ORAL TESTIMONY OF

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Before

House Committee on Transportation and Infrastructure, Subcommittee on Aviation

Hearing on

The Proposed United-Continental Merger: Possible Effects for Consumers and the Industry

2167 Rayburn House Office Building

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Good morning Chairman Costello and Members of the Subcommittee. Thank you for the invitation to testify on the proposed merger of United Airlines and Continental Airlines.

In hindsight, it is easy to see that the merger is a culmination of Continental's efforts over the past two years to integrate its operations with United's. But a year ago Continental was insisting that it did not need to merge. Rather, the company pursued antitrust immunity to join United and twenty other airlines in the far-reaching Star

marketing alliance and United and other airlines in the Atlantic Plus Plus joint venture for transatlantic travel. Over the strenuous objections of the Department of Justice, which feared "substantial consumer harm," Continental received antitrust immunity and now can engage in flight code sharing, coordinate reservations and frequent flyer plans, and, under the joint venture, can even share revenues.

Now Continental and United are back, pursuing the merger they said last year was not necessary. When, last month, the proposed merger was announced, and at the request of the Mayor of Cleveland, I directed staff of the Domestic Policy Subcommittee of the House Oversight and Government Reform Committee, which I chair, to investigate its legal and policy implications. In addition to the significant antitrust concerns that I will briefly outline here, we have found the troubling possibility that Continental may not have been completely forthright with Congress and regulators with respect to its marketing alliance and joint venture last year or the proposed merger before us today. Yesterday, I sent a document request to Continental that is directly relevant to significant concerns produced by the inquiry (and discussed below) regarding the legality of the proposed merger under section 7 of the Clayton Act and the Horizontal Merger Guidelines, the merger's advisability as a matter of policy, and the

veracity of Continental's and United's representations regarding the merger's purposes and likely effects.

When Continental pursued antitrust immunity for its marketing alliance and joint venture, key stakeholders concluded that the alliance was in lieu of a full-blown merger. Senator John Cornyn stated last month at a Senate Judiciary subcommittees hearing that Continental officials informed him that the alliance and joint venture was an attractive alternative to Continental merging with United. Continental had explained to Senator Cornyn that a merger "wasn't in the best interest of its shareholders, employees or the communities [Continental] serves," antitrust immunity for the alliance and joint venture "would provide much of the benefit of a merger without the labor integration and financial risks," and "Houston and Cleveland would be some of the biggest losers in terms of jobs" in the event of a merger. Senator Cornyn and others wrote the Department of Transportation supporting antitrust immunity on the grounds that it was preferable to a full-scale merger between Continental and United that could lead to flight reductions and job losses.

Yet only one year later, after receiving government support for its entry into a marketing alliance, Continental is now pursuing a

merger. Is Continental's change in business strategy just a coincidence? I find that hard to believe. It is more likely that this was Continental's plan all along. Continental's apparent willingness to make whatever representations are necessary to garner support for its plans casts doubt on both Continental's stated motivations for the present merger and its intended post-merger conduct.

Continental and United have stated that they have no present plans to close hubs or to reduce services but instead plan to moderately decrease overhead costs and more substantially realize between $800 and $900 million of revenue gains by more effectively routing network customers through hubs for more profitable business and international flights and more efficiently deploying New United's larger fleet. Not surprisingly, Continental does not list cutting flights or raising fares as a means to revenue growth.

Market observers– including some who support the merger – take a different view. First, they doubt the magnitude of the merger-specific efficiencies. A substantial portion of the claimed network efficiency gains may already have been realized by Continental joining United in the Star Alliance and the A++ joint venture. Moreover, analysts point out that the purported cost and revenue synergies of past airline mergers have almost never materialized; and, despite the theoretical ability of low-cost and regional carriers to enter

markets exited by merging airlines, service cuts and loss of hubs have been a common consequence. Many analysts flatly predict that Cleveland will lose its hub and service to communities formerly served by the hub will not be supplied either New United service out of surviving hubs or low-cost carriers entering the market.

Perhaps more troubling, is the way industry analysts believe New United may increase its profitability – by eliminating up to ten percent of its post-merger capacity and increase and raising fares. According to many merger supporters, the industry's tens of billions of dollars of losses since deregulation are largely a product of destructive competition among airlines that has led to overcapacity and artificially low prices, and the New United and the industry in general would profit from the decreased number of market participants in efforts to reduce capacity and raise fares.

While sustained profitability for our domestic airline industry is important, I don't believe that destructive competition is the cause of the industry's ills and fear that as a remedy consolidation may well be worse than the disease. First, increased fares and declines in service are prototypical examples of the adverse competitive effects of the exercise of market power. Revenue gains based on these practices are not merger-related efficiencies under the law. Second it is possible that if any efficiency gains do materialize, they will be realized

through the Star Alliance and A++ joint venture. DOJ should carefully analyze the efficiencies from the alliance and joint venture and whether its fears regarding the possible anticompetitive effects of these immunized arrangements have materialized before it even considers approval of a full-fledged merger.

In addition, there are a number of other possibilities for anticompetitive behavior that could be exacerbated by further industry consolidation, such as the merger of American Airlines and US Airways that is predicted to occur if United and Continental merge. Others include increased market power in negotiations with bulk-buying business clients; increased leverage to force concessions from vendors, travel agents, and even localities, which may feel more pressure to provide publicly funded infrastructure and facilities. Finally, the size of a New United could raise the prospect of systemic importance (if not systemic risk) to the economy. Even if the New United is not officially considered "too big to fail," it will certainly be big enough to exert increased power over regulators. If the current financial crisis has taught us anything, it is the difficulty in predicting *ex ante* the myriad ways in which immense and concentrated corporate entities can leverage their corporate power to the detriment of citizens.

Assistant Attorney General Christine Varney has explained that the Administration's pursuit of "vigorous antitrust enforcement in this challenging era" will involve the development of competition policy based not simply on the case before it but on a consideration of "the overall state of competition in the industries in which we are reviewing," and "must consider market trends and dynamics, and not lose sight of the broader impacts of antitrust enforcement." It will be important for this Subcommittee to hold the Administration to that promise. For while traditional antitrust enforcement would examine the danger that competition would be immediately be reduced between city pairs that have been served by both incumbent airlines, such a limited analysis is not sufficient because it does not adequately capture trends and dynamics in the industry. DOJ should consider whether the New United will exercise market power to the detriment of consumers through the adoption of anticompetitive practices outline here and elsewhere.

Thank you.