply chain economics, and fleet optimization." And "Consumers are also likely to benefit from improved service made possible by combining under single ownership the complementary aspects of the airlines' networks."

This does not tell us anything about the basis upon which the DOJ rendered its decision. It does not tell us anything about what anticompetitive markets were examined. It only talks about the speculative nature of efficiencies. In that sense, efficiency seems to be king in the airline industry and in antitrust without regard for anticompetitive effects.

I would like to continue this discussion about that. I know my time has expired.

[The prepared statement of Mr. Bush appears as a submission for the record.]

Chairman KOHL. Thank you, Mr. Bush.

Now we will hear from Mr. McGee.

STATEMENT OF WILLIAM J. MCGEE, CONSULTANT, CONSUMERS UNION, NEW YORK, NEW YORK

Mr. MCGEE. Thank you, Chairman Kohl, Senator Cornyn, members of the Committee. I appear before you today as a consultant on travel and aviation issues for Consumers Union, the nonprofit publisher of Consumer Reports. I thank you for the opportunity to express our deep concerns about the proposed merger between United Airlines and Continental Airlines.

When the U.S. airline industry received a $5 billion bailout in 2001, it was argued that airlines were essential to America's economy, infrastructure, security, and defense. Consumers Union agrees. Yet what we have been witnessing is an incredibly shrinking airline industry. With this merger, in less than 20 years, we will have seen the demise of seven major brands in the United States: PanAm, Midway, Eastern, TWA, America West, Northwest, and now Continental.

While others can speak to adverse effects on labor, the travel and tourism industries, and a host of suppliers, I will focus my comments on the potentially adverse effects upon passengers.

In February 2001, the General Accounting Office reported on airline consolidation and identified several potential threats to consumers. We cannot fully predict with absolute certainty how the United/Continental merger ultimately would affect consumers, but

we can examine the recent historical record to see how passengers were affected by American's acquisition of TWA's assets in 2001, U.S. Airways' reverse merger with America West in 2005, and Delta's acquisition of Northwest in 2008.

Unfortunately, the record for consumers is not good. We have identified key problems that emerged. More details are available in my written testimony.

One, less choice and fewer flights. Historically, we have not seen a merger among major carriers that has not led to reductions in service. United/Continental states it will maintain ten hubs, eight of them in the continental United States. What we do know is that other mergers between major airlines eventually led to hub closures and flight reductions, despite promises to the contrary. Consider that TWA's former hub in St. Louis saw a reduction in total passenger traffic from 23 million in 2002 to 12 million in 2009. America West's former hub in Las Vegas has shrunk as well. And although the full effects of the Delta/Northwest merger have yet to be seen, Delta's hub in Cincinnati is already experiencing cutbacks. Meanwhile, consumers on many routes are losing the opportunity to "vote with their feet" where there is no effective competition.

Two, loss of service. It seems apparent the United/Continental merger would mean some cities, particularly smaller cities, would lose nonstop air service, if not all air service. The more mega mergers that are approved, the higher the probability that additional cities will lose service.

Three, higher fares. A July 2008 report from the GAO concluded that mergers and acquisitions can be used to generate greater revenues through fare increases. Some analysts argue low-cost carriers will fill the void; but, A, there is no guarantee they will do so; and, B, even when a low-cost carrier enters a former hub, prices fall only on selected routes, not on all routes.

Four, reductions in service quality. Airline mergers tend to be contentious. In this case it involves two mature companies. United was founded in 1926 and Continental in 1934. So, therefore, a clash of corporate cultures is virtually guaranteed, particularly after layoffs. These sterile corporate terms—downsizing, rightsizing, outsourcing, offshoring, furloughing—really mean two workforces will experience more trauma and jockeying for position on blended seniority lists. Inevitably, this will lead to employee morale issues and slowdowns due to melding of policies, procedures, and technologies.

Five, fewer startups. Greater concentration of market share has a negative effect, according to a 2001 DOT report that noted instances in which incumbent airlines drove new entrants out by cutting fare and flooding the market with capacity, only to later increase fares and reduce service.

Six, less resistance. Since deregulation in 1978, we have repeatedly seen how one major carrier will initiate a fare increase and then watch if rivals will match. If enough key players resist, then the fare hike will be withdrawn. This same principle has applied to introducing airline fees. In a smaller industry with fewer players, the likelihood of an arrival carrier resisting a new fee or airfare increase will dissipate.

Seven, widespread disruptions. With greater concentration, the United States faces a much greater threat of travel disruptions. Imagine the nationwide effects of a labor action or FAA grounding at a combined United/Continental, which analysts estimate would control nearly a fifth of all domestic airline seats. Even a 24-hour loss of service would have severe consequences.

Eight, too big to fail. Just as we have seen with banking and other businesses, we are now seeing the airline industry evolving into an oligopoly of 800-pound gorillas. Those who previously decried any form of assistance to financially struggling carriers would reverse that argument, claiming a mega carrier such as United/Continental would be too big to fail. And they will be right. A shutdown would have immediate and adverse effects throughout the country.

Nine, raising the stakes. Since the approval of the Delta/Northwest merger, some proponents of the United/Continental merger argue that fair is fair. That is why executives from American Airlines may soon appear before this very Committee seeking a merger with U.S. Airways, which, of course, just merged with America West in 2007. Ironically, this sudden leapfrogging in the airline ranks has not been due to genuine growth but to reductions in service. It seems only fair to ask what the end game is here. At what point will this merger mania subside?

Today we are told the domestic airline industry can only support three large network airlines. How long before we are told that number has been reduced to one? Before further consolidation is approved, Consumers Union feels there should be more discussion about the airline industry's ultimate goals and how those goals affect U.S. consumers.

Thank you.

[The prepared statement of Mr. McGee appears as a submission for the record.]

Chairman KOHL. Thank you very much, Mr. McGee. We will now conduct a round of questioning of 8 minutes before I turn to other Senators.

Mr. Tilton, United's proposed merger with Continental is the second major airline merger in the last 3 years. In 2008, Delta and Northwest Airlines merged, and many industry observers are now predicting that another one perhaps between American and U.S. Airways may soon follow. So what were once six major network airline competitors at the beginning of 2008 will now be four, perhaps someday soon only three. Consumers may be left with little or no competition on many routes, with the remaining large airlines carving up the country.

In your view, Mr. Tilton, what is the minimum number of legacy airlines necessary for a competitive market? Is it three? Is it two? Is it one? What is the tipping point, Mr. Tilton?

Mr. TILTON. Thank you very much, Chairman Kohl, for the question. I think that the term "legacy airline" is instructive. Legacy airlines are working hard to get to the point where we are no longer referred to as legacy anything. This is an industry that is in need of innovation. It needs to embrace change.

I do not know what the disposition of strategy will be for either of those two companies. I know that certainly they have both said

the consolidation would be of benefit to the industry as a whole. One of those two companies has said, I think quite clearly, that they do not perceive the need to be part of the merger activity. The other has said that it may well be a benefit to them. I think that the Senators know that our company was engaged in conversations with that particular company prior to the re-engagement of conversations with Continental.

I think it is left really to the strategy and discretion of the individual company and the hubs that they serve. This is a hyper-competitive business with very, very low barriers to entry. New entrants such as Virgin America or JetBlue are being created where opportunity is perceived to exist in this industry on a continual basis. I suspect that given the opportunity for aircraft manufacturers to put their product into service, into this marketplace, they will continue to do so. In the event of the failure of one of those new entrants, the assets are simply moved on into the possession of another airline, which is a unique quality of this business.

So I do not think that there is any worry here that competition is going to be lessened by the combination of two companies who do not overlap in the main and are committed to using the combined network to increase frequency of service rather than reduce it.

Chairman KOHL. Mr. Bush, what is your opinion about Mr. Tilton's argument that this merger will have no negative impact in terms of competition and prices and quality of service? How do you feel about that?

Mr. BUSH. Not too well, Mr. Chairman, and here is why. I think that you cannot discount the competitive effects, even in the number of markets where you do have hub-to-hub service. You will be restricted to one carrier in many cases, two carriers in another. I think of the slogan of Aeroflot, the monopoly airline in the Soviet Union: "You have made the right choice." There is only one choice here for consumers.

I also take with great skepticism the notion that this merger will enhance efficiencies in any way. We have had consolidation in this airline industry for quite some time, and we have not seen any change. Instead, what we have is a cycle of economic violence where we start with a merger which leads to some sort of economic crisis, then some sorts of bankruptcies, followed by further consolidation, and the proclamations that there will be greater efficiencies.

If you continue to do the same thing over and over again and it does not produce any different results, then why do we expect that it is going to be better next time? It is like two people getting married with high credit card debt thinking that getting married will create some efficiencies yet will somehow change their pattern of behavior. That is not innovation.

I also do not think that low-cost carriers will mitigate any of the anticompetitive effects of this transaction for several reasons. One, we have a history in this airline industry of low-cost carriers entering routes and the majors adding capacity and reducing fares and the low-cost carriers scurrying away. With rare exception, low-cost carriers are not all that great at entering hub-to-hub routes and quite rightfully fear, and so do the financers who back these LCCs.

We also should note a great question for the Department of Transportation. What does it take to be an LCC? There is a great deal of startup costs. Six months' operating losses have to be on hand. You have to have cash on hand. You have to secure the planes, train the pilots, get the gates. Low-cost carrier entry is not easy and will not mitigate the anticompetitive effects of this transaction.

Chairman KOHL. Mr. Tilton, in your press release when you announced the merger, you estimated that the merger would result in net annual savings by 2013 in the amount of $1 to $1.2 billion, including between $800 and $900 million in incremental annual revenues and $200 to $300 million in net cost synergies. On the revenue side, Mr. Tilton, your testimony says that the $800 to $900 million in increased revenues will not come from higher fares, so where will you get that $800 to $900 million of additional revenue?

Mr. TILTON. It will come from the network efficiencies that Mr. Bush suggests do not exist. When we combine our two networks together and then apply our 700 aircraft optimally to that network, we are able to gain significant efficiency from the difference between our two fleets. If Jeff and his company are flying a 757 on a route that would be better served if it were regauged up to a 767, we have the 767 in our fleet and Jeff does not have it in his, then the flexibility that we gain by being able to use that aircraft in a better service for that particular hub is part of the synergy creation across our network.

We simply bring these two networks together. We combine the fleets. We optimize the use of the fleets. We take those aircraft in both our regional service and our mainline service, and we are able to fly those aircraft to communities that one of us serves rather than the other in an optimal way. And it simply is a flexibility or an efficiency, Senator, that we do not have today independent of one another.

Chairman KOHL. I hear what you are saying and it may be true, but those are savings. That is not a revenue increase.

Mr. TILTON. Well, it is revenue the way that we account for. We account for revenue, so it may be an efficiency in the revenue performance of the airline, but it is not a cost reduction. It is an efficiency improvement or enhancement to the network, nor is it a fare increase.

Chairman KOHL. I would like to turn now to the Ranking Member on this Committee, Senator Orrin Hatch from the State of Utah.

Senator HATCH. Well, thank you, Mr. Chairman.

For Mr. Tilton and Mr. Smisek, when evaluating any airline merger, the first and most obvious question from the antitrust perspective is whether the merger will result in an increase in fares or a reduction in flights. I would like to take a moment to focus on the latter, the number of flights.

According to your statements, a merged airline will maintain ten domestic hubs. Is that right?

Mr. SMISEK. We will have eight mainland domestic hubs, Senator.

Senator HATCH. OK. Some have argued that this approach will simply not be cost-effective and that at some point one or more of

these hubs will be downgraded, eliminating options for the consumers in those markets. Now, this is particularly likely if there are market redundancies between the two hubs. The scenario that sticks out the most and has gotten the most attention is the potential overlap between the Cleveland and Chicago hubs.

Is it unreasonable to argue, as some have, that the Cleveland hub will see a reduction in service due to its proximity to the Chicago hub? And what about the Newark and Washington hubs as well?

Mr. SMISEK. Well, let me address that, if I could. I think the best way to look at this is how those hubs would fare if we were not to do the merger and let me use Continental as an example. We have built over the years a carrier of which I am greatly proud. I think we do a very good job, and we get awards for greater customer service. We are, however, Senator, eking out a hand-to-mouth existence, and as far out as I can see, we will continue to eke out a hand-to-mouth existence. By merging with United, we will be creating a carrier that, with the network we will have, which is fundamentally not overlapping, the ability for us to attract and retain business travelers and general consumers as well and our frequent flyer program, we can create a carrier that will have a future and a future profitability, which is good for communities and good for us to be able to continue air service.

With respect to Cleveland, I know how important good air service is to the city of Cleveland. I have met with Mayor Jackson. It used to be my OLI city where I used to go up and do relations between Continental and Cleveland. I know the community well; I know the people well. I know how important the air service is. And we will continue to provide good air service to every community that we currently serve.

The future air service is going to be dependent not on us but on demand. And if you can tell me where the economy is going or you can tell me what external shocks we will suffer, then I can help predict that. But it is very difficult to know that at this point. We are always responsive to demand. We work very closely with local officials, with local businesses, particularly in Cleveland, because we want to continue to generate the demand that will permit us to continue to provide high-quality air service to Cleveland.

Senator HATCH. Well, I can tell you right now, if we keep spending like we are here in Congress, the economy is going to go into the—I do not want to say it, but it is not going to go into a good position, we will put it that way.

Did you have any comments, Mr. Tilton.

Mr. TILTON. I would simply say, Senator Hatch, that the domestic hubs for United—Dulles and Chicago, Denver, San Francisco, Los Angeles—are extraordinarily important markets. Depth of market is important for any hub to continue to be a hub. Those markets have significant business travel demand in them, so I do not think there is any jeopardy whatsoever to those hubs, including the Dulles hub, Senator, that has done remarkably well for United Airlines since our restructuring.

Senator HATCH. OK. Mr. Bush, in your testimony, you argued that the entry of low-cost carriers into airline markets is unlikely to mitigate the negative impact this merger will have on competi-

tion. I would like to explore that just a little further because, as I understand it, the market share of low-cost carriers has almost doubled in the last 12 years, moving from less than 20 percent in 1998 to almost 40 percent today. Indeed, their share of the market has grown steadily without any significant decline or even plateau.

Now, this has taken place even as the airline industry has become more consolidated. If that trend continues, it seems fair to me to assume that low-cost carriers will eventually and at a time in the not too distant future control a majority of the market. Now, if that is correct, isn't it reasonable to conclude that competition, particularly the price competition that the networks receive from low-cost carriers, will negate many of the harms you and others have predicted about this and other network airline mergers? Or are you arguing that the penetration of low-cost carriers into the market will soon be on the decline if more consolidation takes place?

Mr. BUSH. I will answer that with a simple yes, I am arguing a bit of both. Here is the issue: The issue is that when low-cost carriers enter markets, with rare exception they are not looking to take on hubs. They are looking for easier-out airports, like Midway. Southwest makes it a moment of pride to say we are not going to go into congested airports. When you have time-sensitive passengers, typically business passengers, they prefer certain airports to others, and in that sense they will not choose the low-cost carrier.

Certainly in certain hubs low-cost carriers have made entry. The big story in the airline industry is AirTran at Atlanta, and what the airline industry learned from that, if you are—sorry—a legacy carrier, is, Oh, my goodness, that cannot happen to us. We cannot have a low-cost carrier right next to us as a side-by-side hub carrier. And airlines that are legacy carriers take great pains to avoid that kind of issue by capacity responses, pricing responses. They have frequent flyer programs. The larger the network, the easier it is to drive out low-cost carrier competition.

Senator HATCH. Do either you, Mr. Tilton or Mr. Smisek, have any——

Mr. TILTON. I suspect, Senator Hatch, that Southwest Airlines, were they here, would likely take some exception to the characterization of their growth strategy as it has been described by Mr. Bush. As I said, they are the largest carrier in the United States. After our merger, they will still be the largest carrier in the United States today. And in sharp contrast to legacy carriers, they have shown a steady, steady pattern of growth. They have shown an ability to accommodate change in their strategy. They are building a more complex proposition to customers, which includes frequent flyer and loyalty schemes and even connections to international carriers, both North and South, with codesharing ventures with Mexico and Canada.

They compete in L.A., one of our important strategic hubs, in a very vigorous way, I would suggest to Mr. Bush, and they continue to grow in a very satisfactory way for them in an important hub for us—in Denver.

Chairman KOHL. Go ahead, Senator Hatch.

Senator HATCH. I can only be here—I have to get to the Intelligence Committee, but let me just ask one last question. It is fairly long, but I would like to ask to Mr. Tilton and Mr. Smisek. It is something that concerns me.

Mr. Bush and others have argued that further consolidation among the network carriers could negatively impact downstream and upstream markets specifically among those industries that compete to provide products and services to airlines. I would like to hear your response to those arguments, and to paraphrase the argument, because airlines tend to contract with outside vendors and suppliers for a number of services, those vendors will see their bargaining power reduced if there are fewer purchasers on the market.

In his written testimony, Mr. Bush mentioned the possibility of the new merged airline exerting undue pressure to extract favorable terms from the air travel websites like Orbitz or Expedia. You could presumably add vendors like food services, equipment manufacturers, and others to the mix, I suppose. It seems intuitive that eliminating buyers in these markets, which is what happens when these mergers take place, can harm competition.

Are these legitimate concerns? And I would just ask you why and why not.

Mr. TILTON. So, Senator Hatch, this is an industry that has lost some $60 billion over the last 10 years. It is an industry that envies the margins that the vendors that Mr. Bush is worried about have for their businesses. I am always a little surprised at the presumption of power that is ascribed to a business that has suffered 186 bankruptcies since deregulation and is having a difficult time paying its economic rent.

Any sharing of our expenses that I could get from our vendors beyond that which I already have I will vigorously pursue, and I doubt very seriously that it will go to the viability of those vendors.

Senator HATCH. Thank you.

Thank you, Mr. Chairman.

Chairman KOHL. Thanks, Senator Hatch.

Senator Klobuchar.

Senator KLOBUCHAR. Thank you very much, Chairman. Thank you for holding this hearing. Two years ago, I remember I was not yet on this Committee, but you allowed me to sit in and ask questions on the hearing about the Northwest and Delta merger. And during those hearings, we discussed how that merger would decrease competition, our concerns about that merger. I cared a lot about it since Northwest Airlines is in my home State—was in my home State. And I remember part of the discussion we had during that hearing was that that merger could usher in a wave of consolidation in the aviation industry. And I think that that prediction—I remember making it at that hearing—appears to be head on. And so my focus today is really going to be about two things that matter to people. One is fares and one is jobs.

And I wanted to start, I suppose, with you, Mr. Tilton and Mr. Smisek. One of the advantages that has been sold about this merger is that there is no overlap between your flight networks. This is what you have said. Even so, I think Mr. Bush has talked about the effect that this could have on consumers, elimination of flights,

decreased services, and potentially increased fares as we have less competition. Could you comment on that?

Mr. TILTON. In our opening statement, Senator, we both mentioned that this merger is not predicated or calculated on fare increases. The benefits of this merger are efficiencies that we would gain by combining our networks and being able to use our combined 700 aircraft more flexibly across the combined network, a fleet that we cannot now share, and that includes actually the deployment of our regional jet contracts as well.

So from a fare increase perspective, as Jeff said in answer to a previous question, this is an intensely, fiercely competitive industry, regardless of what you might hypothesize——

Senator KLOBUCHAR. But don't you think there are certain parts of the country where there is less competition where you do not see the benefits of this competition and you have higher fares?

Mr. TILTON. Well, from the perspective of my company, Senator, we are competing across our network by Southwest Airlines and low-cost carriers to the tune of about 85 percent of the total network. So we are disciplined on fare increase possibilities very effectively by competition. So there is not an instance across our hubs. There is not an instance—and I think the financial record of the industry clearly shows this—where we have significant pricing power at our sole discretion.

Senator KLOBUCHAR. Mr. Bush, do you want to comment on this about the fares? I just tend to see that in a lot of our rural areas or towns that tend to be more dominated by one airline. As we get more and more consolidation, we get less fare competition and higher fares.

Mr. BUSH. That is precisely correct, Senator. When you have—and this is why I mentioned the issue with connection markets as well. These smaller communities are not ones that are typically going to be served by low-cost carriers, for example. Those will not mitigate the market power that would be inherent in these connections, and in particular in certain city pairs, hub-to-hub markets as well.

The other issue is that when we had this hearing a couple years ago about Northwest/Delta, you had the same sorts of arguments with respect to the benefits of the transaction. I recall very specifically this notion that there would be fleet rationalization. I recall very specifically that that would somehow yield a billion dollars' worth of savings and that we have what seems to be Groundhog Day here again, that we have the same argument.

I am curious as to why we think that these efficiencies will somehow pass on to consumers and that this will somehow benefit these markets when there has been no indication that these efficiencies have saved the airline industry in the past. We have had merger upon merger upon merger, and the airline industry is not better.

We can ask why that is, and the answer is probably because the airline industry has chosen, rather than innovate—there have been technological efficiencies which have driven fares down. Do not get me wrong. But they have not chosen to innovate their way out of these problems. Instead, they have chosen to merger their way into more problems.

Senator KLOBUCHAR. I want to just switch—and I can do some questions on this for the record—to just this jobs issue. One of the things when Richard Anderson was here from Delta, when we had that hearing, he actually made some commitments about keeping certain hubs open in our State, keeping certain jobs there for Delta and has worked very hard to keep those commitments. And I guess just on behalf of some of the workers that are here, Mr. Tilton and Mr. Smisek, are you willing to commit to some numbers—actually, Delta put numbers out there last time—and a commitment or at least a general assurance that reductions will be minimal?

Mr. SMISEK. Senator, we believe that this merger will have very little effect on our front-line employees because of the complementarity of our routes. I will not speak so much to the Delta/Northwest transaction, but we have a great deal less overlap than they did.

With respect to headquarters jobs, there will be some reduction in headquarters jobs, but that is a fairly small number of jobs compared to the jobs that will be both preserved and I believe over the long term created as we create an enduring and profitable enterprise.

With respect to your concern on service to small communities as well, I think small communities are better served by this merger than they would be absent this merger because their service depends—they are dependent on network carriers for that service. As Mr. Bush has conceded, low-cost carriers will never serve those markets. It is antithetical to their business model. We are the only carriers that can and will serve it because we need to gather those customers and bring them through our hubs. They are far better served with carriers that have a future, that are stable, that can withstand the shocks to our industry, that can invest and innovate, invest in their products and in their people, than they would be having us drift along at the very edge of existence day by day eking out a hand-to-mouth existence.

Senator KLOBUCHAR. So just on the first topic of jobs, you believe that the reduction in workforce would be minimal?

Mr. SMISEK. I think it will be small compared to the 86,000 people or 87,000 people that we will jointly employ. I believe in the long run there will be job growth because with the power of this network and our ability to attract and retain high-yield business travelers, just as, for example, yesterday Continental announced a new route from Houston, Houston to Auckland, which is facilitated by this merger, by the traffic flows that we will get from this merger as well.

Senator KLOBUCHAR. One of the challenges of this merger will be integrating employee programs, especially pensions. In 2006, United had to take the painful step of defaulting on its pension obligations, which hurt many employees. And I want to make sure that the merger will not create another situation like that. Could you comment on how this merger will affect the pension obligations of both companies, Mr. Tilton?

Mr. TILTON. Well, actually, as Jeff said, this merger will put us in a position to be able to have the appropriate conversations with the various unions who represent our workers across the two companies. They will be competing for representation rights. In some

instances, our employees are represented by different unions. We have agreements with our respective unions that are slightly different, but in the main, we will be talking to our represented employees, our front-line employees, about a means by which they can benefit in, benefit from the synergies that we ascribe to the merger. Absent the merger, Senator, we will not be in a position to be able to do that with $1.2 billion in new dollar value to the companies, and the companies, as Jeff said a moment ago, would have a lesser economic future, undoubtedly, with which we would then be in a position to discuss with our employees that lesser economic future than the one that the merger provides.

Senator KLOBUCHAR. So you think that this will not negatively, adverse——

Mr. TILTON. This will not negatively adverse.

Senator KLOBUCHAR. OK. Thank you.

Chairman KOHL. Thank you so much.

Senator Cornyn.

Senator CORNYN. Thank you.

Mr. Tilton and Mr. Smisek, what I think the contradiction that we are seeing and feeling is this. Certainly we respect your business acumen and your recognition of the hard economic realities of your business, and I do not think anyone begrudges your trying to do your job and be accountable to your board of directors and to your shareholders. I will stipulate to that.

What concerns me is the suggestion that in the process of reducing competition on certainly some routes where there is very little competition already that the consumers will not see an increase in their costs. It seems to me that anytime you reduce competition in this way, the costs for the consumer are likely to go up. Obviously, there is a negative impact if not on the—I think you called it, Mr. Smisek, the front-line jobs, but the 3,000 people who work at the corporate headquarters in Houston I think are going to feel this pretty significantly. And, it seems to me, when you have reduced competition, the quality and the incentives for high-quality service are diminished.

So while I understand, Mr. Tilton, you said that a lot of the benefits you see with this merger are going to be based on efficiencies—Mr. Smisek mentioned that to me as well yesterday—isn't it true that, for example, in the Houston to Washington, Houston to Los Angeles, Houston to San Francisco route, Cleveland to Denver, where in each of those routes there are three airlines that fly nonstop, by eliminating one of those three competitors by consolidation here, there are going to be two choices for consumers, which enhances the likelihood that you will be able to raise prices, which will cost consumers more money and that the benefits of more robust competition will be lost? Can you help me reconcile these?

Mr. SMISEK. Sure, I would be happy to and would ask Glenn to join in.

In terms of the routes that you are describing, the competitors are low-cost competitors, and low-cost competitors not only do they comprise 40 percent of the market today and have continued to grow and have been profitable, but they exert a powerful disciplining factor on our ability to raise prices. And we have the inability to raise prices before this merger. After this merger, we will

have an inability to raise prices. The fact is that this is a brutally competitive industry. It shows in our results, billions and billions of dollars of losses for the industry since 9/11, a billion to Continental alone. And this merger, sir, I believe does not reduce competition.

Senator CORNYN. Well, Mr. Smisek, let me just interject there. For example, if I want to fly from Houston to Washington, D.C., this chart, which I understand we got—I think we got it from you or your associates—lists Continental, Southwest, and United as the carriers that fly nonstop. So when I am in Houston and I want to come to Washington, D.C., after this merger, I will have two choices. I will fly on Southwest or I will fly on the consolidated United and Continental. Explain to me why that does not drive up costs for the consumer?

Mr. SMISEK. Sir, there is something well documented in the economic literature—I think Mr. Bush can attest to it—called the "Southwest effect." When Southwest is in a market, I can guarantee you there is a discipline in the pricing. Not only Southwest but Frontier, Virgin America, JetBlue, there is a plethora of low-cost competition across this industry.

Mr. TILTON. Let me if I could, Senator.

Senator CORNYN. Please.

Mr. TILTON. So perhaps tying up some segments of the conversation, one of the things that we have seen most recently, both Jeff and myself, at Continental and United, is the emergence of the new Delta into markets such as Chicago where previously Delta had perceived that it would be uneconomic for them to test the Chicago market, but now with the combination of Northwest and Delta, they have decided that the Chicago market is a market of some attraction to them and they will add another network carrier into Chicago, which had historically been if not the sole province of United and American, hotly contested between those two carriers, but also Northwest to a lesser extent connecting to the Senator's State. Now, from the east coast of the United States, the newly strengthened Delta is providing competition along our hub structure that it had not previously—had apparently been unable to do or had not been emboldened to do.

So this is anything but a cartel. Irrespective of how many "legacy carriers" there are going to be, we prefer to refer to them as "network carriers" given the unique role that they play in the marketplace.

The other thing that I would offer that I do not think Mr. Bush mentioned—if he did, he mentioned it in passing—is costs inevitably rise in this business, regardless of the carrier. They rise for AirTran, they rise for JetBlue, they rise for Southwest. The way that they mitigate those costs in their business model, Senator, is they grow. And to be perfectly candid with you, they have to grow. They have to continue to grow or costs will catch up with them.

So low-cost carriers are going to continue to grow because that is the essence of their business model.

Senator CORNYN. It is not like the farmer who suffers losses every year but tries to make it up in volume.

Mr. TILTON. No, they do not try to make it up in volume. They grow and they try to grow in a way that, frankly, continues to be contributive to their profitability in the main.

Senator CORNYN. I could not help myself when I met Mr. Smisek in my office— he was nice enough to come by, and we talked about why Chicago, and he told me he only owned one sweater, and I told him, well, that is, you know, another good reason to move the headquarters to Houston. It is a business-friendly town, low taxes, no income tax in Texas, right, Mr. Smisek? No state income tax. But in all seriousness, what was the rationale for moving the headquarters to Chicago as opposed to Houston?

Mr. TILTON. So, Senator Cornyn, as you may know, I have spent two tours of duty with Texaco in Houston. I was the president of Texaco Refining and Marketing in Houston. I was the president of Texaco USA in Houston. You know that my new company, Chevron, has a significant presence. You may know that the Continental employees are in the Chevron building. So I have every appreciation for the benefits of doing business in Houston, Texas. And that is why we will have a significant presence in Houston, a significant head office, headquarter presence. I would hypothesize just that, that the technological functions of the new company, such as information technology, would be very, very logically headquartered in Houston simply because of the tremendous resource that the Houston technological economy provides for recruitment in that segment of the business.

So we will continue to keep a commitment to Houston, and we will be a significant employer in Houston, and that hub is going to continue to grow. So from a Bush perspective, it is going to continue to be a significant employer, the new company will continue to be a significant employer.

In the intervening years between our first discussions relative to the possibility of a merger that were actually mooted by $172 jet fuel and a collapse of the credit markets, in the intervening 2 years, we made a commitment to a new operating center in the Willis Tower in Chicago. And as time progressed, I assured the citizens of our city, the leaders of our city, and the representatives here in this city of our State and our city, that that amounted to a commitment to the city of Chicago regardless of what we might do. And as you know, Senator, we were in discussions with another company when Jeff reengaged, and in that context, in that transaction, had that come to pass, the headquarters of the new company would have been in Chicago.

So from my perspective, it was simply something I was not willing to take off the table.

Senator CORNYN. Well, let me ask one last question, if I may, Mr. Chairman, and I will ask this on behalf of all of the Members of Congress who fly on United and fly on Continental. Will you retain your flight to DCA?

Mr. SMISEK. Emphatically.

Mr. TILTON. Guaranteed.

Senator CORNYN. Thank you, Mr. Chairman.

Chairman KOHL. Thank you very much, Senator Cornyn.

Trying to cut through to some extent as much as we can all the complexities of what is being done in the industry and under-

standing, as you have said, that you are just trying to get ahead of the curve if you can because you have lost so much money over the years, isn't one of the basic intentions, hopes, and goals, to get to the point as soon as you can when you are able to charge customers what you need to charge them to make a buck? Isn't that what it is all about?

Mr. SMISEK. Well, Mr. Chairman, it is not so much in raising fares from our perspective, but we are in a global business. We are a global airlines. We compete with large foreign airlines. We compete heavily for high-yield business traffic. From Continental's perspective, we are becoming marginalized every day. That is why we joined Star Alliance, which has been beneficial to us. It has been necessary, but not sufficient to restore us to profitability. A large portion of the revenue synergies of this transaction are predicated on improving the mix on board our aircraft, not so much the price of any given ticket but the mix of more business travelers, because business travelers, because of their necessity to travel quickly and at the last minute, are willing to pay a higher fare. And that business mix will be beneficial, and rather than having those business travelers fly on Air France/KLM or fly on British Airways/Iberia, they will fly on the combined Continental/United and that will help restore us to profitability.

Chairman KOHL. What you said is, yes, that is right, we are trying to get to the point where our mix of travelers will get us more money.

Mr. SMISEK. Making a profit would be a good thing.

Chairman KOHL. And, you know, I understand where you are coming from. I have been in business all my life. And I think we are getting confused in some of the very involved conversation here using words that are important and meaningful, but they tend to some extent to obscure what we are talking about here. You want to put yourself in a position, as you should, where you are able to get as much as you can in a marketplace from a traveling consumer, not because you are trying to gouge them but because you are trying to make some money. And one of the ways in which that is traditionally, classically, inevitably done in business is to deal with the competition in a way that allows you to do that. I mean, this is Business 101. Isn't that right, Mr. Tilton

Mr. TILTON. Yes, I think it is, and I think the thing that it would be—it would be a worthwhile discussion, uncomplicated discussion, with Messrs. Bush and McGee, is that the American consumer today receives tremendous value, extraordinary value from this industry, I mean exceptional value for money. Fares have declined 30 percent since deregulation adjusted for inflation. Spectacular value. The hubs serve a purpose that is really unique to the provision of service to small communities. No hubs, no point-to-point connectivity from Minot, North Dakota. It simply does not happen.

So the combination of business models, Senator, in this business, network carriers, hubs, of great economic benefit to the host city hub, tremendous economic benefit to a city such as Chicago on a collateral basis, on a full economic GDP basis, and point-to-point carriers which have grown tremendously create business model choices and, indeed, even configuration choices. AirTran offers busi-

ness class. Southwest does not. A tremendous choice for the consumer.

In Milwaukee today—in Milwaukee today—which I am sure you are very keenly aware of—there are three low-cost carriers vying for the customers' affections in that city: Midwest, Southwest, and AirTran. And my company is vying for the opportunity to connect those people in Milwaukee over O'Hare to Tokyo. It is a different business proposition. Regardless of that, the citizens of Milwaukee are very well served today as a function of that hyper-competition for their business.

Chairman KOHL. I understand.

Mr. TILTON. And we would like to make a profit doing it.

Chairman KOHL. What you are trying to accomplish, you and all the other airlines, is to have a situation come about—and I think this merger is part of that thought—where there is only so much competition around so that you can all still make some money. And inevitably that means that some of these others have to go by the wayside. There may be, you know, a somewhat more sophisticated way to do it, but there are too many airlines competing for the available business, which force you to drop your prices below profitability. And this is in the national interest here. We are not talking here to denigrate what you are doing in any way. Until that happens, you are going to continue to lose money. So you desperately go about trying to be as efficient as you can, and that is to your advantage. But ultimately you need to be in a position so that you do not have so many competitors vying for that dollar, which they are forcing you to charge prices that are below your ability to make some money. Is that right, Mr. Tilton?

Mr. TILTON. I think the point that Jeff was making, Mr. Chairman, is we are resigned to the hyper-competitiveness of the domestic market. The domestic market is going to continue to be hyper-competitive, and I frankly do not think that that is going to change. The domestic market for a network carrier serves a different purpose than it does for the three carriers that I mentioned in Milwaukee. The domestic market for the network carriers is a provider of passengers in the main to the international market. Where the network carriers have the opportunity to realize your ambition for us, making a profit and covering our costs and being able to return something to our various stakeholders—our employees, our shareholders, and our communities—is through really our ability to compete with the now more competitive, as we have already said, Air France/KLM, Lufthansa, and the trans-Pacific carriers, as we should, because that is our role. That is really what we do. The fact that we have lost competitive position in those foreign markets, in those international markets, to carriers who continue to also have new entrants, such as Emirates and Etihad from the Middle East, is really where we are going to compete. We are going to compete in the long-haul market. You know, we are now going to be, Jeff was going to be, United now will be, we are going to be the launch customer for 787s. We are going to be the launch customer for 787s. Jeff has ordered 25, Glenn has ordered 25. At the end of the day, if we cannot make this work, Boeing is not going to sell us any 787s. We are going to put them into service and serve those long-haul international markets as a function of

our ability to gather up customers and feed them into the hubs across the United States, all eight of them. That is how we are going to make money.

Chairman KOHL. All right. Before we go any further, we would like to acknowledge the presence of Sheila Jackson Lee, the distinguished Congresswoman from Texas. We are honored by your presence here today.

Senator Hatch.

[No response.]

Chairman KOHL. I would take comments from anybody, but I still want to put out the point of view that what drives your customer attractiveness today is price. There are other things, but price is relentless in your ability to attract customers. And your price is determined by your competition. If there were not any competition in Milwaukee, Mr. Tilton, the price would go up considerably. We understand that. That is just the way it works. And that is the way it works with you all. And you push, as you need to push, and hopefully to wake up one day and have much of your competition evaporate so that you would be in a position not to gouge the customer but simply to charge him or her an amount of money that will enable you to make a profit. As long as there are competitors next door at the next gate charging less than you, you have got a big problem. If that competitor is gone, you do not have such a problem.

Now, how we get there I do not know. Someday do we have to have maybe just one or two airlines that are regulated by the Government and, you know, you are allowed to make a reasonable profit like utilities? Does that make any sense to you fellows, offering the best service you can to customers but not at a loss?

Mr. SMISEK. Senator, no, sir, that does not—I think that consumers have benefited tremendously from airline deregulation. I think Glenn has summed up very well who we are. We are different from low-cost competitors domestically. We are a global airlines serving a global market, competing against large foreign airlines. We can do that effectively. We can do that as long as we have the ability to invest in a product like the 787, flat-bed seats, AVOD, all the things that we need to do to attract and retain high-yield business travelers. Both United and Continental are principally a business airline. We are attractive to a broad range of consumers, but we are principally business airlines. It is a differentiated product. We do a very good job of it. This merger will put us in a position to create a network that will be far more attractive to corporate travelers than either of our networks could be alone. And I believe we will generate sufficient synergies to not only restore us to profitability but be able to sustain that profitability, which, of course, is good not only for this Nation but certainly for our employees and the communities we serve and ultimately for consumers as we offer them a broad global network.

Chairman KOHL. All right. Any other comments? Mr. McGee, what would you like to say?

Mr. MCGEE. Yes, Mr. Chairman. I wanted to agree with Mr. Tilton before when he was speaking about the different models in the domestic airline industry. There is no question that the business model of a low-cost carrier is much different than the network

or legacy carriers, and I think that speaks to what we are talking about here today, what we are talking about in merging and combining two legacy airlines that in many ways compete head to head. If we lose that competition, I think we are going to see two things. One is based on the historical record where we have seen it before. One is that in some cases low-cost carriers will probably come in and on those specific routes fares will drop. But because of the very business model of low-cost carriers, they are not as ubiquitous as legacy airlines.

For example, St. Louis, as I mentioned before, the former TWA hub, has lost almost 50 percent of the flights that it operated 9 years ago. In certain cases, Southwest came into St. Louis, and it was good news for the citizens of St. Louis because on those routes fares went down and service was restored. But on many other routes, they lost service. They certainly lost nonstop service on some routes, and fares went up on routes where there was no meaningful competition.

So it is how we sort through these two very different business models. Southwest and other low-cost carriers are usually very, very deliberate and specific about where they fly, as was pointed out earlier. And that is very different than the model of a hub-and-spoke airline that says, OK, we are now going to be focused in this area and, you know, we are going to spread out from there and cover a broad geographical region.

So when we keep referring to the decrease in fares, I think two points should be made. One is that decrease in fares has been driven by low-cost carriers, but it is also very specific. It is not in all routes. There is tremendous imbalance in terms of fares. Certain areas of the country, as the Senator noted, particularly in the Northwest, in rural areas, smaller cities, fares have not gone down because, you know, they are not served by JetBlue or Virgin America.

And then the other point to make is that over the last 2 years, we have seen another form of fare increase in the form of the fees that the airlines have instituted. The Department of Transportation recently noted that in 2009 airlines generated $7.8 billion in the very fees that you referred to before for things like calling reservations, checked bags, now even talking about in some cases carry-on bags. That is a 42-percent increase over 2008, and we would argue that in many ways that is another form of a fare increase.

Chairman KOHL. Well, what is going to be, in your opinion, the impact of this merger on those fees?

Mr. MCGEE. Well, again, wherever we have seen less competition, we have seen less resistance for airlines to resist measures like this. We see it—you know, as I mentioned briefly in my testimony, there is a certain checks and balances with more competitors. Many, many times over the years we have seen fare increases nationwide or almost nationwide. An airline will raise fares, and then the industry sort of holds its breath for 48 hours or 72 hours to see who matches, who does not match. We keep talking about reducing the size of the pool of airlines that have the ability to match or not match, introduce fees, not introduce fees, resist fees, and it applies not just to fares and fees, but also even to service.

For years, Continental resisted an industry-wide trend by being the only airline to offer meal service in economy class. Eventually, you know, they were unable to do that. American resisted the trend to reduce seat pitch, the distance between seats, and offered more leg room, and that failed. Currently Southwest is resisting the fee efforts in many ways, particularly with baggage fees.

Whether or not they will be successful long term, we do not know, but what we do know is that with fewer major carriers to resist such efforts, obviously that will have an effect on consumers.

Chairman KOHL. Any other comments, gentlemen? Anything at all? Mr. Bush.

Mr. BUSH. Just a couple things, Mr. Chairman. I want to go back to this notion that low-cost carriers are going to be able to discipline the merger and the anticompetitive effects of the merger. In particular, I think Mr. Tilton had mentioned the Southwest effect in certain of the routes where we are consolidating from three to two or two to one. And Southwest, if we consider the Southwest effect, it is in the city pairs—we were talking about city pairs, like flying from Houston to Washington. But, in fact, there is another type of antitrust market that we really talk about when we do these kinds of investigations, and that is an airport pair—Intercontinental to National. When I flew out, it was a $1,400 ticket from Intercontinental to National, which speaks to something about fare increases. If I flew from Hobby to Baltimore on Southwest to BWI, it was $900. So there is disparity between, you know, competition on city pairs and airport pairs.

Now, Southwest could potentially discipline even a greater fare increase from Intercontinental to National, but it is not a parallel; it is not one to one. So, yes, there is a Southwest effect. It does not discipline completely anticompetitive effects of the transaction, nor does it discipline in all markets.

Chairman KOHL. Mr. Tilton?

Mr. TILTON. So it seems to me that it strains credulity to argue in favor of consolidation that has taken place in this industry as if it were constructive consolidation, and we all know that there were liquidations. Those companies did not consolidate of their own free will. They failed. And those brands are not around any longer, in the rather glib way in which they were described to have joined with another carrier. They failed, and they were absorbed. That is precisely what happened, very unfortunately, to TWA in St. Louis.

As I said in my prepared remarks, serial bankruptcy is not a strategy for an industry that is going to benefit any constituent—not consumers, not employees, not shareholders, and not consumers. And to give testimony without regard for the systemic economic failure of this industry that is as important to this country as it is, there is not one single thing that can benefit from the continued economic fragmentation and fragility of this industry. Not one thing.

Chairman KOHL. No argument, but doesn't that at least provoke the argument that we would be better off with fewer airlines, nationally regulated, with rules and regulations to force them to offer certain levels of service and allow them to make certain amounts of reasonable profit?

Mr. TILTON. Senator Kohl, at the point of 1978, I was young in my career in the oil and gas industry and not worrying about being able to pay the economic rent of the industry. So I have come from an industry that was sufficiently robust to have a discussion of a very different sort relative to consolidation, and consolidation in that industry was about being able to afford the multi-billion-dollar capital investments that the industry is required to make to an industry that has a very difficult time turning on the lights.

My understanding is that, even pre-deregulation, this was an industry that did not fare well. It did not do well pre-deregulation either. Certainly the consumer, you know, the constituent represented by the two gentlemen to my far left, has fared very, very well post-deregulation. Certainly the consumer has fared extraordinarily well. The proliferation of new business models, the proliferation of choice, I really only point to Milwaukee as an excellent example, and the choices abound. Transparency of fares. When I first came into the industry, my question relative to bags is why we ever transported them for free. And certainly at $172 jet fuel, I could not fathom why we were transporting them for free. And yet we competed very vigorously by an airline across 83 percent of our network that makes it a point of advertisement that they will transport them for free. So you have got tremendous choice.

So I believe that this market can sort itself out, but I do not believe in the veiled guided hand of comments that have been made to the left as to we ought not re-regulate it but we ought to sort of regulate it.

Chairman KOHL. Mr. Bush.

Mr. BUSH. I hear this argument a lot about ruinous competition. I have read about it in the economic literature quite extensively, and it is usually an impetus for antitrust immunity. The notion is that somehow competition will kill us all.

If that is the case in an industry, one has to question the underlying economics of the industry, because everywhere else in the world and in every other product market one can typically think of, competition actually helps consumers and actually helps innovation and actually helps foster economic growth.

It is kind of puzzling that this industry, which I do not consider very competitive—unless I compare it to railroads—would be considered in such a fashion that would be ruinous to have competitors. Therefore, what we need to do is consolidate, and this is what industry spokespeple have said, this is what CEOs have said. It makes sense to reduce the number of competitors so we can engage in what is called yield management. We can eliminate the lower fares and stack our planes with higher-paying, time-sensitive business passengers. I do not see why that is a reasonable argument that ought to win the day.

Chairman KOHL. Last comment, Mr. Tilton.

Mr. TILTON. The business models are all very different. The business models are compelling for the consumer. I am competed on 83 percent of the domestic market by Southwest today. Our two companies will compete. We will continue to be competed very vigorously not only by Southwest but also by Midwest, also by AirTran, also by JetBlue, also by Virgin America. The consumer in this

country is blessed, and deregulation has really made it possible for them to have the cornucopia of choices they have.

Chairman KOHL. Very good. I think you have brought an awful lot of light and information to this whole issue by your presence today. We want to thank you for being here. With that, we will conclude the hearing. Thank you again.

[Whereupon, at 3:47 p.m., the Committee was adjourned.]

[Questions and answers and submissions for the record follow.]

QUESTIONS AND ANSWERS

DARREN BUSH, Ph.D., J.D.*
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"The United/Continental Merger: How Will Consumers Fare?"

BEFORE
THE SENATE JUDICIARY COMMITTEE
SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS

SUPPLEMENTAL QUESTIONS AND ANSWERS

1. United and Continental argue that there is very little "overlap" between the two airlines – that is, they compete on very few routes. Is this true? Are there any markets where the Justice Department should order divestitures as a condition of the merger?

No, it is not true that there is very little overlap between the two airlines. While the airlines are arguing that they only compete on a non-stop airport-pair basis—and therefore there is minimal overlap—in fact airlines compete on numerous other bases.

First, the importance of competition in these "few" airport-pair markets should not be denigrated. These overlaps are typically hub to hub overlaps as well as other business markets. Substantial consumer harm can occur even in this "small" area of overlap.

Second, airlines compete on network and connection bases, not just airport-pair connections. As I stated in my written testimony, connections from origins or destinations east of Colorado in the Midwest to East coast destinations may only have as reasonable connections options the hubs of the merging firms or the hubs of Northwest/Delta. In other words, after the merger of Northwest and Delta, consumers in the Midwest may face increasingly limited choices—mainly between Northwest/Delta and United/Continental in terms of connecting from the Midwest heading eastbound. These two entities would have hubs at O'Hare, Cleveland, Cincinnati, Minneapolis/St. Paul, Memphis and Detroit.

The potential injury to connection markets is also potentially true on the eastern seaboard, where reasonable connections up and down the east coast are potentially reduced to three airlines (U.S. Airways out of Charlotte and Philadelphia, United/Continental out of Newark and Dulles, and Delta/Northwest out of New York). If one were to place an overlay of the Continental system with that of the United system, one would discover there is a tremendous degree of competitive overlap, with few choices for consumers in the Midwest and along the east coast.

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* The views expressed herein do not purport to reflect the views of the University of Houston.

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Third, there are at least some markets where the companies do not overlap, but could. This is called in antitrust parlance "potential competition." One example might be Los Angeles – Houston, where United might have provided nonstop service. The threat of that potential nonstop service may in some cases be sufficient to provide a competitive response on the route even though United is currently not providing the service. In addition, there are numerous potential competition opportunities in connection markets. Therefore, there is numerous potential for overlap between the two carriers.

Fourth, the merging parties could leverage monopoly power to foreclose competitors from obtaining vital services upstream or downstream.

Finally, there are few competitors who could compete with the large network carriers in terms of corporate contracts. United and Continental may compete vigorously with each other for these contracts, particularly when the corporation requires significant travel on nonstop routes where the companies compete. Moreover, the sheer size of the combined system may make it more difficult for smaller carriers to compete for those contracts

2. After the merger United and Continental will operate a total of eight hubs in the continental United States. Some industry observers believe that this is too many full-fledged hubs for the combined airline, and fear that it is inevitable that some will be closed or downsized once the merger is completed. Continental's Cleveland hub is thought by many to be in jeopardy, being relatively close to United's hub at Chicago. Do you think some hub cities will be eliminated or significantly reduced in scope after this merger? If so, which ones?

If one takes as the guidepost the Northwest/Delta merger and the American/TWA merger, one would expect that Continental's Cleveland hub would be substantially reduced to a "focus city" or perhaps reduced even further.[1]

The hint that Cleveland is in jeopardy can be taken from the testimony of the United and Continental CEOs. The companies claim in their press release that the merger will create $800 to $900 million in incremental annual revenues. The CEOs claimed that this will occur without necessarily causing an increase in revenues all the while attracting greater numbers of business travelers. I have testified that this is highly improbable absent fare increases, reductions in capacity, the elimination of lower-priced fare buckets, and the substantial reduction or elimination of the Cleveland hub.

Nonetheless, taking the CEOs at their word, we can foresee the probably future of Cleveland. The CEOs have suggested that they are seeking to target a greater share of business passengers via an increased presence globally. If that is true, then the focus of the merged company has to be the larger business destinations, of which Cleveland is not one. Instead, other hubs destinations fare better under the merger as larger business

[1] According to the Congressional Research Service, Airline Industry Mergers: Issues of Congressional Interest,June 9, 2010, at 6, Delta has already reduced the role of Cincinnati, where domestic emplaned passengers dropped by more than 50%, from 10.3 million in 2005 to 5 million in 2009

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destinations. If the CEOs are right and they are able to miraculously cull $800-$900 million from increased business traffic, one would expect greater presence and capacity on business routes out of Chicago, San Francisco, Los Angeles, Houston, and Newark.

3. I am very concerned about air service to smaller markets outside the large hubs, such as many smaller communities in Wisconsin and the upper Midwest. How might this merger, or future airline consolidation, affect air service to smaller communities? And even if these communities have air service, will passengers have any choice of carriers?

As I stated in my supplemental answers to my testimony in the Northwest/Delta merger, the ability of smaller and midsized communities to attract air passenger service is complicated. It is a function of the amount of traffic the market will bear. In many instances, such communities face only one option with respect to air passenger service. In those instances, customers must elect to fly and pay the monopoly price or drive.

With respect to those communities already served by major carriers, a major issue with respect to the United/Continental merger is whether the combined firm will operate the bulk of hubs providing connecting service between cities in the Midwest and the Eastern United States. In many instances in the Midwest, and particularly in Wisconsin, only certain connections make sense depending on geography. The more circuitous the route, the more expensive the ticket and the less likely that option will be chosen even among passengers who do not have the ability to enjoy nonstop service.[2] Thus, many communities will be limited to one or two choices, either United/Continental or Northwest/Delta. These airlines would have a lock on reasonable connection opportunities. Communities served predominantly or exclusively by the combined firms may find themselves faced with a reduction in service and increased fares.

Increased airline consolidation can only worsen the plight of smaller communities, as the choices for connection service become increasingly reduced. As stated in my written testimony, this is very much a concern in Midwest markets currently served by both Delta and Northwest.

4. Some airline industry critics argue that mergers such as United/Continental and Delta/Northwest make it very hard for smaller carriers to compete, especially for business customers. Among other things, they point out that the smaller carriers do not have extensive international route networks which therefore renders their frequent flyer programs less valuable. They also allege that large, networked carriers can use revenues from their lucrative international routes to "cross-subsidize" domestic routes. Revenue from international routes can be used to subsidize low fares on selected domestic routes in order to defeat smaller competitors.

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[2] For example, connections from origins or destinations east of Colorado in the Midwest to East coast destinations may only have as reasonable connections options the hubs of the merging firms and Chicago O'Hare, an airport which is seriously congested and constrained.

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What is your view of these arguments? Do mergers of large, networked carriers make it hard for small carriers to compete?

All of the arguments described are precisely correct. Large network carriers are able to fend off low cost carriers for numerous reasons. First, as I stated in my written testimony, the empirical evidence suggests that low cost carriers (LCCs) will be unable to offer competitive products on many of the routes that would be subject to reduced competition and reductions in service due to the merger. First, LCCs typically avoid smaller markets because they typically lack the hub structure to feed traffic efficiently from smaller cities. Smaller cities simply are usually unprofitable for LCCs.

Second, the economics of LCCs makes it difficult for them to enter congested airports, typically choosing close-in substitute airports (e.g., choosing to operate out of Baltimore rather than Reagan-National). On high density routes at these congested airports, the proposed merger creates the most egregious increases in concentration, making entry on a viable scale by LCCs that do not currently operate in those markets even less probable (and less attractive). Because airlines with the greatest frequency receive a disproportionately greater share of traffic on any route, the merger makes it more difficult to achieve profitability.

Moreover and most importantly, any LCC entering a coveted premium business market would likely face predatory pricing and predatory capacity additions are well-recognized phenomena within the airline industry. Much academic literature[3] and many court cases have discussed the issue. Unfortunately, the courts have taken the position, without examination of any facts, that predatory pricing simply cannot take place in the airline industry because the incumbent carrier engaging in predatory behavior cannot recoup the losses incurred in engaging in the strategy.[4]

The basis of a predatory capacity and pricing attack lies within the system presence of the dominant carrier. The low cost carrier entrant predicts some response by the incumbent carrier. As the low cost carrier offers seats at lower prices, the incumbent carrier may offer a limited matching of the low cost carrier's fares in order to prevent its customers from switching. However, the incumbent is unlikely to match fully on all the entrant

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[3] For a small sampling of the literature, see, e.g., Robert G. Berger & Stephanie J. Mitchell, *Predatory Pricing in the Airline Industry: A Case Study--The Policies and Practices of the CAB*, 13 TRANSP. L.J. 287 (1984); Mark T. Clouatre, *The Legacy of Continental Airlines v. American Airlines: A Re-Evaluation of Predatory Pricing Theory in the Airline Industry*, 60 J. AIR L. & COM. 869 (1995); Einer Elhauge, *Why Above-Cost Price Cuts to Drive Out Entrants Are Not Predatory--and the Implications for Defining Costs and Market Power*, 112 YALE L.J. 681 (2003); Russell A. Klingaman, *Predatory Pricing and Other Exclusionary Conduct in the Airline Industry: Is Antitrust Law the Solution?*, 4 DEPAUL BUS. L.J. 281 (1992). For an innovative solution to predatory pricing, see Patrick Bolton, Joseph F. Brodley & Michael H. Riordan, *Predatory Pricing: Strategic Theory and Legal Policy*, 88 GEO. L.J. 2239 (2000). The U.S. Department of Transportation had proposed guidelines to regulate such practices, Enforcement Policy Regarding Unfair Exclusionary Conduct in the Air Transportation Industry, 63 FED. REG. 17,919 (Apr. 10, 1998), but these guidelines were never adopted.

[4] For a rare exception, see Spirit Airlines, Inc. v. N.W. Airlines, Inc., 431 F.3d 917 (6th Cir. 2005).

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carrier's fares, because the incumbent relies upon higher fare customers to retain profitability. Still, some if not many of the higher-fare customers may opt to purchase lower fare tickets on the entrant carrier. The incumbent carrier seeks to prevent this using the limited matching strategy discussed above. Thus, a low cost carrier seeking to enter an incumbent's route expects to be matched on a limited basis.

The difficulty in an incumbent's response occurs when the incumbent offers increased capacity on the route. By increasing the supply of lower fare tickets, the incumbent may keep customers on board the incumbent's planes, sacrificing the profit that could have been achieved by utilizing those planes in a more profitable route (i.e., a route lacking in competition where passengers would experience higher fares). The benefit of this strategy is that it could cause the low cost carrier's passenger base to drop below break even load factors, making the route unprofitable for the low cost carrier. Once the low cost carrier withdraws from the route, the incumbent carrier reduces capacity by either decreasing the number of flights, the size of the aircraft on that route, or both, while raising fares.

The greater the system presence of the network carrier, the more difficult it is for the low cost carrier to attract passengers, even with the offering of lower fares. First, the low cost carrier may not be able to obtain business passengers associated with any corporate contract any company has with the incumbent carrier. Second, the use of frequent flier programs helps the incumbent carrier retain passengers who would sacrifice program benefits if they switched to a low cost carrier. Travel agents, to the extent they are used, may also receive benefits from keeping passengers on the dominant carrier in the form of higher commissions on booked travel. As the size of the incumbent carrier's network grows, so too do the disadvantages associated with passengers switching to low cost carriers.

Moreover, the greater the system presence, the greater the ability of the incumbent to respond without much sacrifice. It is a well-known network phenomenon in the airline industry that the dominant carrier on any route, or in any city origin, receives a disproportionate share of the traffic. In other words, increased network size can be an entry barrier to competition in any nonstop market. It can prevent low cost carriers from entering routes. The threat of a predatory campaign by the incumbent may also deter competition from low cost carriers.

Low cost carriers lack any serious recourse under the antitrust laws.[5] Any monopolization case involving the expansion of capacity and reduction of fares by a dominant carrier is quickly cast into a "predatory pricing" case. In that pigeon-hole of antitrust, plaintiff almost always loses.[6]

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[5] In at least one instance, legislation created a barrier to competition that allowed the perpetuation of monopoly power by a dominant carrier. *See* Shubha Ghosh and Darren Bush, *Predatory Conduct and Predatory Legislation: Exclusionary Tactics in Airline Markets,* 45 HOUSTON L. REV.293 (2008).

[6] The case law is replete with allegations suggesting that the major airlines have engaged in predatory conduct against entrants. See, e.g., Int'l Travel Arrangers v. NWA, Inc., 991 F.2d 1389, 1394 (8th Cir. 1993); Pac. Express, Inc. v. United Airlines, Inc., 959 F.2d 814, 815 (9th Cir. 1992); Cont'l Airlines, Inc. v. Am. Airlines, Inc., 824 F. Supp. 689, 692-93 (S.D. Tex. 1993); In re Passenger Computer Reservations Sys.

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5. How likely do you believe further airline mergers are in the next few years? And do you believe that the Justice Department should analyze this merger on its own, or in light of other airline mergers likely to come in the future?

The difficulty in analyzing whether or not a merger will tend to lessen competition is that the question is typically answered in light of an existing competitive landscape. Within that landscape, government investigators seek to determine whether or not the combined company could exercise monopoly power. While a merger may increase the incentive of other firms in the marketplace to combine, further consolidating the industry and enhancing monopoly power within that industry, it is difficult for antitrust agencies to consider the potential for future consolidation unless specific deals are announced.

For that reason, follow-on mergers typically occur rapidly after an initial proposed consolidation. Otherwise, follow-on deals would likely be examined under a completely different market analysis than the initial merger, as the initial merger will have caused the market dynamics to change, decreasing competition.[7] Thus, savvy industry executives know that it behooves them to propose deals at the heels of any initial proposed merger.

As I stated in my written testimony, follow-on mergers occur because the competitors of the merging parties perceive that there is some potential advantage to merger and consolidation, regardless of the veracity of that notion. There is little time to discern how effective the initial proposed merger will be. Thus, if the initial merger is efficient, it might have the effect of promoting further efficiencies within the industry. On the other hand, an anticompetitive merger may likely incite others to engage in defensive strategies to offset the monopoly power of the initial merging parties, further consolidating the industry.

It is important that the Department of Justice and anyone wanting to understand antitrust law understand the plans and motivations for follow-on mergers. Follow-on mergers in times of industry distress (perceived or actual) are almost inevitable. Such an understanding is particularly important where the industry in question is a network industry such as airlines, where firms not only compete head to head on a nonstop basis, but where the systems as a whole serve the basis of competition.

The difficulty is that the Department of Justice *cannot* address the issue of follow-on mergers in a vacuum. If they are not proposed or announced, speculation is unlikely to prove fruitful, and certainly cannot serve as the basis of a challenge to any transaction under Section 7 of the Clayton Act. Thus, the most credible line of investigation, absent

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Antitrust Litig., 694 F. Supp. 1443, 1451 (C.D. Cal. 1988), aff'd sub nom. Alaska Airlines, Inc. v. United Airlines, Inc., 948 F.2d 536 (9th Cir. 1991); Brian Clewer, Inc. v. Pan Am. World Airways, Inc., 674 F. Supp. 782, 784, 788 (C.D. Cal. 1986) (granting defendants' motion to dismiss plaintiff's claims that defendant airlines priced their tickets to drive a competitor affiliated with plaintiff out of business).

[7] For example, upon consummation of a merger, the market's "HHI", a measure of how concentrated a market is, will increase. Thus, a follow on merger announced after consummation of the initial merger will be examined in light of a more concentrated market, which may cause the enforcement agencies to challenge the follow-on merger even where the agencies did not challenge the initial merger.

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another announced transaction, is to examine the effects of the proposed transaction under the existing competitive landscape.

Sen. Kohl's Follow-Up Questions for the Record for the Hearing
"The United/Continental Airlines Merger: How Will Consumers Fare?"

To Bill McGee

1. We often hear complaints from consumer groups regarding increased fees for once-free services such as checked bags and telephone reservations. But given the problems that the airline industry has faced over the last decade, including very high fuel prices, high labor costs, and bankruptcies, don't the airlines need to cut costs, and doesn't this necessarily result in added fees and lowering the standard of service? Haven't passengers shown us that all they really care about is ticket price, and aren't the airlines just responding to the free market – and their need to turn a profit – with these service cutbacks and fees?

THERE IS NO QUESTION THAT A FINANCIALLY HEALTHY AND VIABLE AIRLINE INDUSTRY IS GOOD FOR CONSUMERS, AND CONSUMERS UNION CERTAINLY SUPPORTS SENSIBLE MEASURES DESIGNED TO ENSURE SUCH STABILITY. AT THE SAME TIME, CONSUMERS OFTEN HAVE DEMONSTRATED A DESIRE TO CHOOSE AIRLINES BASED ON PRICE. YET AIRLINES NEED TO PRICE THEIR PRODUCT TO REFLECT THE TRUE COST OF OPERATIONS. FOR EXAMPLE, THE U.S. AIRLINE INDUSTRY'S EFFORTS TO REDUCE MAINTENANCE COSTS BY OUTSOURCING CRITICAL WORK TO FACILITIES BOTH IN THE U.S. AND ABROAD HAVE RAISED SERIOUS QUESTIONS ABOUT THE WISDOM OF SUCH COST-CUTTING, AND DESERVE FURTHER INVESTIGATION.

INSTEAD WHAT WE'VE SEEN IN RECENT YEARS IS A SERIES OF BACK-DOOR PRICE INCREASES THROUGH ANCILLARY FEES FOR SERVICES SUCH AS TELEPHONE RESERVATIONS, CHECKED BAGGAGE, CARRY-ON BAGGAGE, SOFT DRINKS, PILLOWS, ETC. IN SOME CASES, THESE FEES ARE CHARGED FOR SERVICES THAT COST THE AIRLINE NOTHING, SUCH AS PREFERRED SEATING. SINCE THE U.S. DEPARTMENT OF TRANSPORTATION RECENTLY REPORTED THAT SUCH FEES GENERATED $7.8 BILLION IN REVENUES LAST YEAR, IT'S CLEAR THE AIRLINE INDUSTRY IS NOT EAGER TO LOSE SUCH A CASH STREAM. HOWEVER, CONSUMERS UNION AND OTHER CONSUMER ORGANIZATIONS ARE CONCERNED THAT SUCH FEES AMOUNT TO DE FACTO FARE INCREASES. THESE FEES ALSO RAISE ISSUES ABOUT PRICING TRANSPARENCY, SINCE THEY ARE MAKING IT INCREASINGLY DIFFICULT FOR CONSUMERS TO DETERMINE BOTTOM-LINE PRICING AND COMPARE AIRFARES IN AN APPLES-TO-APPLES ENVIRONMENT. AIRLINE EXECUTIVES CLAIM THESE ANCILLARY FEES PROVIDE CONSUMERS WITH MORE CHOICES, BUT INSTEAD THEY HAVE PROVIDED CONSUMERS WITH GREATER CONFUSION—AND AN INCREASE IN FRUSTRATION.

AS FOR AIRLINE SERVICE, MUCH OF THIS DECLINE HAS COME FROM AIRLINE POLICIES THAT HAVE RESULTED IN REDUCING STAFF AND OUTSOURCING KEY FUNCTIONS. IN TURN, THIS HAS LED TO FEWER AIRLINE EMPLOYEES, A HIGHER PERCENTAGE OF MINIMALLY TRAINED TRANSIENT WORKERS, AND MORALE ISSUES. IRONICALLY, THIS PROPOSED MERGER BETWEEN UNITED AND CONTINENTAL WOULD ONLY EXACERBATE SUCH CONCERNS.

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2. United and Continental argue that there is very little "overlap" between the two airlines – that is, they compete on very few routes. Is this true? Are there any markets where the Justice Department should order divestitures as a condition of the merger?

AS NOTED IN MY WRITTEN TESTIMONY, AN ANALYSIS OF THIS PROPOSED MERGER BETWEEN UNITED AND CONTINENTAL BY JP MORGAN CONCLUDES THERE WOULD BE 13 NONSTOP ROUTES SERVED BY BOTH AIRLINES, AND 7 OF THESE ROUTES WOULD HAVE NO OTHER COMPETITORS. BY COMPARISON, THIS ANALYSIS FURTHER STATES THAT THE DELTA-NORTHWEST MERGER CONSISTED OF 12 OVERLAPPING ROUTES, AND 4 HAD NO OTHER COMPETITORS. THIS ANALYSIS ALSO STATES THAT FOUR U.S. CITIES WOULD EXPERIENCE FARE INCREASES AFTER THIS MERGER; THOSE CITIES ARE WASHINGTON, D.C.; NEW ORLEANS; SEATTLE; AND SAN DIEGO.

CLEARLY THE JUSTICE DEPARTMENT SHOULD CLOSELY EXAMINE THESE 13 NONSTOP ROUTES.

3. After the merger United and Continental will operate a total of eight hubs in the continental United States. Some industry observers believe that this is too many full-fledged hubs for the combined airline, and fear that it is inevitable that some will be closed or downsized once the merger is completed. Continental's Cleveland hub is thought by many to be in jeopardy, being relatively close to United's hub at Chicago. Do you think some hub cities will be eliminated or significantly reduced in scope after this merger? If so, which ones?

CONSUMERS UNION CAN'T PREDICT HOW EXECUTIVES AT A CONSOLIDATED UNITED-CONTINENTAL WILL ACT. BUT WE CAN EXAMINE HOW EXECUTIVES AT SIMILAR MERGED AIRLINES HAVE ACTED IN RECENT YEARS. THE HISTORICAL RECORD IS CLEAR: ONCE TWO MAJOR CARRIERS MELD THEIR OPERATIONS, SERVICE IS REDUCED, REDUNDANCIES ARE ELIMINATED, AND ONE OR MORE HUBS ARE SHUT DOWN. THIS WAS SHOWN RATHER DRAMATICALLY AFTER AMERICAN AIRLINES ACQUIRED THE ASSETS OF TWA IN 2001; TWA'S FORMER HUB IN ST. LOUIS IS RELATIVELY CLOSE TO AMERICAN'S HUBS IN CHICAGO AND DALLAS, AND THE AIRLINE COULD NOT AND DID NOT SUSTAIN ALL THREE HUBS. THE SERVICE REDUCTIONS IN ST. LOUIS WERE EXTENSIVE AND SEVERELY AFFECTED CONSUMERS, BUSINESSES, AND COMMUNITIES, NOT ONLY IN THAT METROPOLITAN AREA, BUT IN MANY OTHER COMMUNITIES WHERE SERVICE TO AND FROM ST. LOUIS WAS REDUCED OR CUT.

AS FOR UNITED-CONTINENTAL, IT SEEMS FAIR TO SURMISE THAT MAINTAINING TEN HUBS—EIGHT OF THEM WITHIN THE CONTINENTAL UNITED STATES—WILL BE A DAUNTING TASK IN THE YEARS TO COME. NO OTHER U.S. CARRIER WILL OPERATE THAT MANY HUB AIRPORTS. A CLOSER EXAMINATION OF THOSE EIGHT DOMESTIC HUBS (NEWARK; WASHINGTON, D.C.; CLEVELAND; CHICAGO; HOUSTON; DENVER; SAN FRANCISCO; AND LOS ANGELES) REVEALS THE

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GEOGRAPHICAL PROXIMITY OF CHICAGO AND CLEVELAND MAKES CLEVELAND PARTICULARLY VULNERABLE.

4. I am very concerned about air service to smaller markets outside the large hubs, such as many smaller communities in Wisconsin and the upper Midwest. How might this merger, or future airline consolidation, affect air service to smaller communities? And even if these communities have air service, will passengers have any choice of carriers?

THAT IS A VERY LEGITIMATE CONCERN. SMALL AND RURAL COMMUNITIES ARE AMONG THE MOST VULNERABLE AS THE AIRLINE INDUSTRY CONSOLIDATES AND THE NUMBER OF MAJOR LEGACY OR NETWORK CARRIERS IS REDUCED. FOR EXAMPLE, IN A PAPER EXAMINING THE PROPOSED UNITED-CONTINENTAL MERGER, AIRLINE ANALYST VAUGHN CORDLE OF AirlineForecasts STATES THE FOLLOWING: "Network airlines must be able to afford to fly the thinly populated short haul flights utilizing small regional jets if small communities are to continue to receive air transportation service. The low-cost airline model is not designed to service these small communities." MERGERS AMONG LEGACY AIRLINES LEAD TO REDUCTIONS IN SERVICE AND HUB CLOSURES, THEREBY THREATENING MANY SMALL AND RURAL COMMUNITIES.

THE CONTENTION THAT LOW COST CARRIERS WILL FILL SUCH A VOID IS ONLY PARTIALLY CORRECT. WHAT WE HAVE SEEN IS THAT LOW COST CARRIERS SUCH AS SOUTHWEST AND OTHERS HAVE ENTERED MARKETS WHERE LEGACY AIRLINES HAVE DOWNSIZED, BUT THEIR PRESENCE HAS NOT BEEN UBIQUITOUS. LOW COST CARRIERS TEND TO BE MUCH MORE SELECTIVE AND DELIBERATE ABOUT GROWTH AND USUALLY DO NOT SERVE SMALLER MARKETS. AGAIN, THIS MEANS A GREAT MANY SMALL AND RURAL COMMUNITIES ARE PARTICULARLY VULNERABLE.

5. Some airline industry critics argue that mergers such as United/Continental and Delta/Northwest make it very hard for smaller carriers to compete, especially for business customers. Among other things, they point out that the smaller carriers do not have extensive international route networks which therefore renders their frequent flyer programs less valuable. They also allege that large, networked carriers can use revenues from their lucrative international routes to "cross-subsidize" domestic routes. Revenue from international routes can be used to subsidize low fares on selected domestic routes in order to defeat smaller competitors.

What is your view of these arguments? Do mergers of large, networked carriers make it hard for small carriers to compete?

YES, MERGERS AMONG LARGER NETWORK AIRLINES AFFECT COMPETITION IN SEVERAL WAYS THAT ARE HARMFUL TO CONSUMERS, AS NOTED IN MY WRITTEN TESTIMONY. WHAT WE HAVE SEEN OVER THE YEARS IS THAT MAJOR LEGACY AIRLINES HAVE USED THEIR SIZE TO THWART NEW ENTRANT AIRLINES, PARTICULARLY LOW COST CARRIERS. ACCORDING TO A 2001 REPORT FROM THE U.S. GENERAL ACCOUNTING OFFICE NOTED THAT MAJOR AIRLINES "HAVE THE

OPPORTUNITY AND THE MEANS" TO PROTECT THEIR MARKET POWER BY FRUSTRATING NEW ENTRY. FURTHER, GAO CITED DOT ANALYSIS THAT FOUND INSTANCES IN WHICH INCUMBENT [LEGACY] AIRLINES DROVE NEW ENTRANTS OUT OF MARKETS BY CUTTING FARES AND FLOODING THE MARKET WITH CAPACITY, YET ONCE THE NEW ENTRANT WAS DRIVEN OUT OF THE MARKET, THE INCUMBENT SOUGHT AN INCREASE IN FARES AND REDUCTIONS IN SERVICE. IN ADDITION, THE GAO ALSO NOTED: "Low fare carriers are recognized as providing the primary fare discipline in the marketplace."

IN CONSUMERS UNION'S VIEW, FURTHER CONSOLIDATION AMONG LEGACY AIRLINES WILL ONLY INTENSIFY SUCH BEHAVIOR, MAKING IT HARDER FOR NEW ENTRANT COMPETITORS AND ULTIMATELY HARMING CONSUMERS.

June 18, 2010

Continental Response to Sen. Kohl's Follow-Up Questions for the Record in the Hearing "The United/Continental Airlines Merger: How Will Consumers Fare?"

To Jeffery Smisek

1. We've heard United and Continental state as a reason for this merger the very high costs (including fuel and labor) and capital expenditures required to run your airline. Yet during the hearing you also claimed that entry of new airlines was easy and that we didn't need to worry about any anti-competitive effects arising from the merger because of the likelihood of entry of new airlines. Glenn Tilton stated that "this is a hyper-competitive business with very, very low barrier[s] to entry." Aren't these two points – that airlines face very high fixed costs but that new entry is easy -- contradictory? How do you reconcile them?

High costs for network carriers like Continental and United and low barriers to entry in the airline industry are not contradictory because the likely new entrants have much lower cost structures than traditional network airlines. Operation of a hub-and-spoke route network that serves smaller cities and communities is more costly than the point-to-point service generally provided by low-cost carriers ("LCCs"). Moreover, a substantial majority of Continental's employees belong to unions and the cost of their wages and benefits generally is higher than that of employees at LCCs. Both lower costs and ease of entry are reflected in the significant growth of LCCs over the past ten years. Indeed, many LCCs have demonstrated not only that they can enter successfully but in many cases they can earn higher profits (or lose less money) than network carriers such as Continental and United.

The recent history of LCC entry demonstrates clearly that new airlines face low barriers to entry and expansion. Any airline with a presence at one end of an origin-and-destination city pair is a potential entrant onto that route. For example, since it began operations in 2000, JetBlue has grown dramatically and now provides service to 60 destinations in the U.S., the Caribbean, and Latin America. Likewise, since it began operations in 2007, Virgin America has already grown to provide service to 9 destinations across the United States. The strong, steady growth of LCCs during the last decade has fundamentally changed the competitive landscape of the airline industry. LCCs have nearly doubled their share of U.S. domestic passengers and now account for nearly 40% of domestic passenger share. In fact, Southwest Airlines now has the largest U.S. domestic passenger share of any airline and will continue in that position even after the merger.

The Continental-United merger will create a lower cost network carrier better able to compete with these new entrants. The combined Continental-United is expected to realize net cost-saving synergies of $200-$300 million per year. These cost savings will come mostly through reductions in overhead, such as rationalizing the two companies' information technology platforms, and combining facilities and corporate functions such as finance, marketing, sales, and advertising. In addition, the combined CO/UA will have

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one of the youngest and most fuel-efficient fleets among the major U.S. network carriers. This will result not only in greater fuel cost savings but in less environmental impact from our fleet.

2. Reuters reported that the CFO of American Airlines, Gerald Arpey, spoke publicly at a shareholders' meeting in May in support of the United/Continental merger. He stated that "A combined United/Continental would mean one fewer choice in the marketplace, and may result in a better balance between industry supply and demand, potentially resulting in a more rational competitive environment."

Do you agree with Mr. Arpey's comments, specifically that the merger would "mean one fewer choice in the marketplace"? And when he says that the merger would result in "a more rational competitive environment" isn't that just another way of saying that the merger would reduce price competition?

We do not agree with the comment that the Continental-United merger would "mean one [less] choice in the marketplace," or that air fares are likely to increase as a result of the merger. Continental and United have the most complementary route networks of any two U.S. network air carriers: the companies' hubs are geographically dispersed; each serves a large number of distinct destinations; and their networks present a very small number of overlapping nonstop routes. This network complementarity and geographic diversity mean the merger will create substantial service benefits for consumers with little operational redundancy.

As a result, the Continental-United merger will not mean the reduction of consumer choice – rather, it will mean more choices for passengers. Following the merger, 116 destinations will be new to either Continental or United passengers. New online travel choices will thus be available to any person travelling to or from these destinations. For example, after the merger a passenger will be able to fly from Tyler, Texas to Sydney, Australia on a single airline, a travel choice that was not available pre-merger.

United and Continental have no international nonstop overlaps, and of the thousands of routes that each individually serves, there is overlapping nonstop service on only 15 domestic routes. Competition is vigorous and new entry is likely on these primarily hub-hub routes. On each of these routes, after the merger, travelers would be served by at least one other carrier, but more often by several carriers. All but two of the overlapping routes are served by an LCC (including all hub-to-hub routes) and six are served by two LCCs. In the four 3-2 nonstop city pairs presented by the Continental-United merger, Southwest is an incumbent on three (and is larger than United) and Frontier is an incumbent on the fourth (and is larger than both Continental and United). LCCs have continued to enter and expand their presence in nearly 90% of the highest traffic routes served by the carriers, and this trend is expected to continue. Extensive competitive connecting service further constrains pricing on these routes. In fact, air

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fares have declined by more than 30 percent in real terms over the last decade and the combined Continental-United will compete with LCCs at all its hubs after the merger. The LCC presence alone is sufficient to ensure that airline pricing will remain disciplined by vigorous competition, and Continental does not believe that the merger can facilitate any price increases; indeed, none of the revenue synergies expected from the merger is modeled on a fare increase.

Finally, flight frequencies on these routes will not be reduced and likely will even increase after the merger due to larger traffic flows over the combined Continental-United network. Passengers thus will have more scheduling choices after the merger. Flight times on these routes also will be optimized so that business travelers will be able to choose from a better range of departure times. In sum, the Continental-United merger will enhance consumer choice by without threatening price competition among airlines.

3. We've heard the airlines argue that over the last decade, air fares have actually declined so that shows that the airline industry is highly competitive. Yet some wonder if this tells the whole story. Passengers now pay fees for services that ten years ago we all took for granted were free. On United, for example, it costs $60 to check two bags, $25 to make a reservation by phone, and $ 150 to change a previously purchased ticket. Will fewer competitive choices likely to cause these fees to become even higher?

Yes, fares have declined substantially, and they will not increase as a result of the merger. As discussed above, Continental believes there will be more, rather than fewer, competitive choices after the merger. For the same reasons that the Continental-United merger is not likely to affect prices, the merger is not likely to affect ancillary service fees. Ancillary fees simply are recognized by purchasers as part of the total price paid. Thus, for example, while Continental and United generally have instituted fees for ancillary services, other airlines such as Southwest have based entire advertising campaigns on the fact that they do not charge for checked bags.

We expect that improved connectivity and direct service options, as well as improved service for our customers, will enable the combined airline to generate substantial revenue synergies. None of these network synergies are dependent upon fare *or fee* increases. Indeed, even taking into account newer fees for ancillary services, the inflation-adjusted cost of air travel continues to decline.

4. Writing in USA Today on April 29, Bill McGee argued that mergers did not improve airlines' service, and, in fact, often result in worse performance. Airlines must merge differing aircraft fleets, personnel, and business models, often resulting in a sharp decline in quality and service. Mr. McGee pointed out that in 2001, TWA ranked second by the Transportation Department among all domestic carriers for on-time performance, while American ranked 7th. A year later the two airlines merged. In 2009, American ranked 16th for on-time performance. In 2005,

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America West ranked 4th in on time performance. It then merged with US Airways, and last year, the combined airline ranked 7th. Likewise, in 2005, America West ranked 11th for overall customer complaints; last year its successor US Airways ranked 17th.

In light of these statistics, how can you assure us that your merger will be different and that service will actually improve? Can you think of a single airline merger in which quality of service improved after the merger?

On-time performance is only one dimension of airline service quality, yet it is the subject of frequent expert statistical analysis. The issue is complex because many factors contribute to departure delays. Continental is aware of no study, however, that attributes decreases in on-time performance to industry mergers. Factors affecting delays include weather, airport congestion, air-traffic control, and regional carrier ownership structure, among others.

Consider Senator Kohl's US Airways-America West example. Before the parties' merger, most of America West's flights went through hubs in the good-weather cities of Phoenix and Las Vegas, where air-traffic congestion is also relatively favorable. On the other hand, US Airways operated primarily in the East Coast, where the weather is far more erratic and air-traffic control is much more complex and demanding. It should be no surprise that America West dropped in the rankings after merging with US Airways, since its own on-time statistics were subsequently combined with those of US Airways. There is no reason to believe that there has been any reduction in service quality on the routes previously operated solely by America West.

The combined Continental-United fleet should be able to optimize service with sufficiently common equipment to avoid on-time performance problems. The merger will combine Continental's excellent service, culture, and history with United's record for on-time performance to produce an even more service-oriented airline.

5. After the merger United and Continental will operate a total of eight hubs in the continental United States. Some industry observers believe that this is too many full-fledged hubs for the combined airline, and fear that it is inevitable that some will be closed or downsized once the merger is completed. Continental's Cleveland hub is thought by many to be in jeopardy, being relatively close to United's hub at Chicago.

(a) will you pledge that all the existing United and Continental hubs will be neither closed nor significantly downsized in the forseeable future?

(b) we've seen pledges in the past from airline CEOs not to close hubs when they are seeking approval of their mergers. For example, American closed the former TWA hub in St. Louis despite pledges to the contrary during its 2001 American/TWA merger, and Delta has significantly downsized its hub in Cincinnati

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despite its pledge to maintain its hubs during the review of the 2008 Delta/Northwest merger. Assuming your answer to part (a) is a promise not to close hubs, how can we count on this promise not to close hubs being adhered to this time? And how long are your promises good for?

The merger will produce synergies and increase the value of the combined network to consumers, which in turn will produce greater demand for the merged airline's hubs than if the two companies remained separate. When the merged airline optimizes schedules and fleets, Continental expects the enhanced efficiency and greater passenger connectivity at each hub to create opportunities for growth, not contraction. The new combined airline will be committed to continuing to work with the local business and civic communities of all of its hubs.

The airline industry nevertheless must continually manage external factors ranging from skyrocketing fuel prices to recession, and sudden shocks such as volcanoes and pandemics. As such, the merged carrier must maintain the flexibility in the long run to operate its business and make decisions – including the ability to grow, reduce or redeploy capacity – that enable it to compete successfully.

Finally, the comparison of Cleveland to Cincinnati is inapposite, as Delta's Cincinnati hub was significantly larger at the time of the Delta-Northwest merger than Continental's Cleveland hub is today. The merger of Continental and United has its own objectives, which are based on preservation and growth of the combined global network. Cleveland has been important in the Continental network for many years, and it will remain important in the merged airline's network.

6. I am very concerned about air service to smaller markets outside the large hubs, such as many smaller communities in Wisconsin and the upper Midwest. How might this merger, or future airline consolidation, affect air service to smaller communities? And even if these communities have air service, will passengers have any choice of carriers?

The Continental-United merger will benefit small communities, as the combined entity will be able not only to preserve but to enhance existing, extensive services to such communities. As network carriers, Continental and United have a long history of serving small- and medium-sized communities. For example, Continental's service to and from Houston has been instrumental to the growth of the 20 Texas communities it serves. Air travel opens up the world and provides business and leisure opportunities to all Americans, no matter where they live. Airlines often are the lifeblood of small communities, not only because of the economic benefits they provide, but due to their civic and charitable contributions and the volunteer activities of their employees. Both Continental and United are committed community partners with robust corporate contributions and responsibility programs and strongly support their employees' volunteer activities.

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The Continental-United merger will enable residents of small communities to connect through eight mainland domestic hubs and travel on to hundreds of destinations on thousands of routes worldwide. The combined airline will offer these travelers online access to 350 destinations in 59 countries. Following the merger, 93 of the 116 destinations that would be new to either Continental or United passengers would be small communities. Passengers from communities in Texas presently served by Continental, for example, will have new service on a single airline to all the destinations that United currently serves. Furthermore, none of the few routes on which Continental and United currently offer overlapping nonstop service involves a small community point, and thus there will be no reduction in carrier choices for small community passengers as a result of the merger.

When Continental and United announced the merger, we said we would continue to provide service to all of the communities our airlines currently serve, including 148 small communities and metropolitan areas. In fact, the merger is likely to enable service to additional destinations, for two reasons: (1) by improving connectivity at the hubs, the merger will increase demand on existing spokes, and (2) by improving efficiency and realizing synergies, the merger will increase the probability that we will add new spokes to new destinations.

7.(a) Some airline industry critics argue that mergers such as yours and the Delta/Northwest merger make it very hard for smaller carriers to compete, especially for business customers. Among other things, they point out that the smaller carriers do not have extensive international route networks which therefore renders their frequent flyer programs less valuable. They also allege that large, networked carriers can use revenues from their lucrative international routes to "cross-subsidize" domestic routes. Revenue from international routes can be used to subsidize low fares on selected domestic routes in order to defeat smaller competitors.

What is your response to these claims?

The argument of those critics does not comport with the facts. "Smaller" U.S. carriers actually are large domestic carriers by many measures, and these carriers have been growing rapidly while network carriers have not.

Indeed, Southwest Airlines is the largest U.S. airline measured by domestic passenger share; the merged Continental-United will rank only third with a domestic passenger share of 16%. Southwest, in fact, has a larger market cap than United, Continental, American, or US Airways. Many business passengers actually prefer Southwest to the traditional U.S. network carriers. JetBlue Airways and Frontier Airlines also have experienced significant recent growth.

U.S. domestic carriers without large international networks simply operate under different business models than Continental and United. The best example again may be Southwest Airlines. Although the Southwest business model does not depend upon a large international route network, it has been profitable where Continental and United

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have not. This is despite the lack of any "cross-subsidization" from international routes. The LCC experience has clearly demonstrated that smaller airlines can enter domestic routes, expand service, and often be more profitable than legacy carriers with international route networks.

Continental is proud of the fact that the new combined airline will provide better service and more options for its customers. The parties have predicted that the increased attractiveness of their complementary networks will drive more customers to fly on the combined network, and modeling indicates that this traffic flow will generate annual revenue synergies of close to $1 billion. Network airlines simply have something different to offer passengers than their allegedly "smaller," lower cost competitors, but the experience of the last decade has shown that "smaller" airlines can compete quite successfully utilizing their own business models. The low-cost carriers' growth has been strong and steady for over a decade, and the merger is unlikely to affect their growth.

7.(b) We've also heard that the large network carriers, when negotiating travel contracts with large corporations, will demand that the customer book all domestic travel with the network carrier in order to get a discount on international travel. This is a real disincentive for corporate customers to enter into travel contracts with small carriers. Does this occur and, if so, isn't this very destructive to competition?

The premise of this question is unsupported and, in Continental's experience, incorrect. Continental offers both joint and independent domestic and international packages to its corporate customers and may sometimes offer larger discounts to corporate customers booking a larger percentage of their total travel, both domestic and international, on Continental. Continental does not require corporate customers to commit to booking all domestic travel on Continental as a condition of receiving an international discount.

8. Many industry observers believe another major airline merger is likely in the next few years, perhaps involving American and US Airways. How likely do you believe that or another similar merger to be, and should it concern us if this deal leads to further consolidation?

Continental has no knowledge of any future domestic airline merger and cannot predict whether there will be one. Continental believes that each merger should be considered on its own merits under the applicable legal standards. Nevertheless, Continental notes that mergers are most beneficial when they combine largely complementary networks, and Continental-United combines the two U.S. network carriers with the most complementary route systems.

9. We have heard accusations from some small carriers that Continental is "warehousing" take-off and landing slots at Newark in order to keep competition

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out. Continental already has over 70% of the slots at Newark. In order to satisfy DOT rules that these slots are actually being used, your critics charge, Continental flys small turbo-props to small airports. This includes six daily turbo-prop flights to Raleigh/Durham, five daily prop flights to Norfolk, and four daily prop flights to Harrisburg, PA. Continental also flys turbo-props to major airports like Washington-Reagan National and Pittsburgh where the market would support flying larger jets. Competitors argue that these slots could be much better used by competitors flying jets to major routes, but that Continental's behavior keeps small carriers shut out of Newark.

What's your response? Does Continental "warehouse" slots at Newark in order to keep out competitors?

Consistent with our response to the concerns you expressed about airlines providing service to small communities in question 6, Continental is proud of the service it provides from Newark Liberty to the comparatively smaller communities of Raleigh/Durham, Norfolk, and Harrisburg. These flights provide residents in these communities with convenient access to New York City as well as access to Continental's extensive network at Newark with minimal layover times. One of the primary benefits of the network carriers' hub-and-spoke business model is that it incentivizes carriers to provide service to communities that otherwise might not have any service if all airlines relied on the point-to-point business model of LCCs. This is reflected by the fact that (1) none of the LCCs provide non-stop service between Norfolk and any of the New York City airports and (2) Continental is the only airline providing non-stop service between Harrisburg and any of the New York City airports. In contrast, LCCs more likely to provide point-to-point service on high-density routes such as New York City - Los Angeles, where there are 43 daily flights, over twelve of which are offered by Jet Blue and Virgin America. Although it is true that an airline could use a slot at Newark Liberty to offer an additional non-stop flight on a larger gauge aircraft between New York City and Los Angeles, Continental believes that the incremental public benefit of a 44th daily non-stop flight between New York City and Los Angeles is much less than the incremental public benefit of the non-stop flights that Continental currently provides to small communities such as Harrisburg.

The turbo-prop aircraft used to provide service to these communities have numerous benefits compared to regional jets. The Bombardier Dash 8 Q200 and Q400 used by Continental on the routes in question are more fuel efficient and spacious compared to 50-seat regional jets. With 74 seats, the Q400 used on the Norfolk route also offers more seating capacity than most regional jets. Moreover, the Q400 can land with greater tailwinds than regional jets. This characteristic is particularly beneficial at Newark Liberty because it has the potential to provide Air Traffic Controllers with greater flexibility when sequencing the landings of these turbo-craft aircraft, which in turn helps reduce congestion and delays at one of the country's busiest airports.

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In sum, Continental does not "warehouse" slots at Newark Liberty and fully abides by all FAA slot-use requirements. Continental's Newark Liberty slots are integral to its global network and to the multi-billion dollar investment that it has made at Newark Liberty; this investment has helped convert Newark Liberty into an important New York City gateway for domestic and international travel. Continental is proud of the thousands of jobs and extensive airline service it provides to the New Jersey / New York area as well as to small communities such as Harrisburg.

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RESPONSE FROM GLENN TILTON TO SENATOR KOHL'S FOLLOW-UP QUESTIONS FOR THE RECORD FOR THE HEARING "THE UNITED/CONTINENTAL AIRLINES MERGER: HOW WILL CONSUMERS FARE?"

1. We've heard United and Continental state as a reason for this merger the very high costs (including fuel and labor) and capital expenditures required to run your airline. Yet during the hearing you also claimed that entry of new airlines was easy and that we didn't need to worry about any anti-competitive effects arising from the merger because of the likelihood of entry of new airlines. You stated that "this is a hyper-competitive business with very, very low barrier[s] to entry." Aren't these two points – that airlines face very high fixed costs but that new entry is easy --contradictory? How do you reconcile them?

These propositions are not contradictory and are best explained by focusing on the tremendous growth of low cost carriers (LCCs) over the last decade. Industry-wide, LCCs now compete for 80% of all domestic travelers and Southwest has grown to become the largest domestic airline in terms of passengers. Several LCCs, such as JetBlue, AirTran, and Virgin America, successfully have entered the market in the past few years and their passenger shares have grown rapidly. LCCs are present at every one of United's and Continental's hubs and have market shares in our hub cities ranging from 28% in Cleveland to 50% in Denver and San Francisco. LCCs operate profitably at lower unit revenues than traditional network airlines, generally due to significant cost advantages related to a less costly point-to-point business model. Consequently, their presence limits the ability of higher cost network competitors to increase fares.

2. At the hearing I asked where the additional $ 800-900 [million] in "incremental annual revenues" that you claimed in your press release announcing the merger the combined airline would earn by 2013 would come from. You replied by describing "network efficiencies." But the press release speaks of $800-900 million in increased "revenues" not efficiencies. So what is the source of these increased "revenues" you claim are coming from the merger, separate and apart from any cost savings or efficiencies?

By bringing together two highly complementary route networks, this merger will give travelers expanded access to an unparalleled global network. It combines United's Midwest, West Coast, and Pacific routes with Continental's service in metropolitan New York, the East Coast, the South, Latin America, and across the Atlantic.

Customers will have access to 116 new domestic destinations; 40 will be new to United customers, and 76 will be new to Continental customers. The merger will create more than 1,000 new domestic connecting city pairs served by the combined carrier, providing additional convenience to customers.

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Our fully optimized fleets and routes will provide greater flexibility, options, connectivity, and convenience for customers. This improved connectivity and direct service options, as well as improved service, are expected to enable the combined airline to generate $800-$900 million in annual revenue from our improved network synergies – and – for the reasons explained in our response to the previous question – we expect to achieve these synergies without increasing fares.

Importantly, the combined airline will be better able to enhance the travel experience for our customers through investments in technology, the acquisition of new planes, and the implementation of the best practices of both airlines. The new airline will be more cost effective; we expect to realize net cost-savings synergies of $200-$300 million per year, mostly through reductions in overhead such as rationalizing our two information technology platforms, and combining facilities and corporate functions such as finance, marketing, sales, and advertising.

We will have one of the youngest and most fuel-efficient fleets among the major U.S. network carriers, as well as the flexibility to manage our fleet more effectively. With one of the best new aircraft order books in the industry, we also will be able to retire older, less efficient aircraft. This will result not only in greater efficiency but in less environmental impact from our fleet.

Once the merger is complete, customers also will participate in the industry's leading frequent flyer program, which will give millions of members more opportunities to earn and redeem miles than ever before. Through Star Alliance, the leading global alliance network, our customers will continue to benefit from service to more than 1,000 destinations worldwide.

3. Reuters reported that the CFO of American Airlines, Gerald Arpey, spoke publicly at a shareholders' meeting in May in support of the United/Continental merger. He stated that "A combined United/Continental would mean one fewer choice in the marketplace, and may result in a better balance between industry supply and demand, potentially resulting in a more rational competitive environment.

Do you agree with Mr. Arpey's comments, specifically that the merger would "mean one fewer choice in the marketplace"? And when he says that the merger would result in "a more rational competitive environment" isn't that just another way of saying that the merger would reduce price competition?

As discussed in previous questions, the changing dynamics of the airline industry have resulted in robust competition that maintains significant downward pressure on fares. With the changing industry landscape and the relative ease with which LCCs can enter into competition with network carriers and other LCCs, this merger will not result in a reduction in competition. There are only 15 overlapping non-stop domestic routes among the hundreds that we fly (and no overlapping international routes). The combined carrier's ability to raise prices on any individual overlapping route is constrained because

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each has current non-stop competitors. Moreover, extensive competitive connecting service further constrains pricing.

In addition, through the combination of two highly complementary route networks, customers will have access to 116 new domestic destinations; 40 will be new to United customers, and 76 will be new to Continental customers. The merger will create more than 1000 new domestic connecting city pairs served by the combined carrier, providing additional convenience and choices to customers. We also expect the merger to result in increased frequencies and more optimal routings for consumers -- expanding choice.

4. We've heard the airlines argue that over the last decade, air fares have actually declined so that shows that the airline industry is highly competitive. Yet some wonder if this tells the whole story. Passengers now pay fees for services that ten years ago we all took for granted were free. On United, for example, it costs $ 60 to check two bags, $ 25 to make a reservation by phone, and $ 150 to change a previously purchased ticket. Will fewer competitive choices likely to cause these fees to become even higher?

Even when one takes into account fees for services, commonly referred to as ancillary fees, the average cost to a passenger of air travel, adjusted for inflation, has steadily declined over the last two decades, so that it now costs approximately 60% of the 1990 price. Ancillary fees are subject to the same market pressures as other aspects of air travel. The merger of United and Continental is not going to reduce the vigorous competition in the industry; indeed we have significant LCC competitors at each and every one of the eight domestic hubs -- including those who seem to be building their advertising campaigns around the fact that they don't charge baggage fees. Just as this merger is not likely to impact prices, it is not likely to impact ancillary fees.

5. Writing in USA Today on April 29, Bill McGee argued that mergers did not improve airlines' service, and, in fact, often result in worse performance. Airlines must merge differing aircraft fleets, personnel, and business models, often resulting in a sharp decline in quality and service. Mr. McGee pointed out that in 2001, TWA ranked second by the Transportation Department among all domestic carriers for on-time performance, while American ranked 7th. A year later the two airlines merged. In 2009, American ranked 16th for on-time performance. In 2005, America West ranked 4th in on time performance. It then merged with US Airways, and last year, the combined airline ranked 7th. Likewise, in 2005, America West ranked 11th for overall customer complaints; last year its successor US Airways ranked 17th.

In light of these statistics, how can you assure us that your merger will be different and that service will actually improve? Can you think of a single airline merger in which quality of service improved after the merger?

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United and Continental have both made significant operational improvements. United now ranks as the leading U.S. global airline in on-time performance as measured by the Department of Transportation, and Continental is regularly recognized in independent surveys for the high quality of its customer service. Additionally, our alliance relationship has given each airline the opportunity to know and partially integrate the systems practices and procedures of the other. We expect to adopt the best aspects of each company's culture and practices. We are confident that we can integrate our operations fairly, effectively and efficiently once the merger closes.

6. After the merger United and Continental will operate a total of eight hubs in the continental United States. Some industry observers believe that this is too many full-fledged hubs for the combined airline, and fear that it is inevitable that some will be closed or downsized once the merger is completed. Continental's Cleveland hub is thought by many to be in jeopardy, being relatively close to United's hub at Chicago.

(a) will you pledge that all the existing United and Continental hubs will be neither closed nor significantly downsized in the foreseeable future?

(b) we've seen pledges in the past from airline CEOs not to close hubs when they are seeking approval of their mergers. For example, American closed the former TWA hub in St. Louis despite pledges to the contrary during its 2001 American/TWA merger, and Delta has significantly downsized its hub in Cincinnati despite its pledge to maintain its hubs during the review of the 2008 Delta/Northwest merger. Assuming your answer to part (a) is a promise not to close hubs, how can we count on this promise not to close hubs being adhered to this time? And how long are your promises good for?

The merger will produce synergies and will increase the value of the network to consumers, which in turn will produce greater demand for the merged airline's hubs than if the two companies remained separate. When schedules and fleets are optimized by the merged airline, the enhanced efficiency and greater passenger connectivity at each hub will create opportunities for growth, not contraction. We are committed to continuing to work with the local business and civic communities of all of our hubs in order to understand the strength and market demands of each.

When we announced the merger, we said we would continue to provide service to all of the communities our airlines currently serve, including 148 small communities and metropolitan areas. This service enables residents of small communities to connect through our eight mainland domestic hubs, and travel on to hundreds of destinations on thousands of routes worldwide. The combined airline will offer these travelers access to 350 destinations in 59 countries.

Our industry must continually manage external factors ranging from skyrocketing fuel prices, to recession and pandemics. As such, we must maintain the flexibility to

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operate our business and make decisions – including the ability to grow, reduce or redeploy capacity – that enable us to compete successfully.

7. I am very concerned about air service to smaller markets outside the large hubs, such as many smaller communities in Wisconsin and the upper Midwest. How might this merger, or future airline consolidation, affect air service to smaller communities? And even if these communities have air service, will passengers have any choice of carriers?

This transaction will enhance and stabilize service to small communities and small metro areas. A difficult operating environment over the past decade, has forced some network carriers to reduce service to some small communities and small metro areas. This led to a significant contraction of service, leaving many communities with a single carrier -- or even, in several places, with no carrier at all.

The merger will reverse this contraction. The combined airline would add new online service and new destinations for small communities. Most of the 1,000 new online city-pair routes that would be created by the merger are comprised of small community and small metropolitan areas. This additional connectivity increases the options for consumers in these areas to fly to more places. For example, United serves Eau Claire, Wausau, and Appleton; Continental does not. Post-merger these consumers will have online service to scores of Continental destinations currently without any United presence.

8. (a) Some airline industry critics argue that mergers such as yours and the Delta/Northwest merger make it very hard for smaller carriers to compete, especially for business customers. Among other things, they point out that the smaller carriers do not have extensive international route networks which therefore renders their frequent flyer programs less valuable. They also allege that large, networked carriers can use revenues from their lucrative international routes to "cross-subsidize" domestic routes. Revenue from international routes can be used to subsidize low fares on selected domestic routes in order to defeat smaller competitors.

What is your response to these claims?

In terms of scale, many LCCs are not "smaller." Southwest, for example, has the largest domestic passenger share of any U.S. carrier, and is larger in terms of market capitalization, than many network carriers, including United, Continental, American, and US Airways. This still will be true after the merger. Other LCC carriers, such as the now-merged Frontier/Midwest, and JetBlue, have shown phenomenal growth in recent years. There can be no doubting that these "smaller" carriers are here to stay, and we welcome their competition. As for "cross-subsidization," it is important to note, again, the differences in the network and LCC business models. By eschewing small communities as well as international routes, domestic LCCs have been able to focus on

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the largest domestic routes with high profit margins. Network airlines, like United and Continental, provide scores of communities more online access to domestic hubs and global networks with varying profitability. By combining complementary networks, United and Continental will be able to provide benefits in service and efficiency that will attract consumers and thus support the enhancement of small-community service.

(b) We've also heard that the large network carriers, when negotiating travel contracts with large corporations, will demand that the customer book all domestic travel with the network carrier in order to get a discount on international travel. This is a real disincentive for corporate customers to enter into travel contracts with small carriers. Does this occur and, if so, isn't this very destructive to competition?

United Air Lines does not impose requirements that customers must book all their domestic travel with us in order to get international travel discounts. We are pleased to offer substantial discounts to corporate or institutional customers who book large amounts of their travel through us, and we offer a wide variety of deals to attract such customers.

9. Many industry observers believe another major airline merger is likely in the next few years, perhaps involving American and US Airways. How likely do you believe that or another similar merger to be, and should it concern us if this deal leads to further consolidation

Any proposed merger needs to be judged on its own merits. We are not able to offer a view as to whether there will be additional consolidation. If there are future transactions between different parties, we would expect that they would be analyzed with regard to their level of complementarity or overlap, and their consumer benefits. It may well be the case that another transaction in the future could present competitive issues. This one, between United and Continental, does not.

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SUBMISSIONS FOR THE RECORD

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The United/Continental Airlines Merger: How Will Consumers Fare?

BEFORE
THE SENATE JUDICIARY COMMITTEE
SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS

ON

May 27, 2010

I. INTRODUCTION

Mr. Chairman, Ranking Member Hatch, and other distinguished members of the Judiciary Committee Antitrust Subcommittee, I want to thank you for giving me the opportunity today to speak about the potential anticompetitive effects inherent in a new wave of consolidation that may be spurred by the proposed merger of Continental Airlines and United Airlines. I speak today on behalf of myself and the American Antitrust Institute,[1] based upon my experience as an Antitrust Division trial attorney focused on deregulated industries, as an economist, and as a law professor whose research and writing has focused on antitrust issues arising in the context of regulated/deregulated industries, including airlines.[2]

[1] Per University of Houston guidelines, the views I express here do not purport to reflect those of the University of Houston system and should not be construed as reflecting the position of the University of Houston or the State of Texas. The American Antitrust Institute is an independent, non-profit 'virtual network of experts' whose website is www.antitrustinstitute.org.

[2] The term "deregulation" is a bit of a misnomer. See Harry First, *Regulated Deregulation: The New York Experience in Electric Utility Deregulation*, 33 LOY. U. CHI. L. J. 911 (2002)(noting that New York's electricity market was not deregulated, but in fact replaced "one regulatory system with another.").

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It has been approximately two years since this Committee held a similar hearing on the merger of Delta Air Lines and Northwest Airlines.[3] Since that hearing, little has changed for the better in the airline industry, except that the pressure to consolidate has increased in the wake of this previous merger, and the pending transaction reflects what I believe to be the start of yet another airline merger wave.

The substance of my testimony is divided into four parts. Part II of my testimony examines what I think are the *potential* anticompetitive harms of the transaction. This section should be treated not as an indictment of the transaction, but as a guide to issues I think key in determining when the effect of such merger "may be substantially to lessen competition, or to tend to create a monopoly."[4] Part III addresses what I believe are the key *potential* benefits of the transaction. Part III strongly cautions against interpreting the antitrust laws as allowing mergers because of a wrongly yet widely held belief that efficiencies generally, even if not fully evidenced, somehow should be a trump card which enables a proposed merger to fly despite antitrust review even when the transaction raises serious anticompetitive issues. Part IV offers speculation as to the reason behind the transaction, and the problems associated with the mindset that mergers and acquisitions resolve issues caused by uncertainty in input markets and economic factors as a whole.

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[3] *An Examination of the Delta-Northwest Merger*, hearing before the U.S. Senate Judiciary Subcommittee on Antitrust, Competition Policy, and Consumer Rights, April 24, 2008, available at http://judiciary.senate.gov/hearing.cfm?id=3307. See also Also see Testimony of Albert A. Foer, AAI, at http://www.antitrustinstitute.org/archives/files/TESTIMONY%20Delta-NW%20AAI%20%205-14-08_051420080959.pdf.

[4] 15 U.S.C. § 18.

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II. WHAT ARE THE ANTICOMPETITIVE EFFECTS OF THE MERGER?

a. Nonstop Competition Is Potentially Injured

The first question that must be addressed is whether the proposed merger will be harmful to consumers. The standard antitrust answer to this question is a complicated analysis to determine the relevant market in which the merging parties overlap, the concentration within that market, the likely anticompetitive effects that arise due to the proposed merger within the relevant market, and whether entry mitigates the injury to consumers caused by those anticompetitive effects or whether efficiencies outweigh the anticompetitive effects to such a degree as to justify the transaction. This classic analysis embedded in the Department of Justice/Federal Trade Commission Horizontal Merger Guidelines is the standard tool of antitrust analysis within the agencies.[5]

The relevant market traditionally examined in airline mergers is the non-stop city-pair or airport-pair market. These routes are usually examined first in any merger of major carriers because hub-to-hub routes between competitors are commonly duopoly routes served only by the merging parties, or, in some circumstances, the routes are served by an additional nonstop competitor such as a low cost carrier. For example, in the Department of Justice's Press Release discussing the threatened challenge of the United's acquisition of U.S. Airways,[6] the press release noted that these two carriers, the second and sixth largest at the time, would create "a monopoly or duopoly on nonstop service on over 30 routes."[7] Additionally the press release stated that, "US Airways is

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[5] U.S. Dep't of Justice & FTC, Horizontal Merger Guidelines (1992), available at http://www.usdoj.gov/atr/public/guidelines/hmg.htm (hereafter Horizontal Merger Guidelines). The recently published draft revised guidelines do not change this.

[6] http://www.usdoj.gov/atr/public/press_releases/2001/8701.htm. The proposed merger was abandoned due in large part to the Department of Justice's threatened suit.

[7] *Id.* The DOJ's analysis should be compared with its press release in the Northwest/Delta merger. This will be discussed infra.

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United's most significant competitor on densely-traveled, high revenue routes between their hubs, such as Philadelphia and Denver, as well as for nonstop travel to and from Washington D.C. and Baltimore, and on many routes up and down the East Coast."[8]

Similarly there are issues with respect to nonstop routes served by Continental and United. For instance, at the very least, the Antitrust Division will likely examine the overlap between United and Continental on nonstop hub to hub routes. In particular, the routes that are problematic are: 1. Cleveland-O'Hare; 2. Cleveland-Denver; 3. Cleveland-Dulles; 4. Cleveland-San Francisco; 5. Cleveland-LAX; 6. Houston Intercontinental-Denver; 7. Houston Intercontinental – O'Hare; 8. Houston Intercontinental – Dulles; 9. Newark-O'Hare; 10. Newark-Denver; 11. Newark-Dulles; and 12. National Airport-O'Hare.[9] Hawaiian and international markets may be implicated as well in this transaction, in particular flights from Los Angeles to Honolulu.

b. Competition on a Connection Basis May Be Potentially Injured

The next issue typically raised by airline mergers is whether or not the combined firm will operate the bulk of hubs providing connecting service between cities in the Midwest and the Eastern United States. Only certain connections make sense, depending on geography. The more circuitous the route, the more expensive the ticket and the less likely that option will be chosen even among passengers who do not have the ability to enjoy nonstop service. For example, connections from origins or destinations east of

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[8] *Id.*

[9] The airport pairs I list above have, in many instances, close-in airports which may serve as substitutes for *some* passengers. For example, Midway Airport may be a substitute for some classes of customers for flights to O'Hare. However, for some classes of customers, such as time-sensitive business passengers, such airports may not be acceptable substitutes. In some instances, however, close-in airports would need to be considered in the analysis. For example, Washington-Dulles and National Airport may be close substitutes. Thought would have to be given to JFK/La Guardia/Newark with respect to the New York City metropolitan area.

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Colorado in the Midwest to East coast destinations may only have as reasonable connections options the hubs of the merging firms or the hubs of Northwest/Delta. In other words, after the merger of Northwest and Delta, consumers in the Midwest may face increasingly limited choices—mainly between Northwest/Delta and United/Continental in terms of connecting from the Midwest heading eastbound. These two entities would have hubs at O'Hare, Cleveland, Cincinnati, Minneapolis/St. Paul, Memphis and Detroit.

The potential injury to connection markets is also potentially true on the eastern seaboard, where reasonable connections up and down the east coast are potentially reduced to three airlines (U.S. Airways out of Charlotte and Philadelphia, United/Continental out of Newark and Dulles, and Delta/Northwest out of New York).

c. The Two Carriers Are Potential Competitors

In other markets, United and Continental may be potential competitors[10] in hub to hub routes. One example might be Los Angeles – Houston, where United might have provided nonstop service. The threat of that potential nonstop service may in some cases be sufficient to provide a competitive response on the route even though United is currently not providing the service. In addition, there are numerous potential competition opportunities in connection markets.

[10] *See* Darren Bush and Salvatore Massa, *Rethinking the Potential Competition Doctrine*, 2004 WIS. L. REV. 1035.

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d. Competition for Contracts May Be Injured.

As the government stated in its press release concerning United/U.S. Airways, major airlines bid for high volume contracts with large corporations, "negotiating discounts to their airfares in return for a corporation's commitment to concentrate travel on the airline."[11] United and Continental may compete vigorously with each other for these contracts, particularly when the corporation requires significant travel on nonstop routes where the companies compete. Moreover, the sheer size of the combined system may make it more difficult for smaller carriers to compete for those contracts.

e. The Combination May Foreclose Downstream and Upstream Markets

Airlines may be less vertically integrated than in the past, with airlines outsourcing maintenance and other items not core to their business. However, there are still vertical implications for any merger in the airline industry. Specifically, care must be taken to examine the nature of any contract vital to the core function of providing air passenger service. In particular, contracts between the merging parties and vendors and suppliers should be examined to determine whether there is the potential that the combined firm could foreclose competitors from obtaining vital services.

As an example, the combined firm would potentially have the ability to eliminate downstream marketers and other product offerings, focusing customer attention solely to its website. It could, for example, fully withdraw from offering products to Orbitz, Expedia, and other online travel sites, or at least secure more favorable terms from them. It could also, for example, eliminate bundled offerings with some partners (such as hotel-

[11] http://www.usdoj.gov/atr/public/press_releases/2001/8701.htm.

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airfare vacation bundles), or at least renegotiate more favorable terms that might not have been obtained if competition had remained the status quo.

The upshot is that sellers in downstream and upstream markets will have fewer buyers to whom they can sell services. Hence, where buyers are few, they have reduced bargaining power, distorting market competition.

f. Follow-on Mergers May Lead to Further Anticompetitive Issues

I stated, apparently correctly, during my testimony concerning the Northwest/Delta merger that the merger may lead to follow-on mergers, and the one most contemplated in the popular media at the time was a merger between United and Continental. Follow-on mergers occur because the competitors of the merging parties perceive that there is some potential advantage to merger and consolidation, regardless of the veracity of that notion.

Once an industry is concentrated, follow-on mergers raise serious issues, including further reduction in nonstop and connect service along the lines described above. While this hearing is not explicitly about mergers not yet announced, it is important to keep in mind that such mergers are likely. Follow-on mergers raise other concerns not previously addressed in this statement.

It is important that the Department of Justice and anyone wanting to understand antitrust law understand the plans and motivations for follow-on mergers. Follow-on mergers in times of industry distress (perceived or actual) are almost inevitable. Such an understanding is particularly important where the industry in question is a network industry such as airlines, where firms not only compete head to head on a nonstop basis,

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but where the systems as a whole serve the basis of competition. It is unclear to me how five systems will offer consumers better service when it seems impossible in an already highly concentrated market for the airlines to do so.

g. Entry by Low Cost Carriers Will Not Cure These Effects

Low cost carrier [LCC] entry will be unlikely to cure the most egregious anticompetitive effects of the merger. As the American Antitrust Institute pointed out in its white paper concerning the Northwest/Delta transaction:

> Empirical evidence supports the notion that LCCs could be expected to serve as a competitive constraint only on high-density routes. LCC entry into smaller markets served more efficiently by hub-and-spoke networks of the legacy carriers like Delta and Northwest would undermine the cost-effectiveness of their existing point-to-point networks. Delta/Northwest are thus unlikely to face a competitive threat from LCCs on more thinly-traveled routes. And on high-density routes, the proposed merger creates the most egregious increases in concentration, making entry on a viable scale by LCCs that do not currently operate in those markets even less probable (and less attractive). Moreover, there is a compelling argument that because airlines face each other in several markets, the fear of retaliation in one market diminishes the incentive to compete vigorously in another.[12]

This argument applies with equal veracity to the United/Continental merger. Moreover, should an LCC enter a route in which the combined carrier holds monopoly power, there is great risk that the incumbent carrier will match the LCC's fares and add capacity to the route, eliminating the ability of the LCC to exceed or even achieve break even load factors such that the LCC will be profitable on the route.[13]

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[12] AMERICAN ANTITRUST INSTITUTE, THE MERGER OF DELTA AIR LINES AND NORTHWEST AIRLINES: AN ANTITRUST WHITE PAPER 18 (2008).
[13] United States v. AMR Corp., 140 F. Supp. 2d 1141 (D. Kan. 2001), *aff'd*, 335 F.3d 1109 (10th Cir. 2003).

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III. WHAT ARE THE BENEFITS OF THE MERGER?

a. Cost Savings or Market Power?

According to United and Continental's press release:

> The merger is expected to deliver $1.0 billion to $1.2 billion in net annual synergies by 2013, including between $800 million and $900 million of incremental annual revenues, in large part from expanded customer options resulting from the greater scope and scale of the network, and additional international service enabled by the broader network of the combined carrier. Expected synergies are in addition to the significant benefits derived from the companies' existing alliance and expected from their future joint venture relationships. The combined company is also expected to realize between $200 million and $300 million of net cost synergies on a run-rate basis by 2013. One-time costs related to the transaction are expected to total approximately $1.2 billion spread over a three-year period.[14]

The language of the press release is interesting. Ordinarily, one speaks of efficiencies in terms of reducing costs. However, the benefits arising from cost cutting are pegged by the companies at around $200- $300 million. By far the larger portion purportedly will arise from some revenue enhancements related to the scope and scale of operations.[15] It is difficult to determine from the press release how these efficiencies will miraculously appear, particularly as it does not appear from the merger website that the company anticipates closing any hubs.[16]

However, it is possible to speculate as to the efficiencies which might be obtained from the transaction. The first potential efficiency might arise from the rationalization of the combined firm's fleets. For example, Delta and Northwest argued that the nature of

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[14] Available at http://www.unitedcontinentalmerger.com/press-release.
[15] See http://www.unitedcontinentalmerger.com/press-release.
[16] As I point out *infra*, the antitrust enforcement agencies do not view anticompetitive reductions in output or service and accompanying increases in fares as "efficiencies." Instead, they are redistributions of wealth from consumers to the firm with monopoly power.

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Delta and Northwest's aircraft size were different, with Delta having more mid-range capacity and Northwest having low and large capacity aircraft. With complementary fleets, the merged firm could "right-size" aircraft on routes, allowing the proper capacity to meet demand.

More questions must be asked concerning this type of proposed efficiency. Have the airlines been buying the wrong gauge of equipment such that they have been mismanaging capacity on their routes? Is it not possible for the airline companies to rationalize their fleets absent the merger? In which routes are capacity mismatched with demand? With respect to the last question, one might argue that the greatest benefits might arise from international route capacity rationalization. However, such an efficiency gain does not cure a loss of competition in United States nonstop and connect markets.

A second potential efficiency, one seemingly argued in the United/Continental press release, arises from an airline industry specific phenomenon. It could be argued that network airlines are trying to reach optimum scope or "presence" not yet achieved by their already enormous size, allowing them to broaden their network in any given market so they can provide more destinations to the traveling public served by the system. The argument suggests both a gain in terms of presence within particular routes and over the system as a whole.[17]

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[17] "As for service, [Continental CEO] Smisek said the new United will focus on increasing the number of business-class travelers, since they pay more for their airline tickets and bring in more revenue. But this will not be at the expense of the everyday people who fly coach, he said." *CEO: United-Continental Deal Won't Mean Fare Hikes*, available at http://cbs2chicago.com/business/united.continental.merger.2.1673675.html. This statement suggests that somehow the merged airline will be able to yield manage such that business passengers will elect to pay even higher fares without concern that those passengers will take advantage of other fare classes. Ordinarily, airlines limit lower classes of fares to avoid such "spill" from higher fare categories.

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The problems with this assertion are manifold. To begin, it is not entirely clear how this strategy translates to any efficiencies or cost savings, apart from the fleet rationalization argument described above. To the extent that the argument involves tightly run hubs yielding efficiencies, the argument should be treated with caution. As the American Antitrust Institute properly pointed out in its white paper on the Northwest/Delta merger:

> Past a certain point . . ."hubbing" can neutralize or even negate economies of density. For example, bigger networks create peak-load problems because network effects encourage a hub carrier to bunch its flights at peak times. This increases the disparity during the day in the number of arrivals and departures and creates problems for efficient staffing of gate, ticket, and maintenance personnel. Bunching of flights at hubs occurs even at the cost of additional delays to a carrier's own flights and is the largest contributor to air traffic congestion. Indeed, empirical research demonstrates that as networks become larger (e.g., through merger), economies of scale and scope begin to diminish.[18]

In short, the efficiency argument here requires greater specificity. At its inception it is at best is illusory and ephemeral.

But the real concern is that the presence and accompanying revenue effect relates to the monopoly power of the combined entity post merger. With a reduction in network carrier competition, the only competitors capable of mitigating potential monopoly power on particular city-pair routes are low costs carriers.[19] The problem is that the very "efficiencies" described by this theory are substantial barriers to entry for any non-network competitor. [20] In other words, that which purportedly makes the airlines stronger

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[18] AMERICAN ANTITRUST INSTITUTE, THE MERGER OF DELTA AIR LINES AND NORTHWEST AIRLINES: AN ANTITRUST WHITE PAPER 14 (2008).

[19] *See* U.S. GEN. ACCOUNTING OFFICE, AIRLINE INDUSTRY: POTENTIAL MERGERS AND ACQUISITIONS DRIVEN BY FINANCIAL AND COMPETITIVE PRESSURES 39 (2008) [hereinafter AIRLINE INDUSTRY GAO REPORT.

[20] The carriers are asserting an economy of scope that is not exhausted unless a carrier gets at least as big as the combination of United and Continental. Moreover, the purported efficiency gain is not through direct cost reduction, but through enhanced benefits to consumers due to network interconnections that can only

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also kills competitors and presumably results in higher prices and less competition. Thus, such combinations do not yield "efficiencies" in the Department of Justice/Federal Trade Commission Horizontal Merger Guidelines sense of the term.[21]

As with all mergers, unless more concrete and tangible information is provided, the only realistic efficiency is the reduction in management and staff. The problem is that there is a rich history of airline mergers. There is little history of, in spite of these transactions in the past, the airline industry improving profitability.[22] The default position for the government, therefore, should be that efficiencies must be proven, not merely asserted.[23] As I will discuss in the next section, I have come to question whether that is what occurs in reality, particularly in industries which are prone to distress.

b. "Efficiencies" Analysis Is King, To the Detriment of Consumers

As the Department of Justice/ Federal Trade Commission Horizontal Merger Guidelines state,[24] merger specific efficiencies do not arise from anticompetitive reductions in output or service; and are cognizeable.[25] If the efficiencies "likely would be

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be captured if the carriers are merged (an alliance isn't enough). The empirical predicates for these claims are unproven and theoretically highly questionable for the reasons set forth in the prior discussion.

[21] My concern is exacerbated when competitors of the merging parties endorse the transaction. "'It makes the industry more efficient. We end up with less fragmentation. It makes the industry stronger and therefore makes US Airways stand-alone stronger,'' [U.S. Airways CEO] Parker said." *U.S. Airways CEO Supports UAL/CAL Merger*, available at http://news.airwise.com/story/view/1274229288.html. Efficiencies in one system do not transfer to that of a competitor. Therefore, the only benefit that U.S. Airways would obtain is from reduced competition and the associated reduction in capacity.

[22] *See* GAO REPORT at 1.

[23] While Delta operated at a loss in 2009, some other carriers are seeing a more rapid return to profitability. Southwest and Continental, for example, were reporting positive profits in the fourth quarter of 2009.

[24] "The Agency will consider only those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects. These are termed merger-specific efficiencies. Only alternatives that are practical in the business situation faced by the merging firms will be considered in making this determination; the Agency will not insist upon a less restrictive alternative that is merely theoretical." Horizontal Merger Guidelines, Section 4.

[25] Id.

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sufficient to reverse the merger's potential to harm consumers in the relevant market, e.g., by preventing price increases in that market,"[26] they are relevant for purposes of determining the net effect of the transaction. However, "the Agency will not simply compare the magnitude of the cognizable efficiencies with the magnitude of the likely harm to competition absent the efficiencies."[27]

This recitation of the Horizontal Merger Guidelines is important because, in my opinion, it has recently been the case in much of antitrust law that efficiencies have been a trump card, allowing transactions to proceed and anticompetitive conduct to continue even where efficiencies are speculative at best. It should not be the case, given the serious potential for anticompetitive harm in these markets that the purported efficiencies are taken at face value. Any purported efficiencies should meet the requirement that they are cognizeable, verifiable, merger-specific, and not obtainable via alternatives less restrictive to competition.

As evidence to support my concern, one need only compare the Department of Justice's (DOJ) press release in the proposed United/U.S. Air merger to its press release in the Northwest/Delta merger. In the former case, the DOJ's concerns[28] were hub-to-hub nonstop markets, particularly DC/Baltimore nonstop markets, as well as east coast connect markets. The DOJ also raised concerns in the press release as well over

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[26] Id.
[27] Id.
[28] Press Release, Department of Justice – Antitrust Division, Department of Justice and Several States Will Sue to Stop United Airlines from Acquiring US Airways: Deal Would Result in Higher Air Fares for Businesses and Millions of Consumers (July 27, 2001), http://www.usdoj.gov/atr/public/press_releases/2001/8701.htm.

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international routes, corporate and business arrangements, and enhanced dominance in airline service in general.[29] The press release did not mention efficiency claims.

In contrast, in its press release in Delta/Northwest, the DOJ stated that the "two airlines currently compete with a number of other legacy and low cost airlines in the provision of scheduled air passenger service on the *vast majority of nonstop and connecting routes* where they compete with each other."[30] The implication of this statement was that in some markets there would be a substantial loss of competition, but the DOJ statement never identified how many or which markets were to be sacrificed for the sake of "efficiencies." The press release continued "In addition, the merger *likely* will result in efficiencies such as cost savings in airport operations, information technology, supply chain economics, and fleet optimization that will benefit consumers. Consumers are also likely to benefit from improved service made possible by combining under single ownership the complementary aspects of the airlines' networks."[31]

The difficulty with the press release is that it lacks sufficient information to determine upon what information the DOJ relied in rendering its decision. It also makes the efficiencies seem speculative and dubious, or at the very least vague. However, if the efficiencies were as purported by the CEOs of the companies in the press and to this Committee, there is much reason to believe that the DOJ's examination appears to have ignored anticompetitive effects that might occur in the remainder of the nonstop markets in which they compete and instead focused on the efficiencies that might never occur.

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[29] *Id.*
[30] *Delta Airlines and Northwest Airlines Merger Approved*, Oct. 29, 2008, http://pressmediawire.com/article.cfm?articleID=19588.
[31] *Id.*

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The result is an incipiency standard turned on its head. In other words, instead of saying that a merger that might lead to less competition must be halted, the DOJ seems to be saying in some instances that a merger that might lead to more efficiency must be approved. Mergers in industries under distress or in the face of broader economic crisis appear to yield fewer questions from enforcement agencies in the moment about future anticompetitive effects while efficiencies are more heavily weighed. Yet the history of airline mergers already teaches us the outcome. Airlines have consolidated but have not improved profitability.[32] The passenger flying experience is at an all-time low,[33] and passengers are seeking legislative protections that might otherwise not be required were competition effective.[34] In short, the cycle of consolidation, crisis, consolidation continues in the airline industry.[35]

What may explain this apparently inconsistent result? If, as the foregoing analysis has demonstrated, the dominant incumbent airlines are able, by use of their networks and differential prices, to exclude more efficient new entrants, then, what we would observe is markets with firms, i.e., the dominant airlines, barely breaking even and more efficient rivals excluded. What this shows is that evidence of current or even projected price-cost relationships may not indeed reveal the likely competitive effects of

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[32] Dempsey, *infra* note 35, at 432-34 (detailing the economic history of the airline industry and its corresponding lack of profitability).

[33] See http://businesscenter.jdpower.com/news/pressrelease.aspx?ID=2009121. *See also* Jad Mouawad, *In United-Continental Deal, Birth of A Behemoth*, available at http://www.nytimes.com/2010/05/04/business/04air.html. ("[CEO Smisek] has started charging for exit-row seats, eliminated Continental's free food on domestic flights and quickly matched a bag fee increase that Delta Air Lines introduced. He has also criticized as "inane" the new federal rule imposing fines for tarmac delays of more than three hours and compared Continental's previous membership in the SkyTeam alliance, where Delta Air Lines was the dominant carrier, as "a lot like being married to a woman who wants to poison your food.")

[34] *See id.*

[35] Paul Dempsey's work has demonstrated that, despite increased consolidation, the industry is worse off than ever. *See* Paul Dempsey, *The Financial Performance of the Airline Industry Post-Deregulation*, 45 HOUS. L. REV. 421 (2008).

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a merger. In the case of airlines, to be specific, the continued mergers among the historic firms appear as much intended to concentrate market power among an increasing small group of inefficient firms as to advance any kind of legitimate goals. Yet, the potential for such firms to retain over a long period of time dominance is also a real and substantial risk because as dominance increases the capacity of potential entrants to enter and compete successfully will diminish.

IV. WHAT IS THE REAL REASON FOR THIS MERGER?

A second consideration that is not addressed seriously under modern antitrust analysis is the purpose of the merger. While outsiders lack the inside understanding of the United or Continental management, it should not be presumed that the merger's purpose is profit maximization and efficiencies. Mergers are marriages. People tend to get married for a variety of reasons. Many times, these reasons are bad. Often times, people do not want to be alone during the difficult times of their lives. Airlines, during a time of high fuel costs and a looming recession with associated reduced demand, perhaps sought out bad marriages out of fear and as a knee jerk reaction to increased difficulty. And when times are apparently better, they will assume that the marriage will make them even happier. It is difficult to see how two organizations in the same dire straits will, when combined, produce a better airline. But it is easy to see that a merger is more like a DeBeers diamond: *i.e.*, forever. Once the higher level of concentration is obtained, a growing economy may not yield additional competitive airlines.

Business as usual, albeit in a much-larger combined company, will apparently not translate into an improved customer experience. Business as usual has not been working,

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despite repeated previous eras of consolidation, and it should not be incumbent upon the airline passenger to subsidize a potentially anticompetitive merger because a dominant carrier has the ability to extract dollars from the wallets of consumers.[36]

The fear of the major carriers is understandable. Their business model has not proven to be all that profitable. However, it should not be the case that those factors are relevant to any antitrust analysis. These firms are not failing in any sense of the term, except perhaps failing to understand the nature of their own markets such that they continue to look towards consolidation as the answer to every challenge.

V. CONCLUSION

For many years now I have been greatly concerned about the role of antitrust laws in deregulated industries. It is not a lack of faith in my former colleagues at the staff level at the Department of Justice, as they are hard-working and dedicated public servants who, when properly led, have served to protect competition and consumers. Rather, my concern is about the role of antitrust law in general, particularly where there are serious high-stakes mergers coming to the forefront, particularly in the airline industry.

First, antitrust law should take into account not only the obvious anticompetitive harms associated with a merger. In the case of airlines, nonstop competition is the obvious relevant analysis. However, other forms of competition are important in the airline industry, a fact that the Department of Justice attempted to teach us in its United/U.S. Airways press release. Other important factors include connect competition,

[36] *See, e.g.*, Gary Stoller, *Airlines Add $10-$30 fees for peak travel days in summer*, available at http://www.usatoday.com/travel/flights/2010-05-24-1Aairsurcharge24_ST_N.htm. Depending on the airline, fees have been charged to consumers for checked-in baggage, exit row seating or other premium seats, carry-on baggage, and food.

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alliance competition, competition for business contracts, and the overall level of concentration in the number of systems available. It is my hope that the Department of Justice is as thorough in its analysis of this transaction as it was in that case.

The problem is that in recent time efficiencies analyses have become the end of the analyses. When efficiencies, real, potential, or imagined are present, it appears from recent antitrust lore, including some recent Department of Justice decisions, that antitrust should ignore the competitive issues underlying any transaction. That is not what antitrust law is about, it is not what the Horizontal Merger Guidelines teach us, and it is certainly not the way to run a competition policy. Efficiencies, even if proven, must mitigate anticompetitive harms caused in the relevant market due to the transaction's consummation.

This Committee can use the United/Continental transaction to examine these issues and restore antitrust law to its rightful place as the Magna Carta of free enterprise.[37] It can also use this merger to ask the harder questions as to the nature of antitrust analysis, even as such analysis has been eroded partly by certain recent Department of Justice investigations, but also by recent Supreme Court decisions, with one very recent exception.[38]

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[37] United States v. Topco Assoc., 405 U.S. 596, 610 (1972).
[38] *See, e.g,* Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 127 S. Ct. 1069 (2007); Bell Atl. Corp. v. Twombly, 127 S. Ct. 1955 (2007); Credit Suisse Secs. (USA) LLC v. Billing, 127 S. Ct. 2383 (2007); Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705 (2007); Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398 (2004); *c.f.* American Needle, Inc. v. National Football League, __ U.S. ___ (slip op. May 24, 2010).

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WRITTEN TESTIMONY

OF

DAVID CUSH

PRESIDENT & CEO, VIRGIN AMERICA INC.

BEFORE THE

ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS SUBCOMMITTEE

OF THE

U.S. SENATE COMMITTEE ON THE JUDICIARY

THE UNITED/CONTINENTAL AIRLINES MERGER: HOW WILL CONSUMERS FARE?

MAY 27, 2010

Thank you Chairman Kohl, Ranking Member Hatch, and other distinguished Members of the Committee for the opportunity to present this written testimony. My name is David Cush and I am the President and CEO of Virgin America Inc., a new, California-based low-fare airline which began operations in August 2007. Currently, Virgin America serves San Francisco (SFO), Los Angeles (LAX), New York (JFK), Washington D.C. (IAD), Seattle (SEA), Las Vegas (LAS), San Diego (SAN), Boston (BOS) and Fort Lauderdale (FLL). Next month, we will inaugurate service to Toronto Canada (YYZ) and, in the fourth quarter of 2010, Orlando (MCO).

Virgin America employs more than 1,500 full-time aviation professionals throughout the United States, and presently operates a fuel efficient fleet of 28 Airbus A320 family aircraft, with plans to operate a fleet of up to 44 aircraft by next year. In less than four years since its launch, Virgin America has captured a host of travel industry best-in-class awards, including "Best Domestic Airline" by Condé Nast Traveler for two consecutive years and "Best Domestic Airline" in Travel + Leisure World's Best Awards for two consecutive years.

The proposed merger between United and Continental would create the world's largest airline by most measures. This combination presents several important public policy issues including, most particularly, its effect on competition. How consumers ultimately fare after such a merger will largely depend on the ability of those airlines remaining in the marketplace to compete effectively with the merged entity. Among the issues that will determine whether other airlines will be able to provide an effective competitive alternative are access to (1) those airports where the combined entity will have a significant presence and (2) corporate travelers who the merged airline, with significantly increased capacity and an enhanced route network, will pursue more aggressively through corporate discount agreements.

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Airport Access

Turning initially to airport access, market entry by low-fare airlines is an essential component for airline competition and the key to sustained growth in the industry. Beginning with the Department of Transportation's (DOT) groundbreaking 1993 report on the "Southwest Effect,"[1] several studies have documented the power of low-fare airlines to stimulate aggressive price competition and dramatically increase total passenger enplanements after entering a market. Moreover, low-fare airlines have a proven track record of creating jobs while their legacy network peers have shed positions. According to the latest DOT data, the number of full-time employees at low-fare airlines grew by more than 14% between 2006 and 2010, while the number of full-time employees at network legacy airlines shrank by more than 4%.[2]

Nevertheless, the competitive benefits of low-fare market entry are limited at a number of airports because of slot controls and difficulties securing gates. Although lack of access to airport terminal facilities may prove difficult, it can usually be overcome. The inability to secure scarce slots and gates, on the other hand, acts as an absolute barrier to entry that prevents low-fare airlines from providing more choices and lower prices to consumers. This is especially the case at several New York area airports and, in Virgin America's own experience, Chicago's O'Hare International Airport.

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[1] U.S. Department of Transportation, *The Airline Deregulation Evolution Continues: The Southwest Effect* (1993), available at http://ostpxweb.dot.gov/aviation/domesticaffairs.htm.

[2] U.S. Department of Transportation, Bureau of Transportation Statistics, *March 2010 Passenger Airline Employment Down 3.8 Percent from March 2009* (May 18, 2010), available at http://www.bts.gov/press_releases/2010/bts024_10/pdf/bts024_10.pdf.

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By way of background, the Federal Aviation Administration (FAA) has long utilized a system of slots to manage congestion and delays at airports where demand at peak travel times significantly exceeds airport capacity. However, as set forth in the High Density Rule (the mechanism by which the FAA historically allocated and administered slots), it was well settled that "slots do not represent a property right but represent an operating privilege subject to absolute FAA control . . ." 14 C.F.R. § 93.223(a).

The High Density Rule used to be in effect but was eventually rescinded at each of the three major New York area airports – JFK, Newark and LaGuardia. Between 2006 and 2008 however, following overscheduling by airlines and extensive delays, the DOT/FAA issued a number of orders re-imposing a system of caps and slots at each of these airports, limiting the number of hourly operations and preventing airlines from adding new flights during peak periods. These controls continue in place today, even though they were imposed as a short-term solution to mitigate delays and congestion, with the initial allocation of slots based on historic operations at each airport. Consequently, the incumbent airlines at these airports have had their large slot bases "grandfathered," while new entrants and limited incumbents are now limited to whatever relatively low capacity levels they were providing during the base period used for the initial allocation of slots. Market shares at New York area airports are, therefore, concentrated among only a handful of airlines.

For example, at Newark, one airline – Continental – accounts for more than 70% of all passenger enplanements and controls most of the terminal space and gates at that airport.[3]

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[3] Port Authority of New York & New Jersey, *Newark March 2010 Traffic Report,* available at http://www.panynj.gov/airports/general-information.html.

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Similarly, at JFK, three airlines – Delta, JetBlue, and American – account for nearly 66% of all passenger enplanements;[4] and at nearby LaGuardia, three airlines – Delta, American, and US Airways – control about 70% of all passenger enplanements.[5] This concentration of a few airlines dominating the US's largest airline market is a direct result of the system of slot controls.

Even before the DOT/FAA imposed the current system of slot controls at New York area airports, one airline, JetBlue, received – at no cost – 75 slot exemptions for use at JFK during the controlled period (3 p.m. – 8 p.m.) when the High Density Rule was in effect at that airport. It was only after receiving these slot exemptions in 1999 that JetBlue was able to very quickly build up its JFK operations. Although the High Density Rule was eventually terminated at JFK, the slots that were "grandfathered" to JetBlue at JFK in 2008 included JetBlue's historic operation of these 75 slot exemptions. More recently, JetBlue reached a deal to trade 12 slots to American in return for slots at Washington's Reagan National – effectively monetizing the windfall that JetBlue was awarded in 1999 and controlling its competition at JFK. In a similar fashion, Continental last year acquired all 10 of AirTran's slots at Newark (where Continental was and continues to be the dominant airline) in return for four slots at LaGuardia and six slots at Reagan National. As with the example of JetBlue at JFK, the Newark slots that AirTran traded to Continental did not have any value to the participants until the Federal Government recently created them. However, given that slots are a scarce commodity allocated free-of-charge by the Federal Government, an airline that did not incur any costs when it initially received the

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[4] Port Authority of New York & New Jersey, *JFK March 2010 Traffic Report*, available at http://www.panynj.gov/airports/general-information.html.

[5] Port Authority of New York & New Jersey, *LaGuardia March 2010 Traffic Report*, available at http://www.panynj.gov/airports/general-information.html.

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underlying slots in the first instance, such as JetBlue at JFK and AirTran at Newark, should not now be permitted to trade the slots in order to receive a financial benefit, i.e. "free" access to airports such as Reagan National, which continues to be subject to the High Density Rule and where access is generally only available through purchases made under the Buy/Sell rule[6] or Congressionally created exemptions from slot controls.

Meanwhile, at Chicago's O'Hare International Airport, only two airlines – American and United – now account for nearly 80% of passenger enplanements.[7] Although slot controls at that airport were lifted in 2008 following the opening of a new runway, new entrants have effectively been shut out of the airport because of the shortage of gates. This barrier has been exacerbated by the unwillingness of American and United to relinquish gates to competitors. Indeed, Virgin America's long-standing interest in starting service at Chicago's O'Hare International Airport has been repeatedly blocked by our inability to obtain access to gates at the airport. By holding long term leases to valuable gates, the incumbents have reduced the supply of O'Hare gates, and are thereby able to pick and choose their competition.

Unfortunately, given existing slot controls in the New York area, Virgin America has not been able to grow its New York service above the level provided when the airline launched operations there in 2007. Similarly, Virgin America has effectively been shut out of Chicago's O'Hare International Airport for the reasons discussed above.

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[6] The Buy/Sell Rule is codified at 14 C.F.R. § 91.221.

[7] U.S. Department of Transportation, Bureau of Transportation Statistics, *Airport Snapshots, February 2010*, available at http://www.transtats.bts.gov/airports.asp.

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Airport access is further hampered by scheduling practices by large incumbents. As the FAA Administrator, J. Randolph Babbitt, recently noted,[8] the Federal Government has been forced to resort to the use of "blunt tools" such as operational caps, restrictions, and rules to counter delays caused by aggressive industry overscheduling, whereby airlines compress an unrealistically large number of flights into a relatively short time window. In particular, Administrator Babbitt identified Atlanta, Chicago, and San Francisco as cities where airline scheduling behavior has increased delays. The large incumbent airlines that individually operate hundreds of daily flights at these airports should, quite properly, be required to adjust their schedules before the situation becomes so dire that the Federal Government is left with no other choice than to impose operational limitations. Indeed, this was precisely the behavior that prompted the DOT/FAA to reintroduce caps and slots at the New York area airports between 2006 and 2008 – a capacity management system which grandfathered the majority of slots to large incumbents that were already entrenched at those airports while simultaneously erecting an insurmountable barrier of entry to new service by low-fare airlines – all to the detriment of consumers.

Where Virgin America has launched service, the consumer benefits have been measurable and dramatic. For example, JFK—San Francisco, JFK—LAX, and Washington Dulles—San Francisco average fares have all fallen by nearly one-third since Virgin America entered those markets. Moreover, LAX-Boston fares have dropped 29% since Virgin America

[8] Remarks of J. Randolph Babbitt, "NextGen is Happening," Aviation Week and Space Technology NextGen Forum (May 20, 2010).

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entered the market. Similarly, Washington Dulles—LAX and San Francisco—Boston average fares have both fallen 23% since Virgin America began competing in those markets.[9]

As the Congress considers U.S. airline consolidation and the overall state of competition in the industry, great care must be taken to ensure that low-fare carriers are provided meaningful opportunities to compete with entrenched legacy airlines at capacity-controlled airports. Moreover, the Federal Government, acting through the Transportation and Justice Departments, needs to continue to keep pressure on the airports to assure that new entrants and smaller incumbents can provide competition to the well-entrenched incumbents which, in a very real sense, can effectively restrict access to these airports through their control of gates.

At bottom, the Federal Government not only has the authority, but the responsibility, to take steps to enhance the level of competition at airports subject to operating limitations or gate shortages. Many studies have been completed since the 1980s detailing the serious competitive problems that exist at slot-controlled airports in the United States. The findings of these studies are still true today, in particular the fact that the secondary market at slot-controlled airport is so limited that it has not resulted in any significant market entry by new entrants or expansion by limited incumbents. Indeed, as the Government Accountability Office, the investigative arm of the Congress, warned as far back as 1996, "[C]ontrol of slots by a few airlines greatly deters entry at key airports in . . . New York and Washington."[10] Policies that cultivate and enhance low-fare competition are necessary to ensure that the objectives of the Airline Deregulation Act

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[9] U.S. Origin and Destination Survey via APGDat, www.apgdat.com

[10] GAO, *Airline Deregulation: Barriers to Entry Continue in Several Key Domestic Markets*, GAO/RCED 97-4 (Oct. 1996).

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of 1978 are realized, particularly as the industry becomes increasingly consolidated. That statute requires, among other things, that the Federal Government consider, as being in the public interest, policies that place maximum reliance on airline competition as well as provide opportunities for new entrant airlines.

Given the increased market consolidation that will result from the proposed merger, the Federal Government must begin to address the serious access problems at the New York area airports and Chicago's O'Hare International Airport. The Federal Government must now begin to develop, through a carefully constructed rulemaking, a new pro-competitive allocation system that will be used going forward at these and other airports where demand for access significantly exceeds capacity. The current stop-gap measures employed thus far – the short-term administrative allocation of slots based on historic airport operations – have not fostered new competition. To the contrary, such measures have conferred a tremendous advantage upon entrenched incumbents at the affected airports. These entrenched incumbents are inclined to hoard their slot holdings rather than see such slots relinquished to competitors, thereby allowing them to control service and fares.

The reality is that all of the ideas and issues concerning the allocation of slots at capacity-controlled airports have been on the table for the better part of 25 years. During this time, industry consolidation has increased and serious access problems have persisted at capacity-controlled airports. As a consequence, the Federal Government must develop a market-based solution to determine the most efficient allocation of slots to airlines that are eager to launch or expand service at capacity-controlled airports. Indeed, a variety of mechanisms are available to the Federal Government, including auctions and peak period pricing to more appropriately align

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demand with capacity. If indeed auctions are utilized, all slots at the affected airport should be available for bid, not just a small fraction, to avoid conferring an unfair competitive advantage on entrenched incumbent airlines at the airports. On the other hand, a mere extension of the orders limiting operations at the New York area airports and reliance on the status quo at O'Hare International Airport without any mechanisms to ensure meaningful access for new entrants and limited incumbents is contrary to the pro-competitive objectives of the Airline Deregulation Act and will be harmful to consumers in the long run. In any event, the Federal Government must resolve the issue of new entrant and limited incumbent access at capacity-controlled airports through the development and implementation of a market-based solution before approving any further slot swaps or industry consolidation.

Corporate Discount Agreements

Another area of competitive concern that may arise from increased consolidation is the enhanced ability of the merged airline to use the terms and conditions of corporate discount agreements to increase market share vis-à-vis its competitors, particularly new entrants that have not yet been able to develop similarly extensive route networks.

By way of background, a corporate discount agreement is an arrangement by which an airline grants discounts to businesses with significant amounts of travel in markets served by that airline. In return for the discounts, the agreements require the businesses to meet predetermined monthly goals for travel on that airline. The amount of the discount and the required travel levels reflect the relative leverage of the airline and the business in these markets, and provide the airline with an opportunity to pursue competitive goals in the markets covered by the agreement.

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These agreements may permit the merged airline to increase market power and increase market share by means of such agreements in at least three ways. First, an airline could use a dominant position in a domestic market as leverage to increase market share in other more competitive domestic markets at the expense of other competitors who lack the airline's market power in the market dominated. Second, a similar situation could arise when an airline dominates an international market that is important to corporate customers, and uses that leverage to increase market share in other more competitive domestic markets against competitors that don't enjoy domination of such an international market. In each of these two instances, consolidation exacerbates the competitive situation by significantly increasing the opportunities in which the merged airline can increase market share by means of the leverage provided by these agreements.

In a third instance, an airline may structure an agreement such that the level of discount increases as the company's use of the airline on a particular route increase. In these situations, the competitive impact is most significant on routes where the services provided by the merging airlines overlap or where access in a particular market is restricted.

In short, these corporate discount agreements are very powerful in the hands of a legacy airline with an extensive route network. Their power is significantly enhanced as legacy airlines merge with one another and operate more capacity on any given route leaving fewer airlines to compete across large networks. As a result, the merged legacy airlines will increase their market power to capture greater market shares at the expense of new entrants with much smaller networks. To the extent that the merged airline can, by use of these agreements, increase market share significantly in one or more markets at the expense of other airlines, consumers can be

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harmed if the loss of market shares by these other airlines compromises the ability of competitors to effectively compete against the merged airline.

Virgin America appreciates the opportunity to provide this testimony and would be pleased to respond to any questions the Committee may have concerning these matters.

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Statement Of Senator Patrick Leahy (D-Vt.),
Chairman, Senate Judiciary Committee,
Hearing On "The United/Continental Airlines Merger: How Will Consumers Fare?"
May 27, 2010

Today, the Antitrust Subcommittee examines the proposed merger between United Airlines and Continental Airlines. This merger would combine two of the Nation's largest airlines, offering potential benefits to travelers around the world. However, such a significant merger also brings the potential for anticompetitive effects. I thank Senator Kohl for chairing this important hearing to examine the antitrust implications of this transaction.

The past several years have brought significant changes to the airline industry. One of the most notable changes has been an increased concentration among carriers. While larger airlines benefit consumers by offering more travel options from one carrier, consolidation also brings the risk of competitive harm. I trust that the Department of Justice will conduct a thorough review of this proposed merger to ensure that it will advantage hard-working consumers, and not result in higher fares or fewer flight choices.

In Vermont, flight options today are limited for consumers traveling to and from Burlington. There are only three regular westbound flight routes out of the state – to Chicago, Cleveland, and Detroit. Of those three flights, two are run by United or Continental. If the proposed merger were to result in a reduction of these routes and services, that may be evidence that the merger will harm competition. On the other hand, it is quite possible that the merged airline will produce efficiencies that will improve service.

I know that many other cities around the country face these same issues. My hope is that any airline merger approved by the Justice Department will result in more flight options for Vermonters and all Americans, rather than fewer. I also trust that the Justice Department is wary of creating a slippery slope where smaller airlines must merge in order to compete.

The Obama administration has promised a more vigilant enforcement of the antitrust laws. Thus far, the administration's actions have matched its words. In the fall, I chaired a Committee hearing in Vermont at which Christine Varney, the Assistant Attorney General in charge of the Antitrust Division, promised to take a close look at competition issues in the dairy industry. Subsequently, the Department of Justice began workshops around the country to analyze these competition issues, and the Department even challenged the acquisition of two dairy bottling plants by the country's largest dairy distributor. I am confident that the Justice Department's vigorous enforcement in these areas will extend to the airline industry.

I look forward to hearing from our distinguished panel of witnesses today.

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CONGRESSWOMAN SHEILA JACKSON LEE, OF TEXAS (D - 18TH)

TESTIMONY BEFORE THE U.S. SENATE COMMITTEE ON THE JUDICIARY SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS

"The United/Continental Airlines Merger: How Will Consumers Fare?"

Dirksen Senate Office Building, Room 226

2:15 PM, May 27, 2010

Good afternoon ladies and gentlemen. I would like to thank

Chairman Herb Kohl and Ranking Member Orrin Hatch for allowing me

to submit my testimony on the proposed merger between United Airlines and Continental Airlines.

As you know, as a Member of the House of Representatives, I serve on two Subcommittees with jurisdiction over this matter, the Subcommittee on Courts and Competition Policy of the Committee on the Judiciary and the Subcommittee on Transportation Security and Infrastructure Protection of the Committee on Homeland Security.

One of my primary concerns is related to the anti-trust implications of the proposed merger. Specifically, I worry about the possible anti-competitive effects of the third and fourth largest competitors in an ever-shrinking market formally joining together, to become the largest airline in the world. The Department of Justice is investigating whether the merger will limit competition and raise prices for customers, as required under Section 7 of the Clayton Act. However, recent history has shown that findings of anti-competitive effects may still not be enough to stop the merger, as the Department of Justice-Federal Trade Commission Horizontal Merger Guidelines have allowed potential increased efficiencies from mergers to trump the anti-competitive effects.

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I have other concerns as well. In addition to customer costs, I worry about declining customer service standards. I worry about the effect of this merger on the local economy in my District of Houston, TX. I would like more information on how the proposed merger will affect the two companies' workforces. I am concerned that the merger might impact the safety and maintenance standards of the existing airlines. Lastly, I have reservations about the effect that this merger might have on the airline industry, encouraging still other mergers in response, leading to an ever shrinking number of competitors in the air travel market.

Of course, Houston is one of the cities that will be adversely affected by the proposed merger. Houston is a city of 2.3 million people, 15,000 of whom are Continental employees. Continental's passengers have expressed concern about the prospects of the merger, stating they dislike United's customer service. Continental's employees have shared similar concerns. Airline mergers have traditionally led to a decrease in customer satisfaction, particularly as workforces with distinct corporate cultures are forced to work together. As such, I am

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concerned that the repeated assertions we have heard from executives of both airlines, that the integration will be "seamless", are far from the truth.

In addition, I have major concerns about the economic impact on the city of Houston, the greater Houston metro area, the state of Texas, and the many people and businesses that will be affected. While we know that corporate headquarters for the new airline are slated to be in Chicago, we have been told that Houston will remain a hub, possibly the largest in the new combined system. However, almost every merger in recent years has resulted in a reduction in the number of active hubs. Coupled with the loss of Continental's Houston corporate headquarters, the loss of additional jobs for baggage handlers, ticket agents, other airline workers, and many service workers would be devastating to the local Houston economy.

The status of existing labor agreements with the new entity is also unclear. Five years ago, United defaulted on their pension plan as part of a bankruptcy re-organization, and I have concerns about the security of the pensions Continental's employees have worked hard to earn. The

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companies have refused to guarantee that no existing pension plan would be reduced or eliminated, that they would protect bargained-for benefits, or that employees would be offered the higher of the two existing salary structures and benefits. So far, United and Continental have simply promised to do what is best for the new company as a whole.

I am not the only one to voice such concerns. Yesterday, the House Judiciary Chairman John Conyers and the Subcommittee on Courts and Competition Policy Chairman Hank Johnson released a statement detailing the inadequacies of United/Continental's responses to written questions from the Committee on the Judiciary.

I am greatly concerned about the safety and security implications of the merger. The merger will inevitably lead to a consolidation of work forces, with different corporate cultures, and most likely an overall reduction of personnel. Fewer people performing maintenance for the same number of flights, with unfamiliar policies and procedures, could increase the likelihood of mistakes that could cost lives, as well as other security issues.

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Let's face it, during the last few decades, we have seen an unfaltering trend towards merger and consolidation in the airline industry. In the last twenty years, seven major airlines have disappeared, and the remaining airlines grow larger and larger. At some point, size itself becomes an issue. In the last several years, we have seen unpopular, but approved, bailouts in the banking and automotive industries. With fewer and fewer competitors, and more and more of the nation's wealth tied into each remaining corporation, what will prevent this combined airline, or the next, from being declared "too big to fail" when its profits disappear? What about the possibility of wide scale disruptions due to a labor strike, or the Federal Aviation Administration grounding one carrier's fleet, when that carrier has one-third, or even half of the entire market share?

Consumer protection is another problem. In the past, each merger has inevitably resulted in a decrease of available regional flights, and an increase in overbooked flights. When United West merged with US Airways, United West's former hub in Las Vegas went from 140 flights daily to only 64, and then to 26 flights daily; and when American

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Airlines acquired TWA, TWA's hub in St. Louis reduced departing flights from over 500 daily departures to a mere 36. Currently, United and Continental have eight hubs between them in the continental United States. Would the combined business be able to sustain all eight of those hubs? If so, at what level of activity, and where would the hubs be located?

Currently, there are a total of 13 nonstop routes where Continental and United overlap. If the merger goes through, 7 of those 13 will have no other competitor. With the reduced competition on those routes, passengers will have practically no alternative, and the carriers with the near or actual monopoly will be able increase prices with no consequences. Analysts have already predicted fare increases in flights originating in New Orleans, Seattle, San Diego, and here in Washington.

Finally, there is the concern that mergers encourage more mergers, leading us closer and closer to monopolies, resulting in higher prices and market imperfections. This merger mimics the merger between Delta and Northwest, which was preceded by US Airways merging with United West, which followed many other mergers. Each step in this

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process has reduced competition, leaving customers with fewer and fewer options, higher prices, and less service. While we have to focus on the immediate effects of this particular proposed merger, we also have a duty to consider the long-term implications of the merger on the U.S. economy.

I continue to engage with Continental officials, hoping these major concerns will be addressed. Unfortunately, their responses have not been satisfactory. I find myself in opposition to this merger, and urge the members of this Subcommittee to oppose it as well, until all outstanding issues have been resolved.

Thank you.

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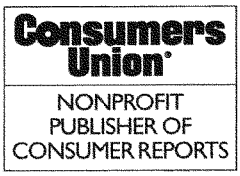

TESTIMONY OF

WILLIAM J. McGEE
CONSUMERS UNION

BEFORE THE

UNITED STATES SENATE
JUDICIARY SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY
AND CONSUMER RIGHTS

ON

"THE UNITED/CONTINENTAL AIRLINES MERGER:
HOW WILL CONSUMERS FARE?"

27 MAY 2010

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Thank you Chairman Kohl and Members of the Committee:

Good afternoon. My name is William J. McGee. I appear before you today as a consultant on travel and aviation issues for Consumers Union[1], the nonprofit publisher of *Consumer Reports*®. I thank you for the opportunity to express our deep concerns about the proposed merger between United Airlines and Continental Airlines.

When Congress passed the Air Transportation Safety and System Stabilization Act just 11 days after the 9/11 attacks and the U.S. airline industry received a $5 billion bailout, it was argued that the nation's airlines were essential to America's economy, infrastructure, security, and defense. Consumers Union agrees with these assertions, and that is why we're so concerned that a mega-merger between United and Continental will be detrimental to airline passengers.

What we've been witnessing in recent years is an incredibly shrinking airline industry. With the approval of this merger, in less than 20 years we will have seen the demise of seven major airline brands in the United States: Pan Am, Midway, Eastern, TWA, America West, Northwest, and now Continental.

Such a merger undoubtedly will have an adverse effect on labor, since thousands of jobs will be at risk. It also will dampen the travel and tourism industries in certain destinations and threaten a host of airline suppliers, ranging from aircraft manufacturers to travel agencies. In fact, some airports, cities, and even entire regions would stand to lose service and jobs. This seems particularly true for Houston, Continental's headquarters, after the new airline consolidates at United's headquarters in Chicago. While others can speak to the consequences the proposed merger will have on communities and jobs, I will focus my comments on passengers, because passengers will suffer adverse effects as well.

In February 2001, the U.S. General Accounting Office (GAO) reported on airline consolidation and identified several potential threats to consumers, including:

- a decrease in vigorous competition in certain markets;
- a greater threat of travel disruptions due to labor or financial crises;
- a loss of service in certain communities;
- additional barriers for new-entrant airlines.

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[1] Consumers Union of United States, Inc., publisher of *Consumer Reports*®, is a nonprofit membership organization chartered in 1936 to provide consumers with information, education, and counsel about goods, services, health and personal finance. Consumers Union's publications and services have a combined paid circulation of approximately 8.3 million. These publications regularly carry articles on Consumers Union's own product testing; on health, product safety, and marketplace economics; and on legislative, judicial, and regulatory actions that affect consumer welfare. Consumers Union's income is solely derived from the sale of Consumer Reports®, its other publications and services, fees, noncommercial contributions and grants. Consumers Union's publications and services carry no outside advertising and receive no commercial support.

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We can't predict with absolute certainty how the United-Continental merger ultimately will affect consumers. But we can examine the recent historical record to see how passengers were affected by American's acquisition of TWA in 2001, US Airways' "reverse merger" with America West in 2005, and Delta's acquisition of Northwest in 2008. Unfortunately for consumers, that record is not good.

What follows is a breakdown of the key problems that have emerged for airline passengers in the wake of mergers between major carriers.

1. **LESS CHOICE AND FEWER FLIGHTS**. Historically we have not seen a merger among major carriers that has *not* led to reductions in service and usually a dramatic reduction of flights at one or more hubs. In fact, among the arguments *for* airline mergers are reducing redundancies and achieving "economy-of-scale" benefits. There is no reason to believe we will not see service reductions with United-Continental. This new airline states it will maintain ten hubs, eight of them in the continental United States: Newark; Washington, D.C.; Cleveland; Chicago; Houston; Denver; San Francisco; and Los Angeles. Only time will tell if the new airline decides to consolidate such an extensive network of domestic hubs. Due to the relative proximity of network hubs, potential redundancies include Newark and Washington, Cleveland and Chicago, and Houston and Denver.

What we do know is that other mergers between major airlines eventually led to hub closures and flight reductions, despite promises to the contrary. Consider the following:

- TWA's former hub in St. Louis saw a reduction in total passenger traffic from 23 million in 2002 to 12 million in 2009. After American's acquisition of TWA in 2001, it began reducing daily departures, from a total of nearly 500 down to just 36. Last year Francis Slay, the mayor of St. Louis, pointed out that passenger loads on American's flights out of St. Louis remained high, and stated: "I think this is a bad business decision for the airline. American is cutting service in a good market and walking away from loyal customers." Yet to many industry analysts, it was apparent that St. Louis' location between American's existing hubs in Chicago and Dallas meant St. Louis passengers and businesses would begin losing service shortly after American's acquisition of TWA became final. That's exactly what happened.

- America West's former hub in Las Vegas also has been reduced in size in the aftermath of that airline's merger with US Airways. At its peak it operated about 140 flights daily, but that number was slashed to 64 and then again last year to just 26 daily flights. Ten years ago Las Vegas was ranked as the 12th busiest airport in the world; it now ranks 23rd.

- Although the full effects of the Delta-Northwest merger have yet to be seen, it's apparent that Delta's hub in Cincinnati is already experiencing cutbacks. In March the airline announced 840 jobs were being cut there, and news reports stated 123 flights have been eliminated since the merger. Again, even before this merger analysts had noted Cincinnati's proximity to Northwest's former hub in Memphis.

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In short, this means that consumers in these cities now have fewer choices, fewer flights, and fewer nonstop flights. Separately American and TWA could support hubs in Chicago, Dallas, and St. Louis, but after acquiring TWA American could only support hubs in two of those three cities. It's fair to ask if United-Continental will be able to support eight domestic hubs should their merger be approved. In addition, as the industry consolidates, consumers on many routes are losing the opportunity to "vote with their feet." The pressure to satisfy customers at the point of sale and during air travel is diminished when there is no effective competition for the consumer's business.

2. **LOSS OF SERVICE.** It seems apparent that a United-Continental merger would mean some cities—particularly smaller cities—would lose nonstop air service, if not all air service. A total of 12 cities recently lost nonstop service to St. Louis in the wake of the American-TWA merger, and a total of 10 cities have lost nonstop service to Las Vegas since the US Airways-America West merger. The more mega-mergers that are approved, the higher the probability that additional cities will lose service.

3. **HIGHER FARES.** A July 2008 report from the GAO concluded: "Mergers and acquisitions can also be used to generate greater revenues through increased market share and fares on some routes." Proponents of the United-Continental merger have noted that airfares have fallen nationwide in recent years, but this is an ironic observation since fares have fallen *despite* legacy airlines such as United and Continental, not *because* of them. Without this new generation of Low Cost Carriers, legacy airlines undoubtedly would be charging more on routes populated by these low-fare airlines, particularly in vacation markets such as Florida.

As the GAO noted, airfares rise after former rivals stop competing and merge into a single airline. In the case of United-Continental, overlaying their route maps indicates where such fare increases are likely to occur. *The Wall Street Journal* recently reported an airline analyst from J.P. Morgan identified 13 nonstop routes served by both United and Continental, and further noted that seven of these routes have no other competitors, which is even a higher concentration than occurred with Delta-Northwest. Further, this analyst indicated "only" four cities would experience price increases after a United-Continental merger. However, these are four very large cities: Washington, D.C.; New Orleans; Seattle; and San Diego. This means that millions of air travelers will experience fare hikes due to less competition.

What we saw in St. Louis was rather clear. A few years after American's acquisition of TWA, fares rose on three of the six routes dominated by those carriers pre-merger. The only reason fares also did not rise on the other three routes was because Low Cost Carriers such as Southwest had entered the market. This raises a key issue, since some analysts argue that a major airline abandoning a former hub will not harm consumers in the long run, because Low Cost Carriers will fill the void. The problem with this theory is that 1) there is no guarantee that Low Cost Carriers, with their more limited resources, will do so; and 2) even when a Low Cost Carrier enters a former hub, prices fall only on selected routes, not on *all* routes. In fact, spikes in ticket prices are particularly common on routes connecting the former rivals' hubs, such as American's hub in Dallas and TWA's hub in St. Louis. In late 2004, the St. Louis-Dallas route

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experienced a 34% year-over-year fare increase, the seventh-largest fare jump nationwide that quarter.

4. REDUCTIONS IN SERVICE QUALITY. Mergers tend to be contentious, and airline mergers have proven to be particularly contentious. This case involves two mature companies—United was founded in 1926 and Continental in 1934—so therefore a clash of corporate cultures is virtually guaranteed. There seems to be no question a merger of this size eventually will lead to lay-offs. These sterile corporate terms—downsizing, rightsizing, outsourcing, off-shoring, furloughing—really mean that two workforces already shell-shocked from two decades of lay-offs will experience more trauma. Those employees who remain will find themselves jockeying for position on blended seniority lists. Inevitably this will lead to employee morale issues and slowdowns due to melding of policies, procedures, and technologies; in the end, passengers will experience the brunt of these obstacles for years to come.

What we've seen with recent mega-mergers is the new airline does not perform as well as one or both of its partners performed pre-merger. American's on-time performance fell in the years after it acquired TWA, which had been an on-time leader. And US Airways currently ranks lower in on-time flights than it did when it operated as America West; similarly, it generates more consumer complaints today as well.

5. FEWER START-UP CARRIERS. Greater concentration of market share among just a few major airlines has a negative effect on competition and fares in an indirect way as well. The 2001 GAO report noted the following: "A January 2001 DOT report on exclusionary practices concluded that major airlines have the opportunity and the means to protect their market power by frustrating new entry. DOT found there had been instances in which incumbents drove new entrants out of markets by cutting fares and flooding the market with capacity. Once the new entrant was driven out of the market, the incumbent sought an increase in fares and reductions in service." The GAO report further noted: "Low fare carriers are recognized as providing the primary fare discipline in the marketplace." Simply put, the more market share that is dominated by mega-mergers, and the smaller the pool of major carriers becomes, the harder it will be for new airlines—particularly Low Cost Carriers—to compete. And there's no question this will hurt consumers.

6. FEWER AIRLINES, LESS RESISTANCE. In the post-Deregulation era since 1978, time and again we have seen how the marketplace affects airline pricing and even service. One major carrier will initiate an airfare increase and then the industry watches to see if others will match; if enough key players are strong enough to resist such an increase, then the initial fare hike will be withdrawn. This same principle has applied to the introduction of airline fees, particularly baggage fees, which recently topped a *Consumer Reports* poll of 2,000 travelers as the most annoying complaint about airlines, And there's a greater need than ever for such resistance: The DOT recently reported that in 2009 airlines generated $7.8 billion in such "ancillary revenue" fees, an increase of 42% over 2008. Airlines also have employed this "matching" method to initiate changes to frequent flyer programs; new service initiatives; and even policies such as reducing travel agency commissions. If we help create a domestic industry with fewer major airlines, the likelihood of a rival carrier resisting a new fee or

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airfare increase will be much less likely. Conversely, there will be less chance of a single carrier successfully introducing consumer-friendly initiatives. In recent years, for example, we've seen major domestic airlines attempt to differentiate their products, such as American offering more legroom, Continental offering economy class meal service, and Southwest resisting baggage fees. Eventually both American and Continental gave in to competitive pressures, while the jury remains out on Southwest's ability to resist the fee movement. Obviously, greater concentration among the majors will mean even greater resistance to initiatives that help consumers.

7. **THE THREAT OF WIDESPREAD DISRUPTIONS**. With greater concentration of market share among just a handful of mega-carriers, the United States faces a much greater threat of travel disruptions. Imagine the nationwide effects of a labor slowdown or strike at a combined United-Continental, which analysts estimate would control nearly a fifth of all domestic airline seats. And while we certainly hope it never came to pass, imagine the effects if the Federal Aviation Administration were forced to ground this mega-airline's fleet due to maintenance or operations irregularities. Even a 24-hour disruption in service would have severe consequences for the nation.

8. **THE "TOO BIG TO FAIL" ARGUMENT.** Just as we have seen with banks, with financial services companies, and with automobile manufacturers, we are now seeing the domestic airline industry evolving into an oligopoly of 800-pound gorillas. Few industries are as financially cyclical as the airline business—the investor Warren Buffet famously declared the airline industry from the time of Wilbur and Orville Wright has made zero money, net. Five major U.S. carriers filed for Chapter 11 bankruptcy reorganization at least once during the last decade. In the past, Wall Street investors and executives at competing airlines have decried any form of assistance to financially struggling carriers, asserting the government should let the marketplace decide which airlines survive and which airlines fail. In the future, these same parties will reverse that argument, claiming that a mega-carrier such as United-Continental will be too big to fail. And they will be right: The overnight shutdown of such a large percentage of the nation's commercial airlift would have immediate and adverse effects on America's economy, infrastructure, and even security. Therefore the wise move is to prevent the further concentration of the nation's airline industry—before it's too late.

9. **RAISING THE STAKES**. Because of the Delta-Northwest merger, which was approved in the final days of the Bush Administration, some proponents of the United-Continental merger are arguing that fair is fair, and the Department of Justice and the Department of Transportation should allow United and Continental to join forces as well. If this were to happen, there is little doubt that within a short time executives from American Airlines will appear before this very committee, seeking your blessing to merge with US Airways, which of course just merged with America West in 2007. This underscores there are many ways to measure the size of an airline, but regardless of the method employed, it's clear that over the last decade the issue of which airline is the largest U.S. carrier has been in constant flux. Delta's recent merger with Northwest made it the number one carrier, only to be eclipsed by United-Continental, which in turn would be eclipsed by American-US Airways. And this sudden leapfrogging in the ranks has not been due to genuine growth—to expanding service into new cities, hiring more

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employees, ordering more aircraft—but to legal exercises, which have led to reductions in service, laying off more employees, and parking more aircraft.

What's become apparent is airline executives and investors are engaged in a high-stakes form of poker—and the pot keeps growing. It seems only fair to ask what the end game is here. At what point will this merger mania subside? Until there are only three major airlines in the U.S.? Two? One? And then what? Will this trend extend overseas, with the same domestic mega-players seeking to acquire and merge with carriers throughout Europe and Asia? Before future consolidation is approved, Consumers Union feels there should be more discussion about the airline industry's ultimate goals, and how those goals affect U.S. consumers.

The Air Transport Association of America, the industry's primary trade organization, states the following: "Commercial aviation is the backbone key engine of the modern American economy, driving $1.2 trillion in annual economic activity and 11 million well-paying American jobs. Aviation supports local economies and creates new markets at home and abroad. Communities from coast to coast depend heavily on access to the air transportation network for economic development." Why, then, would we want an industry that generates less economic activity, creates fewer jobs, abandons local communities, and provides less access?

Today we're being told the domestic airline industry can only support three large network airlines; how long before we're told that number has been reduced to one large network airline? And how will such consolidation benefit American consumers?

— William J. McGee
Consumers Union
27 May 2010

JOINT STATEMENT OF GLENN F. TILTON, CHAIRMAN, PRESIDENT AND CEO, UAL CORP. AND JEFFERY SMISEK, CHAIRMAN, PRESIDENT AND CEO, CONTINENTAL AIRLINES, INC.

BEFORE THE UNITED STATES SENATE

COMMITTEE ON THE JUDICIARY

SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY & CONSUMER RIGHTS

"THE UNITED/CONTINENTAL AIRLINES MERGER: HOW WILL CONSUMERS FARE?"

MAY 27, 2010

Good afternoon Chairman Kohl, Ranking Member Hatch, and members of the subcommittee.

Thank you for the opportunity to discuss the benefits and answer any questions related to the planned merger of equals between Continental Airlines and United Airlines that we announced on May 3. As we said at the time, this transaction will enable us to provide enhanced long-term career prospects for our more than 87,000 employees and superior service to our customers, especially those in small communities throughout the United States. Our combined company will be well-positioned to succeed in an increasingly competitive global and domestic aviation industry – better positioned than either airline would be standing alone or as alliance partners.

This merger will provide consumers access to 350 destinations in 59 countries around the world. We will offer a comprehensive network in the United States, and we will have strategically located international gateways to Asia, Europe, Latin America, the Middle East and Canada from well-placed domestic hubs throughout the country. We will have 10 hubs, eight in the continental U.S. (Chicago, Cleveland, Denver, Houston, Los Angeles, New York/Newark, San Francisco and Washington Dulles) and two others in Guam and in Tokyo. We will continue to provide service to all of the communities that our companies serve today.

This merger comes at a critical juncture for the U.S. aviation industry, which has confronted extremely difficult business challenges for the last decade. During this time, our industry has lost over 150,000 jobs, and there have been nearly 40 bankruptcies since 2001. U.S. airlines have lost a total of $60 billion since 2001.

While the economy and our industry are beginning to slowly recover from the worldwide recession, we continue to be subject to the volatility of fuel prices and an intensely competitive environment in all of our markets.

As individual companies, we have taken significant steps to respond to these challenges. United went through a bankruptcy restructuring and both airlines have become more efficient and reduced our cost

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structures. But to survive, we have also been forced to reduce the number of aircraft we fly, the number of destinations we serve and the number of people we employ.

At the same time, we have made significant operational improvements. United now ranks as the leading U.S. global airline in on-time performance as measured by the Department of Transportation, and Continental is regularly recognized in independent surveys for the high quality of its customer service. Through our joint venture and alliance relationships, we have provided enhanced benefits to our customers and achieved substantial synergies.

While we are proud of these recent improvements at our companies, we believe it is clearly in the best interests of our customers, employees, shareholders and the communities we serve to bring our two airlines together in a merger. This merger will provide a platform to build a more financially stable airline that can invest in our product and our people to succeed in a highly competitive environment and be better able to withstand future economic downturns and challenges. The fact is that sustained profitability is the only way to improve service and reward employees over the long term.

The Merger Will Benefit Customers

By bringing together two of the most complementary route networks of any U.S. carriers, the merger of Continental and United will give travelers expanded access to an unparalleled global network. It combines United's Midwest, West Coast and Pacific routes with Continental's service in New York/New Jersey, the East Coast, the South, Latin America and across the Atlantic.

Customers will have access to 116 new domestic destinations; 40 will be new to United customers, and 76 will be new to Continental customers. The merger will create more than 1,000 new domestic connecting city pairs served by the combined carrier, providing additional convenience to customers.

Our fully optimized fleets and routes will provide greater flexibility, options, connectivity and convenience for customers. This improved connectivity and direct service options, as well as improved service, are expected to enable the combined airline to generate $800-$900 million in annual revenue synergies – and these synergies are not dependent on fare increases.

Importantly, the combined airline will be better able to enhance the travel experience for our customers through investments in technology, the acquisition of new planes and the implementation of the best practices of both airlines. The new airline will be more cost effective; we expect to realize cost-savings synergies of $200-$300 million per year, mostly through reductions in overhead such as rationalizing our two information technology platforms, combining facilities and corporate functions such as finance, marketing, sales and advertising.

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We will have one of the youngest and most fuel-efficient fleets among the major U.S. network carriers, as well as the flexibility to manage our fleet more effectively. With one of the best new aircraft order books in the industry, we will also be able to retire older, less efficient aircraft. This will result not only in greater efficiency but less environmental impact from our fleet.

Once the merger is complete, customers will also participate in the industry's leading frequent flyer program, which will give millions of members more opportunities to earn and redeem miles than ever before. Through Star Alliance, the leading global alliance network, our customers will also continue to benefit from service to more than 1,000 destinations worldwide.

The Merger Provides Job Stability for Employees

The past decade has been a tumultuous time for our employees. They have faced ongoing uncertainty as the industry has been forced to shed tens of thousands of jobs. In fact, in January 2009, the full time equivalent employees for the U.S. airline industry numbered 390,700 – that figure is 151,000 – or more than 25 percent – less than the all time high airline employment figure of 542,300. Employees have been forced to weather the volatility of oil prices and the challenges of terrorist attacks, increased security, a massive recession and unforeseen events such as SARS, H1N1 and volcanic ash. Through all of this, they have continued to perform at their best, providing our customers with clean, safe and reliable air travel.

We're proud of the work that our employees do every day. The merger will offer our employees improved long-term career opportunities and enhanced job stability by being part of a larger, financially stronger and more geographically diverse carrier that is better able to compete successfully in the global marketplace and withstand the volatility of our industry.

We will continue to serve all of the communities that we serve today and we expect that any necessary reductions in front line employees will come from retirements, normal attrition and voluntary programs. Our plan is to integrate our workforces in a fair and equitable way. Our focus will be on creating cooperative labor relations, including negotiating contracts with our collective bargaining units that are fair to the company and fair to our employees. United has two members of its collective bargaining units on its Board of Directors, and the seats allocated to the collective bargaining units will continue to be part of the Board of the combined company.

The merged company's headquarters will be in Chicago. In Houston, we will continue to have a significant presence and will remain one of Houston's largest private employers. Houston will be our largest hub and will continue be a premier gateway to Latin America for more travelers than ever before. Some corporate positions will remain in Houston and our CEO will have an office there as well as in Chicago. Over time, as our business grows as a result of the merger, we expect to see a net gain in jobs in Houston.

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We expect to adopt the best aspects of each company's culture and practices. People at both companies have come to know, admire and learn from their counterparts in many functions due to our joint venture and Star Alliance relationships, and we are confident that we can integrate our organizations fairly, effectively, and efficiently.

Service to Small Communities Will Be Enhanced

As network carriers, we have a long history of serving small- and medium-sized communities. United is proud to fly passengers from places like Portland, Maine to Honolulu or Charleston, South Carolina to Chicago, while Continental's service to and from Houston has been instrumental to the growth of the 20 Texas communities served.

Air travel opens up the world and provides business and leisure opportunities to all Americans, no matter where they live. Airlines are often the lifeblood of small communities, not only because of the economic benefits they provide, but due to their civic and charitable contributions and the volunteer activities of their employees. Both of our companies are committed community partners with robust corporate contributions and responsibility programs and we strongly support our employees' volunteer activities.

The turmoil in our industry has been devastating to many small- and medium-sized communities. Since 2000, more than 100 small communities have lost all network carrier service. Approximately 50 more have seen their service levels cut, losing at least half of their seats.

Low cost carriers have not filled this void because service to these communities is typically inconsistent with their business model. They are more-often dependent on point-to-point, high-density routes and often have one-size aircraft, which makes it difficult for them to serve these small communities. As a result, approximately 200 of these small communities and metropolitan areas, many of which have fewer than 500 passengers traveling to or from their airports daily, are served only by network carriers.

When we announced our merger, we committed to continuing to provide service to all of the communities our airlines currently serve, including 148 small communities and metropolitan areas **(CHART ONE).** This service enables residents of small communities to connect through our eight mainland domestic hubs and travel on to hundreds of destinations on thousands of routes worldwide. The combined airline will offer these travelers access to 350 destinations in 59 countries.

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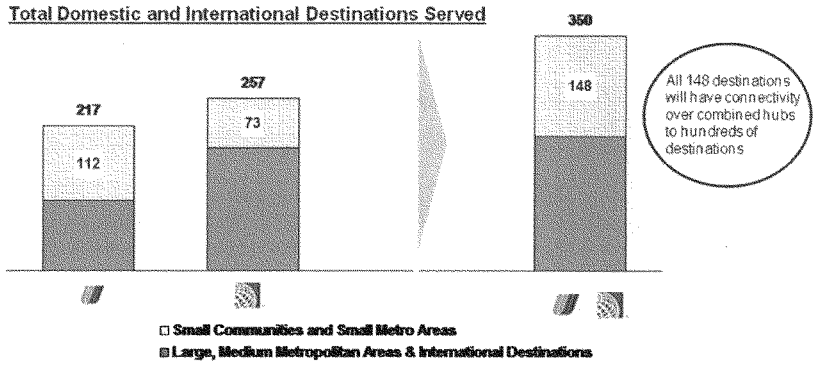
CHART ONE
THE MERGER MAKES A MORE EFFICIENT CARRIER, BETTER ABLE TO SERVE SMALL COMMUNITIES



Source: OAG FY 2010.
Notes: Consolidated operations. Domestic destinations with at least one route served 20 times by either United or Continental during at least one month in 2010. International destinations with at least one route served 12 times by either United or Continental during at least one month in 2010. Bristol, UK is excluded for Continental as it will be cancelled in November. Moses Lake, WA and Oxnard, CA are excluded for United as they will be cancelled in June. Airports in the following major metropolitan areas are grouped: New York (JFK, LGA, EWR), Washington (DCA, IAD, BWI), San Francisco (SFO, OAK), Chicago (ORD, MDW), Houston (IAH, HOU), Dallas (DFW, DAL), Los Angeles (LAX, BUR, LGB) Cleveland (CLE, CAK), Tampa (TPA, PIE), Cincinnati (CVG, DAY), and Miami (MIA, FLL). In addition, the following small community airports are also not counted as separate destinations because they are adjacent to a larger airport - Bedford, MA; Carlsbad, CA; Houston/Ellington Field, TX; Mesa, AZ; Seattle/Boeing Field, WA; Wilmington, DE. Airports in major international cities are grouped.

Following the merger, 93 of the 116 destinations that would be new to either Continental or United passengers would be small communities. As a result, a businessperson will be able to fly from Tyler, Texas to Sydney, Australia on a single airline.

The Merger Will Enhance Competition

The potential impact of this merger must be viewed in light of the fundamental changes that have occurred in our industry since 2000. The increased competition from low cost carriers (LCCs) has been dramatic as they have experienced tremendous growth over the past decade. They operate profitably at lower unit revenues than traditional network airlines, generally due to significant cost advantages related to less costly point-to-point business model. Consequently, their presence limits the ability of their competitors to increase fares.

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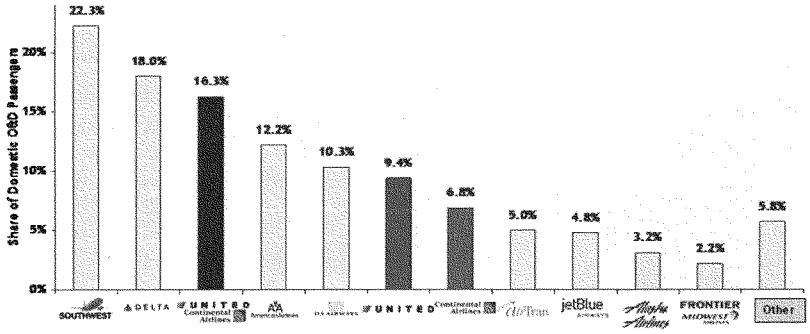
Industry-wide, LCCs now compete for 80% of all domestic travelers. In fact, Southwest has grown to become the largest domestic airline in the U.S., in terms of passengers and will continue in that position after our merger **(CHART TWO).** Over 85% of passengers traveling non-stop on either Continental or United have an LCC alternative. LCCs compete on domestic city-pairs accounting for 77% of United and Continental's combined passengers, and 46 of each of Continental and United's top 50 routes, have LCC competition.

CHART TWO
U.S. DOMESTIC PASSENGER SHARE: MERGED AIRLINE WILL BE ONLY THIRD LARGEST WITH 16%



Source: U.S. DOT O&D Survey YE 2009 Q3.
Note: Frontier includes Midwest. Share of domestic O&D passengers. Largest Other carriers include Hawaiian (1.6%), Allegiant (1.2%), Spirit (1.1%), Virgin America (0.9%), and Sun Country (0.3%).

There once was an assumption that LCCs would have difficulty competing at the hubs of network carriers. This assumption has long since been disproven. LCCs directly compete at all of our hub airports and have very large presences at airports adjacent to our hubs, such as Hobby in Houston, Akron near Cleveland, BWI near Washington and Midway in Chicago. LCCs have market shares in our hub cities ranging from 28% in Cleveland to 50% in Denver and San Francisco.

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LCCs are increasingly being used by business travelers and are targeting those travelers by providing amenities such as preferred seating and boarding access. They are also providing service from the United States to international destinations, including Mexico, the Caribbean, Latin America and Canada.

In addition to the growth of LCCs, competition from international carriers has increased. Mergers between Air France and KLM; Lufthansa, SWISS, bmi, Brussels Airlines and Austrian; British Airways and Iberia; and Cathay Pacific and Hong Kong Dragon Airlines have given these preeminent global carriers international networks and global reach that overshadow those of U.S. network carriers. In 2000, the top two airlines in terms of worldwide revenue, American Airlines and United, were both U.S.-based. Today, the top two are Lufthansa and Air France/KLM **(CHART THREE)**. In fact, more than half of all transatlantic capacity and more than two-thirds of all transpacific capacity is provided by foreign carriers. The merged carrier will be able to compete far more effectively with foreign carriers and to maintain competitive domestic service to cities large and small in the U.S.

CHART THREE
U.S. NETWORK CARRIERS HAVE LOST THEIR #1 AND #2 WORLDWIDE REVENUE RANKINGS

Top 10 Carriers Ranked by Revenue

CY2000			CY2009		
Rank	Airline	Operating Revenue ($B)	Rank	Airline	Operating Revenue ($B)
1	American	$19.7	1	Lufthansa	$31.0
2	United	$19.4	2	Air France-KLM	$29.2
3	Delta	$16.7	3	Delta/NW	$28.1
4	JAL	$15.4	4	American	$19.9
5	Lufthansa	$14.0	5	JAL	$16.4
6	British Airways	$13.7	6	United	$16.3
7	ANA	$11.5	7	ANA	$12.9
8	Northwest	$11.4	8	British Airways	$12.6
9	Air France	$11.1	9	Continental	$12.6
10	Continental	$9.9	10	Emirates*	$11.2

* Emirates 2009 is full year ending June 2009.
Source: For 2000 – Airline Business September 2001. For 2009: Domestic Carriers Company 10-Ks, Foreign Carriers Press releases and Annual Reports.
Notes: 2009 foreign carriers' operating revenues are calculated using the following exchange rates for 2009: 1USD=0.719055EUR; 1USD=0.641035GBP; 1USD=93.59617JPY; 1USD=3.67291AED.

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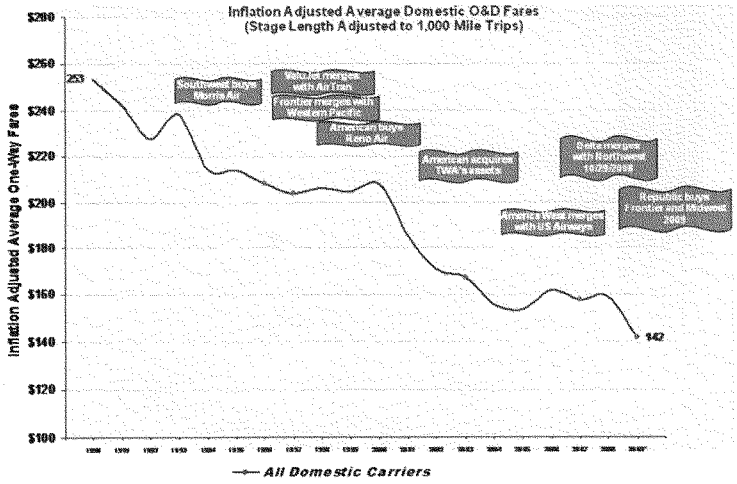
Additionally, well-funded newcomers (such as Emirates and Jet Airways) are making inroads into U.S. international routes from emerging economies in the Middle East and South Asia. This trend will continue, and is a credit to the success of the Open Skies policy as these agreements expose U.S. carriers to more competition than ever before.

Price competition in our industry has also increased due to the ready availability and transparency of fare information to consumers through online sites such as Expedia and Orbitz. Consumers have become more savvy and sophisticated as they search for the fare that meets their needs. "[R]aising airfares isn't like raising the price of milk…the internet can hunt the cheapest fare worldwide in seconds. If one carrier has some empty seats to fill, it will have to cut the price because getting something for that seat is better than flying it empty" (Scott McCartney, "As Airlines Cut Back, Who Gets Grounded", *Wall Street Journal*, 6/5/08). Online sites have expanded their business models and now offer targeted services to corporations and business travelers.

In short, the changing dynamics of the airline industry have resulted in robust competition that maintains significant downward pressure on fares. As a result, airfare prices have declined by more than 30 percent over the last decade on an inflation adjusted basis **(CHART FOUR)**.

CHART FOUR
DESPITE NUMEROUS MERGERS, AVERAGE PRICE* CONTINUES TO DECLINE



Sources: US DOT O&D Survey. CPI from U.S. Bureau of Labor Statistics.
Notes: 2009 Dollars. 2009 FYE Q3.
*Average price per passenger based on average price per mile then adjusted to 1,000 mile trips.

Especially given this landscape and the relative ease with which LCCs can enter into competition with network carriers and other LCCs, this merger will not result in a reduction in competition. There are only 15 overlapping non-stop domestic routes among the hundreds that we fly (and no overlapping international routes). The combined carrier's ability to raise prices on any individual overlapping route is constrained because each has current non-stop competitors. Moreover, extensive competitive connecting service further constrains pricing.

On each of these 15 non-stop overlapping routes, after the merger, travelers would be served by at least one other carrier, but more often two, three, four or five. All but two of the overlapping routes are served by an LCC and six are served by two LCCs **(CHART FIVE)**.

CHART FIVE
NON-STOP OVERLAPS

	City-Pair	Non-Stop Competitors	Current LCC Non-Stop Competitors	UA/CO O&D Passenger Share (%)	LCC O&D Passenger Share (%)
	Hubs				
1	**Washington - Houston**	3	Southwest	62.6%	27.0%
2	**Los Angeles - Houston***	3	Southwest	54.6%	35.8%
3	**Houston - San Francisco**	3	Southwest	57.5%	35.4%
4	**Denver - Cleveland**	3	Frontier	46.0%	48.7%
5	**Chicago - Houston**	4	Southwest	53.4%	33.3%
6	**Denver - Houston**	4	Southwest and Frontier	60.4%	38.3%
7	**Chicago - Cleveland**	4	Southwest	40.8%	47.6%
8	**Washington - Cleveland**	4	Southwest	40.4%	53.0%
9	**Denver - New York**	5	Frontier and jetBlue	62.7%	26.1%
10	**Los Angeles - New York**	6	jetBlue and Virgin America	24.3%	36.0%
11	**Chicago - New York**	6	Southwest and jetBlue	42.0%	9.1%**
12	**New York - San Francisco**	6	jetBlue and Virgin America	37.2%	32.5%
13	**Washington - New York**	7	Southwest and jetBlue	18.6%	10.2%
	Non-Hub-to-Hub				
14	**Los Angeles - Kahului**	4	—	52.0%	—
15	**Los Angeles - Honolulu**	5	—	29.6%	—

*Reflects recently announced new service by United from LAX-IAH starting Aug 24.
** Does not fully reflect Southwest LGA-MDW service that began June 29, 2009. LCC share for Q3-Q4 2009 is 13.3%.
Source: OAG May 2010: U.S. DOT O&D Survey YE 2009 Q3.
Notes: Consolidated operations Competitors with at least 5 roundtrips per week. Delta includes Northwest. Frontier includes Midwest. Airports in the following metropolitan areas are grouped: Chicago (ORD, MDW), Cincinnati (CVG, DAY), Cleveland (CLE, CAK), Dallas (DFW, DAL), Houston (HOU, IAH), Los Angeles (LAX, BUR, LGB), Miami (MIA, FLL), New York (LGA, JFK, EWR), San Francisco (SFO, OAK), Washington DC (DCA, IAD, BWI), and Tampa (TPA, PIE).

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The Merger is a Natural Extension of Our Current Relationship

About two years ago, our companies began an extensive alliance relationship. We are both members of Star Alliance, the leading global alliance network. Domestically, we have a codeshare arrangement, frequent flyer reciprocity and shared lounge access.

We have antitrust immunity for international coordination including our A++ transatlantic joint venture that also includes Air Canada and Lufthansa. We have an immunity application pending with ANA that includes a transpacific joint venture, in connection with the Open Skies agreement initialed and soon to be implemented with Japan.

While these agreements have generated significant synergies and customer benefits, they do not provide the cost savings and employee and customer benefits of a merger. For example, following a merger, we can fully optimize our schedules and integrate our fleets. Our combined mainline fleet of more than 700 aircraft of a broad range of sizes and mission capabilities will enable the most efficient utilization of seat capacity. We will be able to reassign aircraft across the network to better meet demand on different routes, yielding a net increase in annual passengers and improving the business mix of those passengers through the appeal of our broad combined network.

The merger will also enhance our frequent flyer programs. Currently, it is sometimes difficult to obtain reciprocal benefits, elite recognition and awards. A combined program would offer more benefit to customers as they accrue and redeem awards across our combined network on a seamless frequent flyer program.

Our alliance relationship has given each airline the opportunity to know and partially integrate the systems, practices and procedures of the other. As a result, it gives us great confidence that we can successfully integrate our two companies once the merger closes.

Conclusion

Each of our companies has a long and proud history of independence. Continental and United are among the pioneers in the aviation industry and, in fact, have the same founder, Walter T. Varney.

Although our companies have been performing better since the economic recovery began, we analyzed the competitive environment and reflected on the volatility that has plagued our industry. As we looked ahead, we each strongly believed that our combined future was brighter than our standalone future, that this is the right time for a merger, and that we have found the right merger partner.

As we have talked to our customers, our employees and our shareholders, we have felt a great sense of excitement about this merger. By bringing the best of both organizations together, we believe we can not

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only create a world-class airline with enduring strengths, but also serve our customers and communities better than ever, provide security and stability for our employees and benefit shareholders with a strong financial foundation.

We look forward to continuing to outline the benefits of this merger in Washington, D.C., and throughout the country and the rest of the world. But more importantly, we look forward to our people working together to create the world's leading airline.

###

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Stockton Ca 95202
Tel. (209) 235-5555
Fax (209) 235-5565
woolfson@telswitch.com

In Matter of the Merger of United Airlines and Continental Airlines,
before the Senate Judiciary Subcommittee to Examine United/Continental Merger,
May 27th, 2010, 2:15pm – Dirksen-226

ANALYSIS OF SCHEDULED FLIGHTS AND THE MERGER
AFFECT ON FLIGHT AVAILABILITY
RE: MERGER OF UNITED AIRLINES AND CONTINENTAL AIRLINES

This analysis produced on May 25th, 2010, with amendments to declaration made May 31, 2010.

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I, Aaron Woolfson declare as follows:

***

1. Attached is my own independent analysis of the United Airlines and Continental Airlines flight schedule covering week April 26th – May 2nd, 2010, and the impact that the pending merger of United Airlines and Continental Airlines would have on availability of flights listed in that schedule.

2. I have not been asked to conduct this analysis by any party involved or any individual or organization related to the parties – I am doing this as a private individual.

3. This document has not been peer-reviewed. It has not been made available to any other party before this time.

4. The only outside information that I used while preparing this analysis was my having obtained an Excel™ formatted file from OAG (Official Airlines Guide) of flight schedules for United Airlines and Continental Airlines.

***

5. I am not a shareholder of either United Airlines or Continental Airlines, and have no financial interest in the outcome of the committee's findings, and

6. Any travel that I conduct on either of these two airlines is incidental and is a consequence of clients arranging flights for me.

7. I am not aware of any relationships that currently exist between my existing clients and United Airlines or Continental Airlines.

8. This analysis has been conducted using techniques that I have been employing for years as a Expert Database Analyst. Methods and Procedures are exclusively by my own authoring – and all of the language is exclusively of my own authoring.

Qualifications

9. I am a founder of TelSwitch, Inc., and managing partner at Merkt-Woolfson;

10. TelSwitch, Inc. builds and develops telephonic database service for several major telecommunications companies to manage their billing, as well as calculating and maintaining

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extensive databases related to the accurate calculation of the rates and rounding mechanisms used on telecommunications services.

11. Merkt-Woolfson develops billing and database mechanisms for banks to keep track of the paperwork that banks require to maintain mortgage and loan origination. It also provides extensive database management services to both government and private industries. My clients include the largest banks, military contractors, and publicly held telecommunications carriers where accuracy and accountability are a necessity.

12. I have extensive experience in creating, managing, and analyzing large databases, including payroll, timekeeping, telecommunications, and other proprietary databases. A typical transaction-load on an average database maintained by my company is around 1 million records a day. I am accustomed to, and comfortable with, working with a large amount of data across a variety of industries, including for litigation purposes.

13. I have been retained over 30 times over the last two years to conduct analysis on large time-keeping databases, and to provide written and spoken declarations on the results of my findings, related to wage and hour Class Action cases by attorneys in Northern and Southern California.

Conclusions

14. As explained in detail below, the data reflects the following information:

Currently Operated Flights:

System wide:

- Number of total flights per week operated by United: 22,337
- Number of total flights per week operated by Continental: 14,567
- Number of total seats-available per week operated by United: 1,873,162
- Number of total seats-available per week operated by Continental: 1,228,332
- Average # of Flights per day, for United: 3,191
- Average # of Flights per day, for Continental: 2,081
- Average # of seats-available, per day, for United: 267,595
- Average # of seats-available per day, for Continental: 175,476

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Number of Cities served:

- Cities that are served by United: 181
- Cities that are served by Continental: 138
- Cities that are served by both United Airlines and Continental Airlines: 96

Unique City Pairs (Routes):

- City pairs (Routes) served by United: 796
- City pairs (Routes) served by Continental Airlines: 507
- Average # of United Flights per day between City Pairs served by United Airlines: 4.00
- Average # of Continental Flights per day between City Pairs served by Continental Airlines: 4.10

Cities served by only United (and/or) Continental :

- Number of Cities served by only United Airlines: 24

orig	city	Carriers	# daily	Codes
AOO	Altoona PA USA	1	3	UA
BKW	Beckley WV USA	1	2	UA
CEC	Crescent City CA USA	1	3	UA
CIC	Chico CA USA	1	4	UA
CKB	Clarksburg WV USA	1	3	UA
CLD	Carlsbad CA USA	1	6	UA
CMX	Hancock MI USA	1	2	UA
EAU	Eau Claire WI USA	1	3	UA
EGE	Vail/Eagle CO USA	1	2	UA
GUC	Gunnison CO USA	1	1	UA
HDN	Steamboat Springs CO USA	1	2	UA
IPL	El Centro/Imperial CA USA	1	3	UA
IYK	Inyokern CA USA	1	3	UA
JST	Johnstown PA USA	1	4	UA
LMT	Klamath Falls OR USA	1	4	UA
MGW	Morgantown WV USA	1	4	UA
MKG	Muskegon MI USA	1	2	UA
MOD	Modesto CA USA	1	5	UA
MWH	Moses Lake WA USA	1	2	UA
OTH	North Bend OR USA	1	3	UA
OXR	Oxnard/Ventura CA USA	1	3	UA
PAH	Paducah KY USA	1	2	UA
PKB	Parkersburg/Marietta (Regional	1	2	UA
SHD	Shenandoah Valley VA USA	1	4	UA

- Number of Cities served by only Continental Airlines: 7

orig	city	Carriers	# daily	Codes
BFD	Bradford PA USA	1	3	CO
BPT	Beaumont/Pt. Arthur TX USA	1	5	CO
DRT	Del Rio TX USA	1	2	CO
FKL	Franklin PA USA	1	4	CO
JHW	Jamestown NY USA	1	4	CO
LWB	Greenbrier WV USA	1	2	CO
VCT	Victoria TX USA	1	2	CO

- Number of Cities served by only United and Continental: 1

orig	city	Carriers	# daily	Codes
MTJ	Montrose CO USA	2	3	CO, UA

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- Same routes served by both United and Continental: 24

Orig	OrigName	Dest	DestName	Flights/day (UA)	Flights/day (CO)
CLE	Cleveland(Intl) OH USA	DEN	Denver(Intl) CO USA	2	1
CLE	Cleveland(Intl) OH USA	IAD	Washington(Dulles Intl) DC USA	4	2
DEN	Denver(Intl) CO USA	CLE	Cleveland(Intl) OH USA	2	1
DEN	Denver(Intl) CO USA	EWR	Newark/New York(Liberty) NJ USA	4	4
DEN	Denver(Intl) CO USA	IAH	Houston(G Bush Intl) TX USA	6	8
EWR	Newark/New York(Liberty) NJ USA	DEN	Denver(Intl) CO USA	4	5
EWR	Newark/New York(Liberty) NJ USA	IAD	Washington(Dulles Intl) DC USA	4	7
EWR	Newark/New York(Liberty) NJ USA	ORD	Chicago(O'Hare) IL USA	11	9
EWR	Newark/New York(Liberty) NJ USA	SFO	San Francisco(Intl) CA USA	2	6
HNL	Honolulu Oahu HI USA	LAX	Los Angeles(Intl) CA USA	3	2
IAD	Washington(Dulles Intl) DC USA	CLE	Cleveland(Intl) OH USA	4	2
IAD	Washington(Dulles Intl) DC USA	EWR	Newark/New York(Liberty) NJ USA	4	7
IAD	Washington(Dulles Intl) DC USA	IAH	Houston(G Bush Intl) TX USA	4	3
IAH	Houston(G Bush Intl) TX USA	DEN	Denver(Intl) CO USA	7	6
IAH	Houston(G Bush Intl) TX USA	IAD	Washington(Dulles Intl) DC USA	3	3
IAH	Houston(G Bush Intl) TX USA	ORD	Chicago(O'Hare) IL USA	6	10
IAH	Houston(G Bush Intl) TX USA	SFO	San Francisco(Intl) CA USA	1	8
LAX	Los Angeles(Intl) CA USA	HNL	Honolulu Oahu HI USA	3	2
CLE	Cleveland(Intl) OH USA	ORD	Chicago(O'Hare) IL USA	9	8
ORD	Chicago(O'Hare) IL USA	CLE	Cleveland(Intl) OH USA	10	8
ORD	Chicago(O'Hare) IL USA	EWR	Newark/New York(Liberty) NJ USA	8	9
ORD	Chicago(O'Hare) IL USA	IAH	Houston(G Bush Intl) TX USA	6	11
SFO	San Francisco(Intl) CA USA	EWR	Newark/New York(Liberty) NJ USA	4	7
SFO	San Francisco(Intl) CA USA	IAH	Houston(G Bush Intl) TX USA	3	7

Cumulatively there are 250 flights per day that are operated on the exact same route by United Airlines and Continental, representing 26,863 available seats:

- 136 out of the 3333 (4.08%) daily flights operated by United Airlines overlap Continental's Flights..
- 114 out of 2340 (4.87%) daily flights operated by Continental Airlines overlap United Flights.
- Of the cities served by exact routes on both airlines, no cities are served exclusively by United **and** Continental, and none are served by no less than 4 other competing carriers in that market.

If a 50% reduction in overlapping flights were to take place (eliminating ½ of all of overlapping flights), this would result in reduction of only 125 flights with similarly overlapping schedules between exact city pairs, or 13,431 available seats.

Since almost all of the the overlapping flights appear to be between cities that are hubs to of either United Airlines, or Continental, I would suspect that these service elimination would take place on these routes where overlapping flights depart or arrive within 2 hours of one another.

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- Number of Cities served by United and One Other Airline (not including Continental):

orig	city	carriers	codes
ACV	Eureka/Arcata CA USA	2	AS, UA
ASE	Aspen CO USA	2	F9, UA
BFL	Bakersfield CA USA	2	UA, US
COD	Cody WY USA	2	DL, UA
LAN	Lansing MI USA	2	DL, UA
LNK	Lincoln NE USA	2	DL, UA
MBS	Saginaw MI USA	2	DL, UA
RDD	Redding CA USA	2	AS, UA
SBP	San Luis Obispo CA USA	2	UA, US
SMX	Santa Maria CA USA	2	G4, UA
SPI	Springfield IL USA	2	AA, UA
YUM	Yuma AZ USA	2	UA, US

- Number of Cities served by Continental and One Other Airline (not including United):

orig	city	carriers	codes
ACT	Waco(Municipal) TX USA	2	AA, CO
BRO	Brownsville TX USA	2	AA, CO
CLL	College Station TX USA	2	AA, CO
DUJ	Dubois PA USA	2	3M, CO
HRL	Harlingen TX USA	2	CO, WN
LCH	Lake Charles (Regional) LA	2	AA, CO
ROP	Rota Mariana Is.	2	CO, FP
TYR	Tyler TX USA	2	AA, CO

- Number of Cities served by United, Continental, and only 1 Other Airline: 0
- Number of Cities served by United, Continental, and only 2 Other Airlines: 3
- Number of Cities served by United, Continental, and only 3 Other Airlines: 5
- Number of Cities served by United, Continental, and at least 4 Other Airlines: 87

Hubs:

- Number of Hubs – United Airlines: 5:
  Washington(Dulles Intl) DC USA, Los Angeles(Intl) CA USA, Chicago(O'Hare) IL USA, San Francisco(Intl) CA USA, Denver(Intl) CO USA
- Number of Hubs – Continental Airlines: 3: Newark/New York(Liberty) NJ USA, Houston(G.Bush Intl) TX USA, Cleveland(Intl) OH USA

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Flights between hubs:

- Daily # of Flights between United hubs, operated by United Airlines: 207

origName	destName	
Chicago(O'Hare) IL USA	Denver(Intl) CO USA	10
Chicago(O'Hare) IL USA	Los Angeles(Intl) CA USA	10
Chicago(O'Hare) IL USA	San Francisco(Intl) CA USA	10
Chicago(O'Hare) IL USA	Washington(Dulles Intl) DC USA	8
Denver(Intl) CO USA	Chicago(O'Hare) IL USA	10
Denver(Intl) CO USA	Los Angeles(Intl) CA USA	8
Denver(Intl) CO USA	San Francisco(Intl) CA USA	10
Denver(Intl) CO USA	Washington(Dulles Intl) DC USA	9
Los Angeles(Intl) CA USA	Chicago(O'Hare) IL USA	11
Los Angeles(Intl) CA USA	Denver(Intl) CO USA	8
Los Angeles(Intl) CA USA	San Francisco(Intl) CA USA	18
Los Angeles(Intl) CA USA	Washington(Dulles Intl) DC USA	7
San Francisco(Intl) CA USA	Chicago(O'Hare) IL USA	14
San Francisco(Intl) CA USA	Denver(Intl) CO USA	10
San Francisco(Intl) CA USA	Los Angeles(Intl) CA USA	18
San Francisco(Intl) CA USA	Washington(Dulles Intl) DC USA	9
Washington(Dulles Intl) DC USA	Chicago(O'Hare) IL USA	8
Washington(Dulles Intl) DC USA	Denver(Intl) CO USA	11
Washington(Dulles Intl) DC USA	Los Angeles(Intl) CA USA	9
Washington(Dulles Intl) DC USA	San Francisco(Intl) CA USA	9

- Daily # of Flights between Continental hubs, operated by Continental: 58

origName	destName	
Cleveland(Intl) OH USA	Houston(G.Bush Intl) TX USA	8
Cleveland(Intl) OH USA	Newark/New York(Liberty) NJ USA	7
Houston(G.Bush Intl) TX USA	Cleveland(Intl) OH USA	6
Houston(G.Bush Intl) TX USA	Newark/New York(Liberty) NJ USA	14
Newark/New York(Liberty) NJ USA	Cleveland(Intl) OH USA	7
Newark/New York(Liberty) NJ USA	Houston(G.Bush Intl) TX USA	16

- Daily # of Flights between United hubs, operated by Continental: 0
- Daily # of Flights between Continental hubs, operated by United: 0

Files that I used for my analysis:

15. For my analysis, I have obtained a file from OAG (Official Airline Guide) for the week of April 26 through May 2nd, 2010.

16. This file was in Excel™ format, and was a listing of all non-Code-Shared flights operated by United Airlines or Continental Airlines for the week of April 26th though May 2nd, 2010.

17. Additionally, the file contained a list of all airports served by United Airlines or Continental Airlines, along with all other carriers operating out of that respective airport, for purpose of analysis.

18. The data did not contain international flights.

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19. The data did not contain non-published, or charter flights.

20. The data did not contain load factors, details about number of passengers who experienced Involuntarily Denied Boarding (DOT § 250.5, etc.), or other considerations.

21. The data did not contain information on which flights were cancelled flights, and which flights were delayed.

22. The following fields were contained within the Excel™ Formatted File provided by OAG:

Header from File	Sample	Sample
ORIGIN CODE	ALB	ABQ
ORIGIN	Albany NY USA	Albuquerque NM USA
DESTINATION CODE	CLE	LAX
DESTINATION	Cleveland(Intl) OH USA	Los Angeles(Intl) CA USA
PUBLISHED CARRIER CODE	CO	UA
PUBLISHED CARRIER	Continental Airlines	United Airlines
FLIGHT NUMBER	2439	6471
OPERATOR CODE	A136	A296
OPERATOR	Expressjet/CO Express	UA EXP/Skywest
EQUIPMENT TYPE	'ERJ	'CR7
DEPARTURE TIME	10:10	17:28
ARRIVAL TIME	11:35	18:31
SEATS CONFIGURATION	50	66
DAYS OF OPERATION	1 45	7

Methods and Procedures

23. I utilized Structured Query Language ("SQL"), a computer language for querying and modifying data and managing databases, to take the provided raw time data and construct a database that combined flight schedules in a form that I could run reports from. I will refer to this database from here on as "United and Continental Flights Database." (or simply "Flight Database")

24. These are the steps I took to construct the Database:

a. First I took all the raw OAG data and downloaded it onto my secure database server.

b. I imported all of the data from the files provided by OAG, using exact headers and field names, to retain 100% database authenticity into a local "staging file" on this server, prior to importing it into the SQL database;

c. Then I created master Schedule and Airport tables in the SQL database called "airlines", "airports," and "city pair"

d. This contained the fields from the raw files provided by OAG, (with native-SQL formatted Date and Time Stamp format added), for purpose of performing necessary sorting and grouping operations. This enabled me to sort this data and run queries based upon native SQL language.

e. I then wrote a procedure that categorized each flight according to the city pair, and the number of operated flights between city pairs, including the # of seats on each flight.

f. Each airport pair represented by a single "row" of data containing the # of flights on and # of seats scheduled on that day.

g. The formulas I used provided the necessary alignment of unique shift origination and termination airports, so that individual routes by airline, if appearing more than once, were de-duplicated.

h. The de-duplication did not change any of the results that I would obtain from the data;

i. I did not modify any fields for any purpose of calculation. I maintained all fields with their original data intact, with exception of changing the field type on the date and time fields, so that the SQL database could perform sort and group operations.

25. I then created a list of questions that I wanted to query against the data, related to schedules.

26. My conclusions are summarized below:

***

27. As a member of the travelling public, I do not feel that the merger of United Airlines and Continental Airlines provides any significant drawbacks to myself, or the travelling public, based upon the following:

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In a combined United Airlines – Continental Airlines system:

- There does not appear to be significant overlap of United Airlines and Continental Airlines flight schedule footprint; (less than 5% of flights, currently.)
- Elimination of overlapping flights do not appear to produce unfavorable flight schedules, I believe that flights that would be eliminated are those likely to depart (or arrive) within two hours of one another, in overlapping cities.
- Increased hub diversity may lead to less delay for passengers who may have to be re-routed for weather, or other situations.
- Although United Airlines and Continental Airlines do serve 96 cities in common, only 12 cities are served with some flights that experience the same exact routings on both airlines.
- There will remain at least one additional airline serving all cities affected by the consolidation of the airlines –except – Montrose, Colorado – which will lose the only 2 competing carriers serving that airport – United and Continental – when they become one airline.

28. If I were in possession of Load Factors, Flight Delays, Flight Cancellation data, IDB (Involuntary Denied Boarding) instances, and weather information at the airports over an expanded period, I suspect that I would be able to show:

- Number of flights that were cancelled due to weather conditions, related to routings of passengers and the respective hub that they were routed through.
- Number of passengers who were endorsed onto other airlines due to Involuntarily Denied Boarding conditions, or situations where the customer would have arrived at their destination more than 2 and more than 4 hour later, and the affect that the merger would have on these passengers.
- Flights scheduled on the same route by United Airlines or Continental Airlines where one, or both, were cancelled.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. Executed on May 31st, 2010 at Stockton, California.

Aaron Woolfson

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