

1951

International Airline Collaboration in Traffic Pools, Rate-Fixing and Joint Management Agreement

Walter H. Wager

Follow this and additional works at: <https://scholar.smu.edu/jalc>

Recommended Citation

Walter H. Wager, *International Airline Collaboration in Traffic Pools, Rate-Fixing and Joint Management Agreement*, 18 J. Air L. & Com. 192 (1951)
<https://scholar.smu.edu/jalc/vol18/iss2/5>

This Article is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in Journal of Air Law and Commerce by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

INTERNATIONAL AIRLINE COLLABORATION IN TRAFFIC POOLS, RATE-FIXING AND JOINT MANAGEMENT AGREEMENTS

By WALTER H. WAGER

Special Assistant for International Affairs to the Director of Civil Aviation of Israel; Graduate of Columbia University, A.B., 1943; Harvard University, LL.B., 1946; Northwestern University, LL.M., 1949; member, New York Bar. *Formerly* Fulbright Grantee for advance research; graduate fellow at Northwestern Law School and Departmental Editor of the JOURNAL.

IN the 32 years which have passed since the beginning of international airline operations in 1919, it has become apparent that flying is the most expensive form of transportation and that scheduled services are generally unable to survive without government subsidies. Modern planes and navigational aids have increased safety and decreased operating costs to such an extent in the past decade, however, that several companies may be carrying enough traffic and earning enough to become self-sufficient in the not too distant future. The "Big Four"¹ American carriers have already done so.²

But those U.S. operators are not typical of the airlines of the world, for the "Big Four" are flying routes (a) of medium length (b) between large metropolitan centers (c) in a rich populous country (d) with highly developed commerce and industry and (e) a superior level of income. The routes are frequently much shorter in Europe, and less economical to operate.³ The development of traffic has been inhibited by the fact that air fares are higher than in the U.S.A. and average earnings lower. There is also good cheap surface transportation which continues to provide real competition.

In addition, European flying services are competing with each other for almost every country on the Continent has one or more airlines. For over three decades, the problem of competition has been of primary importance to the airlines of Europe and the division of traffic has been so painful economically that a number of methods have been tried in efforts to minimize the "harmful effects of excessive competition."

While it is universally recognized that air transportation is an industry so touched with national interest that it must be treated as a

¹ American Airlines, Trans-World Airlines, Eastern Air Lines and United Air Lines are the four largest U.S. domestic air transport operators.

² D. W. Rentzel, Chairman, C.A.B., "The Current Position of American Air Transportation," an address before the Aviation Writers Association in Washington, D. C., on January 11, 1951.

³ It is well recognized that certain routes are too short to permit the most effective utilization of transport aircraft and crews.

public utility, the question of just how much regulation and competition are desirable has yet to be resolved. Both governments and carriers have been concerned, and have resorted to a number of arrangements to encourage "cooperation" and lessen the impact of competition.

There have been many relationships between the airlines and between the governments and the carriers, ranging from agency and/or inter-line agreements to the advanced consortium of the Scandinavian Airlines System. They may all be described as forms of "cooperation," although some tend to retard the growth of air transport while others open vast new vistas. In considering these miscellaneous stages on the long road to international ownership and joint operations, it should be kept in mind that most of the signatory companies were and are "chosen instruments" with close economic and political support from their governments. A rival operator reluctant to agree to such "cooperation" might find it almost impossible to secure essential landing rights.

HISTORY OF THE POOLING ARRANGEMENTS

According to the French Ministry of Foreign Affairs,

"Historically, international cooperation in air transport seems to have appeared initially and mainly in the form of commercial cooperation, the purpose of which was not to eliminate competition between airlines but rather to attempt to limit the unfavorable repercussions of competition for both parties."⁴

There are those who doubt whether it has achieved its purpose. Among the most common forms of commercial cooperation has been the "pool," an inter-carrier contract with a long history and wide use:

"These pooling arrangements are generally limited to commercial matters: pooling of revenue in a common fund to be allocated in proportion to the mileage flown, agreement on flight frequencies and schedules, with the consequence that commercial and financial services are performed in each country by the national airline on behalf of the associate company.

"Pooling arrangements still permit a considerable amount of competition and, therefore, only solve a small part of the problem; nevertheless, in view of the economies made possible, and the fact that they avoid dispersion of effort, and since experiments have proved the effectiveness of the system, such arrangements deserve a special place in the list of methods of international cooperation which have already been tested."⁵

Pool partners have consistently refused to make public the terms of their carefully negotiated understandings lest the information be of

⁴ "Memorandum on International Ownership and Operation of Air Transport" submitted to ICAO by France, A4-WP/8 EC/3 Appendix D March 1950, p. 16.

⁵ *Ibid.*, p. 17.

assistance to other carriers. Additional light was cast on the pre-war pools of Lufthansa⁶ by a U.S. intelligence team which reported that:

"... both revenues and expenses were pooled and subsequently pro-rated based on several formulae, one of which involved the use of 'kilometers flown' as the basic yardstick. Another was based on the number of seats made available although not necessarily used. This pro-ration allowed an equitable distribution of both expenses and revenue, and was a definite means employed in the control of competitive operation."⁷

It was not always possible to negotiate pool arrangements, for some carriers refused to be forced into uneconomic "cooperation." An example of this may be seen in the deal which Italy offered Britain two decades ago. Imperial Airways sought permission to cross Italy en route to India, and the Italian government asked in exchange landing rights in Alexandria and

"demanded a pooling of the income, from both passenger and mail traffic, for the whole route from England to India, of which pool the Italian company was to receive one-half of the total. In the previous twenty-five weeks, the Italian company had not carried a single paying passenger. The result of these extravagant demands was to divert the route from Italy to central Europe."⁸

Willingly in some cases and reluctantly in others, most European airlines have entered into pools. The two big new carriers of the post-war period, British European Airways and the Scandinavian Airlines System, have been noticeably unenthusiastic about participating in such restrictive arrangements and have given evidence of their confidence in their ability to get along in free competition.

The pool is not limited to Europe, although it has found the greatest acceptance on the Continent. It may be found in South America too, where the Uruguayan carrier CAUSA is operating the Montevideo-Buenos Aires route in pool with the Argentine airline ALFA⁹ and the Colombian operator LANSAS is running the Bogota-Caracas service "in conjunction with LAV"¹⁰ of Venezuela.

Although subject to a great deal of economic regulation as public

⁶ Tome 1, *Revue Generale de Droit Airien* (1932), p. 514 lists 15 of the pools in which the Deutsche Lufthansa participated in a report on cooperation in civil aviation.

⁷ U.S. Technical Industrial Intelligence Committee study on "*The German Commercial Air Transport Industry and Related Aeronautical Developments and Activities*," available from H.M.S.O. London as Combined Intelligence Objectives Sub-committee Item No. 25-28, p. 30.

⁸ TOLLES, "*A History of French Subsidies to Commercial Aviation*," 161, Vol. XVIII, *Smith College Studies in History*, July 1933.

⁹ Foreign Air Transport Division, C.A.B., "*Airlines of South America*," April 5, 1949, p. 103.

¹⁰ *Ibid.*, p. 79.

¹¹ Among the inter-carrier agreements which must be filed with the C.A.B. are those for "pooling or apportioning earnings, losses, traffic, service, or equipment."

utilities, the United States airlines have not been barred by law from pools. Indeed, Section 412¹¹ of the controlling Civil Aeronautics Act of 1938 requires that pool contracts be filed with the Civil Aeronautics Board and implies that such agreements are legal. Section 414 goes on to exempt the airlines from anti-trust legislation. The U.S. carriers have developed in the traditional American spirit of competition,¹² and there are many observers who attribute their growth in large part to such healthy contest. The C.A.B. has done its best to insure compliance with the "Declaration of Policy" in Section 2 of the 1938 Act which calls for "competition to the extent necessary to assure the sound development of an air-transportation system properly adapted to the needs of the foreign and domestic commerce of the United States, of the Postal Service, and of the national defense." The Board has also tried to prevent "unfair or destructive competitive practices."¹³

It might also be noted that British Overseas Airways Corporation is engaged in joint operation with South African Airways between London and Johannesburg¹⁴ and with Qantas Empire Airways between London and Australia.¹⁵ These arrangements are part of the long range program for British air transport cooperation which has resulted in the Commonwealth Air Transport Council¹⁶ and its subsidiary bodies.

A majority of the early pools¹⁷ were purely inter-carrier deals, but in recent years a number of governments have taken an increasing interest in the economic affairs of the "chosen instrument" airlines which they have been protecting and supporting. Several countries have shown concern lest foreign operators flying to and through their territories should offer too much capacity, *i.e.*, run more services than the normal traffic would justify, and take "too much" of the traffic.

¹² The competition was particularly fierce before the Act of 1938, and remains strong today in different forms.

¹³ Para. (c) of Sec. 2.

¹⁴ The study of South African Airways compiled by C.A.B. in 1946 reported that "one of the important decisions reached at the Southern Africa Air Transport Conference held in Capetown on March 20, 1945 was to establish an air service between London and Johannesburg to be operated jointly by Great Britain and the Union of South Africa with British aircraft."

¹⁵ "Civil Aviation in Australia and New Guinea," 10 Commonwealth Air Transport Council Newsletter 3, 6—January, 1949.

¹⁶ "The Council was set up as a result of informal Commonwealth conversations in which representatives of Canada, Australia, New Zealand, the Union of South Africa, Southern Rhodesia, India, Newfoundland and the United Kingdom participated, held in Montreal in October 1944 and continued in London in December the same year, when a resolution was passed in favor of constituting a Council of a consultative nature to discuss matters affecting Civil Aviation of common interest to the Commonwealth countries." CATC Doc. CIV, 23890, p. 1.

¹⁷ For a "sample" pool text, see Tome 1, Revue Generale de Droit Aerien (1932), pp. 515-521. The Air Transport Bureau of ICAO has made a study of the pre-war agreements, but has not released that document for public distribution.

The Fifth Freedom¹⁸ traffic has been a major source of disturbance, despite the general acceptance of the Bermuda principles.¹⁹

France has been especially anxious about this question, and made it clear in her November 9, 1949 report²⁰ to the International Civil Aviation Organization:

"Most of the bilateral agreements concluded to date include special provisions regarding the capacity to be operated on the services in which both countries are interested.

"In certain of the agreements signed by France, special provisions are included in respect of this matter for particular services.

"This is the case, for instance, with:

- (1) the Franco-British Agreement of 28 February, 1946 for services between Metropolitan France and the United Kingdom. This agreement provides for arrangements to be agreed between Aeronautical Administrations for the determination of capacity to be operated, and it specifies that: 'the frequency of the services, the time-tables and in general the conditions under which services shall be operated jointly and in pool by the designated airlines' are to be determined by agreement between the companies.
- (2) the Franco-Portuguese Agreement of 30 April 1946 for services connecting Metropolitan France and North Africa with Portugal and for the regional colonial services in which both countries are concerned.

This agreement provides for the same arrangements as above between Aeronautical Administrations and between operating companies, but provision is also made for the possibility of third countries operating services on the routes involved, and it is specified that, if this occurs, 'the French and Portuguese airlines concerned may, with the approval of their respective Aeronautical Authorities, conclude agreements with the airline or airlines of such countries with a view to establishing procedures for cooperative operations based on similar principles.'

- (3) the Franco-Irish Agreement of 16 May 1946 which provides for arrangements between airlines with a view to the possibility of 'joint and pooled' operation of services between Paris and Dublin.
- (4) the Franco-Swedish Agreement of 2 August 1946, modified on 22 April 1947, which provided for an initial joint examination by the Aeronautical Authorities of both countries of 'the possibility of a pooling arrangement between the companies operating on the Stockholm-Paris and Stockholm-Malmoe-Copenhagen-Paris routes.'

Discussions to this effect took place in April 1947, with the participation of the companies concerned, and both the French and Swedish Aeronautical Authorities recognized in an exchange of letters dated 22 April

¹⁸ This is the term applied to the privilege granted to the carrier of one country to pick up traffic in a second nation on a reasonably direct line between the homeland and a third country under Section 1 of Article I of the International Air Transport Agreement prepared as Appendix IV to the Chicago Convention, PICA O Doc. 2187, p. 71.

¹⁹ Signed by the U.K. and U.S. on February 11, 1946, the Final Act of the Bermuda Conference sets forth the principle (6) that "capacity should be related: (a) to traffic requirements between the country of origin and the countries of destination; (b) to the requirements of through airline operations, and (c) to the traffic requirements of the area through which the airline passes after taking account of local and regional services."

²⁰ "Memorandum on International Ownership and Operation of Air Transport" A4-WP/8 EC/3 Appendix D 24 March 1950, pp. 18-19.

1947 that they had 'taken cognizance of the expressed intention of the airlines . . . to conclude an agreement with a view to setting up joint operations, due consideration being given to economic traffic data.'

- (5) the Franco-Italian Agreement of 3 February 1949, which provides for an understanding between the airlines designated to operate services between France and Italy on the routes specified in the agreement, this understanding 'to take into consideration the capacity to be operated by each of the airlines, and accordingly to determine the frequency of services, the allocation of schedules, and, in general, the manner in which operations are to be conducted.'

A joint Standing Franco-Italian Committee has been established to monitor traffic and implement the capacity clauses, and there is a similar body to discuss capacity problems with the United Kingdom. Great Britain was a signatory to the Bermuda Agreement, and has not been too enthusiastic about France's insistence on such capacity controls. The United States has been even less willing to accept such restrictions on the operations of T.W.A. and Pan American World Airways to and through Paris, as has been clear in the recent Franco-American negotiations for revision of the bilateral agreement between those governments.

But Italy has been pursuing a policy similar to that of France, and has withheld permanent permits for certain airlines that were not willing to "cooperate," *i.e.*, pool with Italian carriers. Italy's utilization of the concept of capacity controls has been much less reasonable than that of France, and can probably be attributed to the concern of civil aviation officials in Rome over the post-war weakness of the Italian airlines. The Swiss have been busy protecting their ambitious carrier, taking advantage of their geographical position athwart the route to the Mediterranean and Asia to force through-north-south operators into pools with Swissair.

JOINT UNIFORM FARES AND CHARGES

Another form of "cooperation" is the rate-fixing agreement, a pre-war practice which was institutionalized with the creation of the International Air Transport Association in Havana in April, 1945. All the important scheduled airlines outside the Soviet orbit now develop joint uniform passenger fares and freight charges at the three annual regional traffic conferences²¹ of that trade association. These rates are subject to the approval of the governments, which accept the device of the traffic conference as a time-tested method of avoiding certain economic and political problems in publicly regulated transportation. IATA provides the airlines with a private forum for discussion of international fares and charges, while the carriers deal with their own governments in establishing fares for domestic services.

It should be noted that there are both advantages and disadvantages in setting rates in traffic conference, a system with a long maritime his-

²¹ See J. G. Gazdik, "International Rate-Making," 9 IATA Bulletin 61, July 1949.

tory. Although subsidy-supported rate wars are avoided and their nasty political by-products eliminated, some of the incentives present in free competition are also absent. The rates and charges are often based on the operating costs of the less efficient carriers, and it may take a long time to achieve the reductions made possible by modern aircraft, efficient organization and good cost control systems. Some of the airlines outside IATA argue that it is based on "cartel thinking," while the member carriers point out that all kinds of transport rates are set by public utility commissions and traffic bodies in many countries.

In considering IATA, one might also take into account the great amount of technical cooperation which the members achieve through that trade association of scheduled carriers in international service. In addition, there are the important technical annexes of ICAO which have done so much to achieve standardization of operating procedures, rules of the air, etc.

"In listing examples of cooperation, it is interesting to note that, in the field of international operations, a number of airlines have made their own facilities available to other operators over the same route. An instance of this is the hotel accommodation provided by Trans-Canada Airlines at Goose Bay, the operating cost of which is shared by other airlines using the airport as a stopping place. Another example is the Pan American Airways G.C.A. blind landing aid which is available to all airlines operating through Gander.

"The establishment of International Aeradio, Ltd. is another interesting example of cooperative spirit. The services provided by this Organization in countries where adequate air safety could not otherwise be provided are a good illustration of the value of collective effort.

"It is particularly desirable that joint efforts should be exerted also in the field of airway facilities, including airports, so as to improve facilities available and to save Governments useless expenditure . . . In this connection, France and Switzerland have built an international airport at Bale-Mulhouse . . ." ²²

The benefits to be derived from technical cooperation, such as the vital ICAO program for joint support of weather stations on the North Atlantic and airway facilities, have been obvious to both carriers and governments for some time. A good deal of important progress has

²² *Opus cit.*, note 20, p. 20. "The airport was established by the French and Swiss Governments as a public corporation. It is located on French territory and is controlled by a Council half of whose members are French and the other half Swiss. The Council is assisted by a Director and an Airport Manager (commandant d'aerodrome) with various subordinate officers.

"The French Government has made available to the airport those facilities which already existed and has agreed further to acquire and make available whatever land may be required for the airport or its facilities, as defined in the agreement. The Swiss Government, on the other hand, agrees to bear a portion, to be determined, of the capital expenditures.

"The public corporation is responsible for the operation of the facilities, but technical services, such as radio, flight control and ground control, are provided by the Governments themselves on a basis of allocation to be defined. Airline traffic, health, customs and immigration services are also provided by the States themselves, each one acting on its own behalf."

been the result of combined efforts to resolve technical problems.

Cooperation in the realm of economic and political aspects of international civil aviation has moved more slowly, for the issues are infinitely more complex. Inter-governmental efforts since the Chicago Conference of 1944 have not been too successful in the multilateral sphere and most countries are currently concentrating on bilateral pacts. The airlines, however, have proceeded to develop a number of interesting and varied relationships as they have realized that international cooperation need not be limited to attempts to soften the impact of "excessive" competition.

These arrangements have ranged from the simple contract which T.W.A. has to manage Saudi Arabian Airlines²³ to the advanced new scheme for international ownership planned by S.A.S. Some 10% of the stock of Iranian Airlines has been held by T.W.A. which also has a contract to manage that company. It is not unusual for one airline to have shareholdings in another,²⁴ with the extent of the investment determined by the objectives. A carrier may buy some stock with the thought of later expanding its holdings into control, or one airline may acquire such a big block of the other's securities that the purchaser has control. In 1947, the C.A.B. reported²⁵ that Pan American held between 20% and 100% of 17 foreign airlines and that T.W.A. had investments of between 10% and 40% in 7 others. B.E.A. and B.O.A.C. also have large holdings in widely scattered associated and subsidiary carriers.

Of course, a big share-holder will have a man on the Board of Directors to influence long-range policy and may also have a representative in the day-to-day management. These arrangements have been common in the Pan American subsidiaries in Latin America.²⁶ B.E.A. owns 40% of the Alitalia company and keeps a "Resident Director" in Rome to guide policy; the two carriers work together very closely. The other important Italian airline, L.A.I., is basically under the control of T.W.A. which holds 40% of the shares and plays an active role in the day-to-day management. It is generally felt that both B.E.A. and T.W.A. have made significant contributions to the recovery of Italian civil aviation and that this type of cooperative venture should be encouraged.

(To be continued)

²³ Wholly owned by the government of Saudi Arabia.

²⁴ In general, see the "Survey on Ownership of Airlines," ICAO Doc. 4953-AT/633, February 1948.

²⁵ Exhibit 35 of April, May 1947, *Hearings on Overseas Air Transportation by Steamship Operators or a Consolidated Air Carrier* before the House of Representatives Committee on Interstate and Foreign Commerce, pp. 1350-51.

²⁶ It is not always easy to determine the amount of influence exercised by the parent company, and Pan American has never hesitated to deny that it has control if such a statement were convenient.