

D R A F T – April 28, 2012
UA Comments & HAS Responses

CITY OF HOUSTON
INTEROFFICE CORRESPONDENCE

TO: Mayor Annise D. Parker

FROM: Director of Aviation
Houston Airport System

DATE: April 9, 2012

SUBJECT: Recommendation on
Southwest Airlines'
Request for Expansion of
Federal Inspection
Facilities at William P.
Hobby Airport

Southwest Airlines (Southwest) has notified the Houston Airport System (HAS) of its intent to initiate scheduled international air service at William P. Hobby Airport (Hobby). This would require expansion of the limited Federal Inspection Services (FIS) facilities currently available there. Southwest seeks the City's support for the facility expansion.

As discussed in detail below, I recommend that the City support this effort. Since receiving Southwest's request, HAS has undertaken a review of the key factors involved; this memorandum summarizes the background, issues and process involved in reaching my recommendation. We considered what is in the best interests of the residents and taxpayers of the City and of the region, and asked what would be a common sense solution for the opportunity proposed by Southwest. Critical to my recommendation are the results of economic impact reports completed at HAS's request, which show that international air service at Hobby would produce significant benefits for the City and its residents. Factors underlying my recommendation include:

- New international air service at Hobby is projected to generate an additional 1.5 million passengers traveling to, from, and through Houston each year, creating over 10,000 jobs and generating an annual economic impact of over \$1.6 billion for the greater Houston metropolitan area.
- New international air service at Hobby will create competition in the Houston- Latin America market, leading to lower airfares and more travel options for Houston passengers.
- Numerous other metropolitan areas - including Chicago and Miami/Ft.

Lauderdale - successfully operate multiple international airports and have proven that the resulting competition lowers airfares and grows the overall metropolitan and regional air travel market.

Whether Southwest were to operate internationally at Hobby or at George Bush Intercontinental Airport (Bush Intercontinental), additional Customs and Border Protection (CBP) resources would be required given the volume of additional air traffic that would be generated in Houston.

- We believe we can work with the Department of Homeland Security (DHS) (as have many other airports across the country) to manage this issue and accommodate the growth in international passenger traffic expected for Houston, without compromising federal inspection services at Bush Intercontinental.
- As a consequence of accepting funding from the FAA for airport infrastructure development, the City and HAS are bound by FAA grant assurances that encourage competitive access and prohibit the granting of exclusive rights to any airline, as further detailed below in paragraph VI. NATIONAL AVIATION COMPETITION POLICY

UA COMMENT: Critical to United's objection to Mr. Diaz's recommendation is the fact that HAS's economic impact study is based on faulty assumptions. **HAS**

RESPONSE: Mr. Diaz's recommendation is based on a number of points, of which the economic impact study is one. Additionally, the recommendation is founded on the principle of supporting competition and granting open and equal access to airport facilities. The "Southwest effect" and the resulting assumptions on market stimulation are well documented.

UA COMMENT: The assumptions of the InterVISTAS study result in inflated passenger and job growth figures, while ignoring the United capacity cuts which would more than offset these gains.

In addition, the passenger stimulation figures are not only contradicted by the report itself, but can be shown to be clearly unrealistic. **HAS RESPONSE:** See above. The InterVISTAS analysis was based on a forecast model that is utilized worldwide by airlines, airports, governments and consultants. The study concluded that United would respond with lower fares prices when faced with competition from Southwest, which would stimulate demand. United might lose some profit should it choose to compete with Southwest, but it is not the City's role to favor one carrier over another or to prevent competition.

UA COMMENT: Over the last five years, fares today in markets that Southwest (WN) has entered are 4% *higher* than before entry. Also, with United's reductions in schedule as a result of the Hobby FIS, travel options will be reduced not only to points that WN serves, but points that WN doesn't serve, resulting in schedules with less depth and breadth than today. **HAS RESPONSE:** It is not relevant what fares have done over time, which is largely a function of a number of factors. Instead, it is relevant that fares in a market decline when a low cost carrier, such as Southwest, enters a market that previously lacked competition.

This effect is well known and documented and continues today in markets that have not yet experienced this phenomenon – such as Houston to Latin America, where United operates 95 percent of the capacity. The economic impact analysis, commissioned by HAS, does not support United's assertion that it will be forced to cut capacity.

UA COMMENT: FALSE. Chicago has three flights to Mexico (WN is adding a fourth) which cannot be defined as a meaningful increase in service for the city of Chicago. United's (UA) and American's (AA) increases to Mexico since 2010 are in response to Mexicana (MX) going out of business, NOT as a result of Low Cost Carrier (LCC) presence at Midway (MDW). **HAS RESPONSE:** Often it does not take a large amount of low cost carrier service to instill competitive pricing in a market. This is well documented by economists, such as Dr. Jan Brueckner and others, who even point to the meritorious effects of "potential LCC competition".

I'd like to begin by describing our evaluation process and the specifics of Southwest's proposal. Thereafter I will highlight the key findings and considerations that support my recommendation.

I. EVALUATION PROCESS

As you know, in the interests of providing the City, its businesses and residents with global international air service, HAS operates an ongoing program to expand the range and scope of those services, working closely with airlines domestically and around the world. In recent years all scheduled international services in Houston have been operated from our largest airport, Bush Intercontinental, using that airport's FIS to process arriving international passengers. Southwest's request posed unique circumstances given its plan to utilize its existing and sizeable domestic network operation at Hobby to generate connecting (flow) traffic to feed its projected international flights. Based on these unique circumstances and utilizing expert consultants and advisers, we undertook an in-depth review of the key issues. This included (1) review of the feasibility of possible Southwest international operations at Bush Intercontinental, rather than at Hobby, including the availability of terminal space; (2) the development of data regarding the economic benefits to the City and this region, its residents and its businesses from implementation of Southwest's proposal; (3) consideration of CBP resource availability for a potential new FIS facility at Hobby; (4) review of the proposed FIS expansion for consistency with the nation's pro-competitive air transportation policy; and (5) input from stakeholders and the public.

UA COMMENT: Based on CBP statistics, in recent years IAH's ranking in average processing times (passenger-weighted) have dropped from among the best in 2006 to near the bottom in 2011. IAH's relative performance is especially challenged during peak international travel times, averaging higher than all other competing hubs. With wait times regularly exceeding one hour, in 2011 IAH

ranked in the bottom three airports in the nation in CBP peak wait times. Having longer average processing times than ATL, DFW and MIA puts IAH at a competitive disadvantage to other southern hubs, since frequent international business travelers consider the speed and efficiency of customs processing when they choose itineraries. If additional resources are to be had, it would make more sense to deploy them to IAH. **HAS RESPONSE:** We agree that there is no reason for IAH to have longer CBP processing times than other airports and this is something that we should work together to correct. HAS is in ongoing discussions with CBP regarding arrivals processing at IAH and improving the customer service experience. Regarding the concerns raised over CBP staffing for a new FIS, the City Administration has met in Washington, D.C. with the Associate Administrator for Custom and Border Protection – In Charge of Field Operations. The Administrator assured the City Administration that CBP never says no to a request for establishing a new FIS. Presently, there are over 41 airports across the country requesting assistance. CBP assigns agents on an as needed basis, and if Houston were to make a request, it would be given a high priority given the volume of traffic being forecasted at Hobby. There is a very specific process to be followed with CBP to create a new FIS and it does not happen overnight, but CBP advises it has never denied an airport the necessary agents needed to staff an FIS once it is demonstrated the demand for the facilities is real and that it would not compromise the operation at IAH in order to staff Hobby. The Administrator gave as an example Miami and Fort Lauderdale, Florida. There you will find two international airports and two ports. All four are staffed and are functioning well; Fort Lauderdale's FIS facilities were significantly expanded in the middle of the last decade to support US Airways' plans at the time to provide expanded international service to Latin America, and subsequently have been the basis for growth by Spirit and other low cost carriers. The Tampa Airports Authority is in the process of expanding its FIS, and next month the City of Atlanta will be opening a new international terminal and FIS. The City will be receiving 120 new CBP agents to staff the FIS. For fiscal year 2012 CBP received 300 additional agents to staff international operations. Seventy-five of those agents were split between Atlanta and Miami.

UA COMMENT: Neither the policy objectives in the federal aviation statute, which apply to DOT economic regulation, nor the FAA Grant Assurances require HAS or the City to allow international operations at HOU or to provide FIS there. To the contrary, HAS is allowed to continue its current policy, just as DFW is doing today. Indeed, the FAA has long recognized an exception for owners/operators of multi-airport systems like Houston's from the general nondiscrimination requirements of Grant Assurance 22 where, as at Hobby, the volume of air traffic is approaching or exceeding the maximum practical capacity of an airport. See *Centennial Express Airlines and Golden Eagle Charters d/b/a Centennial Express Airlines v. Arapahoe County Public Airport Authority*, FAA Docket Nos. 16-98-005, 13-94-03 (Feb. 18, 1999), at 26. **HAS RESPONSE:** There is no HAS current policy, and DFW's situation is entirely different, for reasons of federal law. In the case cited above, the Federal Aviation

Administration found against the Arapahoe Airport Authority and the City of Greenwood Village, Colorado when they attempted to deny access to Centennial Express Airlines at Centennial Airport. The case did not in fact involve a multi-airport system, and the FAA found (see p. 28) that “[T]he Airport Authority violated the following:

- 49 U.S.C. 47107(a)(1) and standard Airport Improvement Program (AIP) grant assurance no. 22 (prohibiting economic discrimination)
- 49 U.S.C. 47107(a)(4) and 40103(e) and standard AIP grant assurance no. 23 (prohibiting granting exclusive rights)
- 49 U.S.C. 41713 (prohibiting state and local regulation of air carrier prices, routes, or services).

The FAA then ordered the Airport Authority to present a plan within 60 days on how it intended to address the FAA’s concerns by eliminating the violations; and pending approval of the corrective action plan the Airport Authority would be ineligible to apply for new FAA grants. The FAA’s decision was upheld by the U.S. Court of Appeals for the Tenth Circuit, and Arapahoe rescinded its ban. The federal court strongly supported the FAA’s authority to make its decision. Additionally, in subsequent guidance, the FAA has indicated that to the extent that a multi-airport system exception exists at all, it is extremely narrow, with predicates that are not met at Hobby (i.e., traffic at Hobby is not approaching or exceeding its current capacity, much less its theoretical maximum capacity). The federal government has pre-empted the field of airline competition regulation and severe consequences could flow to Houston from any attempt by the City to regulate airline competition.

II. SOUTHWEST'S PROPOSAL/COST TO THE CITY

1. New flights to Mexico, Central America, and potentially the Caribbean and northern South America

Southwest proposes operating low-fare flights to Mexico, Central America, and potentially the Caribbean and the northern tier of South America from Hobby. While Southwest has not disclosed the precise markets it would serve, they would likely be concentrated initially in Mexico and Central America given Houston's central location along the southern border of the U.S., the size of the local Houston air travel market to cities in those areas, and Southwest's initial international services offered from other cities in the western half of the U.S. Using its fleet of Boeing 737 aircraft, Southwest could also reach destinations in the Caribbean and northern tier of South America. However, the operational limitations of this aircraft type and the runway length at Hobby would limit service beyond this stage-length.

A start-up Southwest operation could likely consist of 10 daily flights to four or

five markets in Mexico and Central America. As the operation builds, Southwest could operate up to 20 daily flights, expanding its reach to markets in northern South America. We have also received interest from other carriers, in providing international service at Hobby, and we could expect them collectively to operate a handful of daily flights.

2. A New International Concourse and FIS Facility at Hobby to be funded by PFCs

To support the proposed new international services at Hobby, the City would need to build a new international concourse containing an FIS facility. The facility would accommodate international service offered by any airline, not just Southwest, and would consist of five gates in addition to the FIS, as outlined in Attachment 1. Enabling infrastructure projects, such as a new garage and improved roadways, would also need to be completed.

The cost of the international concourse and FIS facility would be approximately \$100 million, and would take three years to design and build.

UA COMMENT: These carriers could fly immediately to IAH if they desired, and in fact, would have more interline connecting support at IAH than at HOU and, therefore, a better chance of sustainability. Any other carriers would likely come from IAH.

UA COMMENT: HAS has not yet briefed UA or the other carriers at IAH as to the specific funding structure that would be used to develop an FIS at HOU. If the intent is to use revenue from an increased Passenger Facility Charge, it would appear that all HOU travelers would be paying for the facility, including those HOU carriers other than WN. This plan would appear to contradict what WN has said publicly, that it would pay for the FIS. It is unclear whether WN is assuming any obligation or risk in the project.

UA COMMENT: Again, HAS has not provided detailed information on the financing structure of the HOU project, including the estimated cost of these additional elements. We assume they are not included in the \$100M HAS investment in the FIS facility. The nature and extent of both HAS' and Southwest's investment is unclear.

HAS RESPONSE: The means of financing this expansion will be defined in an agreement between the City and Southwest Airlines if that agreement is reached.

III. BUSH INTERCONTINENTAL FACILITIES

Because of the importance of this matter to the City, we considered whether we should ask Southwest to relocate all its operations to Bush Intercontinental or to conduct split operations, i.e., maintain its current domestic operations at Hobby

while operating its new international services from Bush Intercontinental.

Neither concept is feasible. At Bush Intercontinental there are insufficient gates to accommodate a complete relocation of Southwest, absent construction of a new terminal. Doing so would cost the City and Southwest over \$1.5 billion, redundantly duplicate the investment recently completed at Hobby, and could leave Hobby with only non-commercial general aviation traffic and an unworkable cost structure.

Splitting Southwest operations between Hobby and IAH is not a reasonable solution either. This would force passengers connecting between Southwest's split international and domestic services to travel between Bush Intercontinental and Hobby. Passengers doing so would be highly inconvenienced, others would simply choose not to do so, and Southwest would be placed at a severe competitive disadvantage compared with United, which operates both its domestic and international services at Bush Intercontinental. Realistically, Southwest's international flights at Bush Intercontinental could carry only local passengers who either begin or end their trips in Houston. Southwest would, in effect, lose the opportunity to carry flow traffic from its domestic flights at Hobby, which is essential for its international services to be economically viable. Southwest does not have split operations in any other metropolitan region. Indeed, no other major U.S. carrier has such an operation in the U.S. For example, about 70% of United's international traffic to Latin America at Bush Intercontinental transfers between its domestic and international flights.

UA COMMENT: FALSE. WN operates in many split markets: SJC/SFO/OAK (San Jose, San Francisco, Oakland); ISP/EWR/LGA (Islip, Newark, LaGuardia); LAX/ONT/SNA (Los Angeles, Ontario, Orange County); IAD/BWI (Dulles, Baltimore); BOS/PVD/MHT (Boston, Providence, Manchester) etc. Of all split markets across the U.S., WN splits its operations in over 50% of those regions.

HAS RESPONSE: Most of these markets have international facilities in more than one airport. Southwest is not forced to operate domestic service at one airport and international service at another but chooses to serve the multiple airports, in part because their catchment areas are not identical, the service is point-to-point, and some of these airports are spoke connections to one of their hubs. For instance, in the case of Dulles and Baltimore, the airports are roughly 60 miles apart.

UA COMMENT: FALSE. Delta (DL) at JFK/ LGA is doing exactly this, and this was discussed in detail in the public arena during the DL/US (US Air) slot transaction. **HAS RESPONSE:** New York is the largest air service market in the U.S. and potentially can support flights based solely on the strength of the local market. Delta Air Lines operates a "Shuttle" service from LaGuardia as have Eastern, New York Air, The Trump Shuttle and many others before to Boston, Chicago, Washington, D.C., and Atlanta. Delta entered into the slot swap with US Air for this very reason: to obtain additional slots to Washington, D.C. One

reason airlines fly to LaGuardia is that it is the close-in airport to Manhattan, with strong local demand, and commands high airfares. Additionally, the three major New York-area airports all are subject to slot restrictions which require carriers to make best use of limited resources – a situation that does not exist in Houston. A split airport hub and spoke strategy, designed to flow passengers from one flight to the next (especially from domestic to international) at a different airport, is not practiced by any major U.S. carrier. In fact, United's predecessor in Houston, Continental, attempted a split operation at IAH and HOU in the 1980s, with an air shuttle (the "Houston Proud Express") between the two airports; the experiment was quickly abandoned.

None of the parties expressing opposition to the Southwest request have provided any means or methods by which Southwest could realistically resolve this problem, and Southwest has indicated that it would not conduct such an operation.

IV. ECONOMIC BENEFITS TO HOUSTON

In order to assess the economic impact to the flying public and the City that would result from the addition of international air service at Hobby, we commissioned two studies by leading aviation economic experts, InterVISTAS Consulting LLC (IVC) and GRA, Incorporated (GRA), to evaluate the effects of such an operation on the City, its residents, and our airports. Their evaluation included a market analysis, passenger traffic forecast, and an economic impact assessment. Attachment 2 comprises the complete report, merging the two studies and including extensive technical appendices with supporting data and details of the methodologies used.

The report first reviews the local market and industry-wide trends, the current state of competition in the market, and the experience of other metropolitan regions with multiple international airports. It then provides a forecast of the likely air services to be initiated, the projected passenger increases at both Hobby and Bush Intercontinental, the number of jobs that would be created in the Houston region, and the economic benefits for the residents, businesses and community of Greater Houston. The methodology applied is well tested, highly valued and utilized extensively by airlines and airports across the United States, as well as by the Federal Aviation Administration (FAA) in preparing its ongoing reports of the economic impact of U.S. civil aviation.

UA COMMENT: Much of the report actually runs counter to industry trends.

HAS RESPONSE: We have received no information to support this comment.

UA COMMENT: FALSE. United has planners with history/background across six major airlines, and none have ever seen these stimulation or price elasticity formulae before. In fact, most algorithms used by InterVISTAS look not only foreign, but unsubstantiated and inaccurate. **HAS RESPONSE:** The

methodology is widely used in the aviation industry worldwide, including by the FAA.

The report finds that "the addition of international airline services at Houston Hobby will have a significant positive impact on the region's economy" based on the following:

1. Houston's population and local air service market are large and growing
2. New international service at Hobby is projected to create over 10,000 jobs and generate approximately \$1.6 billion in annual economic impact for the Houston area

UA COMMENT: Reference earlier comment about faulty assumptions. **HAS RESPONSE:** Reference earlier HAS response.

3. Southwest will provide needed competition to United's dominant position in the Houston-Latin America market (where United currently offers 97% of all available seats), resulting in lower fares and new travel options for Houston passengers

UA COMMENT: The HAS study and Diaz memo overstate UA's passenger share in Houston by using a measure of capacity, i.e. seat shares. Hub carriers will always have a large percentage of capacity, but most of the seats are filled with connecting passengers — in UA's case, two-thirds. The industry standard measure of market share is by percentage of local passengers (origination and destination - O&D). United's share of O&D passengers flying in the Houston-Latin America market is 78%. **HAS RESPONSE:** The real issue is United's overwhelming market share to Latin America. Even when measuring the market share from IAH to that region on the basis of local enplanements, the small amount of competition in the Latin American market offered by Aeromexico, TACA and VivaAerobus combined (134 scheduled outbound departures from IAH during April 2012, or about 4½ per day, vs. United's 2802 departures during the month, or about 93½ per day) almost certainly means that United will still have more than 90% of the Latin American market. This is due in large measure to United's share of seats in the market (97%) which would still outnumber those provided by AM/TA/VB by 11-to-1 even if it is assumed that only one-third of United's seats are filled with local passengers. And this result is aided by United's greater average aircraft seats (115 vs. 73 for AM/TA/VB, or 58% more).

4. Through the "Southwest Effect", international service at Hobby will expand the market for all airlines, including for United at Bush Intercontinental

UA COMMENT: Recent history shows that in markets WN enters, fares climb 4% in the long-run (versus before WN entry). Stimulation levels used by InterVISTAS are not supported with historical data, and appear to be overstated by a factor of

18. HAS RESPONSE: HAS has received no information that would support this assertion. Moreover, it is not relevant what fares have done over time, which is largely a function of changes in industry structure. Instead, it is relevant that fares in a market decline when a low cost carrier, such as Southwest, enters a market that previously lacked competition. This effect is well known and documented.

5. Other metropolitan areas, including Chicago and Miami/Ft. Lauderdale, have experienced significant air service growth with multiple international airports

UA COMMENT: FALSE. In overlapping markets, MIA/FLL (Miami/ Fort Lauderdale) is down 2.5% since 2007, with jetBlue and Spirit in the market. In Chicago, daily seats to Mexico are down 12% since Volaris entered the market. **HAS RESPONSE:** 2007 was the beginning of the Great Recession economic downturn and a time period when fuel prices were significantly lower. Most airports, including IAH, experienced a decline in traffic from this point in time.

6. Southwest will continue to expand internationally at other U.S. cities if it cannot do so at Hobby, leading to fewer local air travelers at Hobby, diversion of connecting passengers from Houston and the loss of associated economic benefits.

UA COMMENT: Given WN's point-to-point operation, they can expand at SAT (San Antonio) regardless of activity at HOU. The best way for the city to compete with SAT, DFW, ATL, and all other cities looking to grow internationally, is to focus resources in its most effective connect hub – IAH. Why does this need for competitiveness apply at a weaker HOU but not a stronger IAH? **HAS RESPONSE:** As an international gateway, Houston is in competition for the business of the travelling public. The best way to ensure the City can compete with other cities for this business is to ensure that our air service is of the highest quality and the lowest price. This is best achieved by supporting and encouraging competition in air services in Houston. It is up to Southwest to decide where they want to expand; HAS feels fortunate that they want to expand at Hobby. Furthermore, expansion in San Antonio will not bring to the City and its residents the benefits projected as a result of Hobby expansion.

While the report speaks for itself and documents its conclusions comprehensively, I would like to highlight some of the main findings:

1. Houston's population and local air service market are large and growing

The Houston metropolitan region is the fastest-growing and most diverse in the U.S., officially reaching a total of 6 million people last summer, surpassing Philadelphia to become the nation's fifth-largest metropolitan area. From 2000 to 2009, Houston's population grew by 24.4 % compared to the national average of

9.1%.

The Houston metropolitan region has the fourth largest Hispanic population in the U.S. By 2035, Houston is expected to add nearly 3.4 million new residents, and a large majority of them will either be from or have roots in Latin America. These factors support the likely success of new international flights and the ability of the market to support multiple international airline services to Latin America.

2. International service at Hobby is projected to create over 10,000 jobs and generate approximately \$1.6 billion in annual economic impact for the Houston area

The addition of more local travelers, connecting passengers and visitors to Houston is estimated to generate over 10,000 jobs and approximately \$1.6 billion in annual economic impact for the region. More travel by Houston residents means that there would be additional employment and income at the airports and in airport-related sectors. More visitors to Houston will result in more money being spent on shopping, hotels, and restaurants, among other things. Of note, it is important to bear in mind that the economic impact analysis does not attempt to calculate benefits resulting from real estate purchases, new business formation, foreign visits to the Texas Medical Center, and many other types of economic activity that would inevitably result from more foreign visitors coming to Houston because of the availability of more affordable air service.

3. Southwest will provide needed competition to United's dominant position in the Houston-Latin America market, resulting in lower fares and new travel options for Houston passengers

United and its Star Alliance partners have a 90%+ share of all domestic seats at Bush Intercontinental.

United's share of the overall domestic market in Houston (all domestic services at Hobby and Bush Intercontinental combined) is 66% as compared to Southwest's 25%. All of Houston's international flights are operated at Bush Intercontinental, and there United and its Star Alliance partners hold an extremely dominant position, offering 87% of all international seats worldwide, and 97% of all seats to Latin America.

Southwest's entry into markets in Mexico, Central America, the Caribbean and northern South America from Hobby will increase service offerings and lower airfares through competition. A comparison of airfares in these markets from Chicago — where airlines at both O'Hare International (O'Hare) and Midway airports offer international service in a competitive environment — show that, in general, fares are significantly lower than those available from Houston, despite the extra distance to those markets from Chicago. The report projects that opening Hobby to international service would create a more competitive landscape, with United and its Star Alliance partners continuing to offer 73% of

the available seats compared to a 20% share by Southwest and 7% by other carriers. The potential entry into the Hobby market by other low-cost carriers would further increase competition and help bring additional balance to Houston's air transportation network. The report projects that this new competition would result in fares for Houston passengers that are lower by 47% or more, depending on the market.

UA COMMENT: These figures are meaningless since UA operates a hub. The only meaningful share figure to compare is share of domestic O&D passengers, and with those, UA and WN are not that far apart. **HAS RESPONSE:** No data has been provided to HAS to support the assertion that the figures cited are meaningless. As mentioned above, the real issue is United's overwhelming market share to Latin America. Southwest currently has no international service from Houston, so seats is a meaningful measure of share. Even when measuring the market share from IAH to that region on the basis of O&D passengers, the small amount of competition in the Latin American market offered by Aeromexico, TACA and VivaAerobus combined (134 scheduled outbound departures from IAH during April 2012, or about 4½ per day, vs. United's 2802 departures during the month, or about 93½ per day) means that United will still have an overwhelming market share.

UA COMMENT: United's share of domestic O&D passengers in Houston is 48%, while Southwest's share is 31%. UA international passenger share is 55% worldwide. **HAS RESPONSE:** Domestic market share is not the issue here. United and Southwest compete with one another in the domestic market, each operating from its Houston hub. Southwest desires to expand into international markets from Hobby, and to place itself in a competitive position by concentrating both its domestic and international services at one Houston airport, something that United has done and now enjoys.

UA COMMENT: UA's passenger share to Latin America is 78%. **HAS RESPONSE:** This confirms the point made in the report on market dominance that United has an overwhelming market share between Houston and Latin America regardless of how it is measured.

UA COMMENT: Houston already has a competitive landscape, with a 36% increase in international carriers over the last 5 years. **HAS RESPONSE:** Houston has enjoyed an increase in the number of international carriers, which has increased competition to Europe and the Middle East. Since 2007, Emirates, Qatar, Singapore and VivaAerobus have started service, while Aviacsa and Cayman Airways have discontinued service. As a result, the number of international carriers has increased from 12 to 14. However, there has been and remains a lack of meaningful competition in Houston-Latin America markets. Furthermore, it is not the City's role to regulate the amount of competition in the marketplace, which is the province of the federal government. Southwest has requested to add international service at Hobby which would allow it to originate

and connect passengers on the same basis that United does today.

UA COMMENT: As previously stated, the study's purported fares would be economically unsustainable in light of WN's published costs and are inconsistent compared to WN's current published fares in domestic markets. **HAS**

RESPONSE: A simple review of fares to Mexico, Central America and the northern rim of South America shows that it is cheaper to fly from another U.S. city to these markets than it is to fly from Houston. The reason is because these markets enjoy competition. One-way fares in the range of \$100 to \$200 are prevalent in other cities. All one need do is to log on to any travel website and look up ticket prices for trips from cities across the country to Latin America. Here is an example using Orbitz.com (April 24, 2012) of what one would find for coach fares: For a trip from Washington D.C. to Bogota, Colombia, Spirit Airlines offers a fare of between \$162 and \$181 one-way. From Fort Lauderdale to Bogota, \$98 to \$136 one-way; from Orlando to Bogota both JetBlue and Spirit offer fares of just \$99 one-way. Look for the same fares from Chicago and you will find that United charges \$454, while the same ticket from Houston to Bogota goes for \$774 on United. All fares are for travel on May 9, 2012.

4. Other metropolitan areas, including Chicago and Miami/Ft. Lauderdale, have experienced significant air service growth with multiple international airports

The report highlights other major metropolitan areas that support multiple international airports and the positive impact of low-fare competition on their air travel markets. While New York, Los Angeles, San Francisco, and Washington provide good case studies, the cities whose airports are most comparable to Houston's are Chicago and Miami/Fort Lauderdale. Chicago re-opened Midway to international service in 2002, and since then it has attracted low-fare international flights to Mexico and the Caribbean that compete with the services offered by United and American Airlines (American) at O'Hare. Continuing this trend, Southwest's subsidiary, Air Tran Airways (AirTran) recently was granted approval by the U.S. Department of Transportation (DOT) to begin nonstop Midway-Cancun service, which will provide additional competition to United and American.

A similar situation exists in the Miami/Fort Lauderdale area where low-cost airlines in Ft. Lauderdale, most notably JetBlue Airways (JetBlue) and Spirit Airlines (Spirit) compete with American and its Oneworld partners, which operate a large-scale domestic/international transfer hub in Miami. In both cases, the legacy airlines have actually expanded their operations and passenger traffic due to the low-cost (low-fare) competition at the alternate airport. In the case of Chicago, the entry of two Mexican low-cost carriers at Midway has caused American and United to increase their departures from O'Hare by 29% and 46%, respectively. We can expect to see a similar stimulative effect on traffic at both Bush Intercontinental and Hobby.

UA COMMENT: To the contrary, these cities provide sound case studies to demonstrate that fractured markets remain flat while combined markets grow. Over the last five years, combined markets have, on average, grown 6.4% in international seats, while fractured markets (like these) have stagnated. The same trend is true for major western European hubs. **FALSE:** On what basis? Houston is most comparable to DFW and ATL and it certainly competes more closely with these due to geography. **HAS RESPONSE:** New York, Los Angeles, San Francisco and Washington have long been relatively competitive markets with multiple airports. Chicago and Miami are most comparable to the question facing Houston, in that they have only recently seen new LCC competition enter their market from a second airport in the regional passenger catchment area in which they operate. Combined markets may have grown as legacy hub carriers have looked to expand internationally in chase of higher yields. However, the more relevant question is what has happened to prices. It is documented that competition leads to lower airfares.

UA COMMENT: FALSE. In overlapping markets, AA is down 8% since 2007, and the entire MIA/FLL market to these points (including LCCs) is down 2.5%. AA is up 11% at MIA, but this is due to its closure of SJU as a hub, and consolidation of those flights to MIA. Combined MIA/SJU, AA is down 8%. **HAS RESPONSE:** 2007 was the beginning of the Great Recession economic downturn and a time period when fuel prices were significantly lower. Most airports, including IAH, experienced a decline from this point in time as a result of the recession. The better comparison is from 2010 when VivaAerobus and Interjet entered the market and American expanded its seats.

UA COMMENT: This statement totally ignores the “elephant in the room” — the MX (Mexicana) shutdown. AA/ UA changes had nothing to do with the entry of the LCC’s, but rather were intended to recapture share and slots from MX in the wake of its failure. Total Chicago to Mexico capacity is actually DOWN 12% since the LCC’s entry. **HAS RESPONSE:** The shutdown of Mexicana certainly provided an opportunity for the other airlines to expand, but they were able to do so in the face of LCC competition.

5. Through the "Southwest Effect", international service at Hobby will expand the market for all airlines, including for United at Bush Intercontinental

The term "Southwest Effect" was first used by DOT in 1993 to describe the boost in air travel that follows Southwest's (or any low-cost airline's) entry into a new market. These markets have usually been dominated by incumbent carriers able to charge high fares. The entry by a low-cost carrier sparks competition with incumbent carriers, and the combination of more available seats and lower airfares generates more travelers. Established (legacy) airlines, like United, have traditionally had concerns about losing passengers to the low-fare competition, but the drop in airfares actually has stimulated demand for air transportation from

both business and leisure travelers. Opening Hobby to international service would provide competition in key Latin American markets, and just as competition and low-fare service options are beneficial for Houston's domestic travelers, they will also be beneficial for our international travelers. While the "Southwest Effect" has been at work in the broader domestic U.S. market for approximately 20 years, it remains relevant today in select U.S. markets and many international ones. But the "Southwest Effect" has nothing to do with where fuel prices were in the past, where they are today or where they might be in the future. It has to do with the entry by Southwest (or any low-cost airline) into markets dominated by a single airline that has been able to use its market power to charge higher fares due to that dominance, as is the case with United's current service from Houston to Latin America. It is that gap between those higher fares and the costs of service that the Southwest Effect serves to narrow, and why Southwest sees opportunity in and for Houston. See Attachment 3 for recent illustrations of the "Southwest Effect". In total, there will be a net incremental gain for Houston of over 1.5 million passengers annually, as more Houstonians decide to fly more frequently due to the availability of lower fares, and more connecting passengers reroute over Houston versus other U.S. international gateways.

UA COMMENT: This is based on a 20-year old study of an effect that is no longer measurable: Since 1993, WN yields are up 66%, legacy carriers only 11%; For the period 2006-2011, in markets that WN has entered, fare levels today are 4% higher versus before WN entered, while market sizes are only 10% larger, on average; In markets where an LCC enters, capacity reductions occur in the long-run by other carriers (in JFK, jetBlue's increases have been met on a more than 1:1 basis with legacy carrier reductions, resulting in JFK to Latin America capacity being down 2.1% in overlapping markets). **HAS RESPONSE:** This all supports the "Southwest Effect". Since 1993, Southwest yields have grown with inflation and fuel price increases while growth in the legacy carriers' yields, which were uncompetitive back in 1993, have been held in check through competition. While the "Southwest Effect" may have played its course already in certain domestic U.S. markets where there is now widespread competition, lower fares can still stimulate traffic in international markets that have yet to be exposed to this kind of competition.

6. Southwest will continue to expand internationally at other U.S. cities if it does not do so at Hobby, leading to passenger diversion from Houston and the loss of associated economic benefits

Southwest's acquisition of AirTran has created a merged company with international service currently provided from numerous U.S. cities. While these cities do not provide the same strong demographic, geographical and market size advantages for serving short-haul Latin American markets that are present at Hobby, Southwest will continue to develop and expand internationally out of these other U.S. international gateways if the City does not build an FIS at

Hobby. Southwest has already begun its international expansion elsewhere, announcing new international flights to Mexico from Austin, Chicago, Denver, Orange County, and San Antonio, in addition to its current international operations at Atlanta, Baltimore, and Orlando that were acquired through its merger with AirTran. This trend threatens Houston's position as an international gateway, particularly to Latin America, and the result will be diversion of more and more connecting traffic from Bush Intercontinental to competing gateways. The Houston community could potentially claim this growth if Southwest International operations were initiated and expanded at Hobby.

UA COMMENT: The greatest threat to Houston's position as an international gateway is the fragmentation of connecting traffic. This matters far more than a handful of flights added from spokes across the US. **HAS RESPONSE:** As an international gateway, Houston is in competition for the business of the travelling public. The best way to ensure the City can compete with other cities for this business is to ensure that our air service is of the highest quality and the lowest price. This is best achieved by supporting and encouraging competition in Houston. It is not the City's role to favor one carrier over another, but to help create an even playing field for all carriers that wish to provide air service to Houston.

UA COMMENT: Or ... the Houston community could watch the growth potential of its former single international hub disappear forever, along with our ability to compete with DFW and ATL — the airports we most resemble. **HAS RESPONSE:** We disagree with United's assertion that competition will reduce service for Houston as a whole. The Houston regional economy, its growing population, the continued accretion of business capital, the relocation of businesses to the Houston region all drive demand for air service; it is not the other way around: that airlines create demand by providing service. There is no airline that believes in the strategy "provide a flight and passengers will come". We do not believe United would walk away from one of the fastest growing and strongest regional economies in the United States today. In fact, assuming that United competes by lowering prices, InterVISTAS forecasts that traffic at IAH will increase. In total, competition will lead to more flight options and lower prices that will make Houston a more attractive gateway versus other cities, while also providing Houston residents and businesses with more low-fare travel options. In fact, HAS' economic impact analysis forecasts a significant shift in traffic from these other gateway cities as a result of greater scheduling options and lower fares through Houston, if Southwest were to initiate international operations here.

V. CUSTOMS & BORDER PROTECTION RESOURCES

Data routinely collected by HAS, in collaboration with CBP, shows that, consistently, over 70% of all passengers arriving at Bush Intercontinental clear primary federal inspection screening within 30 minutes. We are working with CBP

to push that percentage well into the nineties. This is a goal we believe we can attain.

There are several important and positive trends that will help CBP reduce average processing time and meet the demands of increased passenger volumes, despite staffing limitations, in the future. In particular, technology solutions are proving to be effective in reducing CBP staff workload and increasing the efficient use of CBP resources. These include Trusted Traveler programs, such as Global Entry, for which Bush Intercontinental is known as a national leader. Global Entry is a relatively new program, and HAS is working closely with CBP and others to expand participation by Houston passengers. Increased use of this very effective program will help CBP manage its workload to address increasing demand. Various other technology-driven solutions are being used to increase the flow of passengers through the regular immigration process, including CBP's Electronic System for Travel Authorization (ESTA) program, which collects information from travelers planning to travel to the U.S. under the Visa Waiver Program (VWP) and eliminates certain paperwork. Overall, CBP has achieved a 58% faster processing time for travelers under the VWP since the implementation of ESTA.

Expansion of these programs is critical to the growth of U.S. airports, and is occurring with the strong support of the Obama Administration. In 2012, Global Entry will be expanded to four new airports and children under the age of 14 will now be allowed to participate, allowing more families to enjoy the benefits of the program. As part of his strategy to boost tourism, President Obama announced in January that Global Entry will be made available to almost all international travelers coming to the U.S., and he directed the extension of the VWP program to more countries. Attachment 4 contains materials on these and other related initiatives.

While the Hobby project represents growth and opportunity for Houston, we also recognize that there are limits on CBP resources over the short-term. While CBP's current funding for additional officers and support staff at major airports around the country is constrained, over the medium- to long-term we believe that CBP resources will be increased to meet the needs of growing international air services, given the positive economic benefit of those services for U.S. communities. In any event, these additional resources would not be needed until the 2015 target date for completion of a new Hobby FIS facility, and the facility would not open until they were secured. We will also take all practical steps that these resources do not diminish CBP at Bush Intercontinental.

We should note that DHS has an obligation to allocate CBP staff where there is demand for its services, and it is reasonable to expect that Houston will secure its fair share of national resources if this is where international traffic growth occurs. Other airports, such as Atlanta and Miami, have recently expanded their FIS facilities and have been able to secure higher CBP staffing levels, while

others, such as Tampa, are just beginning that process. In the case of Atlanta, it will open a new twelve-gate international terminal on May 16, 2012, adding 120 CBP officers to its existing FIS facilities. As noted above, Southwest will grow its international traffic at other U.S. cities, if not at Hobby, and additional CBP resources will be required regardless of the location. The need for more CBP resources is equally applicable to the growth of international services in Houston by United, which has the option under its Council-approved agreements to build a second FIS at Bush Intercontinental in Terminal B (vs. the existing one in Terminals D and E).

For many years HAS has worked closely with United, CBP and others to develop the FIS facilities needed at Bush Intercontinental; that effort is ongoing. We intend to work closely with Southwest, CBP, other airlines, local businesses, Houston's Congressional delegation and other interested groups to secure the necessary approvals and staffing for the new FIS at Hobby.

UA COMMENT: While HAS highlights that 70% of the passengers clear the FIS within 30 minutes, they fail to note that in CBP's statistics IAH has been, for the last three years, at the bottom of the ranking in CBP wait times on a passenger-weighted average. IAH continues to be at a competitive disadvantage, especially measured against international gateways in the region. IAH needs to be more competitive since passengers, especially those connecting, will choose alternative hubs that offer better CBP wait times, including Atlanta and Dallas Fort Worth. An essential aspect for a competitive hub operation is the ability to manage significant passenger throughput at peak times. Having 30% of passengers, especially those connecting during peak times, experience lengthy connections that routinely exceed one hour is unacceptable. At peak times, CBP passenger-weighted average line waits at IAH were 66 minutes, while Atlanta and Dallas Fort Worth had an average at peak time of minutes 48 minutes.

HAS RESPONSE: We agree that there is no reason for IAH to have longer CBP processing times than other airports and this is something that we should work together to correct. Indeed HAS is engaged in ongoing discussions with CBP with the goal of minimizing wait times and improving the overall international arrivals process for passengers. Regarding the concerns raised over CBP staffing for a new FIS, the City Administration has met in Washington, D.C. with the Associate Administrator for Custom and Border Protection – In Charge of Field Operations. The Administrator assured the City Administration that CBP never says no to a request for establishing a new FIS. Presently, there are over 41 airports across the country requesting assistance. CBP assigns agents on an as needed basis, and if Houston were to make a request, it would be given high priority given the volume of traffic being forecasted at Hobby. There is a very specific process to be followed with CBP to create a new FIS and it does not happen overnight, but CBP advises it has never denied an airport the necessary agents needed to staff an FIS once it is demonstrated the demand for the facilities is real. Moreover, it would not compromise the operation at IAH in order to staff Hobby. The Administrator gave as an example Miami and Fort Lauderdale, Florida. There you will find two international airports and two ports.

All four are staffed and are functioning well; Fort Lauderdale's FIS facilities were significantly expanded in the middle of the last decade to support US Airways' plans at the time to provide expanded international services to Latin America, and subsequently have been the basis for growth by Spirit and other low cost carriers. The Tampa Airports Authority is in the process of expanding its FIS, and this month the City of Atlanta opened a new international terminal and FIS. The City of Atlanta will be receiving 120 new CBP agents to staff the FIS. For fiscal year 2012 CBP received 300 additional agents to staff international operations. Seventy-five of those agents were split between Atlanta and Miami.

UA COMMENT: The aspiration for processing 90% of passengers through the FIS within 30 minutes is a step in the right direction to make IAH more competitive. However, absent additional staffing we don't see how IAH can increase its passenger processing rates through the FIS and reach this goal consistently. **HAS RESPONSE:** Additional staffing and leveraging technology solutions can improve passenger processing rates and reduce staffing requirements. But more important is that we work together to solve these challenges as Delta in Atlanta and American in Dallas have done working with the airport sponsors.

UA COMMENT: The important and positive trends noted in the memo are red herrings that attempt to shift the attention from the issues at IAH to be resolved through overall national programs, which will take significant time to produce positive benefits. These technology and policy changes, if they occur, would occur nationwide and therefore would not change IAH's competitive position. **HAS RESPONSE:** The designation of IAH as a model port by CBP was not something that occurred nationwide. We can influence this and our competitive position by our efforts and effective implementation of what is available in Houston. In any event, these changes will be needed if a second FIS is built at IAH as UA has proposed.

UA COMMENT: The ESTA program was introduced in 2009 and has been in full effect since then. The 58% processing time improvements noted are already reflected in the current IAH and national performance figures. **HAS RESPONSE:** The ESTA program is an example of the impact of technology and process change on passenger throughput. Other initiatives in the future can be expected to have similar results.

UA COMMENT: This is an example of the potential growth that a single international hub can provide. Atlanta is the busiest hub worldwide and that is due in part to its ability to focus all traffic at one gateway. **HAS RESPONSE:** Atlanta is simply an example of a City's ability to secure the CBP staffing it needs when opening a new FIS when the major hub carrier works with the City. The growth of international facilities in Atlanta is driven more by the success of the Delta/Northwest merger in garnering market share and the airline's strategy to expand internationally where there is less competition and the flying is more

profitable, but also the well-known fact that Delta simply does not yet have adequate terminal facilities in JFK International Airport in New York and so moves more traffic through Atlanta than it might want to.

VI. NATIONAL AVIATION COMPETITION POLICY¹

The City's support for a new FIS at Hobby would be consistent with the nation's laws and policies encouraging competition between airlines and airports.

Indeed, the Congressionally approved statutory mandate which governs our nation's air transportation system places "maximum reliance on competitive and market forces and on actual and potential competition." That same mandate encourages "efficiency, innovation and low prices", and emphasizes the importance of "avoiding unreasonable industry concentration, excessive market domination, monopoly powers, and other conditions that would tend to allow at least one air carrier...unreasonably to increase prices, reduce services, or exclude competition in air transportation." 49 U.S.C. § 40102. Applying this mandate, DOT has consistently emphasized both the importance of avoiding domination of air services in a metropolitan region by one airline, and the benefits to communities that flow from competitive service at international gateways. Where, as here, new international air services at Hobby and enhanced competition in the Houston market overall would produce such significant economic advantages to the City, its residents and the region as a whole, the arguments in favor of supporting construction of a new FIS are significant.

UA COMMENT: See earlier comment on page 1. **HAS RESPONSE:** (Same as page 1) Mr. Diaz's recommendation is based on a number of points, of which the economic impact study is one. Additionally, the recommendation is founded on the principle of supporting competition and granting open and equal access to airline facilities. The "Southwest effect" and the resulting assumption on market stimulation are well documented.

VII. STAKEHOLDER AND PUBLIC INPUT

We have discussed this project with many stakeholders during the weeks leading up to this recommendation. They include Southwest and United, as well as the leadership of our constituent chambers of commerce and business groups. Overall, with a few exceptions (the principal objections coming from United), stakeholder input and public sentiment are highly supportive of starting international operations at Hobby. Attachment 5 contains recent correspondence between Southwest and the City, and United and the City.

¹ Another consideration is that, as a consequence of accepting funding from the FAA for airport infrastructure development, the City and HAS are obligated to provide fair and open access to all airlines interested in serving Houston. In particular, the City and HAS are bound by FAA grant assurances that encourage competitive access and prohibit economic discrimination and the granting of exclusive rights to any airline. Violations can lead to the loss of federal funding, both for airports and other municipal projects, such as for highways and port facilities.

We did not conduct any formal surveys of public sentiment on the question of international air service at Hobby, but we have received numerous communications from individuals, and recorded several hundred comments and opinions from local media reports and the resultant commentary/blogs (i.e., chron.com). An overwhelming majority of the public supports the idea of scheduled commercial international air service from Hobby.

With respect to the concerns raised by some interested parties, I believe it is worth addressing the following:

1. Alleged City Policy of Bush Intercontinental Being Houston's Sole International Airport

The claim has been made that there is a long standing City policy in effect that Bush Intercontinental would be the only international airport in the Houston Airport System. We have not been able to find a single document or any evidence supporting that contention. On the contrary, I have spoken with my two immediate predecessors, one of whom served as far back as 1982. Neither recalls any such policy, and both maintain that if such a policy had been discussed they would have been opposed to it.

It is also worth noting that, dating back to at least 2002, HAS's Master Plan for Hobby has anticipated international operations as a key component of the airport's future, plans which include the development of international passenger traffic forecasts for the 2007-2022 time frame, and construction of an FIS and new international operations terminal. For example, in 2003, the Master Plan Oversight Committee noted that: "If the demand exists for international flights from Hobby, there should be no reason that the activity could not take place". Both United (then the pre-merger Continental Airlines) and Southwest were involved in discussions with HAS on this issue. These documents have long been available to the public on HAS's website. Indeed, the Master Plan documents specifically mention not only Southwest's interest in developing international air service from Hobby, but also that of Continental. See Attachment 6 for a summary of the 2003 Master Plan and excerpts from the Oversight Committee's comments.

UA COMMENT: The 2006 IAH Master Plan states that "The Airport is the international gateway to Houston for commercial airline traffic with nonstop service to 152 cities throughout the world." **HAS RESPONSE:** This statement simply describes the nature of airline service in Houston in 2006, it does not reference or indicate the existence of a policy limiting international service to IAH.

UA COMMENT: The Hobby Master Plan contemplates three future growth scenarios: a) baseline, b) connecting and c) accelerated. Only the accelerated scenario contemplates international service, and the forecast selected for use in the Master Plan is the connecting scenario. Note the following citations: Section 3.9: As a result, the forecasts associated with the connecting scenario

are recommended for use in the Master Plan. This recommendation is based on numerous assessments, including but not limited to historical aviation activity at the Airport, the stated policy goals of HAS, industry trends, Southwest Airlines feedback, and other factors. 3.5.2: International Air Carrier Enplanements. As previously stated, the HAS does not plan to develop facilities to process international passengers (such as FIS) at the Airport. Under the baseline and connecting scenarios, no international air carrier activity is anticipated and it was assumed that international air carrier activity would continue to be accommodated at Intercontinental. **HAS RESPONSE:** A master plan is designed to look at future scenarios and must be flexible for a changing world; these statements reflect where matters stood nearly a decade ago. The 2003 master plan considered and planned for the possibility of international service at Hobby, should conditions arise warranting it. In addition the Airport Layout Plan - a document that must be updated and approved periodically by the Federal Aviation Administration – shows an international terminal at Hobby. This information has been available to the public since 2003. The City is not aware of any policy limiting international expansion at Hobby.

2. Impact on United and Bush Intercontinental

United has raised objections to Southwest's proposal, and has described the negative consequences it asserts will befall Houston and United if international service is introduced at Hobby. We understand that United has retained consultants to provide support for its claims. United is and has long been an invaluable partner with HAS and the City in developing the global air transportation network that the City enjoys today. We hope for a long and mutually beneficial partnership in the future, and we certainly will review and evaluate any data that United wishes to provide.

However, thus far United has presented no persuasive data to support its claims. United is saying that it would not compete with Southwest by lowering its prices and improving the quality of service it provides in Houston, and indeed that it will drop a large number of flights at Bush Intercontinental, with resulting layoffs of employees. But that assertion is at odds with its actions at every other airport where it has faced low-cost competition. We know from numerous examples across the country that legacy carriers - including United do compete by lowering prices, increasing capacity and/or frequencies, and improving the quality of the services they provide.

That said, it is not the City's role, nor is it in the community's best interests, to act as an arbitrator between two competing carriers over airport access. Rather it is our duty to help provide a level playing field for competition to flourish, to the ultimate benefit of Houston travelers and our entire region. I would also note that the economic impact report prepared by HAS's expert consultants demonstrates that international flights at Hobby will produce long term traffic gains at both Hobby and Bush Intercontinental, resulting in economic benefits that will flow

from both airports to the advantage of Greater Houston as a whole.

UA COMMENT: FALSE. In 8 of 8 UA domestic mainland hub markets, network carrier seats are down over the last five years, with Low Cost Carrier seats up.

HAS RESPONSE: Five years ago puts us in 2007, which was the beginning of the Great Recession economic downturn. Most airports, including IAH, experienced a decline from this point in time, as a result of the recession. The growth in Low Cost Carrier seats simply shows the success of this business model in appealing to the cost conscious nature of consumers. United will continue to compete for Houston travelers' domestic business, and will now do so in certain international markets. It is not the City's role to favor one carrier over another or one airport over another, but to provide facilities for new services when they are requested which encourages competition and enables multiple travel choices for Houston passengers.

CONCLUSION

At HAS we compete daily with many other cities to generate interest from airlines in serving our community. There are many more cities than there are airlines, and those communities with competitive air service enjoy proven economic benefits. Just last week the City of Chicago expressed its appreciation that Southwest's AirTran subsidiary was selected to provide new international service at one of that city's airports, releasing a statement that "the Chicago Department of Aviation and the City of Chicago are pleased to learn that AirTran, a wholly owned subsidiary of Southwest Airlines, today received final approval from the U.S. Department of Transportation to provide daily nonstop service from Chicago Midway International Airport to Cancun International Airport. It will be the first service from Midway to Cancun in four years". It is worth noting that in making the selection, DOT emphasized the enhanced competition that AirTran's service will bring to the market. DOT noted especially the market structure benefits that will accrue from AirTran service at Midway competing with legacy carrier service from O'Hare. DOT Order 2012-3- 10, March 16, 2012.

I believe we are fortunate that Southwest is interested in making this significant investment in Houston's future, and that the City should be as pleased as was Chicago that Southwest is interested in providing the same level of quality air service at comparable prices to our community.

I would be happy to answer any questions you may have, and I look forward to working with you and City Council on this important decision.

UA COMMENT: The fact that MDW has been able to sustain only three flights to Mexico (but none to Cancun), despite having an FIS facility for over 10 years, speaks to the lack of economic viability of this service. A fourth flight (CUN) is hardly a boon to the City of Chicago. Has the investment in an FIS paid off? It does not appear to have done so. **HAS RESPONSE:** The investment should be

measured by the influence that competition has had on prices, passenger traffic, jobs and economic impact -- not measured by the number of flights that are operated at any given point in time. In the past, ATA Airlines, a low-cost carrier (LCC), used the MDW FIS for flights to Mexico and the Caribbean and now another LCC, Porter Airlines, uses the FIS for its multiple daily flights to Toronto. These operations have had a positive effect on Chicago's fares to numerous foreign markets. Also, we recognize that Southwest is just getting started with its international flying. In the case of Houston, we anticipate competition in international markets by Southwest will reduce fares significantly – saving Houstonians money to spend elsewhere in Houston - and generate more passengers, more jobs, and create a positive economic impact. This is more than a fair return on the potential investment. In any event, only carriers using the proposed new FIS will participate in that investment.

Mario C. Diaz

MCD:IW:kk

CC: Andrew F. Icken
Chief Development Officer