United States General Accounting Office

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Report to the Chairman, Committee on the Budget, House of Representatives

July 1999

AVIATION COMPETITION

Information on the Department of Transportation's Proposed Policy

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United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-281479

July 29, 1999

The Honorable John Kasich
Chairman, Committee on the Budget
House of Representatives

Dear Mr. Chairman:

On April 6, 1998, the Department of Transportation (DOT) issued a proposed policy statement designed to address unfair competitive practices by major airlines against "new entrants"—new low-fare airlines that entered their markets. You asked us to provide information on the proposed policy to facilitate your review of the final policy, which the Department is required to submit to the Congress before implementing it. Specifically, we agreed to address the following: (1) Why did DOT develop the proposed policy? (2) What process did DOT use to develop the proposed policy? (3) Does the proposed policy address the specific problems that led DOT to issue it?

Results in Brief

DOT decided to develop its proposed policy statement after receiving 17 complaints from new entrant airlines alleging that major airlines were unfairly lowering their fares, increasing capacity on certain routes, or both; investigating two of those complaints; and analyzing industrywide data concerning pricing and capacity activities by major airlines. DOT's investigations and analyses indicated possible unfair competitive practices by at least five major airlines. DOT concluded that the best approach for addressing its concerns about this conduct was to issue policy guidance on what, in its view, constituted unfair competitive practices warranting departmental action. DOT did not intend for the policy to discourage major airlines from competing against new entrants; rather, it wanted to prevent extreme behavior that was intended to drive a new entrant from a market. By issuing the proposed policy, DOT expected to initiate a national debate on the issues surrounding unfair competition. In addition, DOT officials believed that this approach would help with future enforcement regarding unfair competitive practices by major airlines in response to new low-fare airlines.

DOT followed an informal process and began developing the proposed policy statement in summer 1997. DOT did not consider the policy to be a rule requiring notice and comment under the Administrative Procedure Act. The act provides an exemption from certain notification requirements

when an agency issues a general statement of policy. However, DOT published the proposed policy in the Federal Register for public notification and to obtain comments.

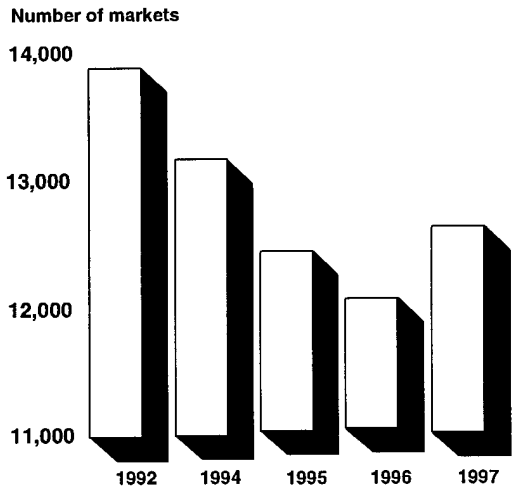
DOT's proposed policy statement generally addresses the complaints dealing with price cuts or capacity increases that the Department received as well as the practices that DOT identified in its investigations and analyses of industrywide data. In addition, the proposed policy described practices that would trigger enforcement action. The policy described these practices as a major airline expanding its capacity and selling a large number of seats at very low fares in response to a low-fare airline entering its hub market. The Department would consider such practices unfair competition if they resulted in lower revenue for the major airline in the short term than would result from a reasonable alternative strategy for competing with a new entrant airline, such as matching the new entrant's low fares on a limited basis and not significantly increasing capacity. The Department received comments from several major airlines and an industry trade association that questioned the proposed policy's enforceability because of the vagueness of the wording of critical elements. For example, the comments noted that the proposed policy statement did not define "reasonable alternative response," "very low fares," or "large number of seats." DOT is revising the policy statement to address concerns about vagueness as well as other comments. The Department expects to issue the final policy statement in September 1999.

Background

Deregulation of the airline industry in 1978 has led to lower airfares and better service for most air travelers, largely because of increased competition spurred by the entry of new airlines into the industry and of established carriers into new markets. In many markets, the entry of low-cost airlines, such as Southwest, Vanguard, Spirit, AirTran, and Frontier, has resulted in lower fares and better service. For example, according to DOT, markets in which low-cost airlines compete with major airlines have lower fares on average—often more than 50 percent lower—than similar markets without such competition. In markets with low-fare competition, matching the prices of this competition is generally a reasonable response by major airlines. However, in recent years, some low-cost airlines have complained that this behavior by major airlines has not been reasonable and, instead, has been an attempt to drive them out of certain markets.

DOT has found that recent trends indicate the level of competition may be declining. The Department's data indicate that the number of airline markets in the United States with two or more competitors fell steadily from 1992 through 1996.[1] The number of competitive markets increased in 1997 to just over the 1995 level, but remained below the levels established in 1992 and 1994. (See fig. 1.) Moreover, while the number of passengers benefiting from low-fare competition grew steadily for years, the trend was reversed in 1997, when both the number and percentage of passengers in markets with low-fare competition declined.

Figure 1: Number of Markets With Two or More Competitors, 1992 Through 1997



Note: The Department was not able to provide us with data for 1993 or for years prior to 1992.

Source: U.S. Department of Transportation.

The aviation industry has several unique pricing and service characteristics that set it apart from other industries and affect how airlines compete. Airlines operate networks in which passengers flying on the same segment of a flight may have different origins or destinations. On any given flight segment, typically there are passengers whose entire one-way trip is only that segment (called "local traffic") and other passengers who are connecting to or from other flights (called "flow traffic"). For example, a flight from Washington, D.C., to Chicago would

[1]The Department was not able to provide us with data for 1993 or years prior to 1992.

have passengers traveling between the two cities as well as other passengers who would connect to flights going to other cities. Thus, when airlines set their prices for flights on a given segment, they must be aware that if they sell too many tickets to passengers traveling on only that segment, they risk supplanting a passenger who could use that segment to fly on a more profitable route.

In addition, airlines charge different prices to different passengers even when those passengers are flying to the same place. For example, passengers traveling on short notice usually pay more than passengers who are able to plan in advance. Generally, the prices are set so that those passengers who require the greatest flexibility pay the highest price and those who require less flexibility pay lower prices. The airlines try to fill as many seats as possible with passengers paying high fares. However, rather than allowing seats to go unsold, the airlines will sometimes sell unsold tickets at deep discounts to receive some revenue from passengers who otherwise would not have taken the flight. As a result, different passengers on any route or flight segment may pay substantially different amounts for their trips.

Unique aspects of the air transportation industry allow major airlines to respond quickly to competition with changes in price and capacity. Using computerized reservation systems, airlines can change their prices almost instantaneously as competitive conditions change or as they manage the number of seats remaining to be sold. Similarly, the number of seats available on a particular route can change rapidly because airlines can shift resources between markets much more readily than firms in other industries. In response to market conditions, an airline can increase its capacity on a route by increasing the number of flights, the size of the aircraft, or both.

The Proposed Policy Was Intended to Address Unfair Competitive Practices

On April 6, 1998, DOT issued a proposed policy statement regarding unfair exclusionary conduct in the air transportation industry that was designed to address unfair competitive practices by major airlines in response to new entrant airlines that provide competing service in the major airlines' hub airports.[2] The proposed policy describes three practices that would

[2]Specifically, the draft policy proposes that a major airline is engaging in unfair exclusionary practices if, in response to new entry into its hub markets, it pursues a strategy of price cuts and/or capacity increases that either (1) causes it to forgo more revenue than all of the new entrant's capacity could have diverted from it or (2) results in substantially lower operating profits—or greater operating losses—in the short run than would result from a reasonable alternative strategy for competing with the new entrant. The draft policy defines new entrant airlines as independent airlines that have started jet service within the last 10 years and pursue strategies of charging low fares.

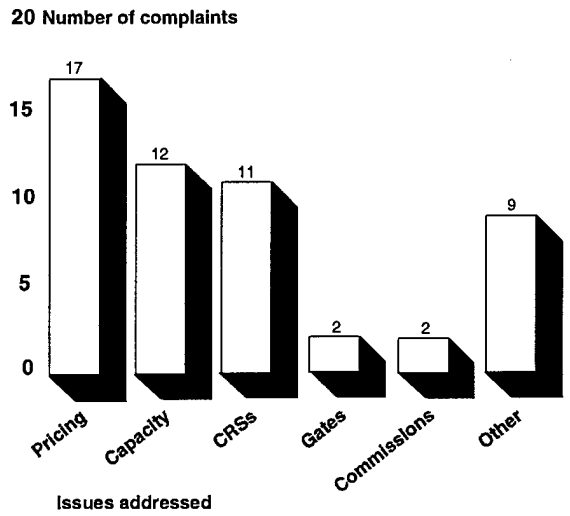
trigger an investigation by DOT. Specifically, DOT will initiate an investigation when a major airline (1) adds capacity and sells a large number of seats at very low fares, (2) carries more local passengers at the new entrant's low fares than the new entrant's total seat capacity, or (3) carries more local passengers at the new entrant's low fares than the new entrant carries at low fares. The proposed policy also states that these actions must result in lower local revenue for the major airline than would result from a reasonable alternative response.

The proposed policy states that DOT does not intend to discourage major airlines from competing against new entrants at hub markets. Matching the new entrant's low fares on a limited basis and not significantly increasing capacity would be permissible under the proposed policy, but extreme behavior intended to drive the new entrant from the hub market would trigger enforcement. DOT would determine whether carriers had engaged in unfair practices and decide whether to initiate enforcement on a case-by-case basis (see app. I).

DOT Developed Evidence of Possible Unfair Practices

Before DOT began developing the proposed policy statement in summer 1997, it received 32 complaints from airlines, travel industry associations, Members of Congress, and others concerning unfair competition in the airline industry. Seventeen of the 32 complaints dealt with new entrant airlines' concerns about unfair pricing and capacity increases by larger airlines. The remaining complaints addressed concerns such as access to gates and other airport facilities, display biases in computerized reservation systems that would result in a major airline's flight being listed ahead of a new entrant's flight, and unfair use of travel agent commissions. Many of the complaints dealt with more than one issue. (See fig. 2.) The Department received the complaints in various ways, including letters, meetings, and telephone calls.

Figure 2: Issues Addressed in 32 Complaints Received by DOT, March 1993 Through May 1997



Notes: Some complaints addressed more than one issue.

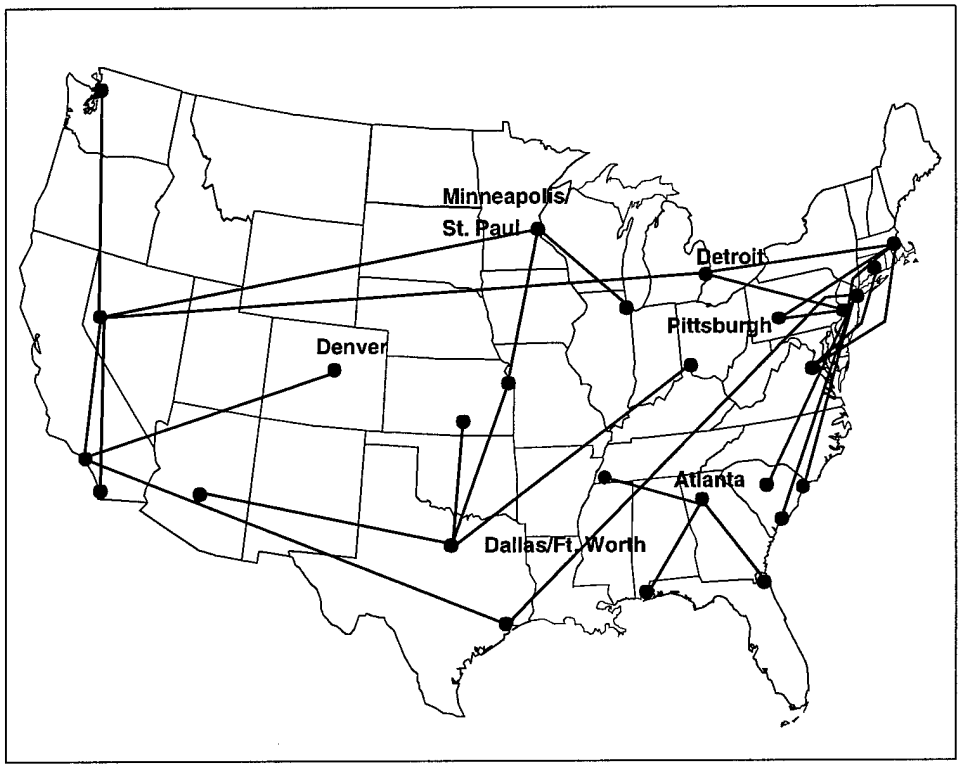
"CRSs" refers to computerized reservation systems; "commissions" refers to commissions paid to travel agencies.

Source: U.S. Department of Transportation.

The 17 complaints of unfair pricing and capacity increases were raised from March 1993 through May 1997, involved 7 major airlines and 10 new entrants, and included at least 27 routes.[3] For example, in May 1997, Reno Air complained about Northwest Airlines' practices in the Detroit-Reno market. According to Reno Air, Northwest entered the market only after Reno Air had indicated that it would serve the market. After Reno Air initiated service, the airline alleged that Northwest substantially undercut its fares and increased service to become the dominant airline in the market. Then, when Reno Air reduced its service in the market, Northwest also reduced service, according to Reno Air. As shown in figure 3, the complaints DOT received encompassed many of the major airlines' hub airports, including Atlanta, Dallas/Fort Worth, Denver, Detroit, Minneapolis/St. Paul, and Pittsburgh.

[3]In some cases, the routes were not specified.

Figure 3: Routes Cited in 17 Complaints Concerning Pricing and Capacity That Were Received, March 1993 Through May 1997



Source: U.S. Department of Transportation.

According to DOT officials, they handled some of the 17 complaints from new entrant airlines by informally negotiating with the parties. In some cases, DOT initially requested further information from the airlines. According to Department officials, they investigated two complaints and shared information about those two investigations as well as information about three other complaints with the Department of Justice. According to a DOT official, 15 of the 17 complaints are closed and 2 that were under investigation remained open in June 1999.

According to Department officials, their investigations indicated possible unfair competitive practices by two major airlines. For example, in one case, DOT found evidence that a major airline was specifically targeting new entrant airlines. Documents obtained from the airline indicated that when a new entrant obtained 5 percent of a local market, the major airline's strategy was to respond aggressively, in stages, with the intent of

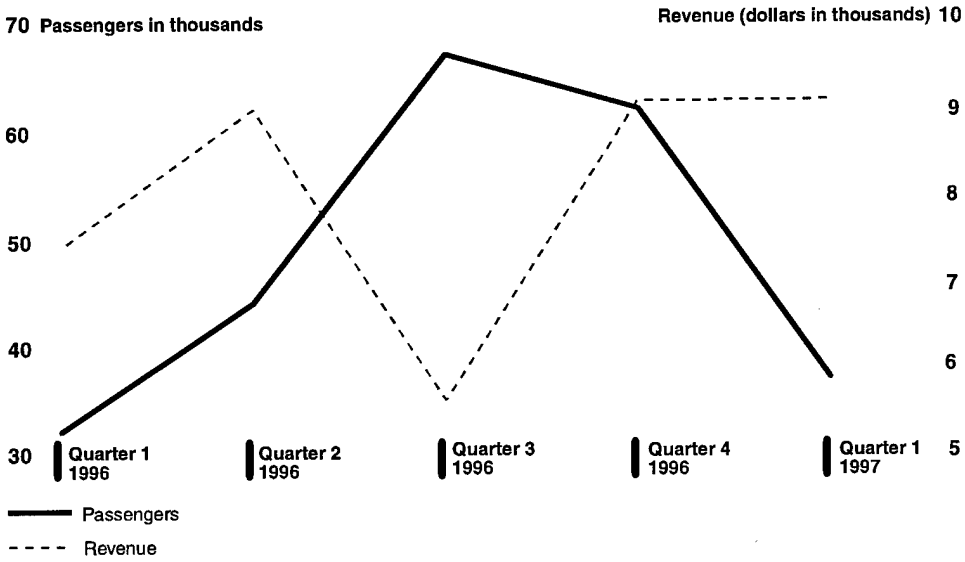
driving the new entrant out of the market. First, the airline matched the new entrant's low fares, but with restrictions—such as requirements for the advance purchase of tickets and a Saturday night stayover—then it eliminated the restrictions, and, finally, it increased the number of seats available at the low fare. The Department's analysis of data on fares, revenues, and the number of passengers for one route indicated that the major airline was selling such a large number of tickets at the low fare offered by the new entrant, that it sold low-fare tickets to many passengers who would otherwise have paid higher fares, resulting in substantially lower revenue from the route than it would have realized if it had been seriously attempting to bolster its revenue. Over the first year that the new entrant served the route, the major airline shifted traffic from high-fare categories to low-fare categories, which resulted in a significant decrease in revenue for the major airline despite a significant increase in passengers over that period.

In addition, the Department examined at least 40 to 50 routes on which other major airlines competed with new entrants or with Southwest Airlines[4] and found behavior that caused it concern. For the analysis, DOT used data for 1992 through the first quarter of 1997 that it collected routinely from airlines on fares, traffic, and revenue. For three major airlines, DOT found examples of pricing or capacity behavior similar to the behavior it identified in its investigations. The Department published several of these examples in August 1998.[5] For instance, the Department reported that during the first quarter of 1996, a new entrant airline started service on a 450-mile route. The major airline serving the route initially did not increase its sale of low-fare seats, and its revenue for the first two quarters of 1996 changed very little. However, during the third quarter of 1996, the major airline greatly expanded its capacity and increased the number of seats it sold at low fares by almost half. During that quarter, the major airline's revenue on that route dropped by about a third. (See fig. 4.) The new entrant left the market the following quarter, after which the major airline sold fewer seats at low fares and sold a large percentage of its seats at higher fares. The major airline's average fares were about $190 just before the new entrant began service, fell to just over $80 when it was competing with the new entrant, and rose to almost $250 6 months after the new entrant departed the market.

[4]Southwest Airlines is considered a low-fare airline but has been in operation since before deregulation and, therefore, is not a new entrant.

[5]U.S. Department of Transportation, "Competition in the U.S. Domestic Airline Industry: The Need for a Policy to Prevent Unfair Practices."

Figure 4: Total Passengers and Total Revenue for a Major Airline Competing With a New Entrant Airline



Note: The new entrant entered the market in the first quarter 1996 and left the market in the fourth quarter 1996.

Source: U.S. Department of Transportation.

Information from these investigations and analyses was presented to senior DOT officials, who concluded that the best approach for addressing the Department's concerns about pricing and capacity-setting was to issue policy guidance on what the Department viewed as potentially unfair competitive practices that warranted formal enforcement. In particular, the Department took this approach because the Secretary of Transportation wanted to have a national dialogue on the concerns regarding unfair competition. In part, that dialogue took the form of meetings that the Department held with industry and community groups after the proposed policy statement was issued. In addition, according to a Department official, this approach would help with future enforcement since the lack of a description of unfair competitive practices concerning pricing and capacity-setting had inhibited DOT from taking enforcement actions in the past.

Complaints of Unfair Practices Continued After DOT Developed the Proposed Policy

DOT continued to receive complaints of unfair competitive practices after it began developing the proposed policy statement in summer 1997. From September 1997 through February 1998[6]—while DOT was developing the policy statement—it received seven complaints against major airlines from other airlines, Members of Congress, an industry association, and city officials. After issuing the proposed policy—from late April 1998 through May 1999—the Department received an additional 21 complaints from similar groups as well as travel agents and state officials. Eleven of the 28 complaints concerned pricing or capacity increases. For example, in April 1999, the Attorney General of Minnesota complained that Northwest Airlines appeared to be offering low fares and increased capacity in selected Minneapolis-St. Paul markets in anticipation of the inauguration of scheduled service by a new entrant—Sun Country Airlines—on June 1, 1999.

The remaining 17 complaints concerned issues involving access to gates and airport space, computerized reservation systems, travel agent commissions, and airline ticketing practices. Twenty-five of the 28 complaints have been closed, and 3 are pending further action by the Department. According to DOT officials, the Department has a total of five open complaints—two were received prior to its developing the proposed policy, and three were received since it issued the proposed policy.

On May 13, 1999, the Department of Justice filed an antitrust lawsuit against American Airlines, charging that the airline tried to monopolize service to and from Dallas/Fort Worth by driving out low-fare airlines. The lawsuit specifically focused on American's responses to Vanguard Airlines, Sun Jet, and Western Pacific on four Dallas/Fort Worth routes to Wichita, Kansas; Kansas City, Missouri; Long Beach, California; and Colorado Springs, Colorado. Justice charged that American repeatedly sought to drive these small start-up airlines out of Dallas/Fort Worth by adding flights and cutting fares. According to Justice, after American drove out a new entrant, it reestablished high fares and reduced service. The suit further alleged that for the flights that American added, the costs exceeded the revenues generated. According to Justice, American expected to recoup those temporary losses by charging higher fares after a new entrant ceased operations. For example, according to Justice, American increased fares for the Dallas/Fort Worth-Wichita route by more than 50 percent after Vanguard stopped serving that market. American has stated that it merely matched the fares that Vanguard set and that its actions on the Dallas/Fort Worth routes will prove to be nothing more than

[6]DOT did not receive any complaints from June through August 1997.

those of a tough competitor in a highly competitive industry. American filed a response to the complaint on July 13, 1999.

DOT's Process to Develop the Proposed Policy Statement Has Been Informal

In summer 1997, DOT's Office of the Assistant Secretary for Aviation and International Affairs and the Office of the General Counsel began developing the proposed policy statement. Since DOT considered the policy to be exempt from the notice and comment requirements under the Administrative Procedure Act, it followed an informal process in developing it. DOT's early efforts in developing the proposed policy focused on defining unfair competitive practices. In addition, the Department of Justice and the Federal Trade Commission (FTC) reviewed and commented on the proposed policy before it was issued.

DOT Followed an Informal Process

From summer 1997 through early 1998, staff from DOT's Office of the Assistant Secretary for Aviation and International Affairs and the Office of the General Counsel developed and drafted the policy statement. Meetings among senior officials from these offices were held during this period to review and comment on the proposed policy. The document was revised in an iterative manner based on comments from within the Department. During this process, the Secretary of Transportation decided to issue a policy statement. A general statement of policy does not have to follow certain procedures established under the Administrative Procedure Act—such as issuing in the Federal Register a proposed rulemaking for public comment and then a final rule.

Although DOT does not consider the proposed policy to be a rule subject to notice and comment requirements, the Department did publish it in the Federal Register for public notification and to obtain public comments. Initially, DOT allowed a 60-day period for filing comments and a 90-day deadline for filing reply comments. DOT extended the deadline for filing comments until September 25, 1998. DOT established a docket for receipt of public comments and, according to Department officials, received over 5,000 comments by the final deadline. Additional comments were received after the deadline passed. DOT allows late comments to be considered.

Comments by some major airlines suggest the proposed policy is a rule that should be subject to the notice and comment provisions of the Administrative Procedure Act. For example, an industry association and a major airline stated that the proposed policy was a substantive rule because it would proscribe specific conduct by major airlines. Because

DOT did not follow certain provisions of the act, some commenters further stated that the Department did not provide sufficient information to constitute adequate notice and a meaningful opportunity for interested persons to comment on the proposed policy. In particular, some major airlines commented that DOT provided insufficient information in the public record about its informal investigations and other data supporting the policy.

However, some small airlines, which would be defined as "new entrants" under the policy, commented that the policy statement was in compliance with the Administrative Procedure Act. For example, one airline stated that the policy was an interpretive, rather than a substantive rule, because the policy did not create new requirements or change existing ones. Under the Administrative Procedure Act, an interpretive rule or a general statement of policy is exempt from the notice and comment requirements of the act.

DOT's Efforts Focused on Defining Unfair Competitive Practices

DOT's early efforts to develop the proposed policy focused on defining unfair competitive practices in terms of pricing and levels of capacity and revenue. Reducing prices to increase business and match the prices of new competitors is generally a reasonable competitive response. However, the Supreme Court has ruled that this behavior is not always reasonable and has defined it as predatory pricing under the antitrust laws when a company (1) sets prices below an appropriate measure of costs and (2) has a reasonable likelihood of recapturing its losses by setting higher prices after its competition leaves the market.[7] For the airline industry, the appropriate measure of cost is often considered to be the incremental cost of serving additional passengers.

DOT's proposed policy on unfair competitive practices by major airlines differs from predatory pricing under the antitrust laws because it focuses on a firm's forgone revenue rather than the relationship between the firm's prices and costs. DOT's policy defines unfair competitive practices as fare cuts and capacity increases resulting in short-term revenue losses that will be recouped after the competitor is driven from the market. DOT noted that it can be difficult to determine when the airlines' normal practices of cutting prices and increasing capacity would be illegal predatory pricing under the antitrust laws because of the industry's cost characteristics, among other things.

[7]See Brooke Group Ltd. v. Brown & Williamson Tobacco Corporation, 509 U.S. 209 (1993).

DOT believes that because airlines incur costs over their entire route networks, defining the cost of serving a route or the incremental cost of serving additional passengers depends on the circumstances involved. For example, DOT noted that the incremental cost of serving an additional passenger depends on whether that passenger can be served on a flight that is less than full or if that passenger would displace another passenger on the flight. The incremental cost of a passenger on a flight that would otherwise fly with an empty seat is very low. However, according to DOT, the incremental cost of another passenger on a full flight is the forgone revenue from the passenger who would be displaced because the flight is full. In addition, DOT noted that if the airline decides to add flights or use larger aircraft, the incremental cost would be the additional cost associated with those decisions.

Other Federal Agencies Involved in Developing the Proposed Policy

Several months before issuing the proposed policy statement, DOT met with officials from Justice and FTC, who reviewed and commented on the document. DOT consulted with these agencies because of their responsibility for enforcing federal antitrust laws. According to officials from Justice and FTC, their comments mainly dealt with the description in the policy statement of their agencies' respective missions and responsibilities. DOT revised the language of the proposed policy statement to address those concerns. Staff from the Office of Management and Budget did not formally review the policy statement but, along with staff from Justice and FTC, attended meetings held by DOT to review drafts of the policy statement.

DOT Expects to Issue the Final Policy in September 1999

Senior DOT officials have stated that they plan to issue the final policy in September 1999. The Department has been revising the policy statement based on the comments that it received. The Congress required DOT to send it the final policy and mandated that the policy will not become effective until at least 12 weeks after it is received.[8]

Prior to issuing the final policy, the Congress also required the Department to send it a report on competitive practices in the airline industry. The report is to include (1) a description of and examples of complaints received by the Secretary concerning acts of unfair competition or predatory pricing in the airline industry; (2) a description of options available to the Secretary for addressing acts of unfair competition or

[8]See P.L. 105-277. The law states that the 12-week period includes only weeks in which the House of Representatives is in session for at least 1 day.

predatory pricing; (3) an analysis of the policy statement, including information on the impact of the final policy on such things as scheduled service to small and medium-sized communities, air fares, and members of frequent flyer programs; and (4) a description of the manner in which the Secretary plans to coordinate the handling of complaints against air carriers filed with the Secretary and similar complaints filed with the Attorney General. DOT staff are preparing the competitive practices report and expect to deliver it to the Congress in September along with the final policy.

Proposed Policy Addresses Potential Problem Practices, and DOT Plans Revisions to Improve Its Enforceability

In issuing the proposed policy statement, the intent of DOT was to address what it viewed as potentially unfair competitive practices by some major airlines and to help with future enforcement by identifying some practices that would trigger an enforcement proceeding. DOT's proposed policy statement generally addresses the complaints dealing with price cuts and capacity increases that the Department received as well as the behaviors that DOT identified in its investigations and analyses of industrywide data. As we discussed earlier in this report, DOT's proposed policy statement addresses unfair competitive practices in the form of a major airline expanding its capacity and selling a large number of seats at very low fares, which results in lower revenue in the short term than would result from a reasonable alternative strategy for competing with a new entrant airline at the major airline's hub airport. However, DOT acknowledges that the policy's description of unfair competitive practices may be vague and plans to revise it.

The proposed policy statement generally addresses 16 of the 17 complaints dealing with alleged price cuts or capacity increases that DOT received prior to developing it. One complaint of alleged price cuts did not cover routes from a hub airport of a major airline and, therefore, would not be covered by the proposed policy. Another complaint included four routes, only one of which would be covered by the proposed policy because it was the only route that included a hub airport of a major airline. According to DOT, the 10 new entrant airlines that made these complaints started operations within the last 10 years and, therefore, would be encompassed by the proposed policy. For the most part, the complaints did not mention whether the major airlines involved received lower revenues in the short term because of their actions; therefore, we were not able to assess whether the complaints dealt with this aspect of the policy statement.

Similarly, the proposed policy statement addresses the pricing and capacity-setting practices that DOT identified in its investigations and analyses of industrywide data. In its two investigations, DOT examined new entrant airlines' complaints that the major carrier in particular markets added capacity and matched or undercut the new entrants' fares. In one complaint, the new entrant specifically mentioned that the major airline's actions were designed to force the new entrant to leave the markets and did not constitute a legitimate competitive response to new entry. As we discussed earlier in this report, in one investigation, DOT also found that the major airline's pricing and capacity-setting activities resulted in substantial diversion of its revenue, behavior the proposed policy statement addresses.

In addition, DOT's analyses of industrywide data indicated that three other major airlines exhibited behavior that is addressed by the proposed policy statement. As we discussed earlier in this report, DOT's analyses of major airlines' practices in markets in which they were competing with new entrants showed that the major airlines greatly increased the total number of seats sold, but earned substantially less revenue because they were selling so many seats at low fares.

Finally, DOT intends the proposed policy statement to help with future enforcement by describing practices that would trigger an investigation. The Department, however, has received comments from several major airlines and an industry trade association that question the proposed policy's enforceability. For example, the trade association commented that the proposed policy is "riddled with vague and undefined terms, and no carrier can know in advance whether its response to a new entrant will later be judged unreasonable by DOT." The commenter noted that critical terms in the proposed policy—such as "reasonable alternative response," "very low fares," and "large number of seats"—are undefined and do not provide meaningful guidance to airlines in distinguishing prohibited from permitted practices. These concerns were echoed in other comments. Such vagueness, according to a major airline, will lead to arbitrary enforcement. Another major airline, commenting on the vagueness of the proposed policy, stated that the policy imposes an impossible burden on major airlines to guess at its meaning as well as how the marketplace and competitors will react to the airline's price and capacity offerings. In addition, one smaller airline commented on the need to revise the wording of the three "triggers" for enforcement, noting that they could be construed more broadly than the Department intended. According to senior Department officials, the policy statement is being revised to

address concerns about vagueness as well as other concerns raised in the comments.

Agency Comments

We provided the Office of the Secretary of Transportation with a draft of this report for review and comment. The Deputy Assistant Secretary for Aviation and International Affairs and the Assistant General Counsel for Aviation Enforcement and Proceedings advised us that they generally agreed with the information presented in our report. They also provided several technical corrections, which we incorporated as appropriate.

Scope and Methodology

To address this report's three objectives, we interviewed officials from DOT's Office of the General Counsel and Office of the Assistant Secretary for Aviation and International Affairs. To gather information on why DOT developed the proposed policy statement, we also obtained from the Department documentation of complaints it received about unfair competition practices. To determine what process DOT used to develop the proposed policy, we reviewed the Department's docket for public comments on the process it used. We also interviewed officials from the Department of Justice, FTC, and the Office of Management and Budget to obtain information on DOT's consultations with them. To determine if the proposed policy statement addressed the problems identified in the complaints, we compared the proposed policy statement with the list of complaints we obtained from DOT. Similarly, we compared the proposed policy statement with DOT's findings from its investigations and analyses. For this last objective, we also analyzed comments in the docket about the enforceability of the proposed policy statement.

To determine DOT's authority to promulgate the proposed policy statement, we reviewed the Administrative Procedure Act and the provisions of title 49, U.S. Code, concerning DOT's authority to enforce competitive practices in the airline industry. We also interviewed officials from DOT and the Department of Justice.

We conducted our work from December 1998 through July 1999 in accordance with generally accepted government auditing standards.

We are providing Rodney E. Slater, Secretary of Transportation, with copies of this report. We will make copies available to others on request. If

you or your staff have any questions about this report, please call me at (202) 512-2834. Key contributors to this report are listed in appendix II.

Sincerely yours,

John H. Anderson, Jr.
Director, Transportation Issues

DOT's Authority to Prohibit Unfair Aviation Competition

The Department of Transportation's (DOT) legal authority to undertake enforcement actions against airlines engaged in unfair practices affecting competition in the industry stems from sections 40101 and 41712 of title 49, U.S. Code. In section 40101, the Congress directed DOT to consider the following issues, among others, to be in the public interest: (1) the prevention of predatory or anticompetitive practices in the airline industry; (2) the avoidance of unreasonable industry concentration, excessive market domination, monopoly powers, and other conditions that would allow an airline to unreasonably increase fares, reduce service, or exclude competition; and (3) the encouragement of entry by new and existing air carriers. Under section 41712, DOT has authority to prohibit business practices that are deceptive practices or unfair methods of competition.

The Congress originally granted the legal authority in section 41712 to the Civil Aeronautics Board (CAB). When CAB was abolished in 1984 during the process of airline deregulation, the Congress granted DOT that same legal authority to prohibit unfair or deceptive business practices. DOT and CAB have used this authority to address various practices, including deceptive practices involving ticket agents, advertising and sale of air transportation, and carrier-owned computerized reservation systems. In some areas—such as deceptive advertising—DOT has taken enforcement action, including assessing penalties. In addition, DOT has adopted regulations in areas such as computerized reservation systems.

DOT has a range of compliance tools available. The Department has informally negotiated with the affected parties to resolve a problem—the Department refers to this as "jawboning." The Department has informally investigated some complaints and asked the parties to provide relevant data and documents.[9] In addition, section 41712 authorizes DOT to conduct a formal investigation and hearing on unfair practices.[10] DOT can initiate this activity on its own or after receiving a complaint. DOT first determines whether an enforcement proceeding is warranted. Next, DOT notifies the affected parties that an enforcement proceeding is commencing or notifies the complaining party that no such proceeding will be instituted. The DOT Deputy General Counsel and Assistant General Counsel for Aviation Enforcement and Proceedings have overall responsibility for the

[9]DOT can conduct informal investigations using the procedures described in 14 C.F.R. 305 (Rules of Practice in Informal Nonpublic Investigations) and can collect information using the authority provided under 49 U.S.C. 41708.

[10]Procedures for investigations for enforcement and subsequent legal proceedings are described in subpart B of 14 C.F.R. part 302 (Aviation Proceedings Before the Office of the Secretary).

prosecution in the proceedings. If necessary, the Assistant General Counsel may develop an information request to gather facts from the affected parties. If the Assistant General Counsel determines that enforcement action is warranted, a complaint is filed, and the proceeding is assigned to one of the Department's administrative law judges for a formal hearing. If the judge determines that a violation has occurred, the judge may order the airline to "cease and desist" from the illegal conduct and, under certain circumstances, impose civil penalties. Failure to comply with an order could also result in fines. The judge's decision may be reviewed by the Department, and the U.S. Court of Appeals has the authority to review the Department's final order. At any point in the process, the Deputy General Counsel and Assistant General Counsel can settle a case with the party involved.

Lastly, DOT can refer cases to the Department of Justice, which has the authority to enforce federal antitrust laws. Until May 1999, when Justice filed a lawsuit against American Airlines, it had never used that authority to file an antitrust lawsuit concerning predatory pricing in the airline industry.

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