The Path to Open Skies: Transcending Global Alliances

Brian F Havel
Andrew C Eastmond

Available at: https://works.bepress.com/brian-havel/49/
The Path to Open Skies: Transcending Global Alliances

by Brian F. Havel and Andrew C. Eastmond

Introduction

Alliances have become a marquee attraction in today's global aviation industry. In fact, as of the end of the year 2000 there were more than 500 international alliances involving over 200 airlines. These cooperative arrangements can lie anywhere between the two extremes of basic arrangements to honor each other's tickets, to competing global networks that link the big U.S. airlines with partners from Europe, Asia, and Latin America. "Strategic" global alliances are fast becoming the pacesetters of the industry, and international airlines have been seeking as a matter of high priority to become connected to one of these alliances. In September 1998, for example, American Airlines and British Airways joined forces with Canadian Airlines, Cathay Pacific, and Qantas to announce a global partnership—the "oneworld" alliance—to challenge the existing industry leader, the "Star" alliance led by United Airlines and Lufthansa. The launch of these alliances responds to a ten-year doubling in global air travel (a trend that is projected to continue), but has also been a reaction to the constricted legal regime within which international air travel has operated for the past five decades. Taken together, these are powerful forces for change.

This essay discusses some of the basic legal and economic issues raised by international airline alliances. We consider why alliances exist, how they operate, and the advantages they create for both
airlines and their passengers. We then review the impact of the American antitrust laws on alliances that include a U.S. airline, and why these alliances regard it as so important to obtain a legal bounty known as "antitrust immunity" from the U.S. Department of Transportation (DOT). We also note that it is the general policy of the U.S. government to insist that an alliance with a foreign airline will not receive immunity unless its home country enters into a liberalized air transport agreement (an "open skies" agreement) with the United States.

The second part of the essay examines problems arising from the rapid growth of airline alliances and the problems created by the DOT's hard-wiring of open skies agreements to the condition of antitrust immunity. We conclude that an effective way—although by no means the only way—to begin to resolve these increasingly complex issues would be through a new treaty-based framework for international air transport. This new multilateral treaty, ideally involving the United States and European Union as founding partners, would supersede the present straitjacketed system of laborious and sovereignty-obsessed bilateral treaties. The founding precepts of this new treaty would include the abolition of the "cabotage" and "nationality" principles, as discussed below, and possibly the creation of global competition tribunals for air transportation. In this transformed global aviation order, alliances could retain their importance as a competitive weapon, but would not be used when a full scale international merger (which cannot occur under existing laws) would be more economically desirable.

I. The Evolution of Airline Alliances and Antitrust Immunity

A. The Legal and Business Rationales for Alliances

At the outset, the critical inquiry is why alliances exist at all. Why do international airlines not follow the model of their peers in the expanding automobile, telecommunications, or pharmaceutical industries, for example, and enter into full-scale corporate mergers with one another? Airlines would no doubt like to consider strategic mergers with their foreign competitors. They are prevented from doing so, however, by the convoluted legal regime that has ruled international air transport since the signing of the Chicago Convention in 1944. Under this highly restrictive regime, governments conclude bilateral air transport agreements which do not permit their home airlines to be owned or controlled by nonnationals. Ironically, this exclusion of foreign ownership, known as the nationality principle, was originally introduced at the behest of the United States, which did not want foreign governments to peddle their U.S. air traffic rights to airlines controlled by third countries.
with which the United States did not have diplomatic relations. Nowadays, it appears that U.S. attachment to the nationality principle is largely economic: U.S. labor unions, in particular, have been notoriously hostile to conceding foreign ownership or control of U.S. airlines. Thus, the nationality principle forbids foreign takeovers simply because ownership and control of each country's airlines remains vested in its own nationals. Even the new U.S. open skies agreements, which seek to moderate some of the old regulatory restrictions on international air travel, include this provision.

The nationality rule is not the sole legal restriction that hampers global network development by single airlines. Under the Chicago Convention, airlines can only fly international routes that have been negotiated by their home governments using conventional diplomatic channels. If a U.S. airline wishes to fly from New York to London, that route must be obtained by the U.S. government through treaty conclaves with the transport ministry representatives of the United Kingdom. And if the U.K. airline would like to pick up passengers in New York and fly them to Canada as an extension of its London/New York service, this extended service, known in Chicago Convention parlance as the "fifth freedom," would require the permission of both the United States and the third state, Canada. Moreover, under the cabotage principle alluded to earlier, most states refuse to allow foreign airlines to carry passengers between points that lie entirely within their domestic route systems. No British airline (or, for that matter, no foreign airline) has ever obtained a permanent right to pick up passengers at a U.S. point-of-origin for transportation to a U.S. destination.

With all of these legal obstacles in place, airlines are forced to cooperate with each other in order to build transnational networks beyond their home hubs. If a U.K. airline wants to serve multiple foreign markets, it has to ensure that its government negotiates all of the necessary authorizations with all of the countries involved. One failed treaty negotiation will break the chain of connections that might be needed. Moreover, if a foreign airline wishes to provide through service within the huge U.S. internal market, which represents 40% of the world's airline service, it must form commercial links with a domestic U.S. airline (typically through sharing airline designator codes, an arrangement which under some of the more restrictive bilaterals was not possible until very recently).

Beyond this stout wall of legal restrictions, however, the sheer cost of creating a foreign route network makes carrier cooperation inevitable. It is difficult for airlines, even for those within the top echelon of international carriers, to dedicate large resources to
untested international markets that are often blemished by decades of protectionism. And, as the summer of 2000 has uncomfortably demonstrated in both the United States and the European Union, many national airports lack the physical capacity (both airside and landside) to accommodate new competitive services. In economic terms, alliance-building uses each partner's comparative advantage in its home region to reduce the enormous sunk costs of new market penetration. And even on routes where both alliance partners already operate, it is surely efficient not to bear the cost of dual ticket offices, dual country managers, dual gate and handling staff, and dual sales staff.

B. Code-Sharing and the Growth of Alliances

Thus, the airlines embraced alliances as a strategy to overcome both the legal restrictions and the exploding investment costs associated with their international operations. The ingenious (and controversial) device that serves as the economic basis for most alliances is called code-sharing. Code-sharing allows each alliance partner to sell seats on the other partner's flights using its own two-letter designator code in the computer reservations system. In this way, the connecting flights between two alliance partners can appear as an online connection operated entirely by one airline. There are now over 70 code-share agreements between U.S. and non-U.S. airlines.

Code-sharing allows each alliance partner to access the other's route network to build "bridges" between the partners' respective home hubs. But code-sharing alone has not been sufficient to capture the efficiencies and consumer benefits potentially extractable from a fully integrated multi-hub system. Accordingly, alliances have expanded to include sophisticated joint marketing efforts, coordinated passenger and baggage check-in, coordinated scheduling, uniform standards of service, and participation in each other's frequent-flier programs. Some involve joint travel agent commission programs; others use arrangements whereby the partners buy blocks of seats on each other's aircraft and sell them under their own names. On close inspection, at least one of the alliances, the iconic KLM/Northwest model, has involved such deep levels of collaboration that it arguably now resembles a legal merger. Signals of stronger collaboration include some degree of common ownership (but not enough to violate the foreign ownership rules), coordination of pricing, standardization of equipment, services, and supplies, and revenue and profit-sharing.

The integration also creates a new kind of economy of scale for the airlines, in the form of strong world brand identities that can easily be extended to new partners in ever more distant destin-
tions. United's Star Alliance, for example, has reached beyond its transatlantic provenance to embrace partners from Asia and Latin America. United-Lufthansa-SAS, the core members of the Star Alliance, can claim an astounding 66,000 new city-pair markets.\textsuperscript{29} Economists have tended to underestimate the "information effects" of a strong brand name, and the value of these effects is undeniably compounded by the creation of a global alliance among strong brand-name airlines.\textsuperscript{30} The splicing of strong brand-names helps to stimulate new passenger and cargo business and to capture traffic from competitors, because the alliance seeks to offer the equivalent of seamless service on a single airline.

\section*{C. Tracking the Consumer Benefits of Alliances}

The concept of "seamless" service, if it can be delivered, would clearly comprise an important consumer benefit of alliances. In a fully integrated global alliance, as opposed to a loose code-sharing on selected points, the passenger can travel to virtually any point on the globe with one ticket, under one frequent flier program, with common airport lounges and consistent, predictable service.\textsuperscript{31} In its ideal manifestation, the integrated alliance would allow passengers to travel by air to destinations abroad with the same ease and convenience with which they can place a telephone call or send a fax worldwide.\textsuperscript{32} All of the major transcontinental alliances are working on plans to move arrival and departure gates closer together, to consolidate check-in operations in joint terminals, and to give a much broader range of flight times.\textsuperscript{33} Research shows that customers particularly like the integration of frequent flier programs,\textsuperscript{34} with extended opportunities both for earning miles and for redemption of miles for travel awards.\textsuperscript{35} Cargo shippers, incidentally, can also benefit from the integration opportunities provided by alliances, and indeed the extension of international cargo access is a pivotal issue in the contentious bilateral negotiations between the United States and Britain.\textsuperscript{36}

Ideal integration of alliances would likely spur lower cost structures that would translate into more attractive pricing for the customer.\textsuperscript{37} There is some evidence that alliances do honor their promise to offer a broader bandwidth of promotional fares, because the increased number of passengers offsets any reduced yield from lower fares or increased carriage of discount traffic.\textsuperscript{38} Also, by consulting one another on yield management issues and thereby obtaining an enhanced ability to predict consumer preference, the partners can release for earlier sale a greater number of discounted fare seats.\textsuperscript{39} A regime of improved fares, of course, could only continue if alliances operate in a competitive environment and (at least under the DOT's macroeconomic paradigm) are subject to
competition from other alliances. It is the key question of competition, therefore, that brings our attention to the operation of the antitrust laws.

D. The Antitrust Dimension of Alliances

As we have shown, airlines have attempted much more integration than the simple code-share. A code-share agreement, by itself, raises limited competitive concerns. The airlines in a code-share agreement remain full competitors in the traditional sense, and they separately price and market the seats on each shared flight. However, when a U.S. airline attempts to leverage the code-share relationship to create further synergies with its competitors, it will face much tougher scrutiny under U.S. antitrust laws.

The leaders of each of the global strategic alliances are U.S.-based airlines. Consequently, all alliances between U.S. and overseas airlines must comply with the American antitrust laws. One of the central missions of these laws is to ensure that competitors do not work together with the aim, explicit or tacit, of reducing competition and consumer benefits in the marketplace. When U.S. airlines enter alliances with their foreign competitors, it is hard to predict how far they can truly integrate their operations without risking exposure to antitrust enforcement. Every common action the partners take to expand beyond the simple code-share—conducting joint route and schedule planning, common marketing and advertising, co-branding and joint product development, pricing and yield management coordination, revenue sharing, and joint procurement—may potentially lead to raised fares or reduced service, and may therefore invite investigation and attack under the antitrust laws. Thus, while the alliance must constantly weigh its actions for compatibility with the antitrust laws (and to avoid being sued by the government, by a rival carrier, or even by a group of passengers), the cooperating airlines are unable, because of the national ownership rules, simply to merge. This is a very unstable way to do business and tremendously vexing for airline planners.

1. Antitrust Supervision of Alliances

If a U.S. airline enters a cooperative alliance agreement with a foreign airline, it has no legal obligation to file the agreement with the DOT for approval unless the agreement contemplates code-sharing or requests what is called "antitrust immunity." Outside these two special circumstances no filing is required, but the agreement remains nevertheless subject to the general antitrust laws of the United States and will be open to later attack by the government or by any private parties (including the alliance's competitors and passengers) as a violation of those laws. It is always prudent,
therefore, to secure formal government clearance in order to deter potential lawsuits, and U.S. airlines typically file their foreign alliance agreements for that reason.

When the DOT examines an agreement between a U.S. airline and a foreign airline, the agency tries to ensure that the alliance will yield consumer benefits. The DOT will typically sanction the alliance if it considers that enough market competition will survive—including competition from other alliances—to prevent harm to consumers through price increases and reduced services. To paraphrase the language of the statute, the alliance must not be against the public interest and must not substantially reduce or eliminate competition. The DOT’s analytical approach is case-specific, and different factors receive weight depending on who the partners are and what markets they occupy.

In its essence, the key test used by the DOT to decide if competition is reduced is to identify which markets the alliance partners compete in, and the extent of their market power to raise prices without causing other airlines to enter the market and challenge them with lower fares. Like mergers and acquisitions, alliances have potential to be pro-competitive—they can create new service, enhance existing service, reduce costs, and bolster efficiency, all adding to the welfare of the traveling public. Antitrust officials, however, fear that alliances have an anti-competitive Doppelgänger—airlines can deliberately stay out of partner markets they would otherwise enter, keep lids on capacity in order to boost fares, jointly fix higher fares, and keep rivals out of markets. As several DOT investigations have illustrated, the more the putative partners are actual or potential competitors on a particular route, the more concern the agency will have. The primary concern for the DOT, therefore, is overlapping service. This overlapping may occur city-to-city, country-to-country, or region-to-region. British Airways and American Airlines, for example, which by some market definition criteria command over 60% of the U.S.-U.K. transatlantic market, defended their doomed alliance on the premise that it would hold less than 30% of the U.S./Europe "region-to-region" market.

But even if an alliance does not meet all of these (admittedly somewhat vague) standards, the federal statute provides that the agreement can still win approval if it achieves important public benefits that cannot be obtained by less anticompetitive means. The most conspicuous benefit inserted by the DOT into its analysis is the willingness of the foreign partner’s home state to conclude an open skies agreement with the United States. The legislation, moreover, specifically recognizes that some kinds of agreements...
with a foreign airline might very well reflect policy compromises that the U.S. government has reached with another sovereign nation.\textsuperscript{56} In this sense, an alliance agreement might pass regulatory muster precisely because it reflects the price paid by the United States to secure an open skies treaty. Under the prototypical open skies arrangement, the United States allows the other contracting state's airlines to serve all cities (and airports) in the United States, and removes restrictions on picking up domestic passengers in U.S. territory for onward transit to third countries.\textsuperscript{57} The arrangement voids limits on the number of airlines each country can designate to serve routes into the other state, eliminates capacity restrictions, and withdraws government interference with the setting of fares except in exceptional circumstances.\textsuperscript{58} Open skies treaties usually allow generous code-share provisions, but never award cabotage privileges that would allow foreign airlines to carry internal city-to-city U.S. passenger traffic (otherwise than through the code-share device).\textsuperscript{59}

2. Antitrust Immunity—and Its Advantages

Enterprising airline officials, led by KLM's U.S. Vice President for Government and Legal Affairs, Paul V. Mifsud, discovered an ingenious means to dispel the threat of antitrust attack that would otherwise becloud major transnational alliances. Their solution was to press into service a simple legal anachronism that survived from the pre-1978 regulatory era in the United States. The holdover provision granted the government power to give some airline cooperative arrangements an exemption from the full effect of the antitrust laws. After deregulation, this kind of antitrust immunity, as it is called, was no longer available in domestic U.S. operations, but by virtue of a quirk in the deregulation laws, it still applies in international air transportation.\textsuperscript{60} And this historical anomaly has been instrumental in facilitating the emergence of the new global strategic alliances.

If the alliance qualifies under the general tests of competition outlined above, the DOT has the authority to exempt the parties to the alliance from the impact of the antitrust laws if it finds that immunity serves the public interest (willingness of the foreign partner's home country to enter an open skies agreement is typically necessary to satisfy this second test of "public benefit`).\textsuperscript{61} Immunity, as might be surmised, confers a significant competitive advantage on an alliance. United Airlines, for example, appears to define its transcontinental Star Alliance by the existence of immunity.\textsuperscript{62} Ironically, immunity allows the members of the alliance to work together in a kind of pseudo-merger.
While an alliance should produce synergies on both the cost and revenue sides, immunity is more likely to be essential on the revenue side.\textsuperscript{63} Cost savings would come from activities with relatively low antitrust risk such as joint purchasing (of fuel, or information networks, or cabin service items), co-location of crews, common maintenance operations and ticket offices, ground service coordination, and joint use of facilities. But to achieve superior integration efficiencies, an alliance must include exclusive code-sharing, bind parties together for a long time (the United-Lufthansa application requested an initial five-year approval), and have a coordinated revenue management system that integrates capacity, scheduling, and pricing decisions.\textsuperscript{64} While exclusive code-sharing and a long marriage may not be too troublesome to achieve or to operate in practice, the exchange of confidential information on price, capacity, and scheduling would be bound to attract scrutiny from antitrust regulators and other competitors.

\textit{With immunity, then, airlines can mimic the features of a full merger by freely discussing schedule and route integration. More importantly, they can make joint pricing decisions and conclude prorate agreements on how to apportion revenues on itineraries involving flights operated by both airlines.}

—Havel and Eastmond

With immunity, then, airlines can mimic the features of a full merger by freely discussing schedule and route integration. More importantly, they can make joint pricing decisions and conclude prorate agreements on how to apportion revenue on itineraries involving flights operated by both airlines. As a matter of consumer welfare, they can also consult each other to obtain an enhanced ability to predict customer preference and to ensure the earlier availability of discounted fare seats.\textsuperscript{65} This kind of consultation should allow more accurate control of booking practices, reducing the possibility that business passengers will be excluded from their preferred itineraries.

In the absence of immunity, the antitrust laws of the United States apply \textit{fully} to international airline alliances, and the major alliances would almost certainly face costly, distracting, and inefficient private antitrust suits by excluded airlines—or even by private citizens—even if the DOT (or the federal antitrust authorities)
did not oppose the alliance arrangement. (Indeed, the alliances have already faced serious challenges from the European Union competition enforcers, who have no comparable power of broad immunity). A critical advantage of immunity, therefore, is that it gives the airlines flexibility to engage in aggressive, innovative action in the marketplace without being shadowed by the cost and unpredictability of antitrust investigations or lawsuits. Precisely for this reason, the airlines that have enjoyed immunity have been required to assure the DOT that they would not enter their alliances without the grant of immunity.

3. The Open Skies Condition of Immunity

Immunity is such an extraordinary concession that the DOT typically has conditioned its grant on an undertaking from each foreign partner's home government to enter into an open skies bilateral air services treaty with the United States. If the undertaking is given, the agency is likely to find that the grant of immunity satisfies the "public interest," as the legislation mandates. It is easy to unwrap the underlying public benefit rationale: as long as open skies remains the cynosure of U.S. international aviation policy, the DOT anticipates that other governments, under pressure from their home airlines, will be lured by the promise of immunity into open skies agreements and moderation of protectionist regulatory control of their home markets.

Interestingly, the DOT seems prepared to discount competitive concerns if it believes that an open skies agreement is achievable. A new open skies agreement with the Netherlands trumped reduced competition in several key markets when the original KLM/Northwest alliance was immunized in 1992, for example, and the DOT has maintained this broad perspective ever since. The concept of open skies, in any event, is (at the least) a logical antidote to reduced competition on any given route, because all international routes between the contracting parties will be thrown open to competition by rivals of the alliance.

The blueprint for immunity is the 1992 open skies agreement between the United States and the Netherlands, but immunity has been bestowed on several similar international alliances since 1992. But global alliances are complex multi-state creatures trying to adapt themselves to an uncongenial bilateral regulatory climate. As a general matter, therefore, the DOT has conditioned immunity on the signing of an open skies treaty with each participating foreign airline's home country. If any member of the alliance cannot induce its home government to accept open skies, it will be excluded from the immunization grant. Thus, in 1997, United Airlines announced the formation of the Star Alliance, which
linked the immunized United-Lufthansa-SAS and United-Air Canada alliances with unimmunized code-sharing alliances between United and Thai Airways and between United and Varig (the Brazilian national airline).

II. Immunized Alliances: New World Order or Impediment to Revolution?

A. A Structural Flaw (Literally) in DOT's Open Skies/Immunity Policy

Although the phenomenon of immunized airline alliances is fairly new, already a major "structural" flaw has revealed itself in the U.S. policy of trading immunity for open skies. Open skies, as empyrean theory, proposes unrestricted point-to-point access to each party's territory. For the United States and the Netherlands, for example, theory has largely evolved into practice. But the ideal falls short in countries where airport capacity constraints make it impossible for intensified competition to flourish even if an open skies agreement is signed. This problem is demonstrated acutely by the capacity problems of two of the United States' most important aviation partners, the United Kingdom (at London-Heathrow) and Japan (at Tokyo-Narita), neither of which has yet signed an open skies agreement. The agency, and its open skies policy, seem stymied by these problems. In its recent order dismissing the application of British Airways and American Airlines for antitrust immunity for their joint alliance, for example, the DOT insisted that "open skies in the case of the United Kingdom must include adequate provision for new and expanded U.S. carrier service through London airports." The bait of immunity, in this context, is simply inconsequential to the DOT's regulatory assessment. But what stands in its place?

The U.S. insistence on improved access makes sense as a method of promoting more competition, but as a negotiating strategy it fails to take into account the agency's own implicit expectation, revealed so often in the past, that pressure from the foreign partner's own airlines is typically crucial to winning open skies concessions from a restrictive government.

The keen enthusiasm of British Airways to win immunity for its alliance with American Airlines waned perceptibly after the U.S. Department of Justice (in comments to the DOT) agreed with the EU and UK competition authorities that British Airways should yield a sufficient number of take-off and landing slots at London Heathrow "to make access 'meaningful.' " The British carrier is Heathrow's dominant slot-owner, and may rationally have concluded that the monopoly rents from these scarce resources far
exceeded the costs of divestment. After dismissal of the BA/AA application for antitrust immunity, opens skies talks between the United States and the United Kingdom have been infrequent and inconsequential.76

While the U.S. strategy for achieving open skies with Britain could succeed if access to Heathrow were not a zero-sum game (but merely a matter of overcoming British resistance to increased competition), it is poised to fail within the current limitations of the bilateral system. Broadening the field of play toward multilateral discussions, British Airways could register gains on a network level through (for example) seventh freedom services from Amsterdam or Paris to the United States.77 Immunity issues would not feature so prominently, if at all, in this expanded environment for services.

B. Other Problematic Issues Confronting Alliances

1. Disparate Systems of Competition Review

Alliances, being transnational, encounter the pervasive problem of parallel, and often conflicting, regulatory supervision. Multiple competition review not only harms the alliance partners if (as in the BA/AA debacle) the agreement must be screened by local, national, and even supranational agencies, but may harm consumers if an agreement receives favorable treatment in one jurisdiction while another rejects the same agreement as anti-competitive.

The recent airline ownership saga in Canada illustrated some of these risks of disparate treatment. The Onex Corporation proposed a buyout of ailing Canadian Airlines to the Canadian Ministry of Transport, and then announced plans for a hostile takeover of Air Canada, the chief competitor of Canadian Airlines, if the Ministry of Transport approved its plan to take over Canadian Airlines. Were this combination to occur, the new combined carrier would be poised to capture over 75% of the U.S.-Canada transborder market, and the oneworld alliance, dominated by American Airlines, would hold 100% of the domestic Canadian market (the proposed takeover would have pulled Air Canada out of United Airlines' Star Alliance). Intriguingly, the sole competition authority to express an intention to review the proposed transactions was the European Union, representing a group of countries that would be affected only marginally by the Canadian/Air Canada combination. Impelled by the political need to protect Canadian Airlines from job losses and even bankruptcy, the Canadian government suspended application of its competition laws to the proposal, and the U.S. antitrust authorities simply announced that they would defer to the Canadian government.78

¶ 25,051 ©2001, CCH INCORPORATED
The problem of disparate treatment of alliances can also occur in the course of domestic competition review. Within the United States, for example, the two agencies primarily charged with assessing the competitive impact of airline alliances, the DOT and the Department of Justice (DOJ), have differed historically in their strictness of review. A recent study by the Transportation Research Board (TRB), a U.S. public/private partnership, raised concerns that the "DOT has taken a position of promoting . . . alliances while also being responsible for objectively assessing the competitive effects of antitrust immunity requests, a potentially conflicting set of consequences." To illustrate this bipolarity (and, incidentally, also to spotlight the perils of raising the expectations of foreign carriers that immunity will automatically occur after a foreign carrier's home country signs an open skies agreement), we cite the example of the DOT's award of immunity to an alliance between American Airlines and LanChile. Although the two carriers would capture a virtual monopoly on routes between the United States and Chile, under pressure from the Chilean government the DOT agreed to grant antitrust immunity in exchange for an open skies agreement. The DOJ's anti-competitive concerns were brushed aside. As a sensible way to end this interagency conflict, the TRB proposed a new review process for applications for antitrust immunity by transnational airline alliances. The DOJ should perform the initial review and then forward to the DOT only those applications acceptable on competitive grounds, and should also conduct follow-up critiques of immunized alliances approaching renewal.

A final concern about the overlapping systems of antitrust review of airline alliances arises from the European Union's unusually activist approach in this area. The strictness of review and glacial pace at which the Union's competition directorate has analyzed global alliances present obvious regulatory mismatches with the DOT's relatively rapid and forgiving review. Although transferring initial scrutiny to the DOJ might temper these disparities, airlines entering into unapproved alliances may still have to absorb enormous sunk costs to comply with the EU's proposed conditions (if they ever become final), due to the strategic investments they have made in the four years since the EU announced its review of the major alliance agreements.

2. International Alliances and the Competitive Structure of the Domestic Airline Industry

The TRB study raises the important issue of "whether the number of international alliances—each of which is developing into a large, multicarrier alliance—will ultimately dictate the number of U.S. carriers that can maintain international operations, possibly
reducing the number of domestic airlines capable of survival." 81 In this environment, "the absence of unaffiliated carriers abroad, or even of carriers willing to interline, raises the possibility that independent U.S. airlines will be weakened and possibly not survive." 82

Trans World Airlines (TWA), prior to its recent post-bankruptcy absorption into American Airlines, was a good example of what the TRB has in mind. TWA was a network carrier domestically that had no membership in a global alliance and limited international routes, but which suffered from costs that were too high to perform competitively in point-to-point domestic markets against aggressive, low-cost carriers like Southwest Airlines. TWA may also have been effectively precluded from merging with any strong domestic carrier, perhaps the most sensible resolution of its challenges, because of the prevailing political suspicion of domestic alliances and mergers. 83 TWA's own structural problems may have been the most important factor foreclosing it from alliance-mating, but it is also possible that it faced strategic exclusionary behavior by the U.S. carriers that anchor the global airline alliances. Arguably, there is a role in this kind of situation for one of antitrust law's most paradoxical features, the essential facility doctrine. An essential facility is a productive asset that cannot reasonably and economically be duplicated and to which access is necessary if one wishes to enter the market and compete meaningfully in it. 84 TWA might have been able to prove the elements necessary for an essential facilities claim: (i) that it is economically infeasible to reproduce the facility (access to a global airline network or at least its frequent flier plan), and (ii) that denial of access imposes a severe competitive handicap on the affected airline. 85 Even if TWA could have made out a claim of this sort, however, there is no single forum that exists currently that could expediently craft and seek to enforce any remedy that would be appropriate for this behavior.

The DOT has correctly suggested, in any event, that some domestic carriers will adjust to the realities of the global marketplace better than others and that protection of these weaker carriers "is not a basis for taking actions to inhibit the development of pro-consumer and pro-worker alliances." 86 A compromise regulatory solution that might still help a carrier like TWA is suggested by the European Commission's draft proposal, issued in 1998, concerning the United/Lufthansa/SAS alliance. 87 The Commission suggested allowing "airlines without comparable frequent flier programs to participate in the joint frequent flier programs of [the alliance] in respect of the transport services covered by the alliance, while preserving confidentiality of transferred data by mechanisms
to be defined." Another potentially useful regulation suggested by the Commission's proposal would be to entitle unaligned domestic carriers to an interlining agreement on international routes that the alliance carriers dominate.

3. Unions are Becoming Increasingly Aware of the Effects of Global Airline Alliances

Labor unions are also becoming increasingly fearful that global airline alliances pose threats to their job security and are forming their own "alliances" with their counterparts at foreign flag carriers. Pilots, for instance, are concerned that despite U.S. carriers enjoying a cost advantage over most of their European counterparts, they are being "whipsawed" by their alliance partners. The Air Line Pilots Association (ALPA) claims that the net result of this whipsawing is that while U.S. carriers' growth in the transatlantic market has remained relatively flat since 1993, operations marked with a U.S. carrier's code, but performed by a European carrier, have grown dramatically. The decentralized structure of alliance management also increasingly makes unions like ALPA feel that they are not constructively engaged in the development and decision-making in global airline alliances.

4. Safety Oversight Issues

The recent safety problems affecting Korean Airlines have exposed a major challenge facing alliances and their respective governments in ensuring that, in the absence of centralized regulatory supervision of global aircraft safety, all alliance partners meet comparably high standards of safety in their operations. Although the U.S. anchor carriers claim that they conduct internal reviews of their code share partners and that they can provide a common level of safety oversight for all their alliance partners, without certifiable control over the decision-making process at deficient carriers these lofty goals may not be achievable. Various governmental bodies have reacted to these challenges in different ways. The United States has attempted to promulgate a set of safety regulations that would only apply to code-share operations. The European Union is attempting to formulate safety regulations that would apply commonly to all carriers. The various governments also have divergent opinions on which agencies, domestic or international, should enforce these regulations, with the United States favoring some sort of International Civil Aviation Organization enforcement that would placate smaller countries who oppose U.S.-imposed standards. Regardless of their form, development of these new safety guidelines has lagged far behind the pace of alliance growth. The DOT, for
example, has only recently published its proposed draft guidelines on code-share safety.\textsuperscript{95}

C. An Emerging New World Aviation Order

1. What Are the Founding Principles for the New World Order for Aviation?

Although alliances are growing at a rapid pace within the current bilateral system of trading aviation rights, there is a growing consensus in the international aviation community that a fresh blueprint is needed to bring global aviation into the 21st century. As one airline executive has pointedly asked, "What would we have if we could start all over again?"\textsuperscript{96}

As the economic backbone of the new network, this executive envisioned a global hub and spoke system, and airline alliances that would be integrated to the point of providing the kind of "seamless" service to customers which global telecommunications companies already provide today. To make this network a reality, the governments that negotiate air service treaties must inevitably embrace a multilateral or plurilateral system\textsuperscript{97} because the complexity of navigating through the current maze of bilaterals threatens to stifle alliance growth in its current form.\textsuperscript{98} Within this new system, the twin vestigial principles of the bilateral system, nationality and cabotage, would be abolished to allow free flow of capital to its most efficient use.\textsuperscript{99} At a high level of juristic evolution, the multilateral/plurilateral agreements would have their own competition tribunals (consolidating eventually into one tribunal) to perform supranational oversight of the competitive behavior of the airlines operating within their jurisdiction.\textsuperscript{100} While supranational solutions may be temporarily out of political vogue in the United States given the recent controversial record of the World Trade Organization, the EU member states have accepted this kind of pan-national supervision for over forty years. Moreover, a competition authority that is liberated from the intense political pressures that national governments face is the only way to fairly resolve the airport access issues that vex the global aviation system and to ensure genuine equality of opportunity for all carriers in all of the new marketplaces.

2. How Can These Principles Be Realized?

A new blueprint for global aviation is unlikely to come from a "big bang" deregulation of the international system.\textsuperscript{101} It is more likely to flow from a series of incremental steps, and the pressing issue for the next three years is for airlines and governmental officials to determine the forum in which a multilateral or plurilateral agreement can be optimally negotiated.
One idea that has been hotly debated would be to include air transport services in upcoming negotiating rounds for the General Agreement on Trade in Services (GATS), an approach that has garnered some support among European Commission officials but objection from sovereign states with large aviation markets (like the United States and Japan). Large country opposition to a GATS strategy focuses on a perceived lack of reciprocity inherent in the GATS "most favored nation" and "national treatment" principles. There is an even greater strategic risk that, in this forum, the nationality/cabotage principles could be traded away as part of a more general trade agreement without achieving a specific multilateral agreement on air transport rights or a global aviation competition tribunal in return.

A more promising route to a multilateral system would be for the United States and the European Union to work toward a Common Aviation Area that would first allow airlines to fly freely between and among the partners' territories without the required home connection, and eventually, if cabotage and nationality restrictions are removed, within the entire United States/European "common airspace." While the combined size of the two markets makes this option attractive, the European Commission's lack of a negotiating mandate, coupled with the insistence of the Association of European Airlines (AEA) that U.S. cabotage rights must be incorporated in any negotiation, are two major obstacles to an incremental launch of the project. On both sides of the Atlantic, critical labor issues must be resolved, including the U.S. labor union shibboleth that "there will never be cabotage in the United States," and harmonization of the diverse airline labor rules for EU nationals.

The AEA's recent proposal of a so-called "Transatlantic Common Aviation Area" has become the plat du jour that is attracting the most attention from airlines, government officials, and scholars, but U.S./EU bipartisanship is not the only potential source of founding members to construct a first multilateral agreement. At the DOT's "Beyond Open Skies" ministerial conference in Chicago, the Dutch representative suggested that if no progress could be made on a broad multilateral agreement, the Netherlands might forge ahead independently with current partners. Marking a new stage in this highly incremental process of finding multilateral solutions, on November 15, 2000, the DOT announced that the U.S., together with Brunei, Chile, New Zealand, and Singapore, had initialed a new multilateral open skies agreement at a meeting of the Asia Pacific Economic Co-operation group (APEC) in Brunei. While this agreement slightly eases the traditional nationality rule,
it holds fast to the principle of cabotage. Access to U.S. cabotage routes, therefore, remains the elusive key to a true multilateral open skies regime.

Conclusion

For as long as the bilateral system continues on its path to entropy, strategic airline alliances will continue to be both necessary and significant. As the new world aviation order begins to evolve, however, the alliance concept will still retain importance, but may be increasingly limited to simple code-shares in markets that are too small or not lucrative enough to permit full-scale mergers. Where mergers are efficient, they will take place and will result in full integration. Most importantly, full-scale mergers will also ensure more coordinated safety oversight. Although there remain formidable barriers to the achievement of a comprehensive open skies regime for international aviation, the practical effects of achieving this goal will be undeniably beneficial for airlines, for consumers, and for labor.

Brian F. Havel is Associate Professor of Law at DePaul University College of Law in Chicago. He is the author of In Search of Open Skies: Law and Policy for a New Era in International Aviation (Kluwer 1997). Andrew C. Eastmond is a 2000 J.D. graduate of DePaul.
Endnotes

1 See AIRLINE BUS., Alliance Survey 2000.

2 Four major groupings of global alliances had evolved. In addition to oneworld and Star, the two other major alliances are the "Wings" group (Northwest, KLM, and potentially Continental) and the Delta/Air France/Aeroméxico/Korean Air "SkyTeam" partnership. (A fifth, much smaller group, the "Qualifier" alliance, links Swissair and Sabena with a number of smaller airlines.) British Airways, however, would probably have withdrawn from the oneworld alliance had it completed a previously-announced takeover bid for KLM; the British carrier hinted that it would have preferred, had the merger succeeded, to maintain the Wings connection with Northwest. See Jane Martenson, BA Ditches US Move to Focus on Europe, The Guardian (London), Mar. 26, 2001, at 23. Regulatory disfavor for a British Airways/American Airlines transatlantic code-share arrangement has prompted American to conclude a partnership agreement with Sabena and Swissair that could lead to those airlines' eventual incorporation into oneworld. See Daniel Michaels and Scott McCartney, British Air Weighs Northwest Partnership, WALL ST. J., Sept. 11, 2000, at A4; see also SAIRGROUP Faces Strategic Review, AIRLINE BUS., Mar. 2001, at 23 (noting that Swissair has also been in talks with Star and SkyTeam). Alitalia has recently indicated that it is interested in participating in the SkyTeam alliance. See Alitalia Talks to Air France About Forming an Alliance, N.Y. TIMES, Apr. 23, 2001, Sec. C, at 7. The importance of joining an alliance was highlighted in December 1999 when long-time alliance skeptic Virgin Atlantic Airways announced that it was selling a 49% stake to Singapore Airlines and entering into a broad marketing alliance with Singapore that will include code-sharing and cooperation in areas such as frequent flier programs and airport lounges. See Singapore Airlines to Take 49% of Virgin, AIR TRANS. WORLD, Feb. 1, 2000, at 9.

3 The Boeing Corporation projects that global air travel will grow annually by an average of 4.8% over the 20-year period to 2020. The European consortium Airbus projects a growth rate of 4.9% for the same period. See Boeing Forecasts Point-to-Point Flights to Increase, CHINA POST, Apr. 3, 2001.

4 Transnational merger and acquisition activity in these sectors has skyrocketed in recent years. Of particular interest to aviation specialists, for example, has been global consolidation in the automobile industry (e.g. Daimler/Chrysler, Ford/Volvo).

5 One of the architects of the alliance phenomenon, Paul V. Mifsud, KLM's Vice President, Government and Legal Affairs, U.S., has suggested that the global aviation regulatory system initiated by the Chicago Convention is "more like the mercantilist regimes of the 19th century" than any modern trade system. Paul Mifsud, address before the CCII Aviation Law Conference, The Coming Revolution in Airline Competition: Free Trade, Global Markets, and a New Passenger
Declaration of Independence (Sept. 2, 1999) (transcript on file with authors) [hereinafter, CCH Aviation Law Conference 1999].

Paul Mifsud also noted in his address at the CCH Aviation Law Conference 1999 (see supra note 4) that “the United States is the most restrictive country on nationality issues.” Id. Some relaxation of these rules can be detected in recent events, for example, Swissair's bid for control of the Belgian national airline, Sabena (although the circumstances of that bid relate to Switzerland's ongoing negotiations for closer commercial relations with the European Union). See Swissair Report, AIR TRANS. WORLD, June 1, 2000, at 10. However, if Swissair abandons its investment in Sabena, Belgium may not ratify the treaty between Switzerland and the European Union which is necessary under current EU airline nationality and control law for Swissair to acquire a majority stake in an EU carrier. See Elizabeth Olson, Its Strategy Off Course, Swissair Looks For A New Bearing, INT'L. HERALD TRIB., Mar. 16, 2001, at 15. Given that recent merger negotiations between KLM and British Airways were abandoned, the collapse of the Swissair/Sabena takeover would be another signal that the traditional nationality rule cannot be readily overcome.


8 Duane E. Woerth, president of the U.S. Air Line Pilots Association, criticized a proposal to place “national treatment” status within U.S.-controlled airspace on the bargaining table for the World Trade Organization meeting in Seattle in late 1999. According to Woerth, “[g]ranting national treatment for foreign carriers is nothing less than allowing cabotage [i.e., domestic point-to-point services] under a different name.” Duane E. Woerth, President’s Forum: Fair Trade or Free Trade, AIR LINE PILOT, Oct. 1999, at 4.

9 These restrictive clauses have their genesis in the text of the two subsidiary accords agreed at the Chicago Conference, the Two Freedoms and Five Freedoms Agreements. The relevant text in each instrument is identical:

Each Contracting State reserves the right to withhold or revoke a certificate or permit to an air transport enterprise of another State in any case where it is not satisfied that substantial ownership and effective control are vested in nationals of a Contracting State.


10 See Air Transport Agreement Between the Government of the United States of America and the Government of Canada, Feb. 24, 1995, art. 1(2), 3 Av. L. Rep. (CCH) ¶ 26,426a, at 21,977 (2000), which provides that:
Nothing in this Article shall be deemed to confer on the airline or airlines of one Party the rights to take on board, in the territory of the other Party, passengers, their baggage, cargo or mail carried for compensation and destined for another point in the territory of that other Party.

11 The philosophy that prevailed at Chicago was to treat international air routes and traffic as a specialized commodity subject to granting, acquisition, or exchange. J.G. Gazlik, Nationality of Aircraft and Nationality of Airlines as a Means of Control in International Air Transportation, 25 J. AIR L. & COM. 1 (1958). Commerce in this commodity would be the exclusive patronage of the national governments. Moreover, these "rights" remain the sovereign property of the states and not of the airlines that use them. The "closed" Chicago system necessarily implies that the "freedoms of the air" are privileges rather than rights.

12 Among the air traffic "freedoms" introduced in the Two Freedoms and Five Freedoms Agreements (see supra note 9) are the third and fourth freedoms, which bestow upon designated carriers the right to carry passengers and cargo to and from the home country and a foreign country, respectively; the fifth freedom, mentioned in the main text, which allows a designated carrier to enplane passengers and cargo in a foreign country for onward transit to a third country (this is the network-building freedom). In addition to these freedoms, state practice has introduced some nuances into the Chicago routing system that increase airline flexibility: when air traffic originates from a point other than the home country of the designated carrier, transits through the home country of the designated carrier, and continues to a third country, this is known as sixth freedom traffic; under the rarely-accorded seventh freedom, the designated carrier operates without a stop at the transit point in the home state (for example, United Airlines could offer direct service from Mexico to the United Kingdom). For a full discussion of the freedoms, see BRIAN F. HAVEL, IN SEARCH OF OPEN SKIES: LAW AND POLICY FOR A NEW ERA IN INTERNATIONAL AVIATION 35-39 (1997).

13 This traffic is known as "beyond" fifth freedom traffic. If the U.K. carrier enplanes no additional passengers in the United States but merely transports some of its U.K.-origin passengers to additional beyond points (i.e., Canada), this is usually treated as "blind sector" transit and does not require negotiated permission (unless the beyond point is a second destination in the United States, a so-called coterminalization right). See HAVEL, supra note 12, at 36 n.29.

14 A notable, and fairly recent, exception to this rule are the member states of the European Union. As of April 1, 1997, as part of a final package of air transport liberalization initiatives launched ten years earlier, the airlines of the member states (as long as they are registered under a new common system of community licensing) are allowed plenary cabotage rights within the EU. These rights allow EU airlines to provide services between any two airports within the fifteen national territories. See, e.g., Daniel Michaels, No-Frills Irish Airline Flies High, WALL ST. J., Sept. 6, 2000, at B1 (describing how Ryanair, a European imitator
of Southwest Airlines, has "fundamentally shifted[ed] the economics of flying around Europe; the airline, a no-frills service, "can break even even with its planes almost half empty").

15 The statutory language generally prohibiting cabotage allows for two exceptions in very specific circumstances: (1) emergencies (such as labor strikes or severe weather conditions) and (2) "dry"-leasing (without crew) of foreign-registered aircraft by U.S. carriers. 49 U.S.C. § 40104(g) (1994). The U.S. Department of Transportation (DOT) has activated this authority in only a few, closely circumscribed instances. See, e.g., Application of Heavylift Cargo Airlines Ltd., Order No. 89-10-7, 1989 DOT Av. LEXIS 655 (Oct. 3, 1989), granting Houston, Texas/St. Thomas, V.I., cabotage rights to a U.K. cargo carrier to assist in hurricane disaster relief.

16 See discussion infra (explaining the code-share device).


18 "The cost of operating in a new market can be quite high since the fixed costs are usually spread over only a single round trip. Also the competition may be well entrenched especially if it has the 'home field' advantage. If these barriers prove to be insurmountable, the alliance path could be the more attractive alternative than flying alone." Merrill Lynch, Global Airline Alliances: Why Alliances Really Matter From an Investment Perspective (Sept. 25, 1988), at 9. "In some cases a carrier may possess the route authority to serve a particular market, but it is uncertain about how long it will take to reach an acceptable return. This is critical to the decision process since aircraft represent significant capital expenditure, especially aircraft flown on international routes which are typically widebodies." Id.

19 "Airside" refers to gates, taxiways, and runways beyond the terminal security points; "landside" describes the airport infrastructure prior to security screening.


"Outsourcing these types of fixed costs among alliance partners may be the easiest way to start controlling major airline costs," but has been difficult for the partners to implement in practice. See Joan M. Feldman, Disappearing Act: Will Alliance Partners Find Savings In Outsourcing With One Another? Air Transp. World, Feb. 1999, at 24. In Feldman's predictive view, incidentally, "after today's commercial linkages are history and have been replaced by real mergers, alliance cooperation to reduce costs may have more impact." Id.

The practice of code-sharing actually originated in the United States domestic market in the 1970s. Allegheny Airlines assigned its AL designator code to some small commuter airlines when it decided that some routes that it operated were unprofitable, but could not be exited because of federal entry and exit regulation. See James T. Lloyd, Airline Alliances—A Practical Guide, in PAPERS PRESENTED AT THE ABA FORUM ON AIR AND SPACE LAW, San Francisco (1998).

The International Air Transport Association assigns two-letter air designator codes to individual airlines and these codes are used in reservations, schedules, and ticketing. See GAO/RCED-95-99, International Aviation: Airline Alliances Produce Benefits, but Effect on Competition is Uncertain (Apr. 1995), at 13.

This has the important effect of listing the code-share flights in computer reservations along with nonstop and other direct flights. These flights are displayed above traditional connecting flights on the travel agents' computer screen. Code sharing has a poor image in the popular media and has been described as "a common airline industry shell game." Joe Brancatelli, Beware The Airlines' Shell Game, Home Office Computing, Dec. 1994, at 18. However, there is conflicting evidence from the DOT showing that consumers generally prefer code-sharing over interline connections, believing that (purported) same carrier connections involve quicker gate transfer at terminals, and are less likely to cause lost luggage. See GAO/RCED-95-99 Report, supra note 24, at 14.

This type of marketing arrangement is known as a "blocked-space" agreement. Under a blocked-space agreement one airline provides another with a certain number of seats on flight segments that the second airline does not operate. The second airline then independently markets and sells the "space" under its own two-letter designator code. See HAVEL, supra note 12, at 108 n.389.

KLM, beginning with its initial relationship with Northwest and extending to its (recently-terminated) agreement with Alitalia some years later, has sought to use alliances to integrate its partners' services so completely with its own that the airlines would be operating "as if they were a single carrier." Joint Applications of Northwest Airlines, Inc. and KLM Royal Dutch Airlines for Approval and Antitrust Immunity of an Agreement Pursuant to Section 412 and 414 of the Federal Aviation Act, as amended, Final Order No. 93-1-11, 1992-1994 Transfer Binder Av. L. Rep. (CC11) ¶ 22,876 (Jan. 11-12, 1993) at 14,056. The integration envisioned was so complete that Delta Airlines, in lodging its objection to the original KLM/Northwest antitrust immunity application, argued that the transaction was a de facto merger, rather than an ordinary business venture between two carriers; therefore, the transaction could not qualify for special

Issues in Aviation Law and Policy
antitrust exemptions (see discussion infra). See generally Havel, supra note 12, at 105 (discussing DOT review of KLM/Northwest applications).

28 The U.S. General Accounting Office, reporting on international aviation alliances in 1995, attached the label "merger model" to the KLM/Northwest alignment, specifically to distinguish it from the "investor model" (the former BA/US Airways alliance) in which cooperative strategies were the recipient's (US Airways's) cost for transfer of foreign carrier (BA) capital, and the "marketing agreement + code sharing" model (Lufthansa/United) that describes most large-scale (noninvestment) alliances in the international air transport industry today. See generally GAO/RCEI-95-99 Report, supra note 24, at 15, 24.

29 See Michael G. Whitaker, Strategic Alliances: "Is Bigger Better?", address before the IATA Legal Symposium 97 (Feb. 4, 1997), at 4 (copy on file with authors).


31 This is the ideal scenario of alliance customer service as envisioned by airline officials. See Whitaker, supra note 29, at 2.

32 See id.

33 See John Schmeltzer, $3 Billion O'Hare Revamp: New Terminals and Traffic Snarls Ahead, CHI. TRIB., May 2, 2000, at 1 (discussing construction at O'Hare airport to benefit members of United Airlines-led Star Alliance and American Airlines-led oneworld alliance).

34 On the competitive effects of so-called loyalty programs, see generally Havel, supra note 12, at 209.

35 "Alliance networks are attractive . . . to the exhausted international business passenger, interested in the 'ultimate' frequent flier plan." Merrill Lynch, supra note 18, at 7. Although most code-sharing partners typically allow cross-accrual of frequent flier programs, no pan-alliance frequent flier programs have yet been initiated. The Merrill Lynch study notes that "[t]here are some legal issues involving privacy in creating a pan-alliance frequent flier program but we think those can be ironed out." Id. at 12.

36 See Douglas W. Nelms, Somewhat Open Skies, AIR TRASP. WORLD, Feb. 2000, at 75, for a discussion of the complexity of liberalizing air cargo rights between the United States and Britain, and the entanglement of cargo issues with negotiations for passenger carrier rights.

37 Economic theory suggests that the reduction in fares would arise from two sources. First, joint pricing theoretically would allow the two partners to assess the full costs to both partners of operating the shared service, potentially eliminating what economists call the "negative externality" associated with lack of cooperation when non-allied carriers set fares for interlined routes in otherwise competitive markets. Second, this fare reduction would then stimulate new traffic, leading to a lower cost of carrying additional passengers within the networks of the alliance partners. In turn, this lower cost structure would put further downward pressure on the alliance fare (i.e., the same revenue would accrue from the lower fare), and also potentially allow the partners to charge

38 See supra note 37. A recent comprehensive study of the economic effects of airline alliances showed that alliance partners charged interline fares that were 18-28 percent below those charged by non-allied carriers. Of some concern, however, was the finding of an anti-competitive alliance effect in gateway-to-gateway markets and that an alliance between two previously competitive carriers would raise fares by 4 to 6 percent in these markets. See Brueckner and Whalen, supra note 37, at 30. A July 2000 follow-up study by these authors suggests that the Star Alliance group had reduced fares in markets where the alliance holds antitrust immunity. The authors established a gross percentage fare reduction of 27% (representing a consumer surplus of $100 million). Within this gross figure, code-sharing accounted for a 7% reduction, alliance membership 4%, and antitrust immunity 16%. A full copy of the report can be obtained at www.brueckner-report.com.


40 The DOT's paradigm shift from concern over intra-alliance competition to promoting inter-alliance competition was revealed in 1996 when the agency conditioned approval of antitrust exemptions for alliances on the withdrawal of the partners from most IATA tariff coordination activities. In its Final Order on the Lufthansa/United antitrust immunity application the DOT stated that "[t]he issue of competition between the alliance and other carriers, particularly other alliances, is pressed upon us by the need to mitigate the potential anti-competitive effects of the immunity provided for the alliance's internal integration and to make it as likely as possible that the economic efficiencies of the alliance can be passed on to consumers." Joint Application of United Air Lines, Inc. and Lufthansa German Airlines for Approval of and Antitrust Immunity for an Alliance Expansion Agreement, Final Order No. 96-5-27, 11994-1999 Transfer Binder Av. L. Rep. (CCH) ¶ 23,375 (May 20, 1996), at 14,411, 14,412.

41 See generally Mifsud, supra note 5. Mifsud noted that the domestic market power of the U.S. Big Three (United, American, and Delta) made them magnets for foreign partners eager to access the disproportionately huge U.S. internal market. See id.


In its application for antitrust immunity for its alliance with Lufthansa, United Airlines argued that "[e]ven though these arrangements will expand service and achieve merger-type efficiencies that cannot be achieved otherwise, without antitrust immunity there will be . . . the continuing risk that the parties' activities will be challenged in U.S. legal proceedings by competitors or others."

United Air Lines, Inc., and Lufthansa German Airlines, Joint Application of, for Approval of and Antitrust Immunity for an Alliance Expansion Agreement, Dkt. 0ST 96-1116 (Feb. 29, 1996), at 35 (copy of application on file with authors) [hereinafter Joint Application of United/Lufthansa].

"As former Secretary of Transportation Federico Peña stated, "the central inquiry is whether 'the overall net effect of . . . [the] transaction . . . is pro-competitive and pro-consumer.'" Joint Application of United/Lufthansa, supra note 44, at 25.


See id.

See id.

See Hunnicutt Testimony, supra note 47.

See id. at 7 (discussing proposed alliance involving British Airways and American Airlines).

See 49 U.S.C. § 41309(b)(1)(A) and (B).

See infra for explanation of the U.S. open skies policy for international aviation. In its order granting Northwest and KLM antitrust immunity, the DOT emphasized that "[w]e would expect that our willingness to take such action [granting an antitrust waiver] might well encourage other countries to seek liberal aviation agreements with the United States . . . so that comparable opportunities may become available to other U.S. carriers."

Joint Applications of Northwest

©2001, CCH INCORPORATED
Airlines, Inc. and KLM Royal Dutch Airlines for Approval and Antitrust Immunity of an Agreement Pursuant to Sections 412 and 414 of the Federal Aviation Act, as amended, Order to Show Cause No. 92-11-27, 1992 DOT Air. LEXIS 827 (Nov. 16, 1992), at 25.


58 See id.; see also HAVEL, supra note 12, at 192 n.322 (explaining exceptions to the liberal pricing protocols in open skies agreements).

59 See DOT Policy Statement, supra note 57, at 19,147 (offering only liberalization of international gateway services, with indirect service—including domestic point-to-point services—to be pursued only through commercial relationships among U.S. and foreign carriers).

60 Although the Airline Deregulation Act sunset legislation ended the DOT’s regulatory control of domestic intercarrier agreements on January 1, 1989, the extraordinary antitrust immunity power continues to apply to intercarrier agreements involving foreign air transportation. See Section 414 of the Federal Aviation Act, 49 App. U.S.C. § 1384 (1979), recodified as 49 U.S.C. §41308 (1994). This provision inter alia authorizes the grant of an antitrust exemption to an otherwise anti-competitive agreement "when the Secretary of Transportation decides it is required by the public interest." (The persistence of the immunity power, while an anomaly, should be understood in the context of Congress’s legal inability unilaterally to extend its domestic deregulation legislation to the international sphere; although some legislation was passed to monitor foreign anti-competitive practices, federal regulatory control of foreign air transportation remained substantially unmodified: see generally HAVEL, supra note 12, at 154 (discussing limitations of U.S. efforts to liberalize international air transportation)).


62 See generally Whitaker, supra note 29, at 2.

63 "There are far more economies of scale on the revenue side than on the cost side." Flint, supra note 30, at 33.


65 Joint yield management has been extremely hard to achieve in practice because of the varying information technology systems that partners have. Even the oldest and most integrated alliance, the Wings group, has set a 2005 deadline for integration of their information technology resources. See Feldman, supra note 22, at 26. Academic research published in July 2000 attributed fare reductions within the Star Alliance primarily to enjoyment of immunity. See supra note 38.

See HAVEL, supra note 12, at 173 n.233 (noting that “this somewhat disingenuous position” reflects past agency practice, whereby the DOT denied immunity to agreements that did not violate the antitrust laws unless the immunity was required by the public interest and the parties would not proceed without immunity; in this way, the agency can give a “public interest” veneer to the grant of immunity even if there are undetected or unresolved anti-competitive risks in the parties’ arrangements). In the United Airlines/Lufthansa application, for example, the partners claimed that “[r]emoval of this threat [litigation] through antitrust immunity is ... an essential condition precedent to implementation of the Alliance Expansion Agreement.” Joint Application of United/Lufthansa, supra note 44, at 6.

In two individual gateway markets, Minneapolis-St. Paul/Amsterdam and Detroit/Amsterdam, the DOT found that competition would be entirely eliminated by the projected joint operations of Northwest and KLM. See HAVEL, supra note 12, at 172 (analyzing the DOT’s review of the KLM/Northwest application).

At least theoretically—airport congestion and slot restrictions may dictate otherwise.

See generally HAVEL, supra note 12, at 174.

This condition is not explicitly stated in the 1995 DOT policy statement but has entered U.S. air diplomacy through the exigencies of practical negotiation. See HAVEL, supra note 12, at 193 n.325.

Ironically, because of the dominance of conventional diplomacy in air treaty negotiations, other states have flipped the U.S. open skies/immunity strategy by demanding immunity for their home airlines as a prior condition of accepting open skies. While this tactical switch may not have any ultimate consequence, it
The Path to Open Skies: Transcending Global Alliances

13,129


The 1998 amendment to the 1952 U.S./Japan air services agreement has relaxed or removed some regulatory restrictions but does not provide the liberal route and airport access of a full open skies agreement. See supra note 17.

See American Airlines, Inc. and British Airways plc, Joint Application of, for Approval of and Antitrust Immunity for an Alliance Agreement, Dkt. OST 97-2058-446 (July 30, 1999), at 2 [hereinafter BA/AA Joint Application].

The British government’s desire to protect BA’s interests has meant that official support for open skies has waxed and waned with BA’s corporate agenda. At the DOT’s December 1999 Ministerial Conference, “Beyond Open Skies,” views were expressed concerning the desirability of having other British carriers (notably British Midland and Virgin Atlantic) involved in pressuring the British authorities on open skies. See Joan M. Feldman, Useful Posturing, AIR TRANS. WORLD, Feb. 2000, at 67, 73; see also Mark Pilling, Only a Call Away, AIRLINE BUS., Mar. 2001, at 38 (commenting that the U.K. government has acknowledged its determination not to make “substantive moves” toward open skies until it secures antitrust immunity for BA’s transatlantic alliance efforts); Adrienne Larson, Alliance for BA Remains Key to Progress on U.S.-U.K. Pact, 344 AVIATION DAILY, No. 13, Apr. 18, 2001, at 1 (noting that, according to U.S. and U.K. officials, BA’s decision on how to “jump start” its efforts to achieve an immunized transatlantic alliance remains “the determining factor” in achieving a U.S.-U.K. open skies bilateral).

For an explanation of seventh freedom air traffic service, see supra note 12.

The actual denouement of these proposed transactions took a quite different turn, however. After a Canadian court ruled that Onex Corporation’s takeover bid was illegal, Air Canada agreed to acquire its failing rival, Canadian Airlines, for U.S. $62 million and to operate Canadian as a separate code-sharing subsidiary. Although Air Canada’s new “subsidiary” will be a member of the Star Alliance, American Airlines reached an agreement with Air Canada by which Canadian would continue to maintain a code-sharing and loyalty program relationship with American for 10 years. See generally Game and Set Air Canada, AIR TRANS. WORLD, Jan. 1, 2000, at 11. Another regulatory player also joined the fray: The U.K. Competition Commission recently gave its blessing to the Air Canada/Canadian Airlines merger with respect to Air Canada’s coveted landing slots at Heathrow Airport.


Id. at 152.

Id. at 150-51.
KLM's U.S. Vice President, Government and Legal Affairs, has referred to a political "backlash" against domestic alliances and mergers. See Paul Mifsud, address before the CCH Aviation Law Conference 1999, supra note 5 (transcript on file with authors). Arguably, US Airways, currently the object of a takeover bid by United Airlines, finds itself in a similar strategic position to TWA prior to its bankruptcy. See Airline Consolidation: Has It Gone Too Far?, hearing before the Senate Judiciary Comm., Feb. 7, 2001 (statement of Stephen M. Wolf, chairman, US Airways Group, Inc.) (apparently attributing US Airways' weak economic performance to the fact that it is neither a low-cost carrier nor a network carrier). Nevertheless, it appears that U.S. antitrust authorities gave the American Airlines bankruptcy rescue of TWA the benefit of so-called "failing company" analysis, whereas it is unlikely that US Airways could be considered a "failing company." See Cynthia Wilson & Philip Dyne, Proposed United-US Airways Merger Draws Scrutiny, St. Louis Post-Dispatch, Apr. 12, 2001.

Alaska Airlines v. United States, 948 F.2d 536 (9th Cir. 1991); Hecht v. Pro-Football Inc., 570 F.2d 982, 992 (D.C. Cir. 1977); for a more extended analysis of the aviation implications of the essential facility doctrine, see Prepared Testimony of Dr. Paul Stephen Dempsey, Professor of Law, Director of the Transportation Law Program, University of Denver College of Law, Before the Committee on the Judiciary of the U.S. House of Representatives, Nov. 5, 1997, at 25 (copy on file with authors).

Alaska Airlines v. United States, 948 F.2d 536 (9th Cir. 1991).

See DOT, Response to TRB Report (see supra note 79), at 11 (copy on file with authors).


Id.

See id.

Some pilot alliances that have been formed are the Association of Star Alliance Pilots, the Global Pilot Alliance, and the oneworld Cockpit Crew Alliance. Duane E. Woerth, Constructive Engagement: A Presentation By ALPA President Duane E. Woerth Before Selected Clients of Dr. Julius Malduits (Jul. 15, 1999), available at http://www.alpa.org/internet/prescorner/7-15-99/index.htm.

Id.

See id.

See id.


A plurilateral agreement is one that seeks the strongest concessions among a group of states with mutual leverage. Unlike multilateral agreements generally, a plurilateral can only be acceded to by non-founding states without any reservations. Plurilaterals are typically comprehensive in detail, and seek to settle all future relations among the founding parties with respect to the subject matter. See generally Havel, supra note 12, at 405 (discussing framework for a U.S./EU aviation plurilateral); see also Michael E. Levine, Scope and Limits of Multilateral Approaches to International Air Transport, in OECD, Forum for the Future: New Policy Approaches to International Air Transport (1993), at 79.

In a recent position paper proposing a new Transatlantic Common Aviation Area, the Association of European Airlines noted: "This fragmented bilateral framework with its built-in burdensome effect on airlines and occasional inconsistencies caused by conflicting requirements and discriminatory policies is increasingly out of touch with the needs of the airline industry seeking to achieve maximum efficiency in serving its customers." Association of European Airlines, Towards a Transatlantic Common Aviation Area, AEA Policy Statement 4 (Sept. 1999) [hereinafter AEA Report].

In fact, elimination of the nationality rule would logically deprive the cabotage rule of meaning. If KLM can acquire majority ownership and control of TWA, for example, it would gain access to all of TWA's cabotage points within the United States. See Havel, supra note 12, at 84.

For the constitutional implications of this kind of supervision, see Brian F. Havel, The Constitution in an Era of Supranational Adjudication, 78 N.C. L. Rev. 257 (2000) (arguing that a grant of supranational jurisdiction to a global aviation tribunal can be made consistently with the Judiciary Article of the U.S. Constitution).

The expression "big bang" comes from Margaret Thatcher's deregulation of the London Stock Exchange in 1986. The sudden introduction of brokerage competition, accomplished on a single day, was referred to as the "Big Bang." Dennis Swann, The Retreat of the State: Deregulation and Privatization in the UK and US 280 (1988).

See generally Martin Staniland, Transatlantic Air Transport: Routes to Liberalization (unpublished paper, copy on file with authors), at 21 (discussing implications of GATS negotiations for air transport).

These would be seventh freedom rights (see supra note 12). Thus, for example, British Airways could park a 747 in Amsterdam and operate direct flights to New York or Los Angeles from the Netherlands—in direct competition with KLM, or as KLM's merger partner if a British Airways/KLM merger were approved. U.S. airlines, in turn, could generate originating traffic in the Netherlands for onward connections to other EU points, competing directly with a host of EU airlines.
Nevertheless, the AEA accepts that the United States "is known to have reservations about cabotage," and anticipates a need for "transitional arrangements" in liberalizing the freedom to provide services. AEA Report, supra note 98, at 8.

See Woerth, supra note 90, and Feldman, supra note 22, at 26.


Multilateral Agreement on the Liberalization of International Air Transportation, Nov. 15, 2000, 3 Av. L. Rep. (CCH), ¶ 26,018, at 21,121. The agreement was signed on May 1, 2001 by U.S. Secretary of Transportation Norman Y. Mineta, Minister of Communications Pehin Dato Haji Zakaria bin DMW Haji Sulaiman of Brunei, Ambassador to the Organization of American States Estaban Tomic of Chile, Minister for Trade Negotiations and Minister of Agriculture Jim Sutton of New Zealand, and Minister for Communications and Information Technology Yeo Cheow Tong of Singapore.

[The next page is 13,151.]