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Aviation Alliances: Implications for the Qantas-Ba Alliance in the Asia Pacific Region

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AVIATION ALLIANCES: IMPLICATIONS FOR THE QANTAS-BA ALLIANCE IN THE ASIA PACIFIC REGION

MICHAEL S. SIMONS

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This Essay examines the emergence of global airline alliances in the mid-1990s. Created through a series of strategic relationships, alliances enable airlines to enter markets across the world traditionally denied to them under bilateral air service agreements. The decision of the Australian Trade Practices Commission in March 1995 granting Qantas Airways Ltd. (Qantas) and British Airways Plc. (BA) the right to jointly set fares and services on the Sydney-London route raises competitive issues for carriers on the route as well as other carriers competing in the Asia Pacific Region. This Essay will discuss the nature of airline alliances and the regulatory regime in which they seek to operate. The Essay will also discuss codesharing. The Essay will conclude with the view that while Qantas is Australia’s principal carrier in the Asia Pacific Region, whether it achieves global status or remains a regional carrier will depend upon the success of its alliance with BA in the long term as well as the outcome of the Qantas privatization which occurred in August 1995.

I. INTRODUCTION

The purpose of this Essay is to examine the emergence of global aviation alliances and the position Qantas Airways Ltd. (Qantas) enjoys with its alliance partner British Airways Plc. (BA) in an increasingly competitive market, particularly in the Asia Pacific Region. These arrangements are of particular relevance given the recent sale of Qantas. At the time of this writing, 75% of Qantas’ equity has been placed in the world’s commercial markets. Local and international financial institutions have responded favorably with the allotment to the Australian general public being fully subscribed and overseas commercial interests oversubscribing the 49% limit to the extent of 51.3%.1

This Essay will analyze the development of international airline alliances, the major participants, the advantages and disadvantages of such relationships, and Qantas-BA’s competitors in the Asia Pacific Region. The Essay will conclude with the view that the new alliance between Air New Zealand, Singapore Airlines, Ansett International, Lufthansa, and United Airlines will challenge the Qantas-BA partnership, not only in the Asia Pacific Region, but in the future on a global scale.

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II. INTERNATIONAL AIRLINE ALLIANCES

The objective of an airline alliance is to create between two or more carriers a seamless integration of standards, products, and services for the benefit of the traveller. The aim is to add value to the products and services of each partner airline while at the same time achieving economies of scale in reducing costs and unnecessary duplication. For example, it allows the alliance partners to operate more efficient and flexible reservation and ticketing systems, which in turn permit passengers to transfer from one international partner carrier to another at a designated international terminal without delay or a diminution of standards or service. Alliances are the new generation of marketing partnerships between airlines cooperating their networks to provide global reach.

The alliance involves participating partners accessing reservation systems for the history of a loyal traveller, treating them as a "customer or client," and rewarding them with benefits including special car rental rates, hotel accommodations, or bonus points on the airline's frequent flyer programs. The airlines undertake to issue boarding passes promptly by combining speedy and efficient baggage check-ins, handling, and collections, especially on interline services with partner airlines. Loyal clients are encouraged to use the airline's designated club lounge facilities which provide world TV news, business and information service centres, and selected entertainment.

III. TYPES OF INTERNATIONAL ALLIANCES

Alliances consist of two categories, equity alliances where airlines take equity or part ownership in other carriers, and joint venture alliances where the arrangements between airlines are limited to specific objectives. The former alliances are wide-ranging, while the latter have route specific marketing arrangements. In each case the alliances contain a joint marketing component. Alliances are predicated on the basis that airlines are required to maximize market penetration worldwide in order to enhance profits for co-partners and shareholders with minimum exposure to negative effects.

Views differ as to the number of alliances. One view suggests there are in excess of 401 alliances in the world, 133 of which

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involve intercontinental links. This is double the number four years earlier. Approximately 70% of alliances are national or regional in nature, providing smaller airlines with access to the larger carrier’s hub airports. The Boston Consulting Group, in their examination of 200 alliances globally in force in 1991, suggests that 107 have collapsed. Equity alliances were three times more likely to succeed than non-equity alliances. In the case of regional alliances, the Boston Consulting Group considered that 80% of alliances were successful. Intercontinental alliances were likely to have a success rate of 77%.

Central to the alliance is the approval of both the carrier’s country and the host country under a bilateral agreement which permits traffic rights to be established between the parties. The commercial aspects of the alliances can only operate between the respective partner airlines where a bilateral agreement has previously been entered into by their respective national governments. This is generally not an issue. Traditionally, most international carriers (other than those in the United States) have either been owned by their national government or privatized, such as BA in 1989. Alternatively, many airlines are now in the process of being either fully or partly privatized, as is the case in Europe with Lufthansa, Sabena, and Swissair. On July 19, 1995, it was announced that Swissair’s purchase of 49.5% in the Belgium carrier Sabena had been approved by the European Commission. Since codesharing is a precondition to the formation of international alliances, an understanding of their origins and importance is necessary.

IV. INTERNATIONAL REGULATION OF THE AIRLINE INDUSTRY: BILATERAL AGREEMENTS AND CODESHARING

The practice of codesharing between international airlines arises from the relationship established under bilateral air ser-

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4 Formation Flying, AUSTL., July 26, 1995, at 32.
5 Id.
6 Id.
8 Id.
9 Id.
10 Id.
11 See generally de Groot, supra note 3.
12 Ian Verchère, Swissair Deal Threatens Sabena Status, EUROPEAN, May 11, 1995, at 32.
vice agreements, referred to as "air service agreements" or ASAs. These agreements have their origin in the Chicago Convention of 1944 (Convention). The Convention confirmed the fundamental principles of (a) the sovereign state's control over all navigation within territorial limits and (b) the independent, bilateral negotiation of international air service arrangements. The Convention also established the International Civil Aviation Organization (ICAO), which under article 37 had the objective of adopting uniform international standards of air safety, regularity, and efficiency of aviation. The Convention provided the legal basis for the creation of bilateral air service agreements among nation states through which air carriers could operate.13

Under articles 1 and 2, the Convention established "complete and exclusive sovereignty" over the territorial air space of each state, drawing upon the sentiments expressed in the Paris Conference of 1919.14 The Convention recognized the fundamental importance of such a concept to the future of commercial aviation. The Convention also required that permission or authorization be obtained before scheduled or non-scheduled commercial international air services could operate over or into the territory of a contracting state.15 The Convention confirmed that such international aircraft would have the nationality of the state in which it was registered, and that as a matter of principle dual nationality would be excluded.16

The signatories to the Convention undertook to enforce their own "rules of the air" which would also apply above the "High Seas."17 Similarly, enforcement would exist in relation to a state’s passports, immigration, customs, and health, as well as the right to search an aircraft.18 It should be noted that the implication of the right of state sovereignty carries with it the desire by most states that their own airline companies satisfy the demand for air transport to and from their own countries independently. "[Governments] show a strong tendency to impose major limitations on foreign airline companies . . . [which] may

14 Id. at 121.
15 Id. at 121-22.
16 Id. at 122.
17 Id.
18 Id.
affect the number of passengers to be carried, the flight frequency and other vital matters.\textsuperscript{19}

The right of nation states to permit greater freedom of movement has been made in two agreements which are annexed to the Convention and which divide the Freedoms of the Air into five categories.\textsuperscript{20} Other writers extend the freedoms to the sixth, seventh, and eighth freedoms.\textsuperscript{21} The Freedoms of the Air fall into two categories, Technical Rights and Traffic Rights, and were established under the International Air Service Transit Agreement (IASTA).\textsuperscript{22} The first two freedoms were extended by each contracting nation to the other by the Transit Agreement (also known as the Two-Freedoms Agreement).\textsuperscript{23} The International Air Transport Agreement,\textsuperscript{24} known as the Transport Agreement or the Five-Freedoms Agreement, contained the third, fourth, and fifth freedoms\textsuperscript{25} that were debated at the Chicago Convention but which were not settled on a multi-national basis as originally envisaged. These freedoms have been subsequently negotiated on a bilateral basis between nations.

Briefly, the five freedoms are as follows:

(a) \textit{The First Freedom}. The right to fly across the territory of another nation without landing.\textsuperscript{26}

(b) \textit{The Second Freedom}. The right to land for non-traffic purposes (to refuel or to carry out repairs).\textsuperscript{27}

(c) \textit{The Third Freedom}. The right to disembark passengers, mail, or cargo in another nation.\textsuperscript{28}

(d) \textit{The Fourth Freedom}. The right to embark passengers, mail, or cargo in another nation.\textsuperscript{29}

(e) \textit{The Fifth Freedom}. The right of an airline of one nation to embark passengers, mail, and cargo in another nation and fly

\textsuperscript{20} Id. at 12.
\textsuperscript{23} Diederiks-Verschoor, \textit{supra} note 19, at 10 n.3, 12.
\textsuperscript{25} Diederiks-Verschoor, \textit{supra} note 19, at 10 n.3, 12.
\textsuperscript{26} Pengilley & McPhee, \textit{supra} note 21, at 240.
\textsuperscript{27} Id.
\textsuperscript{28} Id.
\textsuperscript{29} Id.
them to a third nation.\textsuperscript{30} It is these Fifth Freedom rights which have been the source of a number of disputes concerning the Australian Government and its national carrier Qantas, most notably in respect to capacities and the carriage of passengers with Northwest Airlines, Air New Zealand, and most recently Cathay Pacific.\textsuperscript{31}

The other freedoms, referred to as the sixth, seventh, and eighth freedoms, are as follows:

(a) \textit{The Sixth Freedom}. The right of a nation’s airline to carry traffic between two other nations via an airport in its own country.\textsuperscript{32}

(b) \textit{The Seventh Freedom}. The right of one airline of one nation to carry passengers on stand alone services between two other nations.\textsuperscript{33}

(c) \textit{The Eighth Freedom}. The right of one nation’s airline to carry origin and destination traffic within the borders of another nation ("cabotage").\textsuperscript{34}

In the view of one noted author, the last three freedoms are simply minor variations of the first five.\textsuperscript{35}

V. POOLING, INTERLINE COOPERATION, AND ALLIANCES

Cooperation between domestic airlines and international carriers is not a new concept. Over the years, and for a range of commercial reasons, airlines have entered pooling arrangements, coordinating flight programs and sharing the proceeds.\textsuperscript{36} The Scandinavian Airline System (SAS) formed cooperative arrangements in which Sweden, Norway, and Denmark participated.\textsuperscript{37} Similarly ATLAS, consisting of Air France, Alitalia, Lufthansa, and Sabena, formed consortiums for the purpose of purchasing aircraft and maintenance services.\textsuperscript{38} Agreements also exist among airlines for the interchange of aircraft and crew

\textsuperscript{30} Id.
\textsuperscript{32} PENGILLEY & MCPHEE, supra note 21, at 240.
\textsuperscript{33} Id.
\textsuperscript{34} Id. at 241.
\textsuperscript{35} DIEDERIKS-VERSCHOOR, supra note 19, at 13.
\textsuperscript{36} Id. at 19.
\textsuperscript{37} Id.
\textsuperscript{38} Id.
for short or long-term periods.\textsuperscript{39} This practice is known as "wet leasing" where it involves using another airline's crew, or "dry leasing" where the arrangement is limited to the aircraft.\textsuperscript{40}

However, in the mid-1990s, airline alliances are characterized by greater complexity. In the United States, these alliances have taken the form of partnerships or alliances involving codesharing, joint marketing, equity investment, or a combination of one or more of these factors.

VI. DEREGULATION AND CODESHARING IN THE UNITED STATES: AN HISTORICAL OVERVIEW

The major U.S. carriers developed in the 1970s and 1980s. Originally, codesharing arrangements evolved in the United States to achieve economies of scale in the provision of airline services by larger carriers operating out of major airport centres to remote locations using regional or feeder aircraft. It was uneconomical for the major airlines such as TWA, American Airlines, Delta, or United Airlines to fly these smaller destinations below capacity. The cooperative interlining arrangement between large and small carriers reflected the "hub and spoke" configuration which was emerging as a result of federal government policy in the late 1970s.\textsuperscript{41} The strategy was aimed at meeting the demand of airline traffic from cities such as New York, Washington, D.C., Chicago, Dallas, and Los Angeles. In some cases, the major airlines held equity in or owned the local carriers.

A. Deregulation

The Airline Deregulation Act of 1978 in the United States was significant in stimulating competition between the carriers and allowing new competitors to enter the market. At the same time, the economic incentive to increase in size, combined with the government policy of permitting airlines to merge rather than fail, increased the dominance of the major airlines. Despite the recession that began in 1979, air traffic between the years 1978 and 1982 increased by more than 14% while seat miles increased by 19%.\textsuperscript{42} In short, more people were flying and

\textsuperscript{39} Id. at 20.
\textsuperscript{40} Id.
\textsuperscript{41} ROBERT M. HARDAWAY, AIRPORT REGULATION, LAW, AND PUBLIC POLICY 26 (1991).
\textsuperscript{42} Id. at 24.
"air travel was becoming democratized as the travel mode of the masses rather than the elite." Consequently, airlines using the hub and spoke model gained a multiplier effect from the number of city-pairs they could serve with a given amount of flight mileage. To maximize their position in the market, the larger airlines recognized that greater aircraft capacity and a nationwide network were necessary. As a result, by 1988 all but four of the nation's airports were effective monopolies, with Chicago, Atlanta, Dallas, and Denver, oligopolies. It was against this background that codesharing began.

B. CODESHARING

Permission to create a codesharing arrangement exists on any destination listed in a bilateral agreement. The International Air Transport Association (IATA) assigns designator codes to airlines that are used for reservations, schedules, telecommunications, legal documents, and other commercial and traffic purposes. It is a two-letter code identifying the carrier, followed by a number corresponding to the flight and destination. For example, QF 11 signifies a Qantas Sydney-Los Angeles route, and QF 324 signifies the Los Angeles-San Francisco portion of the flight undertaken by one of Qantas's codeshare partners, USAir.

Under arrangements to codeshare, the two-letter code may be used on a flight operated by another carrier. This means that carriers with their own code or combined designator codes can sell seats on the same flights operated by the codesharing partner. In attaching the same designator code to the connecting flights, the partner is able to market both flights as if it were a connecting flight to the same carrier. The difference is that instead of interlining passengers from one air carrier to another, there is the appearance of an on-line connection where the passengers are transferred to the same carrier. In this re-
spect, codesharing is a misnomer, as it is not the code that is shared but the flight, that is, the carrier’s capacity.\textsuperscript{51}

The London Heathrow Succession Agreement in 1990 was a significant step in the development of airline services. At that time the United Kingdom received universal codesharing to the United States in exchange for United Airlines and American Airlines being allowed to replace Pan-AM and TWA as the U.S. carriers at Heathrow.\textsuperscript{52} Subsequently, BA’s purchase of 24.6% of USAir enabled it to enter the U.S. market.\textsuperscript{53}

The main issue concerning the US-German bilateral agreement was the creation of codesharing with six different formulas.\textsuperscript{54} It gave German airlines access to the U.S. domestic markets and the U.S. airlines access to the German interior markets, together with access to third countries from Germany and fifth freedom services between London and Frankfurt.\textsuperscript{55}

It was the use of fifth freedom services which contrasted this codeshare arrangement from the BA-USAir and the KLM-Northwest codesharing operations.\textsuperscript{56} The KLM-Northwest alliance is the most highly developed codeshare in respect to beyond access to third countries.\textsuperscript{57} Consequently, this alliance is the subject of much criticism by countries such as Israel which, under its bilateral agreement with the U.S., has no codesharing provisions.\textsuperscript{58} The Israeli government was distressed to find that the KLM-Northwest alliance assumed it could be a beyond-Amsterdam point and characterized the arrangement as “an external bilateral authority.”\textsuperscript{59} As a matter of practice, bilateral agreements do not make provisions for cooperative commercial relationships.\textsuperscript{60} However, the United States appears to have adopted in the latest US-Russian agreement a limited capacity to codeshare destinations.\textsuperscript{61}

\textsuperscript{51} Id. at 63.
\textsuperscript{53} Id.
\textsuperscript{54} Id. at 13.
\textsuperscript{55} Id.
\textsuperscript{56} Id.
\textsuperscript{57} Id.
\textsuperscript{58} Id.
\textsuperscript{59} Id.
\textsuperscript{60} Id.
\textsuperscript{61} Id.
VII. RECENT DEVELOPMENTS IN CODESHARING

In early 1994, the German bilateral negotiations were completed and marked the beginning of codesharing as an aeronautical-political issue. It seems that, from that time, codesharing passed from a marginal marketing concept to a primary issue in the designation of airline services.

The question remains unanswered at this stage as to whether codesharing will become a tactical trend with limited objectives or the first stage of liberalization in a new global aviation industry. Recognizing the apparent advantages of codesharing, national governments may well seek to intervene and control codesharing, given the authority they enjoy under bilateral agreements. A trend is emerging where governments are using the bilaterals to control the conditions under which carriers will operate in the future. For example, in the case of Swissair and Delta, the partners were only permitted to codeshare on the basis that they maintained separate finances, marketing, sales, and pricing.

The United States Department of Transportation has announced that it intends to amend its rules from requiring “reasonable notice” to “actual compliance” as a condition for approval of codesharing pacts. Codesharing, originally designed as a marketing tool, may eventually be used as a political tool by nations granting beyond rights over their country.

Codesharing alliances have expanded in recent years. Concurrently, the major carriers' ownership and use of computer reservation systems (CRS) has enabled them, through the codeshare device, to gain a competitive advantage in placing their names on the screens of the CRS ahead of their smaller and possibly more vulnerable opponents. Codeshare flights appear on the CRS as on-line connections which, in line with consumer preference for on-line connections, are shown in the “primary display” and given priority over interline connections shown in the “secondary display.”

62 de Groot, supra note 3, at 67-68.
63 Jennings, supra note 52, at 12.
64 de Groot, supra note 3, at 67.
65 Jennings, supra note 52, at 14.
67 Id.
time means money, agents are more likely to try to book the flight from the first primary screen.\textsuperscript{68}

A central question facing the airline industry is whether global alliances will remain tied to the present bilateral arrangements. Because of the complexities arising from the growth and proliferation of codesharing agreements among international carriers, there is a need for a new formula to be devised involving multilateral agreements. This could take the form of a trade block approach involving like-minded nations with the United States and European Union (already multilateral) or perhaps the United Kingdom taking the lead. The vice-president of United Airlines has suggested a strategy for establishing a global standard for codesharing agreements with the only restriction being consumer notice requirements.\textsuperscript{69} If such a policy is accepted by both carriers and governments, it could create an environment for a deregulated, global airline industry.\textsuperscript{70}

Since the Qantas-BA alliance represents one of the more recent global airline alliances which will affect its competitors on the London-Sydney Kangaroo route as well as airlines within the Asia Pacific Region, a brief analysis of the Qantas-BA alliance follows.

A. THE QANTAS-BRITISH AIRWAYS ALLIANCE

The Qantas-British Airways alliance was formed in 1992. In their official statement the partners announced:

In the evolving climate of inter-dependence in the aviation industry, the proposed partnership between British Airways and Qantas is both attractive and logical, particularly given the airlines' complementary route structures and cultural compatibility.

An alliance would allow the airlines to offer a more comprehensive service to travellers and would provide the means for Qantas to further boost its presence in its home region . . . .

It would also present both airlines with the opportunity to improve their commercial performance by taking advantage of their operational synergies and coordinating many functions and activities.\textsuperscript{71}

\textsuperscript{68} Id. at 23.

\textsuperscript{69} Jennings, supra note 52, at 14.

\textsuperscript{70} Id.

\textsuperscript{71} BRITISH AIRWAYS, WE GO FURTHER TOGETHER—A NEW ERA FOR AUSTRALIAN AVIATION 6 (1992) (statement of Colin Marshal, Deputy Chairman and Chief Executive of British Airways) (on file with the Journal of Air Law and Commerce).
Following these commitments, the partners embarked on a series of initiatives to promote cooperation rather than competition through joint advertising and promotion, ground handling and cargo operations, information management, capital equipment, and quality assurance.

In October 1994, Qantas and BA announced a number of policy decisions to improve customer services levels and enhance their relationship. Included in the statement was a provision for increased codesharing, the use of Singapore and Bangkok airports as major international hubs to permit the exchange of passengers at the midpoint of the UK-Australia service, and the creation of greater capacity on the Sydney to London route (Kangaroo route) on which thirty-two carriers competed. The effect of this strategy was immediate, with Lufthansa and Air France announcing their withdrawal from the route in October 1995.72 Due to changes in aircraft type, the airline partners offered thirty-five flights per week, creating one thousand additional seats on the route. British Airways is responsible for fourteen flights and Qantas for twenty-one. Codesharing, however, is not planned for this route.

Other strategies initiated by the alliance partners included creating joint sales offices to actively market their products and flights. It is calculated that the changes will ensure an estimated $1.0 billion in joint revenues shared on a proportional basis.73

On November 17, 1994, the Australian Trade Practices Commission (Commission), in an interim determination, stated that the proposed route sharing and pricing policies on the Sydney-London route constituted a breach of section 88(1) of the Trade Practices Act of 1974.74 The Commission considered that the partners' present arrangements amounted to "price fixing" which would have a deleterious affect on the market and inhibit competition.75 Qantas resubmitted its proposal in a modified form in March 1995. It provided the Commission with additional information sufficient for it to grant an authorization in favor of the alliance partners on the grounds that the public benefits of competition outweighed any apparent anti-competi-

75 See id. at 4.
tive effects. In the last nine months, the Qantas and BA alliance appears to be operating effectively. However, its success and profitability levels exist only to the extent that its competitors are prepared not to compete directly in the same markets. On a global scale, the KLM-Northwest alliance remains a major competitor.

B. THE KLM-NORTHWEST AIRLINES ALLIANCE

Established in 1989, the Dutch airline KLM invested $400 million in the purchase of Northwest’s parent company, NWA Inc., recently renamed Northwest Airlines Corp. by Wings Holdings. In 1990, Northwest’s Atlantic route consisted of flights connecting three cities in the United States to five destinations in Europe. In 1991, Northwest and KLM entered a joint venture to carry traffic between Northwest’s Minneapolis/St. Paul hub and KLM’s Amsterdam hub. In 1992, a similar transaction was arranged which included Northwest’s largest hub in Detroit. As a result of the joint venture, traffic rose 10% more than other transatlantic routes in the years 1992 to 1993 and doubled the total industry traffic growth of 7%.

At the same time, the United States and the Netherlands governments’ new bilateral agreement granted antitrust immunity to Northwest and KLM from January 1, 1993, giving both airlines the opportunity to enhance their partnership. It is the only alliance which has been granted such immunity by the United States under a bilateral agreement. As previously stated, within weeks of the grant of immunity, the KLM-Northwest alliance was challenged by Israel, accusing KLM-Northwest of deceptively advertising flights to Tel Aviv from New York when Northwest did not offer a service from that market. Germany also claimed that the alliance was predatory and attempted to block Northwest’s codeshare access to German cities by seeking

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76 TRADE PRACTICES COMMISSION, QANTAS AIRWAYS LIMITED AND BRITISH AIRWAYS PLC. TRADE PRACTICES DETERMINATION vi (Mar. 1995).
77 Emiliya Mychasuk, TPC Go-ahead on Route-sharing a Boost for Qantas, SYDNEY MORNING HERALD, May 13, 1995, at 27.
79 Id.
80 Id.
81 Id.
82 Id.
83 Mead Jennings, A Sense of Stability, AIRLINE BUS., July 1994, at 50.
a court injunction against it. Other complaints came from Turkey, Greece, and Saudi Arabia.\textsuperscript{84}

In September 1994, Northwest added to its schedule KLM’s nonstop flights to Amsterdam from eight U.S. cities. The Managing Director of Northwest Airlines in the Southeast Asian Region stated, "These joint venture flights represented the single largest expansion ever of Northwest’s service to Europe . . . [to the extent that] scheduled flights to Europe were nearly doubled—from 70 to 136—without adding to industry over-capacity."\textsuperscript{85} The unique alliance between Northwest and KLM appears to be one of Northwest’s strategic assets.

Northwest also gained fifth freedom rights to offer services to Russia under the bilateral agreements in May 1993. The carrier sought permission from the United States Department of Transportation to operate to Moscow and St. Petersburg under a codesharing agreement with KLM from August 1993. Moscow would be serviced via Amsterdam and St. Petersburg via Amsterdam and Helsinki, with no traffic rights between Helsinki and St. Petersburg. KLM would operate the aircraft on the Amsterdam-Moscow and Amsterdam-Helsinki-St. Petersburg segments. Northwest also gained authority to operate U.S.-Amsterdam-Budapest flights under a codeshare with KLM.\textsuperscript{86}

The alliance created significant cost savings and revenue earnings and broadened the relationship from its original codesharing operation. Between 1990 and 1993, KLM’s shared annual operating benefits increased from $5 million to $160 million.\textsuperscript{87} Northwest believed its alliance pre-tax profits to be $30 million.\textsuperscript{88} It is estimated that the total benefits could reach $150 million per carrier.\textsuperscript{89} The combined revenue in 1993 amounted to $16 billion.\textsuperscript{90} The alliance carriers have recently agreed to utilize joint paper stocks, shared terminal space, and reciprocal ticket sales.\textsuperscript{91}

KLM and Northwest plan to merge their respective cargo operations which is estimated to return to the partners $25 million

\textsuperscript{84} Id.
\textsuperscript{85} Neidermire, supra note 78, at 7.
\textsuperscript{86} Id.
\textsuperscript{87} Jennings, supra note 83, at 50.
\textsuperscript{88} Id.
\textsuperscript{89} Id.
\textsuperscript{90} Id.
\textsuperscript{91} Id.
In 1994, a jointly marketed World Business Class product was established offering more comfort, choice, and control to travellers. Similarly, in January 1994, the alliance produced a combined international fare sale that discounted air tickets by 30% to the U.S., Europe, the Middle East, and Africa.

With the existing fifty codeshare points in the U.S. and twenty-four beyond the Netherlands, codesharing opportunities in the Pacific appear to be the next challenge. The two codeshare carriers’ schedules now meet each day at Northwest’s Asian hub in Tokyo, as well as Bangkok and Seoul, a KLM hub.

Pricing initiatives developed in tandem by the carriers have averted pro rate agreements. The KLM-Northwest formula for dividing revenue based on the production costs for each carrier appears unique. In 1994, Northwest received the award for the best improvement in net results among world carriers. In seeking to merge their respective accounting systems, the partners believe they have a competitive advantage over other alliances. The only competitor facing KLM-Northwest at present is the United-Lufthansa alliance. On September 14, 1994, Fosters Brewing Group announced the sale of its 6% interest in Northwest to KLM for $242 million.

C. THE SINGAPORE-DELTA-SWISSAIR ALLIANCE

Singapore Airlines, Delta Airlines, and Swissair developed a marketing alliance in 1989. The aim of this alliance was to strengthen each airline’s operational capability to create a global presence. Critics suggested that the combination of three bilateral agreements would lead to an unbalanced alliance. However, with joint cargo handling, the alliance enabled Singapore Airlines to maintain its preeminent position with profitability amounting to $510.5 million in 1994.
1. Singapore Airlines

Singapore Airlines (SIA) was privatized in 1985. SIA established effective route strategies, cost efficient operations with modern carriers, and a cohesive labor management relationship. In addition, SIA has preferential tax treatment for its airlines. Other reasons for the airline's success include efficient management, an effective long haul route network, a hub central to the Asia-Pacific market, and the location of its operations at one of the most modern airports in the world. The airline has acquired an image of quality and enjoys the support of a government that offers liberal traffic rights and airport facilities.

Yet SIA's yields are falling. Costs are increasing as skilled labor becomes more expensive. The airline has experienced four years of declining profits. In the half year ending September 1994, SIA announced a 15% rise in pre-tax profits.\(^\text{103}\) Earnings per share increased by 18% to 35.9¢ per share and net profit rose 18% to $461 million.\(^\text{104}\) SIA's revenue for the period April to September 1994 increased by 7% to $3.25 billion from the previous comparative period.\(^\text{105}\) It is estimated that SIA will grow at the rate of 8% per year offering more capacity in the year 2000 than British Airways' current capacity. However, an issue of concern for SIA in the future remains—the establishment of new traffic rights within a small home market.

In 1993-1994, SIA attained profits of U.S. $648 million after tax which was an increase of 14.5% over the previous year.\(^\text{106}\) This was achieved, according to SIA's chairman J. Y. Pillay, as a result of productivity improvements “through investment in resources—whether in facilities, equipment, aircraft or people.”\(^\text{107}\) Significant gains have also been achieved during the tendering process for new aircraft because of the competition between aircraft and engine manufacturers for SIA's business.\(^\text{108}\) By operating a young fleet with modern aircraft, SIA is able to optimize fuel efficiency, minimize maintenance costs, and ensure sus-

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105 Id.
106 Id.
107 Id.
108 Id.
tained reliability of its flights, which results in lower investment in spares and support facilities.\textsuperscript{109}

As a result of profit sharing agreements with unions, SIA staff productivity rose an average of 8\% per employee during 1994 bringing with it improvements across the board.\textsuperscript{110}  Nevertheless, capacity was expected to slow from 10.3\% in 1994 to 9\% in 1995-1996.\textsuperscript{111}

SIA is also a major competitor in the Asia and South Pacific Region. SIA has a hub located at the gateway to Asia and is positioned to actively compete for market share in the Asian region against its rivals. SIA's recent alliance with Delta Airlines and Swissair now places it within the global aviation market and, hence, a major competitor of Qantas.

2. \textit{Delta Airlines}

Delta Airlines (DA) established a relationship with United Airlines and American Airlines in 1984 which permitted them to achieve an effective marketing presence in the United States and abroad. DA operates in Asia, Central America, and Europe. It serves twenty-six cities in thirteen countries and has the largest computer reservation system (CRS) through WorldSpan. The airline is ranked third in the world for total revenue tonne km, second in relation to the total number of passengers carried, and third in respect to revenue from passenger km.\textsuperscript{112}

The partners, in seeking their goal of a profitable and balanced alliance, recognize their relative dependency position within the relationship and coordinate corporate strategy. The criteria for continued success now includes prudent financial management; effective human resource policies and labor relations; a common plan for creating new business; extensive networks serving the airlines business; and a reputation for customer service.

3. \textit{Equity of the Partners}

The limitations of ownership are based on the financial strength of each partner and fixed at no more than 5\% of each partner's common stock equity. The amount of allocation is di-

\begin{itemize}
  \item \textsuperscript{109} Id.
  \item \textsuperscript{110} Id.
  \item \textsuperscript{111} Id.
  \item \textsuperscript{112} Whitaker, \textit{supra} note 98, at 44-45.
\end{itemize}
rectly influenced by prevailing exchange rates between U.S. currency and other currencies.

The partners introduced Global Excellence logos for specific alliance products, including round the world fares, joint frequent flyer programs, joint sale promotions, pro rata fares, and 50% discounts in Comfort Class. In technology, the partners now share maintenance facilities at nominated airports, spare parts, joint development on cargo and warehousing, and the purchase of aircraft from the same manufacturers.

Similarly, the partners entered into agreements to purchase eighty McDonnell Douglas MD11s over five years to enhance cockpit and passenger configurations, improve the use of their carriers on feeder routes, and reduce wasted parking time due to time zone differences and scheduling limitations.

In October 1993, DA, having invested $556 million in the Pan Am Corporation’s trans-Atlantic franchise, entered a codeshare alliance with the German carrier Lufthansa. DA anticipated that the alliance would provide $30 to $40 million in added revenue during 1995. It was unfortunate for DA that with the withdrawal of Pan Am from the Atlantic route, the new Air Services Agreement between the United States and the United Kingdom did not permit DA to take up Pan Am’s rights of access to Heathrow terminal, used by forty-eight million people per year.

4. Swissair

Swissair (SR) has a reputation for punctuality, service, and a high standard of cuisine. Despite improved levels of capacity, SR had a pre-tax loss of $50 million during the first half of 1994. Only SR’s profit from its hotels and catering operations enabled the company to remain profitable. Last year, SR reported earnings of $46 million on operating revenues of $4.9 billion.

With the object of ensuring profitability in the future, SR embarked on a series of cost reduction measures including job...
SR is expected to reduce its workforce by at least four thousand out of a total payroll of twenty-five thousand personnel over the next three years. Food and aircraft cleaning have been contracted out. The goal is to increase productivity by reducing labor costs, which amount to 36% of revenue. Airlines that have resolved their labor problems are operating in the range of only 25% to 30%. SR currently faces the task of gaining a secure niche in a rapidly changing European market. SR was permitted entry to the European Union in July 1995.

VIII. AIRLINE DEREGULATION IN EUROPE

The deregulation of the airline industry in Europe is similar to the experience in the United States in the 1980s. The date for an open skies policy in Europe was January 1, 1997. Competition is increasing as the European Union countries move into markets once denied to them. British Airways has established subsidiaries in France and Germany (Deutsche BA) and announced direct flights from Rome to Paris. Conversely, there is pressure on the European airlines to privatize without delay. Lufthansa, a major competitor of Swissair, is selling 51% of its stock to the public, leaving the German Government as a minority shareholder with approximately 32%.

At the same time, the European Commission announced the clearance of the agreement under which Swissair will invest $6.5 billion (BEF) in Sabena as part of a BEF $10 billion capital injection, buying back the 37% share previously held by Air France. Swissair will acquire 49.5% of Sabena with the option to buy additional shares only when European Union rules on airline ownership are changed.

120 Id.
121 Id.
122 Id.
123 Id.
124 Id.
125 Id.
126 Id.
127 Id.
128 Id.
129 Mark Odell, Germany’s Perfect Union, AIRLINE Bus., Sept. 1994, at 34, 39.
131 Id.
Alitalia and Air France are due to privatize in 1996-1997. However, the accumulated losses of both carriers will make it a difficult task. The dilemma facing the European Union members is that policies exist to ensure free market competition in the airline industry; however, national preferences and economies may well create a different agenda. Alitalia, which has experienced six consecutive years of losses and debts of $1.2 billion, is close to bankruptcy.

In the first nine months of 1994, the European Union approved government aid of $7.4 billion to state-operated carriers, including Portugal's TAP, Olympic Airlines, and Aer Lingus. The largest payment was to Air France of $3.7 billion. Yet payments of state aid are not available to Swissair, which is privately owned. The challenge facing Swissair, particularly as a member of the Singapore Airlines-Delta Airlines alliance, is maintaining its market share in Europe. The experience of the Alcazar meetings in 1993 demonstrated how national governments will react when national pride is at stake. In this instance, the countries' representatives failed to agree on the location of the headquarters site and the apportionment of job redundancies which was intended to link Swissair with three other European carriers, KLM, Austrian Airlines, and SAS, the Scandinavian Airlines System.

According to recent announcements, Swissair will still be excluded access to the European Union since the European Commission advised that any effort to take control of the Brussels-based carrier would invalidate Sabena's status as an EU airline.

The central question facing the international airline industry is whether global alliances supported by equity interests can offer security in such a turbulent environment. For example, Scandinavian Airlines lost its equity in Continental Airlines when the U.S. carrier filed for bankruptcy. KLM also wrote down its investment in Northwest Airlines. BA's investment of $400 million in USAir is of concern to BA's shareholders, and

132 Tagliabue, supra note 116, at F11.
133 Id.
134 Id.
135 Id.
136 Id.
137 Id.
138 Id.
139 Verchère, supra note 12, at 1.
the outcome of negotiations with USAir's unionized employees remains uncertain.\textsuperscript{140} The chairman of BA anticipates that the benefits of the partnership will continue to accrue as illustrated by the profit gained through traffic feed, joint frequent flyer programs, and cost and facility sharing amounting to $27.2 million for BA and $5.6 million for USAir.\textsuperscript{141}

IX. THE ASIA PACIFIC REGION

In the Pacific Region, Qantas Airlines has been a dominant carrier alongside Air-NZ which together account for more than 50% of the traffic across the Pacific. At various times since the 1970s, U.S. carriers such as Pan Am, American Airlines, Continental Airlines, Northwest, and more recently United Airlines, have offered regular services to the United States. United Airlines is the only remaining U.S. carrier on the route alongside Air Pacific, Air-NZ, and Qantas. However, economic growth in the Asian market in the last five years has ensured that Qantas's strategic planning includes links to all the major capital cities in the region. The new markets include China, Indonesia, and Vietnam. At the same time, the development of new alliances by other carriers (that is, Air NZ, Singapore Airlines, Ansett Australia, and the Lufthansa-United Airlines and Thai International alliance) is of concern to the Australian carrier.

A. AIR NEW ZEALAND

The Sydney-Los Angeles route has not been a profitable one for the airlines that cross the Pacific Ocean. This fact was evident from the withdrawal of American Airlines, Continental, and Northwest, as stated previously. The result is that United Airlines is the only American carrier servicing the route. Air Pacific, in which Qantas has a 20% holding, recently introduced a Sydney-Fiji-San Francisco service. In July 1996, the Australian and New Zealand governments announced a landmark agreement creating a single domestic aviation market across the Tasman Sea which separates Australia and New Zealand.\textsuperscript{142} The agreement, which does not affect the regulation of international flights, will enable each country's airline to operate within the

\textsuperscript{141} Jacqueline Gallacher, \textit{A Question of Give and Take}, \textit{Airline Bus.}, June 1995, at 54.
\textsuperscript{142} Mark Riley, \textit{Air NZ to Be Third Domestic Carrier}, \textit{Sydney Morning Herald}, July 3, 1996, at 33.
other's domestic market as part of the arrangement.\textsuperscript{143} It is projected that the arrangement will stimulate the market which is worth $5 billion (Australian dollars) and carries more than thirty-one million passengers per year.\textsuperscript{144} The "beyond rights" between New Zealand and Australia, in which Air New Zealand (Air NZ) seeks access to Brisbane Airport as a hub to its markets in Southeast Asia and which, in the past, has been a source of dispute between Qantas and Air NZ, will be negotiated separately between the respective governments.\textsuperscript{145} Air NZ will also purchase a 50% shareholding in Australia's second domestic carrier, Ansett Airlines Ltd.\textsuperscript{146}

Air NZ remains a future competitor for Qantas. This is because Air NZ has entered into an arrangement with Ansett International in the South Pacific region in partnership with the American carrier United Airlines. Air NZ considers itself a niche carrier for the Southwest Pacific, Australia, and the Pacific Islands. Air NZ also recently announced that it will now seek to purchase the 50% shareholding held by TNT in Ansett Airlines.\textsuperscript{147} The other principal shareholder is News Corporation, owned by the Murdoch Group.\textsuperscript{148}

One quarter of Air NZ's revenue is derived from the business traveller with the balance coming from the leisure market.\textsuperscript{149} Air NZ has maintained a profitable profile for the last ten years and ranks eleventh in the world in terms of net profits, having announced for the third successive year a 36% growth in earnings to reach $260.2 million (New Zealand dollars) in 1995.\textsuperscript{150}

\section*{B. Ansett Australia and Ansett International}

In November 1994, when Qantas Airlines announced weekly flights to Vietnam as an important market for Australian business, government, and tourism, Ansett Australia announced, through its new entity Ansett International, expansion into Asia with regular flights and travel incentive marketing schemes. In

\begin{enumerate}
\item Id.
\item See Riley, \textit{supra} note 142, at 33.
\item Id.
\item Id.
\item \textit{Air NZ Makes $228m}, \textit{AUSTL. BUS.}, Sept. 6, 1995, at 43.
\end{enumerate}
1994 the airline established a profitable destination to Bali, with weekly flights to Japan, China, and Vietnam. Following recent discussions between Ansett International and Thai International, a broader alliance with Lufthansa and United Airlines has been developed.

C. The Lufthansa-United-Thai Alliance

The creation of the new Lufthansa, United Airlines, and Thai International alliance represents an immediate and competitive challenge to Qantas-BA. A review of their main features follows.

1. Lufthansa

Lufthansa (LH), in preparation for privatization at the end of 1995, undertook a reduction program. In the first half of 1994, LH announced a pre-tax profit of DM100 million ($63 million).\(^\text{151}\) This result was in contrast to the deficit of DM221 million recorded in the first half of 1993.\(^\text{152}\) The airline also introduced a Frequent Flyer Program in 1993, acquiring over one million members.\(^\text{153}\) LH rationalized the management structure, reduced the general workforce by 17\%, and increased productivity by 11\%.\(^\text{154}\) The airline entered agreements to purchase a 25\% interest with the U.S. computer-based system house EDS which operates System One CRS for Continental Airlines.\(^\text{155}\) The objective was to create cost savings of about 20\% on its annual data processing fees.\(^\text{156}\)

LH entered a codesharing and marketing alliance with United Airlines in May 1994.\(^\text{157}\) The scheme covered fifty-two codeshare destinations which had a significant impact on forward bookings for LH in 1995. The agreement was predicted to assist LH in expanding its North American market in which it had previously suffered losses.\(^\text{158}\) The fact that United Airlines is employee-owned is consistent with LH's stated policy of offering its employees a 20\% share in the airline.\(^\text{159}\) The alliance fulfills

\(^{151}\) Odell, supra note 129, at 34.
\(^{152}\) Id.
\(^{153}\) Id.
\(^{154}\) Id.
\(^{155}\) Id.
\(^{156}\) Id.
\(^{157}\) Id. at 39.
\(^{158}\) Id.
\(^{159}\) Id.
LH’s global strategy without the financial ties BA faced with USAir or Qantas.\textsuperscript{160}

LH and United Airlines held negotiations with Thai International in 1994. A marketing alliance with a cargo hub in Bangkok was a predicted outcome.\textsuperscript{161} The alliance would not be LH’s first entry into Asia, as it established a joint venture with Air China in relation to a maintenance and a technical support agreement with ModiLuft in India several years ago.\textsuperscript{162}

2. United Airlines

United Airlines (UA) was not among the world’s leading airlines in net profitability in 1994. However, in its ranking of total revenue tonne km, it was first in the world; in carrying passengers it was third; and in revenue passenger km it was also first.\textsuperscript{163}

UA employees own 55% of the carrier in exchange for $4.9 billion in wage and work rule concessions. This record testifies to its relative strength in the global airline market. UA is the last American carrier on the Pacific route. UA shows no sign of abandoning this market and is well positioned to establish its alliances in Asia with Thai International Airways and in the Pacific with Air NZ and Ansett International.

3. Thai Airways International Airlines

Thai Airways International’s net profit of U.S. $171 million ranked fourth in the world in 1993.\textsuperscript{164} It recently embarked on a range of measures including rationalizing aircraft types and engines previously ordered from fourteen different aircraft manufacturers.\textsuperscript{165} However, the airline still suffers from over capacity, poor management, and excessive interference by government and the military.\textsuperscript{166}

In 1994, Thai Airways launched Royal Orchid Plus, its new frequent flyer program.\textsuperscript{167} Membership forecasts were expected to be 50,000 but reached 200,000 within twelve months.\textsuperscript{168} The airline retains its markets in Europe, yet is under competitive pres-
sure in the Pacific and Australian markets. The alliance formed with United Airlines in December 1993 was strengthened in 1994 with the coordination of schedules, frequent flyer programs, and inflight products.\textsuperscript{169} With no bilateral agreement operating between the U.S. and Thailand, there is little possibility of codesharing arrangements in the near future.\textsuperscript{170}

Thai International faces competition from Cathay Pacific, Singapore Airlines, and Malaysian Airlines.\textsuperscript{171} There is heavy discounting by the major carriers on the trans-Pacific route.\textsuperscript{172} Thai International may be forced to withdraw its carriers from the route in favor of United Airlines if changes occur among its other competitors in the Asian regional market. Concurrently, the linkages being explored with Ansett Australia is timely given its recent expansion into the Asian markets. The alliance between Thai International and Ansett is wide ranging. It will include codesharing, frequent flyer programs, and access to Ansett's Australian domestic network as well as its wholly owned travel agency, Traveland. This arrangement with Thai International may be a difficult issue for Ansett Australia as it enjoys a successful relationship with Singapore Airlines, a major competitor for Thai International in the Asian market.

D. Qantas in a Global Competitive Market

Qantas is a recognized brand name known domestically and internationally for airline safety, security, and customer service. As an international airline, it has a significant presence on the Sydney-London route, particularly through the BA alliance, and on the Sydney-Los Angeles and North American routes through its alliance with American Airlines. Qantas has gained access to the Asian markets with linkages to Japan, Hong Kong, China, Malaysia, Thailand, and, more recently, Vietnam. It has established alliances and frequent flyer programs with BA, Scandinavian Air Services (SAS), and Canada Air International.\textsuperscript{173} Qantas's alliance with BA has forced it to restructure its management and organizational base during 1993-1994 in time for privatization which, at the time of this writing, has only recently been completed.\textsuperscript{174}

\textsuperscript{169} Id. at 41-42.
\textsuperscript{170} Id.
\textsuperscript{171} Id. at 42.
\textsuperscript{172} Id.
\textsuperscript{174} Cummins, supra note 1, at 47.
Yet Qantas faces a dilemma. It holds a 20% equity in Air NZ which has alliances with Air Canada (joint marketing, codesharing, and FFPs), Delta (FFP cross participation), Japan Airlines (joint weekly flights and FFP participation), Korean Air (codesharing and block space agreement), and Lufthansa (FFP participation), thus making Air NZ a direct competitor. This is especially so following the creation of the “single aviation market” between Australia and New Zealand on November 1, 1996, referred to earlier in this Essay.\textsuperscript{175}

The other threat is Ansett Australia. It represents a domestic as well as an international challenge. Ansett has enjoyed an alliance with Lufthansa in sales agencies for the Ansett domestic sector since 1993. It has also enjoyed alliances since 1993 with Malaysian Airlines in frequent flyer program participation and with United Airlines in codesharing. It seems clear that Ansett Australia, Thai International, and Lufthansa will continue to enhance their relationship, giving them a global presence in the future.

X. CONCLUSION

Asia is Australia's most important market and is likely to remain so in the future.\textsuperscript{176} Qantas is Australia's principal international carrier and faces significant competition from other carriers in the region. This Essay has suggested that the emergence of airline alliances requires airline board members and executives to formulate policies and strategies on a global basis. Finding suitable and profitable partners is a major challenge. It is clear that Qantas acquired a formidable alliance partner in BA. There are critics, nevertheless, including Sir James Leslie, the previous chairman of Qantas, who believes that BA will become the dominant partner given the 49% of overseas institutional ownership following Qantas's recent public float. Whether Qantas fulfills its mission as a global carrier or one which only has a limited presence in the Asia Pacific Region remains a matter for future analysis.

\textsuperscript{175} Riley, supra note 142, at 23.
\textsuperscript{176} See AUSTRALIAN TOURIST COMMISSION, TOURISM PULSE 1-2 (Sept. 1995).
Comments