

Testimony of
Mr. Larry Kellner

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Good afternoon Mr. Chairman and Members of the Subcommittee, I am Larry Kellner, President of Continental Airlines. Continental is the fifth largest airline in the United States, offering more than 2000 departures daily to over 200 domestic and international destinations. Continental's employees have established our airline as an industry leader by consistently ranking at or near the top of the U.S. Department of Transportation consumer metrics. As a result of this kind of consistent quality service, Continental has been recognized as an industry leader and continues to receive many of the most coveted awards for airline service. Continental has won the Frequent Flyer/J.D. Power and Associates award for customer satisfaction four of the past five years, and has been named the Airline of the Year by Air Transport World magazine in 1996 and 2001, the first time an airline has won the award twice in such a short period of time. Continental ranked eighteenth in the most recent Fortune Magazine list of the 100 best companies to work for, and was one of only two airlines to appear on this coveted list.

This kind of recognition and achievement is just one indication of how qualified and prepared we are to compete with U.S. and foreign flag carriers - but we can only compete if we are given the opportunity to do so. We will only be given the opportunity to do so if the U.S. Government actively and aggressively protects competition and consumers on a worldwide basis. For this reason, I applaud this committee's longstanding interest and concern about mergers and alliances in the airline industry.

Competition is the reason we are here today. I very much appreciate this opportunity to testify today on the important topic of the U.S.-U.K. aviation environment and the very serious and potentially disastrous impact that the American Airlines/British Airways antitrust immunized alliance, a virtual merger, would have on competition. The airline industry is currently facing some of its greatest challenges. The government's action on the American/British Airways merger will determine whether the airline industry continues to be competitive or is dominated worldwide by a few global airlines. Never before has careful scrutiny and reasoned analysis been more necessary. The timing of this hearing is indeed propitious and the issue crucial.

Earlier this year, after careful and extensive review, the antitrust experts at the U.S. Department of Justice decisively turned down the proposed merger of United Airlines and US Airways - correctly deciding that the combination of the second and sixth largest carriers in the U.S. would be nothing less than a catastrophe for consumers.

The proposed American/British Airways "merger" is similarly anticompetitive and, in fundamental respects, is even worse. In fact, American/British Airways would have an even greater effect on concentration in the U.S. - U.K. market than would a merger between the 1st, 2nd and 3rd largest carriers in the United States -- American, United and Delta - in the U.S. market. It would produce a level of seat concentration in the U.S. - U.K. market even greater

than that of a merger between seven of the top ten domestic European airlines in the intra-European service market. Frankly, it takes enormous chutzpah on the part of American Airlines and British Airways to even make such a proposal.

Continental has not opposed earlier applications for antitrust immunity. We did not oppose Northwest/KLM, United/Lufthansa, or American/Swissair/Sabena. More recently, we have not opposed Delta/Air France/Alitalia/CSA Czech. But, those alliances were and are very, very different. They are what we call "end-to-end" alliances that allow each carrier to extend its network into areas it could not serve on its own, thereby increasing competition and providing consumer benefits. But we have opposed the American/British Airways alliance, both when it was originally proposed in 1996 and again now. The reason for our opposition is that the American/British Airways alliance is a brutally anticompetitive horizontal alliance - combining the two biggest competitors in some of the most important markets in the world and allowing them to dominate an entire region and control some of the world's largest and most important gateways. Their combined share in markets where they currently compete will mean a substantial reduction in competition. The anticompetitive, anti-consumer effects of the proposed alliance far outweigh the insignificant end-to-end benefits of this largely horizontal alliance.

In 1997, the Antitrust Division of the Department of Justice commented on the then-proposed American/British Airways alliance by saying,

"The alliance as proposed will significantly reduce competition in the many U.S.-U.K. city pairs without producing sufficient efficiencies to outweigh the harm."

What the Department of Justice said then is just as true today. While the ultimate decision in this case rests with the Department of Transportation, it is important that this Subcommittee and the Department of Justice have the time and the wherewithal to analyze the proposed antitrust immunized alliance and provide insight into the harm that approval of this deal will bring. There should be no rush to sacrifice consumers and competition on the altar of "open skies". Important information regarding competition in the airline industry has already been gathered in other Justice Department cases (including the last time that American/British Airways asked for antitrust immunity) and should be carefully analyzed. This information will (1) prove that the proposed antitrust immunized alliance between American Airlines and British Airways is even more anticompetitive in the relevant markets than the recently rejected United/American/US Airways transaction, and (2) that meaningful competition to the proposed alliance is impossible.

While the applicants claim that their alliance should be treated like any other, the plain truth is that it is not the same. The Department of Justice, in comments submitted to the Department of Transportation on May 21, 1998 (in the docket from the last American/British Airways attempt to gain approval for their anticompetitive alliance), agreed that this alliance is different, stating,

"There are some important differences between the AA/BA Alliance and earlier alliances reviewed by DOJ. First, the competitive losses threatened by the transaction affect a far larger number of passengers than were affected by any of the other alliances...Second, the potential consumer benefits from this Alliance are more limited than those associated with the prior alliances."

What American and British Airways are proposing is different from prior alliances, and a "me too" claim is not appropriate.

Consider the following:

American and British Airways are the two largest carriers in the world's largest intercontinental market. They are asking for immunity from antitrust laws in order to fix prices, divide markets, allocate capacity, and pool revenues in large and important markets where they currently compete.

American and British Airways already dominate London (Heathrow). By combining, they will effectively eliminate competition in the U.S.-U.K. market.

The American/British Airways combination, unconstrained by antitrust concerns, will crush smaller competitors in the U.S.-U.K. market. They will be free to manipulate prices, capacity, and schedules, and use their market power in the most important business markets in the world to drive their competitors from those and other markets. Smaller carriers will have no means to respond, even under an open skies agreement. A combined American/British Airways will have the market power to discipline those few airlines who are in a position to compete, and who dare to do so.

Nominal access to London Heathrow -- which is all that is contemplated under open skies -- is meaningless given (1) the overwhelming dominance of American and British Airways in the U.S.-U.K market, (2) facility constraints at London Heathrow, (3) the limitations of the London Heathrow slot system, and (4) the inability of smaller competitors to discipline American/British Airways fares in the U.S.-London markets.

Elimination of the current barriers to entry at London Heathrow and London Gatwick is crucial to achieving any benefit whatsoever from an open skies treaty with the U.K. An open skies treaty will be a hollow shell if American and British Airways are allowed to control critical airport slots and facilities and, thereby, to dominate the relevant U.S.-U.K. markets.

Given the size and importance of the relevant markets and the certainty and significance of the anticompetitive effects, this unique and troubling alliance requires extraordinary government scrutiny. With the instability facing the airline industry as a result of the September 11 terrorist attacks, now is not the time to allow ourselves to be rushed into a decision with permanent and potentially devastating consequences.

The U.K. Market is Different and London Heathrow Has No Viable Alternatives

American and British Airways propose to functionally merge their transatlantic operations, fix prices, divide markets, allocate capacity, and pool revenues with complete immunity from the antitrust laws. This is an astounding proposition in light of their combined size and position in the world's largest intercontinental market. American is the largest airline in the U.S. and worldwide. British Airways is the largest airline in the U.K. These airlines dominate access to the premier airport in Europe, London Heathrow, a slot and facilities constrained airport where they control the most valuable slots and facilities. American and British Airways compete directly

with one another and are the two largest airlines in the U.S.-U.K. market. The two carriers now propose to combine their large number of overlapping routes and eliminate direct competition in the largest U.S.-Europe market. The two carriers will do this by utilizing their dominant presence at London Heathrow.

The U.S.-U.K. market is different than any other market where carriers have attempted to gain antitrust immunity. The London market has been severely restricted by the aviation bilateral in place between the two nations (Bermuda II). While this bilateral treaty has basically opened the skies between the U.S. and all U.K. points except London Heathrow and London Gatwick, the skies remain closed at London Heathrow and London Gatwick. The bilateral restricts the number of airlines that can operate to London, the number of U.S. cities from which flights to London can originate, and the number of actual operations to London that can take place. American and British Airways have fared exceedingly well under this bilateral, growing to be the two largest airlines between the U.S. and London, both having access to London Heathrow with multiple overlapping flight and gateway opportunities.

The U.S.-U.K. market is also different because of its sheer size. The U.K. accounts for the largest number of U.S.-Europe passengers -- well over one-third of all U.S.-Europe traffic, nearly the same amount of U.S. to Europe traffic as Germany, France, and the Netherlands combined. London accounts for nearly 90% of U.S.-U.K. traffic and, while fewer carriers serve London Heathrow than London Gatwick, London Heathrow accounts for nearly 60% of all U.S.-U.K. traffic. London Heathrow is the primary gateway in the U.K. and by far the largest European airport for U.S. passengers. London Gatwick, at half the size of London Heathrow, is about the same size gateway as Frankfurt or Paris.

Having access to London Heathrow is critical because it is the preferred gateway for London passengers and consistently receives a better mix of high fare paying business passengers than other European hubs. London Heathrow is closer to the center of London, provides convenient and extensive connections to the rest of Europe and beyond, and is surrounded by business areas. Even London Gatwick is not a reasonable alternative to London Heathrow. For example, most U.S. airlines serve London Gatwick only at points where London Heathrow is unavailable to them. Even American, as one of only two U.S. carriers permitted to fly to London Heathrow, serves Dallas/Fort Worth, Raleigh/Durham, and St. Louis from London Gatwick because London Heathrow is not available to it from those cities under Bermuda II. Other examples include Continental at New York/Newark, Houston, and its suspended Cleveland service, Delta at Atlanta, Boston, and Cincinnati, Northwest at Detroit and Minneapolis, and US Airways at Charlotte, Philadelphia, and Pittsburgh. In fact, London Heathrow is such a preferred airport that over 23% of U.S. carrier passengers in London Gatwick gateways chose connecting service to London Heathrow over nonstop London Gatwick service.

Another illustration of how London Heathrow is clearly the preferred airport is the fact that average fares between the U.S. and London are almost one-third higher at London Heathrow than at London Gatwick. Average round trip fares are also consistently higher (20-40%) between the U.S. and London Heathrow than between the U.S. and other hub airports in Europe, such as Amsterdam, Paris or Frankfurt. Additionally, other European gateways are not viable alternatives for London passengers because of the additional time it would take to make such a circuitous

trip. For the year ending May 2001, minimal numbers of passengers used these other European gateways as a connect point for London.

American and British Airways Dominate London Heathrow

The fact that London Heathrow is the preferred airport in London and Europe and other airports do not provide viable and competitive alternatives is crucial to evaluating the proposed antitrust immunized alliance between American and British Airways. As I stated earlier, these carriers are two of only four carriers who currently have access to London Heathrow under Bermuda II. These carriers already dominate the market between the U.S. and London Heathrow, operating service to eleven U.S. gateways with almost three hundred weekly departures (as compared to zero for other London operators like Continental, Delta, Northwest, and US Airways). They control over 60% of the seats in the U.S.-London Heathrow market, over three times the next largest competitor. After open skies, this dominance will increase, as the carriers will be free to move their current London Gatwick service to London Heathrow utilizing their vast London Heathrow slot portfolio, while new entrant carriers, like Continental, will be unable to begin any significant operations from London Heathrow as they seek to obtain commercially viable slots and facilities in order to mount competitive service. American and British Airways already directly overlap on seven U.S.-U.K. routes (six involving London Heathrow) and are proposing to fix prices and allocate capacity on all of these. They already have combined seat shares ranging from a dominant "low" of over 43% in Los Angeles to a monopolistic high of 100% in Dallas/Ft. Worth and Miami. In fact, nearly half of American and British Airways' transatlantic passengers fly on routes where the carriers overlap.

While much of my testimony focuses on London Heathrow, let me assure you that competition and constraints at London Gatwick are not much better. London Gatwick, which is not a viable alternative for London Heathrow, is itself a severely capacity constrained airport dominated by the proposed American/British Airways alliance. There are eight London Gatwick gateway routes between the U.S. and U.K. where American and British Airways control 100% of the market. Proof of British Airways' attempt to dominate both London airports is the fact that, even though British Airways has announced a significant pull down of Gatwick operations, it has stated that it does not intend on returning any of its slots or facilities at the airport.

To put the American/British Airways dominance in perspective, consider the following points:

Nearly 9 million passengers per year, or 81% of all London Heathrow passengers, would have reduced or no competition following an American/British Airways alliance.

Combined, American and British Airways would be nearly three times the size of the nearest competitor in the U.S.-London Heathrow and Gatwick markets.

In the top three U.S.-London Heathrow markets (New York, Los Angeles, and Chicago), which account for over 60% of all U.S.-London Heathrow passengers, the antitrust immunized alliance would have more scheduled flights than their competitors by at least a 3:1 ratio.

A U.S.-U.K. Open Skies Agreement is Meaningless Unless a Significant Number of Competitive and Economically Viable Slots and Facilities are Given to New Entrant U.S. Carriers

The Department of Transportation has a policy that states that unless a country has an open skies bilateral with the U.S., carriers from that country are not eligible for antitrust immunity. American and British Airways have indicated that the immediate benefit of approval of their agreement would be the implementation of a new open skies aviation bilateral between the U.S. and U.K. and have hinted that open skies will not happen without it. The carriers claim that the benefits of open skies far outweigh any harm their alliance would cause, and in fact, open skies would aid the competitive environment even with an American/British Airways alliance because it would end the restrictions on carriers, cities, and operations currently included in Bermuda II. They claim that because an open skies bilateral would allow for non-incumbent airlines, like Continental, to legally begin service to London Heathrow, it is pro-competitive and in the best interest of the U.S. and consumers.

Nothing could be further from the truth. In order for there to be effective competition following an open skies treaty between the U.S. and the U.K., a substantial number of competitively viable slots, and adequate facilities to operate those slots, would have to be allocated to new entrant U.S. carriers. However, slots and the required facilities at London Heathrow are not available. The capacity and infrastructure constraints at London Heathrow make it impossible for a carrier like Continental to obtain the required slots and facilities that would be needed to attempt to compete with a dominant American/British Airways alliance. Without that competition by Continental and others, consumers would be doomed.

It is ironic that British Airways is now suggesting that open skies will solve the anticompetitive problems that the proposed alliance would create. One of the main reasons we do not have open skies today is that in the past British Airways has not wanted it. For 20 years Bermuda II has afforded British Airways protection from full and open competition, thereby giving it an enormous incumbency advantage over new entrants and the ability to consolidate its position in London, especially regarding slots and facilities. Now British Airways has changed its tune. As the price for dropping its opposition to open skies, it wants to proceed with an obviously anticompetitive alliance that would give it immense market power and eliminate its principal competition. British Airways wants to replace the artificial barrier to competition created by bilateral restrictions with the commercial barrier created by its (and American's) dominance of the market as well as critical airport slots and facilities. British Airways' proposed "cure" would be even worse than the current "disease".

Continental has estimated that in order to try and compete with American and British Airways, it would require a minimum of ten new daily operations at London Heathrow, a total of 140 weekly arrival/departure slots. These operations would include six daily New York/Newark-London Heathrow flights, in order to have a prayer of competing with the 12-16 combined daily New York/Newark-London services offered by the mega-alliance. It would also include three daily Houston-London Heathrow flights to compete with American/British Airways' Dallas and Houston service, and one daily Cleveland-London Heathrow flight in order to provide needed competition in the mid-west market.

Slots would need to be at competitively viable times (for transatlantic services) and would need to be accompanied by competitive facilities. These facilities requirements include ticket counters, baggage service centers, back office space, transfer desks, airport club lounges, piers for all

arriving and departing aircraft, gates, adequate parking, and storage facilities. Other U.S. carriers have made requests for similar numbers of flights, and foreign flag carriers, most notably Virgin Atlantic, have indicated they would require a significant number of London Heathrow slots as well. Given the current constraints at the airport, short of direct transfer of slots and facilities from American or British Airways, it is not possible to meet these requirements. Thus, signing an open skies agreement with the U.K. would do nothing to open access for new entrant U.S. carriers like Continental. It would, however, guarantee that American and British Airways raised prices and reduced capacity on the largest business market in the world. An open skies agreement without significant slot and facilities transfers would merely substitute slot and facility restrictions for bilateral restrictions. In short, the skies are not "open" if the ground is closed. We have no interest in flying to London Heathrow if we cannot land there.

Slots and Facilities at London Heathrow are Not Available

American and British Airways argue that they control a smaller proportion of slots at London Heathrow than many other U.S.-Europe alliance partners do at their primary European hubs. While this is technically true, it is wholly irrelevant. What really matters is the access to slots at the right times of the day and an ability to get the necessary facilities on commercially reasonable terms at these hubs. Even British Airways has acknowledged that London Heathrow is full. New entrant carriers, like Continental, cannot gain access. This has not been true at other European hubs, and is certainly not true in the U.S. where the Government has provided slots to all authorized foreign carriers that have requested them. In fact, the U.S. has taken slots away from U.S. carriers in order to meet its obligations to foreign carriers.

There are three constraints that a new entrant would need to overcome in order to serve London Heathrow: arrival and departure slots, capacity within a terminal (which is limited by the number of passengers the terminal can accommodate), and aircraft parking capacity. All three are significantly constrained at London Heathrow and there has been very little expansion of capacity at London Heathrow over the past few years. According to the British Airports Authority (BAA) and the London Heathrow slot coordinators (ACL) in their submissions to the Department of Transportation responding to the Department's questions on access to slots and facilities at London's airports (submitted October 3, 2001), the number of movements per hour at London Heathrow increased by less than 1% for the summer of 2001 compared to the summer of 2000, with no new slots created during the standard transatlantic operating hours. Such a minimal number of new slots clearly will not satisfy the necessary demand by new entrant and other carriers trying to compete with the dominance of American/British Airways. Significant amounts of new airport capacity are not expected anytime in the foreseeable future and a decision on a new London Heathrow terminal has not even been made. BAA notes in their submission:

"...it is not possible to increase Heathrow's runway capacity by more than a minimal amount without changing the operating protocols. And, until Heathrow's Terminal 5 is approved, built and opened, there is relatively little that can be done to relieve the aircraft parking and terminal capacity constraints...BAA currently believes that the earliest opening date for the first phase of Terminal 5 is Autumn 2007."

This response from BAA is not new. In April 2001, BAA, responding to the U.K. Government's "The Future of Aviation" Consultation Document, stated:

"Air Transport demand has been constrained by capacity for many years and will almost certainly continue to be constrained at peak times. Slots at Heathrow and Gatwick are significantly oversubscribed so there is already considerable unfulfilled demand."

ACL agrees, and told DOT:

"In ACL's professional judgment the opportunities to accommodate new entrant US carriers from the allocation of pool slots in the first two seasons are extremely limited. It may be possible to accommodate up to one daily service...with arrivals in the late evening and departures mid-afternoon the next day."

The admission by the London Heathrow slot coordinator itself that, at best, only one new non-competitive daily flight will be possible at London Heathrow is a clear indication that London Heathrow is closed and that competition to the proposed American/British Airways alliance will be nonexistent.

Some have claimed that many new entrant airlines have begun operations at London Heathrow over the past five years, so what is there to complain about? Plenty. While a small number of new airlines may be found at London Heathrow, the reality is that since American/British Airways first requested approval for their immunized alliance in 1996, virtually no new entrants have gained access to London Heathrow. The few "new entrants" bandied about by American and British Airways fall within one of three categories: subsidiaries of existing London Heathrow carriers (i.e. Deutsche BA and KLM Cityhopper), carriers that gained slots through the transfer of slots from an existing flag carrier (i.e. Transaero Russian Airlines), and carriers that reinstated service that had been suspended due to the political environment (i.e. Sudan Airways or Libyan Airways). This is scarcely what one would rely on to provide effective competition against a combined American and British Airways in the largest business markets in the world.

It has also been argued that new entrant carriers can gain access to London Heathrow through the purchase/trade/lease of slots from established London Heathrow carriers. Current European Commission slot regulations prohibit the sale/purchase/lease of slots between carriers with or without monetary compensation (except carriers that have corporate links, parents and subsidiaries, and business takeovers). It is true, however, that "artificial exchanges" where carriers "trade" slots have been permitted by the Commission. Revisions of the slot legislation currently under consideration would strengthen the prohibition on slot transfers and could eliminate even artificial exchanges of slots as an option. Even artificial exchanges have had minimal success over the past few years, and any potential "sellers" of slots have long ago sold the available slots in their portfolio, most likely to a U.K. carrier (British Airways or Virgin Atlantic). ACL notes that in the winter of 2000/2001, 52 weekly slots were transferred at London Heathrow airport through the use of an artificial exchange, 42 of them going to British Airways. For the summer of 2001, 72 weekly slots were transferred with 48 going to British Airways and 14 going to Virgin Atlantic. Finally, for the winter 2001/2002 period only 26 weekly slots were transferred, 12 to British Airways, 14 to Virgin Atlantic. Keep in mind that Continental alone would require 140 weekly slots, and U.S. new entrants alone will need over 400 weekly slots to

provide any kind of competition. It should be noted that these artificial exchanges amount to significantly less than 1% of the total weekly slots at London Heathrow and were not necessarily (and probably were not) at competitively viable times for transatlantic services.

Moreover, utilizing artificial exchanges for obtaining slots at London Heathrow has become nearly nonexistent because the pool of potential trading partners has dried up. Carriers have absorbed virtually all commercially viable slots as they became available over time, leaving little to no room for new carriers who might wish to begin London Heathrow service. London Heathrow slots are heavily concentrated in the hands of the oneworld global alliance (of which American and British Airways are members) and the Star global alliance (of which United Airlines and its British partner bmi are members). Combined, these two global alliances hold nearly 75% of all London Heathrow slots and have no incentive to provide slots to any other new entrant airline. In fact, all but two of the top ten slot holders at London Heathrow are in one of the two mentioned global alliances (with the exceptions being Virgin Atlantic, which itself is desperate for additional London Heathrow slots, and Air France). Because of the very small number of competitive slots the remaining slot holders have, it is not possible for new entrants to obtain a competitively viable slot portfolio through artificial exchanges.

American and British Airways have argued that new entrant U.S. carriers can obtain any necessary London Heathrow slots or facilities from their own European global alliance partners. For starters, Continental has no immunized alliance with a European airline, so this avenue would not be open to Continental in any event. Most European airlines have insufficient slots to transfer to their "have-not" U.S. carrier alliance partners. For example, the largest non-oneworld, non-Star alliance European airline at London Heathrow is Air France (a Delta alliance partner), which has less than 3% of slots at the airport. U.S. carriers would require virtually all of the partner's slots to operate the required number of flights and create a competitive London Heathrow market position against American/British Airways for transatlantic services. European airlines have no economic incentive to transfer slots to U.S. airlines (even alliance partners) for transatlantic service, as London Heathrow slots are equally scarce for them. Just as London Heathrow is critical to the route network of U.S. carriers, the airport is a critical destination for European carriers which operate networks at their respective hubs. London Heathrow is typically the largest international market for European airlines, and it is a critical spoke to every hub city and airline network in Europe. A transfer of slots by a European carrier to its U.S. alliance partner would significantly reduce the European carrier's ability to compete on London Heathrow-Europe routes. Finally, a number of U.S. new entrants do not even have a European partner from which they could try to obtain slots and facilities.

The Situation Has Gotten Worse, Not Better, Since the Last Time American and British Airways Applied for Approval

Just a few years ago American and British Airways attempted to dominate the skies between the U.S. and U.K. and filed with the Department of Transportation for an alliance with antitrust immunity. This Subcommittee held hearings on the subject of this alliance, and scores of parties weighed in as to the anticompetitive nature of the alliance.

Less than four years ago the Department of Justice advised the Department of Transportation on the proposed alliance, filing public comments. In those comments Justice stated:

"The Alliance as proposed will significantly reduce competition in many U.S.-U.K. city pairs without producing sufficient efficiencies to outweigh the harm. Divestiture conditions, primarily slot divestitures at London Heathrow Airport ("Heathrow" or "LHR") can reduce that harm, but will not eliminate it...Hence, if DOJ were reviewing the Alliance under the antitrust laws, we would oppose it."

Justice also contradicted any argument that the potential for open skies justified approval of American/British Airways by stating

"...the potential benefits of open skies are not sufficient to outweigh the harm of the Alliance as it is currently proposed, in large part because slot constraints at LHR create grave doubts that open skies alone will produce significant new entry and competition in U.S.-London markets."

The GAO also weighed in the last time American and British Airways proposed their alliance. In testimony before this very Subcommittee, GAO stated

"The proposed alliance of American Airlines and British Airways - the two largest carriers in the U.S.-U.K. markets - raises significant competition issues."

Earlier, in testimony before the Senate Subcommittee on Aviation, the GAO stated

"Barriers exist at Heathrow in the form of a limited number of takeoff and landing slots and a scarcity of available gates and facilities that prevent U.S. airlines from having adequate access to that airport. As a result, action will be necessary to address these barriers if open skies is to result in increased competition."

With this second coming of American/British Airways, the applicants argue that times are different, that they need their alliance for survival, especially given the growth of the Star alliance. With this second coming of American/British Airways, the applicants argue that slots at London Heathrow are available if new entrants were just willing to work for them. With the second coming of American/British Airways the applicants argue that the door to open skies may close forever if quick approval of their alliance is not made. And with the second coming American and British Airways argue that competition authorities and experts worldwide were wrong when they opposed the alliance the first time.

But the Department of Justice was correct in 1997, and its position then is even more correct now. Just like last time, the proposed American/British Airways alliance is anticompetitive and should not be approved. The U.S. should not sign an open skies agreement with the U.K. unless the substantial London Heathrow access issues are appropriately addressed. The Departments of Transportation and Justice should send these clear messages to the applicants so that there never is a third coming. Nothing has changed to make the situation better...all of the changes have made such an anticompetitive alliance even worse.

Much has happened in the world since the last time that American and British Airways proposed their alliance. First, as already discussed, the already difficult prospect of obtaining slots in London has gotten worse because of current and long-term airport constraints. While American

and British Airways have strengthened their dominant market position, they have ensured that new entry competition is impossible.

Next, market concentration has grown as bmi, the second largest slot holder at London Heathrow, joined the Star alliance. While American and British Airways argue that United/bmi create a competitive balance to their alliance, the true fact is that United/bmi, on top of an already dominant American/British Airways, does nothing but to create a duopoly in the U.S. - U.K. market and further assure that new entry is impossible.

The last time that American and British Airways applied, bmi argued vigorously that it wanted to be a new entrant in the U.S.-U.K. market offering low fares and competitive service to the London Heathrow carriers. bmi's own press releases from mid-1999 frequently stated "...British Midland has been at the forefront of bringing lower fares and greater competition" over and over again. Then, at the end of 1999 bmi announced that it was joining the Star alliance and selling a significant stake in itself to Star alliance members. A quick transformation from low cost new entrant to entrenched alliance member quickly ensued. Today bmi, as part of the Star alliance, cannot be relied on to bring competition into the market. Today bmi has abandoned its goal of becoming a low fare new entrant (any new bmi service would be no different than entrenched incumbent United adding service) and is focusing solely on the Star alliance, antitrust immunity with United, and helping to create a U.S.-U.K. duopoly.

In fact, United/bmi compounds the American/British Airways problem. The two airline groups would control 65% of U.S.-U.K. frequencies and an astounding 84% of U.S.-London Heathrow frequencies. This is even before bmi, in conjunction with United, begins new U.S. service utilizing its existing London Heathrow slot portfolio and before American and British Airways switch current London Gatwick service to London Heathrow, utilizing their slot portfolios. The two alliances, with their current partners, will control 75% of all London Heathrow slots and effectively reduce all other carriers to non-competitors in the U.S.-U.K. market. It is clear that American and United are attempting to divide the U.S.-U.K. market just as they attempted, but failed, to divide the U.S. domestic market when they tried, and failed, to divvy up US Airways.

One other significant event has occurred since the last time American and British Airways attempted to gain antitrust immunity. The tragic events of September 11, 2001 have changed the world, and the airline industry has changed in ways that we are just now starting to understand. In our weakened condition, major carriers have cut capacity significantly, furloughed valuable employees, and stared at bankruptcy as a realistic possibility. All airlines have been forced to reevaluate their networks and competitive strategies. These events have direct bearing on the proposed American/British Airways alliance and would make a combined American/British Airways even more dominant and anticompetitive.

Since September 11, Continental has announced the discontinuation of New York (Newark) - Stansted service and the suspension of Cleveland - London (Gatwick) service. Virgin Atlantic, a London Heathrow incumbent and one of the very carriers expected to significantly compete with an American/British Airways alliance, has reduced capacity to New York, Chicago, Los Angeles, San Francisco, and Toronto. Even American and British Airways have announced reductions in service. The rapidly changing airline industry is unstable. As the competitive landscape continues to shift in material and unpredictable ways, it makes intelligent and reliable analysis of the

proposed alliance and antitrust immunity extremely difficult, if not impossible. Only one thing remains clear: the dominant position that American and British Airways would have will be further enhanced.

The Rush to Conclude the Governmental Review of American/British Airways is Misplaced and Misguided

The Department of Transportation appears to be moving with unseemly haste in its consideration of the proposed American/British Airways alliance and antitrust immunity. Four years ago, adequate time was given to review the tens of thousands of pages of documents filed in the American and British Airways proceeding so that the Department could receive the benefit of the analysis of industry experts. Further, the Department committed to a public oral hearing where the issues could be debated in full with the participation of all interested parties. This time around the Department has arbitrarily cut off access to documents, provided inadequate time for review and comment, refused to require that the applicants provide ongoing memos and analysis that could be crucial to the review, and has not even discussed the possibility of holding an oral hearing. In fact, the Department has refused even to consider the fact that the tragic events of September 11th have significantly altered the aviation landscape. This unseemly haste raises serious concern about the objectivity of the Department's review and suggests that the proposed alliance is so significantly flawed competitively that it cannot withstand serious and careful scrutiny.

Some have argued that it is critical for the U.S. and U.K. to rush to agreement on open skies because it is expected that sometime during the next few months the European Court of Justice will rule on the longstanding European Commission case against Member States who signed open skies agreements with the U.S. The belief is that the Court will rule that no new Member State can sign such an agreement and that the European Commission alone has the authority to negotiate with the U.S. The U.K. would lose its right to negotiate a new U.S. agreement.

The Department of Transportation has used this as an argument justifying their need to move quickly. In Order 2001-9-12, issued and served on September 17, 2001, the Department stated,

"We here enjoy a unique opportunity to reach this goal with the United Kingdom. We understand, however, that the U.K. is likely to be unwilling to sign an open skies agreement unless and until we have granted the applicant's request for approval and antitrust immunity. Because of a pending challenge to the U.K.'s authority to sign a bilateral aviation services agreement with the United States, we must act promptly on the application filed here by American and British Airways."

But the U.S. should not rush to sign a bad deal and approve an anticompetitive alliance simply because of this concern. Open skies without competition gains nothing and materially harms consumers. Moreover, one would think that the pending European Court of Justice decision should concern the U.K. negotiators, not the U.S. The U.S. currently has the leverage in the negotiations since it is the U.K. that may soon lose its negotiating power. And it is the U.K. that needs to come forward with a deal that truly meets the needs of the U.S., its carriers, and consumers on both sides the Atlantic. Such a deal must include true and full access to London Heathrow. Such a deal does not need to include approval of an anticompetitive alliance between

American and, British Airways. As I stated earlier, an open skies agreement is meaningless without open access to London Heathrow and Gatwick. The threat of losing this "unique opportunity" should have no weight in the Department's decision, and certainly should not cause the DOT to rush to make a poor judgment that it and American consumers will soon regret.

Even negotiating with the U.K., as the U.S. did most recently just two weeks ago (curiously, without the normal presence of industry observers), will simply increase the pressure to approve the anticompetitive agreement between American and British Airways. The Department needs to stop heading down this misguided path.

At the conclusion of these hearings, I urge this Committee to express its grave concern about the adequacy of this rushed and incomplete review to Secretary Mineta and Attorney General Ashcroft. Please urge them to set forth a careful and judicious process that ensures that the Government has all of the information needed to make the right decisions on behalf of the traveling public.

Conclusion

The combination of American and British Airways is so clearly anticompetitive and the benefits of a U.S.-U.K. open skies agreement (without significant slots and facilities attached) are so illusory that approval of the alliance cannot possibly serve the public interest. The Department of Transportation, with guidance from the Department of Justice, must deny the American/British Airways request in order to preserve competition in these critical markets.

Mr. Chairman and Members of the Committee, I thank you for giving me the opportunity to discuss this very important topic with you and for your attention. I would now be pleased to answer any questions that you may have.