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INTERNATIONAL AVIATION ALLIANCES: MARKET TURMOIL AND THE FUTURE OF AIRLINE COMPETITION

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BEFORE THE

SUBCOMMITTEE ON ANTITRUST, BUSINESS RIGHTS, AND COMPETITION

OF THE

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INTERNATIONAL AVIATION ALLIANCES: MARKET TURMOIL AND THE FUTURE OF AIRLINE COMPETITION

WEDNESDAY, NOVEMBER 7, 2001

UNITED STATES SENATE,
SUBCOMMITTEE ON ANTITRUST,
BUSINESS RIGHTS, AND COMPETITION,
COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The Subcommittee met, pursuant to notice, at 12:39 p.m., in Room SD–226, Dirksen Senate Office Building, Hon. Herb Kohl, Chairman of the Subcommittee, presiding.

Present: Senators Kohl, DeWine, and Specter.

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

Chairman KOHL. The Subcommittee will come to order.

Good afternoon, ladies and gentlemen. I want to welcome everyone to the hearing and thank you for coming. Our hearing today is very timely. We are in the process of making decisions in the next 6 months that likely will reshape the aviation industry for years to come. From international alliances, to loan guarantees, to potential mergers or company failures, to airline security, virtually every aspect of the industry is in flux. Yet critical decisions about the future of airline competition are being made in the midst of market turmoil, on an ad hoc basis, and in a frantic atmosphere. Sometime in the near future—perhaps in a year—the situation will calm down and return to something like normalcy. The question is: When that time comes, will American consumers pay the price for or reap the rewards of the decisions being made today? We have an obligation to protect competition in the face of enormous—but perhaps temporary—pressures on the industry.

And at least three international alliances are currently awaiting a final decision by the Department of Transportation on whether to grant them antitrust immunity. Most importantly, the alliance between American Airlines and British Airways would create an international aviation giant with its hub at London's crowded Heathrow Airport. Will this giant compete against other alliances or prove to be anti-competitive?

But while these competition concerns would ordinarily occupy almost all of our attention, these are not ordinary times. The simple fact is, if air travel is not safe and if passengers do not fly, the en-

tire industry is imperiled. There can be no meaningful competition unless safety and security in the airline industry is first assured.

Nearly 2 months after September 11, many Americans question whether anything substantial has really been done to improve aviation security in our country. We have all seen the long lines at check-in gates and armed soldiers patrolling airport concourses. But it looks like many airport security enhancements are merely cosmetic. Obvious security weaknesses remain. For example, nearly 2 months after September 11, checked bags in the United States are still not routinely screened for explosives. The machines in place to do so—even in limited amounts—are not fully utilized. Checked baggage is not matched to see if the person checking the bag ever really boards the airplane.

By contrast, in Europe, a checked bag does not get on the plane unless the passenger boards that plane. And within a year in Europe, all checked bags will be mechanically screened for explosives. So many of us do not understand why we should tolerate this gaping hole in our security system.

In addition, many of those screening passengers' carry-on baggage at security checkpoints are still poorly trained, minimum wage employees. Just 2 weeks ago, as we know, it was still possible for a passenger carrying a gun to board a flight in New Orleans, and earlier this week, another passenger in Chicago passed security with several knives and a stun gun. Meanwhile, airport terminals, from JFK to O'Hare, have been temporarily shut down due to security lapses.

That these and other important problems remain unanswered is very troubling to all of us and to all Americans. We are confident that they trouble each of you here today as much as us. Any further delay in solving these problems we would like to feel and we would like to hope you feel is not acceptable. And cosmetic quick fixes such as people patrolling our airports—sometimes cosmetic things won't get the job done either. No system can be made 100 percent safe, but we should never again tolerate an aviation system so vulnerable to terrorists as it was on September 11, and we know that you agree with this. We, therefore, will expect each of you to tell us, specifically, if you can today, of the steps that your airline is taking to make flying safe from those who wish to do harm. And so we would request you to address this issue in your opening remarks, even if you are ad-libbing in those remarks.

One of the great accomplishments of the 20th century was building a safe, reliable, and efficient air transportation system that could transport at high speed and relatively low cost ordinary citizens from coast to coast and virtually everywhere in between and beyond. We must act, and we must act now, to take meaningful and effective steps to strengthen the aviation security and to assure aviation competition in the future. And it is you, the leaders of the airline industry who sit before us today, who have the primary responsibility for implementing the necessary measures to assure the safety of the millions of Americans who entrust you with their safety when they board your airplanes. I thank you very much.

Senator DeWine?

STATEMENT OF HON. MIKE DEWINE, A U.S. SENATOR FROM THE STATE OF OHIO

Senator DEWINE. Mr. Chairman, thank you very much, and I thank you for calling this hearing.

Almost 5 years ago, the first hearing that Senator Kohl and I scheduled as chairman and ranking member of this Committee was on the proposed alliance between American Airlines and British Airways. We are back here again to examine this newest proposal. But as Senator Kohl has so eloquently stated, the world is different. The situation is different and certainly the airline industry is different.

Today, our aviation market is far more complicated. The industry, of course, is reeling, as you all know, from the devastation of the September 11th terrorist attacks. Most airlines are suffering huge losses. The market is literally in turmoil.

All of these factors I believe must be considered in our analysis of the competitive implications of the American Airlines/British Airways proposal, as well as two other alliance proposals that we will consider today: Delta Airlines' deal with Air France and United's deal with British Midland.

Furthermore, in today's environment, any discussion of aviation must address, as Senator Kohl has said, the issue of security. I thank Senator Kohl, the chairman of this Committee, for his comments on aviation security which I believe have put our discussion today in its proper perspective. Without strong security measures in place, the aviation industry will not survive.

Since this Subcommittee looked at the American Airlines/British Airways alliance proposal almost 5 years ago, the Department of Transportation has gathered data on the competitive impact of immunized international aviation alliances. The Department of Transportation has concluded that so far, alliances have increased competition, increased demand, and lowered prices for consumers.

Now, of course, some have challenged these findings, and I think it is fair to say that the results of DOT's general studies cannot replace case-by-case analysis. And I believe that we must examine each alliance on its own merits. So today we hope to gather more information on each of the proposed alliances to help us evaluate the impacts on competition and on consumers.

Our job today is made more complicated by the fact that the American Airlines/British Airways alliance is linked so strongly to the ongoing efforts to negotiate an "open skies" agreement between the United States and our friends in the United Kingdom. In principle, such an agreement has obvious appeal and could offer many benefits to airlines and consumers of both countries. However, this Subcommittee has long been convinced that an "open skies" agreement is of little value in the passenger market unless Heathrow Airport is truly open to competition from a wide range of airlines.

The importance of Heathrow, specifically, and the London market, in general, is hard to overstate. The U.S./U.K. market is more than double the size of the next largest U.S./European market. Heathrow Airport is far and away London's key airport. Competition at Heathrow helps set the tone for competition in the entire U.S./Europe market.

The American Airlines/British Airways deal would join together two of only four competitors that fly between Heathrow and the United States. If that competition cannot be replaced, consumers certainly will suffer the consequences. The only way for that competition to be replaced is if other airlines have access to Heathrow and are able to compete effectively with American Airlines and British Airways, with flights that are desirable for U.S. travelers. It seems to me that we are back again to the issue we were most concerned about four and a half years ago, and that issue, of course, is slots. There continue to be disputes about slot availability and possible divestiture, and we need to carefully examine today the details of the slot allocation.

American Airlines and British Airways both argue strongly that market conditions have changed significantly since they last filed for immunity. This is a crucial issue, and I look forward to hearing your thoughts on this issue today. Furthermore, many of our witnesses today will make the point that alliances offer many consumer benefits and provide competition against each other, both globally and in specific markets. This is certainly true and will be an important factor in our examination and in the examination being done by both the Justice Department and the Department of Transportation.

Before I turn back to Chairman Kohl, there is one additional point that I think should be made. Most of our focus to this point has been on the impact of "open skies" and the various alliances on competition in the passenger market. But the Subcommittee has had a number of discussions with cargo carriers as well, and I believe it is clear from those discussions that an "open skies" agreement would benefit U.S. freight carriers by allowing them to compete more vigorously in the United Kingdom. We were considering having Federal Express as a witness to discuss this point, but space considerations made that impossible. So we are going to accept their testimony for the record. I think that they make an important point, though, one we should keep in mind as we move forward in considering these alliances.

Let me thank our witnesses for coming, and we look forward to hearing your testimony.

Thank you, Mr. Chairman.

Chairman KOHL. Thank you, Senator DeWine.

We have six distinguished witnesses from the commercial airline industry here today. Our first witness is Mr. Donald Carty, President and Chief Executive Officer of American Airlines. Mr. Carty has worked for American Airlines since 1978 and has served in his current position since 1998. Mr. Carty began his career in the commercial airline business in Canada over 25 years ago.

Also joining us here today is Mr. Leo Mullin. Mr. Mullin has been the CEO of Delta Air Lines since August of 1997. Prior to joining Delta, Mr. Mullin served in key management positions in major industries, including banking and transportation. In addition, Mr. Mullin also spent a number of years here in Washington working for a management consulting firm.

From Northwest Airlines, we will hear from Richard Anderson. Mr. Anderson was named CEO of Northwest in February of 2001. He joined Northwest in November of 1990 as Vice President and

Deputy General Counsel and later served as Executive Vice President and Chief Operating Officer.

From Virgin Atlantic, we are joined by Mr. Richard Branson. Mr. Branson, also known for his role in the music industry via the Virgin Group's international megastores, is the original founder and CEO of the Virgin Atlantic Airways. In 1984, Virgin Atlantic started with a single jumbo jet flying between London and New York, and currently the airline flies from London to over 18 destinations worldwide. In 1999, Mr. Branson received the honor of knighthood from the Queen of England for his many accomplishments.

Representing British Airways here today is Roger Maynard, Director of Alliances and Strategy. Mr. Maynard has worked for British Airways since 1987. In 1991, he was appointed Director of Corporate Strategy, where he assumed responsibility for the company's airport policy, fleet planning, and general corporate strategy, including the development of the company's global alliance strategy. Prior to his joining British Airways, Mr. Maynard served the British Embassy in Washington as consular for aviation and shipping.

Finally, we will hear today from Larry Kellner, President of Continental Airlines. Mr. Kellner started with Continental in 1995 as Executive Vice President and Chief Financial Officer, and he was named President in May of 2001. As President, Mr. Kellner is responsible for the airlines' sales and marketing, scheduling, pricing, reservations technology, financial operations, corporate real estate alliances, and corporate development. Prior to joining Continental, Mr. Kellner worked in the banking industry as Executive Vice President and Chief Financial Officer of American Savings Bank.

Gentlemen, we ask you to limit your testimony to 5 minutes, if possible. We will hold the record open for one week to allow for you to submit additional written testimony of any length.

And so right now, Mr. Carty, we start with you.

STATEMENT OF DONALD J. CARTY, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, AMERICAN AIRLINES, FORT WORTH, TEXAS

Mr. CARTY. Chairman Kohl, Senator DeWine, I do appreciate the opportunity to testify again before you. I wish, of course, it were under better circumstances. The 2 months since the terrorist attacks of September 11th have been, without any question, the worst months in the history of our industry. Indeed, the recent weeks have taken an emotional and a financial toll on all of us.

Before I begin, I would like to publicly express my gratitude to the members and staff of this Subcommittee who worked night and day in the aftermath of the terrorist attack to assure the airline stabilization legislation contained provisions to assure adequate compensation for the families of the victims without bankrupting the airlines. This really was an essential, essential component of the bill, and the contribution of this Committee to that effort simply cannot be understated, and the people of American Airlines are very, very appreciative of those efforts.

While the stabilization package that you, of course, passed has prevented an immediate economic disaster in our industry, we will not be out of the woods until airline traffic returns to a more robust level. To put the situation in perspective, even after account-

ing for our share of the Federal assistance, we at American lost $414 million in the third quarter, by far our largest quarterly loss ever.

Clearly, the most painful action we have had to take in response to the significant challenges we now face was reducing our workforce. With the drop in demand for air travel, we have had to reduce our flying by some 20 percent. That in turn has forced us to eliminate the equivalent of approximately 20,000 jobs. And while clearly this is something we all wish we could avoid, in the airline business our cost structure just doesn't permit operating at 100 percent staffing if you only have a schedule of 80 percent. There is nothing that we want more than to see traffic pick back up enough for us to allow to begin rehiring again. And I do hope in that regard the conferees will act expeditiously to resolve the differences between the House and Senate on the airport security legislation so that we can continue to build a system in which the traveling public has the utmost confidence.

Senator Kohl, you suggest that I ad lib some remarks on where I think we have made progress, and, indeed, you have identified some areas where I think progress yet needs to be made, and hopefully the bill that the conferees will agree on will provide at least the envelope for us moving forward on some of those. But I do think we have accomplished a fair bit in the period since September 11th.

Obviously, with respect to the integrity of the cockpit, all of the airlines have moved expeditiously to bar the cockpit from intrusion in a very significant way with these so-called "Katie" bars. They are a very effective way of keeping unwanteds out of the cockpit. We have also at virtually every airline established procedures by which that door could only be opened after the pilot and the flight crew in the back of the airplane resolved any question about the security of the airplane.

We have as well, of course, enhanced the security of the checkpoint in a number of ways. It may not be where it needs to be, but it has been enhanced. It has been enhanced by the way we check, the way we wand, and the way we pat down people. We have developed a selectee program with the FAA where, for a variety of reasons, a customer can be selected and not only screened more thoroughly at the checkpoint but, perhaps more importantly, be subjected to a second screening at the departure point at the gate. And, indeed, by all reports, while there was a significant security failure in Chicago last week, there was also a significant security success because the catching of the first mistake happened because of the selectee program and the subsequent examination of bags. And I think while we have to deplore the failure, the enhanced security that has been put in place by the new FAA regulations actually served the industry and United Airlines in that instance really quite well.

All of you know, of course, we and the FAA have put in place much more disciplined security procedures with respect to Reagan Airport. So I do think there is a lot that has been accomplished there as well. And in addition to that, and perhaps not as evident to the traveling public, is the better coordination of intelligence between the Federal Government on the one hand and the airlines,

not only through the selectee program but also through the identification of very specific names of people for airlines to look for to subject to further security screening that we might otherwise do.

So while I agree with you there is more to be done, I think in a relatively short span of time the FAA and the airlines have worked to put in place a number of things that make air travel substantially more safe than it was on September 10th.

One of the other questions I was asked to address today was how the competitive conditions in the industry have changed post–September 11th, and obviously, given the industry-wide decline in demand, we simply don't have the resources to fly the schedule we had before the attack.

Now, not surprisingly, among the hardest hit by the travel slowdown has been our international routes, forcing us to significantly reduce our flying to Europe. In addition, two of our key international partners—SwissAir and Sabena—have been forced into bankruptcy, leaving American and our customers with a significantly diminished network to and within continental Europe.

Now, today there are two mature international airline alliances operating with antitrust immunity among its key transatlantic partners: The Star Alliance, obviously, and the Wings Alliance. A third, the SkyTeam, is on the brink of approval, and American and British Airways are seeking antitrust immunity to establish a fourth such alliance. We seek nothing more than those before us have been granted by the regulatory authorities.

There can be little doubt that the creation of a strong fourth alliance is in the public interest. As corporate travel managers will tell you, it is much easier and much more cost-effective to negotiate a single global package with a single alliance representing several airlines than it is to cobble together a patchwork of deals with multiple airlines.

I think it is very highly significant that the Business Travel Coalition which represents corporate travel managers, and does so throughout the country, has reversed its previous position on our alliance and has filed in strong support with the Department of Transportation as well as submitting testimony at this hearing. In addition, the Airline Passengers Association has also filed in support of the AA/BA alliance, and the support of these consumer organizations for our alliance is reflective of the fact that to be truly competitive, carriers must provide today's international customers with a seamless air travel network spanning Europe, the United States, Canada, Latin America, and Asia.

Antitrust immunity with British Airways would not only allow us to be more efficient and cost-effective in the delivery of these services, but the evidence shows that consumers would be winners also. After all, we have seen a dramatic rise in Northwest and KLM's transatlantic traffic ever since they were granted antitrust immunity in 1993. Likewise, we are increasingly seeing a shift in share to the Star Alliance, which is comprised most notably of United and Lufthansa, carriers that were granted antitrust immunity in 1996. And since 1996, in fact, Star's combined share of transatlantic traffic has increased by some 13 percent, where our One World Alliance has seen its combined share drop by 15 percent.

Now, I understand that some have argued that the regulatory review of our alliance with BA should be delayed until some time has passed, presumably to better understand the fallout from the September 11th attacks. We are pleased that the DOT has firmly rejected requests for delays. Ironically, the same companies that are arguing for our alliance to be delayed have been actively moving forward on their own alliance plans. Continental Airlines, for instance, recently applied for authorization to code-share globally with KLM, setting the stage for Continental to formally join KLM and Northwest in the Wings Alliance. In fact, in commenting on the post–September 11th airline marketplace, Continental CEO Gordon Bethune last week stated flatly, "Alliances are more important today." And for once—and I am sorry he is not here—I wholeheartedly agree with Gordon.

For its part, Delta is proceeding with its alliance with Air France. A Delta official recently stated the airline was "very hopeful and reasonably optimistic."

I can see that my time has run out and the chairman is urging me to move on, so I would just like to close by addressing the biggest myth that is perpetuated by our opponents, namely, that without massive divestiture of Heathrow slots, American and British Airways would dominate the London/U.S. market. To do so, I would like to draw your attention to another previous witness before this Committee, and that is Professor Alfred Kahn. Like many others, Professor Kahn has a new view of the AA/BA alliance that is based on market changes since 1996. We have requested and received an analysis from Professor Kahn in which he explicitly states that his own disposition towards AA/BA has turned positive. And if I could read briefly from his analysis, and I quote:

"'Hub dominance' such as apparently makes possible a hub premium is rarely, if ever, to my knowledge, defined as flowing from a 39 percent share of total operations. The addition of American's slots to those of British Airways, I understand, would raise the share of the 'dominating' entity only from 37 to 39 percent. Although my experience with airline merger cases under the antitrust laws is far from encyclopedic, I am unaware of any case in which so small an increment, particularly to a pre-merger share of 37 percent, was deemed worthy of antitrust concern, let alone condemnation."

He concludes, as shall I, with the following observation which I urge this Committee to consider carefully, and again I quote:

"Competition in international aviation has increasingly in recent years been primarily a competition among alliances, dominating their own respective hubs and competing with one another worldwide. In these circumstances, posing impediments to the American Airline/British Airways alliance becomes a highly objectionable enterprise in competitive handicapping, such as I have deplored in a large number of contexts."

With your permission, Mr. Chairman, I would like to submit a copy of Professor Kahn's statement for the record, and I would be very happy to be available to answer questions that the chairman and any members of the Subcommittee might have.

[The prepared statement of Mr. Carty follows:]

STATEMENT OF DONALD CARTY, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, AMERICAN AIRLINES

Chairman Kohl, Senator DeWine, and Members of the Subcommittee, I appreciate having the opportunity to testify before you again, although I wish it were under better circumstances. The two months since the terrorist attacks of September 11th have been, without question, the worst months in the history of the airline industry. Indeed, the recent weeks have taken an emotional and financial toll on all of us.

While the stabilization package passed by Congress has of course helped, the airline industry will not be out of the woods until Americans start flying again. Even after accounting for our share of the federal assistance, we at American lost $414 million in the third quarter, our largest quarterly loss ever. Prior to September 11th, we were certainly seeing a softer revenue environment as the economic slow-down had resulted in a sharp drop in business travel. However, the events of September 11th eclipsed any trends that existed previously.

Clearly, the most painful action we have had to take in response to the significant challenges we now face in the marketplace was reducing our workforce. In conjunction with our plan to reduce capacity by 20 percent, we have announced that we would be forced to eliminate approximately 20,000 jobs, or roughly 17 percent of our workforce. These reductions are across the board, impacting about 15,000 employees at American, 3,000 at newly acquired TWA, and 1,500 at our commuter affiliate American Eagle. While clearly this is something we all wished we could avoid, our cost structure just does not permit operating at 100 percent staffing of a schedule that is 80 percent of pre-September 11th levels.

I should also note that these cuts have been spread across every department and at every level, with over 2,000 management personnel being cut as part of the reduction. I am proud, though, to say that over 1,500 management employees at American have joined me in taking voluntary salary reductions.

Now, one of the questions I was asked to address today was how the competitive conditions in the industry have changed post September 11th. Obviously, given the industry-wide decline in demand, it does not make sense for any of us to fly the schedule we had before the attacks. Speaking for American, our 20 percent schedule reduction is, though painful, fairly straightforward.

First, we cut back on the number of trips we flew in high-frequency markets. Next, we trimmed back our point-to-point flying in areas where the new demand levels didn't justify nonstop service. Third, we cut out the last bank of the day at our hubs in Chicago, St. Louis, and Dallas/Fort Worth. Finally, we reduced our international flying.

Domestically, other large network carriers have been implementing similar type reductions. Obviously, smaller carriers have not been immune from the falloff in travel demand and have had to draw down their schedules too, particularly shaving some frequencies in their high frequency markets. For instance, Midwest Express Airlines, which I am proud to say partners with American Eagle in a number of markets, has drawn down from five to three the number of daily flights between its Milwaukee hub and New York La Guardia.

While the current conditions are exceedingly challenging for all of us big and small, I believe that the measures Congress put in place, including creating $10 billion in loan guarantees and establishing the Airline Stabilization Board, will serve to bolster those carriers, such as Alaska Airlines, Midwest Express, and Jet Blue, that were highly competitive before September 11th. This in turn should minimize any potential long-term competitive impacts of this period on the domestic marketplace. Indeed, last week, Frontier Airlines actually reported a profit in the September quarter of $7.3 million.

Turning to the international sector, it should come as no surprise that among the hardest hit by the travel slowdown have been our international routes, forcing us to significantly reduce our flying to Europe. In addition, one of our key international partners, Swissair, has been financially crippled. All of this has left American, and our customers, without a viable alternative network to and within continental Europe.

As such, what was already an unlevel playing field-with two international airline alliances having antitrust immunity among its key transatlantic partners, one whose key partners are about to get it, and our alliance with British Airways without it—has become an even greater obstacle to providing our customers with what they demand. For example, as corporate travel managers will tell you, it is much easier and more cost effective for them to negotiate a single global package with one alliance representing several airlines than it is to cobble together a patchwork of several deals with several airlines to meet their comprehensive travel needs. From an airline perspective, we want to provide today's international corporate customers

a seamless air travel network spanning Europe, the United States, Canada, Latin America, and Asia. Antitrust immunity would not only allow us to be more efficient and cost effective in the delivery of these services, but consumers would be big winners also.

Quite simply, in this increasingly global economy, what our customers are telling us is that they want one-stop shopping. Immunity allows airline alliances to provide that, while at the same time it allows allied carriers to offer better and more competitive network services. This is why, I believe, we have seen a dramatic rise in Northwest and KLM's transatlantic traffic ever since they were granted antitrust immunity in 1993 in exchange for open skies with the Dutch. Likewise, we are increasingly seeing a shift in share to the Star Alliance, which is comprised, most notably, of United and Lufthansa-carriers that were granted antitrust immunity in 1996 in exchange for open skies with the Germans. Since 1996, Star's combined share of transatlantic traffic has increased by 13 percent, while our oneworld alliance has seen its combined share drop by 15 percent. Today, Star is by far the largest international alliance with 15 airlines, spanning 869 destinations, and accounting for 307 million passengers in 2000. By contrast, oneworld currently has 8 airlines, spanning 561 destinations, and accounting for 214 million passengers in 2000.

Now, I understand that some have argued that the regulatory review of our alliance with British Airways should be delayed until some time has passed, presumably to better understand the fallout from the September 11th attacks. We are pleased that the Department of Transportation has firmly rejected such requests for delay. Ironically, those making this argument are at the same time moving forward on their own alliance plans. Continental Airlines, for instance, recently applied for authorization to engage in global code-sharing with KLM, setting the stage for Continental to formally join the Wings alliance. In fact, in commenting on the airline marketplace post September 11th, Continental CEO Gordon Bethune last week stated flatly, "Alliances are more important today." I agree with Gordon.

For its part, Delta is proceeding with its alliance with Air France. In fact, a Delta official recently stated that Delta is "very hopeful and reasonably optimistic" that its application for antitrust immunity with Air France is on track for approval by December 1. Indeed, just three weeks ago, the United States concluded an open skies agreement with France that paves the way for granting Delta/Air France immunity. The world is clearly moving forward, and so should we.

In fact, the same time pressure that propelled the French to move forward on open skies by the end of *this year* exists on the British as well. It is no secret that the European Union is actively seeking to, and most likely will, wrest the right to negotiate aviation treaties away from France, Britain, and the other European nations by the end of this year. The European Court of Justice is expected to hand down a decision on this matter as early as January. If the EU prevails, the current opportunity to open the skies between the U.S. and the U.K. will be gone. EU officials have made it clear that they will pursue issues, such as cabotage, that have not heretofore been included in open skies agreements. Reaching agreement with the United States on such issues will take the EU years.

I personally think it would be very unfortunate indeed if we as a nation missed this opportunity to scrap, once and for all, the anachronistic bilateral agreement that governs air service between the U.S. and U.K. For three decades, the United States has been trying to replace the truly restrictive, anti-free market Bermuda 2 accord with open skies. It is somewhat hard to fathom that the relationship between the United States and United Kingdom is so close and open on so many fronts, yet Bermuda 2 still exists. Fortunately, the United States has never been closer to getting rid of Bermuda 2 than it is today.

As this Subcommittee is well aware, Bermuda 2 limits direct air service between the United States and London's Heathrow Airport to only two U.S. airlines, two British airlines, and 12 U.S. communities. Although there is substantial nonstop service to London's other principal airport, London Gatwick, cities like Atlanta, Cleveland, and Pittsburgh are shut out of Heathrow. As a consequence, air travelers from many small cities have fewer options for getting to Heathrow than would be the case under open skies. Eliminating Bermuda 2 will change all that. Cities that could support nonstop service to Heathrow will finally have the opportunity to receive such service and small communities will benefit from a plethora of new one-stop options.

For the past decade, the United States has pursued a policy of exchanging open skies for the granting of antitrust immunity to alliances. In recent studies, the DOT has found that the policy has worked well for consumers: competition in those markets is up, fares are down, and service levels greater. DOT found, for example, that in open skies markets where immunity for alliances is available, average fares de-

clined by 20 percent between 1996 and 1999, compared to a 10 percent decline for non-open skies markets.

I have little doubt that the benefits from previous open skies agreements, though substantial, will pale in comparison to those produced by a U.S.-U.K. open skies agreement. One recent study by Professor Jan Brueckner, for example, projects the benefits to consumers will exceed $40 million annually just from the American-British Airways alliance alone. The United Kingdom is this country's largest overseas aviation market. It is also our largest European aviation market by a factor of two. And, as I described earlier, it is our most restricted. Once these restrictions are lifted, *five* new entrants—Continental, Delta, Northwest, US Airways, and Britain's second largest carrier bmi british midland-will have the right to fly to Heathrow, an amount of new entry unparalleled by any other open skies agreement.

Now clearly our alliance with BA is the catalyst to getting a U.S.-U.K open skies deal done. We strongly believe that our alliance will bring consumers the same benefits that other immunized alliances have produced as well increase competition between alliances. As you know, American and BA first announced our proposed alliance in 1996 and applied for immunity shortly thereafter. We predicted back then that alliances would define the competitive landscape in the future and that slots would be available at Heathrow to start a substantial number of new services. Quite frankly, time has proven us right on both counts.

In 1996, alliances were in their embryonic stages. Just three years later, however, roughly 60 percent of worldwide capacity was accounted for by five alliances. Today, that figure tops 75 percent. Indeed, recognizing that U.S. airlines could neither physically nor economically serve every corner of the globe with their own airplanes, DOT has actively encouraged the formation of these alliances as it has sought to deregulate the international marketplace.

Likewise, as we predicted, slots have become available at Heathrow since 1996. Through the creation of new slots, exchanges between carriers, and the replenishing of the slot pool as slots were returned under use-it-or-lose-it rules, enough slots have come available to allow for a total of 15 new daily roundtrips to be added between Heathrow and the United States since 1996. This is equivalent to 210 weekly slots, which I might add, approximates American's entire slot holdings at Heathrow. In this same time period, enough slots and facilities became available to allow 10 new carriers to begin operations at Heathrow. But because we failed to grasp the opportunity to achieve open skies then available, none of the new airlines at Heathrow are U.S. carriers.

While I will leave it to Roger Maynard to discuss Heathrow in further depth, I would like to highlight a few important points. First, most of the U.S.-Heathrow flights started since 1996 have been added by our competitors United and Virgin in four of the six nonstop markets where AA and BA overlap, namely Boston, Chicago, Los Angeles, and New York. Overall, United has increased its number of flights between the United States and Heathrow by 64 percent and Virgin by 68 percent since 1996. Somewhere, somehow, United and Virgin were able to get Heathrow slots. As a result, in terms of passengers carried, American is the smallest of the four airlines flying between the United States and Heathrow.

Second, bmi british midland holds 14 percent of all Heathrow slots and has publicly announced that under open skies it will serve a number of U.S. cities, including Chicago and Miami where AA and BA currently overlap. Moreover, bmi british midland and its partners in the Star Alliance, which holds a combined total of 27 percent of all Heathrow slots, have announced recently that they will invest over $70 million to develop Heathrow as a hub for Star.

British Airways accounts for just under 37 percent of all Heathrow slots. American Airlines adds only 2 percent to that total. Indeed, the combined AA/BA slot total at Heathrow has declined from 42 percent in 1996 to 39 percent in 2001. Importantly, in a statement last week showing that his own disposition towards AA/BA has turned positive, Professor Alfred Kahn provided the following observations on this point:

> "1. 'Hub dominance' such as apparently makes possible a hub premium is rarely if ever, to my knowledge, defined as flowing from a 39 percent share of total operations. 2. The addition of American's slots to those of British Airways, I understand, would raise the share of the "dominating" entity only from 37 to 39 percent. Although my experience with airline merger cases under the antitrust laws is far from encyclopedic, I am unaware of any case in which so small an increment, particularly to a pre-merger share of 37 percent, was deemed worthy of antitrust concern, let alone condemnation."

It sounds to me as if Dr. Kahn would be far more concerned with Lufthansa and United's 63 percent share of Frankfurt, Air France and Delta's 57 percent share of Paris De Gaulle, and KLM and Northwest's 56 percent share of Amsterdam, than he is with BA and AA's 39 percent share of Heathrow.

In closing, I think you can probably tell that I strongly believe that it is simply unfair to hold AA/BA back while other alliances continue to move forward. I am gratified that Professor Kahn, as evidenced in his statement last week, now shares that view:

> "Competition in international aviation has increasingly in recent years been primarily a competition among alliances, dominating their own respective hubs and competing with one another worldwide. In these circumstances, posing impediments to the American Airlines/British Airways alliance becomes a highly objectionable enterprise in competitive handicapping, such as I have deplored in a large number of contexts."

Thank you again for the opportunity to testify today. I would be happy to answer any questions that the Chairman and Members of the Subcommittee might have.

Chairman KOHL. Thank you, Mr. Carty.

Mr. Mullin, you are next and, gentlemen, I hope you will keep your statements down to 5 minutes so we can have time for an exchange of views.

Mr. Mullin?

STATEMENT OF LEO F. MULLIN, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, DELTA AIR LINES, ATLANTA, GEORGIA

Mr. MULLIN. Thank you, Senator Kohl, and thank you, Senator DeWine. I would like to associate myself with comments that were just made by Don Carty on two points: one, to thank this Committee for the terrific work that it did in the aftermath of the tragedy on September 11th. It was both necessary and extraordinarily commendable. And, secondly, to also join myself in terms of his comments on security, and in the interest of time, I won't repeat those, but I would be happy to take questions on them as well. But I think Mr. Carty has done a very fine job of stating them, and if I can, I would also like to commend Don Carty for his leadership of the Air Transportation Association. He is our chairman, and he has done an excellent job in leading us during this difficult time.

This morning, then, I would like to focus on two key points: one, and most importantly, Delta is staunchly in favor of alliances as long as the competitive balance of the marketplace is maintained; secondly, however, the grant of antitrust immunity for British Air and American Airlines raises serious questions about competitive balance due to lack of access at London Heathrow, the biggest and most lucrative U.S.-to–Europe destination.

Beginning with my first point, Delta is a staunch supporter of alliances. These alliances have enabled airlines to meet the growing demand of passengers to travel from anywhere to everywhere. And as part of the SkyTeam Alliance, Delta and partners Air France, Alitalia, and CSA Czech Airlines currently compete in the transatlantic marketplace with Star and with KLM and Northwest, two alliances with antitrust immunity. We are hopeful that DOT will soon approve SkyTeam's application for antitrust immunity, bringing that number to three. Combined, these alliances offer over 110,000 potential transatlantic markets and give passengers more choices and lower prices.

Mr. Chairman, with one notable exception, which I will discuss, Delta has not opposed antitrust immunity for any competing alli-

ance, nor will we, as long as a competitive marketplace is maintained. That exception is obviously the proposed American Airlines/British Airways alliance, which would, without specific alterations, create overwhelming dominance at London Heathrow.

It is worth noting that while Delta's SkyTeam application has generated no opposition, the response to American Airlines and British Airways' application stands in stark contrast. The key point of difference is the matter of competition and access at London Heathrow. Heathrow, as Senator DeWine has mentioned, is Europe's premier airport, serving almost 11 million passengers each year, twice as many as Frankfurt, twice the combined 6 million served by both Paris airports, Charles De Gaulle and Orly.

London passengers continue to prefer Heathrow to London–Gatwick two to one, and high-yield business travelers prefer it three to one. Instead of increasing competition at Heathrow, the proposed alliance would allow the largest two carriers in the market—American Airlines and British Airways—to fully dominate the market.

Now, in a time period when much change has been going on in aviation around the world, with respect to this situation, nothing has changed. The proposed American Airlines/British Airways alliance is a repeat of the proposal that was resoundingly rejected in 1998. At that time, each regulatory body that reviewed the alliance drew the same conclusion: Absent a significant divestiture of slots to allow other carriers to compete at Heathrow, the American/British Airways alliance was anti-competitive. In the words of the Department of Justice, "The competitive losses accompanying approval of this alliance would be immediate and substantial."

Mr. Chairman and members of the Subcommittee, nothing has changed. The key issue continues to be access to Heathrow. The owners of Heathrow, BAA, and Airport Coordination Limited noted in filings to the Department of Transportation that they expect "only a few additional slots to be created at Heathrow, a small amount of which are expected in the hours that transatlantic flights are currently being operated. Without reallocation of current slots, no new meaningful access is possible."

Proponents of American/British Airways allege, however, that three factors have significantly changed the competitive landscape: first, that Heathrow has lost its competitive importance; secondly, that an immunized United/British Midland alliance will remedy competitive concerns; and, third, that other carriers seeking entry to Heathrow can obtain slots and facilities from their alliance partners.

Mr. Chairman, these representations are simply not true. As President John Adams once said, "Facts are stubborn things."

So, to the first point, London–Heathrow's importance is undiminished. To the contrary, Heathrow continues to handle twice as many passengers as the next largest airport, Frankfurt.

Secondly, to the second point, that United/British Midland will remedy competitive concerns, that alliance merely creates a two-alliance monopoly at Heathrow. AA/BA and United/British Midland would control 87 percent of the U.S. Heathrow slots. And the remaining U.S. carriers—Delta, Northwest, Continental, and US Airways—will have no viable access to this immensely important mar-

ket. And since United and BMI already have slots at Heathrow, competition will simply not increase.

Also, finally, Delta's SkyTeam partners cannot give up slots at Heathrow. For our partners, these slots allow them to compete against British Airways and to serve their home markets such as Paris, Milan, Rome, and Prague. And even if this were possible, such exchanges would simply shift slots around rather than increase competition.

Mr. Chairman, again, the problem with this alliance is Heathrow. If the DOT considers approving this application, it must ensure: first, significant divestiture of slots from BA and American to permit other airlines to compete; second, airport gates and terminal facilities adequate for new services; and, third, lead time for new competitors to launch services before implementation of the alliance.

Delta is prepared to launch 11 daily services to Heathrow: three from Atlanta, two from Cincinnati, two from Boston, and four from JFK.

Mr. Chairman, Delta understands AA and BA's desire for antitrust immunity. We welcome that competition. But this alliance is not about creating network expansion through end-to-end combination of complementary hub systems, as is the case for other alliances. This alliance is about allowing two carriers overwhelming domination of the largest and most important U.S. international aviation destination—Heathrow.

American and BA must decide if the benefits of an antitrust-immunized alliance are of sufficient importance to warrant the essential preliminary step of allowing true and meaningful competition at London's Heathrow.

Thank you very much.

[The prepared statement of Mr. Mullin follows:]

STATEMENT OF LEO MULLIN, CHIEF EXECUTIVE OFFICER, DELTA AIRLINES

INTRODUCTION

Mr. Chairman and members of the Subcommittee, thank you for this opportunity to appear before you today to discuss the importance of international airline alliances and the beneficial role anti-trust immunity can play in improving those alliances.

At a time when good news in the airline business is increasingly rare, the subject of alliances is clearly good news.

The evolution of alliances is a compelling story. Beginning with the "outside the box" thinking of KLM and Northwest in being the first alliance to seek antitrust immunity in the early 1990s, to the formation of the STAR alliance in the late 1990s to the recent ascension of our own SkyTeam Alliance (Delta, Air France, Aeromexico, Alitalia, CSA Czech Airlines and Korean Air Lines), these competitive partnerships have created a dynamic environment across the Atlantic and around the globe. The alliance arena has truly gone from a novelty in its infancy to a mature marketplace fixture in just a few short years.

Alliances evolved as a reflection of a changing global economic environment. With the end of the cold war, the world opened up for business and travel. This environment made carriers realize we had to meet the changing demands of our passengers—demands that increasingly focused on total global access.

But no carrier could do this on their own. No carrier could reach every corner of the globe with its own resources in an efficient manner. The task was too large to accomplish given the geography involved, the limits of our resources and the need to remain profitable.

Yet, carriers had to respond to demands of the marketplace or be relegated to a competitively disadvantaged niche carrier status. How did we accomplish this?

We responded by forming cooperative networks with strategically positioned carriers to meet the goal of getting people "from anywhere to everywhere."

And this is where we are today—creating seamless networks that cover the globe. Atlanta and Paris, Chicago and Frankfurt, Detroit and Amsterdam are linked through the resources of their respective hub carriers to create vast end-to-end connecting complexes that give passengers the ability to easily fly virtually "from anywhere to everywhere," safely, quickly and more conveniently than ever before. (Charts 1,2, 3)

Consumers benefit through these combinations by enjoying

increased global access with numerous connecting possibilities via several hubs;

competitive prices and additional flights

enhanced frequent flyer program access with more mileage and more awards, and

consistent policies and procedures across various airlines.

SkyTeam Antitrust Immunity

As part of the SkyTeam alliance, Delta and its European partners Air France, Alitalia and CSA Czech Airlines currently compete in the transatlantic marketplace with STAR and KLM/Northwest, two alliances with anti-trust immunity.

SkyTeam's application for antitrust immunity is currently pending before the DOT.

No carrier has voiced substantive objections to our application, so we are hopeful that a third immunized alliance—namely SkyTeam—will soon create an even more competitive transatlantic market.

Combined, these three alliances will offer over 110,000 potential transatlantic city pair markets—and we will compete for passengers on the bulk of these city pairs.

This vigorous competitive alliance marketplace across the Atlantic creates a win-win for carriers and consumers by generating more flights, more choices, and lower prices for passengers. The Department of Transportation acknowledged this fact in a recent report entitled "Transatlantic Deregulation: The Alliance Network Effect." In the report, the Department stated that alliances have "created a more competitive transatlantic structure. *Thus, new flexibility for carriers to respond to marketplace demands has led to downward pressures on price, both due to increased supply and increased competitiveness."* (Emphasis added)

The Positive Role of the U.S. Government

The Government has played an extremely constructive role in fostering the development of alliances. The Department of Transportation and the State Department have been very pro-active in its pursuit of open skies agreements as a precursor to granting anti-trust immunity.

Working closely with affected carriers, the U.S. government has helped ensure that a sound regulatory backdrop of open access to airports and markets exists so all U.S. carriers enjoy a level playing field in the alliance environment. To date, we have negotiated over 50 open skies agreements and we know there will be many more.

This partnership between government and industry in deregulating the global aviation arena is a key by-product of the evolution of alliances.

I am pleased to say that Delta is taking an active and successful role in these developments to date.

We are anxious to have the SkyTeam join other alliances in receiving antitrust immunity and we believe consumers and our airlines will be better for it.

Summary of Main Points

With that background, I'll focus the remainder of my comments on two main points:

Delta is staunchly in favor of alliances with anti-trust immunity as long as the competitive balance of the marketplace is maintained.

However, granting anti-trust immunity between British Airways and American Airlines raises serious questions about competitive balance due to lack of access to London-Heathrow, the largest and most lucrative U.S.-Europe market.

DELTA IS A STAUNCH SUPPORTER OF ALLIANCES

Beginning with my first point: Delta is staunchly supportive of alliances and of anti-trust immunity for those alliances that are pro-competitive.

We did not oppose formation of the STAR alliance nor its request for anti-trust immunity.

We support the pioneering work by KLM and Northwest as the first immunized alliance.

We did not oppose American Airlines' application for antitrust immunity with Swissair and Sabena.

Mr. Chairman, with one notable exception, which I will discuss in a moment, Delta has not opposed anti-trust immunity for any competing alliance—nor will we, as long as we can be assured a competitive marketplace will prevail.

DELTA'S CONCERN OVER AA/BA

Such a competitive marketplace requires, and our government has supported, open skies agreements between the U.S. and the associated carrier's government.

These agreements guarantee unrestricted opportunity for all U.S. carriers to compete under true—not theoretical—open skies conditions.

Let me explain the difference.

While an open skies agreement removes artificial regulatory restrictions on U.S. carriers serving the associated country's markets, the policy is only "theoretical" if other barriers to entry remain, such as slot scarcity and unavailability of gates and other operational requirements. True open skies exists, for example, in the recent agreement between the U.S. and France, since any U.S. carrier wishing to serve any airport in France, including Charles de Gaulle in Paris, can actually—not just theoretically—do so at any time. The same is true of Skyteam airports in Milan, Rome and Prague.

This is not the case in the proposed open skies and anti-trust immunity alliance between American Airlines and British Airways.

Unlike any previously approved alliance, AA and BA would, without specific alterations, continue to dominate overwhelmingly at London Heathrow, effectively blocking access by most other U.S. carriers in this largest of all U.S.-Europe markets.

Heathrow serves almost 11 million U.S/U.K. passengers each year, roughly twice as many as the 6 million served each year at Frankfurt airport and twice as many as the combined 6 million served by both Paris airports, Charles de Gaulle and Orly Heathrow. (Charts 4,5)

What's more, London passengers continue to prefer Heathrow to London-Gatwick by a margin of 2 to 1, and the lucrative business travelers prefer it by almost 3 to 1. The marketplace has repeatedly proven that Gatwick is not an adequate substitute for Heathrow. (Chart 6, 7)

Instead of increasing competition in this market, which is closed to most U.S. airlines, the proposed alliance would reduce competition by allowing two of the largest carriers in the market, AA and BA, to stop competing with one another.

NOTHING HAS CHANGED

The proposed AA/BA alliance is a repeat of the proposal that was resoundingly rejected in 1998, when each regulatory body that reviewed the alliance drew the same conclusion: absent a significant divestiture of slots to allow other carriers to compete at Heathrow, the AA/BA alliance was anti-competitive.

In the words of the DOJ: "The competitive losses accompanying approval of this Alliance would be immediate and substantial."

Mr. Chairman and members of the subcommittee: Nothing has changed. The potential adverse competitive consequences of an AA/BA alliance remain as significant today as they were in 1998. In fact, if this alliance is approved, 80% of U.S.-Heathrow passengers from cities across the country would have fewer or no choice of airlines. (Chart 8)

HEATHROW ACCESS IS ESSENTIAL

The key issue continues to be access to Heathrow access.

Due to the lack of slots and facilities at Heathrow, there are no current or foreseeable opportunities for non-incumbent Heathrow carriers, such as Delta, to mount a significant competitive presence against AA/BA.

The owners of Heathrow, BAA, and Airport Coordination Ltd., the body that oversees slot allocation at Heathrow, have confirmed this fact in its filings at the Department of Transportation.

To quote directly, ". . .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 restraints." (Chart 9)

Proponents of this alliance allege three factors have significantly changed the competitive landscape and the alliance should therefore be approved:

1. London's Heathrow does not have the competitive importance it once had due to the presence of other competing alliances;
2. An immunized United/British Midland (BMI) alliance will remedy competitive concerns at Heathrow.
3. Other U.S. carriers seeking entry to Heathrow will be able to obtain slots and facilities from their alliance partners.

Mr. Chairman, these representations simply are not true.

1. London-Heathrow's importance has not been diminished by the presence of competing alliances.

Heathrow continues to be by far the most important airport in the U.S.-Europe market, accounting—as I mentioned earlier—for roughly twice passengers as many as the 6 million served each year at Europe's second most important airport—Frankfurt—and twice as many as the combined 6 million served by both Paris airports, Charles de Gaulle and Orly. (Chart 4)

2. Regarding the second point—that an immunized United/British Midland alliance would remedy competitive concerns at Heathrow—that recent alliance merely creates a two-alliance monopoly at Heathrow.

Under this scenario, AA/BA's oneworld alliance and United/British Midland's Star alliance would control 87% of the U.S. Heathrow slots. (Chart 10)

The remaining U.S. carriers—Delta, Northwest, Continental and US Airways—remain locked out of the number one airport in the number one U.S.—Europe market.

What's more, since United and BMI already have slots and facilities at Heathrow, the increase to marketplace competition will be zero.

3. Finally, number three, Delta's SkyTeam partners have already informed us they can not afford to give up slots at Heathrow.

For our partners, these slots from the foundation of their ability to compete against British Airways and are the method by which they serve their home markets such as Paris, Milan, Rome, and Prague. (Charts 11, 12)

In addition, the sacrifice slots should not be a requirement for alliance membership.

Mr. Chairman, I cannot stress enough that the problem with this alliance is access to Heathrow.

Other U.S. carriers must be able to compete with AA and BA in this crucially important international market.

If the DOT is going to consider approving this application, it must ensure:

A significant divestiture of takeoff and landing slots from British Airways and American to permit other airlines to offer competitive services, (Chart 13)

Airport gates and terminal facilities at London Heathrow to accommodate the new services

And the opportunity for competitors to initiate their new services to London Heathrow before implementation of the alliance.

These steps are essential in order to ensure our ability to compete effectively with AA and BA in both price and service.

Delta is prepared to launch 11 daily services to Heathrow:

3 from Atlanta
2 from Cincinnati
2 from Boston
4 from JFK—JFK is especially important as AA and BA are planning to offer a combined 13 daily flights in this market.

Mr. Chairman, Delta understands the desire on the part of AA and BA to attain anti-trust immunity in order to compete more effectively in the alliance market.

We welcome that competition.

But *this alliance is not about creating network expansion through the end-to-end combination of complementary hub systems, as is the case for other alliances*.

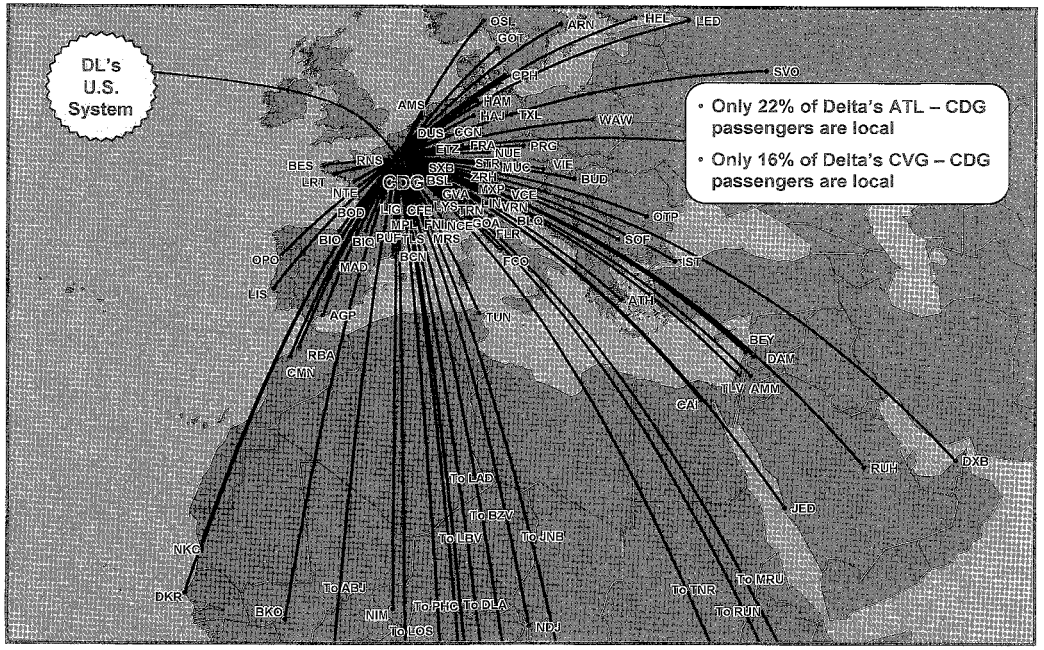
Rather, this alliance is about allowing two carriers overwhelming domination of the largest and most important U.S. international aviation destination—London.

American and British Airways must decide if the benefits of an anti-trust immunized alliance are of sufficient importance to warrant the essential preliminary step of allowing true and meaningful competition at London's Heathrow.

Thank you.

Chart 1

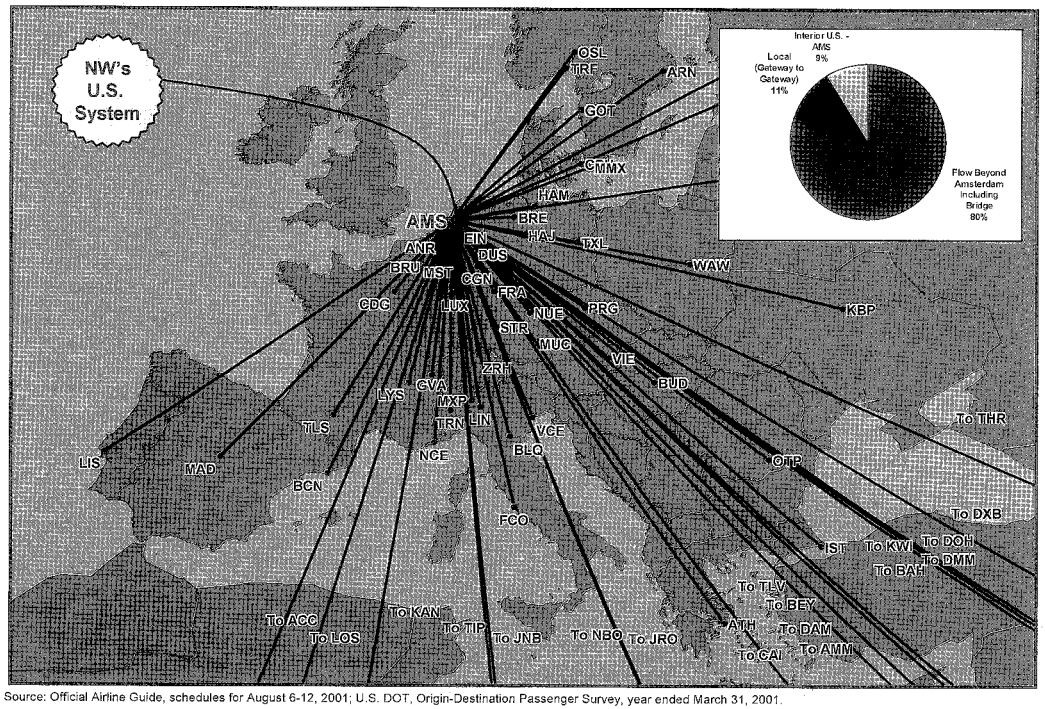
THE DELTA /AIR FRANCE ALLIANCE FOCUSES ON PARIS AS A GATEWAY TO EUROPE AND BEYOND



Source: Official Airline Guide, schedules for August 6-12, 2001; U.S. DOT, Origin-Destination Passenger Survey, year ended March 31, 2001.

Chart 2

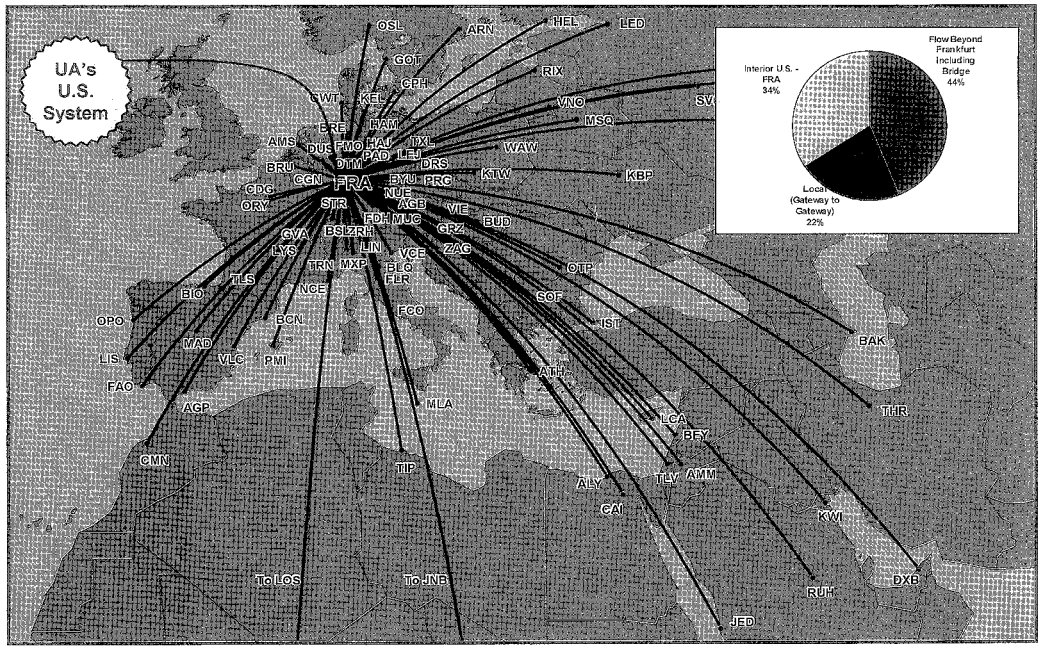
THE NORTHWEST/KLM ALLIANCE FOCUSES ON AMSTERDAM AS A GATEWAY TO EUROPE AND BEYOND



Source: Official Airline Guide, schedules for August 6-12, 2001; U.S. DOT, Origin-Destination Passenger Survey, year ended March 31, 2001.

Chart 3

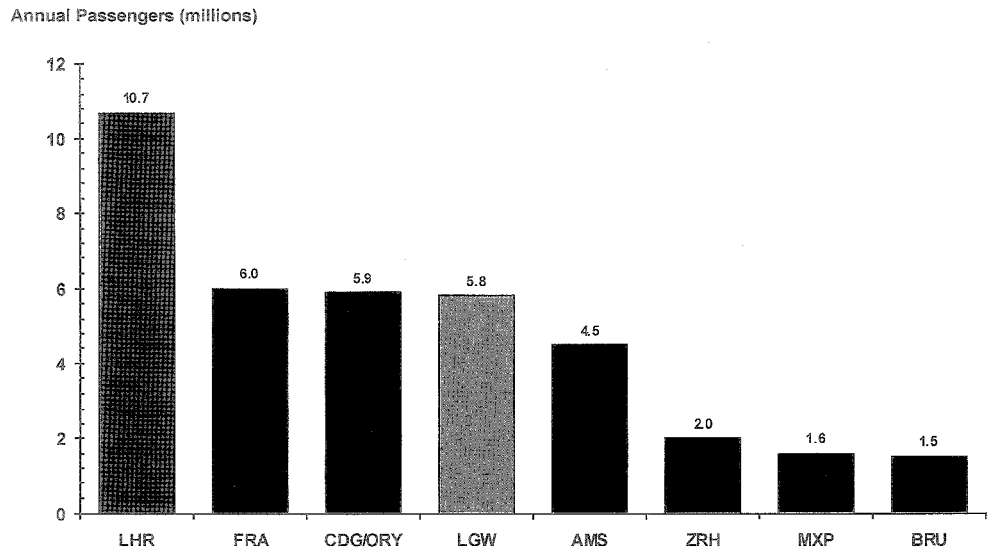
THE UNITED/LUFTHANSA ALLIANCE FOCUSES ON FRANKFURT AS A GATEWAY TO EUROPE AND BEYOND



Source: Official Airline Guide, schedules for August 6-12, 2001; U.S. DOT, Origin-Destination Passenger Survey, year ended March 31, 2001.

Chart 4

LONDON HEATHROW IS BY FAR THE MOST IMPORTANT AIRPORT FOR THE U.S. – EUROPE MARKET

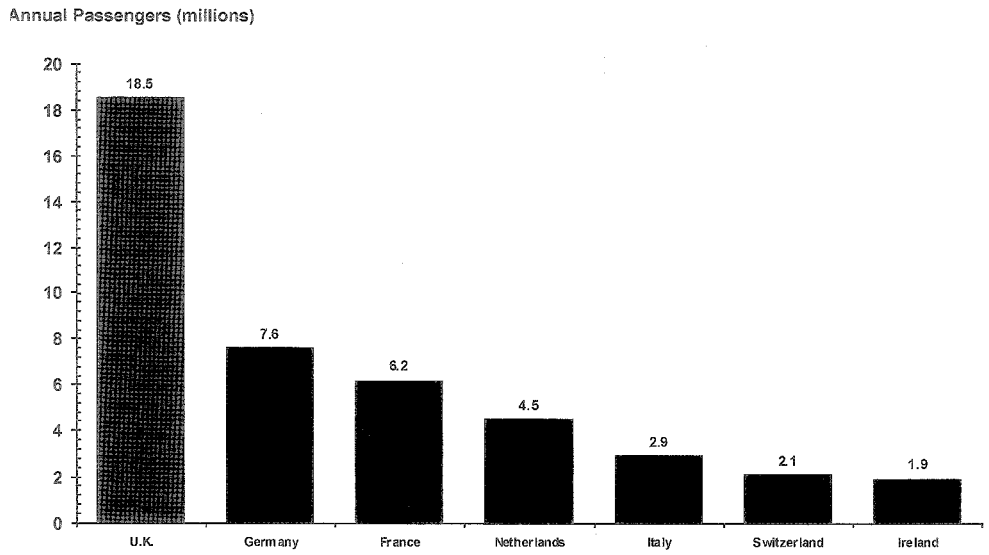


Note: Both directions via scheduled and charter flights of all flags. Includes contiguous 48 states.

Source: U.S. DOT, INS statistics, calendar year 2000, via Data Base Products.

Chart 5

THE U.K. IS THE LARGEST U.S. – EUROPE MARKET
(48 Contiguous States)

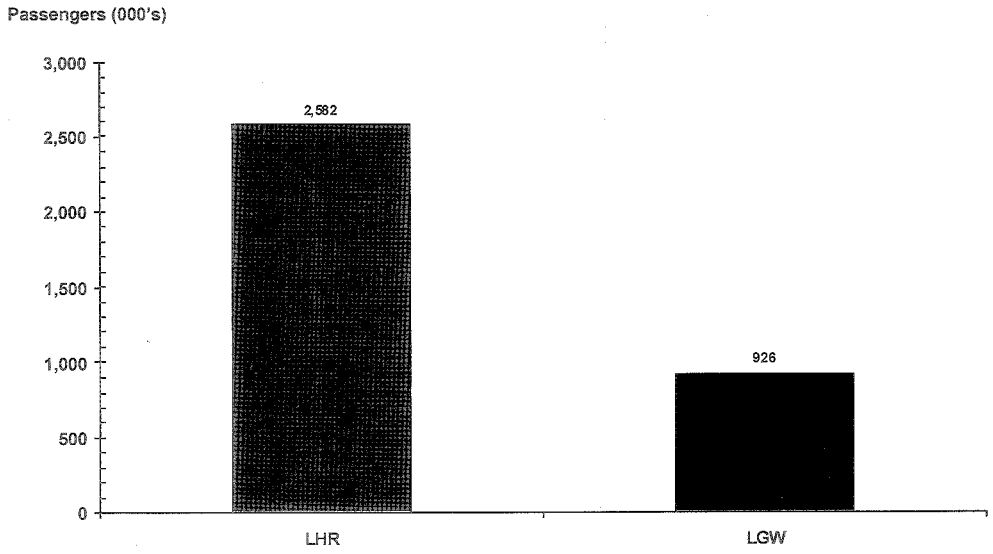


Note: Excludes North America and Caribbean.

Source: U.S. DOT, INS statistics, calendar year 2000, via Data Base Products.

Chart 6

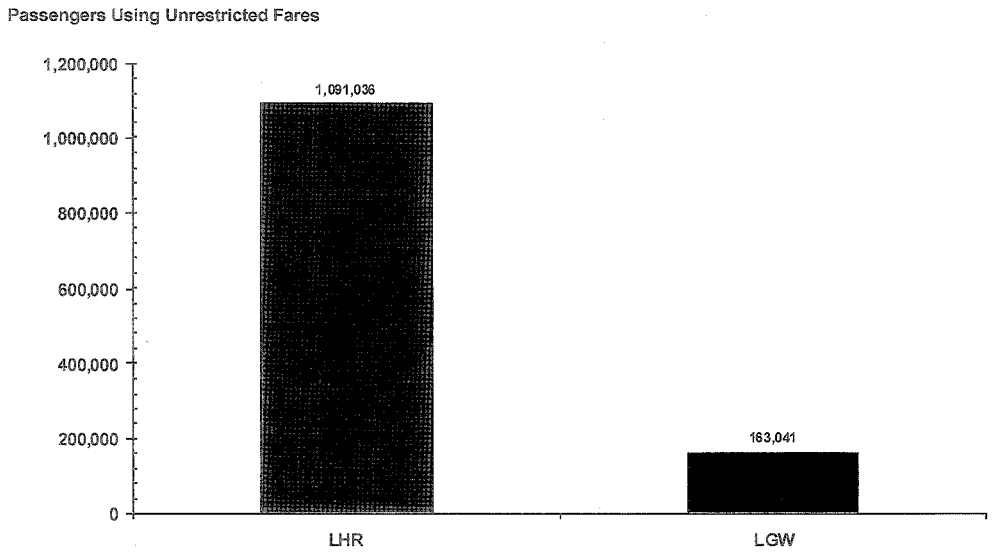
ALMOST THREE TIMES AS MANY U.S. – LONDON BUSINESS PASSENGERS USED HEATHROW AS GATWICK



Source: U.K. Civil Aviation Authority, 1996 passenger survey data.

Chart 7

BA AND AA CURRENTLY CARRY ALMOST SEVEN TIMES AS MANY BUSINESS PASSENGERS TO HEATHROW AS TO GATWICK IN AA-BA COMPETITIVE MARKETS*



* New York, Dallas/Ft. Worth, Miami, Boston, Los Angeles and Chicago where both BA and AA operate nonstop service

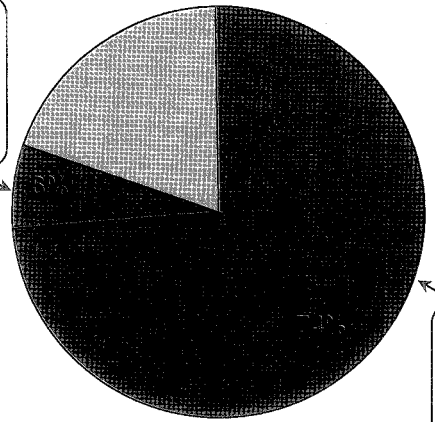
Source: Docket OST-2001-10387, Exhibit JA-8

Chart 8

80% OF U.S. – HEATHROW PASSENGERS WOULD HAVE FEWER OR NO CHOICE OF AIRLINES FOLLOWING A BRITISH AIRWAYS / AMERICAN AIRLINES COMBINATION

Passengers in BA/AA Monopoly Markets

Detroit	170,505
Philadelphia	318,118
Seattle	221,557
Total	710,180



Passengers in Markets with Reduced Competition

Boston	853,957
Chicago O'Hare	1,463,097
Los Angeles	1,596,476
Miami	393,422
Newark	761,369
New York Kennedy	2,808,722
Total	7,877,043

BA/AA would reduce competition on over half of all U.S. – Heathrow routes

Note: Includes contiguous 48 states.

Source: Official Airline Guide, schedules for August 6 – 12, 2001.

Chart 9

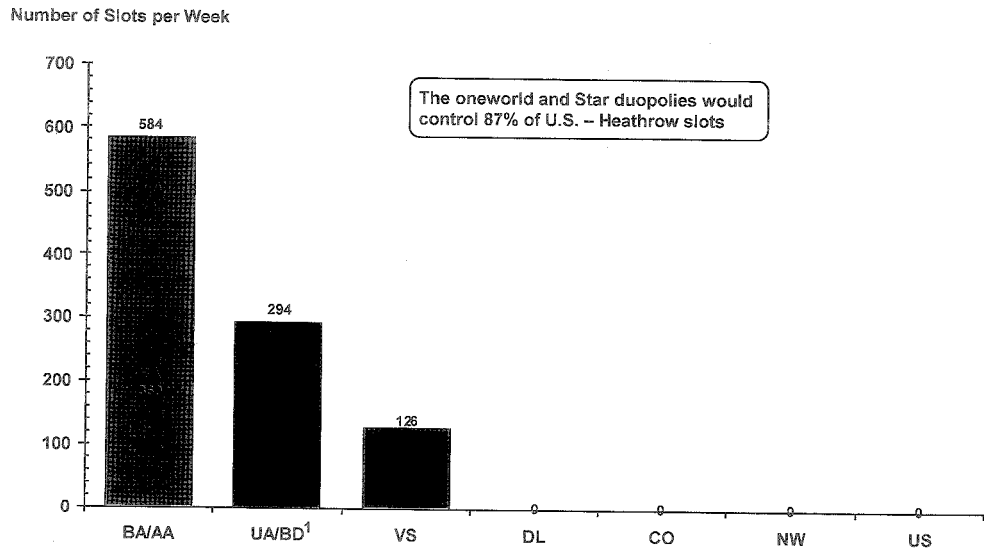
THE OWNERS AND OPERATORS OF LONDON HEATHROW SAY HEATHROW IS FULL

"But 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."

Source: BAA Issues & Principles Paper, paragraph 18.

Chart 10

THE PROPOSED COMBINATION WOULD REDUCE THE U.S. – HEATHROW MARKET FROM FIVE ACTUAL AND POTENTIAL COMPETITORS TO A DUOPOLY AND AN ALSO RAN

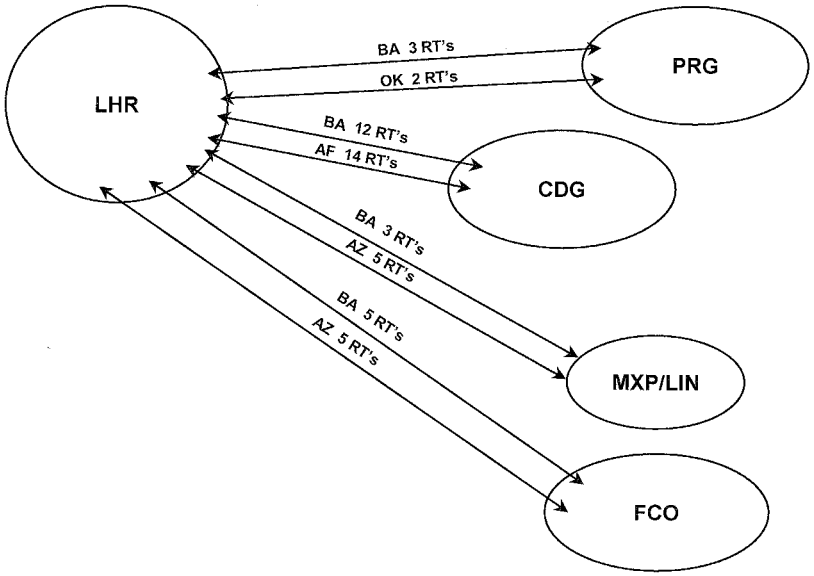


1/ British Midland slot usage based on June 21, 2001 statement by Sir Michael Bishop

Source: Airport Coordination Limited, Summer 2001.

Chart 11

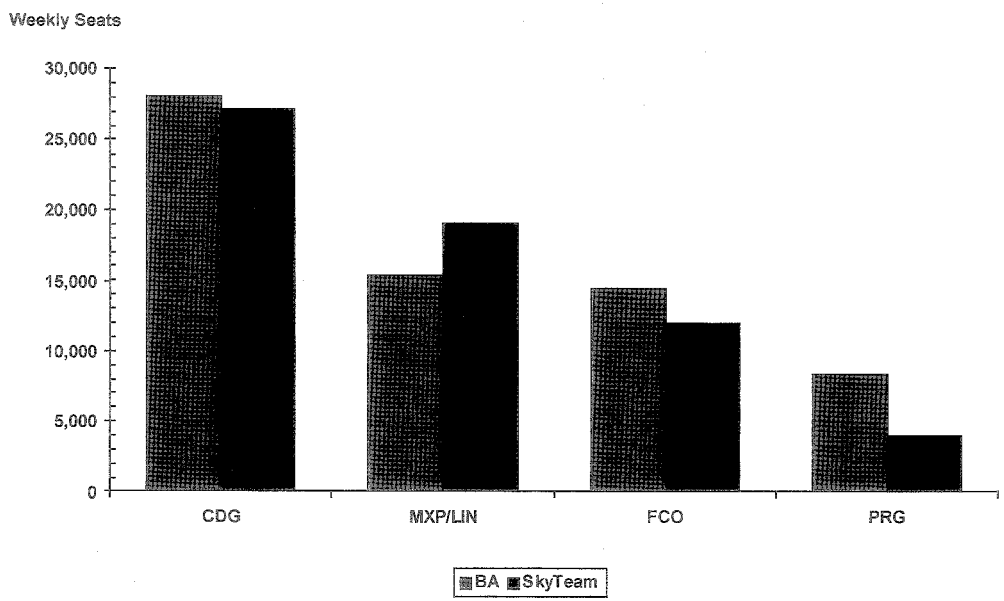
BRITISH AIRWAYS IS HIGHLY COMPETITIVE WITH SKYTEAM CARRIERS BETWEEN HEATHROW AND THE RESPECTIVE HOME COUNTRIES



Source: Official Airline Guide, schedules for August 6 – 12, 2001.

Chart 12

DELTA'S ALLIANCE PARTNERS NEED THEIR LHR SLOTS TO COMPETE WITH BRITISH AIRWAYS IN THEIR KEY HOMELAND MARKETS



Source: Official Airline Guide, schedules for August 6 – 12, 2001.

SLOT DIVESTITURE IS THE KEY TO HEATHROW COMPETITION

	Minimum Heathrow Slot Requirement	Daily Roundtrips
Delta	154	11
Continental (est.)	140	10
Northwest (est.)	70	5
US Airways (est.)	84	6
2 New Entrants (est.)	56	4
Total	504	36

Chairman KOHL. Thank you, Mr. Mullin.

Mr. Anderson?

STATEMENT OF RICHARD ANDERSON, CHIEF EXECUTIVE OFFICER, NORTHWEST AIRLINES, INC., EAGAN, MINNESOTA

Mr. ANDERSON. Yes, thank you, Senator Kohl, Senator DeWine. We appreciate the opportunity to be here. I also endorse Don Carty's statements as chairman of the Executive Committee of ATA on the issue of security, and I would add one amendment. The U.S. airlines have worked closely since the events of 9/11 to increase the pay of screeners at checkpoints, to significantly increase the number of magnometers and X-ray machines at checkpoints so that we have the resources, both personnel and equipment, both at the gates, where we have all bought many more wanding devices, and at the security checkpoints in airports. So we have all made that a priority in terms of expenditures at a very difficult time financially in our industry.

With that I will move to the subject at hand.

Thank you for the invitation to appear before the Committee today to discuss the proposed alliance of BA and AA and, in particular, the request that the alliance be granted immunity from the antitrust laws.

I testify here today as an advocate of international alliances. Northwest and KLM pioneered the first transatlantic alliance with immunity from the antitrust laws. The Northwest/KLM alliance works by connecting the KLM network in Europe with the Northwest network based in Minneapolis/St. Paul, Detroit, and Memphis. This network extension allows passengers traveling from Milwaukee to Warsaw to have more convenient itineraries and generally cheaper fares. When we formed the alliance, there was no head-to-head competition, and since then, United, Delta, US Airways, and Continental have all commenced new competitive service to Amsterdam's Schiphol Airport.

In contrast, BA and AA are each other's biggest competitors in U.S.–London markets with substantial overlap. Their alliance focuses on the elimination of direct competition and not on creating new benefits by connecting two new networks. London's Heathrow Airport is closed to new competitive entry by Delta, Continental, Northwest, and US Airways.

To put it in context, if you analogized the U.S.–Heathrow market to the U.S. domestic market, an AA/BA merger would be equivalent to an American/United merger. But only imagine how much worse an American/United merger would be if Delta, Continental, and Northwest would be precluded from operating any flights to O'Hare or DFW, the functional equivalent of Heathrow in the AA/BA case.

In a recent editorial on the proposed deal, the highly respected London newspaper, the Financial Times, concluded: "In any other industry this would be considered a squalid compromise, clearly contrary to the public interest. It would create the potential for a cartel with a dominant position at Heathrow, even though it would have to surrender some of its existing slots."

The AA/BA alliance is all about Heathrow. Under Bermuda 2, only two U.S. airlines are permitted to serve U.S.–Heathrow: United and American. It is clearly advantageous, it is the choice of

the business traveler, and as Mr. Mullin related to you, it is clearly the preference both of passengers—which, of course, is reflected in the higher yields and fares that are paid for service to Heathrow. I believe our own Justice Department in the previous proceedings on this subject concluded that Heathrow was a separate market or purposes of antitrust analysis.

The AA/BA immunized alliance will create dangerous levels of market power. Under the proposed deal, the anti-competitive harm flowing directly from the proposed alliance will be large and enduring. AA and BA are the largest airlines of each country and two of only four airlines permitted to operate between the United States and Heathrow. Today, they are each other's biggest competitors in the U.S.–London and U.S.–Heathrow market, and in six U.S.–London city pairs—Boston/Chicago/Dallas/L.A./Miami and New York–Heathrow—and give U.S.–Heathrow city pairs—Boston/Chicago/L.A./Miami and New York.

In every case, the AA/BA alliance will increase concentration in amounts and levels that vastly exceed the increases and resulting concentration levels deemed tolerable under the United States Merger Guidelines. If granted antitrust immunity, instead of being each other's strongest competitor, American and BA will cease competing with each other at all and combine their market power to limit capacity and raise prices.

The AA/BA merger will result in increased concentration and afford the two carriers market power in the U.S.–Heathrow market of 6 million annual O&D passengers and a U.S.–London market of almost 10 million O&D passengers. These non-stop U.S.–Heathrow overlap markets alone account for $4 billion in annual business. To put this in context, the revenues in the non-stop U.S.–Heathrow markets where American and BA overlap are twice as large as the United–US Air overlap markets, which were just turned down, and 10 times larger than the revenues in the non-stop overlap markets allegedly affected by Northwest's ownership in Continental, both of which were opposed by the DOJ.

Finally, the competition lost by the AA/BA alliance cannot be replaced by new entry because of slot constraints at London–Heathrow Airport. BAA, the airport authority, has told us there are no more gates, and the slot coordinator has said there are no slots available and there is no real gray market in slots.

American has contended and BA has contended that we can obtain slots from our alliance partners. Our alliance partner KLM has said no to that request. They have very few slots that they serve Amsterdam–London with. And, in fact, those slots are not for wide-body airplanes and do not coordinate to the times of day for departures and arrivals for U.S. connecting service.

I appreciate the opportunity to appear before you today and look forward to questions, either on security or the AA/BA alliance. Thank you for this opportunity.

[The prepared statement of Mr. Anderson follows:]

STATEMENT OF RICHARD ANDERSON, CHIEF EXECUTIVE OFFICER, NORTHWEST AIRLINES

Mr. Chairman and Members of the Committee, my name is Richard Anderson and I am Chief Executive Officer of Northwest Airlines. Thank you for your invitation to appear before the Committee today to discuss the proposed alliance of British Air-

ways and American Airlines and, in particular, the request that the alliance be granted immunity from the antitrust laws of the United States.

I testify here today as an advocate of international alliances. Northwest and KLM pioneered the initial transatlantic alliance with immunity from the antitrust laws. The Northwest/KLM immunized alliance model works by connecting the KLM European network based in Amsterdam with Northwest's US network with hubs in Minneapolis/St. Paul, Detroit and Memphis. This network extension allows passengers traveling, for example, from Milwaukee to Warsaw to have more convenient itineraries and generally cheaper fares. There was no head-to-head competition when the Northwest/KLM alliance was formed. Since Northwest and KLM formed its alliance, United, Delta, US Airways and Continental have all commenced new competitive service to Amsterdam's Schiphol Airport.

In contrast, British Airways and American are each other's biggest competitor in US-London markets with substantial overlap. Their alliance focuses on the elimination of direct competition and not on creating new public benefits by connecting two networks, and London's Heathrow Airport is closed to new competitive entry by Delta, Continental, Northwest and US Airways.

To put this in context, if you analogized the US-Heathrow market to the US domestic market, an AA/BA "merger" would be equivalent to an American/United merger. But only imagine how much worse an American/United merger would be if Delta, Continental and Northwest would be precluded from operating any flights to Chicago O'Hare or Dallas/Fort Worth airports, the functional equivalent of London Heathrow in the AA/BA case.

In a recent editorial on the proposed deal, the highly respected London newspaper the *Financial Times* concluded: "In any other industry this would be considered a squalid compromise, clearly contrary to the public interest. It would create the potential for a cartel with a dominant position at Heathrow, even though it would have to surrender some of its existing slots." (October 23, 2001).

I. The AA/BA Alliance Is All About Heathrow

Under Bermuda 2, only two US airlines (American and United) and two British airlines (BA and Virgin) are permitted to serve the US-Heathrow market. Heathrow's advantageous central location and superior ground access make it the preferred airport for a large majority of passengers, particularly business passengers and others who place a premium on travel time and convenience. It is not possible for US carriers to compete effectively with Heathrow service via Gatwick. BA's public documents acknowledge BA's Heathrow service produces per-passenger "unit revenues" that are 15% higher than its unit revenues at Gatwick. DOT data show that for the fiscal year 2000, as a result of the different passenger mix at the two airports, average fares paid in the US-Heathrow market were 31% higher than in the US-Gatwick market.

II. An AA/BA Immunized Alliance Will Create Dangerous Levels of Market Power

Under the proposed deal, the anti competitive harm flowing directly from the proposed AA/BA Alliance will be large and enduring. American and BA are the largest airlines of each country and two of only four airlines permitted to operate between the US and Heathrow. Today, they are each other's biggest competitors in the US-London and US-Heathrow markets, and in six US-London city-pairs (Boston/Chicago/Dallas/Los Angeles/Miami and New York-Heathrow) and five US-Heathrow city-pairs (Boston/Chicago/Los Angeles/Miami and New York-London).

In every case, the AA/BA Alliance will increase concentration in the relevant markets in amounts and to levels that vastly exceed the increases and resulting concentration levels that are deemed tolerable under the U.S. Merger Guidelines. Using the Herfindaho-hirschman Index of market concentration, the Guidelines state that any market with a post-merger HHI of greater than 1800 points is deemed to be "highly concentrated." The Guidelines further state that enforcement agencies will presume that any merger producing a post-merger HHI greater than 1800 and an HHI increase of more than 100 are likely to create or enhance market power or facilitate its exercise.[1]

[1] The Guidelines also provide that the presumption may be overcome by showing that other factors make it unlikely that the merger will create or enhance market power or facilitate its exercise. As discussed in Part IV below, those factors are not present here because of the extraordinarily high entry barriers at London Heathrow.

A. U.S.-HEATHROW

The proposed Alliance will produce exceptionally high levels of market concentration in the U.S.-Heathrow market, which is already highly concentrated. In the U.S.-Heathrow market, the proposed alliance will produce an HHI increase of 1729n points and an HHI level of 4388 points. This increase would be 17 times the threshold level at which the Merger Guidelines would presume the creation or enhancement of market power. The "merged" alliance, operating 305 weekly frequencies, would have a market share of 61.0% of all frequencies in the U.S.-Heathrow market.

B. U.S.-LONDON

Service to Heathrow is a distinct, relevant market and must be considered on a separate basis from service to "London" in all cases. However, even if London is treated as a single aggregated market combining service both to Heathrow and Gatwick, the proposed Alliance will result in exceptionally high levels of concentration. In the U.S.-"London" market (which is already "highly concentrated"), the proposed alliance will produce an HHI increase of 1287 points and an HHI level of 3327 points. This increase would be 12 times the threshold level at which the Merger Guidelines would presume the creation or enhancement of market power. The "merged" alliance would have 53.5% of the frequencies operated between the U.S. and London. In comparison, the next largest operator in the U.S.-London market, United, provides 14.6% of the frequencies; the remainder are spread among eight airlines.

C. AA/BA CITY-PAIR OVERLAP MARKETS

American and British Airways today compete head-to-head in five U.S.-Heathrow city-pair markets: Boston-LHR; Chicago-LHR; Los Angeles-LHR; Miami-LHR; and New York (including Newark)-LHR.The chart below sets forth the pre-and post-merger concentration ratios on the Heathrow overlap markets, which reflects all competitors operating between the U.S. point and London Heathrow. The chart also shows New York-London Heathrow separately for JFK as well as combined with Newark. As is shown in the chart, each of the five Heathrow increase well in excess of 100 points. In the large New York JFK-London Heathrow market, the HHI increase is 2,081 points and the post-merger market share is 65.1%. Even when combined with service from Newark, the results are largely the same. In Boston-London Heathrow, there is an HHI increase of 3,333 and a resulting market share of 83.3%. And, in the Miami-London Heathrow market, the merger results in a monopoly.

AA/BA OVERLAP ROUTES (U.S.-LHR) HHIS AND MARKET SHARES

BASED ON NUMBER OF FREQUENCIES

SEPTEMBER 2001

Origin	Pre-Merger	Post-Merger	Increase	AA/BA Market share
JFK	2,581	4,662	2,081	65.1%
NYC (JFK & EWR)	2,596	4,593	1,997	64.1%
BOS	3,889	7,222	3,333	83.3%
ORD	3,000	4,531	1,531	61.3%
MIA	5,556	10,000	4,444	100.0%
LAX	2,188	2,813	625	37.5%

American and British Airways today compete head-to-head in six U.S.-London city-pair markets, which includes London Heathrow and Gatwick: Boston-London; Chicago-London; Dallas-London; Los Angeles-London; Miami-London; and New York (including Newark)-London. The second chart below sets forth the pre- and post-merger concentration levels on the U.S.-London overlap markets. As shown in the chart, even when the market is expanded to include service to London Gatwick, the increases in concentration levels post-merger are extremely high. Each route was highly concentrated before the merger, and on each route their is an HHI increase well in excess of 100 points. In the New York JFK-London, the increase in the HHI is even higher than in the JFK-London Heathrow market and the resulting market share is higher as well. And as the chart reflects, the merger results in a monopoly in the Dallas-London market.

AA/BA OVERLAP ROUTES (U.S.-LONDON) HHIS AND MARKET SHARES

BASED ON NUMBER OF FREQUENCIES

SEPTEMBER 2001

Origin	Pre-Merger	Post-Merger	Increase	AA/BA Market share
JFK	2,691	4,831	2,140	66.7%
NYC (JFK & EWR)	2,323	3,980	1,657	59.0%
BOS	2,500	4,375	1,875	62.5%
ORD	3,000	4,531	1,531	61.3%
MIA	3,750	6,250	2,500	75.0%
DFW	5,556	10,000	4,444	100.0%
LAX	2,188	2,813	625	37.5%

III. The Potential Harm To Consumers Is Enormous

The potential harm to consumers in this case is enormous. An AA/BA operating merger will result in increased concentration and presumptive market power in a US-Heathrow market of 6 million annual O&D passengers and a US-London market of 9.4 million O&D passengers. The local U.S.-London market is by far the largest U.S. transatlantic aviation market—alone it is much larger than the total traffic between the U.S. and all of Germany and more than twice as large as the entire U.S.-France market. The U.S.-London market dwarfs the markets that are at the core of the other transatlantic alliances. It is over three times the size of the U.S.-Frankfurt market (the core of the STAR alliance), well over two times the size of the U.S. Paris market (the core of the SkyTeam alliance), and nearly five times the size of the U.S. Amsterdam market (the Core of the NW/KLM alliance).

The nonstop U.S.-Heathrow overlap markets alone account for almost $4 billion in annual business. To put this in context, the nonstop U.S.-Heathrow markets where American and BA overlap are twice The size of the United/U.S. Airways nonstop overlap markets, a transaction that was abandoned in the face of an announced challenge by the Justice Department. Similarly, the revenues in the nonstop overlap markets allegedly affected by Northwest's ownership interest in Continental Airlines, which was challenged by the Justice Department, was much smaller than what is at stake here. In that case, DOJ valued the nonstop overlap markets at $350 million in annual review—less than ten percent of the size of the U.S.-Heathrow nonstop overlap markets at risk in the AA/BA Alliance.

IV. The Competition Lost By An AA/BA Alliance Cannot Be Replaced By New Entry Because Of Slot Constraints At London Heathrow

The competition that would be lost as a result of the AA/BA Alliance will not be replaced by new entry. American and BA will have you believe that new entry at Heathrow is not a problem. They are wrong.

The British Airports Authority ("BAA") and Airport Coordination Limited ("ACL") have officially notified DOT that slots and facilities needed for competitive entry by US carriers at Heathrow are not available through conventional slot allocation procedures or through purchase on the grey market, and will not be available for many years to come. Absent substantial divestitures of slots and facilities at Heathrow, new entry by U.S. carriers into U.S.-Heathrow city-pair markets will not happen.

At the outset, it must be understood that the entire universe of Heathrow slots are not suitable to meet the needs of U.S.carriers attempting to compete with the AA?BA Alliance. It is the availability of slots during the time windows for transatlantic service that is relevant to an analysis of the likelihood of substantial new entry. It must also be understood that a "slot" at Heathrow does not refer only to a landing or departure time. The slots and associated facilities are "aircraft specific," i.e., a slot for use by narrow body aircraft, such as an A320, will have an associated parking stand that can handle such an aircraft and terminal facilities that are geared to carrier that wants to commence transatlantic operations at Heathrow. According to ACl, over 72% of the air transport movements at Heathrow are by narrow body aircraft.

Contrary to assertions by American and BA, it is unlikely that new entrants will be able to acquire slots through puchse, lease or trade. First, there is a serious question as to whether purchasing slots from current Heathrow holders will be legally possible. The European Union has promulgated a draft regulation that will have the effect of prohibiting carriers from buying or selling slots at all EU airports, includ-

ing Heathrow. Even if slot sales are legal, US carriers would face a significant problem in obtaining commercially viable slots will be held by three US-Heathrow operators: AA/BA, United/BMI and Virgin. Collectively, AA/BA and United/BMI hold 58.2% of the commercially viable slots. Virgin's share brings the total to 60.7%. Viewed from an alliance perspective, the Oneworld and Star Alliances together hold a total of 77.9% of the commercially viable slots at Heathrow. It is unrealistic to assume that these Department in 1998 reached the same conclusion: "Al long as AA and BA can us the slot themselves, there is no possibility that a US carrier can buy a slot from AA/BA."

There are only a total of 745 weekly Heathrow slots in the commercially viable transatlantic window that are not held to US-Heathrow incumbent carriers or their partners. Of these 745 slots, 528 are linked to facilities that are not suitable for wide body aircraft. Even if *all* of the remaining 217 slots held by non US-Heathrow incumbents were sold or leased to US carriers, this would not come close to satisfying the slot needs of US carriers. In fact, however, it is unlikely that any of these slots would be available for acquisition by new entrant US carriers.

As ACL's filing to DOT demonstrates, "grey market" for Heathrow slots is very small and BA is doing all of the buying. For the summer 2001 season, only 21 slots in the commercially viable transatlantic window were traded and BA acquired 20 of them. Indeed, even BA acquired 20 of them. Indeed, even BA is not able to acquire the slots it needs for its own Heathrow operations. BA recently cut its own service between Heathrow and approximately 15 pints in order to free up needed slots to implement a strategy of establishing high frequency service in core Heathrow business markets. In addition, it must be noted that BA holds significant advantages over other carriers, and in particular new entrant carriers, when it comes to obtaining slots at Heathrow. BA, for instance, can add slots from its vast supply of Gatwick slots to any inducement it may offer to another carrier for Heathrow slots. The difficulty BA has encountered in obtaining slots is further evidence by the extraordinary high prices it has been forced to pay. If BA itself cannot obtain all the Heathrow slots it needs, new entrants certainly would be even less able to gain access.

American and BA further content that US carriers can obtain all the slots they need from their foreign carrier alliance partners who serve Heathrow. This proposition also is untrue. First of all, some US carriers, such as US Airways, do not have foreign alliance partners serving Heathrow. Second, alliance partners use their scarce Heathrow slots to compete with BA, British Midland and other carriers in their key homeland markets. They are unlikely to trade slots that form an integral part of their own hub and spoke network. Indeed, if they had any inclination to give up their Heathrow slots, especially the few slots usable for wide body service, they would Already have sold them for the extraordinarily high prices that BA is willing to pay.

In Northwest's case, Northwest's alliance partner, KLM, holds but 71 slots that are usable for transatlantic service from a timing standpoint. Divesting any of these slots would directly and immediately compromise KLM's competitive position in the UK market vis-á-vis BA and other carriers at Heathrow. Even if KLM were legally and commercially able to part with some of its London Heathrow slots, those slots would not be suitable for Northwest's transatlantic operations because they are tied to gates and parking stands that can handle the smaller aircraft that KLM operates on its intra-Europe routes but cannot handle the wide body (B–747, DC–10 or A330) aircraft that Northwest would operate. By the token, the terminal facilities that KLM uses in connection with these slots are inadequate to handle the greater passenger volumes that Northwest would generate on its larger aircraft.In sum, the harm here to competition and to consumers comes not just from the higher levels of concentration that will result from immunization of the proposed alliance, but from the combination of high concentration and the insurmountable barriers to entry at Heathrow that new entrants would face in a world that includes AA/BA and UA/BMI alliances. As a result, most US cities would see their hopes for new or competitive Heathrow service dashed. Continental, Delta, Northwest and US Airways, which would have commenced Heathrow service from cities such as Atlanta, Charlotte, Cincinnati, Cleveland, Houston, Memphis, Minneapolis/St. Paul, Newark, Pittsburgh and potentially other cities, will not be able to do so. Because these airlines will be locked out of Heathrow, many US cities will not received the new or competitive service they desire.

V. The AA/BA Alliance Will Not Produce Any New Public Benefits

The AA/BA Alliance is essentially a horizontal merger the effect of which will be to control capacity and price in the critical and lucrative US-Hearthrow markets.

It provides no countervailing consumer benefits to offset these harms. Most particularly, it will not deliver consumer benefits in the form of end-to-end linkage of complentary networks, the type of consumer benefits praised by the DOT in its studies of the existing transatlantic alliances. The DOT has found that existing alliances, such as Northwest/KLM and United/Lufthansa have produced thousands of new "seamless" connecting services between the US and Europe, and that these new routing options have dramatically improved consumer access to markets previously not readily available, and lowered fares in those markets. American and BA have generously cited these studies and have claimed that their proposed alliance would produce similar benefits. However, it is clear that the AA/BA Alliance is not intended to work as the earlier alliances have worked, and will not produce the same public benefits.

First, BA has undertaken an aggressive campaign to expand service in the point-to-point markets while limiting use of London Heathrow for connecting passengers. To implement this plan, BA has been eliminating service between Heathrow and numerous European points, revising schedules in Heathrow-Europe markets to focus on local traffic rather than transatlantic connections, and replacing its fleet of B–747s with smaller B–777 aircraft. Since 1999, BA has eliminated 27 Heathrow destinations. As a Consequence of this de-hubbing strategy, American's ability to flow connecting passengers over Heathrow will be very limited.

Second, American already has constructed an effective network-to-network linkup with five European code-share partners (Iberia, Air Lingus, Finnair, Swissair (including its affilate Crossair) and Sabena). Even if an alliance with BA did, in fact, construct connection opportunities at Heathrow for US passengers, it would not be new or additional connectivity benefiting US travelers. American's existing partnerships already extend American's on-line service from the US to scores of cities throughout Europe, Africa and the Middle East and provide a more extensive connecting network than would an alliance with BA. In fact, the actual code share plan that American and BA offer little new.

This proposed alliance is unique. It would be the first that fails to construct a connecting complex to open new markets, the first that fails to create any cognizable public benefits, and the first that has as its principle objective the elimination of competition in head-to-head nonstop routes.

VI. A Merger of AA/BA Has less Merit Now Than it Did Three years Ago

American and British Airways argue that the competitive situation in the U.S.-London market has hanged dramatically in the two years since the Department dismissed the original AA/BA antitrust immunity application. In fact, the changes that have occurred since 19980 make the AA/BA Alliance even less acceptable today than it was when it was first proposed:

> American has acquired TWA and locked up another U.S. gateway, St. Louis. In 1998, TWA was a potential new competitive entrant at Heathrow that could have offered new one-stop competition for the AA/BA Alliance. Heathrow access is even more closed today than in 1998; slots and facilities usable for transatlantic flights are even less available to new entrants.
>
> British Airways' new strategy, be de-hubbing Heathrow, is to avoid, not enhance, competition with other alliances for U.S.-Europe traffic. The potential connectivity benefits offered in 1998 no longer exist.
>
> Since 1998 American has developed codesharing alliances with five other European carriers providing joint services throughout Europe and beyond; the incremental new connectivity benefits of an AA/BA Alliance today would be minimal at best.
>
> Other global alliances remain insignificant competitive factors in the U.S.-London markets due to geography and circuity. Neither the Northwest/KLM alliance nor a Sky/Team alliance of Delta, Air France, and Alitalia provide reasonable competitive alternatives from U.S.-London passengers. The existence of these alliances, in and of themselves, cannot be a basis for allowing an AA/BA transatlantic merger.

In sum, to the extent circumstances have changed since the first AA/BA application was abandoned, they reinforce the reasons why the Department must reject the current application.

VII. A Divestiture Of A Minimum Of 420 Weekly Slots Would Be Necessary In Order For New Entrant US Carriers To Compete With AA/BA On A One-stop Basis

If the DOT were to approve the AA/BA Alliance, it would need to mandate very substantial slot divestitures as a remedy, and even then it would be unlikely that new entry by US carriers could completely offset the competition lost in many AA/BA overlap markets.

Even if Heathrow slots were available, it is unlikely that there would be significant entry in the nonstop AA/BA overlap markets. Rather, new entrant US carriers are more likely to launch service from their main hubs and compete on a one-stop bass.

American and BA argue that one-stop competition over other hubs can constrain market power. First, it should be recognized that one-stop service from the US to Heathrow via points in Europe will not be effective because connections over these gateways entail circuitous back-hauls, significantly greater elapsed times and the inconvenience and uncertainty involved in making a connection in a third country.

American and BA also assert that one-stop service from a US point to Heathrow via another US gateway will be sufficient to constrain prices for nonstop service. Although one-stop services can constrain the market behavior of nonstop operators, it cannot do so in the US-London markets unless the one-stop operators are able to serve Heathrow with sufficient frequencies to compete with AA/BA. This will only be possible through a substantial divestiture of slots by American and BA.

This is not a radical. Every government agency on both sides of the Atlantic that has looked at this issue since an American/British Airways alliance with first put forward in 1996 has similarly concluded that very substantial slot divestitures would be necessary if American and BA were granted antitrust immunity. The Department of Justice concluded that AA/BA would have to divest well-timed slots sufficient for at least 24 daily roundtrips (i.e., 48 daily slots or 336 weekly slots) in order to assure reasonably effective new competition. The General Accounting office suggested that slots to operate a minimum of 23 daily roundtrip fights (i.e., 46 daily or 322 weekly slots) were needed. The European Commission found that only the introduction of 20 new daily roundtrips by competitors would maintain minimum necessary levels of competition. Similarly, the UK regulatory authority, the Office of Fair Trading, concluded that only with substantial divestiture of Heathrow slots could new competitive entry actually be introduced in the critical US-Heathrow markets.

Northwest estimates that divestiture by AA/BA of at least 420 weekly slots (i.e., enough for 30 daily roundtrips) in commercially viable timeframes and with wide-body capable facilities are necessary to enable Northwest, Continental, Delta and US Airways to initiate service to their hubs and important gateways to compete with AA/BA on a one-stop basis. Northwest will need slots (and related facilities) at Heathrow sufficient to operate a total of seven daily roundtrip flights from Detroit, Minneapolis/St. Paul, Memphis and Seattle/Tacoma combined. Delta has previously estimated that it would require slots sufficient for 10 daily roundtrips to compete from New York, Atlanta, and Cincinnati combined. Continental has previously estimated that it would need slots for 10 daily roundtrips from Newark, Houston, and Cleveland combined in order to be competitive. US Air ways also would need slots to operate multiple flights from its hubs at Charlotte, Philadelphia and Pittsburgh—three daily round trips at a minimum for the three cities combined. For those four airlines alone that totals at least 30 round trips per day, or at least 420 slots per week. Any other US airlines wishing to provide new service and new competition would be in addition to that number.

These 420 weekly slots constitute the *minimum* number necessary to enable new competitors to gain meaningful, competitive access to Heathrow under Open Skies. Even with this number of slot divestitures, the anti competitive effects of an AA/BA Alliance could not be entirely counterbalanced. If American and BA refuse to agree to the timely divestiture of at least 420 slots and facilities, the United States must refuse to enter into an Open Skies agreement with the UK that is linked to approval of an AA/BA Alliance.

Conclusion

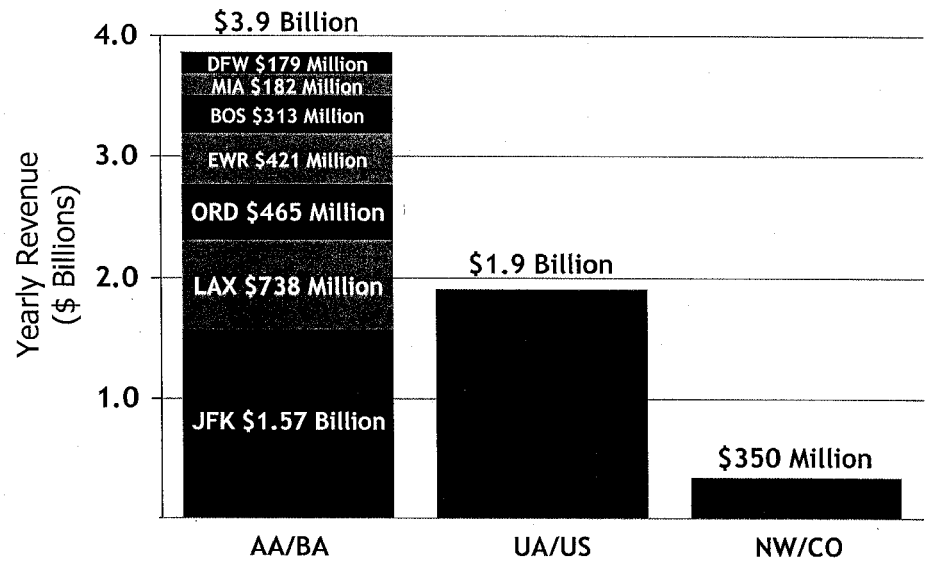
In concluding, I wish to reiterate Northwest's view that international airline alliances, properly structured, can provide very substantial consumer benefits. But not all alliances are the same, and the United States cannot have a "one-size-fits-all" policy for approving alliances and conferring antitrust immunity on them. The proposed AA/BA Alliance will result in a significant loss in competition in very impor-

tant international markets without providing any offsetting new consumer benefits. It should be disapproved.

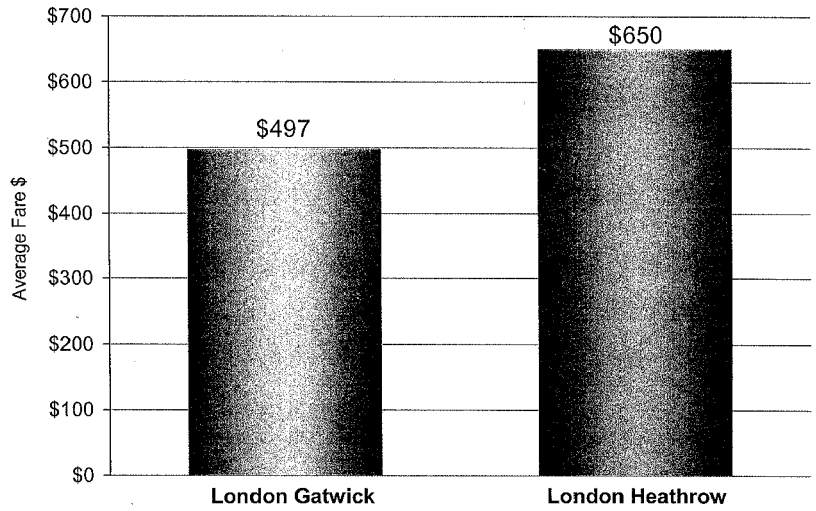
Northwest appreciates having been given this opportunity to testify. I would be happy to answer any questions the Members of the Committee might have.

Thank you.

The Seven Nonstop Overlap American Airlines-British Airways Routes Are Twice As Large As the Nonstop Overlap Routes Challenged in United-US Airways, and 10 Times Larger Than the Nonstop Overlap Routes Challenged in Northwest-Continental



Based on DOT Data, Different Passenger Mix at LHR versus LGW Results in Average Round Trip Fares Between the U.S. and London That Are 31% Higher at Heathrow Than at Gatwick



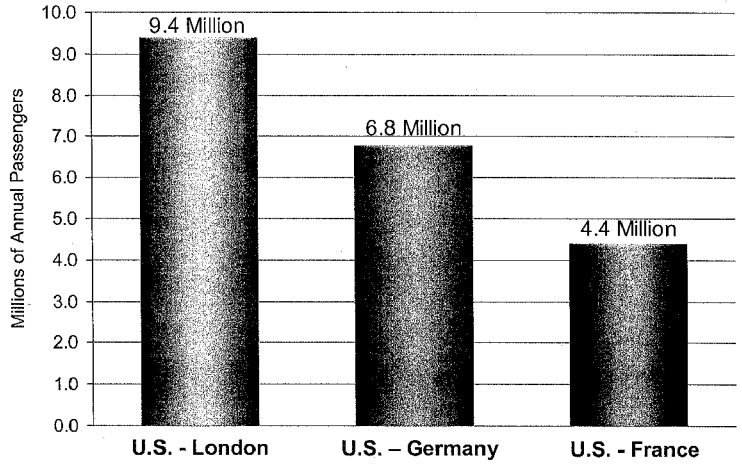
Source: DOT O&D Survey 2000

According to British Airways, Its Unit Revenues for London Heathrow (LHR) Services Are 15% Higher Than Unit Revenues at Gatwick (LGW)

"Where does the value come from for the shareholder from this new strategy? On the longhaul side, the value comes from having a higher proportion of our network at Heathrow, *where we make of the order of 15% higher unit revenues.*" (Emphasis supplied).

-- Robert Boyle, British Airways General Manager Network Planning, British Airways Investors Day, Network, page 14.

The U.S. - London (LHR/LGW) Market Is Larger Than the Entire U.S. - Germany Market and the Entire U.S. - France Market



Source: Based on MIDT: True O&D Bookings – Year Ended April 2001

London Is Almost 3 Times Larger Than the Next Largest U.S. - Transatlantic Market, and Is Bigger Than the Next 3 Largest Markets Combined

	O&D Traffic	Times London Larger
London (LHR/LGW)	9,379,754	--
Paris (CDG)	3,378,941	2.8
Frankfurt	2,971,676	3.2
Amsterdam	1,937,387	4.8
Zurich	1,153,698	8.1
Munich	1,144,083	8.2
Brussels	866,883	10.8
Vienna	489,866	19.1
Copenhagen	420,005	22.3

Source: Based on MIDT: True O&D Bookings – Year Ended April 2001

New Entrant Heathrow Carriers Will Be Unable to Obtain Slots

First Obstacle: Slot Trades and Purchases may be Banned by the EU

"The draft [EU] Regulation . . . will have the effect of preventing carriers from obtaining slots from incumbent carriers except through the total or partial take-over of the carrier."

-- ACL Response at 3.

"The European Commission has published a proposal to amend EU Regulation 95/93 which currently governs slot allocation. . . BAA has significant concerns about several key elements of the draft new regulation.

- The amendment of the 'new entrant' provision which would reduce the opportunities for new US carriers to benefit from this form of priority at Heathrow;
- The prevention of certain forms of slot trading which currently take place, making it more difficult for airlines to set up new services"

-- BAA Paper on Issues & Principles at 8.

Second Obstacle: Even if Slot Trading were legal, there are no slots to be had

"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 at timings similar to Continental's daylight Newark-Gatwick service, with arrivals in the late evening and departures mid-afternoon the next day."

"There is also scope to offer 1-2 morning rotations (ie, pairs of arrival and departure slots) of [sic] on some days of the week, principally the weekends. However, in ACL's experience new entrant US carriers are unlikely to be willing to operate on a less than daily basis."

"In general, it is ACL's observation that there is a general unwillingness on the part of incumbent Heathrow carriers to divest of slots and the market is illiquid."

-- ACL Response at 5.

There Are Virtually No Additional Stands Available at Heathrow That Are Suitable for Wide Body Operations

"To convert slots currently being used for narrow-bodied aircraft to wide-bodied, all airport facilities used in the passenger and baggage processes would need to be considered. The chosen terminal of operation for the wide-body slots will also have an impact. If the wide-bodied slots are to be operated in the same terminal as the narrow-body service was being operated, then the need for additional capacity will be less than that if the slots are operated in a different terminal. The main areas requiring consideration are:

"**Stand availability** – This is dependent on the terminal of operation for the new wide-body service. Terminals 1 and 2 only have a limited number of pier-served stands suitable for use by wide-bodied aircraft of 777 or equivalent size. Terminal 3 does have some spare capacity for larger aircraft, but the cumulative total stand demand during the peak is already approaching capacity at peak hours of the day. **Stand capacity at Terminal 4 [where KLM operates] is a major constraint and is already at or close to maximum levels for the larger aircraft categories (B777 / 747) for peak morning hours.** Additional wide-bodied aircraft (B777 / 747) could only be managed in if other services relocated to another terminal."

-- *Response from BAA plc at 4.*

Frozen Entry Conditions at Heathrow Are Likely to Persist for at Least the Next Six Years

"Growth Prospects"

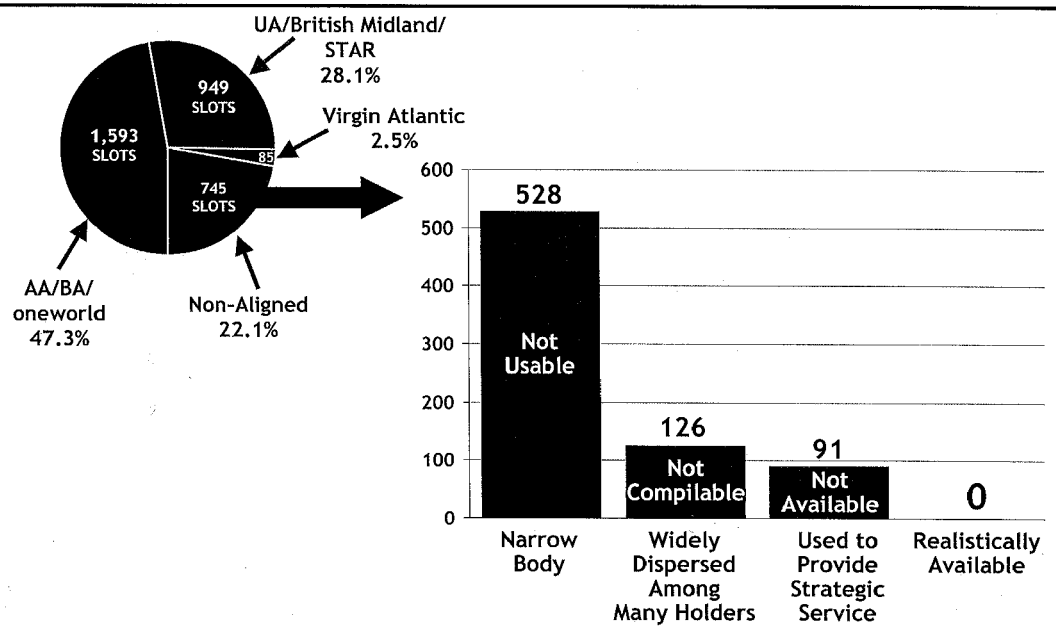
"BAA expects only a few additional slots to be created at Heathrow, a small amount of which are expected in the hours that transatlantic flights are currently being operated. In addition, the new slots are likely to be departure slots and are unlikely to have accompanying arrival slots which would be required to make new services viable. . . The substantial majority of these increases have been in off-peak periods."

-- *Response from BAA plc at 8.*

"[U]ntil Heathrow's Terminal 5 is approved, built and opened, [Autumn 2007 at the earliest] there is relatively little that can be done to relieve the aircraft parking and terminal capacity constraints."

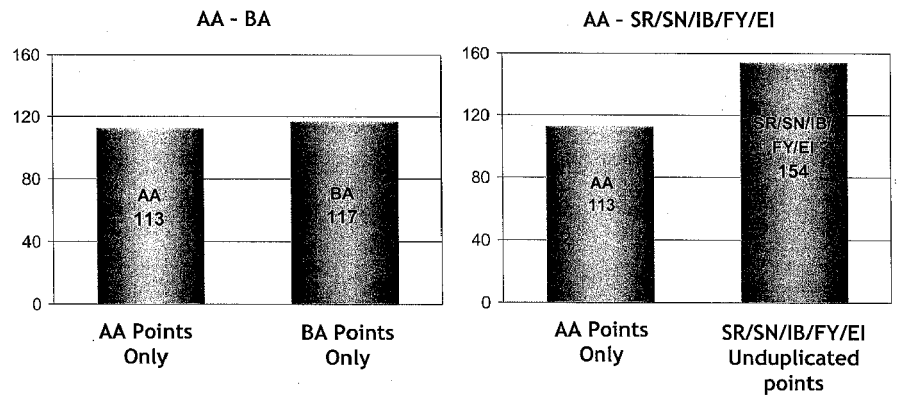
-- *BAA Paper on Issues & Principles at 4.*

Of the 745 Heathrow Slots Theoretically Available for Acquisition by U.S. Airlines, There Are Realistically No Slots Available



On a Hypothetical Total Network to Total Network Basis, American Airlines Passengers Would Have Much Broader Access to Europe, Africa, and the Middle East on Its Existing Code Share Partners Than They Would Have on British Airways

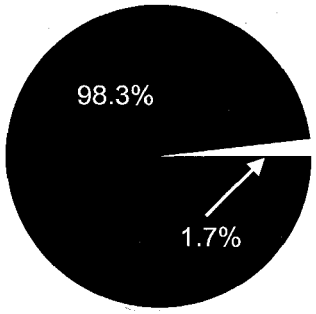
Total Number Cities Operated in U.S., Europe, Africa, and Middle East



Source: Official Airline Guide – September 1-7, 2001

The AA/BA Code Share Plan Provides Virtually No Additional Network Access to Europe, Africa and the Middle East Beyond That Which American Airlines Already Has With Its Existing Code Share Partners

O&D traffic in 44 cities already accessed via AA's 5 European Code Share Partners
-- 2,609,904 passengers



Additional O&D traffic in 17 cities (527 O&D city pair markets) that could benefit from AA/BA alliance Code Share Plan *
-- 45,110 passengers

17 New On-Line Cities Produce Only 45,110 Additional Annual O&D Passengers

* Code Share cities listed in Docket OST 2001-10388

Source: Official Airline Guide – September 2001; O&D Survey ,Year End 2000

Chairman KOHL. We thank you very much. And now that we have heard from two of American Airlines' best friends, Delta and Northwest, we will call upon yet another friend, Mr. Richard Branson.

STATEMENT OF RICHARD BRANSON, CHAIRMAN, VIRGIN ATLANTIC AIRWAYS LIMITED, CRAWLEY, WEST SUSSEX, UNITED KINGDOM

Mr. BRANSON. Thank you, Senator Kohl, thank you, Senator DeWine, for holding this once again. It seems a bit like deja-vu.

A friend of mine rang me last week and reminded me of something he had said to me 17 years ago, and that was that the best way of becoming a millionaire was to start off as a billionaire and go into the airline business.

Anyway, on a positive note, it is obviously wonderful that the U.K. and America are holding together in these difficult times. But we have some concerns that there is some danger for the airline industry in the long term that could come from this. And our concern is that American Airlines is called American Airlines, British Airways is called British Airways, and there might be some people who feel that this merger should be pushed through in these patriotic times. And what we would urge the competition authorities to remember is that 5 years ago, when we met here, they examined the case of American and British Airways seeking to merge and the Justice Department ruled it anti-competitive and so did the EC and so did the British competition authorities. Nothing has fundamentally changed. What was anti-competitive 5 years ago is just as anti-competitive today.

BA and American Airlines together will control over 60 percent of all the takeoff and landing slots to America. They already do. As far as the transatlantic, they are already over 60 percent dominance in that marketplace. That is dominance.

Don Carty mentioned that he disagreed. Only a short while ago, Robert Crandall, who used to be President of American Airlines, said that British Airways has the largest market share between the United States and the United Kingdom and is the largest slot holder at Heathrow. The dominant position of British Airways stifles competition not only for U.S. airlines but also for other U.K. airlines, resulting in higher prices and reduced service options for British consumers. And this was the President of American Airlines only a short time ago.

And British Airways did not come about from the cut-and-thrust business. It was created by government. It was given those slots by government. And we cannot get the slots to replicate the network that British Airways has.

If you put British Airways and American Airlines together, the clout that they will have over the travel trade would be absolutely enormous. In fact, the travel trade will have to put their business with British Airways and American Airlines, and if they are told they have got to do another 3 or 4 percent next year, they will have to do it in order to get their discounts. British Airways already twists arms in this way. They use their network in order to force people to put all their business across the Atlantic their way. If you have got American Airlines in America doing it with them in a pin-

cer movement, it will be something which will just be impossible to compete against.

I think if you can compare it to other businesses, it is like Coke and Pepsi being put together. There would be an enormous outcry if that happened. It would be the same as United Airlines and American Airlines being allowed to get together. And all I can say is that to compete against this would be almost impossible. You know, what is interesting is that every single other airline that has been told that they can get into Heathrow, they are all objecting to it. They know they can't get slots.

Robert Crandall again said, "I can't get any slots at Heathrow. I can't get any gates at Heathrow. British Airways has all the terminal space tied up in knots."

British Airways said through testimony to the U.K. Select Committee, "We have to operate from two airports in the London area because Heathrow is full. It is absolutely full."

When Virgin wanted to fly to Chicago, we had to—we tried for years to get a slot at Heathrow. We couldn't get a slot. In the end, we had to move our Miami service out of Heathrow to Gatwick and swap the slots, and that was how we ended up getting the Chicago slot. But that was the only way you can get slots today.

All I would do is urge the Justice Department in this time of patriotism to look back at what happened 5 years ago. The reasons they gave to stop this alliance then are exactly the same reasons they should use to stop this alliance today.

Thank you.

[The prepared statement of Mr. Branson follows:]

STATEMENT OF RICHARD BRANSON, CHIEF EXECUTIVE OFFICER, VIRGIN ATLANTIC AIRLINES

Good afternoon Mr Chairman and Members of the Committee. Let me begin by saying how much I appreciate this opportunity to appear before you and provide Virgin Atlantic's views on the proposed alliance between American Airlines and British Airways.

I must say that I do have a sense of déja vu sitting here again today. We have been here before. Again we have American and BA seeking immunity for an airline alliance that will dwarf anything that has gone before it. Again they are seeking to "operate as if they were single entity", across both of their networks. They are their words not mine. Any attempt by American and BA to pretend that this application is lesser in scope than their previous anti-trust applications should be dismissed out of hand. And don't forget, the oneworld alliance extends far beyond AA and BA[1]—BA for one is seeking to link up with Finnair and Iberia in Europe, and already has a joint service agreement with Qantas.

Our duty here today should be to cut to the truth, and identify what this alliance truly means for consumers and for competition in the US-UK market. This alliance will mean less, not more, competition. It will mean less choice for consumers. It will mean higher fares across the Atlantic. It will mean increased domination by BA and its oneworld alliance partners at Heathrow. An AA/BA alliance would be blatantly anti-consumer and anti-competitive. This will be doubly true when taken with the proposed Star Alliance immunity application for UK-US services. As Gordon Bethune of Continental has said these "transactions are poison for competition. Allowing dominant participants to operate as single entities would effectively preclude any real competition on most US-UK services."

Before going on to look at the AA/BA proposals further, I should say at the outset that it is beyond me how any competition authority can conduct a relevant, robust and meaningful competition analysis of American's and BA's plans given the state of turmoil and constant change that the airline industry finds itself following the

[1] Oneworld includes American Airlines, British Airways, Qantas, Cathay Pacific, Finnair, Lberia, Lan Chile and Aer Lingus.

tragic events of 11 September. Airlines are cutting schedules, grounding aircraft and making people redundant. Some carriers are very close indeed to bankruptcy, both in Europe and in the United States. It is impossible, therefore, to predict with any degree of certainty what the future competitive landscape will look like. I think the one certainty that we can rely on is that if AA/BA is allowed to proceed unfettered, it can only hasten the demise of certain carriers.

At a time when we may be witnessing a forced reduction in competition among airlines it is madness to actually encourage even less competition by allowing dominant carriers to collude in setting prices, agreeing schedules etc.

In fact, let us not lose sight of the fact that the proposition before the regulators on both sides of the Atlantic is the effective merger of world's largest airline, American, with Europe's largest airline (and the largest trans-Atlantic carrier) British Airways. Acting as one, they will be able to leverage unprecedented control and influence over the marketplace, especially amongst corporate clients and travel agencies, not just across the Atlantic but throughout the world. Indeed, a combined American/BA will be 70% larger than United Airlines. Allowing this alliance to proceed will create a monster of proportions never seen before.

I passionately believe that this deal should not be allowed to proceed.

My main objections to the proposed alliance are:

American and BA will form a dominant force in the trans-Atlantic market, with over 60% of all Heathrow-US services, and over 50% of all passengers travelling between the US and the UK. In 2000, AA and BA between them carried nearly 9 million passengers between the UK and the United States. The next largest airline carried less than 3.5 million.

When coupled with their dominance at their respective hubs, AA/BA will have the effect of eliminating competition. Remember, AA/BA have nearly 200,000 slots per year at Heathrow. Virgin Atlantic has less than 11,000. The sheer scale of this merger will mean that its effect will not be felt solely in the trans-Atlantic market, but throughout the globe.

The establishment of an AA/BA alliance, and possibly a United/bmi british midland alliance, will actually reduce competition across the Atlantic. American and BA will act as one rather than competing against each other as they currently do, and bmi will not compete against United — something which they have admitted in their own joint filing to the Department of Transportation.

The position of joint dominance that oneworld, the BA and American led alliance, and Star, the alliance involving United and bmi, enjoy at Heathrow, when coupled with the undeniable fact that Heathrow is full, means that carriers outside of these alliances will not be able to mount an effective competitive challenge unless the regulators require these groupings, and BA in particular, to give up significant numbers of slots at Heathrow. Between them oneworld and Star operate 85% of all Heathrow-US services, and control nearly three-quarters of the slots at Heathrow. Past experience suggests that this will produce a cost duopoly rather than intense competition.

American and BA between them have a total monopoly on 13 individual routes between London and the United States. They operate the majority of services on a further 5 routes, and have a substantial presence in a further 6 markets between London and the US. And remember that individual routes from Heathrow to the US are the key markets here. Heathrow is the airport of choice for passengers, be they business or leisure, and for airlines. Given the choice all of the airlines operating out of Gatwick would move their services to Heathrow — passenger numbers, revenues and yields are all significantly higher at Heathrow.

The most important trans-Atlantic market is Heathrow-New York JFK. This is a market where BA and American will dominant to such an extent that it will not be worthwhile anyone else even trying to compete in it. In August 2001, between them BA and American were operating 13 services a day to JFK, even before the resumption of Concorde flights. The next nearest challengers were Virgin and United with only three services each. Following 11 September, Virgin has cut back to a double daily service. If BA and American are allowed to proceed it will be impossible for us and other carriers to compete against what will amount to an hourly turn-up-and-ride shuttle.

The key argument in this entire debate is Heathrow access. Open Skies is being held up as a panacea by American and BA in this respect. Any form of liberalisation of outdated bilateral agreements should be welcomed, and no-one has lobbied stronger than Virgin Atlantic to replace the current restrictive Bermuda II agreement governing air services between the US and the UK by a truly open competitive

regime. But in respect of Heathrow-US services Open Skies will make no difference at all. Put simply Heathrow is full and there are no prospects of capacity increases in the foreseeable future.

In order for Virgin Atlantic and the US carriers to compete effectively in trans-Atlantic markets more slots are needed at Heathrow, and the associated terminal facilities that go with the slots. But the slots are simply not there. Not from the slot pool; not from partner airlines; and not on the open market. If slots were available, then Virgin would not have had the struggles that it has had to obtain more slots in recent years.

The only way that the regulators can ensure access to Heathrow is to divest American and BA of slots at the airport. And not just any old slots. They must be slots at the optimal times for trans-Atlantic travel — not at the margins of the day.

But slots are not the only issue. Competitors to AA/BA will also need to have access to their Frequent Flyer Programmes, and must also be offered interline agreements at terms no less favourable than BA and AA make available to each other. It is no good having the slots, if American and BA then stitch up the market in other respects.

Besides, if Open Skies was the answer to all of the competition concerns that arise from the American and BA alliance, then these carriers should be willing to see the UK and the US sign an Open Skies agreement before they get anti-trust immunity rather than seeking to make one dependent on the other. However, that is the last thing that they would want. They know that Open Skies will make little if any difference to the competitive position, but in the meantime they wish to ensure that their dominant position is further entrenched by obtaining anti-trust immunity.

All of the evidence suggests that linking anti-trust immunity to open skies actually has the effect of restricting competition rather than enhancing it. The combination of an airline dominant at a European hub, as BA is at Heathrow, and a US carrier which is dominant at several US hubs, such as American, has by definition removed one competitor from the marketplace and made it more difficult for others to compete. Furthermore, evidence from the Germany-US and Netherlands-US markets shows that the immunised entity grows stronger and more dominant whilst the competition withers on the vine, and in some cases disappears altogether.

American and BA point to the significant presence of Star at Heathrow, and say that this will be a competitive constraint on them. The prospect of course is of a global carve up between the oneworld and Star gorillas. Their internal members do not compete with each other, and as far as services in the largest trans-Atlantic market (accounting for almost 40% of total US-Europe traffic) are concerned, is it really healthy to have 85% of services in the hands of just two entities? Bmi british midland will make no difference to the competitive landscape. It is on the record as saying that it will only operate Heathrow-US services as part of a joint venture with United — and almost everything that bmi claims it wants to do is already available for United to do.

The reasons that have led AA and BA to suggest that Star could be a constraining influence on AA/BA are more likely to lead to a market structure in which there would be every incentive for AA/BA and Star to deter new entrants. Most economists will tell you that three healthy competitors are needed in any market to ensure that competition thrives for the benefit of consumers.

What is before the regulators today is the future of a competitive international aviation industry. I firmly believe that allowing American and BA to proceed with their plans will irrevocably damage an industry that is already on its knees.

Chairman KOHL. We thank you, Mr. Branson.

Representing British Airways here today is Mr. Roger Maynard.

STATEMENT OF ROGER MAYNARD, DIRECTOR OF ALLIANCES AND STRATEGY, BRITISH AIRWAYS, hARMONDSWORTH, MIDDLESEX, UNITED KINGDOM

Mr. MAYNARD. Thank you, Mr. Chairman and Senator DeWine. I very much appreciate the opportunity to testify before you today. Although I have been in the airline business some 14 years, this is my first occasion before a Subcommittee of the United States Congress. It is a privilege.

Before discussing alliances, allow me to note that today is a very special day for British Airways and its relationship with the city

of New York. The 7th of November, today, marks the return of Concorde to commercial service between London and New York. And I might add our Prime Minster is arriving this afternoon in Washington on Concorde to meet with your President.

With respect to alliances, put simply, our grant of application with American before the U.S. DOT for antitrust immunity is linked with and the basis for achieving what would be a truly historic "open skies" treaty between our two great nations. At the same time, our alliance will boost competition worldwide and establish a level playing field with other global airline alliances.

Mr. Chairman, we seek only what our competitors already have. Nearly a decade ago, DOT began granting immunity for alliances in exchange for "open skies." Northwest/KLM and now United/Lufthansa, they both have immunity, which allows two airlines to bring their networks together and serve consumers seamlessly and more economically.

As a result of that, the share of transatlantic traffic flown by Northwest and KLM, known as the Wings Alliance, has tripled since they received immunity. United and Lufthansa have developed the world's largest global alliance, known as the Star Alliance, which now has 15 airlines. Today, Star carries more passengers worldwide than any other alliance.

Not to be outdone, Delta has developed its own six-airline SkyTeam Alliance, and it is anticipated that Delta will soon be granted immunity with Air France.

As you will no doubt remember, and as a number of people around this table have recalled, BA and American first proposed our alliance in 1996. For a variety of reasons, mostly in Europe, that effort was frustrated, though I should add that it was not found against by either the EU or the OFT in the U.K.

Since that time, significant changes have taken place. Alliances were in their infancy 5 years ago, and the likely impacts on competition were based on predictions. Today, the proof is in. DOT's studies have found that alliances benefit the public through better services and at lower prices. Our alliance will continue that trend. Passengers and shippers from any of the 260 cities served by American and its affiliates will be able to reach with ease any of the 146 cities served by BA and its affiliates around the world.

In short, competition amongst four global alliances will provide many more options for consumers than competition between three alliances.

With the ascendancy of Wings, Star, and SkyTeam, it is little wonder that BA and American's combined market share between Europe and the U.S. has declined by 23 percent since 1996. This is also true in the U.S.–U.K. market, with BA and American's combined share down by 20 percent since 1996.

BA and American now account for only 40 percent of the passengers in the U.S.–U.K. market. What we have seen, frankly, is a shift in connecting traffic away from London–Heathrow and Gatwick towards Frankfurt, Paris, and Amsterdam. Indeed, whereas not long ago Heathrow served more destinations than any other European airport, today its 188 destinations is dwarfed by Frankfurt, with 260; Paris, 214; and Amsterdam, 200. And in terms of network competition, that is a vital statistic.

Anybody familiar with the London market as I am knows that both Gatwick and Heathrow effectively serve London. Nevertheless, our opponents remained obsessed with Heathrow, so I feel obliged to go into some more detail. I wish to leave you with four points in that respect.

Point number one, BA has a far smaller share of the total market at Heathrow and faces more competition than any of our U.S. and European competitors at their hubs. Contrary to popular myth, BA is not dominant at Heathrow. We hold just under 37 percent of the slots at Heathrow compared with U.S. competitors who have proportions of 80 percent at many of their hubs.

Nevertheless, our opponents have struggled to make something of the fact that BA and American currently operate 60 percent of the flights between the U.S. and Heathrow. However, this is just plain and simple math. Bermuda 2, which everyone is complaining about, limits U.S.–Heathrow services to two U.S. airlines and two British airlines. It should come as no surprise that two of the four operate half the frequencies. This will no doubt change radically when "open skies" comes in.

Point number two, BA and American are not numbers one and two in the passenger market in the U.S.–U.K. They are number one and four. Secondly, access to Heathrow is available. United and Virgin have increased their flights between the U.S. and Heathrow by 64 and 68 percent since 1996. And in total, as we have heard, American accounts for only 2 percent of the slots at Heathrow. Adding AA's slot total to BA's does not even bring the combined total to 40 percent.

On the overlap routes, which we hear is a competition problem, since 1996 the U.S. competitors and the U.K. competitors have increased service substantially in those markets. So access to Heathrow has not apparently been a problem over the past 5 years.

I would like to—and I know I am running out of time, but just two more points. Sufficient slots. Slots, gates, and facilities are available at Heathrow. Over the past year, 566 weekly slots have been exchanged in the slot coordination process. Thirty-five carriers have entered into 99 different agreements to exchange slots. They are available. Likewise, the BAA has testified to the Department of Transportation that facilities at Heathrow, including desks, including check-in counters, parking bays, will be available immediately for those carriers that come into the market as a result of "open skies."

I would like to finish by saying the U.S. should be congratulated for the 56 "open skies" agreements it has reached throughout the world. There is little doubt that "open skies" with the United Kingdom, given our country's geographic location, the market size, and the volume of trade with U.S., would be the most important "open skies" agreement reached.

However, there exists only a narrow window of opportunity for securing a U.S.–U.K. "open skies" accord. The European Union has challenged legally the right of member states to negotiate individual, bilateral air service agreements. As it has in most other economic sectors already, the EU assumes the mandate to negotiate on behalf of all the EU members. If the EU is successful, as we on our side of the Atlantic expect it to be, the opportunity for

a U.S.–U.K. "open skies" agreement will disappear. Instead, a broader EU–U.S. agenda will emerge, one that will include such thorny issues as cabotage, foreign ownership of U.S. airlines. As a result, our view—and it is a view shared by Her Majesty's Government in their testimony to this Committee. Our view is that, as a result, it will take many years for an EU–U.S. agreement to be hammered out. And putting it bluntly, absent a U.S.–U.K. "open skies" accord before then, a ruling in favor of the EU early next year will lock Bermuda 2 into place for years to come. And so there will remain for many years only two U.S. carriers able to access Heathrow. So we have a window of opportunity to achieve a genuine opening of the marketplace.

Thank you, Mr. Chairman.

[The prepared statement and attachments of Mr. Maynard follow:]

STATEMENT OF ROGER MAYNARD, DIRECTOR OF ALLIANCES AND STRATEGY, BRITISH AIRWAYS

Chairman Kohl, Ranking Member DeWine, and Members of the Subcommittee, on behalf of the 60,000 employees of British Airways, and particularly the 2,500 BA employees in the United States, I very much appreciate the opportunity to testify before you today on international airline alliances. Although I have been in the airline business for 14 years, this is my first occasion to appear before a subcommittee of the United States Congress. In a time when the bonds between the United States and the United Kingdom have never been stronger, I consider it a privilege.

Mr. Chairman, before discussing airline alliances, allow me to note that today is a very special day for British Airways and its relationship with the City of New York. The 7th November marks the return of Concorde to commercial service between London and New York after a 14-month hiatus-a period during which, I might add, we worked closely with regulators to develop enhancements intended to ensure the highest level of safety. Indeed, today Prime Minister Tony Blair is flying Concorde to Washington, D.C., for his visit with President George W. Bush.

Senator Schumer, we at British Airways have been deeply moved by the spirit, pride, and resolve of New York City. Concorde symbolizes British Airways' unwavering commitment to America's largest city as it rebuilds from the unconscionable acts of terror of the 11th September. I believe Mayor Giuliani said it best when he observed: "Concorde's return is symbolic of how all New Yorkers feel about rebuilding this great city."

Let me also note that I am grateful to be appearing today along side Don Carty. Don and his team have worked hard with us to develop our oneworld alliance in an effort to bring our customers the same benefits that air travelers flying internationally via other airline alliances have enjoyed for years. I must say, in these most challenging of times, Don has been a strong leader for the entire airline industry.

Like you, we in the United Kingdom are determined to get back to business. To quote Prime Minister Blair, "In the end this is as much a matter of confidence as anything else and there really is no reason why we cannot carry on and be confident in the basic strength of our economy." It is with that in mind that I would like to turn to international airline alliances and our strong desire to deepen our relationship with our U.S. partner, American Airlines. Put simply, grant of our pending joint application before the U.S. Department of Transportation (US DOT) for antitrust immunity is firmly linked with, and the basis for achieving, what would be a truly historic open skies treaty between our two great nations. At the same time, our alliance will boost competition worldwide, deliver significant benefits for international air travelers and shippers, and establish a level playing field with other global airline alliances. The trend toward such alliances continues unabated, as customers increasingly demand their many benefits.

To be sure, we seek only what our competitors already have. Nearly a decade ago, the US DOT granted antitrust immunity to Northwest Airlines and its partner KLM Royal Dutch Airlines in conjunction with an open skies accord between the United States and the Netherlands. Since then, the share of transatlantic traffic flown by Northwest and KLM, known as the "Wings" alliance, has tripled. Quite simply, anti-

trust immunity allows the two airlines to bring their networks together as one, serving consumers seamlessly, more efficiently, and more economically.

Recognizing the benefits that immunity affords, the US DOT in 1996 granted United and Lufthansa antitrust immunity in concert with a U.S.-Germany open skies accord. Upon this foundation, United and Lufthansa have developed the world's largest global alliance, known as the "Star Alliance," which now includes 15 airlines. Today, Star carries more passengers worldwide than any other alliance, reaching nearly every corner of the globe. It also benefits from immunity between United and several member carriers. Indeed, London Heathrow Airport's second largest slot holder, bmi british midland, is now part of Star and has also applied for antitrust immunity with United.

Not to be outdone, Delta Air Lines has developed its own 6-airline "SkyTeam" alliance, and it is anticipated that Delta will soon be granted antitrust immunity with Air France in conjunction with the recently agreed open skies accord between the United States and France. As a result, the international marketplace has two alliances in which the key transatlantic partners have immunity-Star and Wings-one alliance whose transatlantic partners will likely soon have it-SkyTeam-and one whose key partners are without immunity, namely our 8-airline oneworld alliance.

As you will no doubt remember, British Airways and American first proposed our alliance in 1996 and applied for antitrust immunity shortly thereafter. For a variety of reasons, mostly in Europe, that effort was frustrated. Since that time, significant changes have taken place in the transatlantic aviation marketplace. Transatlantic alliances were in their infancy five years ago, and likely impacts on competition were based on predictions. Today, the proof is in-alliances benefit the public and participating carriers through better service at lower prices.

Indeed, in an October 2000 report, the US DOT found that international airline alliances offered consumers combined networks of seamless service, allowing passengers to travel across the separate networks of alliance members as if they traveled on one airline, on average at considerably lower fares. The US DOT has determined: "Alliance-based networks are the principal driving force behind transatlantic price reductions and traffic gains. . . .we can expect greater consumer benefits as alliances continue to evolve and expand."

Our alliance will continue this trend. Passengers and shippers from any of the 260 cities served by American Airlines and its affiliates will be able to reach with ease any of the 146 cities served by British Airways and its affiliates around the world. In each of these potential city pairs, passengers and shippers will have one more alliance to choose from, and oneworld will be able to compete more effectively with the other immunized alliances. Vigorous competition among four global alliances will provide many more options for consumers than three alliances.

With the ascendancy of Wings, Star, and SkyTeam-and the advantage that immunity affords-it is little wonder that British Airways' and American's position in the U.S.-Europe market has eroded significantly since 1996. British Airways' and American's combined market share between Europe and the United States has declined by 23 percent since 1996 and now accounts for 19.5 percent of the U.S.-Europe market. This is also true in the U.S.-U.K. market with British Airways' and American's combined share down by 20 percent since 1996. British Airways and American now account for only 40 percent of the passengers in the U.S.-U.K. market.

What we have seen, frankly, is a shift in connecting traffic away from London's Heathrow and Gatwick airports toward Frankfurt and Paris De Gaulle. Indeed, connecting traffic on BA and American at Heathrow has declined 12 percent since 1996, while United and Lufthansa have seen connecting traffic at Frankfurt rise by 36 percent. No longer is Heathrow the preeminent hub of Europe. Where as not long ago Heathrow served more destinations than any other European airport, today its 188 destinations served ranks behind Frankfurt (260), Paris De Gaulle (214), and Amsterdam (200).

Anybody intimately familiar with the London market as I am knows that both Gatwick and Heathrow airports effectively serve London. Nevertheless, our opponents remain obsessed with Heathrow. So I feel obliged to go into more detail. Fortunately, it is an airport I know well, so I can dispel some of the myths and outdated perceptions surrounding Heathrow. In doing so, I wish to leave you with four key points relative to Heathrow:

1. British Airways has a far smaller share of the total market at Heathrow, and faces more competition today, than any of our U.S. and European competitors at their hub airports.
2. Between the United States and Heathrow, British Airways and American Airlines are not the two dominant carriers as often suggested. American is in fact fourth in the overall number of passengers flown and third in the

number of business passengers flown out of the four carriers flying between the United States and Heathrow.

3. On the six so-called "overlap" routes between the U.S. and London where British Airways and American compete, new entry has occurred and competition increased on virtually all of the routes since 1996-a trend that will most assuredly continue, particularly at Heathrow, under open skies.

4. Sufficient slots, gates, and facilities are available at Heathrow to accommodate the increase in transatlantic service that is expected following the initiation of open skies.

First, contrary to popular myth, British Airways is far from dominant at Heathrow. British Airways holds just under 37 percent of the slots at Heathrow (Attachment I). In stark contrast, US Airways has 89 percent of the operations at its hub in Charlotte and 86 percent at Pittsburgh; Delta has 86 percent of the operations at its Cincinnati hub and 75 percent in Atlanta. Likewise, Continental has 83 percent of the flights at Houston and 56 percent at Newark; and Northwest has 80 percent of the operations at its hubs in Detroit, Minneapolis/St. Paul and Memphis. Likewise, Lufthansa accounts for 62 percent of the operations at Frankfurt, Air France for 56 percent at Paris De Gaulle, and KLM for 54 percent of the operations at Amsterdam.

Nevertheless, our opponents have struggled to make something of the fact that British Airways and American currently operate roughly 60 percent of the flights between the United States and Heathrow. However, this is just plain and simple math. Bermuda 2 limits U.S.-Heathrow service to two U.S. airlines and two British carriers. It should come as no surprise that two of the four operate roughly half of the frequencies. This will no doubt change radically under open skies, as four additional U.S. carriers and one additional British carrier-bmi british midland-plan to enter the market on day one.

Second, approval of our application would combine the first and fourth-not first and second-largest carriers between the United States and Heathrow (Attachment II). United and Virgin have increased their flights between the United States and Heathrow by 64 and 68 percent respectively since 1996. For example, United has increased the number of daily flights between its Chicago O'Hare hub and Heathrow from 1 in 1996 to 3 in 2001, and, in fact, has received approval to add a fourth flight. In addition, Continental now has a code-sharing arrangement with Virgin that allows Continental to independently sell tickets for service between Heathrow and Boston, Los Angeles, and New York.

In total, American Airlines accounts for only 2 percent of the slots at Heathrow, fewer than United and roughly the same as Virgin. Adding AA's total to BA's does not even bring the combined total to 40 percent. At the same time, United and bmi british midland hold 16 percent of the slots at Heathrow, with bmi british midland Heathrow's second largest slot holder. Moreover, United and bmi's Star Alliance has announced that it will invest over $70 million U.S. dollars to develop a hub at Heathrow, thereby making that airport Europe's only dual hub.

Third, increased competition can be seen in virtually all of the six nonstop markets where BA and AA overlap-competition that will further increase significantly under open skies:

Boston: In contrast to 1996 when AA and BA were the only providers of nonstop service in the Boston-Heathrow market, there are now four nonstop carriers in the market. United and Virgin have both recently begun nonstop service between Boston and Heathrow, and Delta has initiated service to Gatwick-service that Delta may shift to Heathrow under open skies.

Chicago: As I noted earlier, United has significantly increased its service level between O'Hare and Heathrow in the past 5 years. As a result of increasing competition, the combined AA/BA share between O'Hare and Heathrow has fallen from 62 percent in 1998 to 47 percent in 2000. Going forward, bmi british midland has stated publicly that it will immediately serve Chicago nonstop from Heathrow under open skies.

Los Angeles: Both United and Virgin have added flights between LAX and Heathrow since 1996, causing BA and AA's combined share to fall by almost 25 percent, from 42 percent in 1996 to only 33 percent in 2000. Under open skies, the number of available one-stop alternatives to the average 12-hour nonstop flight between LAX and Heathrow will surely grow, yielding even more travel options for consumers and downward pressure on fares.

New York: Both United and Virgin have added flights between JFK and Heathrow, and Continental now has access to Virgin's four daily flights between New York and Heathrow. Under open skies, Delta will undoubtedly enter this market as JFK is its key transatlantic hub; and Continental will

likely serve Heathrow nonstop with its own aircraft via its hub at Newark, which will complement Continental's current twice daily service to Gatwick. Miami: American, British Airways, and Virgin currently compete in the U.S.-London market, as they did in 1996. Under open skies, competition will increase as bmi british midland has announced that it will start service immediately.

As for the final overlap market, Dallas/Fort Worth-London, the significant new entry that will occur after open skies by U.S. airlines from their main hubs will afford air travelers a number of new, competitive one-stop connecting options to Heathrow, such as Delta via JFK and Continental via Newark.

Which brings me to point number four: while new entry is not necessary to ameliorate any potential competitive effects of our alliance, the fact remains that our alliance will open the skies between London and the United States and thereby allow for the first time significant new entry. U.S. carriers and bmi british midland will enter on routes between the United States and Heathrow under open skies. In the case of bmi british midland, it holds 14 percent of all Heathrow slots and thus will be able to commence each of its announced services immediately. As new entrants, the four non-Heathrow U.S. carriers will be given priority for new slots. Since the summer season of 1996, an average of 156 weekly slots have been created at Heathrow each summer season. While these slots are frequently at off peak times, carriers can and often do exchange them with a carrier that has better timed slots, many times with compensation.

Likewise, in addition to new capacity, the pool from which new slots are allocated is continually replenished and expanded as slots are returned to the pool from carriers failing to meet the 80 percent use-or-lose requirement at Heathrow. In the summer 2000 season, for example, 332 weekly slots were returned for reallocation. Again, these slots are often traded between carriers, which enables new, well-timed services. All told, for the winter 2000-summer 2001 seasons, 35 carriers entered into 99 different agreements resulting in the exchange of 566 weekly slots. Moreover, for many of the smaller operators, selling their peak period Heathrow slots and moving their operations to Gatwick may be a highly desired alternative for them at this point.

In any event, as alliances continue to grow, airlines will have an even greater incentive to exchange slots with their alliance partners. KLM, for example, holds over 190 weekly slots at Heathrow and uses many for turboprop services to the European continent. Is there any doubt that once its partner Northwest Airlines is allowed to fly from Detroit and Minneapolis/St. Paul to Heathrow that the Wings alliance partners will decide that it is in the best interest of the alliance to maximize revenue and deploy those slots to enable the more lucrative long-haul services? Such a decision is a "no brainer" as you say here in the States. The same process will quickly play out among the other alliances that have antitrust immunity.

Nevertheless, our competitors have suggested publicly that they would need as many as 600 weekly slots divested from American and British Airways, even though combined American and BA only operate a total of 582 slots currently on routes between the United States and Heathrow. In the words of the U.S. Business Travel Coalition's Chairman Kevin Mitchell in a letter he recently sent to the Chairman of the Senate Commerce Committee,

> "Demanding the divestiture of 600 slots is reckless posturing and a shameful example of corporate greed. BTC understands that Delta, Continental, and Northwest desire to avail themselves of some free slots at Heathrow. . . .However, through their demands these carriers are placing at significant risk the achievement of a quality U.S.-U.K. Open Skies agreement, and billions of dollars of U.S. consumer benefit that will be derived from lower airfares."

I dare say Mr. Mitchell may be on to something here. Similarly, the recent filing to the US DOT by the independent operator of Heathrow, the British Airports Authority, puts to rest the myth that slots as well as gates and facilities are not available at Heathrow. According to the BAA:

> "It is clear that the financial incentive exists for airlines wishing to operate long haul services to procure slots from airlines currently operating short haul services. BAA would expect those US carriers wishing to set up operations from Heathrow to be able to obtain at least some slots through one form of slot 'trading' or another. If these carriers were able to obtain runway slot times, even if these were currently operated by narrow-bodied short haul services, BAA's initial analysis indicates that terminal and aircraft parking stand capacity would allow six to ten daily services operated by U.S. airlines new to Heathrow to be accommodated in the first season

of implementation. . . .In addition to the six-to-ten daily services identified above, it may also be possible to accommodate up to a further four daily services in Terminal 4 at some point in the Summer 2003 season."

In closing, while the US DOT should be congratulated for the 56 open skies accords it has reached throughout the world, including 20 in Europe, there is little doubt that open skies with the United Kingdom, given our country's geographic location, market size, and volume of U.S. trade, will be the most important. In his testimony, Don Carty outlines the significant benefits that await the U.S. airline industry and numerous U.S. communities as a result of a U.S.-U.K. open skies accord. For my part, I would like to wrap-up by focusing on developments in Europe and why they afford a narrow window of opportunity for securing a U.S.-U.K. open skies accord.

With the continuing push toward economic integration in Europe, time is growing short if the United States and United Kingdom wish to reach a bilateral open skies accord crafted to accommodate their mutual interests. The European Union (EU) has challenged legally the right of member states to negotiate individual bilateral air service treaties. As it has in most other economic sectors already, the EU seeks to assume the mandate to negotiate on behalf of all EU members as a whole. Indeed, recent public comments by EU Transport Commissioner Loyola de Palacio indicate a clear desire for the EU to take over this role as soon as possible.

If the EU is successful, as most on our side of the Atlantic believe it will be, the opportunity for U.S. and U.K. negotiators to sit down and come to agreement will be gone. Instead, a broader EU agenda will emerge, one that will likely include such thorny issues as cabotage, dispute resolution, foreign ownership and control of U.S. airlines, and transatlantic competition standards. To date, these issues have not been included in the open skies agreements that the United States has signed. As a result, it would likely be many years before a EU-U.S. agreement could be hammered out and the skies between America and London opened up for the many carriers and U.S. communities currently shut out of Heathrow by Bermuda 2. Put bluntly, absent a U.S.-U.K. open skies accord before then, a ruling in favor of the EU early next year will lock Bermuda 2 in place for years to come. For our part, British Airways is prepared to support the existing U.S. template for open skies, provided we are allowed to move forward with our alliance with American Airlines as other airline alliances have been allowed to do under open skies.

It does seem odd that Americans and the British enjoy a close, free, and open relationship in virtually every sector of trade and commerce except aviation. We, the U.S., the U.K., and the airlines, have the opportunity right now to change all that if we can collectively look past the myths and self-serving arguments of some, toward a future that frees airlines in both countries to pursue their efficiencies and benefits on behalf of passengers and shippers.

Thank you again for the honor of testifying before you today. I would be happy to answer any questions that the Chairman and Members of the Subcommittee might have.

ATTACHMENT

TOTAL NUMBER OF WEEKLY SLOTS AT LONDON'S HEATHROW AIRPORT BY AIRLINE, SUMMER 2001

Airline	Slots	Percentage
1. British Airways	3,367	36.4
2. British Midland	1,251	13.5
3. Lufthansa	348	3.8
4. Aer Lingus	320	3.5
5. SAS	300	3.2
6. Air France	263	2.8
7. United Airlines	238	2.6
8. American Airlines	224	2.4
9. Virgin Atlantic	214	2.3
10. Iberia	210	2.3
11. KLM	194	2.1
Other	2,332	25.1
Total	9.261	100.0

ATTACHMENT II

TOTAL NUMBER OF PASSENGERS BETWEEN THE UNITED STATES AND HEATHROW BY AIRLINE, 2000

Airline	U.S.-Heathrow Passengers, 2000
1. British Airways	1,994,990
2. United Airlines	1,513,099
3. Virgin Atlantic	1,349,333
4. American Airlines	1,065,084

Source: CONCRS data.

Chairman KOHL. We thank you.

Before we hear from Senator Specter, I would like to ask Mr. Kellner to make a brief statement.

STATEMENT OF LARRY KELLNER, PRESIDENT, CONTINENTAL AIRLINES, INC., WASHINGTON, D.C.

Mr. KELLNER. Thank you, Chairman Kohl, and Senators DeWine and Specter. We appreciate very much the opportunity to be here this afternoon to share our views. And I join my counterparts here in thanking you for the leadership you showed during a time of crisis immediately after the attacks of September 11th and the help you provided to the industry.

I would also echo their comments, led by Don Carty, with regard to security and say that we have made a lot of progress; and while I believe I agree with Don there is more to do, clearly we are very focused on that issue. We made a lot of efforts. We greatly appreciate the help given to us by this Committee and the entire Congress, and we look forward to working forward on that.

To sum up our views, I think, on American Airlines/British Airways' request for antitrust immunity under their alliance, we would say it is the wrong deal at the wrong time. Continental has been extremely successful offering high-quality service and a reliable product to its customers, mostly thanks to the hard work and effort of our 48,000 employees today. We believe we can compete very fairly in the marketplace, and we can be very aggressive in doing that. However, we have to get the chance.

Earlier this year, after extensive review, the Department of Justice turned down the United Airlines/US Airways deal. And if you think that deal was bad, the impacts of American Airlines/British Airways are much worse. It is worse in size. It is worse in scope. It is worse in market dominance.

As one of the previous members commented, it is the equivalent of letting American and United, maybe even Delta, in this country merge; but, in addition, putting it in a position such that we can't get access to the airports in which they fly. If you looked at it on a European base, in the European market it would be like letting seven of the top ten European carriers get together.

United/US Airways is expected to devastate competition. This will be the death knell for competition across the transatlantic. At least in the U.S., we have "open skies" and open access to all major airports. But in London, U.S. airlines like Continental cannot even, over an "open skies" regime, be able to compete as there are no slots or facilities available for carriers' use at London–Heathrow. It is interesting as you hear the comments of Roger Maynard and

Don Carty as they talk about the availability, yet you see this group of Delta, Northwest, and Continental very strongly saying there is not availability.

Continental didn't oppose Northwest/KLM. We didn't oppose United/Lufthansa. We didn't oppose American/SwissAir/Sabena. We are not opposing Delta/Air France/Alitalia/Czech CSA.

What we are opposing is kind of an alliance that is not an end-to-end alliance, but is much more driven towards dominating a market—the United Kingdom, more specifically London, more specifically Heathrow, to the U.S., and an airport where we don't have access and we don't have the right to compete, and that is the main reason we are so opposed to this alliance while, as Don Carty commented, we are a large supporter of alliances in general and have not opposed the others.

It is not just us that are concerned or the airlines. In 1997, the antitrust experts at the Department of Justice made it clear that the proposed alliance will significantly reduce competition in many U.S.–U.K. city pairs without producing sufficient efficiencies to outweigh the harm. Hence, if DOJ were reviewing the alliance under the antitrust laws, we would oppose it. What the Department of Justice said then is even more true today.

If you look at the facts and you look at the comparisons, when you talk about slots—and both American and British Airways have talked about being under 40 percent—they are talking about all the slots. The majority of the slots at Heathrow go to serve intra–Europe markets. When you look at the slots that are available for wide-body transatlantic flights, you will quickly see that they have a tremendous dominance in that market, which is what has brought this reaction. There are two largest competitors in this crucial market. They are already, if you look at British Airways, 65 percent larger than its nearest competitor between the U.S. and U.K. And with the combination of American Airlines, they would be 300 percent larger than the nearest competitor.

They are seeking antitrust immunity so that they can collude in order to fix prices, divide markets, allocate capacity, and pool revenues on these very important business markets. Again, we look at Heathrow and do not believe there are any plans to increase the number of landing slots or even add facilities until 2007 at the earliest. We believe that it is a very difficult market, and we believe Virgin's experience has shown how hard it is to get into Heathrow, as Richard Branson has just commented.

"open skies" as the trade? That is a cruel hoax with regard to—if we have no access to the ground. We don't want to fly to Heathrow if we can't land there.

Even those travelers who don't fly to London will be harmed. As American Airlines and British Airways leverage their dominant position in this market, they will use that on corporate deals to get increased corporate traffic, which will clearly have a huge impact on all of our businesses because this is such a dominant market. Continental needs at least 10 daily round trips to Heathrow to have any chance to compete against this monopoly. We need six from New York, we need three from Houston, we need one from Cleveland. That requires 140 weekly slots, something we think in the current market is impossible to obtain.

Further, we need some kind of mechanism to make sure we have adequate counter space, club facilities, places to park aircraft, and all the related facilities we need.

If American Airlines and British Airways are permitted to jointly dominate London, Continental will face a substantial loss among its corporate customer base because using that dominance to force corporations and travel agents to shift market shares away from competitors and other routes, both within the U.S. or elsewhere, it will cause them to face the loss of their coveted discounts and override commissions or comply. No matter what side you see of this issue, we think it is important with that added that this be well studied, especially in light of the events of September 11th, which we think have caused a dramatic change.

The industry is at a crossroads. September 11th changed things. Inexplicably, the Department of Transportation is moving with unseeming haste in consideration of the proposed AA/BA alliance and antitrust immunity. Four years ago, the Department provided adequate review time for thousands of pages of analysis and comment, and they committed to an oral hearing. This year the Department has arbitrarily cut off access to its documents, provided inadequate time for review and comment, and refused to require that 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. The DOT seems intent on sacrificing competition on the altar of "open skies" and doing so as quickly as possible.

I hope this Committee will express its grave concern about the inadequacy of this rushed and incomplete review to both Secretary Mineta and Attorney General Ashcroft.

The proposed AA/BA alliance is the wrong deal at the worst possible time for both the country and the industry in the most important aviation market in the world. The combination of AA and BA is so clearly anti-competitive and the benefits of U.S.–U.K. "open skies" are illusory without the right to land and the related facilities.

Mr. Chairman, thank you for your attention today, and also the members of the Committee. We are grateful for your interest and leadership on the issues. We appreciate Senator DeWine, who represents our Cleveland hub and its 4,000 employees, and we are pleased to answer your questions.

[The prepared statement of Mr. Kellner follows:]

STATEMENT OF LARRY KELLNER, PRESIDENT, CONTINENTAL AIRLINES

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.

II. 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.

III. 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 Airway's 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.

IV. 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 City hopper), carriers that gained slots through the transfer of slots from an existing flag carrier (i.e. Transaero Russian Airlines), and carriers that reinstituted 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 required 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.

V. 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 bring-

ing 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.

VI. 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.

VII. 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.

[Additional material is being retained in the Committee files.]

Chairman KOHL. We thank you, Mr. Kellner, and before we start questioning, we would like to hear from Senator Specter.

STATEMENT OF HON. ARLEN SPECTER, A U.S SENATOR FROM THE STATE OF PENNSYLVANIA

Senator SPECTER. Thank you very much, Mr. Chairman, and thank you for convening this important hearing to begin the process of the Antitrust Subcommittee looking into a great many very, very complicated issues.

The fundamental question, of course, is competition. When you have an alliance between American Airlines and British Airways, which controls now—the two control 61 percent of the traffic from the United States to Great Britain, there is an enormous hurdle to overcome.

When you talk about an alliance, you talk about agreements as to many lines, including fare-sharing. In harsher days, you call it a conspiracy, or you call it an agreement. It is a conspiracy if it is against the law. It is an agreement if it is in accordance with

the law. But the impact on the consumer may be just about the same thing. So that any agreement by the United States Government, Department of Transportation in collaboration with the Justice Department, to approve this alliance I think has to have extraordinarily close scrutiny by this Subcommittee, and we are starting that process.

It seems a little curious to me that it has taken so long to have any realistic effort to renegotiate this 25-year agreement between the United States and Great Britain known as Bermuda 2. And Mr. Maynard may have put his finger on it when he talks about the UE in the wings. And with the UE in the wings, which may supersede Great Britain's ability to negotiate, perhaps candidly, at long last, there may be some willingness to give other airlines an opportunity. But the fundamental concern as a United States Senator is with competition as it affects the American consumer, the U.S. consumer.

Then there is the issue of special Pennsylvania interests with US Airways, and that is an airway which has had very considerable difficulty, just went through a long process on a prospective merger with United, where United did not make the application for an antitrust exemption until the last minute and time ran out, and that merger did not take place, and perhaps for the better. But US Air, with some 17,000 employees in Pennsylvania, prior to the recent cutback, is an obvious concern for a Pennsylvania Senator. And it seems to me that there are going to have to be real assurances when Mr. Maynard talks about slots, and I am sorry I can't stay for the questioning. We have Secretary of Defense Rumsfeld coming in at 2 o'clock to give us a briefing, and that is a very important matter. But we need answers to the questions on slots. Are they meaningful slots? I am advised by staff that the slots are available at a time which doesn't do the airline much good.

So that if there is to be an approval on immunity, it seems to me that Great Britain and the United States Governments have to come up with a package which is meaningful. They are going to have to be meaningful slots. They are going to be meaningful lines. They are going to have to be meaningful competition. And now that the UE is in the wings, maybe the time has come for that.

But I want to see a lot of these very hard questions answered before I am prepared to give my agreement as a United States Senator for all of our consumers and as a Pennsylvania Senator who has a very special interest in US Airways and the many jobs which it controls.

Mr. Chairman, I would talk longer, but my voice is at the very end.

Chairman KOHL. Thank you.

Senator SPECTER. Everyone is in luck. Thank you.

Chairman KOHL. Thank you very much, Senator Specter.

The first question to you, Mr. Carty. Critics of the deal between American Airlines and British Airways point out that the "open skies" agreement has little meaning with respect to London's Heathrow since there are virtually no available takeoff or landing slots at that airport. Mr. Carty, what good is an "open skies" agreement if the competitive airlines cannot gain takeoff and landing slots at Heathrow?

For example, you have a very, very large share of the London market. How could anyone compete against your alliance when you and British Airways have such a large share? I don't believe you would do it to yourself, for example, Mr. Carty. You are not trying today to compete with Delta/Air France at Charles De Gaulle in Paris or United/Lufthansa at Frankfurt. I believe that is a matter of fact. So why would you expect your competitors to see any justice in what you are asking for at Heathrow?

Mr. CARTY. Well, let me respond to that in a couple of ways. First, let me make the observation that my friends, as you referred to them as, testified—or their predecessors in some cases—exactly the same way when this application was submitted 5 years ago. And since that 5 years has elapsed, there have been 15 new frequencies a day added between the United States and the United Kingdom.

The reports that slots weren't available then, absolutely no slots available—each of these airlines testified to that effect 5 years ago. Since that time, between ourselves, British Airways, United, and Virgin Atlantic, who are the only carriers allowed to participate in this market, we managed to add 15 new services.

Now, I might add, seven of those were added by the American carriers. The only reason these gentlemen don't have flights in Heathrow today is because that agreement wasn't approved 5 years ago. The slots became available.

Now, in addition to that, I think the British Airport Authority has already testifies that slows to permit an additional six to ten frequencies would be available immediately. They have also testified that facilities are available, as Mr. Maynard has talked about. Mr. Maynard also referred to the number of transactions that have occurred, trading and buying slots at Heathrow Airport in the last year.

There are slots available. If there weren't slots available, United wouldn't have been able to add five flights in the last 5 years. Virgin Atlantic wouldn't have been able to increase their number of flights by 50 percent. It is a slot-controlled airport, but there are slots available.

Secondly, the dominance that exists, the so-called dominance that exists by British Airways, as Alfred Kahn has testified, is dramatically less than the presence of so-called dominance at Frankfurt and Charles De Gaulle and Amsterdam. Today, I think it is 70 percent of the flights—in excess of 72 percent of the slots at Amsterdam are controlled by the Wings Alliance. Fifty-four percent of the operations at Charles De Gaulle are controlled by the SkyTeam. Sixty-nine percent of the slots at Frankfurt are controlled by the Star Alliance.

So I think you need to put that in perspective, and to your point whether we would be competitive with them, we have service to Charles De Gaulle today from Boston, New York, Dallas, Chicago, Los Angeles, and Miami. We are actively competitive in that market. Indeed, we have entered that market and we have entered the Frankfurt market.

So it would be a grave—I mean, if these gentlemen don't believe they would enter the market, I don't think they would be here arguing it. The opportunities these gentlemen have missed is the

number of slots that have become available in the last 5 years, and if we adopt this same position 5 years from now we will still have Bermuda 2 with British Airways. American, United, Virgin Atlantic, and British Airways will be the only operators into Heathrow, and, of course, it is quite logical to assume that American and British Airways will have somewhere around 50 percent. When there are four carriers in a market, that tends to be what happens.

So I think some of the so-called facts that there are no slots available have been—the facts are found to be wanting on both bases, historical basis and on the basis of the British Airport Authority's indication that there would be slots available for six to ten frequencies.

Chairman KOHL. All right. Mr. Branson, would you like to respond?

Mr. BRANSON. I would just like to challenge Don Carty. He says that—and there are a lot of incredible things coming from both British Airways and American Airlines on slots. He says that the British Airport Authority say that there are six to ten new frequencies available immediately today across the Atlantic. What I am willing to challenge him on is that if we tomorrow apply for those six to ten and we don't get them, will American Airlines hand over six to ten of their slots to us? He won't take up this challenge because he knows they are not available. But I will ask him that question.

Will you give us six to ten of your frequencies if we don't get them?

Mr. CARTY. If any become available, will you give them to us? You, will you give them to us?

Mr. BRANSON. I am asking you a question. Will you—you are saying there are six to ten frequencies—

Mr. CARTY. I am asking you—

Mr. BRANSON. —across the Atlantic.

Mr. CARTY. All I am doing is reading the British Airport Authority's submission to this Committee.

Mr. BRANSON. But you are obviously reading it wrong because there are not six to ten frequencies available. I mean, if there were six to ten available, we would be moving our services from Gatwick to Heathrow. British Airways is moving their services from Gatwick to Heathrow. There are no services available, no slots available at all. And I can go through all the quotes of British Airways and yourself over the last 4 years saying there are none available, if you wish me to, but you know there are none available.

Chairman KOHL. All right. Mr. Anderson?

Mr. ANDERSON. Perhaps the best way to resolve this issue is to go to the horse's mouth, and the horse's mouth is the Airport Coordination Limited. They have filed comments in this proceeding: "And ACL is responsible for coordinating all slots at this airport." They keep the slot directories. They handle all the exchanges of slots at this airport. They are the authority on slots. "In ACL's professional judgment, the opportunities to accommodate new entrant U.S. carriers from the allocation of pooled slots in the first two seasons are extremely limited."

Second, in general, it is ACL's observation that there is a general unwillingness on the part of incumbent Heathrow carriers to divest of slots and the market is illiquid.

Finally, if you go to the time period that Roger Maynard is talking about, back to the summer 2001 season, ACL states that there were only 72 weekly slots available, enough for only five daily round-trip services that were traded for the summer 2001 season. Of those 72 slots, remember, the slot has to be in a window for a morning arrival and an early afternoon departure for it to work for a U.S. carrier, and it has to accommodate a wide-body airplane.

Of the 72 weekly slots that were traded in the summer 2001 season, only 21 of them were commercially viable for a U.S. carrier for a morning arrival of a wide-body and an afternoon departure. And of those 21 commercially viable slots traded for summer 2001 Heathrow operations, guess who bought 20 of them? British Airways.

Chairman KOHL. All right. Gentlemen, I would like to go on to security.

You want 30 seconds, Mr. Kellner?

Mr. KELLNER. Just one quick point. Don pointed out that the U.S. carriers have added seven flights over 5 years. That is 1.4 flights a year, which I think makes exactly the opposite point and shows how unavailable slots are. You look at the three of us sitting here plus U.S. Airways. We need like lots of flights, not 1.4 flights a year. We would be arguing among us who just gets those flights.

Chairman KOHL. Okay. Gentlemen, we all recognize that without safety and security, there is no airline business going on into the future. So we are not operating from a different wavelength here, I would guess that there are no other six people in the country who are as concerned about safety and security as you are because your business depends on it.

So let's talk about just a couple things. One is the bag match and the other is the ability to screen baggage. Bag match is, as you know, the technique whereby airlines ensure that the person who checks a bag and purchases a seat is sitting in that seat when the airplane takes off. In Europe, bag match is or is going to be very shortly universal. In other words, if you check a bag through in Europe and you are not sitting in that seat, that airplane doesn't take off.

I think everybody in this country would like to believe that we would provide the same security to our customers in this country.

It is also true in Europe, as you know, that they are or will be very soon screening all luggage to see to it that the luggage doesn't have explosives. I think it would be a big surprise to many people in this country to know, which is a fact, that a person could very conceivably check through luggage which has explosives on it, and that luggage would be loaded onto the plane and the plane would take off. That is very possible to do in this country.

Now, it seems to me that you want to tell the American public that you are going to put an end to those two practices and that you are going to do it quickly, if not immediately. Certainly bag match is something you can do tomorrow if you wish, to see to it that nobody checks through luggage which has explosives on it and then doesn't get on the plane.

Please respond.

Mr. CARTY. Let me, if I could, take a crack, and then I will invite my colleagues to. Bag screening, as you point out, is a way of ensuring, to varying degrees, depending on what kind of screening device is used, that there are no explosives on a plane. An X-ray of capable of seeing some things. It is not capable of seeing others. The CTX machine is more capable of detecting explosives.

Logistically, as you probably know, Senator, it is very difficult for we, the FAA, and the airports in this country to get that done quickly. The availability of square footage for X-ray machines, the availability of X-ray machines, and if we go to CTX machines, certainly the availability of CTX machines is not something that could get handled very quickly to get us to 100 percent bag screening.

The bag match issue is a somewhat more complicated question for us, because in the first instance, we are troubled post–September 11th that bag match would do nothing to the suicide terrorist event. If someone is willing to die, it doesn't matter whether they are on the airplane or not. And the events of September 11th tell us the terrorism we are facing—

Chairman KOHL. Why not have a bag match? It may not deter the suicide, but it would deter everyone—I mean, they have bag match in Europe. Why shouldn't we have bag match in this country?

Mr. CARTY. Again, the logistical challenge of bag match is it would have a fairly radical effect on the airline system. That is a matter of public policy. But the consequence is we can't run the kind of hubs that we run here in the United States—

Chairman KOHL. Why?

Mr. CARTY. Because of the size and dimension of them. What happens—

Chairman KOHL. Why can't you have bag match on every airplane?

Mr. CARTY. Let me explain what happens, Senator. We bulk-load narrow-body airplanes; in other words, bags just go on the airplane. Suddenly a passenger is missing. We have to take every bag off that airplane.

Chairman KOHL. What do they do in Europe?

Mr. CARTY. I don't know precisely what they do in Europe, but let me just observe that the size and intensity of our bag structure in the United States is dramatically different in Europe.

Chairman KOHL. But if you are, it seems to me, as an industry, gentlemen, if you are sitting here telling the American public that whereas in Europe we have a bag match system to ensure that somebody does not check through a bag with explosives on it and then not get on the airplane, they can do it in Europe and we are not going to provide that service, that life-and-death service, potentially, to our American customers, you are taking a huge risk with your industry.

Now, I have been in business all my life, as some of you may know, and I have some sensitivity to customers and their needs and concerns. And this is a huge risk and a gamble that you are taking.

Mr. CARTY. Let me just articulate—

Chairman KOHL. Does somebody else want to respond to that? Mr. Mullin, Delta, tell us about it.

Mr. MULLIN. Well, first of all, I think every single one here would endorse that we want to do absolutely everything possible to ensure the security of the American people. I think that part of the question on it has to do with cause and effect with respect to something as dramatic as bag match. It is not easy, Senator, as Mr. Carty has just explained. The logistical aspects of this are extremely serious with respect to the operational aspects of this.

I think that what all of us are trying to do here is we want to take every conceivable step that we possibly can take which is going to ensure the security of the American public. And I think if you look at the range of things that have happened with respect to the reinforcement of the doors, the sky marshals on the airplane, the use of the CAP system, the screenings that we are doing of the airplanes and holding them overnight, the great increases that we have made in terms of the intensity with which aviation personnel and travel agents are looking and screening people going forward, we have an immensely improved system.

The biggest weakness that we do, in fact, have is in the baggage-screening area. Everybody agrees with that, and it is because of the immensity of the processing that is going on. There are over 1.4 billion bags going through this system in the United States every year.

And so to take this on is not an easy task. Should we strive to do it better? Should we, in fact, be improving on this? I think absolutely. But I think we have to also give realistic answers to the American public here. The true steps that we have taken so far with respect to ensuring security are real and they are addressed at the kind of situation—

Chairman KOHL. Let me ask you this question, Mr. Mullin. Let me ask—

Mr. MULLIN. I think we should work on this, Senator.

Chairman KOHL. Let me ask you this question.

Mr. MULLIN. Yes, sir.

Chairman KOHL. If it is important to have a foolproof, if possible, security system for carry-on luggage, which you talked about how much you have improved and worked on it—

Mr. MULLIN. If it is possible to have a foolproof system—

Chairman KOHL. Yes. It is something you are working on—

Mr. MULLIN. Yes.

Chairman KOHL. —and is very important, you want to provide the American public the assurance that you are doing it, what about luggage that is checked in and—what is the difference?

Mr. MULLIN. I am agreeing with you, Senator. I am saying that we should, in fact, work over time to have absolutely—

Chairman KOHL. What does over time mean? Six months? Three months? Two months?

Mr. MULLIN. It is longer—

Chairman KOHL. When does it mean?

Mr. MULLIN. We are not arguing, Senator. It is longer—

Chairman KOHL. But we have to tell the American—

Mr. MULLIN. It is longer than this.

Chairman KOHL. We have to be able to tell the American people that in terms of urgency and immediacy because they are flying today and tomorrow—

Mr. MULLIN. We need to improve—

Chairman KOHL. —that we are going to get it done by when, January 1st?

Mr. MULLIN. We need to improve the whole—I don't know the answer to that, sir. I mean, I think that one of the things that all of us have to do is just to recognize that in the past 8 weeks we have re-made the security system in aviation in America. All of us are making massive improvements in every aspect of this, including baggage handling. And I endorse what you are trying to say here, but we cannot say—and I think I would echo what Don Carty has said. It would be unrealistic and untrue for us to say that we could put in a bag match system in a very short period of time that matches what is done in Europe. We can work towards that, but we are making massive improvements throughout the entire process.

Chairman KOHL. Well, bag match is something you could do next week.

Mr. CARTY. Not without changing our airline security dramatically.

Chairman KOHL. Mr. Anderson, why couldn't—

Mr. ANDERSON. Well, first, I think the sort of gravamen of the security system in the United States is centered around two principles, and the first principle is the authorities give us a list of passengers which we are to screen every manifest against, and that list is regularly updated by the authorities. And without saying any more in a public hearing, that is a very crucial part of the security process that is brand new since 9/11.

The second thing is all of aviation security is based upon the CAP system, and the CAP system is essentially controlled and the criteria are controlled by the Federal Aviation Administration. This industry is going to have, if we continue on the current trajectory, 670 million domestic passengers next year. That is an enormous number of passengers. And what we have done is we have used the information we get from the intelligence community, all the information we have in a passenger name record, to profile, in essence, 10 percent of the passengers. And to be certain that we don't dilute our screening and security resources both as a country and at airports, we focus on the 10 percent of passengers that are the passengers that under FAA regulations are the most important in terms of screening. For those passengers, their luggage either goes through a CTX machine or it is dump-searched. And their person is searched both at the security checkpoint and at the gate.

And without going further into the details, which I don't think would be appropriate in this environment—perhaps I have even given more than I should have at this point—I believe that our system hinges on the CAP system and that we must rely on the CAP system.

As to the second point, I will be very direct about trying to do it in a hub-and-spoke system. European airlines are much smaller, and they run relatively few banks. At major airports in the United States, we will have 50 to 60 arrivals within an hour, and those

same airplanes will depart within—our minimum turn time on a narrow-body is 35 minutes. The airplane sits on the ground a relatively short period of time, and the bags are transferred tail to tail. And given the logistics of running a hub operation that has 12 big banks a day spread over 60, 65 gates, the logistics of being able to accomplish that, as you say, next week I must say are practically impossible.

Chairman KOHL. Well, the machine, yes, but not bag match. I am going to turn it over to Mr. DeWine, but I just want to make this point. It is entirely conceivable with the system that we now have operating in this country that on a given day a group of saboteurs could load up 12 different airplanes across the country with explosives, go home, and we would have a disaster, which would virtually end the airline business for an indefinite period of time in addition to causing, you know, an unacceptable occurrence in this country. And as long as that is possible, I think you all are taking a huge risk.

Mr. DeWine?

Senator DEWINE. Senator Kohl, thank you very much.

A recent Wall Street Journal article starts off by saying that nine major U.S. airlines have blown through most of Washington's $5 billion cash bailout and their bleeding continues. The financial carnage is so bad that the industry could be headed for a major restructuring, et cetera, et cetera. In fact, Mr. Mullin, you are quoted in the article.

I want to kind of follow up on Senator Kohl's last line of questioning. Let me just go from my left to your right, and if each one of you could tell me, as of today, what the loss of ridership has been as far as passengers and what your loss of gross revenue has been, two figures for each one of you.

Mr. CARTY. Yes. Our loss of passengers is probably today in the high 20s. It would be higher had we not been price aggressive, and the consequence is our revenue is more between 35 and 40 percent loss.

Senator DEWINE. Okay. Just the figure, and then we will come back.

Mr. MULLIN. Ours is about 35 percent, as well.

Senator DEWINE. Thirty-five percent—

Mr. MULLIN. Thirty-five percent drop in revenue since September 11.

Senator DEWINE. And passengers?

Mr. MULLIN. In passengers, it is less. It is probably the order of 20 percent.

Mr. ANDERSON. Our numbers are similar to the numbers that Leo Mullin just stated for Delta Airlines.

Mr. BRANSON. We have got about a 20 percent drop in passengers and about a 35 percent drop in revenue.

Mr. MAYNARD. Very much the same, 20 percent and 35 percent.

Mr. KELLNER. Yes, very much the same for Continental, as well.

Senator DEWINE. Any movement?

Mr. CARTY. Little movement on passengers, but very much at the expense of yield.

Senator DEWINE. What happens if this continues for six months?

Mr. CARTY. Well, it varies by carrier. At American, if it continues for six months, we are probably running off cash at $10 to $12 million a day, so it would be about $1.8 billion of cash if it continued for six months.

Mr. MULLIN. Senator DeWine, just a fast comment. You mentioned the cash infusion. I did testify on that subject before the Senate and the House. That $5 billion essentially was a cash infusion that put the airlines in the cash position on roughly October 15 that they were on September 10, and that is all that that did. From now on, or after October 15, we were on our own with respect to dealing with the tremendous drop-off in passenger revenues associated with this, and we are all running very substantial losses. Delta's current rate of loss right now is $8.5 million a day.

Senator DEWINE. The rest of you do not have to project anything. If you want to answer, you can.

Mr. KELLNER. I would just add, we have seen a slight improvement in trends over the last three weeks, since kind of the middle of October, in kind of the three- to five-percent range, and we are about half of Delta's and we are running about $4.5 million a day negative in cash.

Senator DEWINE. I think the point is, and we all know this, it is stating the obvious, that unless customers, potential passengers, feel confident about safety, that certainly is a prerequisite before any kind of recovery. It may not be the only issue. There may be a lot of issues out there, some psychological issues, et cetera. But clearly, safety is an issue, and I guess it does come down to two things with you all. One is time and getting changes into place and the other is money.

I believe it was Mr. Mullin, one of you was outlining some of the changes that have been made. Do you want to give me the 60-second version of that, because I think it is important that we get on the record what changes have been made.

Mr. MULLIN. I think the—

Senator DEWINE. And then I want to talk about some changes that have not been made, as Senator Kohl did, as well.

Mr. MULLIN. I think the changes are really quite massive. I will just tick them off quickly. One is the reinforcement of the cockpit doors on all of the airplanes. Secondly, the inclusion of the sky marshals—

Senator DEWINE. Is that done?

Mr. MULLIN. It is done, I think, for almost all the airlines. The inclusion of sky marshals increasingly on more and more flights. The sweeps of the airplanes overnight and keeping them under security for that time period. The adding of security at the airports. Very importantly, as Richard Anderson—

Senator DEWINE. Excuse me. The sweep at night, of course, is something that the passengers do not see.

Mr. MULLIN. Do not see. That passenger does not see a lot of this.

Senator DEWINE. Right.

Mr. MULLIN. The passenger does not necessarily pay any attention to the cockpit door. It does not know who the sky marshals—

Senator DEWINE. Well, they know about that one.

Mr. MULLIN. But they also do not know who the sky marshals are—

Senator DEWINE. Right.

Mr. MULLIN. —or even if the sky marshals are on the plane. They do not know about the use of the CAP system, which I would agree with what Richard Anderson just said, I think, and most of us agree, is one of the most fundamental improvements in terms of identifying potential criminals. Then there is the improvements that have actually been made in terms of the baggage screening process. The terrible examples of egregious faults notwithstanding, it is actually being improved.

And then I think the most important of all is awareness. Remember that this tragedy occurred because our nation was surprised, and certainly we in aviation were surprised. Well, the 700,000 people who work in aviation will no longer be surprised, nor will the 500,000 people in travel who write tickets and so forth who are supplying information pertaining to potential terrorists. We have a vastly improved security system as we speak and we are continuing to improve it now.

Senator DEWINE. But taking it to the next level obviously involves Congress passing legislation, getting it on the President's desk, getting it signed.

Mr. MULLIN. Yes, it does.

Senator DEWINE. We all understand that. We are not going to get into that debate today, but we all know it has to get done and has to get done very quickly.

The other factor, of course, is, ultimately, it is a question of money. Mr. Anderson, I had the opportunity to be on your airline the other day—

Mr. ANDERSON. Thank you.

Senator DEWINE. I will not get the rest of the plugs here. We have to get a few plugs in here.

[Laughter.]

Senator DEWINE. It is a question of money. I was getting ready to board the plane and they did call off five names and I happened to be one of the five that they called and they actually then physically went through my carry-on bag and literally went through everything in the bag. But if that was done, and they only did it for five or six passengers getting on this plane, if you would do that, for example, and I am not saying that is what should be done, but if you did that for everybody who gets on that plane, it is simply a function of money. You would have to have more people to do it.

Mr. ANDERSON. I think it is more than a function of money. I think it is a function of not only resource, but it is also a function of focus and time. The whole principle behind the CAP system and the reason you were selected was because you were a selectee.

Senator DEWINE. Well, let us not get into why I was selected.

[Laughter.]

Mr. ANDERSON. Yes, but you probably—

Senator DEWINE. I am on the list, I am sure.

Mr. ANDERSON. Right.

Senator DEWINE. And I do not want to get too far into, in a public hearing, about how the system works.

Mr. ANDERSON. Correct. I would submit to you that what we should do as an industry, and I think the whole focus of the rapid response team task forces that I served on and Bob Becker from American served on and Herb Kelleher on behalf of our industry, our focus really is—the number of passengers traveling is enormous. I mean, we are going to hit a billion by 2010. The whole idea behind the process is to focus on the areas that need focus on—

Senator DEWINE. Sure, and that is basic security. That is what we do in our house. That is what we do in buildings. Anybody who is a security expert will tell you that.

Mr. ANDERSON. Right.

Senator DEWINE. So I do not disagree with you. I will say this, though, in going back to a question that Senator Kohl had and an answer that you all gave. I am not sure it is acceptable to the American people for you to say, well, they can do it in Europe because there just are not as many people they are dealing with. That is just not an acceptable answer.

It is not an acceptable answer because, as a layman, I assume someone is paying for that security and we can pay for it just as well in the United States as they pay for it in Europe. There is no reason that you could not duplicate that service over a period of time. You cannot do it overnight.

Mr. ANDERSON. Actually, with respect to passenger screening, and I have—

Senator DEWINE. And I am not just talking about passenger screening.

Mr. ANDERSON. Okay.

Senator DEWINE. I am talking about anything that is done in Europe.

Mr. ANDERSON. I was addressing the point you made, which you were one of probably ten percent of the people on the flight you spoke of that was searched at the gate.

Senator DEWINE. That is right.

Mr. ANDERSON. In Europe, it is very similar, and we have a firm—or I should not get into that issue. We have people who actually take each passenger and do sort of a profiling with each passenger, and then based upon those discussions—

Senator DEWINE. You are making it sound worse and worse for me now.

[Laughter.]

Mr. ANDERSON. No, I am saying, but it is no different than what we do in the United States with the CAP system and the governments in Europe do the same thing and then they segregate a certain group, some random and others because of matching regulation that are subject to further scrutiny, just as you were one of the ten percent on our flight last week.

Senator DEWINE. My only point is, I did hear the answer earlier, I cannot remember from which one of you, but in regard to a comment that Senator Kohl made. The comment was, well, we cannot do that in the United States. We are dealing with so many more flights. I am just telling you, no one is going to accept that, folks. You cannot say that in a public—you can say anything you want to, but no one is going to buy it. I mean, we are subject to terrorists, obviously, like they are, we have found out, just like they are

in Europe and no one is going to buy that you cannot handle it because we handle more bags—you handle more bags and you handle more passengers.

Mr. CARTY. Senator, I think—

Senator DEWINE. The answer from the public is going to be, figure it out, guys, and that is what they are saying to us, and that is what they are saying to you.

Mr. CARTY. I think, Senator, if I might, what Richard was saying when he talked about his bank structure is that we do not know how to do it and keep the airlines looking like they look. Now, we could change the airlines dramatically. We could have those connect times double. Then there will be fewer banks. Then there will be fewer flights.

And all we want as a matter of social policy is for those that are going to make these decisions to understand there will be dramatic impact on our customers when we do that. There will be dramatic impact on our employment when we do it, as well, because with fewer flights, we will have fewer employees and we will downsize again. It is not that we cannot do anything. We just want, as this debate unfolds, for people to understand all of the dimensions of the debate.

All Richard meant, I think, was you cannot run a 12-bank structure in Minneapolis with 50 airplanes a bank and have that happen with a tail-to-tail transfer and do bag match without going to ten banks or nine banks, and that is the important thing.

Mr. ANDERSON. I accept that.

Senator DEWINE. I want to make this point. In my opinion, you have to be able to assure your customers that you have a system in place, functioning, that prevents people from loading explosives on your plane. Now, guys, you know that is true.

And you may say it is very hard to do, and we appreciate that. That is part of this hearing today. No one is saying you should have done it yesterday. But I repeat, you have got to tell your customers that you have a system in place and functioning that will prevent people from loading explosives on the plane. Will anybody disagree with that?

Mr. CARTY. Absolutely not.

Senator DEWINE. Mr. Maynard, is that true? You are from Europe. Tell us.

Mr. MAYNARD. Mr. Chairman, after the Lockerbie incident, we instituted the bag passenger reconciliation and have had that in place now for a number of years, so there is no possibility of a passenger getting on a plane without his luggage or vice-versa.

I have to say, one of the implications of that is we quite often have delays of an aircraft when that happens and we have to take all the luggage off to go through it, which is an inconvenience which our passengers sometimes do not like, but ultimately understand.

And secondly, a consequence of it, which I think my colleagues here are referring to, we have much longer connect times at our airports such as Heathrow and Gatwick because we are doing that. We are not allowed to do tail-to-tail transfer of bags because otherwise we cannot do the baggage reconciliation. That is a consequence of having that level of security.

Senator DEWINE. Mr. Branson?

Mr. BRANSON. Yes. I think now you do not have to take all the luggage off. I think we have both introduced new systems where you can actually get that one bag off very quickly if a passenger does not turn up, and I think passengers actually appreciate the fact that there is a five-minute delay while that bag is taken off. I think all international flights, anyway, between here and England, that is the system both BA and Virgin, I think, have.

Mr. CARTY. And we do, as well, internationally.

Chairman KOHL. And you do that on international flights?

Mr. CARTY. We know how to do an airplane, and we particularly know how to do a big airplane where we know what container the bag is in. It is the little airplanes and the 50 of them at a time that cause us to have to somehow change our structure and be smaller airlines again, I think.

Chairman KOHL. But as you said earlier in this hearing, Mr. Carty, if we had that machine in place that prevents anybody from loading on explosives, that would make bag match a little less important.

Mr. CARTY. Yes, sir.

Mr. ANDERSON. Yes, sir.

Chairman KOHL. I mean, guys, you should do it. Is it not true that to the extent that those machines are in place today, the government is paying for them?

Mr. CARTY. The CTX machines, that is true. Now, what we do not know, Senator, until this legislation is finished up is when the legislation is finished, will it require CTX machines? Will it require x-ray machines? What is it that Congress wants us to do? That is why I mentioned earlier, the sooner we get to that bill and the sooner we can put a plan in place, but as I think Richard and Leo both testified, it will not be overnight. We are going to have to go find out from the vendors how fast they can deliver whatever machines it is that Congress tells us we need to have.

Chairman KOHL. But you know—to heck with Congress. It is your business.

Mr. CARTY. But if I go buy a whole bunch of x-ray machines and then you tell me to go buy CTX machines—

Chairman KOHL. And if you want to charge me $5 a ticket more, guys, to provide that assurance, I am one of 250 million Americans who will say, okay.

Mr. ANDERSON. I think the issue on the CTX–5000 is that the FAA and all of us have participated in the CTX–5000 program and we are all very supportive of the program and most of us have those installed in our hubs or are in the process of installing them in the bag systems in our hubs. I know at Northwest, we have them now installed in each of our three hubs and it is just a matter of the time it takes for the manufacturer—I think there is one or two vendors, one vendor, to be able to just produce enough of them.

And I think the FAA has a time line for continuing to roll those out and I think our industry is very supportive of that effort. I know at Northwest, we undertook significant investment to modify our bag systems in our hubs to add those machines into our bag systems. So the industry is enormously supportive, Mr. Chairman, of the CTX–5000, and I believe all of us have been adding x-ray

machines and magnometers at our airports throughout the United States and renegotiating our vendor contracts to be able to add the additional personnel to provide the heightened scrutiny that our passengers deserve.

Chairman KOHL. Thank you.

Senator DEWINE. Well, I bet you never would have thought you would like to talk about slots.

[Laughter.]

Senator DEWINE. I am going to let you talk about slots again one more time here. I look back on the hearing that we held four or five years ago and the arguments were the same. I do not think I have ever seen an issue where people held such adamant positions or had their own versions of the facts as in this case, and I do not mean that disrespectfully at all because I know that each one of you have your own position and you hold it very dearly. But it does make it difficult, I think, for someone to try to sort all this out.

It seems to me that one of the issues is there are slots and there are slots, and maybe this is what Senator Specter was saying. For U.S.–United Kingdom travel, only certain times do, in fact, work. Let me ask a question, maybe do it a little differently.

For all the opponents of this alliance, how many slots do you need and when do you need them? What do you really need to be competitive, so that you would look up here and say, okay, we are okay here? Senator DeWine and Senator Kohl, we can really compete. We can go at and we can beat these guys on a level playing field. Mr. Mullin?

Mr. MULLIN. You will recall, Senator DeWine, that our desire would be three daily flights from Atlanta, two from Cincinnati, two from Boston, and four from JFK. That would require 154 slots for that service.

Senator DEWINE. Mr. Anderson—who is next?

Mr. KELLNER. We need 140 weekly slots. We need six from New York, three from Houston, and one from Cleveland. Those are daily flights, and it translates to 140 weekly slots, and we would need those immediately because I think the key is we cannot wait four or five years to become competitive. We will be run out of those markets long before those. So we need a chance to have an ability to compete on day one.

Mr. BRANSON. I do not actually think it is possible to compete against this, but if we were to name a number, I would have thought something like 15 daily flights, or 210 weekly slots, in the times that we can fly to the States. British Airways also said that there were slots available from the Slot Coordination Committee. They can get those for nothing, and I will then pay them 2.5 million pounds for any slot they can give us that is capable of flying to America and back, just to show that they will not be able to pick up any slots to do that deal with us.

Senator DEWINE. Response, Mr. Carty?

Mr. CARTY. My only response would be, if you add up those numbers, it far exceeds, probably by a factor of two, American's total slots.

Mr. MAYNARD. And if I could add, Mr. Chairman—

Senator DEWINE. Mr. Maynard?

Mr. MAYNARD. The initial point is that none of those slots can be used unless we have an open skies agreement because they do not have access to Heathrow absent an open skies agreement. And the point we are making is that the opportunity to have an open skies agreement is going to last for perhaps three months and no longer, so take it now or you might not get it.

Mr. BRANSON. I am not going to let him get away with that. What British Airways is saying is that the negotiation is going to be handed over to the EC. What British Airways is terrified of is that the EC will have an open skies agreement with America for the whole of Europe and the whole of America, but they will not have this unholy alliance with American Airlines. That is what they are frightened of. They know that when the EC gets hold of it, there will be open skies between our two countries and that is what the EC wants to do and that is what we are looking forward to.

There will be more competition. You know, hopefully, one day, Southwest will fly inside Europe, and hopefully one day Virgin Blue will be allowed to fly inside America and you will get more competition.

Mr. MAYNARD. Mr. Chairman, can I be clear? Sir Richard and I actually agree on that point. British Airways has no problem about the EU negotiating a complete open skies agreement with the United States, which would include cabotage, et cetera, et cetera. However, we have always recognized that some of the issues there, such as cabotage and investment rules, will be extremely difficult for the United States to agree to. That is why it might take five, ten years to agree.

We are prepared to go with U.S. current policy, which is to say, let us have some more competition by an open skies agreement bilaterally with a number of countries, including the U.K. We accept that. We go with the grain. All we are asking for is it to be a level playing field with the other alliances that we compete with.

Mr. MULLIN. Senator DeWine, may I comment briefly?

Senator DEWINE. Mr. Mullin?

Mr. MULLIN. Mr. Carty just made the observation about how this all exceeds the number of slots that American would have there. I think that in times past, both the U.S. authorities, Department of Justice, I believe, and the authority, the Trade Practices Group in Britain, have both come out and put forward that they felt that 350 slots in total for all of us would, in fact, be a sufficient number of slots to mount a competitive service there.

From Delta's perspective, we would certainly be willing to fit our requirements into something like that and work with the rest here to figure out a way to put a competitive service within that. I think that is a reasonable number of slots to be granted here.

And as we have talked about this, we should also keep in mind that British Airways itself controls of the order of 3,400 slots in total at Heathrow. So if we were to have 350 slots granted for international service here, recognizing that a lot of those slots are not suited for the wide-bodies that typically fly the Atlantic, this would solve the problem, and then from our standpoint, it would be fine with us if American Airlines and British Airways had anti-

trust immunity within One World. As I mentioned earlier, we are not opposed to the One World Alliance at all. It is Heathrow.

Mr. KELLNER. Senator, if I could just add on to Leo's comments there, I think the one thing, we would agree with him but add that would also mean we need ticket counters, we need club space, we need facilities for our people, because to have kind of no counters, no place to check in, no clubs, we would run a very uncompetitive product. So we think we need the slots, but in addition, you need the facilities.

Senator DEWINE. Mr. Anderson?

Mr. ANDERSON. Senator, I do not think this is a debatable point, candidly. I would just reference the filing of the Airport Coordination Limited, which is the firm at London Heathrow Airport which is the official repository of all slots, who owns them, and does all the trading in slots. They have filed a paper in this. I repeated it for the record and I would repeat to you again that they are the definitive authority on this and they have essentially said there are no slots available.

Second, British Airports Authority owns and operates this airport. They have told us there are no gates and facilities. That is definitive on both the subject of slots and facilities.

Senator DEWINE. Mr. Carty, Mr. Maynard, can you live with giving up 350 slots?

Mr. MAYNARD. No, sir.

Mr. CARTY. No, sir.

Mr. MAYNARD. But can I just come back to this question of the—

Mr. CARTY. Mostly because I do not have 350 slots.

Mr. MAYNARD. —the British Airports Authority, because I think there must be a misconception, because the testimony which the BAA has put in in this case clearly says that initial analysis indicates that terminal and aircraft park and stand capacity would allow six to ten daily services operated by U.S. airlines new to Heathrow to be accommodated in the first season of implementation. That is a quote from the British Airports Authority's own testimony. So I do not accept that there are no facilities available at Heathrow.

Mr. BRANSON. I am sorry, the British Airport Authority is not the Slot Coordinating Committee.

Mr. MAYNARD. I am not talking about slots. The issue was raised by one of my colleagues here that there are no facilities at Heathrow. I was not talking about slots.

Senator DEWINE. You get the last shot, Mr. Anderson. You are it.

Mr. ANDERSON. I would be happy to give you the quote. I will give you the quote. It is in the exhibits to our brief. It is conceivable that some new entrant airlines may receive the slot from the pool from inter-alliance transfers or through trading, but the BAA would be unable to quickly provide the range and quality of facilities that an airline might need. Stand capacity at Terminal Four is a major constraint and is already at or close to maximum levels for the larger aircraft categories for peak morning hours. Additional wide-body aircraft could only be managed in if other services relocated to another terminal.

I would just ask that you go to the record. We would be happy to provide it to the Subcommittee.

Senator DEWINE. Thank you, Mr. Chairman.

Chairman KOHL. Well, gentlemen, I am not a big fan of Congressional hearings. I am not sure they are always worth the time and the effort, but this is truly an exception. This has been a very good hearing, very informative, educational, and so we appreciate your coming adn you have done a real service.

Before adjourning, I would like to include in the record a statement from Senator Leahy.

[The prepared statement of Senator Leahy follows:]

STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR FROM THE STATE OF VERMONT

Mr. Chairman, thank you for holding this hearing on international airline competition, in particular the proposed alliance between American Airlines and British Airways. It is important for this subcommittee to carefully review any potential antitrust complications arising from such deals.

I also thank this distinguished panel of airline executives for testifying today. I fully expect this hearing will address the current state of airline competition, as well as airline safety and security issues stemming from the events of September 11.

American Airlines and British Airways are seeking antitrust immunity from the Department of Transportation and clearance from the United Kingdom and the European Commission for their proposed international aviation alliance. This is the second attempt in recent years for American Airlines and British Airways to form an alliance. These two airlines first filed for antitrust immunity in 1997, but withdrew their application after it became clear American and European regulators would deny the application as it was structured.

If the Department of Transportation approves antitrust immunity for the AA/BA alliance, it will likely condition this immunity upon the United States and Great Britain entering into an "Open Skies" agreement, permitting any United States or British airline to fly between the United States and any airport in Great Britain.

The AA/BA alliance is an attempt by both airlines to make them stronger competitors against the other existing airline alliances, United Airlines/Lufthansa (the Star Alliance), based in Frankfurt, Germany, and Northwest Airlines/KLM, based in Amsterdam. Another alliance with an extensive transatlantic routes between the United States and Europe would clearly benefit competition between these destinations.

Customers would also benefit from the AA/BA alliance by access to more destinations, more convenient schedules, greater ticket interchangeability, greater flexibility and ease of transfer, and new and improved check-in and luggage facilities.

London-Heathrow is an important gateway to Europe from the United States. Currently, American Airlines and British Airways are head-to-head competitors at Heathrow for travel to and from the United States. While some opponents argue that competition would be lessened if the AA/BA alliance is approved, it may actually make more slots available to other airlines at Heathrow. It is also important to review competition from the entire European perspective. For example, Northwest/KLM has a 70 percent slot share at its European hub in Amsterdam. United/Lufthansa has a 69 percent slot share at its European hub in Frankfurt. And Delta/Air France has a 55 percent slot share at its European hub in Paris de Gaulle. These are all higher than the 47 percent slot share American/British Airways would have at Heathrow.Mr. Chairman, thank you again for holding this hearing today. I look forward to the testimony from all of the witnesses.

Senator DEWINE. This hearing is closed.

[Whereupon, at 2:32 p.m., the Subcommittee was adjourned.]

[Submissions for the record follow.]

SUBMISSIONS FOR THE RECORD

Statement of Kevin P. Mitchell, Chairman, Business Travel Coalition

Mr. Chairman, and Members of the Senate Committee on the Judiciary Subcommittee. on Antitrust, Business Rights, and Competition, my name is Kevin

Mitchell. I am chairman of the Business Travel Coalition (BTC), which represents the interests of major corporate buyers of air transportation services.

BTC supports the application of American Airlines (AA) and British Airways (BA) before the U.S. Department of Transportation (DOT) for antitrust immunity for their proposed alliance. BTC also supports the antitrust immunity application of United Airlines and bmi british midland.

I. POSITION SUMMARY

Specifically, BTC supports the AA-BA application for 3 reasons:

1—A nearly ten-year-old evolution from competition between international airlines to competition among global, networked alliances is almost complete. An immunized American and British Airways alliance would create via the oneworld alliance A fourth competitive global alliance as an alternative for corporate buyers of air transportation services, and considerably strengthen network competition.

2—An immunized AA-BA alliance is the lever DOT requires to achieve an Open Skies agreement between the United States and the United Kingdom. There is a finite and fast disappearing opportunity to liberalize this huge aviation market and drive billions of dollars in benefits to U.S. and UK consumers through increased competition and lower airfares.

3—A U.S.-UK Open Skies agreement would likely be a catalyst for acceleration of efforts to create a fully liberalized trade zone for air transport between the European Union (EU) and the U.S., which if successful, could serve as a template for global air trade agreements.

II. COMPETITION

The current U.S.-UK bilateral agreement, known as Bermuda 11, restricts access to Heathrow to just 12 U.S. cities served by 2 U.S. and 2 UK carriers. Some airline opponents of AA-BA immunity make the argument that AA and BA together have an excessive 60% of U.S.-to-Heathrow frequencies. If one does the math, one would at least expect that 2 carriers at 25% each would be 50% of the marketplace.

That AA and BA control only 60% is arguably surprising given the market-closing nature and intent of Bermuda 11. In 1977, the UK successfully negotiated access to Heathrow for U.S. cities that were essentially non-hubs for U.S. carriers in an endeavor to protect BA from competition. Nevertheless, United Airlines and Virgin Atlantic were able to grow their frequency between the U.S. and London Heathrow by 64% and 68% respectively, in just the past several years alone.

The larger point, however, is that with Open Skies, 4 new U.S. airlines plus bmi british midland—with its 14% slot holdings at Heathrow—would implement U.S.-to Heathrow services. Moreover, bmi british midland and its Star alliance partners will hold 27% of Heathrow slots and have announced their intent to build and invest over $70 million in a Heathrow hub, which would make London Heathrow the only two-hub airport in Europe. AA's and BA's combined market shares can only decrease as these new entrants reshape the competitive landscape in a battle for the high yield business traveler.

In response to ownership restrictions in bilateral aviation agreements—that prevent mergers and acquisitions in international air transport—global alliances were born in the early 1990's as a proxy for true consolidation. Northwest and KLM (Wings) received antitrust immunity in 1993 and United, Lufthansa and SAS (Star) received it in 1997. Delta Air Lines and Air France (SkyTeam) are all but certain to receive antitrust immunity soon as a result of U.S.-France Open Skies.

With a decade-long transition from city-pair and airline-to-airline competition to competition among globally networked alliances nearly complete, only oneworld remains without an immunized transatlantic alliance at its core, and consequently is relatively non-competitive. This is resulting in artificially higher business airfares as corporate buyers of global air transportation services on both sides of the Atlantic have fewer alliance choices than is desirable or possible.

It is a well-voiced concern, for example, among UK and U.S. corporate travel and purchasing managers that, in terms of negotiating a truly global air services agreement, there is no close second choice to the Star alliance with its 15 members and global network reach. Unfortunately, this reduces a buyer's leverage at the negotiating table with airlines.

Indeed, the marketplace acceptance of the Wings and Star alliances has led to an ascendancy of Schiphol and Frankfurt airports vis-á-vis Heathrow, and a concomitant 23% decline in combined Europe-to-U.S. market share for AA and BA, since

1996. Likewise, AA's and BA's share of the UK-to-U.S. market eroded 20% in the same period to a 40% share.

In reality, an immunized AA-BA represents a partnership between the number 1 and 4 carriers, in the Heath row-to-U. S. market. Today, United Airlines carries 42% more passengers to London Heathrow than does American, while Virgin Atlantic carries 26% more than does American. AA has slipped from the number 2 position to the number 4 position in terms of U.S.-U.K. passenger market share in recent years.

Whether or not and to what extent an AA-BA immunized alliance would require some measure of regulatory remedy in overlapping markets, or at Heathrow, is beyond BTC's expertise.

However, BTC is convinced that:

1—the linking up of AA's and BA's two networks would provide many benefits for customers of the air transportation system;

2—the scope and breadth of the Star alliance have grown significantly—and would continue to grow with an immunized bmi british midland arrangement-such that customers need a competitive counterbalance in the form of a fourth, truly competitive global alliance; and

3—an immunized AA-BA would be the key enabling factor to reach Open Skies with the UK.

III. U.S.-UK OPEN SKIES

DOT's strategy to "surround Heathrow" with Open Skies agreements with other countries has worked brilliantly. DOT was right in the late 1990s not to have caved into the UK government's version of "my-way-or-the-highway" Open Skies. Instead of acquiescing to another infamous win-lose Bermuda 11-type of aviation agreement, the U.S. held fast in the belief that the UK would come under increasing pressure to negotiate an equitable Open Skies agreement as Heathrow lost its dominant market position to other European gateways.

The erosion of Heathrow's preeminence is exactly what has transpired. Because of DOT's strong leadership, the U.S. is on the cusp a historic Open Skies agreement with its most important commercial and political ally, the UK. Moreover, U.S. businesses and consumers are closer than ever to having 4 networked global alliances in an all out competition for their business and loyalty.

Adding to the probability, and indeed the urgency, of a successfully negotiated Open Skies agreement is a pending EU court ruling with respect to the European Commission's (EC) position that it alone possesses jurisdiction to negotiate an aviation agreement with the U.S. on behalf of all EU members.

If as is expected, the EU court rules in favor of the EC position, all previously existing Open Skies agreements would be grandfathered. Those countries without such agreements in place would have to wait for the EC to: 1) gather facts for the development of a negotiating strategy, 2) consult with European airlines, 3) build consensus among EU members for a negotiating position, and 4) enter into and conclude negotiations with the U.S. In short, if an Open Skies agreement with the UK is not concluded in the next few months, it would likely be 5 to 7 years before Heathrow is opened up to new competition from U.S. airlines.

The benefits of a U.S.-UK Open Skies agreement are many. In addition to securing a fourth competitively viable global alliance—oneworld—some 5 new competitors would have the opportunity to launch services in the U.S.-UK market. This would bring countless new non-stop and one-stop air service alternatives to Heathrow to communities across the country.

U.S. communities of all sizes would have new links to important business centers in Europe, and around the world. Moreover, new levels of price competition, because of Open Skies, would deliver billions of dollars of savings to U.S. consumers. DOT studies have shown that in markets with Open Skies agreements, average airfares have fallen 20% as compared with 10% in markets where no such agreements exist.

Unfortunately, some airline competitors are perhaps unwittingly placing consumer welfare at risk. The September 5th Financial Times reported that, "In a motion filed by Continental and supported by Delta, the airlines said they both would need at least 140 weekly landing and takeoff slots at Heathrow to ensure transatlantic competition with BA-American, and insisted that more than 600 weekly slots would be needed to accommodate all potential competitors."

Together AA and BA possess 582 weekly U.S. to Heathrow slots! Demanding the divestiture of 600 slots is dangerous posturing. BTC understands that Delta, Continental and Northwest desire to avail themselves of some free slots at Heathrow—worth millions of dollars each—that may become available by way of government-required remedies.

However, through their demands, these carriers are placing at significant risk the achievement of both a competitive fourth alliance and a U.S.-UK Open Skies agreement as well as billions of dollars of U.S. consumer benefit that would be derived from lower airfares. If such competitor demands frustrate negotiations between the U.S. and UK, and if the EU court rules in support of the EC's negotiating jurisdiction, the curtain will have been lowered on new U.S. airline access to Heathrow for years to come.

IV. EU-U.S. LIBERALIZED TRADE ZONE

Airlines' corporate customers are paying higher business airfares than necessary due to some 3,500 restrictive, costly bilateral air trade agreements. The customer has a keen self-interest in encouraging progress toward a global open trade model wherein costs are taken out of the system for airlines and entry barriers are reduced for start up airlines.

If the U.S. and the UK can conclude an Open Skies agreement, then many experts believe that momentum behind a more comprehensive EU-U.S. free trade zone for air transport would build. Foreign ownership, cabatoge and other issues important to the UK, the U.S. and other countries will not have been addressed by a U.S.-UK Open Skies agreement. It would make abundant sense to handle these more complex and contentious issues in the context of EU-U.S. negotiations.

A liberalized air trade arrangement between the U.S. and the EU could provide a template and be a linchpin for liberalized air trade agreements around the globe. BTC strongly favors such a liberalized trade regime for the commercial air transportation sector.

Mr. Chairman, thank you for the opportunity to provide testimony regarding this issue of strategic importance to customers of the U.S. and global air transportation systems.

Statement of Frederick W. Smith, Chairman, President and CEO, FedEx Corporation

A appreciate the opportunity offer'? this statement on behalf of FedEx Corporation' and its subsidiary, FedEx Express, about the proposed alliance of British Airways. and American Airlines. At the present time, FedEx's interest in this alliance is primarily focused on its unbreakable link to the reform of one of the U.S.'s oldest air services agreement, the 1978 agreement with the U.K. Commonly known as "Bermuda If, " this agreement remains one of the most outmoded aviation agreements to which the U.S. is a party. In order to understand where we are today, it might be helpful to see this agreement in its historic context.

It begins in 1994, in the midst of World War IL The venerable DC–3 is-the mainstay of the U.S. airline industry. The first military jet aircraft have only recently taken to the skies, and the inaugural flights of the first commercially successful jet aircraft—the DC–8 and the 707—are still 15 years away. This is. what the world looked like when delegates met in Chicago to develop a framework for facilitating international passenger transportation.

It should come as no surprise then that the 1944 Chicago Conventior4 and the subsequent bilateral agreements framed by national governments to facilitate point-to-point passenger transportation, continue to inhibit the development of efficient, world-wide, hub-and-spoke networks utilized today by all-cargo carriers for the rapid movement of high-value goods. The Convention's framers could never have dreamed that one day hundreds of wide bodied jets would crisscross the skies each day, carrying millions of tons of cargo over thousands of miles.

Bermuda 11 continues these types- of restrictions, allowing bilateral services but ham stringing today's all cargo networks with its restrictions on traffic rights beyond the U.K. For all-cargo services unlike for combination, the transatlantic rights were liberalized in 1980, but the restrictions on U.S. third-country traffic rights that impact today's cargo network remain to this day.

Meanwhile, on April 17, 1973, however, Federal Express revolutionized all-cargo services by introducing the first integrated air/ground express operations. On that first night, our 389 employees delivered 186 packages to 25 U.S. cities using 14 Falcon jets. Today, FedEx Express is one of six independent operating companies that make up FedEx Corporation. Collectively, our more than 215,000 employees and contractors deliver nearly 5 million shipments every business day to 211 countries. We operate 662 aircraft, the largest all-cargo fleet in the world and second largest

overall. In 24 hours, those aircraft travel more than 450,000 miles, a distance of about 17 trips around the equator.

As a leader in the aviation industry, it might be useful to examine what has allowed FedEx to grow from 186 packages a night to 5 million, or from 14 aircraft to 662, or from 389 employees to more than 215,000 employees and contractors. The answer is in two parts.

First, we have followed the advice enunciated by Walt Kelly's great comic strip character, Pogo: "If you want to be a great leader, find a big parade and ran in front of it." Since its inception, our company and our industry have been doing exactly that. We have been running in front of the parade of four powerful trends shaping the world economy: (1) the increase in high-tech and high-value-added products as a percentage of all economic activity; (2) globalization; (3) fast-cycle logistics; and (4) electronic commerce.

The second, and equally important, part of the answer to the question of FedEx's phenomena] growth is deregulation. Had the U.S. Congress not had the good sense and foresight to deregulate both domestic aviation and trucking, the express industry would never have grown to be the engine of world trade that it is today. More importantly, the U.S. economy would have been deprived of the benefits provided by our industry. For example, in 1977, prior to deregulation, the United States spent approximately 17% of its GDP on logistics. Today, that figure has fallen to 10%. That seven percentage points of GDP productivity increase since 1977 undoubtedly contributed to all of the social improvements this country has enjoyed over those 25-odd years, including improved Medicare.and Social Security benefits. Absent deregulation, those improvements would not and could not have taken place.

As a direct result of the United States' successful Open Skies policy, much progress has also been made over the past decade in the struggle to achieve similar deregulation of international aircargo transportation. Indeed, the U.S. has now negotiated more than fifty Open Skies agreements in every region of the world. The U.S.-U.K. agreement remains an unfortunate exception to that trend.

Today, more than 50 years after the Chicago Convention, global aviation has undergone a radical transformation, yet the ability of U.S. all-cargo carriers to respond to the needs of shippers and consumers continues to be hampered by restrictive bilaterals such as the Bermuda H agreement. Its restrictions on beyond traffic rights, change of gauge and routing flexibility makes it a formidable obstacle to the efficient operation of US express operations serving the U.K.

Reviewing that "big parade: those same four macroeconomic forces—(1) hightech and high-value-added products, (2) globalization, (3) fast-cycle logistics, and (4) electronic commerce—keep marching along. While goods moved by air account for less than 2% of all tonnage moved in international trade, they now represent over 40% of its value. As recently as 1970, international trade accounted for only 10% of U.S. GDP. In 2000, it was approximately 25%. That means about a quarter of every dollar produced by our economy is now related to international trade, and this figure will increase in coming years. McKenzie and Company estimates that today, a little over 20% of all manufactured goods are moved across borders, but by 2025, that number may be in excess of 80%.

The current aviation bilateral system, originally designed for point-to-point passenger operations, continues to be used as a sword-and-shield by the U.K. government on behalf of its carriers to resist meeting true market demands in the express and cargo markets. This forces both U.S. and U.K. exporters and importers of goods by air to accept less efficient less desirable services. Numerous independent studies around the world have verified this finding in economies with restrictive international aviation regimes.

We at FedEx strongly believe that all-cargo services are commerce-enablers and should be fully and fairly liberalized, whether in conjunction with or separately from combination services. In that regard, we applaud the U.S. Government's successful efforts to include 7th freedom rights for all-cargo carriers in its recent Open Skies bilaterals such as the recent agreement with France.

It is important to remember that the cargo business is not bilateral in nature, so the very foundation of a bilateral aviation treaty is at odds with the flow of goods around the world. In the same vein, the 5th and 6th freedom rights should be -treated exactly the same, which was the original interpretation in the 1944 Chicago Conference. Because this has not been the case, British carriers now enjoy a competitive advantage over U.S. carriers based purely on the geography of their home countries. Accordingly, we urge the U.S. Government, in negotiating with countries around the world, to require as a matter of course direct equality of 6th freedom rights to 5th freedom rights, at least as applied to all-cargo operations. This can best be achieved by an open skies agreement with no limitation on fifth freedom operations.

The U.S. Government must also strive to ensure that rights granted U.S. carriers under our bilaterals, including our Open Skies agreements, are fully useable. U.S. carriers are increasingly confronted with capacity and envirom-nental restrictions at airports around the world, These defacto restrictions on our operations often effectively trump our dejure rights under the bilaterals.

Some passenger carriers have attempted to use this concept of "fully-useable rights to insist that an agreement with the United Kingdom that does not falfill all their desires for slots at London's Heathrow Airport does not achieve true liberalization. It is important for this Committee to understand that Heathrow is one of three London airports. While it is historically prized by combination ' carriers for its status as a connecting airport, that role is being significantly challenged by the growth of powerful alliance hubs on the European continent. We should not let the issue of access to a single airport stop the effort for open skies in this long restricted market, Instead we should be pressing our European and British counterparts to reform the slot trading system in Europe, so that U.S. and other carriers seeking access to a slot-resuicted airport can in fact use self-help to gain access rather than continuing to rely on governmental intervention. Also, we should continue to urge an increase in capacity as well as the most effective use of that capacity at British airports.

FedEx has been actively advocating this position in the U.S. Department of Transportation proceedings on the alliance, a position that FedEx. has put forward for at least ten years of debate over U.S.-U.K. open skies. This is a great opportunity to move forward toward open opportunities for all carriers in the important transatlantic corridor linking the U.S. and the U.K. We should not let it slip away.

Statement of Hon. James M. Inhofe, a U.S. Senator from the State of Oklahoma

Chairman Kohl and Senator DeWine, thank you for the opportunity to appear before your Subcommittee. Much of the hearing today will focus on issues relating to the United Kingdom. As you know, I sit on the Armed Services Committee, and I can tell you that now more than ever, Great Britain is this country's staunchest ally and closest friend.

Consistent with this bond, virtually every aspect of commerce between our two great countries is open and unrestricted, as it should be. Every aspect, that is, except commercial air travel. I have watched for many years as we have tried to renegotiate with the British the three decades old, highly restrictive, anti-free market bilateral treaty, known as Bermuda 2. It has been a difficult and unproductive process.

However, today we have a window of opportunity to scrap Bermuda 2 and open up the skies between the U.S. and U.K., which will lead to lower airfares and more service. Great Britain's largest airline, British Airways, would like to secure U.S. approval for its proposed alliance with American Airlines. Similarly, Britain's second largest carrier, British Midland, would like to start flying to the U.S. from London's Heathrow Airport for the first time ever as well as gain U.S. approval of its proposed alliance with United Airlines. Overarching these commercial desires is the fact that the European Union is actively seeking to wrest the right to negotiate such accords away from the British and other European nations by the end of this year. Once this occurs, the opportunity to open the skies between the U.S. and the U.K. will be gone for many years to come, as the EU will surely develop and pursue its own aviation agenda.

Let's not squander the opportunity before us. The American Airlines/British Airways alliance is the catalyst for open skies, and I fully support the regulatory approval of that alliance. United has its alliance with Lufthansa, Delta has its alliance with Air France, and Northwest has its alliance with KLM. So should American have its alliance with British Airways. I ask that a letter sent today to Secretary of Transportation Mineta and Secretary of State Powell by myself and Senators Harkin, Durbin, Carnahan, Boxer, Ben Nelson and Allard supporting the AA/BA alliance and open skies with the British be included in the record.

In closing, I understand that several airlines, having already gotten their alliances approved, are lining up to block American. Indeed, like pigs at the trough, they are throwing around their wish lists for slots at Heathrow, to be presumably divested by BA and American. They do this without identifying any justifiable competition grounds. Quite simply, they either want to get lots of free slots or to cause the ANBA deal to fail.

I hope you and the DOT can see through all that. The time is ripe for finally concluding a U.S.-U.K. open skies accord that will be good for air travelers on both sides of the Atlantic and will serve to bring two strong allies even closer together in these most trying of times.

Thank you.

UNITED STATES SENATE
WASHINGTON, DC 20510
November 2, 2001

The Honorable Colin L. Powell
Secretary
Department of State
Harry S. Truman Building
2201 C Street, N.W., Room 7226
Washington, D.C. 20520

The Honorable Norman Y. Mineta
Secretary
U.S. Department of Transportation
400 Seventh Street, S.W., Room 10200
Washington, D.C. 20590

Dear Secretary Powell and Secretary Mineta:

The United Kingdom, now more than ever, is this country's staunchest ally and closest friend. Consistent with this enduring bond, virtually every aspect of commerce between the two countries is generally open and unrestricted. Every aspect, that is, except commercial air travel.

As you are aware, the United States and United Kingdom have been negotiating to replace the three decades old, highly restrictive bilateral air service accord, known as Bermuda 11, with an "open skies" accord. Bermuda 11 limits direct air service from the United States to the premier overseas airport, London Heathrow, to only 2 U.S. airlines and 12 U.S. communities. As has been the track record with open skies accords that our country has signed with many other nations, the removal of such restrictions produces more service, increased competition, and lower airfares. Indeed, in this case, the benefits of an open skies accord will be overwhelming, as four additional U.S. airlines and many U.S. communities will be allowed direct access to Heathrow for the first time. Among other avenues to secure take off and landing slots, U.S. carriers as "new entrants" will receive priority in obtaining new slots at Heathrow thereby bringing about these benefits. In addition, some U.S. carriers with existing partners are likely to be able to immediately redistribute slots in their European partner's hands, this being clearly advantageous to those partnerships. Accordingly, we respectfully urge you to press forward with this effort.

The window of opportunity for securing an open skies accord with the British is clear but narrow. The United Kingdom's largest airline, British Airways, would like to secure U.S. approval for its proposed alliance with American Airlines.

Similarly, Britain's second largest carrier, British Midland, would like to start flying to the United States from Heathrow for the first time ever as well as gain U.S. approval of its proposed alliance with United Airlines. Overarching these commercial desires is the fact that the European Union is actively seeking to and most likely will, wrest the right to negotiate such accords away from the British and other European nations by the end of this year. Once this occurs, the opportunity to open the skies between the United States and the United Kingdom will be gone for many years to come, as the EU will surely develop and pursue its own aviation agenda.

As such, the time is truly ripe for these two great nations to come together to achieve what has been the goal of the previous three U.S. Administrations. Without question, the proposed American Airlines/British Airways alliance is the catalyst that has enabled this historic opportunity to arise. American Airlines and British Airways seek only what their main transatlantic competitors were granted years ago. In conjunction with the signing of open skies accords, the United States in 1993 granted antitrust immunity to the alliance of Northwest Airlines and the Dutch carrier KLM and in 1997 to the alliance of United and the German carrier Lufthansa. Moreover, all indications are that Delta Air Lines and Air France will be granted immunity for their proposed alliance by the end of this year in concert with a U.S.-France open skies agreement.

Indeed, over the past decade, the U.S. government has actively encouraged the formation of such international airline alliances as it has sought to deregulate the international marketplace. The resulting positive benefits for consumers in terms of more service and lower fares have been well documented by the Department of Transportation. Going forward, adding more immunized alliances to the mix will increase alliance-versus-alliance competition and further the success of U.S. policy.

Accordingly, approving the proposed American/British Airways and United/British Midland alliances in conjunction with concluding a U.S.-U.K. open skies accord will be good for air travelers on both sides of the Atlantic and will serve to bring two strong allies even closer together in these most trying of times.

Thank you for considering our views. We are sincerely,

Senator Inholf and Senator Harkin

Statement of Jack W. Creighton, Chairman and Chief Executive Officer, United Air Lines, Inc.

I. INTRODUCTION

Mr. Chairman, Ranking Member DeWine, and other distinguished members of the Subcommittee, United appreciates the opportunity to provide these written comments on the important subject of global airline alliances.

At present, the Department of Transportation has pending before it three applications that airline alliances have filed for antitrust immunity: United, Lufthansa, SAS and the Austrian Group seek to add bmi british midland to their existing antitrust immunity; Delta, Air France, Alitalia and Czech Airlines have filed for quadrilateral immunity; and American Airlines and British Airways have renewed efforts to secure immunity for an alliance that regulatory authorities on both sides of the Atlantic rejected three years ago. As requested by the Subcommittee, these written comments seek to examine the effect that the grant of the pending applications for antitrust immunity would have on global airline competition.

As a preliminary matter, United would like to provide some general comments on the positive contributions that open skies, airline alliances and antitrust immunity have made to competition in the airline industry and to overall consumer welfare. We will then analyze each of the proposed alliances in turn.

II. OPEN SKIES, AIRLINE ALLIANCES AND ANTITRUST IMMUNITY

United has been a vocal advocate of the liberalization of air service markets for many years. United was alone among U.S. combination carriers to support deregulation of the U.S. domestic market in the late 1970s. United has also consistently supported the open skies initiative conceived by DOT in the early 1990s. To date, the U.S. has concluded some 50 open skies agreements. Most recently, the U.S. scored a notable success when it agreed in principle to an open skies agreement with France, thereby finally opening one of the largest markets in the world to unfettered competition. It also appears that after years of patience and perseverance, the U.S. may be close to concluding an open skies agreement with the U.K.

The empirical evidence amply demonstrates the wisdom of DOT's open skies philosophy. In its October 2000 report entitled "International Aviation Developments: Transatlantic Deregulation, The Alliance Network Effect (Second Report)," at p. 3, DOT found that average fares to open skies countries in 1999 had declined by twenty percent overall when compared with 1996. Fares to non-open skies countries had also declined, but at "significantly lower rates." *Id.*

Open skies also amplify the benefits that flow from airline alliances. Alliance benefits depend upon the existence of truly open aviation markets - markets free not only of formal bilateral restrictions but also free of sovereign protectionism and government efforts to "manage" or artificially manipulate the market for aviation services.

The benefits of alliance networks are realized through the rationalization and harmonization of two or more formerly separate airline networks. In an airline alliance, two or more disparate route networks are blended, extracting efficiencies, eliminating redundancies, reallocating capacity and streamlining services. Rationalized and harmonized alliance networks often result in new services to behind and beyond citypairs, as well as enhanced frequencies to existing city-pairs. Alliance networks are also generally credited with stimulating growth in traffic demand.

Rationalized alliance networks, especially those designed around the various hubs of the parties, are also able to realize substantial economies of scope and scale.

Economies of scope arise from the fact that the more spokes a carrier serves from a hub, the greater its ability, with a given number of aircraft, to transport passengers from many origin points over its hub to many destination points. Economies of scale arise because by expanding the number of spokes, the number of city-pair combinations that can be served increases exponentially. These efficiencies are amplified by integrating international hub-and-spoke systems between and among air carriers in a network. By linking hub systems, the networks also connect all of the spokes at either end of the system into unified air service systems.

The growth of global alliances has created competition for passengers in a large number of city-pairs that airlines, acting alone, could not economically serve. As alliances continue to expand, so too do the markets and consumers that benefit from competitive service. In its October 2000 study, DOT estimated that by the third quarter of 1998, "two or more. . .alliances carried almost 800,000 passengers in over 3,000 overlap [US-Europe] city pair markets, representing strong evidence that the alliances are developing a more competitive industry structure." *Id.* at p. 9.

Antitrust immunity permits airline alliances to maximize efficiencies by fully integrating and coordinating operations in areas including service capacity, planning, pricing and marketing. These greater efficiencies directly benefit passengers. A recent econometric study reveals that passengers traveling over an immunized alliance network enjoy deep discounts over the fares offered under traditional interlining arrangements. Professor Jan K. Brueckner, "The Benefits of Codesharing and Antitrust Immunity for International Passengers, with an Application to the Star Alliance" (July 2000). Using data from DOT's Passenger Origin Destination Survey, the study focused on three measures of airline co-operation: code sharing, alliance membership and antitrust immunity. The results show that, together, these three forms of co-operation lead to a substantial 27 percent reduction over traditional interline fares. Of this 27 percent, code sharing itself accounts for 7 percent, alliance membership for 4 percent and antitrust immunity for a full 16 percent. This conclusion shows that, in addition to enjoying the convenience gains made possible by airline co-operation, passengers reap substantial benefits in the realm of pricing, paying substantially lower fares as a result of cooperative behavior, particularly where the co-operative behavior takes place under the umbrella of antitrust immunity.

It is clear that the importance of alliances will further increase in the new market conditions that prevail post September 11, 2001. As each individual carrier re-assesses the services it operates and seeks to rationalize the number of destinations served, there will be greater dependency on alliances to enable the individual carriers to carry out the necessary rationalization, while at the same time ensuring that they are still able to offer their customers a large network. On the expenditure side, alliance carriers can reduce their combined costs through joint purchasing of aircraft, spare parts, and other supplies and services. On the revenue side, airlines will depend more than ever on their ability to market the tickets of their partners to attract additional passenger flows.

The competing applications for immunity and their effect on competition in the transatlantic market must therefore be seen in the context of inter-alliance network competition. Currently, five alliances compete for transatlantic traffic. Some have already secured, and others are currently seeking, antitrust immunity. They are:

- United/bmi/Austrian Group/Lufthansa/SAS;
- Delta/Air France/Alitalia/Czech Airlines;
- American Airlines/British Airways;
- Northwest/KLM; and
- American/Swissair/Sabena.

The first three alliances on this have pending antirust immunity applications with the DOT. The last two alliances already have such immunity. An examination of the seat share of each alliance demonstrates that vigorous inter-alliance competition exists on the transatlantic. The American Airlines/British Airways alliance is the largest alliance in the transatlantic with a 21.9 percent seat share. United/bmi/Lufthansa/SAS/Austrian Group has a 20 percent seat share, Delta/Air France/Alitalia/Czech Airlines 17.8 percent, American/Swissair/Sabena 13.2 percent and Northwest/KLM 7.9 percent. OAG, September 2001. This competition will continue, and will likely intensify, should DOT grant the pending applications for antitrust immunity.

It is important to recognize, however, that not all alliances contribute equally to the enhancement of competition. Indeed, alliances can harm competition where the networks of their individual members are overlapping rather than complementary. Thus in its public comments on American/BA's earlier attempts to secure immunity, DOJ voiced opposition to the alliance in large part because American and BA were the largest carriers in the U.S.-U.K. market and offered overlapping nonstop services on six U.S.-London city pairs that accounted for more than half of total U.S.-

London traffic. Comments of the Department of Justice, OST–97–2058 (May 21, 1998), at p. 4. By contrast, in approving the application to add the Austrian Group to the then existing United/Lufthansa/SAS immunity earlier this year, DOT emphasized that none of the four carriers operated overlapping nonstop services in the U.S.-Austria market and thus the integration of the Austrian Group would not lead to a reduction in nonstop competition in the U.S.-Austria market. OST–2000–7828 (January 26, 2001), at p. 7.

Thus DOT must examine closely each immunity application on its own merits. Special attention should be given to the question of remedies. The remedies imposed should seek to accomplish two goals: to cure the anti-competitive effects of any proposed arrangement and to ensure that all alliances are accorded equal treatment so that they can compete on a level playing field.

III. UNITEDLBMI/AUSTRIAN GROUP/LUFTHANSA/SAS

The application to add bmi british midland to the existing United/Lufthansa/SAS/Austrian Group antitrust immunity presents no competition problems because bmi does not operate nonstop services on any transatlantic city-pair that is served nonstop by the other applicants. Thus, the proposed alliance does not present problems that DOT and DOJ have associated with overlapping carrier networks and sought to address through remedies in prior immunity proceedings. Indeed, the restrictive terms of the current bilateral air services agreement between the U.S. and U.K. (Bermuda II) prohibit bmi from operating nonstop services to the U.S. from its main base of operations in Heathrow. Because United operates in the U.K. to/from Heathrow only, the networks that United and bmi seek to combine are complementary and have no overlaps.

Nor can United and bmi be considered even potential competitors. While it is true that bmi could operate from Heathrow under an open skies regime, bmi is not commercially or practically capable of operating any transatlantic services independently. bmi is a relatively small carrier with only three long-haul aircraft in its fleet suitable for transatlantic service. In terms of size, bmi is comparable to other small European airlines such as Czech Airlines and Finnair that, like bmi, have sought to enter into alliances in order to compete on the transatlantic. Additionally, bmi is without a meaningful market presence, corporate identity and operational infrastructure in the U.S. Without the substantial sales, marketing support and network feed afforded by United, bmi would be unable to bear the considerable risks and costs associated with entering the transatlantic market. Finally, bmi lacks the long-haul slots and facilities at Heathrow, which are necessary to launch services to the U.S. in large part because Bermuda II prohibits it from operating to the U.S. from Heathrow.

Even if bmi could commercially enter the transatlantic market independently, its elimination as a potential competitor on any of the six U.S.-London city pairs where United currently operates nonstop service (London-Boston, Chicago, Los Angeles, New York, San Francisco and Washington, DC) would not lead to a substantial reduction in competition. In each of these city pairs, United faces vigorous nonstop competition from at least two and, in one case, five other carriers. An analysis of the CRS booking shares on each of the city pairs for the 12 months ending August 2001 shows that on none of the six city-pairs does United currently have a share of total CRS bookings greater than 31.4 per cent, on four of the six city-pairs United has a share of total bookings below 21.3 per cent and on three of the six city-pairs its share is 18.1 per cent or lower. Thus, the addition of bmi to the existing immunity will have no negative impact upon competition in the U.S.-U.K. market. Instead, as described more fully below, the addition of bmiwould create an alliance hub at Heathrow that has the potential to offset some of the anticompetitive consequences of the proposed American/BA alliance.

Therefore, the grant of immunity to the proposed bmi alliance should be made effective with the conclusion of the U.S.-U.K. open skies agreement, even if immunity for American/BA alliance is deferred.

IV. DELTA/AIR FRANCE/ALITALIA/CZECH AIRLINES

United does not object to the grant of antitrust immunity to this alliance. Indeed, United believes that approval of the proposed alliance will increase inter-alliance competition for transatlantic passengers. United's support is not without qualification, however. First, DOT must subject the alliance to the traditional remedies that it has imposed on prior alliances, including carve-outs on overlapping nonstop routes. Second, United believes that the Delta alliance enjoys an unfair competitive advantage over other alliances at Charles de Gaulle airport. The Delta alliance is housed in Terminal 2 which boasts state-of-the-art facilities and plays host to the

modern intermodal transportation available at the airport. DOT and the Department of State have requested the French Government to level the competitive playing field by providing a high-speed rail link between Terminal 2 and Terminal 1, where United and some of its alliance partners are housed.

V. AMERICAN AIRLINES/BRITISH AIRWAYS

In United's view the American/BA application raises more significant competition issues than the other two pending applications. Indeed, in its May 1998 comments, the DOJ also recommended that the alliance be subject to considerable remedies to cure its anti-competitive effects, including the forfeiture of over 300 slots at Heathrow.

An examination of the existing competitive landscape at Heathrow amply justifies the concerns expressed by DOJ three years ago. The U.S.-UK market is the largest intercontinental market in the world, with over 18 million passengers traveling annually on flights between the UK and the U.S. To put the importance of the U.S.-UK market in perspective, U.S.-UK bookings account for approximately 27 percent of all U.S.-Europe bookings.

American and BA have a combined share of 40 percent of all U.S.-UK local traffic. Together, they have a combined share of 43 percent of all U.S.-London local traffic. American/BA's leading alliance competitor in the U.S.-UK market, the Star Alliance, has 16 percent of all U.S.-UK traffic and 17 percent of U.S.-London traffic. The shortfall between the two alliances in the U.S.-U.K. and U.S.-London markets runs counter to the argument advanced by American and BA that they need immunity to compete effectively against United and its alliance partners.

Presently, American and/or BA are the only non-stop operators in eleven U.S.-UK city pairs. In six of these city pairs, American and BA offer nonstop overlapping services. Additionally, BA has a rich portfolio of slots and facilities at Heathrow that could be rededicated easily to the lucrative transatlantic market once open skies are in place and the restrictions enshrined in Bermuda II removed.

United does not oppose the proposed American/BA alliance. However, we consider that the U.S. government should take three very important steps to preserve competition in the U.S.-U.K. market in the wake of the proposed American/BA alliance.

First, the U.S. government should reach an immediate and full open skies agreement with the U.K. rather than a transitional arrangement that is linked to the commercial needs of American/BA. A full open skies agreement will immediately inject muchneeded competition into one of the most important, yet one of the most restrictive, aviation markets in the world.

Second, the U.S. government should ensure that any approval of the American/BA alliance is accompanied by reasonable access to Heathrow and Gatwick airports so that all transatlantic alliances are given the opportunity to fully integrate London into their networks and to compete for the large local passenger base. As noted earlier, the formation of global alliances has created global network competition between alliance hub and spoke networks. To promote this inter-alliance network competition, and to avoid the possibility that the American/BA alliance is free to price unilaterally in the U.S.-U.K. market, it is essential that alliance partners be able to connect their networks at London.

Third, the bmi immunity should be implemented at the same time as American/BA, or earlier, if American/BA immunity is artificially delayed or phased in. In any event, bmi immunity should be made effective with the conclusion of the U.S.U.K. open skies agreement.

Indeed, approval of the proposed United/bmi alliance is the most effective means available to ensure that American/BA faces meaningful competition in the U.S.-London market. Because U.S.-London traffic lacks convenient competitive one-stop alternatives over EU hubs, it is critically important that there be a viable competitive alliance in London. In its May 1998 comments, DOJ expressed grave doubts that "a patchwork of replacement carriers will replicate the rivalry that currently exists between AA and BA across a large number of U.S.-U.K. city pairs." DOJ Comments, at p. 4. Subsequent to DOJ's comments, bmi joined the Star alliance. As a result of bmi's hub at Heathrow, the United/bmi alliance is more likely to replicate existing competition between American and BA for the large London passenger base than alliances that lack a developed hub at Heathrow. Thus, with the appropriate slots and facilities at Heathrow, United and bmi could potentially offer American/BA strong network, as opposed to "patchwork," competition in the U.S.-London market.

Mr. Chairman, let me conclude by saying that for airlines like United and other network industries, global alliances are a consumer-driven response to demand for efficient and competitively priced worldwide services. Given the importance of air

transportation in our increasingly interdependent global economy, it is imperative that competition policies, both here and abroad, not undermine the globalization of air services through alliances that clearly serve the needs of the world's consumers. At United, we believe that the proposed alliances currently under DOT review will intensify inter-alliance competition in the transatlantic and enhance consumer welfare provided that DOT takes the steps necessary to cure any anti-competitive effects and to ensure that all alliances are allowed to compete on an equal footing.

5 November 2001

The Honorable Herbert Kohl
Chairman
Sub-Committee on Anti-trust, Business Rights & Competition
Committee on the Judiciary
308 Hart Senate Office Building
Washington DC 20510

The Senate Sub-Committee on Anti-trust, Business Rights and Competition has scheduled hearings on international airline alliances and aviation competition for 7 November. I understand that the hearing will look at the issue of airline alliances, antitrust immunity and "Open Skies" air services agreements.

The UK has a strong interest in this issue. Two UK airlines (BA and bmi British midland) are currently seeking anti-trust immunity for alliances with US airlines (American Airlines and United respectively), and the UK Government is intent on concluding negotiations with the US Government to secure a new, liberalised UK/US air services agreement.

The UK Government therefore very much welcomes the opportunity to set out its position, and I enclose a copy of our written testimony.

I am sending a copy of this letter to the Secretary of State, the Honorable Norman Mineta, the Honorable Pat Leahy, the Honorable Orrin Hatch and the Honorable Mike DeWine.

CHRISTOPHER MEYER

Statement of UK Government

INTRODUCTION

1. The UK Government is grateful for this opportunity to set out its position on, and reaffirm its commitment to, the liberalisation of the UK/US aviation market, in the context of the SubCommittee's hearing on international airline alliances and aviation competition.

2. The UK has a strong interest in this issue, given that two of its airlines (British Airways and bmi British midland) are currently seeking anti-trust immunity for alliances with US airlines (American Airlines and United respectively), and that the UK Government is intent on concluding negotiations with the US Government to secure a new, liberalised UK/US air services agreement. Recent events have made it more urgent than ever to conclude these negotiations swiftly and successfully.

UK/US AIR SERVICES

BACKGROUND

3. The UK Government is firmly committed to liberalising air services between the UK and the US. Throughout negotiations on the revision of the current air services agreement Bermuda II—we have made it clear that we are willing to envisage a wide-ranging liberalisation that would open the UK/US market to the carriers of both sides and increase competition to the benefit of consumers. Our only precondition—and it is a precondition which the Sub-Committee will doubtless both understand and support—is that the newly liberalised market should embrace the principles of fair competition and provide equal opportunities for the carriers of each side.

4. The domestic market for UK carriers is effectively the whole of the European Economic Area (the 15 member States of the European Union and Iceland and Norway). The UK Government has no wish to exclude US carriers from its domestic

market. On the contrary, we view vigorous competition as something to be striven for, for the benefit of consumers, the health of competing airlines and the greater good of our respective economies. However, we note that the US Government's "Open Skies" proposals provide US carriers with access to that market without providing reciprocal access to the US domestic market to UK carriers. It is difficult to reconcile such a one-sided arrangement with the principles of fair competition, nor is it easy to see why consumers—be they US or UK—should be burdened in perpetuity with the consequences of a regime which protects some carriers from the disciplines of fair competition.

5. This is far more than a partisan debating point. In competing for traffic on transatlantic routes US carriers have the distinct advantage of protected access to feed traffic from their large domestic market, with UK carriers being at a particular competitive disadvantage on routes to US hub airports where a very large proportion of traffic is carried by a single US carrier (BA are responsible for only 37% of the air transport movement at Heathrow, whereas many US carriers operate over 80% of the services to and from their hubs e.g. Atlanta, Cincinnati, Houston, and Minneapolis).

6. If US carriers are to have unrestricted access to the UK's international and intra-European market, the principles of fair competition demand that UK carriers must also have effective access to the US domestic market. In negotiations throughout the 1990s the UK Government has put forward a number of options for achieving this and thereby allowing a wide-ranging, balanced liberalisation of UK/US services—to the benefit of both consumers and carriers:

(a) alliances, such as those proposed between British Airways and American Airlines, and now, additionally, between bmi British midland and United;
(b) a liberalised inward investment regime, which would allow UK carriers to buy a controlling interest in a US carrier (foreign ownership is currently limited to 25%);
(c) the grant of cabotage rights.

7. To allow time for the enactment of the necessary legislation in the US, the UK Government also put forward proposals for phasing in full liberalisation. Unfortunately, none of the options outlined above has so far proved acceptable to the US Government. It has not, therefore, been possible to make the progress which the UK Government had hoped for in revising Bermuda II.

THE RECENT PAST

8. The UK Government believes, however, that the prospects for achieving liberalisation are now better than they have ever been.

9. Two UK airlines, British Airways and bmi British midland, have applied to the competition authorities for immunisation of their proposed alliances with US carriers, and the competition authorities on both sides of the Atlantic are making progress with their examination of the competition effects. It would not be proper for the UK Government to comment on the remedies that might be appropriate. That is for the competition authorities to decide. But we are aware that BA and American Airlines have argued to the competition authorities that the remedies should be less stringent than those previously recommended because BA's and AA's market position is less strong than previously as a result of recent market developments, in particular the direct competition offered at Heathrow by The Star Alliance now that bmi British midland is a member. Members of The Star Alliance account for 27% of Heathrow slots. We are also aware that, in the case of other alliances, the US Department of Transportation has recognised that alliances can produce important consumer benefits, in terms of improved quality of service—for example, through improved scheduling of connecting journeys—and through fare reductions;[1] and will take account of these benefits when considering the competition remedies required to offset market concentration in certain point-to-point markets. The aftermath of the events of 11 September in the US have made the airlines' market even more competitive and given further advantage to those airlines already in alliances.

10. The UK Government recognises that if the UK airlines—BA and bmi British midland—are able to accept the remedies proposed by the competition authorities, and their alliances with US carriers are immunised against anti-trust actions, that would secure for two of the UK's transatlantic carriers effective access to the US

[1] US DoT October 2000 report entitled "Transatlantic Deregulation: The Alliance Network Effect": "Alliance based networks are the principal driving force behind transatlantic price reductions and traffic gains. . .we can expect greater consumer benefits as alliances continue to evolve and expand."

domestic market, the principal condition for the UK agreeing to liberalisation of the UK/US market.

TIMING

11. Other bilateral issues remain but, for its part, the UK Government sees no impediment of substance to the resolution of these issues in bilateral negotiations before the end of 2001. There is therefore a very good prospect of achieving within weeks the liberalisation of the UK/US aviation market that has long been the declared objective of both Governments, and the UK Government views with dismay the efforts of those who would defer sine die the benefits to consumers of such a development simply to protect their own commercial interests, or those of their alliance partners. The UK Government notes the sentiments underlying the filings of both the US Air Travelers Association and Professor Darryl Jenkins of the Aviation Institute of the George Washington University in the BA/AA case.[2]

12. It is reinforced in this view by the fact that all parties recognise that the next few months may prove to be the last chance to conclude a liberalised bilateral agreement. That is because the European Court of Justice is expected to deliver its verdict in early 2002 in the case of the European Commission's contention that other member States' "Open Skies" agreements with the US are not in accordance with EU law. That verdict could make it impossible for EU Member States to conclude further bilateral agreements with the US.

CONCLUSION

13. The UK Government attaches great importance to securing early decisions on the antitrust applications for AA's alliance with BA, and United's alliance with bmi British midland, thereby facilitating a significant liberalisation of the UK/US air services market. These alliances, and a new liberalised air services agreement, are if anything more important and urgent, not less so, as a result of the events of 11 September.[3]

14. At Camp David in February both President Bush and Tony Blair, the UK Prime Minister, confirmed the importance they attached to achieving further liberalisation of UK/US air services. The events of 11 September have reinforced the case for this, not weakened it, and the UK Government does not believe that the events of 11 September ought to delay the timetable. The US Department of Transportation appears to agree.[4]

15. We must therefore seize the last opportunity to resolve one of the longest-running irritants in UK/US bilateral relations, and to deliver on the commitment the President and Prime Minister made in February, when they undertook to intensify their efforts to liberalise fully the bilateral civil aviation relationship. Two allies, united in so much else, should be able to reach agreement on something that would be greatly to their mutual benefit.

Statement of Stephen M. Wolf, Chairman, US Airways Group

Dear Chairman Kohl:

Thank you for your invitation to testify on the proposed alliance between American Airlines and British Airways. While I will be unable to attend the hearing, I have prepared a few brief comments which I hope will be of some value to you and members of this Subcommittee as you seek to ensure meaningful access for U.S. car-

[2] Docket number OST–2001–10387–91 dated 29 October and Docket number OST–2001–10387–94 dated 31 October.

[3] Continental Airlines Chairman Gordon Bethune appears to agree. He is quoted in the PioneerPlanet/St Paul (Minnesota) Pioneer Press on 2 November as saying that "alliances are more important today. . .our alliance with Northwest is an important part of our profitability".

[4] US DoT Order 2001–10–13 dated 26 October 2001, in denying a petition of Continental Airlines: "We are not at this point convinced, however, that these effects have been so imponderable that no reasoned analysis of the issue relevant here remains possible. The commercial aviation industry has always been fluid, complex, and unpredictable. . .Moreover, all carriers are striving to return to as normal an operating environment as is possible since September 11. To the extent that they believe that the competitive landscape has changed, the parties may address the nature and consequences of those changes in their answers and replies. . .We are aware of the burden on the parties of continuing with regulatory proceedings in the present difficult circumstances, and we have tried to reduce that burden by extending procedural dates. However, the responsibilities of government continue. We are committed to carrying on the business of government, and this includes processing applications for antitrust immunity.".

riers to the U.S.-U.K. aviation market- the largest and most vital intercontinental a'iation market in the world. I would appreciate your making this letter part of the official hearing record.

At the outset, I want to clearly state that US Airways does *not* oppose alliances. International alliances have proven to create substantial benefits for consumers in the form of lower fares and more efficient services. Moreover, I do *not* advocate that the U.S. Government should refuse to negotiate with the British. I do*not* advocate that we reach no agreement with them. I do*not* advocate that this government set out on a course with a blind eye to the legitimate needs and concerns of our counterparts across the ocean. But, what I *do* advocate is that it is imperative, now, for our government to conclude an agreement that opens Heathrow to vigorous competition, which in turn will drive down artificially high fares in the U.S.-London aviation market.

For almost 25 years, U.S. consumers and U.S. carriers have suffered under Bermuda II and its capacity constraints, route limitations, pricing controls, and limited access to Heathrow Airport. This Subcommittee certainly does not need a detailed review of Bermuda II. Its origins and shortcomings have been catalogued by interested parties and commentators on both sides of the Atlantic for decades. Yet incredibly, Bermuda 11—an anachronism that obstructs progress and denies travelers the true benefits of competition—survives into the 21th century.

Almost three years ago, I expressed the sentiments of other industry officials, business leaders, and consumer advocates about the anti-competitive and anti-consumer nature of the Bermuda II agreement. I wrote then President Clinton encouraging him to renounce Bermuda II. Subsequently, the United States Government engaged in protracted negotiations with the British designed to open London's Heathrow Airport to vigorous competition that would result in meaningful benefits for consurners on both sides of the Atlantic. In the end, however, as in years past, the British rejected these liberalizing proposals, keeping in place Bermuda II and the cartel that has deterred competition and maintained its dominance over the U.S.-U.K. market.

Now, the United States and United Kingdom are, once again, planning negotiations about Bermuda II in conjunction with requests for antitrust immunity for U.S.-U.K. airline alliances. The U.K. is our strongest and closest ally. Since the horrific events of September 11th, the U.K. has proven to be an invaluable partner in the global fight against terrorism. However, when it comes to replacing the anachronistic Bermuda II regime, there are barriers that keep us far apart and prevent us from reaching a fair and equitable agreement. For example, having declined liberalized access for U.S. carriers at Heathrow Airport, it is my understanding that the British now seek to offer only limited entry to U.S. carriers and insist on antitrust immunity for their alliances, believing that if a new agreement cannot be reached on their conditions, the current Bermuda II regime will continue to work for the benefit of British Airways as it has done for the last 25 years.

I am concerned that the United States is lowering the bar by seeking to achieve a new aviation agreement with the British that will provide only minimal access and do little to rectify the lack of vigorous competition in the U.S.-Heathrow market while granting antitrust immunity to U.S.-U.K. alliances. This is not the way to proceed. Approval of an alliance on terms that continue to place U.S. carriers at a disadvantage and perpetuate the anticompetitive restrictions of Bermuda II should not, and indeed must not, be a policy option for the U.S. Government. For the benefit of U.S. communities and consumers, the international aviation policy of the United States for the world's most important international aviation market must be to open this market to vigorous and lasting competition. For US Airways, which has a sizable East Coast network, this means, at a minimum, commercially viable, competitive slots and groundside facilities at Heathrow from day one for four daily roundtrips from our three transatlantic gateways at Philadelphia, Pittsburgh, and Charlotte. And, it is a commercial reality that as a earner that operates only four daily roundtrips to London, US Airways cannot split its operations between Heathrow and Gatwick.

If such an agreement cannot be reached, this Subcommittee and this Congress must be prepared to take essential measures to protect the rights of U.S. consumers and communities. The U.S. Government must make clear that without a truly liberalized agreement, Bermuda Il will not survive. Only when the British recognize this reality will they understand that it is in their own economic interests to reach a fair agreement providing open access to Heathrow.

Mr. Chairman, I firmly believe that the competitive access required to open the U.S.-Heathrow market will not be achieved, unless and until the U.S. Government impresses upon the British that continuation of the anticompetitive Bermuda 11 regime will not be an option.

Thank you for allowing me to share my thoughts with you.