

Order 2001-1-11



UNITED STATES OF AMERICA
DEPARTMENT OF TRANSPORTATION
OFFICE OF THE SECRETARY
WASHINGTON, D.C.

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on the 18th day of January 2001

Served: January 18, 2001

1209854

*Los Angeles-San Jose del Cabo Exemption
Proceeding*

Docket OST-2000-8361-4

FINAL ORDER

Summary

By this order we make final our tentative decision in Order 2000-11-23 to select American Airlines, Inc. (American), to provide foreign scheduled air transportation services between Los Angeles, California, and San Jose del Cabo, Mexico, with its own aircraft, pursuant to exemption authority.

Background

Under the U.S.-Mexico aviation agreement, two U.S. carriers may be designated to serve a given city-pair route with their own aircraft (self-operated services). In addition, up to four U.S. carriers may hold authorization to serve a given city-pair market pursuant to code-share arrangements (code-share only on flights operated by other carriers). Currently, Alaska Airlines, Inc. (Alaska), is the only U.S. carrier designated to provide self-operated services in the Los Angeles-San Jose del Cabo market, and Compania Mexicana de Aviacion, S.A. de C.V. (Mexicana) and Aero California S.A. de C.V. (Aero California) are the two Mexican carriers authorized to provide self-operated services in the market. Continental Airlines, Inc. (Continental), Northwest Airlines, Inc. (Northwest), and United Air Lines, Inc. (United), each hold code-share only authorization to serve the route.¹ Thus, one operating designation remains available, and one code-share only authorization remains available for Los Angeles-San Jose del Cabo services.

United filed an application, in Docket OST-OST-2000-7656, to serve the Los Angeles-San Jose del Cabo market with its own aircraft, and American filed a competing application in Docket

¹ Northwest and Continental code-share on flights operated by Alaska in the Los Angeles-San Jose del Cabo market, and United code shares on flights operated by its partner, Mexicana.

OST-2000-7714.² By Order 2000-11-23, we instituted the *Los Angeles-San Jose del Cabo Exemption Proceeding*, in Docket OST-2000-8361, consolidated the applications of American and United, to the extent that the applicants sought Los Angeles-San Jose del Cabo authority,³ and tentatively selected American for exemption authority to provide self-operating service in the market. Objections to the Department's tentative decision were due no later than December 1, 2000, with replies due no later than December 8, 2000.

Responsive Pleadings

United filed a timely objection to the Department's tentative decision in this case, and American filed a timely answer to United's objection.

United argues that the Department erred in its tentative selection of American because United, not American, offers the greater public benefits in this case. United states that, in reaching the tentative decision here, the Department disregarded certain key advantages of United's proposal and adopted an excessively narrow analysis of the relative competitive implications of the two proposals. United urges the Department to reconsider its provisional findings and award the single available Los Angeles-San Jose del Cabo direct carrier opportunity to United.

In support of its objection, United argues that the Department overlooked the efforts of United to introduce new service to the region in favor of American, "which is already the largest U.S. carrier serving Mexico;" that United, with its hub operation at Los Angeles and extensive connections, offers superior service benefits and is more likely than American to maintain those benefits over time; and that the public interest is not served by the Department's selection of American because it would strengthen American's existing hold on U.S.-San Jose del Cabo traffic, and systematically exclude United from offering an important competitive alternative.⁴

United states that, in its original application to serve the Los Angeles-San Jose del Cabo market, it also included a request for authority, which the Department subsequently granted, to serve the Los Angeles-Puerto Vallarta market. United maintains that, from the outset, it intended to serve the Puerto Vallarta and San Jose del Cabo markets as part of one integrated service and that, if the

² Both United and American propose to offer daily service in the Los Angeles-San Jose del Cabo market, and would begin services immediately. United proposes to use 138-seat Airbus 320 aircraft and would display Mexicana's airline code on United's flights to provide reciprocal code-share services in the market. American proposes to use 129-seat MD-82 aircraft. In addition to the proposed daily service, American also proposes to operate an additional once-weekly flight on Saturdays on a seasonal basis during the period December 2000, through April 30, 2001.

³ United also sought authority, in Docket OST-2000-7656, to provide seasonal services in the Los Angeles-Puerto Vallarta market, where it would place Mexicana's code on United flights in the market. We granted that authority by Notices of Action Taken dated August 4 and August 25, 2000.

⁴ United states that American filed a "me too" application here to exclude United from the U.S.-San Jose del Cabo market because American knows that if United were to establish nonstop service to San Jose del Cabo at its Los Angeles hub, it would divert traffic away from American's existing San Jose del Cabo services at Chicago and Dallas/Ft. Worth, and particularly connecting traffic in the western states where American's online network is inferior to United's. (United objection at 3.)

Department makes final its tentative decision to deny United the opportunity to serve San Jose del Cabo, United regrettably would have to suspend its plans to serve Puerto Vallarta.⁵

United argues further that, while the Department tentatively selected American based on the finding that such selection created “the broadest range of carrier services and choice,” this line of reasoning reflects a misunderstanding of prevailing competitive forces in this market. United explains that there is an “enormous competitive distinction” between a carrier operating its own aircraft in a market versus a carrier that merely places its code on flights operated by another carrier.”⁶

United also maintains that the Department’s analysis in this case isolated the local Los Angeles-San Jose del Cabo market from the broader U.S.-San Jose del Cabo market and the U.S.-Mexico market in general, ignoring the realities about the competitive context of this proceeding. In this regard, United notes that American operates nonstop service to San Jose del Cabo from its hubs at both Chicago and Dallas/Ft. Worth, and United operates no service at all to San Jose del Cabo; and American, not United, is the largest U.S. carrier to Mexico and Latin America.

United also explains that hub-and-spoke operators compete for local and connecting traffic using code-sharing as a means of extending their respective networks into markets from which they are precluded from operating their own aircraft by regulatory or other barriers, such as the city-pair designation limits applicable to the U.S.-Mexico aviation agreement. United states that the U.S.-Mexico market is a typical international market in this regard and that it “makes no sense to analyze the competitive benefits that will flow from the introduction of a new nonstop service between Los Angeles and San Jose del Cabo in isolation from the benefits that will result in the broader U.S.-San Jose del Cabo and U.S.-Mexico markets.”

United also reiterates earlier arguments in this proceeding, including the argument that American will offer fewer connections than United for the proposed Los Angeles-San Jose del Cabo service; that American is disadvantaged because it does not operate a hub at Los Angeles; and that American’s proposal would be subject to self-diversion of American’s Chicago-San Jose del Cabo and Dallas/Ft. Worth-San Jose del Cabo traffic. United also states that the Department’s decision focuses on the quantitative nature of competition at the expense of more important qualitative factors, such as emphasizing the number of existing U.S. gateways to San Jose del Cabo, but failing to explain how selection of American at Los Angeles will enhance inter-gateway or inter-carrier competition in the U.S.-San Jose del Cabo market. United maintains that, by preventing United from using its hub network at Los Angeles to compete in the U.S.-San Jose del Cabo market, the Department would be forfeiting an important opportunity to expand competitive choices for U.S. consumers across the United States; poises the Department to preclude the possibility of true network competition between American and United for service to San Jose del Cabo; and consolidates American’s incumbency in the U.S.-San Jose del Cabo market on the

⁵ United states that the loss of United service to both of these Mexican resorts would mean that even more public benefits will be forfeited as a result of the Department’s selection of American over United in this proceeding. (United Objection at 17.)

⁶ United argues that it is misleading to imply, as the Department does, that the five Los Angeles-San Jose del Cabo carriers would compete with each other on equal terms. (United objection at 4.)

“misguided and illogical premise” that American is a “new entrant” in the Los Angeles-San Jose del Cabo market.

United also argues that the Department’s finding that American is a “new entrant” penalizes United for taking the initiative to implement code-share services with Mexicana, while simultaneously rewarding American for failing to implement similar service with its existing code-share partner, Alaska, or failing to maintain its code-share service with its former partner, Aero California. United states that it has worked with Mexicana to develop a code-share presence in the Los Angeles-San Jose del Cabo market as a prelude to launching service using its own aircraft, and that an award to American in this case would frustrate United’s efforts and penalize United for its commitment to, and investment in, the development of this opportunity.

United states that it cannot offer a fully competitive alternative to the Los Angeles-San Jose del Cabo incumbent carriers unless it, too, is permitted to operate its own aircraft in this city-pair. United states, further, that it will not be in a position to compete fully with American (if American is selected in this proceeding), solely by placing its code on Mexicana flights.⁷ United also argues that, if American fails to deliver on its service promises to San Jose del Cabo, as it did in the Los Angeles-Guadalajara market, then the public benefits that the Department anticipates from the proposed selection of American would not materialize.⁸ United states further that, using American’s Guadalajara services as a guide, American could revert to a more limited service in the Los Angeles-San Jose del Cabo market, such as seasonal service, as it originally proposed.

United maintains that, given the lack of a decisive difference between the applicants in this proceeding with respect to the local market, the Department should focus its decision on the relative connecting service benefits offered, and that, on this basis, United has the superior proposal. United states that only United would offer nonstop connections via Los Angeles to Seattle and Portland, two of the 10 largest cities for U.S.-San Jose del Cabo traffic, and that United is the only applicant that would offer connections at Sacramento and Salt Lake City. United states, further, that United offers more than twice as many connections to San Jose del Cabo as American and that this is a decisive difference that should be the controlling factor in this case. United also argues that the Department’s claim that nonstop service to San Jose del Cabo already is available from 13 different cities is misleading, because only nine enjoy daily San Jose del Cabo service.⁹

United also maintains that the Department appears to apply the logic that, because larger cities in other parts of the country already enjoy connecting service to San Jose del Cabo, the issue of which applicant can generate more connecting traffic at Los Angeles from cities that do not now enjoy any online connections is irrelevant. United argues that, due to the lack of nonstop service by a hub carrier between Los Angeles and San Jose del Cabo, many communities in the western states are without any daily online connecting service to San Jose del Cabo. United states, further,

⁷ United maintains that, absent the authority to operate its own aircraft, and absent antitrust immunity with Mexicana, United lacks the tools to mount a competitive challenge to the true incumbents which operate their own aircraft in the market. (United Objection at 10.)

⁸ See *Los Angeles-Guadalajara Exemption Proceeding*, Docket OST-95-244 (Orders 95-6-27, 95-8-3, and 96-3-36).

⁹ San Jose has four weekly flights, Denver and Minneapolis/St. Paul each have two weekly flights, and New York has one weekly flight to San Jose del Cabo.

that because Alaska does not serve the eastern United States, American faces little competition for the U.S.-San Jose del Cabo traffic in that region. United argues that a significant number of the cities in the eastern and central United States listed by American as proposed connections would more likely feed passengers to San Jose del Cabo via American's existing services at its Chicago or Dallas/Ft. Worth hubs rather than via new American service at Los Angeles. United maintains, further, that nine of the cities American lists as proposed connections already enjoy nonstop United service to Los Angeles.¹⁰ United argues that, for passengers traveling from those cities, new nonstop United service between Los Angeles and San Jose del Cabo would create a new competitive alternative to American.

In its answer to United's objection, American urges the Department to finalize the tentative decision in this case so that American may enter the market as a new competitor. American maintains that the Department's tentative conclusion that United is in effect an incumbent in the market by virtue of its code-share arrangement, and that American would be the new entrant, is consistent with a number of carrier-selection decisions reaching a similar result.¹¹

American argues that United should not be authorized to "double dip" in the Los Angeles-San Jose del Cabo market by holding limited-entry authority to operate its own aircraft, as well as code share with Mexicana under an exclusive arrangement. American states that, while United contends that its codes-share with Mexicana has produced minimal bookings under the "UA" code on the Los Angeles-San Jose del Cabo route, there is nothing to prevent United from making better use of its code-sharing authority.

American also argues that United has exaggerated the potential of Los Angeles to function as a nationwide connecting gateway when United states that the Department will prevent United from using its hub network at Los Angeles to compete in the U.S.-San Jose del Cabo market. In this regard, American maintains that Los Angeles' geographic location in the southwestern corner of the United States is a circuitous gateway for most U.S.-San Jose del Cabo passengers except for those in the "Far West;" that passengers to San Jose del Cabo from points outside of Los Angeles already have many connecting opportunities through other gateways, including Chicago, Dallas/Ft. Worth, Denver, San Diego, San Francisco, San Jose, Seattle, Phoenix, Houston, Minneapolis/St. Paul, New York, and Atlanta; and that, if United wished to compete as an "operating carrier" to San Jose del Cabo from gateway hubs that would give it access to the broader U.S. market, United should focus not on Los Angeles, but on Chicago and Denver, where United operates larger hubs. American also states that, if United wished to compete as an operating carrier from a western gateway, it could do so from its hub at San Francisco.¹²

¹⁰ Those cities include New York, Boston, Chicago, Dallas/Ft. Worth, Houston, Miami, Orlando, Washington, D.C., and Denver. (United Objection at 15.)

¹¹ American cites the following cases: *1999 U.S.-Brazil Combination Service Case*, Order 2000-12-2 (rejecting United's Los Angeles-Sao Paulo request where United already serve the market by code-sharing with Varig); *U.S.-Turkey Third-Country Codeshare Opportunities*, Order 2000-7-25 (tentatively denying limited-entry rights to American in light of American/Turkish Airlines code-share arrangement); and *1999 U.S.-France Combination Service Frequency Allocation Proceeding*, Order 98-10-21 (denying limited-entry rights to Delta in light of the Delta/Air France code-share arrangement). (American answer at 4.)

¹² American disagrees with United's statement that American's Los Angeles-San Jose del Cabo service would divert passengers from Chicago and Dallas/Ft. Worth. American states that it does not expect passengers from Chicago and Dallas/Ft. Worth to travel to San Jose del Cabo via Los Angeles. (American answer at 6.)

American states that, given the large size of the Los Angeles-San Jose del Cabo market, the principal goal of this proceeding should be on meeting the needs of the local passengers for additional service.

American also maintains that the Department should reject United's arguments that American could code-share with Alaska Airlines or Aero California on the Los Angeles-San Jose del Cabo route. American explains that American's agreement with the Allied Pilots Association does not permit the "AA" code to be displayed on flights of a domestic carrier (other than a commuter), and that its American/Aero California code-share arrangement was terminated as of October 13, 1999, ending American's online access to the Los Angeles-San Jose del Cabo market.

American further argues that United has now told the Department "for the first time" that if American is selected for the Los Angeles-San Jose del Cabo route, United will have to cancel its plans for companion service to Puerto Vallarta. American states that there is no apparent reason why United cannot serve Puerto Vallarta independently, as United's service proposal does not link the two routes with, for example, one-stop or round-robin operations. American states, further, that United's "threat" not to serve Puerto Vallarta confirms that American, unlike United, has developed extensive service to resort destinations in Mexico, including Acapulco, Cancun, Puerto Vallarta, and San Jose del Cabo, and is well-positioned to compete with incumbents in the Los Angeles-San Jose del Cabo market. American argues that, by contrast, United currently operates its own aircraft to only a single point in Mexico, Mexico City, and does not serve any Mexican resort cities. American states that United's "failure to develop its own pattern of services to points in Mexico, and particularly to resort destinations such as San Jose del Cabo and Puerto Vallarta," should weigh heavily against United in this proceeding.

Lastly, American responds to United's arguments regarding American's service between Los Angeles and Guadalajara.¹³ American explains that it reduced its service between Los Angeles and Guadalajara from the level it offered in 1995 in response to market conditions. American maintains that over the same period, United reduced its service in limited-entry U.S.-Mexico markets by 56%, and "abandoned the Los Angeles-San Jose del Cabo market itself."¹⁴ American states that, during this same period, American increased its U.S.-Mexico routes by 60% and its U.S.-Mexico frequencies by 37%.

Decision

After careful examination of all of the information presented in this case, we have decided to make final our tentative decision in Order 2000-11-23 to authorize American to provide scheduled foreign air transportation services in the Los Angeles-San Jose del Cabo market.¹⁵ American's exemption authority will be effective immediately for a period of two years and will be subject to

¹³ In the *Los Angeles-Guadalajara Exemption Proceeding* (Docket OST-95-244), the Department selected American over United to serve the Los Angeles-Guadalajara market, finding, among other things, that American would offer a full service pattern of three-daily flights in the market nine months earlier than United.

¹⁴ American Answer at 9.

¹⁵ Based on data officially noticeable under rule 24(g) of the Department's regulations, we find that American is qualified to provide the proposed Los Angeles-San Jose del Cabo services. See Order 2000-5-31.

the standard exemption conditions we impose on U.S. carrier services (see Attachment).¹⁶ Finally, the authority will be subject to our standard 90-day dormancy notice condition for U.S.-Mexico services whereby American will be required to file notice with the Department of Transportation if it discontinues services on the subject route segment for 90 days or longer.¹⁷

As we stated in our show cause order, the principal difference between the applications in this case is that only American would enter the Los Angeles-San Jose del Cabo market as a new competitor. We tentatively found that American's new entry and competition would provide the most significant public benefits in this case, including providing United and other incumbents "with new incentives to provide consumers with service that meets their needs." Order 2000-11-23, at p. 6.

After carefully reviewing the pleadings filed in response to our show cause order, we have decided to make our tentative findings final.

We are not persuaded by United's argument that the competitive benefits it would provide in other markets outweigh those that American would bring to the primary market. The U.S.-Mexico aviation market is one of the largest in the world. American and United are significant participants in that market. The U.S.-San Jose del Cabo market alone is served by eight airlines, including American and United.¹⁸ Together, these airlines offer more than a dozen U.S. cities nonstop service to San Jose del Cabo and offer many other U.S. cities convenient connecting service on more than ten thousand flights to San Jose del Cabo on an annual basis. Five of these airlines – including United – also offer extensive nonstop and/or connecting service in the West Coast-San Jose del Cabo markets. In these circumstances, we cannot find, as United suggested, that the selection of any applicant in this case would have a significant competitive impact on fares and services in any of the relevant markets in this case other than the Los Angeles-San Jose del Cabo market.¹⁹ It is in this market, in terms of the benefits that might derive from this proceeding,

¹⁶ We point out here that American has received an award in this proceeding for year-round service in the Los Angeles-San Jose del Cabo market. Should the carrier wish to convert its authority to a seasonal operation, or to convert its services to code-share only operations, it will be required to file notice with the Department. Notices regarding seasonal services should be filed pursuant to the dormancy notice provisions described below. Notices to convert to/from code-share only services are to be filed in the form of a letter addressed to the U.S. Department of Transportation, U.S. Air Carrier Licensing Division, X-44, 400 Seventh Street, SW, Washington, D.C., 20590, no later than 30 days prior to the proposed change. (For a more detailed discussion of these requirements, see Order 2000-5-31, at 3.) Given the basis for American's award, should it file either such notice, other carriers may seek to use such change as a basis to challenge its award here.

¹⁷ This notice must be given as soon as the decision to discontinue service is made, but in no case later than the 91st day of dormancy. They should be filed in the form of a letter addressed to the U.S. Department of Transportation, U.S. Air Carrier Licensing Division, X-44, 400 Seventh Street, SW, Washington, D.C., 20590, and must identify the dormant city-pair market, and the date the 90th day of dormancy will or did occur.

¹⁸ American, Alaska, America West Airlines, Inc.; Continental Airlines, Inc.; Delta Air Lines, Inc.; Northwest Airlines, Inc.; Sun Country Airlines, Inc.; and United.

¹⁹ There are no restrictions on the number of combination carriers that can serve the U.S.-Mexico market or the number of frequencies that can be operated. Rather, the restrictions on U.S.-Mexico services are applicable to each city-pair market only. In terms of the broader U.S.-Mexico and U.S.-San Jose del Cabo markets, we note that American does not have a significant advantage over United. Specifically, both United and American serve the U.S.-Mexico market extensively, with United serving a total of 29 U.S.-Mexico markets and American serving 15 markets. We also note that both carriers now offer service in two U.S.-San Jose del Cabo markets (Chicago and Dallas/Ft. Worth for American and Denver and Los Angeles for United).

that American has a significant advantage, as we have already noted, that is, its proposed new entrant, self-operated service to provide new competitive opportunities and consumer choice.

It is also in these circumstances that we cannot find, as United would have us, that United's hub and network services at Los Angeles provide it with a material advantage in terms of the overall service benefits that the applicants would provide. American and United have submitted comparable service proposals for the primary market. See Order 2000-11-23, at p. 5. Moreover, while United enjoys a slight edge in terms of beyond-area service, that advantage is tempered, since American could also provide significant beyond-area benefits and American and other airlines would provide on-line service that is either superior or comparable in virtually all on-line markets that United has proposed to serve.²⁰

In these circumstances, we continue to believe that the selection of American best serves the public interest.

ACCORDINGLY,

1. We make final our tentative findings and conclusions in Order 2000-11-23;
2. We select American Airlines, Inc., for exemption authority under U.S.C. Section 40109 to provide scheduled foreign air transportation service of persons, property, and mail between Los Angeles, California, and San Jose del Cabo, Mexico;
3. The selection of American Airlines, Inc., in ordering paragraph 2, above, is effective immediately for a period of two years from the date of service of this order;
4. The exemption authority granted, in ordering paragraph 2, above, is subject to the dormancy notice requirements set forth in condition #7 of Appendix A of Order 88-10-2, and the notice requirement in footnote 16 of this order;
5. We may amend, modify, or revoke the authority granted by this order at any time at our discretion without hearing;
6. To the extent not granted, we deny all requests in the captioned docket; and

²⁰ See, e.g., Exhibit AA-4, American answer at 6 & 7, Official Airline Guide, North America Edition, December 2000.

7. We will serve this order on American Airlines, Inc.; Delta Air Lines, Inc.; United Air Lines, Inc.; the U.S. Department of State (Office of Aviation Negotiations); and the Ambassador of Mexico in Washington, D.C.

By:

SUSAN MCDERMOTT
Deputy Assistant Secretary for Aviation
and International Affairs

(SEAL)

An electronic version of this order is available on the World Wide Web at:
http://dms.dot.gov/reports/reports_aviation.asp

APPENDIX A

U.S. CARRIER

Standard Exemption Conditions

In the conduct of operations authorized by the attached notice, the applicant(s) shall:

- (1) Hold at all times effective operating authority from the government of each country served;
- (2) Comply with applicable requirements concerning oversales contained in 14 CFR 250 (for scheduled operations, if authorized);
- (3) Comply with the requirements for reporting data contained in 14 CFR 241;
- (4) Comply with requirements for minimum insurance coverage, and for certifying that coverage to the Department, contained in 14 CFR 205;
- (5) Except as specifically exempted or otherwise provided for in a Department Order, comply with the requirements of 14 CFR 203, concerning waiver of Warsaw Convention liability limits and defenses;
- (6) Comply with the applicable requirements of the Federal Aviation Administration (FAA) Regulations, including all FAA requirements concerning security; and
- (7) Comply with such other reasonable terms, conditions, and limitations required by the public interest as may be prescribed by the Department of Transportation, with all applicable orders and regulations of other U.S. agencies and courts, and with all applicable laws of the United States.

The authority granted shall be effective only during the period when the holder is in compliance with the conditions imposed above.