

BEFORE THE
DEPARTMENT OF TRANSPORTATION
WASHINGTON, D.C.

Joint Application of)
)

AMERICAN AIRLINES, INC.)
)

And)
)

LINEA AEREA NACIONAL CHILE,)
S.A. (LAN CHILE))

Docket OST-97-3285

Under 49 U.S.C. §§ 41308 and 41309 for)
approval of and antitrust immunity)
for alliance agreement)
)

REPLY OF AEROVIAS DE MEXICO, S.A. de C.V.
TO THE ORDER TO SHOW CAUSE
CONCERNING JOINT APPLICATION OF AMERICAN AIRLINES, INC.
AND LINEA AEREA NACIONAL CHILE, S.A. (LAN CHILE)

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Introduction and Overview

This submission, on behalf of Aerovias de Mexico, S.A. de C.V. ("Aeromexico"), responds to the Department of Transportation's ("the Department") invitation to interested parties to comment on its Order to Show Cause ("the Order") in Docket OST 97-3285-47, dated April 22, 1998. By this submission, Aeromexico wishes to express and illustrate its serious concern that granting antitrust immunity to American Airlines and Linea Aerea Nacional Chile ("LanChile") in the manner suggested by the Order is likely to result in greatly diminished competition in the critical U.S.-Latin America and intra-Latin America markets. While no doubt creating valuable business opportunities for American, LanChile and their other alliance partners, the resulting sharp reduction in competition will foster a dangerous opportunity for these carriers to control traffic, pricing and other critical variables in these increasingly important markets.

This submission briefly provides additional information that underscores this very real prospect, and encourages the Department to reconsider approval of the American/LanChile application. However, should the Department decide to approve the application, Aeromexico strongly urges the Department to impose more meaningful restrictions to prevent the creation of a dangerously anticompetitive environment and to foster real and essential opportunities for other carriers to provide more and better options in this market for U.S. passengers.

Aeromexico's recent efforts not only to enhance its presence and strategic offerings in the Latin America market, but also to take a leading role in securing a greatly enhanced bilateral agreement between the United States and Mexico, are strong testimony to the carrier's desire to participate fully in this critical market. While these actions also underscore Aeromexico's strong support for productive, consumer-oriented international alliances that can expand and enhance existing service, Aeromexico believes that not all international alliances lend themselves to competitive benefits for the carriers or for the U.S. and international passengers that rely on them. The American/Lan Chile is one such alliance that, particularly if immunized, appears antithetical to the Department's stated objectives for true global access and opportunity for U.S. aviation passengers. It is on this basis that we submit this response for consideration.

1. A Broader Analysis of Critical Markets Shows Competitive Threats Are Likely

In its Order, the Department indicates it does not believe that the proposed alliance, when immunized, would control the U.S.-Latin America aviation marketplace, principally because American and LanChile have a combined share of only 38 percent of the U.S.-South America market as a whole. Aeromexico wishes to note, in response, that the immunized alliance would in fact control a far greater portion of this market, directly and in combination with the other carriers with which American and/or LanChile have already established or are establishing

alliances¹. In order to obtain a full and fair understanding of the impact of this proposed alliance, Aeromexico believes that the Department must look at all of American's and LanChile's alliances, since they represent the true reach of American Airlines in the region. Even if the Department elects to narrow its review to include only carriers in which the petitioners have an ownership stake (an analysis which we respectfully submit would not take into account the full scope of the problem), the addition of the market domination of Aerolineas Argentinas in certain key U.S.-Latin American markets boosts the American/LanChile alliance to a much greater level relative to the 22.8 percent combined share of United/Varig, and the 5.4 percent share of Continental. Moreover, the outright market share of these three carriers (American, LanChile and Aerolineas Argentinas), in tandem with the strength of their exclusive local network system, clearly provides a strong basis for the carriers to distort and thwart competition once they are outside the reach of the rules of fair competition.

That said, Aeromexico believes that an analysis of U.S. consumer interests must evaluate the full competitive marketplace – meaning that it must see beyond only traffic between the United States and South America, or between the United States and Central America. This is not only because of the increasing traffic between the United States and virtually all points in Latin America, but also, critically, because U.S. passengers increasingly travel to one destination in Latin America, then to a second or a third, before returning back to the United States. As a result, U.S. passengers have a growing stake in intra-Latin America travel, and the proposed alliance, particularly once immunized, poses a serious threat to competition here. Within Latin America alone, American, LanChile and their various alliance partners together claim between 70 and 100 percent of the following major routes: Buenos Aires-Santiago (82%); Rio de Janeiro-San Jose (100%); Santiago-San Salvador (99%); Santiago-San Jose (99%); and Buenos Aires-San Jose (71%), to name just a few. As these data clearly indicate, the competitive impact

¹ Carriers included in this group are: AeroCalifornia; Aerolineas Argentinas; Aero Postal; Avianca; British Airways; Canadian Airlines; Iberia; LACSA; LanChile; and TACA Group.

of an immunized American/Lan Chile alliance on these intra-Latin America routes -- which are important not only for regional carriers, but also for U.S. carriers, and certainly for U.S. passengers -- could be extremely dangerous.

2. Inherent Market Constraints Limit the Ability of Open Skies to Enhance Real Competition

The Order indicates the Department's view that an "Open Skies" agreement between the United States and Chile will help to open new market opportunities for other carriers, possibly as an offset to the disproportionate market control that American/LanChile will gain from the immunity that may be granted. But it is important to keep in mind that, with or without an "Open Skies" policy, every market has inherent capacity restrictions. Therefore, no matter how much positive competition an Open Skies policy will support in theory, there are always real physical limits on how many carriers can service these markets, and how many new routes and frequencies can be added. This, of course, is true not only for U.S.-South America markets, but also for intra-South America and intra-Latin America markets.

Because of these somewhat finite capacity considerations, who controls the marketplace at the outset is a critical consideration; shifts in control, or even opportunities for control, are unlikely to occur without substantial and direct government intervention or other major capacity expansion. Even when such government intervention occurs -- as is projected to be the case with the anticipated U.S.-Chile Open Skies Agreement -- it is early control that sets the terms of competition for some time to come where markets such as Latin America (which does not foster the same type of broad-based competition as other regions, like Europe and Asia) are concerned. Thus, while Aeromexico and others continually seek to add new service to important U.S.-Latin America markets, this cannot offset a fundamental imbalance in competition that is building through the American web of alliances, and that could become permanent with the grant of antitrust immunity that American and LanChile seek.

3. Minimum Restrictions In Miami Are Critical To Ensuring Basic Competition

With this as a guideline, Aeromexico submits that, at a minimum, the Department should consider extending its proposed carve-out for antitrust immunity to include all New York-Santiago flights, and any flights between any city in Chile and Miami International Airport. Clearly Miami has become the single most important U.S. gateway to Latin America – claiming about 70 percent of all passenger traffic and 80 percent of all freight from the U.S. to Latin America.² Consequently, Miami is also a crucial first link for U.S. passengers who will travel within the Latin America region. Today, as the Order itself alludes, Miami also represents the hub with the greatest potential for control by the immunized alliance.

Certainly both American and LanChile are already strongly positioned to compete at these critical gateways, as both have significant presences there already. Granting the protection of antitrust immunity in this instance benefits only American and LanChile. Consumers and competition would not derive any benefits from a grant of antitrust immunity to these two corridors. American and LanChile are unlikely to expand their offerings or otherwise enhance their services if antitrust immunity is granted. They are much more likely, given the current redundancy of service, to eliminate some of their combined frequencies in this market to enhance their combined efficiencies. A grant of antitrust immunity in the New York-Santiago and the Chile-Miami markets would simply have no redeeming competitive value to consumers.

The value to be gained by excluding Miami is not merely to provide opportunities for other carriers to participate in the Miami market, but also to help foster the development of other cities as alternatives to compete for traffic between these key U.S. and Latin America gateways. Clearly the development of cost-efficient and geographically efficient alternatives is in the best

² Douglas W. Nelms, *Staking Southern Wealth: As The Latin American Market Continues to Grow, More U.S. Airports Are Trying to Gain Some Parts of the Action*, Air Transport World, Mar 1997.

competitive interests of the United States aviation industry and its passengers to and from Latin America.

Conclusion

Aeromexico remains deeply concerned that American Airlines, allied with LanChile, and through an existing series of affiliations and alliances with other important carriers in the region, will block out competition from other carriers – particularly smaller competitors -- once it is fully immunized against the threat of U.S. antitrust laws. American has demonstrated, in the view of Aeromexico, a proclivity to do this in its home market. Aeromexico is therefore concerned that freedom from U.S. antitrust rules, coupled with a network that dominates and controls the most important aspects of the regional marketplace, will allow and encourage anticompetitive behavior in the U.S.-Latin America marketplace as well.

Because this marketplace is so important to the 1.7 million U.S. passengers who fly between the U.S. and South America, as well as the 4.7 million passengers who fly within Latin America each year, Aeromexico urges the Department to take steps to protect against this potentiality, either by rejecting the original application, or by granting immunity with more targeted and meaningful limitations. Aeromexico believes that excluding flights between New York-Santiago and between Chile-Miami from antitrust immunity helps to protect against the prospect of anticompetitive practices in that market while responding fully to the request of the petitioners for an opportunity to coordinate so that they can create new market opportunities. This restriction is also likely to support, if not foster, the creation of other, more geographically and economically efficient U.S. gateways to and from Latin America. In turn, this outcome would not only likely benefit Aeromexico and other carriers which have expressed an interest in this market, but it would undoubtedly yield benefits to the large and growing pool of U.S. consumers who will be impacted.

Aeromexico appreciates this opportunity to share its concerns, comments and recommendations with the Department in this matter of great concern to all the carriers that currently serve, and all those that may wish to serve, this critical marketplace.

Respectfully submitted,



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