

**BEFORE THE  
U.S. DEPARTMENT OF TRANSPORTATION  
OFFICE OF THE SECRETARY  
WASHINGTON, D.C.**

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Joint Application of )  
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**DELTA AIR LINES, INC. and  
WESTJET** )

**Docket DOT-OST-2018-0154**

Under 49 U.S.C. §§ 41308 and 41309 )  
for Approval of and Antitrust Immunity )  
for Alliance Agreements )  
\_\_\_\_\_ )

**ANSWER OF SOUTHWEST AIRLINES CO.  
TO SHOW CAUSE ORDER 2020-10-13**

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its proposed mechanism for doing so – a single-bid, blind auction – has significant shortcomings and is especially unsuitable for illiquid assets like slots. It has long been recognized in academic circles and by a number of government agencies that a *multiple-bid, ascending auction which produces a market clearing price (i.e., the winning bid)* is the best means to assure that scarce assets will be put to their greatest societal benefit. We address this issue in detail below, and for the reasons given, we urge the Department to revise its auction mechanism accordingly.

I. **Divesting WestJet’s 16 LGA Slots is Necessary to Ensure that the Immunized Alliance Does Not Substantially Reduce Competition.**<sup>3</sup>

Southwest fully supports the Department’s tentative decision to require the Joint Applicants to divest 16 LGA slots, an action the Order describes as necessary “to ensure that the transaction does not substantially reduce competition.”<sup>4</sup> Southwest agrees with the Department’s finding that “[a] revenue-sharing and metal-neutral JV, in which Delta and WestJet act as a combined entity, would revert effective control of WestJet’s acquired LGA slots to Delta.”<sup>5</sup> This outcome would effectively reverse the DOT’s 2011 required divestiture of 16 Delta slots to WestJet which was intended to provide LCC competition at LGA to offset the newly dominant Delta. We agree with the Department that to preserve the competitive benefits intended (and currently provided) by the 2011 divestiture, the equivalent of WestJet’s 16 LGA slots must be re-divested to an independent LCC as defined by the Order’s eligibility criteria.

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<sup>3</sup> Southwest recognizes that the Order does not specify which 16 slots must be divested as long as they are within +/- 30 minutes of WestJet’s LGA slots (Order at 29). Southwest supports this flexibility and refers to the 16 slots as WestJet’s for convenience.

<sup>4</sup> Order at 21.

<sup>5</sup> *Id.* at 20.

Considering Delta's dominant share of slots at LGA and the minimal LCC competition at the airport, it is beyond question that immunizing the Joint Venture without re-divesting the WestJet slots would "increase [ ] the concentration of slots at LGA, already a highly concentrated airport, and effectively undo [ ] the 2011 divestiture, the foundation for which is still evident in this case record."<sup>6</sup> Delta should not be permitted to use an immunized Joint Venture as a means to recapture the very slots it was required to divest in 2011.

**II. Divesting the Slots to an Independent LCC at LGA Will Enhance Competition and Benefit the Public.**

Southwest's experience is consistent with the Department's findings that "access to LGA [for new entrant and limited incumbent carriers] is effectively closed for additional services, and it is clear that the secondary market for slots at LGA is not liquid."<sup>7</sup> Despite repeated efforts and a willingness to pay a market price for slots, Southwest has been unsuccessful in acquiring any additional permanent LGA slots since 2011 beyond those made available by government-ordered divestitures.

The severe limits on LCC access to LGA come at a very high cost to the public. As Southwest showed in its Answer to the Joint Application, Delta's average LGA fares are 52% higher than Southwest's average LGA fares (even controlling for distance).<sup>8</sup> In the limited number of markets that Southwest is able to serve at LGA, Delta's fares are

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<sup>6</sup> Order at 20.

<sup>7</sup> *Id.*

<sup>8</sup> Southwest Answer, Dec. 11, 2019, Sec. IV, p. 7, Exhibit WN-104.

15% lower than in LGA markets where Delta faces only legacy carrier competition (again controlling for distance).<sup>9</sup>

If Southwest were able to acquire more LGA slots, it would reduce fares for more consumers and provide new competition to Delta. In its December 2019 Answer, Southwest showed the enormous benefit of its service on fares and traffic in the seven LGA markets it has entered since 2012: One year after Southwest's entry, fares declined an average 20% and passengers increased 31%.<sup>10</sup> The lower fares generated nearly one million more passengers in those markets the year after Southwest began serving them.<sup>11</sup> If Southwest were able to acquire 16 additional LGA slots, the same kinds of benefits would extend to an even greater number of markets and consumers.

**III. A Multiple-Bid, Ascending Auction Would Ensure the Slots Are Put to Their Best Use and Could Benefit the Secondary Market as well.**

The DOT's Order proposes to divest the 16 slots in one bundle to an eligible carrier using a blind, *single-bid* process as was used in the 2011 US/DL Slot Swap proceeding where the slots were first divested.<sup>12</sup> Further, the DOT proposes that the auction be administered and managed by an "independent third party" approved by the DOT.<sup>13</sup> Southwest supports most aspects of the DOT's divestiture proposal, *i.e.*, a single slot bundle consistent with the 2011 divestiture that will allow the winning bidder to launch a critical mass of new flights, a blind auction to hide the bidders' identities, and the use of

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<sup>9</sup> *Id.*, Sec. V, p. 8, Exhibit WN-105.

<sup>10</sup> *Id.*, Sec. V, p. 8, Exhibit WN-107.

<sup>11</sup> *Id.*, p. 10 (U.S. DOT, Origin-Destination Passenger Survey, via Diio).

<sup>12</sup> Order at 29-31.

<sup>13</sup> *Id.* at 30.

an independent third party to manage the process.

However, to ensure the divested slots are allocated efficiently and generate the maximum competitive benefits, we urge the Department to adopt a blind, *multiple-bid ascending auction* process rather than a one-shot “sealed bid” approach.<sup>14</sup> A one-shot auction suffers from several shortcomings and is especially unsuitable for a market which the Department has correctly observed “is not liquid.”<sup>15</sup> Very few slot sales have taken place at any High Density airport, and there has been no transparency to those that have occurred. Bidders therefore have extremely limited information on the market price for slots. This is particularly true for the eligible bidders in this proceeding, which are all LCC or ULCC carriers with relatively few slot holdings. Absent government-imposed divestitures, the large slot holders have been unwilling to sell their slots to LCCs and ULCCs, making the secondary market even more opaque. Since there is no well-established market clearing price for slots, bidders in a one-shot sealed bid auction risk massively over- or under-bidding. Without an iterative process, a carrier could unwittingly bid too low, when it would have been willing to increase its offer if it had information on competing bids. Alternatively, a carrier may unnecessarily overbid due to a lack of such information, thereby overpaying and artificially inflating the price for slots. A process that requires carriers to take a shot-in-the-dark with only a guess on what might be a winning bid creates a random and inefficient outcome. This would not be in the interest of the Department or the public.

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<sup>14</sup> An *ascending* auction (sometimes referred to as an “English” auction) calls for bidders to submit successively higher bids for an item until no bidder is willing to bid higher. The highest bidder wins the item and pays the amount of its final bid. A *sealed bid* auction calls for bidders to submit final bids without receiving any information relating to bids by other bidders.

<sup>15</sup> Order at 20.

In contrast, a multiple-bid, ascending auction will further the Department's objectives by creating an efficient and transparent allocation system that will ensure the divested slots are put to the greatest societal benefit. An ascending auction will also help establish a market-clearing price for the auctioned slots, something that a one-shot, sealed bid process is not even designed to do. This information will inform and potentially encourage the secondary market for LGA slots, and perhaps slots at other High Density airports.

Economists, academics, and federal government agencies have long recognized that multiple-bid, ascending auctions are the most efficient and fair means of allocating scarce assets. Utilizing such an auction in this proceeding will benefit the Department, consumers, and all auction participants including the divesting carriers.

**IV. Economic Research Supports the Use of Multiple-Bid, Ascending Auctions as the Most Efficient Means to Allocate Scarce Assets.**

One of the nation's most prominent auction experts, University of Maryland Economics Professor Peter Cramton, has stated that when allocating scarce assets "a good auction design promotes both an efficient assignment of rights and competitive revenues for the seller."<sup>16</sup> Specifically, Professor Cramton's extensive research found that multiple-bid, ascending auctions are "typically better than sealed bid on both efficiency and revenue grounds."<sup>17</sup> He also observed that a key benefit of dynamic

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<sup>16</sup> Cramton, Peter, "How Best to Auction Natural Resources" (May 2009), p. 1, available at <http://www.cramton.umd.edu/papers2005-2009/cramton-auctioning-natural-resources.pdf>.

<sup>17</sup> Cramton, Peter, "Auction Design and Strategy: Principles and Practice", p. 76, available at <http://cramton.umd.edu/econ415/auction-design-and-strategy.pdf>.

auctions is “reducing common-value uncertainty, [which is] a strong argument in favor of open [ascending] auctions rather than sealed bidding”<sup>18</sup>

Professor Cramton’s findings were reinforced and expanded by the research of the 2020 Nobel Laureates in Economics, Stanford Professors Paul Milgrom and Robert Wilson, on optimal auction formats.<sup>19</sup> Their insights were particularly instrumental in assisting the Federal Communications Commission (FCC) in the successful design of its radio spectrum auctions, and the Nobel Committee noted that their “discoveries have benefitted sellers, buyers and taxpayers around the world.”<sup>20</sup> In a 1989 article, Dr. Milgrom stated that “[i]n summary, at least for fixed quantity environments, the English [ascending] auction .... generates more receipts on average than the Dutch/sealed-bid auction. It leads to efficient outcomes in a wider range of environments.”<sup>21</sup>

A key reason that ascending auctions promote efficiency is that the iterative auction itself reveals information about valuations from other bidders. This reduces uncertainties and allows *all* bidders to make more informed bids, thereby encouraging greater participation among bidders. The Nobel Committee explained this concept in awarding the 2020 prize: “The additional affiliated information revealed to the bidders

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<sup>18</sup> “How Best to Auction Oil Rights”, p. 122, available at <http://www.cramton.umd.edu/papers2005-2009/cramton-auctioning-oil-rights.pdf>.

<sup>19</sup> Nobel Committee Press Release: “*The Prize in Economic Sciences 2020*” (Oct. 12, 2020), <https://www.nobelprize.org/prizes/economic-sciences/2020/press-release/>.

<sup>20</sup> *Id.*

<sup>21</sup> Milgrom, “*Auctions and Bidding: A Primer*,” Journal of Economic Perspectives (Summer 1989) at 17.

during the bidding process will .... encourage more aggressive bidding, leading to higher expected revenue for the seller.”<sup>22</sup>

**V. Multiple-Bid, Ascending Auctions Are Used by Many Government Agencies to Efficiently Allocate Scarce Resources.**

To date, the DOT has had only limited opportunities to allocate divested slots. It is therefore instructive to look at how other government agencies allocate scarce public and quasi-public assets under their jurisdiction. A number of federal agencies have used multiple-bid, ascending auctions to allocate scarce assets with great success, including the following:

- **FCC – Spectrum Auctions:** Since 1994, the FCC has conducted auctions of licenses for electromagnetic spectrum pursuant to Congressional authorization.<sup>23</sup> The FCC spectrum auctions consist of multiple discrete rounds of blind bidding with a predetermined length per round. After each round, the bidders are able to view the other bid amounts. To continue to participate, bidders are required to participate in each round. There is no limit to the number of bidding rounds which continue until there is no bidding activity. At this time, the auction is closed and the scarce resources are awarded to the highest bidder and only then is the winning bidder’s identity revealed. These auctions are seen as an enormous success. The Commission has found that “spectrum auctions more effectively assign licenses than either comparative hearings or lotteries” and that auctions result in licenses being awarded “to those who will use them most effectively.”<sup>24</sup>
- **GSA – Asset Auctions:** The General Services Administration (GSA) uses an auction process that allows the general public to bid electronically on a wide array of federal assets, including surplus, seized, and forfeited assets.<sup>25</sup> The auction site uses an ascending bid method conducted over the internet.

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<sup>22</sup> Nobel Committee, Background Paper (Oct. 12, 2020) at 13, available at <https://www.nobelprize.org/uploads/2020/09/advanced-economicsciencesprize2020.pdf>. For this reason the Joint Applicants have no basis for objecting to an ascending bid format.

<sup>23</sup> <https://www.fcc.gov/auctions/auction-designs>.

<sup>24</sup> <https://www.fcc.gov/auctions/about-auctions>. The FCC spectrum auctions limit the time for each round but the rounds continue until there are no more bids, thereby maximizing the bidding and creating a market clearing price.

<sup>25</sup> <https://gsaauctions.gov/html/tutorials/index.html>.

- **Department of Interior (DOI) / Bureau of Land Management (BLM) – Land Sales:** The BLM has long used ascending bid auctions in connection with leases of federal land parcels. It first used oral auctions and then in 2016 switched to Internet-based bidding. BLM’s 2016 announcement for Internet-bidding stated, “Leases will still be awarded to the highest bidder based on a sequential and ascending bid auction system.”<sup>26</sup> These auctions have been an extraordinary success.<sup>27</sup>
- **DOI / BLM – Helium Auctions:** BLM also uses competitive, ascending auctions to sell federally-owned supplies of helium generating millions of dollars.<sup>28</sup> These auctions provide for market-based pricing and competitive auctions for the sale of federal helium.<sup>29</sup>

## **VI. A Multiple-Bid, Ascending Auction Can Easily Be Implemented in This Proceeding.**

As shown above, many federal agencies use Internet-based, ascending-bid auctions to allocate scarce and valuable assets. We are not aware of any technological limitations with those auctions, and the agencies using them consider the process to be uniformly successful. The Department’s Show Cause Order contemplates the use of an independent third party to manage the allocation process, and that entity can easily implement an ascending bid auction for the single slot bundle at issue. Consistent with the Order, the bidders’ identities would be blind, which can be accomplished simply by assigning anonymous identifiers to each bidder. The winning bidder’s identity would be disclosed only after the bidding is completed. The bidding manager can also organize

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<sup>26</sup> <https://www.blm.gov/press-release/blm-takes-important-step-toward-online-oil-gas-lease-sales>.

<sup>27</sup> See, e.g. <https://www.blm.gov/press-release/blm-hold-oil-and-gas-lease-sale-beginning-march-24-2020> (describing recent internet-based, open bidding auctions and revenues raised in the program).

<sup>28</sup> See, e.g. [https://www.blm.gov/sites/blm.gov/files/2019%20Helium%20Auction%20Notice%20and%20Guide\\_Reissue%20FRN.pdf](https://www.blm.gov/sites/blm.gov/files/2019%20Helium%20Auction%20Notice%20and%20Guide_Reissue%20FRN.pdf).

<sup>29</sup> <https://www.blm.gov/press-release/bureau-land-management-helium-sales-generate-60-million-american-taxpayers-2020>.

successive rounds of internet bidding, with time limits for each round (perhaps an hour in this case), which will ensure the bidding will end with a winning bid within a reasonable period of time.<sup>30</sup> The process will be inherently simple in this case because only one asset (the slot bundle) is the subject of bidding.

### **CONCLUSION**

For the reasons above and in our previous pleadings, a divestiture of 16 LGA slots to an independent LCC is necessary to remedy the competitive harm that would otherwise result from granting antitrust immunity to the Joint Applicants. Southwest urges the Department to use a blind, multiple-bid, ascending auction to ensure the divested slots will be allocated efficiently and put to the best public use. This remedy will enable the winning carrier to offer a meaningful increase in low-fare service at LGA to provide critical competition against Delta's continuing dominant position.

Respectfully submitted,

  
Leslie C. Abbott

November 20, 2020

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<sup>30</sup> For this reason, an overall time limit on the bidding is not necessary and would be detrimental to the process because it could lead to last-bid-timing gamesmanship.

## CERTIFICATE OF SERVICE

I hereby certify that on November 20, 2020, a copy of the foregoing was served via e-mail on the following persons:

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