COMPASS LEXECON

Reply Submission to the TDLC on Behalf of AA and LATAM

Compass Lexecon

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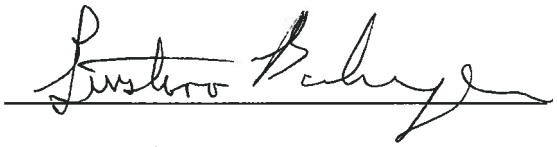
Prepared By



Gustavo Bamberger

I. INTRODUCTION.

1. At the request of counsel for American Airlines, Inc. ("AA"), TAM-Linhas Aereas, S.A., LATAM Airlines Group S.A. d/b/a LATAM Airlines, LATAM Cargo, Aerovías de Integración Regional, Aires S.A. d/b/a LATAM Airlines Colombia, and LAN Peru, S.A. (collectively, "LATAM"), we previously provided and presented several analyses to the Fiscalía Nacional Económica ("FNE") regarding the likely economic benefits and costs of the proposed Joint Business Agreement ("JBA") between LATAM and AA. We also recently made a submission to the Tribunal de Defensa de la Libre Competencia ("TDLC").[1]

2. We have been asked by counsel for AA and LATAM to review and evaluate two submissions to the TDLC on behalf of other parties: (1) a report prepared for the FNE by Leonardo J. Basso, David Gillen and Thomas W. Ross ("BGR"); and (2) a report prepared for the Asociacíon Chilena de Empresas de Turismo by F&K Consultores ("F&K").

3. We previously came to the conclusion that the proposed JBA would be procompetitive. Nothing in either the BGR or the F&K submission to the TDLC has caused us to change our prior conclusion. The rest of this rebuttal submission is organized as follows.

- In Section II, we evaluate the analyses of the competitive effects of the proposed JBA in the BGR and F&K submissions. Both BGR and F&K adopt the approach taken in our prior submission and analyze the proposed JBA by evaluating its net competitive effect – that is, both BGR and F&K compare the likely procompetitive effects of the proposed JBA to potential anticompetitive harms. Both submissions accept that the JBA may provide procompetitive benefits, but raise concerns that potential anticompetitive effects can outweigh the procompetitive effects. However, neither submission provides an empirical analysis of the effects of the proposed JBA. Instead, each relies on prior

1. *See* Presentación al TDLC en nombre de AA y LATAM, Compass Lexecon, 2 de mayo de 2017 ("Presentación al TDLC").

studies in the economics literature that are not analyses of metal-neutral joint ventures ("JVs") like the proposed JBA. In addition, while conceding the quality-enhancing effects of JVs, the BGR and F&K submissions do not consider those benefits in assessing the proposed JBA's net competitive effect.

- In Section III, we show that the criticisms of the Compass Lexecon Worldwide Study ("Worldwide Study") contained in the BGR and F&K submissions are unfounded.
- In Section IV, we respond to the BGR criticisms of our estimates of the JBA's benefits.
- We summarize our conclusions in Section V.

II. NEITHER THE BGR NOR THE F&K SUBMISSION PROVIDES AN EMPIRICAL ANALYSIS OF THE PROPOSED JBA.

4. Both the BGR and F&K submissions adopt the same "net benefit" approach to evaluating the effect of the proposed JBA as we do – each submission discusses a comparison of the procompetitive benefits and potential anticompetitive harm of the proposed JBA. Both BGR and F&K agree that the proposed JBA could provide benefits, but raise concerns that potential harms could outweigh those benefits. BGR, for example, discuss the potential for the proposed JBA to raise nonstop fares but recognize that the proposed JBA could also reduce connecting fares and increase traffic:

> If the airlines cooperated rather than competed in the setting of strategic variables such as prices, then non-stop passengers will be hurt by decreased competition. Multi-airline connecting passengers, though, might benefit because the double marginalization problem would be resolved, as this would now be a case of online connecting passengers, implying lower fares and consequently, more traffic. Therefore, a switch from pure competition to coordination between airlines would be beneficial to consumers on balance, if enough multi-airline connecting passengers benefit, such that these benefits dominate the harm to non-stop passengers.[2]

2. BGR, ¶ 28 (emphasis added). Although BGR recognize that reductions in connecting fares would be expected to lead to increases in traffic, they do not address our analysis of demand stimulation. *See* BGR, ¶ 118 (discussing the benefits that we analyzed in a prior report). Our analysis of demand stimulation is presented in Section IV of "Economic Analysis of the Benefits and Costs of the Proposed American Airlines LATAM Joint Business Agreement," Compass Lexecon, May 16, 2016. *See* Presentación al TDLC, Section IV for

F&K discuss potential benefits and harms and conclude that "it is not clear if the pressure to raise rates that results from the increase in market power would dominate over the pressure to lower them resulting from the use of network efficiencies and density and the partial reduction of the double marginalization problem."[3]

5. Because coordination between international airlines could potentially have procompetitive and anticompetitive effects, the question of whether the proposed JBA between LATAM and AA is likely to be on balance procompetitive cannot be evaluated on theoretical grounds and must instead be evaluated based on empirical evidence. BGR and F&K have not conducted any empirical studies, but instead rely on findings from the airline economics literature. However, the studies that BGR and F&K cite analyze different forms of airline coordination – for example, the effect of antitrust immunity ("ATI") on fares – but do not analyze the effect of JVs like the proposed JBA. For example, BGR rely on two studies by Gillespie and Richard ("G&R").[4] G&R study the effect of ATI on nonstop fares, but do not distinguish between ATI granted to alliance partners that are not members of a JV as compared to ATI granted to JV partners.[5] Because many of the ATIs analyzed by G&R are not JVs, the G&R studies do not provide an estimate of the effect of a JV on nonstop fares.

6. In contrast, the Worldwide Study distinguishes between different forms of cooperation – including ATI and JV – and directly analyzes the effect of JVs on airline fares and

(...continued)
our revised demand stimulation estimates.

3. F&K, § 6.2.2 (emphasis added).
4. *See* William Gillespie and Oliver M. Richard, "Antitrust Immunity and International Airline Alliances," Economic Analysis Group Discussion Paper, EAG 11-1, February 2011 ("G&R (2011)") and William Gillespie and Oliver M. Richard, "Antitrust Immunity Grants to Joint Venture Agreements: Evidence from International Airline Alliances," *Antitrust Law Journal*, 2012, vol. 78, *Antitrust Law Journal*, 2012, vol. 78 ("G&R (2012)"). G&R (2012) is a revised version of G&R (2011).
5. See G&R (2012), Table 1, at 447, which lists the year in which certain airlines received ATI, but does not distinguish between ATI for members of a JV and ATI in the absence of a JV.

traffic.[6] As we discussed in our prior submission, the Worldwide Study finds that JVs are uniquely procompetitive, leading to passenger benefits not realized through simple codesharing or even ATI. In particular:

- The Worldwide Study finds that JVs reduce fares on connecting routes. BGR appear to accept this result.[7]

- The Worldwide Study, like the G&R studies, finds that eliminating a nonstop competitor raises fares.[8] However, the Worldwide Study finds that implementing a JV is not equivalent to eliminating a nonstop competitor. Instead, the Worldwide Study finds no statistically significant effect on nonstop fares following the implementation of a JV.[9]

- The Worldwide Study finds that JVs increase traffic.[10] The BGR and F&K submissions do not appear to challenge these findings.[11]

- The Worldwide Study finds that JVs increase the average number of carriers providing service between the home countries of the JV partner airlines.[12] The BGR and F&K submissions do not appear to challenge these findings.[13]

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6. *See* Israel, Mark A., Robert J. Calzaretta, and Yair Eilat, "Airline Cooperation and International Travel: Analyses of the Impact of Antitrust Immunity and Joint Ventures on Fares and Traffic," (February 22, 2017), available at SSRN: https://ssrn.com/abstract=2921941 ("Israel et al.").
7. *See* BGR, ¶ 127.
8. G&R (2012) conclude that eliminating a nonstop competitor increases fares by "around 5 percent" (G&R (2012), p. 454). The Worldwide Study finds that eliminating a second or third nonstop competitor increases fares by between four and five percent. *See* Israel et al., Figure 11.
9. *See* Israel et al., Figure 11.
10. *See* Israel et al., Figure 8.
11. BGR say that "Gillespie & Richards (2012) would not support the applicants' capacity expansion claim" (BGR, ¶ 107). However, as in the case of nonstop fares, G&R evaluate the effect of ATI, not the effect of a JV, on capacity.
12. *See* Israel et al., Figure 14.
13. BGR claim that "when airlines establish alliances, there is an incentive to reduce entry. An incumbent airline would discourage an alliance partner from entering or expanding on a route in order to reduce capacity, and therefore reduce competition in a market. This effect is more likely the closer the alliance partner products are to being close or, at the extreme, perfect substitutes" (BGR, ¶ 106). Even if a JV partner is discouraged from entering because of the implementation of a JV, a rival firm could enter instead, so it is not clear even on theoretical grounds that the number of carriers on routes served by the JV partners would fall as a result of the JV. In any event, the empirical evidence presented in the Worldwide Study rebuts BGR's apparent claim by showing that the implementation of JVs tends to increase the number of JV partners providing nonstop service between the home countries of the JV partners (*see* Israel et al., Figure 14). BGR also claim that "[i]t seems, then, that antitrust immunity is not necessary for launching new non-stop routes" because AA launched nonstop service between Dallas/Fort Worth and Madrid "'more than one year

III. THE CRITICISMS OF THE WORLDWIDE STUDY IN THE BGR AND F&K SUBMISSIONS ARE UNFOUNDED.

7. The BGR and F&K submissions each contain criticisms of the Worldwide Study: (1) F&K appear to dismiss the Worldwide Study's analysis of nonstop fares because a large share of the nonstop routes in the Worldwide Study are flights between the United States ("USA") and Europe; and (2) BGR appear to question the approach and data used in the Worldwide Study. Both sets of criticisms are unfounded.

A. Criticisms by F&K of the Worldwide Study are Unfounded.

8. F&K claim that the "USA-Europe market [is] a strikingly different market from the relevant one in this case."[14] In particular, F&K claim that "the [USA-Europe] sample is not representative for South America, since the characteristics of the markets – such as size and degree of competition – are very different."[15] But "USA-Europe" is not a market, and so it is not appropriate to compare "USA-Europe" to "USA-Chile." Instead, "markets" in the airline industry are routinely defined as "city-pairs" or "origin and destination pairs" ("O&Ds"). For example, BGR agree that the relevant markets to study are O&Ds: "There is now a large consensus across countries and competition agencies that the relevant market for scheduled passenger air transport services is on the basis of the 'point of origin/point of destination' ('O&D') city-pair

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before oneworld got an immunity grant'" (BGR, ¶ 110, quoting G&R (2012)). But BGR do not analyze the effect of implementing the AA/British Airways/Iberia JV on the introduction of new nonstop service between the United States and Europe. After the implementation of that JV in 2010, the JV partners introduced nonstop service on at least 12 routes: Austin, Texas – London (Heathrow); New York (JFK) – Birmingham; New York (JFK) – Dublin; New York (JFK) – Edinburgh; Las Vegas – London (Gatwick); Los Angeles (LAX) – Madrid; Miami – Barcelona; Miami – Milan; Chicago (O'Hare) – Düsseldorf; Chicago (O'Hare) – Helsinki; San Diego – London (Heathrow); and San Jose – London (Heathrow).

14. F&K, § 6.3.3.

15. F&K, § 5.3. The Worldwide Study includes variables (e.g., number of carriers) that control for the level of competition on each O&D. The Worldwide Study also includes "fixed-effect" variables that control for factors that are specific to each route, including average market size.

approach."[16] F&K also analyze competition at the O&D level. For example, F&K report the "weighted average of relevant competitors in an O&D pair"[17] and report airline shares on an O&D basis.[18]

9. Because of the difference in traffic levels between USA-Europe and USA-Chile, F&K suggest that information from flights between the United States and Europe is not relevant to an analysis of flights between the United States and Chile: "Due to [United States-Chile] being a market of low traffic volumes and high fixed costs, the space for competition between airlines is reduced, which is why a low number of competitors for each O&D . . . pair and high market concentrations tend to be observed."[19] But the Worldwide Study's analysis of nonstop fares is based on nonstop flights between the United States and countries all over the world, not just flights between the United States and Europe. Furthermore, with respect to nonstop flights between the United States and Europe, the Worldwide Study contains many nonstop O&Ds with fewer passengers than the Santiago-Miami O&D, and in which the two largest carriers on the route have an aggregate share that is similar to or larger than the aggregate share of LATAM and AA on Santiago-Miami. In addition, the two largest carriers are members of the same JV for a substantial number of these O&Ds.

10. Table 1 lists 16 O&Ds between the United States and Europe with fewer passengers in 2015 than Santiago-Miami in which the two largest carriers are members of the same JV. In 2015, the aggregate LATAM/AA share of total passengers (including connecting passengers) on the Santiago-Miami route was 77.6 percent. On the 16 routes in Table 1, the aggregate share of the two largest carriers is between 60.9 percent and 90.6 percent; for seven of the O&Ds, the aggregate share of the two largest carriers is larger than the LATAM/AA share for Santiago-Miami. That is, the Worldwide Study includes a substantial number of nonstop

16. BGR, ¶ 43.
17. F&K, § 6.1.
18. *See* F&K, Table 2.
19. F&K, § 6.1.

O&Ds between the United States and Europe that are even smaller than Santiago-Miami; in which the two largest carriers have a similar share to LATAM/AA on Santiago-Miami; and in which the two largest carriers are members of a JV.[20] There is no basis to dismiss the Worldwide Study results because of a claim that characteristics of the markets included in that study "such as size and degree of competition – are very different" from the characteristics of Santiago-Miami. Instead, the Worldwide Study contains a substantial number of markets – O&Ds – that are similar to Santiago-Miami. Thus, the results of the Worldwide Study are relevant to O&Ds between Chile and the United States, like Santiago-Miami.

Table 1
Nonstop Routes Between the United States and Europe with Only Two Nonstop Carriers On Which The Two Nonstop Carriers are Members of a JV and Total Passengers In 2015 were Less than on Santiago-Miami

LATAM/AA Share of Santiago-Miami = 77.6 Percent (Including Connecting Passengers)

U.S. City	European City	Total Passengers (Including Connecting)	Nonstop Carriers	Aggregate Nonstop Carrier Share (Including Connecting)
New York, NY	Munich	215,925	LH/UA	60.9%
New York, NY	Geneva	199,499	LH/UA	72.0%
San Francisco, CA	Frankfurt	176,791	UA/LH	75.6%
Dallas/Fort Worth, TX	London	159,156	AA/BA	87.0%
Washington, DC	Frankfurt	134,884	UA/LH	72.9%
Chicago, IL	Frankfurt	119,419	UA/LH	77.2%
Detroit, MI	London	86,129	DL/VS	88.9%
Atlanta, GA	Paris	75,811	AF/DL	84.7%
Washington, DC	Brussels	71,139	UA/SN	69.2%
Chicago, IL	Munich	69,217	LH/UA	67.4%
Washington, DC	Munich	60,408	UA/LH	68.5%
Atlanta, GA	Amsterdam	52,298	DL/AF	88.7%
Detroit, MI	Paris	50,233	DL/AF	90.6%
Houston, TX	Frankfurt	49,991	LH/UA	81.7%
Minneapolis, MN	Paris	46,378	DL/AF	74.9%
Atlanta, GA	Manchester	34,716	VS/DL	84.1%

Source: Adjusted MIDT data for 2015.
Note: AA=American; BA=British Airways; UA=United; LH=Lufthansa; SN=Brussels; DL=Delta; VS=Virgin Atlantic; AF=Air France.

20. Four of the 16 O&Ds in Table 1 were "carved out" of the grant of ATI for part of the period analyzed by the Worldwide Study (New York – Geneva, July 2009 to June 2011; Washington, D.C. – Frankfurt, May 1996 to December 2010; Chicago – Frankfurt, May 1996 to December 2010; and Atlanta – Paris, January 2002 to June 2009). Those carve outs were eliminated when a JV between the airline partners was implemented. *See* Israel et al., Appendix B.

11. To the extent that it is appropriate to analyze markets on a country-pair basis, the aggregate nonstop seat share of the two largest carriers on many country pairs between the United States and Europe is similar to or higher than the aggregate nonstop seat share of LATAM and AA on United States-Chile routes. For seven country pairs, the two largest carriers are members of the same JV, and for five of those seven, the aggregate nonstop seat share of the two largest carriers is similar to or larger than the LATAM/AA share for United States-Chile.[21] Furthermore, there are four carriers that each account for at least 10 percent of nonstop seats between the United States and Chile (LATAM, AA, United Airlines and Delta Airlines). In contrast, five of the country pairs in which the two largest carriers have an aggregate nonstop seat share that is similar to or larger than the LATAM/AA share have only two carriers that each have at least a 10 percent share of nonstop seats (United States to Germany, the Netherlands and Switzerland) or three such nonstop carriers (United States to France and Spain). See Table 2.

21. Table 2 shows that United States – Belgium is of roughly the same size as United States – Chile in terms of nonstop seats. In 2015, the aggregate share of the top two carriers on United States – Belgium routes was 53.3 percent, as compared to the LATAM/AA share of 74.6 percent on United States – Chile routes. However, one of the carriers providing nonstop service between the United States and Belgium in 2015 was Jet Airways, an Indian airline that flew only one route between the United States and Belgium. In particular, Jet Airways offered nonstop service between Brussels and Newark, as one leg of a connecting flight from India to Newark (e.g., as one leg of a Mumbai-Brussels-Newark itinerary). Jet Airways discontinued Brussels-Newark service in March 2016 (*see* http://onemileatatime.boardingarea.com/2015/12/14/jet-airways-brussels/). For the second and third quarters of 2016, the aggregate nonstop seat share of the top two carriers on United States – Belgium routes was 76.6 percent (in comparison, the LATAM/AA share on United States – Chile routes in the second and third quarters of 2016 was 76.1 percent). Seat information is not yet available for the full 2016 calendar year.

Table 2
Top Two Nonstop Carrier Seat Shares Between the United States and Selected European Countries, 2015
Country Pairs with at Least Two Nonstop Carriers

Country	Seats	Number of Nonstop Carriers (10% Cutoff)	Largest Nonstop Carrier	Nonstop Seat Share	Second Largest Nonstop Carrier	Nonstop Seat Share	Aggregate Nonstop Seat Share	Are Top 2 Carriers in JV?
Chile	1,247,085	4	LA	44.1%	AA	30.5%	74.6%	
United Kingdom	23,307,328	4	BA	36.1%	VS	20.2%	56.3%	
Germany	12,406,108	2	LH	53.2%	UA	19.0%	72.1%	YES
France	8,364,384	3	AF	48.4%	DL	23.0%	71.4%	YES
Netherlands	5,743,174	2	DL	53.3%	AF	33.4%	86.7%	YES
Italy	3,804,740	4	AZ	31.4%	DL	22.7%	54.1%	YES
Spain	3,622,180	3	AA	33.7%	BA	32.7%	66.4%	YES
Ireland	2,921,982	4	EI	57.3%	AA	14.7%	72.0%	
Switzerland	2,653,138	2	LH	60.8%	UA	19.4%	80.2%	YES
Belgium	1,511,168	4	UA	34.8%	SN	18.5%	53.3%	YES
Iceland	1,258,051	2	FI	82.2%	WW	12.4%	94.7%	
Denmark	1,038,472	2	SK	70.6%	DY	26.3%	96.9%	
Sweden	734,727	2	SK	48.9%	DY	38.5%	87.4%	
Portugal	650,454	4	TP	52.5%	S4	19.0%	71.4%	
Norway	586,310	3	DY	51.2%	SK	33.7%	84.9%	
Greece	237,463	2	DL	60.5%	AA	39.5%	99.9%	

Source: BTS T100 data.

Note: AA=American; LA=LATAM; BA=British Airways; VS=Virgin Atlantic; LH=Lufthansa; UA=United; AF=Air France; DL=Delta; AZ=Alitalia; EI=Aer Lingus; SN=Brussels; FI=IcelandAir; WW=Wow Air; SK=Scandinavian Airlines; DY=Norwegian Air; TP=TAP Portugal; S4=Azores Airlines.

B. Criticisms by BGR of the Worldwide Study are Unfounded.

12. BGR compare the Worldwide Study results with the results of two studies by G&R. BGR suggest that the Worldwide Study results are unreliable because the Worldwide Study relies on a different approach and different data than G&R. Specifically, BGR say that "Compass Lexecon uses a panel approach while [G&R] use a cross section approach. . . . A typical problem with using a panel data approach for US routes is that most of the data comes from DOT's DB1B data, which does not include tickets ticketed by foreign carriers that have no flights operated by U.S. carriers."[22]

13. BGR's description of the G&R study is incorrect. A "panel" approach refers to a study that includes information on various markets over time. For example, a panel approach in the airline industry can refer to the use of a data set that includes information on the same O&D over time. The Worldwide Study uses a panel approach, based on quarterly data from 1998 to

22. BGR, ¶ 102.

2015. Despite BGR's claim, the G&R (2012) study also uses a panel approach (for the shorter period 2005 to 2011). G&R explain that in their analysis: "The fare effects of the number of competitors and presence of an additional ATI carrier in a route are tested empirically using a panel approach."[23]

14. Also, despite BGR's suggestion that relying on DB1B data is a "problem" in panel studies, DB1B is the standard source of fare data in the economics literature. Indeed, G&R rely on the same DB1B data source as the Worldwide Study: "The data are the publicly available DB1B data maintained by the [U.S. Department of Transportation]. The data are compiled quarterly and represent a 10 percent random sample of tickets either ticketed by a U.S. carrier or where a U.S. carrier operated at least one flight in the ticket's itinerary."[24]

15. Thus, the differences between the Worldwide Study and the G&R findings cannot be explained by: (1) the use of a different approach, because both studies rely on a panel approach; or (2) the use of a different data source, because both studies rely on DB1B data. However, there are important differences between the G&R study and the Worldwide Study:

- The G&R (2012) study is based on the years 2005 – 2011, while the Worldwide Study is based on data from the years 1998 – 2015. The number of passengers flying on JVs grew substantially relative to the number flying on carriers with ATI (but which were not

23. G&R (2012), p. 452 (emphasis added). *See also* G&R (2012), Table 4, p. 454 (reporting that the nonstop analysis is based on "2005-2011 quarterly data"). G&R (2011) – an unpublished working-paper version of G&R (2012) – uses a data panel (i.e., quarterly data from 2005-2010), but does not use a panel approach to estimate the effect of antitrust immunity on nonstop fares because the model in that paper does not include "fixed effects" to control for determinants of fares that do not change over time (e.g., nonstop distance). Nor does G&R (2011) use a pure cross-section approach (i.e., because G&R (2011) does not include route fixed effects in their model, the effect of ATI in their analysis is identified by both cross-sectional and time-series variation – in a panel analysis, the effect of ATI is identified only by time-series variation).
24. G&R (2012), p. 450.

members of a JV) after 2011.[25] Thus, the G&R study does not include in its analysis of nonstop fares the period in which JVs have grown most rapidly.

- More fundamentally, the G&R studies analyze the effect of ATI – not JVs – on nonstop fares. Thus, the G&R results do not provide information with which to evaluate the proposed JBA.

IV. RESPONSE TO BGR'S DISCUSSION OF OUR ESTIMATES OF BENEFITS FROM THE PROPOSED JBA.

A. Discussion of Benefits from Increased Service Quality.

16. In our prior submission, we explained that we estimated the benefits of higher-quality service using the results of AA's "Quality of Service Index" or "QSI" model.[26] In that model, the effect of the proposed JBA is modeled by increasing the extent of codesharing between LATAM and AA. BGR appear to agree that JVs like the proposed JBA can increase service quality by increasing codesharing.[27] However, BGR suggest that codesharing could be increased without implementing a JBA, and so that benefits from increases in codesharing are

25. *See* Israel et al., Figure 2 and p. 5 ("Indeed, as Figure 2 demonstrates, since 2012, JV partners carried more traffic between the United States and abroad than all other multi-carrier arrangements combined.").
26. BGR state that "QSI models have received heavy criticism in the literature" (BGR, ¶ 122, footnote 22). BGR cite only one study in support of their claim, in which the authors state that many airlines using non-QSI models "are contemplating reintroducing QSI methodologies due to the perceived complexity" of the non-QSI models. *See* Timothy L. Jacobs, Laurie A. Garrow, Manoj Lohatepanont, Frank S. Koppelman, Gregory M. Coldren and Hadi Purnomo, "Airline Planning and Schedule Development," in *Quantitative Problem Solving Methods in the Airline Industry: A Modeling Methodology Handbook*, Barnhart, C. and Smith, B., eds., p. 50. More importantly, as we discussed in our prior submission, AA routinely uses QSI models to make key business decisions, and the results of QSI models have been relied on by the U.S. Department of Transportation and the U.S. Department of Justice in their reviews of airline mergers and JBAs. *See* Presentación al TDLC, ¶ 9.
27. BGR, ¶ 123.

not attributable to the proposed JBA: "[i]t is not clear why the JBA is needed to expand codesharing."[28]

17. But BGR do not analyze whether LATAM and AA would have an economic incentive to increase codesharing if they are not members of the same JV. For example, BGR do not analyze – or even discuss – the economic incentive that a carrier has to place passengers on its own "metal," especially on long-haul flights, which reduces its incentive to offer codeshares to an alliance partner on connecting routes. Instead, BGR state that G&R (2011) "explain that price coordination through a joint venture with ATI is not necessary."[29] But as we have discussed, G&R analyze the effects of ATI, not the effect of implementing a metal-neutral joint venture like the proposed JBA. In our prior submission, our analyses of the Air France/Delta and AA/British Airways JVs show that those JVs increased codesharing substantially over the levels achieved by those carriers when they were members of the same alliance but not members of a JV.[30] BGR's analysis provides no explanation for this finding.

18. BGR also claim that higher service quality "will increase consumers' willingness to pay, putting upward pressure on prices, thus diminishing traveler benefits."[31] According to BGR, this potential effect makes our estimate of consumer benefits from higher service quality unreliable. We disagree.

19. Because price is not incorporated explicitly in the AA QSI model, to the extent that higher-quality itineraries have higher prices on average, the effect of that higher price is already reflected in the QSI model's predictions. Thus, to the extent that higher quality-itineraries generate higher share, this effect is *net* of the fact that the higher-quality itinerary may

28. BGR, ¶ 121 (emphasis in original). BGR say that "proponents argue that quality will be increased, in the form of more codesharing, better coordination and so on. . . . [I]f these benefits could have been achieved without the JV, they should not be attributed to the JV" (BGR, ¶ 35). BGR do not, however, appear to take a position on whether these benefits could, or could not, be achieved without the implementation of a JV.
29. BGR, ¶ 121.
30. *See* Presentación al TDLC, Tables 2 – 4.
31. BGR, ¶ 123.

also have a higher price. That is, the estimated impact of the higher-quality service already deducts any associated price increase and thus measures the value of higher quality to consumers above and beyond any price increase.[32]

20. Finally, BGR claim that it is inappropriate to add benefits from quality improvement to benefits from lower fares: "Even if the quality increases do exist and are caused by the operation, it is not correct to translate that quality increase into benefits and add them as separate benefits, because quality increases and price changes interact in more complex ways."[33] We disagree, but we note that the estimated benefits from quality improvement by themselves substantially outweigh our estimate of hypothetical harm from the proposed JBA.[34] In any event, as we have discussed, the Worldwide Study finds that JVs do not increase nonstop fares.

B. Discussion of Benefits from Reductions in "Double Marginalization."

21. BGR appear to accept that the proposed JBA will reduce fares on connecting flights (e.g., from the reduction of double marginalization).[35] BGR apply the estimated fare reductions only to "multi-airline connecting flights" (i.e., flights with one or more leg on LATAM

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32. Indeed, BGR recognize that "empirical estimates of price reductions for multi-airline connecting passengers already have incorporated that quality may have increased. In that sense, the price reduction may not be the only source of benefit for consumers, although it is obviously the easiest one to measure" (BGR, ¶ 98, emphasis added).
33. BGR, ¶ 120.
34. *See* Presentación al TDLC, ¶¶ 78 – 82 and Table 15. The hypothetical harm we estimate is based on the assumption that the parties do not agree to any "remedies" to alleviate a potential anticompetitive effect. BGR discuss and dismiss potential remedies (although two of the remedies they discuss do not apply to Chile). For example, for the capacity maintenance remedy, BGR state that "[e]ven if they maintain capacity, if the pre-alliance price/quantity is in the inelastic portion of the demand curve, under the alliance they would still have an incentive to raise prices" (BGR, ¶ 144). However, BGR provide no evidence that the "pre-alliance price/quantity is in the inelastic portion of the demand curve" for the Santiago-Miami route.
35. *See*, for example, BGR, ¶ 128 ("[A] final relevant exercise would use a middle value for fare decreases in connecting markets, say 3.5%, and to apply that only to multi-airline connecting passengers.").

"metal" and one or more leg on AA "metal"). In our May 2 submission to the TDLC, we use the same approach – that is, we apply an estimated fare reduction only to "mixed-metal" connecting flights.[36]

V. CONCLUSION.

22. We have reviewed and evaluated submissions to the TDLC on behalf the FNE prepared by Leonardo J. Basso, David Gillen and Thomas W. Ross and on behalf of the Asociacíon Chilena de Empresas de Turismo prepared by F&K Consultores. Nothing in either of those submissions has caused us to change our prior conclusion that the proposed JBA would be procompetitive. In particular, nothing in either submission has caused us to change our prior views that: (1) the proposed JBA between LATAM and AA likely will reduce fares on connecting routes; (2) the proposed JBA is <u>not</u> equivalent to eliminating a nonstop competitor on nonstop routes like Santiago-Miami, and that, instead, JVs are not associated with higher fares on nonstop routes; (3) the proposed JBA likely will increase traffic between Chile and the United States; and (4) the benefits of the proposed JBA will substantially exceed the potential hypothetical harm from higher fares on nonstop routes.

36. *See* Presentación al TDLC, ¶¶ 37 – 43 and Tables 6 – 9.