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Application of

NATIONAL AIRLINES, INC.

for an exemption from 14 C.F.R. Part 93,  
Subparts K & S, pursuant to 49 U.S.C. § 41714

Docket OST-99-5521 - 6

CONSOLIDATED REPLY OF NATIONAL AIRLINES, INC.

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Dated: May 3, 1999

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CONSOLIDATED REPLY OF NATIONAL AIRLINES, INC.

National Airlines, Inc. ("National") submits the following consolidated reply to the answers of America West Airlines, Inc. ("America West"), Atlantic Coast Airlines, Inc. ("Atlantic Coast"), and United Air Lines, Inc. ("United") to National's application for five slot exemptions for service between McCarran International Airport in Las Vegas, Nevada and O'Hare International Airport in Chicago, Illinois.

Notwithstanding these carriers' assertions to the contrary, granting National's application for five O'Hare slot exemptions would be in the public interest and consistent with the requirements of the slot exemption statute, 49 U.S.C. § 41714(c)(1). Significantly, National is the only current applicant for slot exemptions that: (1) is an "air carrier," (2) is truly a "new entrant," and (3) is not operating in affiliation with a major airline with substantial slot holdings at O'Hare. Additionally, National proposes to introduce more

capacity, price competition, and higher quality service in an underserved market.

I. Introduction

To briefly summarize the discussion in National's application, Congress has expressly authorized the Department to grant slot exemptions to enable "new entrant air carriers," such as National, to provide air transportation at O'Hare if the Department "finds it to be in the public interest and the circumstances to be exceptional." 49 U.S.C. § 41714(c)(1). The Department has established the following three-part test for determining whether granting slot exemptions to a new entrant air carrier would be justified under the "exceptional circumstances" standard of the statute:<sup>1</sup>

- The carrier's proposal must be based on the use of jet aircraft that meet Stage 3 noise requirements;
- There must be a reasonable expectation that the proposed service will be operationally and financially viable; and
- The carrier must propose to introduce (a) new nonstop service or (b) new competitive services (particularly if the carrier offers lower fares) where: (i) there is only single carrier service and the market

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<sup>1</sup> Applications of Simmons Airlines, Inc., et al., DOT Order 97-10-16 at 4; Applications of Trans States Airlines, Inc., et al., DOT Order 98-4-21 at 4; Applications of Reno Air, Inc., et al., DOT Order 99-2-26 at 4.

could support entry, or (ii) existing services do not produce meaningful price competition.

Consistent with the Department's decisional criteria, National intends to operate an all-Boeing 757 fleet that meets the Stage 3 noise requirements, and no party can really dispute that National's proposed service would be operationally and financially viable. Rather, the principal arguments made by two carriers opposed to National's request, United and Atlantic Coast,<sup>2</sup> relate to whether National's proposed service would satisfy the "exceptional circumstances" requirement of 49 U.S.C. § 41714(c)(1) by introducing price competition to an underserved market. National submits that neither Atlantic Coast nor United has undermined the validity of National's position that its proposed new nonstop O'Hare-Las Vegas service would respond to an unmet demand for seating capacity and would offer lower fares than currently exist in the market.

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<sup>2</sup> As discussed hereinafter, America West opposes National's application primarily on the ground that its desire for additional slot exemptions at O'Hare should be accorded priority.

II. National Will Provide Needed Additional Service in a Market that Lacks Meaningful Price Competition

The arguments by Atlantic Coast and United that National's proposed O'Hare-Las Vegas service does not satisfy the "exceptional circumstances" criteria of the new entrant air carrier slot exemption statute are based on the false premise that the Chicago-Las Vegas city-pair is the appropriate market for consideration, and fail to recognize that O'Hare and Midway should be treated as two distinct markets. Particularly when viewed as a discrete market rather than merely part of a larger city-pair market, it is evident that the O'Hare-Las Vegas market is capacity constrained and lacks meaningful price competition.

A. O'Hare and Midway Are Different Markets

Atlantic Coast and United contend that the Chicago-Las Vegas city pair, rather than the O'Hare-Las Vegas airport-specific route, is the relevant market for determining the absence of adequate service and price competition. However, this view runs contrary to established Department precedent and ignores the existence of important differences in the market characteristics of O'Hare and Midway.

First, in finding that O'Hare and Midway represent distinct markets, the Department rejected carrier arguments to the contrary and stated that

“[a]irport-specific routes can and do constitute separate markets if airlines serving such routes have some ability to disregard fares and services offered at other airports.” See Applications of Accessair Holdings, Inc., et al., Order 98-4-22 at 17-18.<sup>3</sup> Neither Atlantic Coast nor United disputes the long-standing principle that airport-specific routes may constitute different markets even though they involve the same city pairs.<sup>4</sup>

Further, in treating O’Hare and Midway as part of a single market, Atlantic Coast and United ignore important differences between the two airports, such as the existence of slot controls at O’Hare. While airport access is critical to preserving free market competition in the airline industry, the slot controls at O’Hare short-circuit price and service competition by establishing a formidable obstacle to the introduction of

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<sup>3</sup> Indeed, as described below, evidence demonstrates that the routes constitute distinct markets under the Department’s standards because the carriers serving the O’Hare-Las Vegas route are able to charge a 25% premium over the fares charged by the carriers serving the Midway-Las Vegas route.

<sup>4</sup> See, e.g., Joint Application of Texas Air Corp. & People Express, Inc., DOT Order 86-10-53 (“A specific airport pair will constitute a separate market if there is a large number of travellers who will rarely consider using alternative airports and if the carriers serving that airport pair can therefore disregard the level of fares and service offered at other airports in determining their fares and service levels.”).

service by new entrants lacking slots. In contrast, carriers more freely may introduce new routes, more capacity, better service options, and lower prices at Midway.

A second important distinction between O'Hare and Midway is that O'Hare has a host of international flights, while Midway has none. O'Hare also offers more connecting service than Midway due primarily to its status as a major hub of the two largest domestic air carriers.

Thus, there can be no doubt that O'Hare and Midway constitute two distinct markets for air transportation services.

B. The O'Hare-Las Vegas Market Currently Is Underserved and Lacks Meaningful Price Competition

Atlantic Coast and United argue that "exceptional circumstances" justifying the award of slot exemptions to National do not exist because there is adequate service and price competition in the Chicago-Las Vegas market. As shown above, the appropriate market for consideration in this case is the O'Hare-Las Vegas market, as opposed to the Chicago-Las Vegas city-pair. The existing circumstances in the correct market validates National's original position that the market is underserved and lacks meaningful competition.

First, market power is highly concentrated in the incumbents in the O'Hare-Las Vegas market. For example, United currently provides 59.1% of the available nonstop passenger seats in the market. American provides 27.2%, and America West provides 13.7%.

Second, the average fares and load factors of the incumbent carriers in the O'Hare-Las Vegas market are significantly higher than in the O'Hare-Midway market, even though the two markets serve a common destination and involve essentially the same distance. Specifically, as the following chart demonstrates, the average fare charged by the incumbent carriers at O'Hare is 25% higher than the average fare charged by the incumbent carriers at Midway. Notwithstanding the significant fare premium charged for service from O'Hare, many passengers continue to use O'Hare, and the average load factor at O'Hare is 14 percentage points (or 19%) higher than the average load factor at Midway.

	O'Hare	Midway
Average Fare	\$135	\$108
Load Factor	86%	72%

Source: DOT O&D Data for the year ending in the third quarter of 1998.

United and Atlantic Coast minimize the significance of the high load factors at O'Hare, stating that "low average fares and high average load

factors are necessary collaries [sic] of each other.”<sup>5</sup> If this is true, then nothing other than a lack of capacity and meaningful price competition explains why the load factor at Midway is not higher than at O’Hare because the Midway incumbents are offering lower fares and, thus, need to have higher load factors, according to United and Atlantic Coast.

In Exhibit NA-3 to its application, National showed that the three incumbent carriers in the O’Hare-Las Vegas market also realized above-average load factors for their O’Hare-Las Vegas service compared to other markets. For instance, American’s average load factor in the O’Hare-Las Vegas market averaged slightly over 90% in the year ending in September 1998. During that same period, its system-wide load factor averaged only 70%. Similarly, United’s O’Hare-Las Vegas load factor was 86.5% while its system-wide load factor was only 71.4%. America West’s average O’Hare-Las Vegas load factor also was significantly higher than its average system-wide

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<sup>5</sup> Answer of United at 7; see also Answer of Atlantic Coast at 5 (“The observation of high load factors is hardly surprising in a leisure market which attracts high numbers of discretionary passengers at relatively low fares. In such markets high load factors are the norm and permit carriers the ability to economically offer low fare service.”).

load factor (nearly 77% versus almost 68%).6 As the Department previously noted, these comparatively high load factors for O'Hare-Las Vegas indicate that the existing service is inadequate.7

Finally, Las Vegas McCarran International Airport ("Las Vegas Airport") has pointed out that notwithstanding the unmet capacity need and load factor increases, United and American reduced capacity in the O'Hare-Las Vegas market in 1998.8 Nevertheless, Atlantic Coast attempts to bolster its argument that there is not a lack of capacity by citing an anticipated 20% increase in nonstop seats in the market between May 1998 and May 1999. While increases in the quantity of seats supplied can be significant, the true measure of their significance depends on the relative number of seats being demanded. In this case, capacity in the O'Hare-Las Vegas market is still below competitive levels. If it were not, then the average fares and load

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6 "Taken together, the three airlines have an average load factor of 86% in the Las Vegas-O'Hare market." Answer of Las Vegas McCarran International Airport at 6.

7 Order 98-4-21 at 13 (stating that the high load factors in the O'Hare-Las Vegas and O'Hare-Phoenix markets "are an indication that both markets are underserved").

8 Answer of Las Vegas Airport at 6.

factors would not be as high at O'Hare as they presently are. Moreover, Atlantic Coast's argument ignores the incremental traffic that would be created by National's proposed price-competitive service at O'Hare.

C. National's Proposed Service Will Introduce Significant Service and Price Competition to the O'Hare-Las Vegas Market

National's proposed O'Hare-Las Vegas service would satisfy the "exceptional circumstances" criteria not only by helping to meet service requirements in the O'Hare-Las Vegas market but also by introducing significant new price competition between the two points.

National's proposed service will address the need for additional service by providing an immediate 24% increase in capacity in the O'Hare-Las Vegas market. See Exhibit NA-1. National estimates that its new service will attract an additional 145,000 passengers between O'Hare and Las Vegas during the remainder of the 1999 calendar year. See Exhibit NA-1.

National's proposed O'Hare-Las Vegas service also would help to reduce excessive market dominance by the incumbent carriers in the O'Hare-Las Vegas market. As measured by the number of passenger seats offered, introduction of National's proposed service will decrease United's market share from 59.1% to 47.6%, American's share from 27.2% to 22.0%, and America West's share from 13.7% to 11.1%.

Importantly, National's entrance into the O'Hare-Las Vegas market also will clearly aid in lowering the average ticket prices for passengers. National's proposed fares for its O'Hare-Las Vegas service are set forth in Exhibit NA-4, and will be significantly lower across the board than the fares currently being charged by the incumbent carriers in the O'Hare-Las Vegas market. For example, National's unrestricted, round trip first class fare will be 60.7% lower than the fare being charged by all three incumbents. National's unrestricted, round trip coach/tourist class fare will be 52.8% to 60.3% lower than the incumbents' fares. National's 14-day advance purchase, round trip fare will be 28.0% lower than the fare being charged by all three incumbents.

III. National's O'Hare Service Will Compliment Its Midway Presence

America West, Atlantic Coast, and United have suggested incorrectly that National will not be disadvantaged if the Department does not grant its slot exemption application because National will still be able to provide service to leisure travelers between Midway and Las Vegas. In the first place, while leisure travelers to the rapidly growing Las Vegas area will benefit from National's new air service at O'Hare, National will also market heavily to business travelers who will be attracted to National's superior new

service, which will offer greater leg room, liberal carry-on baggage allowances, more overhead bin space per passenger, and prepared meal service. Many business travelers visit Las Vegas regularly in connection with the city's unique entertainment and resort industries and its other vibrant business enterprises. Many more travelers come to Las Vegas to participate in conventions. Additionally, business passengers traveling between points on National's system will be offered the attractive option of unlimited stopovers at Las Vegas at no extra cost. National will work to become the carrier of choice for business travelers to Las Vegas.

Second, Midway is important to National's business plan, and National is committed to providing service there. However, there are infrastructure limitations at Midway that may hinder National's desired expansion at that airport.<sup>9</sup> In addition, Midway has no international flights and has fewer connecting flights to other U.S. destinations than O'Hare. Thus, by being confined to serving Midway, National will be unable to develop broader passenger benefits through interlining and, in the long-term, through code-

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<sup>9</sup> Specifically, Midway lacks gates that can readily accommodate Boeing 757 aircraft, which will be used by National. To enable its aircraft to provide service at Midway, National has been required to purchase special equipment for use between the gate and the aircraft.

sharing arrangements with the many carriers that provide international or domestic connecting service at O'Hare.

IV. America West Is Not Currently an Applicant for O'Hare Slot Exemptions

In its answer, America West supports the proposition that the Department should grant O'Hare slot exemptions for additional O'Hare-Las Vegas service. America West argues, however, that National's application should be deferred until the Department awards additional O'Hare slot exemptions to America West. But America West's contention ignores the fact that the carrier does not have a pending application for O'Hare slot exemptions.<sup>10</sup> Accordingly, America West is foreclosed from maintaining that it should obtain slot exemptions for O'Hare-Las Vegas service in preference to National.<sup>11</sup>

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<sup>10</sup> In its most recent order granting O'Hare slot exemptions, the Department did not identify America West as a carrier with a pending slot exemption application. See Applications of The Communities of the Virginia Peninsula, et al., DOT Order 99-3-12 at 2. America West's last application for O'Hare slot exemptions was dismissed by the Department in Order 99-2-26, and America West has not subsequently filed another application.

<sup>11</sup> America West also contends that its O'Hare-Las Vegas service would be superior to National's. These claims are irrelevant to this proceeding because America West has not filed a competing application for O'Hare slot exemptions. In rebuttal, however, National notes that each National flight will offer more first class and tourist class seats, more leg room, more liberal

V. National's Application Is Clearly Superior to the Other Pending Requests for O'Hare Slot Exemptions

The Department does not now have before it any exemption applications for O'Hare slot exemptions that merit priority over National's application. As contended in National's application and in United's answers to several community applications filed in other dockets, communities are not "air carriers" and, thus, are not qualified to receive slot exemptions under the express terms of 49 U.S.C. § 41714(c)(1).<sup>12</sup> Furthermore, the current air carrier applicants, Atlantic Coast and American Eagle, have already received a significant number of slot exemptions from the Department for service at

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[Footnote continued]

carry-on baggage allowances, more overhead bin space per passenger, and superior meal and cabin service than America West offers on its existing O'Hare-Las Vegas frequencies.

<sup>12</sup> The Department's previous decision granting slot exemptions to two communities should not be considered controlling precedent here because the Department repeatedly emphasized the "experimental" nature of the exemption award and indicated that the award was a "limited one-time test." See, e.g., Order 99-3-12 at 1, 2, 3, 6 (referring to the "experimental allocation," "an opportunity to obtain information" for future policies and legislative initiatives, "limited one-time test" to enable observation, and "the unique character of this experiment"). Additionally, the pending community applications are distinguishable and should be denied for the reasons identified in National's application.

O'Hare.<sup>13</sup> Both of them have been enabled "to implement a significant portion of its aggregate plan as presented in its slot exemption applications."<sup>14</sup> Moreover, any slot exemption granted to Atlantic Coast or American Eagle will have "the secondary effect of adhering to the advantage of a large carrier such as American" or United, which already exert market dominance at O'Hare but have failed to add needed capacity to Las Vegas.<sup>15</sup>

VI. Conclusion

For the reasons advanced above and in National's application, National's proposed O'Hare-Las Vegas service would be in the public interest and would satisfy the "exceptional circumstances" standard of the new entrant air carrier slot exemption statute. Accordingly, the Department

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<sup>13</sup> See Applications of Simmons Airlines, Inc., et al., DOT Order 98-9-24 (increasing the number of slot exemptions granted to American Eagle from 16 to 18); Order 98-4-21 (granting Atlantic Coast Airlines 16 slot exemptions). Effective June 1, 1998, American Eagle is discontinuing its use of eight slot exemptions previously granted by the Department, leaving the carrier with ten slot exemptions.

<sup>14</sup> See Applications of Accessair Holdings, Inc., et al., DOT Order 98-10-29 at 11 (stating that the Department is unable to grant America West's requests for additional slot exemptions because it had already received a number of slot exemptions).

<sup>15</sup> See Order 99-2-26 at 6.

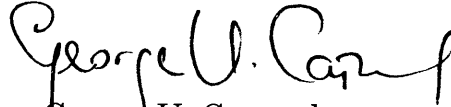
should award five of the nine O'Hare slot exemptions currently available to  
National.16

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16 Under the sixty-slot exemption limitation established by the Department in Order 98-4-21, the Department presently has nine slot exemptions available for distribution. See Order 99-3-12 at 6 n.7 (leaving one slot exemption unallocated); Letter from American Eagle Airlines, Inc. to the Department, dated April 12, 1999 (announcing that American Eagle is discontinuing use of eight slot exemptions and offering them for reallocation by the Department).

WHEREFORE, National Airlines, Inc. requests that the Department grant it an exemption from the provisions of 14 C.F.R. Part 93, Subparts K & S, to enable National to conduct five flight operations a day (departures or arrivals) at Chicago O'Hare Airport during the slot-controlled hours of 6:45 a.m. to 9:15 p.m. for the purpose of providing nonstop service between Las Vegas, Nevada and Chicago O'Hare Airport.

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