

**BEFORE THE
DEPARTMENT OF TRANSPORTATION
WASHINGTON, D.C.**

_____))
Joint Application of))
))
AMERICAN AIRLINES, INC.))
 and))
LINEA AEREA NACIONAL CHILE, S.A.) Docket OST-97-3285
(LAN CHILE)))
))
under 49 U.S.C. Sections 41308 and))
41309 for approval of and antitrust))
immunity for alliance agreement))
_____)

DATED: May 20, 1999

STATEMENT OF OBJECTIONS OF UNITED AIR LINES, INC.

United Airlines opposes the Department's tentative decision in Order 99-4-17 to approve and immunize from the antitrust laws the Alliance Agreement between American Airlines and Linea Aerea Nacional Chile ("Lan Chile"), subject to certain conditions.

That tentative decision is premised, in large measure, on a finding by the Department that with open skies, other airlines will be able to extend their networks into Chile to compete with the American/Lan Chile alliance for the "vast majority" of U.S.-Chile passengers. Order 99-4-17 at 18. The sole basis for this finding is the Department's conclusion that the Miami-Santiago route, where American/Lan Chile are entrenched incumbents with a monopoly share of the available traffic, "accounts for a relatively small proportion of the total U.S.-Chile market." Id.

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However, as explained below, that conclusion is erroneous. Rather than accounting for a mere 15% of total U.S.-Chile demand, as the Order states, Miami-Santiago local passengers represent closer to 50% of the total U.S.-Chile air travel market. If the Department approves the American/Lan Chile alliance, other carriers will not have a meaningful opportunity to compete for these local Miami-Santiago passengers, leaving this large segment of the U.S.-Chile market without effective network-to-network competition, even assuming the U.S.-Chile open skies agreement enters into force.

Because all of the Department's tentative conclusions about other carriers' ability to enter the U.S.-Chile market are ultimately grounded on its erroneous finding about the relative size of the Miami-Santiago local market, those conclusions cannot be relied upon by the Department in deciding whether to make its tentative decision final. If, despite this fatal flaw in its analysis of demand patterns in the U.S.-Chile market, the Department does proceed to make the decision final, the end result will be a less, not a more, competitive U.S.-Chile air travel market, even with open skies.

Such a decision will also increase substantially the pressure on the Department to approve and immunize from the antitrust laws alliances between American and other regional

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carriers that today are its principal competitors in key Miami-South America city pairs. If the Department goes forward with its tentative decision to "pay" for open skies with Chile by immunizing American's alliance with Lan Chile, its principal Miami-Santiago competitor, it will be impossible for the Department to turn down similar deals elsewhere in South America, including in Argentina and Colombia where American is working to implement alliances with Aerolineas Argentinas and Avianca. With each subsequent alliance, American's regional dominance will increase, the ability of other carriers to enter U.S.-South America markets will decline despite the spread of pro forma open skies agreements, and the opportunity for the development of a viable second online network in Miami-South America city pairs will be lost. If the Department is to avoid such a seriously anti-competitive outcome, it cannot make its tentative decision final.

In further support of this objection, United submits the following:

1. In Order 99-4-17, the Department finds that "despite American's position now as the dominant carrier in the U.S.-Chile market the vast majority of passengers ... travel beyond each of the current U.S. gateway cities. The Miami-Santiago route ... accounts for a relatively small portion of the total U.S.-Chile

market." Id. at 18, footnote omitted. The Department concludes from this finding that "with established domestic and international networks [other airlines] will be able to compete for the preponderance of traffic to and from Chile over their own gateway cities." Id.

The Department's finding that the Miami-Santiago route accounts for only a relatively small share of total U.S.-Chile demand is, according to the Order, based on a review by the Department of its O&D Survey data. See Order 99-4-17 at n. 29. However, the Department does not include in the Order the data on which its calculation is based.

As a participant in the O&D Survey, United has access to the data. United has carefully reviewed the Survey data, as well as INS data relating to the U.S.-Chile market, and compared those data to consolidated CRS booking data relating to the U.S.-Chile market for sales made in both the U.S. and Chile. Based on this review, United is persuaded that the 15% figure cited in the Order is erroneous. Instead, United believes Miami-Santiago local passengers represent between 40% and 50% of total U.S.-Chile demand, as United pointed out in its initial comments in this docket. Because the Department's tentative decision in the Show Cause Order is premised on this erroneous finding, it

clearly would be reversible error for the Department to proceed to make the Order final.

2. Experience in Miami-Central America city pairs since the Department approved American's alliance with the TACA Group of carriers in 1998, confirms that such alliance has led to a reduction in competition in those markets, just as United, the Department of Justice, and other carriers had predicted in opposing that alliance. For example, in July 1998, there were a total of 213 weekly nonstop frequencies scheduled between Miami and the nine principal destinations in Central America. Based on schedules being held out in CRS systems, by July of this year, the total number of weekly scheduled nonstop flights in these Miami-Central America city pairs will have decreased by nearly 10%, with a comparable decrease in available seats. While the total number of weekly frequencies and seats available in Miami-Central America city pairs is declining, American's share of the service available is increasing; as of July, American will hold a nearly 60% share of the service available in these city pairs.

The Department's decision to approve the American/TACA alliance prevented the development of a second viable network in Miami-Central America city pairs that could compete with American for local traffic. Not surprisingly, the result has been a substantial increase in fares in these city pairs for local

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passengers.¹ Even though the open skies agreements in place in Central America have made it possible for Continental and Delta to enter markets in Central America from other gateways, those services offer no competition to American/TACA for Miami-Central America local passengers due to Miami's unique geographic location. And, Miami-Central America city pairs continue to be the largest U.S.-Central America city pairs by a considerable margin.

The structural advantages American enjoys in Miami-Central America city pairs that prevent other carriers from challenging its dominant position in those markets are also present in the Miami-Santiago market. If the Department, nonetheless, proceeds to approve the American/Lan Chile alliance, the end result will be the same as it has been in Central America: No carrier will be able to develop a viable second network linking Miami to Santiago that can compete with American for local Miami-Santiago passengers, insulating American's service in the market from effective network competition.

¹ For example, a review of the lowest available roundtrip fares published in the Miami-San Jose, Guatemala City, Panama City, and San Salvador markets shows that between June 1998 and June 1999, fares rose by 158%, 138%, 118%, and 213%, respectively. Fares in other Miami-Central city pairs also rose, although by a lesser amount. For example, the lowest published roundtrip fare between Miami and Belize rose by 22%; between Miami and Managua, the increase was 39%.

Unless the Department intends to repeat the Miami-Central America experience in Chile, it should not make the Show Cause Order final.

3. United objects to the Department's tentative decision even though it is a firm proponent of global alliances and an advocate of open skies agreements. Open skies agreements and alliances are not, however, ends in themselves, only the means to an end: The opening of international aviation markets to increased competition and the opportunity for carriers to enter or exit individual city-pairs solely in response to supply and demand considerations, not governmental route policies. Open skies agreements in themselves do not ensure that markets will perform competitively, only that governmental barriers to entry in the form of designation limitations and frequency and capacity controls are eliminated. Nor can open skies agreements in themselves substitute for competition policy in ensuring that markets perform competitively.

Notwithstanding the Department's tentative findings in Order 99-4-17, the alliance proposed between American and Lan Chile poses substantial risks to competition that cannot be offset simply by bringing into force the open skies agreement with Chile. Nor will bringing that agreement into force ensure that other carriers will be able to extend their networks into

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Chile to compete with the American/Lan Chile alliance, despite the Department's tentative findings to the contrary in Order 99-4-17.

United, Delta and Continental are effectively frozen out of the U.S.-Chile market today by the restrictive terms of the current bilateral agreement. As such, it makes utterly no sense for these carriers to be opposing the grant of antitrust immunity to American and Lan Chile as the price for securing open skies, if the Department's pollyannaish view of their ability to extend their networks into Chile was even remotely close to the commercial realities the carriers will face in trying to compete with an immunized American/Lan Chile alliance. The commercial reality, however, is that extending immunity to the American/Lan Chile alliance will serve only to entrench American and Lan Chile as the dominant competitors in the U.S.-Chile air travel market, and to prevent the entry into the market of a second viable network competitor, even with the entry into force of the U.S.-Chile open skies agreement.

United fully shares the Department's desire to see the U.S.-Latin America air travel market opened to entry by all carriers as a means of facilitating increased network-to-network competition throughout the region. Nonetheless, despite the Department's tentative findings in Order 99-4-17, United remains

firmly persuaded that such a pro-consumer outcome will not be achieved by allowing American, in effect, to hold open skies agreements throughout the region hostage to its ability to implement immunized alliances with its leading competitors. Moreover, because the Department will be forced to pay the same ransom elsewhere in South America, a decision to make the tentative findings and conclusions in the Show Cause Order final will lead to similar anti-competitive consequences throughout the continent.

4. American is the only carrier that currently has an online network that links its hubs in the United States with virtually every major population center in Latin America. Today, that network is effectively insulated from effective network-to-network competition from any of American's U.S.-flag competitors because of the restrictive bilateral air service agreements in effect throughout all of South America.

American is now seeking to replace these governmental barriers to entry with a series of profoundly anti-competitive alliance agreements with its principal foreign competitors throughout the region, including not only Lan Chile, but the six carriers of the TACA Group, Avianca, TAM-Mercosur and TAM. In addition, American has made a strategic investment in the holding company that controls Aerolineas Argentinas and Austral, giving

it substantial leverage to influence these carriers' alliance strategy.

The record in this proceeding makes clear, and the Department does not find to the contrary in Order 99-4-17, that American does not need a coordinated alliance with Lan Chile, or with any other carrier in Latin America, to extend its network into the key population centers in the region. Rather, it is continuing to pile up these alliances in order to ensure that its foreign partners do not form alliances with its U.S.-flag competitors, which are struggling to extend their networks into Latin America to offer consumers a viable competitive alternative to American.

Because American gains no access to valuable new markets in South America through an alliance with Lan Chile, why is it willing to provide Lan Chile access to its substantial feed network behind its Miami hub? The record in the TACA case, docket 96-1700, showed persuasively that American decided to grant the TACA carriers access to its network of routes behind Miami in order to preclude its U.S.-competitors from entering into alliances with the TACA Group carriers.² Such alliances would make both the carriers in the TACA Group and their U.S.

² See Order 97-12-35 at 29 and n.62.

partners more competitive with American at the strategic Miami gateway, a result American clearly wants to avoid.

American's motives here are no different. By securing an immunized alliance with Lan Chile, American trades off the access it grants Lan Chile to its route network behind its Miami hub against the economic benefits it gains from foreclosing another U.S. carrier securing an alliance with Lan Chile that might facilitate meaningful network-to-network competition with American in the Miami-Chile market that could threaten American's dominance at Miami. In other words, an alliance with Lan Chile will seal American's ability to engage in predatory conduct, if necessary, to drive United (or another competitor) from the Miami-Santiago route.

5. In deciding whether to make the Show Cause Order final, the Department should not lose sight of the reasons the U.S.-Chile market is currently subject to severe capacity and designation limits. Up until 1993, the U.S.-Chile air services agreement was a liberal, post-deregulation agreement. In May 1993, American proposed to double the number of weekly frequencies it scheduled between Santiago and its fortress hub in Miami.

Chilean carriers, believing that this increase was a predatory attempt by American to drive them from the market,

filed complaints against American's proposed schedule increases with Chile's Anti-Monopoly Commission. The Commission ordered a freeze on carrier schedules while it reviewed the complaint.

American responded to the freeze by filing a complaint with the Department against the Chilean carriers under the International Air Transportation Fair Competitive Practices Act of 1974. The matter was ultimately resolved by the governments agreeing to replace the liberal U.S.-Chile air services agreement with the current understanding in which designations and frequencies are subject to government-agreed limits. See e.g., Orders 93-11-33 and 93-11-22.

Although Chile is now offering to replace these capacity limits with an open skies agreement, that offer is contingent upon the Department granting American and Lan Chile immunity from U.S. antitrust laws to implement what would amount to an operational merger between them. Order 99-4-17 at 4-5.

Although United shares the Department's desire to bring the open skies agreement with Chile into force, it does not agree with the Department's tentative conclusion in Order 99-4-17 that antitrust immunity can be extended to the American/Lan Chile alliance without a substantial lessening of competition. Even though the Department is obviously correct that the open skies agreement removes all governmentally-imposed restrictions on

entry into U.S.-Chile city pairs, theoretically opening those city pairs to more intense competition than now exists, open skies alone does nothing to redress the enormous market power American enjoys due to its dominance of the strategic Miami gateway, where American alone operates 80% of the total U.S. carrier nonstop seats between Miami and South America and 100% of U.S. carrier nonstop seats between Miami and Central America.³ Miami is the predominant U.S. gateway to Chile, just as it is to the rest of Latin America, with 70 percent of total U.S.-Chile passenger traffic using the Miami gateway. And, local Miami-Santiago passengers constitute nearly half of total U.S.-Chile demand.

The Department's tentative decision to grant American and Lan Chile immunity from U.S. antitrust laws so that they can effectively implement an operational merger of their competing U.S.-Chile services will lead inevitably to a substantial reduction in competition at the key Miami gateway, and would secure no public benefits that might support the grant of such immunity under applicable statutory standards.

Miami's leading role as a U.S. gateway to Latin America is due both to the high level of local demand in Miami-Latin America city-pair markets, and the city's unique geographic

³ Based on schedules published in the OAG for July 1999.

location as the most direct gateway to most of Latin America from the Eastern United States. Because of Miami's unique position as a gateway and destination for such a large portion of U.S.-Latin America traffic, maintaining competition in Miami-Latin America city pairs is far more important than at other U.S. points where there is less local demand.

Because of Miami's unique geographic location, as well as the large and affluent Spanish-speaking population living in South Florida, Miami controls both the flow and the source of traffic to virtually all of Latin America. Moreover, Miami has become the primary business center for this region, with banking and other regional businesses located there. Because of this, local demand in U.S.-Latin America air travel markets is concentrated at a single U.S. destination, Miami, to a degree not matched by any other inter-continental market. And the mere bringing into force of the open skies agreement with Chile (or any other country in Latin America) will not change the structural nature of demand in this market.⁴

Because of Miami's unique status as both the principal destination and leading gateway for Latin American travel, any

⁴ This is amply demonstrated by experience in U.S.-Central America markets where local demand is also heavily concentrated at Miami despite the absence of any governmental barriers to entry into these markets.

reduction in competition on Miami-Latin America city-pair routes has a proportionally greater effect on the traveling public than would, for example, a similar reduction in any individual U.S.-Europe city-pair market. Maintaining competition at Miami is complicated, however, by the fact that American alone maintains a hub at Miami and dominates overall traffic at that strategic gateway.

United is the only carrier that has been seeking to develop a network of services at Miami that could serve as a competitive counter-weight to the network American already has in place in all major (and many major) Miami-Latin America markets. However, if the Department allows American to enter into alliance agreements with most of the major foreign carriers in Latin America, United's ability to operate profitably a network of Miami-Latin America services for local passengers will be seriously eroded.

In effect, because American has a hub at Miami, it is the only carrier operating Miami-Latin America service at minimum efficient scale. United and Lan Chile, on the other hand, which do not have hubs at Miami (and in United's case, no hub at Santiago either),⁵ operate on this route below minimum efficient

⁵ While Lan Chile maintains something of a hub at Santiago, the record here suggests that, due to Santiago's geographic
(continued...)

scale. However, by entering into an alliance, United and Lan Chile could improve the efficiency of their Miami-Chile services, and thereby be better positioned to compete with American. To forestall that outcome, American is willing, in effect, to acquire Lan Chile.

From American's standpoint, acquiring Lan Chile is economically rational even though American gains no new market access from such acquisition because it forecloses United's ability to achieve minimum efficient scale on the Miami-Santiago route through an alliance with Lan Chile. So long as United is forced to operate this route below minimum efficient scale, it is at risk of being driven from the route by American.

From Lan Chile's standpoint, effectively selling out to American makes more economic sense than would entering into an alliance with United. The reason is that by selling out to American, it will be able to share in the monopoly rents American will be able to earn if American is successful in forcing United to exit the route. On the other hand, if Lan Chile enters into an alliance with United, it would merely be a participant in a two carrier competitive market, an outcome that would certainly be less profitable than joining with American to achieve a

⁵ (...continued)
location, Lan Chile gains only limited behind gateway traffic support from the services it operates beyond Santiago.

monopoly. Because American has a uniquely dominant hub at Miami, the calculus will always be the same for every carrier in Latin America: Operationally merge with American and share in the monopoly rents American hopes to gain on its Miami-Latin America services, or enter into an alliance with another U.S.-flag competitor to achieve a second efficient network of services that will compete with American between Miami and Latin America.

A decision by the Department to grant the American/Lan Chile alliance antitrust immunity will facilitate the maintenance of a Miami-Latin America market structure in which it is impossible for United to gain alliance partners that would enable it to achieve minimum efficient scale on its Miami-Latin America services so that it can challenge profitably American's domination of these markets. In such event, United may have no choice but to exit these markets and assign its aircraft resources to other global markets with greater profit potential.⁶

The issue the Department must resolve in this proceeding is how to preserve meaningful competition in Miami-

⁶ If United were forced to exit the market solely because of American's superior competitive performance, United's exit would be of no governmental concern. However, if United is forced to exit because of a series of Departmental decisions that foreclose its ability to establish a second efficient online network through alliances with Lan Chile and other Latin American carriers, the Department will have failed to carry out its responsibility under the statute to exercise its administrative discretion to promote competition and serve the public interest.

Latin America city-pair markets where American is moving to implement alliance agreements with the foreign-flag carriers that are its principal nonstop competitors. This is an issue that cannot be resolved simply by incanting, as the Department does in the Show Cause Order, that the bringing into force of the open skies agreement with Chile (or with any other government in Latin America) removes all governmental barriers to entry by United or another U.S. carrier in any Miami city-pair market where American and its partners operate overlapping nonstop service.

Nor, in the unique circumstances of Miami, can this issue be resolved by simply carving out from any immunity granted American and its Latin American partners cooperation on any nonstop Miami city-pair routes where American and its foreign partners compete. So long as these foreign carriers are free to enter into alliances with American, it would be economically irrational for them to cooperate with any of American's U.S.-flag competitors. As such, by approving American's multiple overlapping alliance agreements in Latin America, the Department will effectively be denying American's U.S.-flag competitors the ability to utilize code sharing and alliance agreements with these foreign carriers to create a U.S.-Latin America market structure in which there is network-to-network competition between competing alliances, the very outcome the Department

believes it will achieve in extending immunity to the American/Lan Chile alliance. The fact is, however, that a Department decision making its tentative decision final will be the first step down the road to an even more entrenched American monopoly in Miami-South America city-pair markets. If that outcome is to be avoided, the Show Cause Order must not be made final.

5. Should the Department nonetheless decide to make its tentative decision final, United urges the Department to clarify in the final order that by extending antitrust immunity to the American/Lan Chile alliance, it does not intend to preclude United from participating in IATA tariff conference activities where through U.S.-Chile rates, fares or charges are discussed. See Order 99-4-17 at 22-23, and ordering paragraph 4.

In deciding to immunize from the antitrust laws alliances between U.S. and European carriers, including United's alliances with Lufthansa and SAS, the Department imposed a condition limiting the carriers' ability to participate in IATA tariff coordination activities affecting through rates, fares and charges between the U.S. and the homelands of the foreign airlines participating in these alliances. The Department's rationale for imposing this condition was that it was duplicative and unnecessary for participants in immunized alliances to

simultaneously participate in IATA tariff coordination. See e.g., Order 96-11-1 at 19-20.

As the Department explained there, one of the reasons it has been persuaded to extend antitrust immunity to alliances is the potential for increased price competition between alliance carriers and other carriers, particularly other international alliances. Id. at 20. According to the Department, permitting carriers in immunized alliances to participate simultaneously in IATA tariff coordination undermines the network-to-network competition it is intending to foster through the grant of antitrust immunity. Id.

Whatever the merits of the Department's concerns may be in the context of U.S.-Europe air travel markets, those concerns are not appropriately applied to U.S.-Chile city pairs. In U.S.-Europe markets, United and its alliance partners, Lufthansa and SAS, can utilize their antitrust immunity to develop a coordinated network of services that facilitates the carriers' ability to compete against other carriers and alliances in city pairs between points in the U.S. and points in Austria, Belgium, Denmark, Germany, Norway, Sweden, Switzerland, and the Netherlands. In U.S.-Chile markets, however, United's ability to compete with American and Lan Chile is not enhanced to any meaningful extent by its alliance with Lufthansa and SAS. Nor

does United's ability to coordinate its pricing decisions with Lufthansa and SAS, subject to certain exceptions, duplicate in any meaningful way IATA tariff conference activities for U.S.-Chile through prices.

On the contrary, because United's access to much of the U.S.-South America air travel market remains severely restricted due to bilateral limitations, United is far more dependent upon interline arrangements to hold out service to South America than it is to Europe. And United cannot rely upon its alliance with Lufthansa and SAS to overcome those bilateral limitations as it does in Europe.

Because United is more dependent upon interlining to compete in South America, including Chile, there is no justification for excluding United from participation in IATA tariff coordination solely because of United's immunized alliances with Lufthansa and SAS. The level of interlineable fares agreed to through IATA's tariff coordination activities imposes no limit on the prices United may charge for U.S.-South America air services. Those fares do, however, have a direct bearing on the revenue United will receive whenever it participates in providing interline transportation between points in the U.S. and points in South America, including points in Chile.

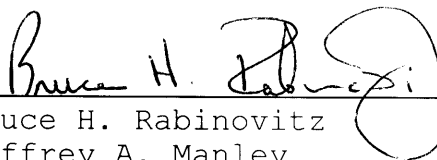
Unless United can participate in IATA's U.S.-Chile pricing activities, other South American carriers with which United competes will be able to manipulate the level of IATA's U.S.-Chile interlineable fares to United's disadvantage. To the extent this happens, United will be less able to price its U.S.-Chile services aggressively because of the potential for serious revenue dilution if United's selling prices are too much below the IATA interlineable fare. To avoid such unintended anti-competitive consequences, if the Department makes its tentatively decision final, it should clarify that any conditions it may impose on American's and Lan Chile's participation in IATA tariff coordination for U.S.-Chile through prices do not limit United's ability to participate in IATA tariff coordination for through U.S.-Chile rates, fares and charges.

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The Department's decision to approve the American/TACA alliance precluded the development of a second viable network in Miami-Central America markets to compete with American, even though there are open skies agreements in place in the region. Without an effective network competitor in these city pairs, American has been able to raise its Miami-Central America prices

to the detriment of local passengers in these markets. Unless the Department intends to repeat this Central America experience in Chile, it must not approve the American/Lan Chile alliance.

Respectfully submitted,



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DATED: May 20, 1999

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the Statement Of Objections Of United Air Lines, Inc. on all persons named on the attached Service List by causing a copy to be sent via first class mail, postage prepaid.


Kathryn Dionne North

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