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Regulatory Schizophrenia: Mergers, Alliances, Metal-Neutral Joint Ventures and the Emergence of a Global Aviation Cartel

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REGULATORY SCHIZOPHRENIA: MERGERS, ALLIANCES, METAL-NEUTRAL JOINT VENTURES AND THE EMERGENCE OF A GLOBAL AVIATION CARTEL

PAUL STEPHEN DEMPSEY*

I. INTRODUCTION

AIRLINES ARE A HIGH FIXED-COST, safety- and labor-intensive industry prone to destructive competition.¹ Demand is fickle, and fuel prices are volatile. In a manner consistent with Garrett Hardin's insight into the *Tragedy of the Commons*,² after deregulation, airline management has behaved in an individually rational and collectively irrational manner, competing away airline profits in order to fill seats that otherwise would fly empty.³ Destructive competition emerged from airline deregulation,⁴ eventually causing every major pre-deregulation interstate

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¹ See generally Paul Stephen Dempsey, *The Financial Performance of the Airline Industry Post-Deregulation*, 45 HOUS. L. REV. 421 (2008); Paul Stephen Dempsey, *Airline Deregulation and Laissez-Faire Mythology: Economic Theory in Turbulence*, 56 J. AIR L. & COM. 305 (1990).

² See generally Garrett Hardin, *The Tragedy of the Commons*, 162 SCIENCE 1243 (Dec. 13, 1968), <http://science.sciencemag.org/content/162/3859/1243.full> [<https://perma.cc/8WM7-JZ9G>].

³ Paul Stephen Dempsey, *The Disintegration of the U.S. Airline Industry*, 20 TRANSP. L.J. 9, 13–14 (1991).

⁴ Commercial airlines were deregulated by the Airline Deregulation Act of 1978, Pub. L. No. 95-504, 92 Stat. 1705. This was followed by the Civil Aeronautics Board Sunset Act of 1984, Pub. L. No. 98-443, 98 Stat. 1703-04, which terminated the Civil Aeronautics Board (CAB) and transferred its remaining responsibilities to the Department of Transportation. One prominent deregulation apologist expressed why the deregulation movement gained bipartisan support in Congress, stating,

airline to collapse into bankruptcy.⁵ This led to massive cost-cutting, service deterioration, restructuring, and, in more than 150 cases, bankruptcy and liquidation.⁶ Financial distress also corroded management-labor relations. Once the finest commercial aviation industry in the world and the launch customer for every new aircraft that Boeing, Douglas, or Lockheed produced pre-deregulation, U.S. airlines today no longer stand first in line for deliveries. Nor are U.S. airlines today viewed as the world's finest. Businesspeople who fly across oceans tend to avoid U.S. airlines whose service levels have deteriorated enormously vis-à-vis their foreign counterparts.⁷

The U.S. Department of Transportation (USDOT) posts data on several measurements of consumer abuse (e.g., delays of

Deregulation succeeded against industry opposition because it was supported by a coalition of academics able to highlight concrete examples of lower fares with less regulation, consumer groups, politicians looking for an anti-inflation or pro-free market issue, public disgust with scandals, and charismatic individual spokesmen, all of which excited a media blizzard that lasted for several years.

Michael E. Levine, *Why Weren't the Airlines Reregulated?*, 23 YALE J. REG. 269, 291 (2006).

⁵ Paul Stephen Dempsey, *The Cyclical Crisis in Commercial Aviation: Causes & Potential Cures*, 28 ANNALS AIR & SPACE L. 1, 17 (2003). Former American Airlines CEO Bob Crandall observed:

Our airlines, once world leaders, are now laggards in every category, including fleet age, service quality and international reputation [T]he financial health of the industry, and of the individual carriers, has become ever more precarious. Most have been through the bankruptcy process at least once, and some have passed through on multiple occasions I feel little need to argue that deregulation has worked poorly in the airline industry. Three decades of deregulation have demonstrated that airlines have special characteristics incompatible with a completely unregulated environment. To put things bluntly, experience has established that market forces alone cannot and will not produce a satisfactory airline industry, which clearly needs some help to solve its pricing, cost and operating problems.

Terry Maxon, *All Hail, Bob Crandall*, DALLAS NEWS ¶¶ 10, 12, 21 (Apr. 2009), <https://www.dallasnews.com/business/airlines/2009/04/17/all-hail-bob-crandall> [<https://perma.cc/W9RQ-GMPR>] (quoting Robert L. Crandall at The Wings Club).

⁶ See PAUL STEPHEN DEMPSEY & LAURENCE E. GESELL, AIRLINE MANAGEMENT: STRATEGIES FOR THE 21ST CENTURY 205–09 (3d ed. 2012); see also Paul Stephen Dempsey, *Airlines in Turbulence: Strategies for Survival*, 23 TRANSP. L.J. 15, 51–57 (1995); Paul Stephen Dempsey, *The Prospectus for Survival and Growth in Commercial Aviation*, 19 ANNALS AIR & SPACE L. 163–64 (1994); Paul Stephen Dempsey, *Must the Airline Industry Collapse?*, JURISCONSULTUS 59 (1994).

⁷ See Paul Stephen Dempsey, *America's Grand Experiment in Airline Deregulation: Good Intentions Producing Bad Results*, 14 ANNALS AIR & SPACE L. 21, 27–28 (1989).

more than fifteen minutes, flight cancellations, denied boarding, lost bags).⁸ Consumer ratings of airlines reveal that the ultra-low-cost carriers (ULCC) have the worst approval ratings.⁹ To thwart ULCC inroads, the major airlines have also skimmed service amenities off the basic economy fares (which have been lowered to ULCC levels or thereabouts) and imposed *a la carte* supplemental pricing on reserved seating, checked and carry-on bags, and items for which there were historically no separate charges. Consumers appear to have resigned themselves to poor quality service and, by and large, have stopped complaining except when their adverse treatment is extreme. At the same time, passenger rage appears to be growing, as reported incidents of unruly passengers increase.¹⁰ Consumer frustration probably contributes to that rage. In response, consumer protection legislation and regulation is proliferating worldwide.¹¹

To offset this unsustainable financial distress and to avoid re-regulation, the U.S. Department of Justice (DOJ) abdicated while the industry consolidated. Further, the USDOT injected airlines with antitrust immunity so that they could establish global alliances, allowing competitors to collude on pricing, capacity, frequency, and service. The U.S. government jettisoned both economic regulation and antitrust oversight, which had historically protected the public interest, in favor of airline self-regulation without meaningful government oversight, leaving an industry characterized by collusion, monopolization, consumer exploitation, and predation, with skeletal consumer protection.¹²

⁸ See *Air Travel Consumer Reports*, U.S. DEP'T OF TRANSP. 1, <https://www.transportation.gov/airconsumer/air-travel-consumer-reports> [<https://perma.cc/5UZB-KKEE>] (last updated Feb. 8, 2018).

⁹ Julian Mark Kheel, *The Best and Worst Airlines in the United States*, THEPOINTS GUY.COM (Feb. 27, 2017), <https://thepointsguy.com/guide/best-and-worst-air-lines-2017/> [<https://perma.cc/S5SJ-L2JV>].

¹⁰ More than 10,000 incidents of unruly passengers worldwide were reported by airlines in 2015, up from 9,316 the year before. See *Collaboration Needed to Stem Unruly Passenger Incidents*, IATA (Sept. 28, 2016), <http://www.iata.org/pressroom/pr/Pages/2016-09-28-01.aspx> [<https://perma.cc/69N5-MP3U>].

¹¹ See Int'l Civ. Aviation Org. [ICAO], *Worldwide Air Transport Conference: Consumer Protection and Definition of Passenger Rights in Different Contexts* (July 12, 2012), https://www.icao.int/Meetings/atconf6/Documents/WorkingPapers/ATConf6-wp005_en.pdf [<https://perma.cc/M24U-KRHC>].

¹² See generally Paul Stephen Dempsey, *Predatory Practices & Monopolization in the Airline Industry: A Case Study of Minneapolis/St. Paul*, 29 TRANSP. L.J. 129 (2002); Paul Stephen Dempsey, *Predation, Competition & Antitrust Law: Turbulence in the Airline Industry*, 67 J. AIR L. & COM. 685 (2002).

Of late though, airlines may have learned something from the capacity and fare wars of the first several decades of deregulation. If they refrain from fighting for market share, yields generate more sustainable revenue. Keeping load factors relatively high facilitates yield maximization, as do government-sanctioned price and service collusion.

This article examines the tortuous path from economic regulation, to deregulation and liberalization, to consolidation and collusion. It examines several elements of antitrust and competition law and policy, including mergers and acquisitions, coordination of pricing and service between competitors, and the failure of governmental institutions to advance a coherent transportation policy.

II. THE METAMORPHOSIS OF AIR TRANSPORT AGREEMENTS

The Chicago Convention of 1944 laid the foundation for the bilateral negotiation of traffic rights.¹³ Article 1 of the Convention affirms the “complete and exclusive sovereignty” of every State “over the airspace above its territory.”¹⁴ Article 5 provides certain traffic rights for non-scheduled flights, though potentially restricted by “such regulations, conditions[,] or limitations” as the underlying State may deem desirable.¹⁵ Article 6 prohibits scheduled international flights over the territory of a State, “except with the special permission or other authorization of that State, and in accordance with the terms of such permission or authorization.”¹⁶ Article 7 allows a State to restrict foreign airlines from engaging in for-hire domestic (cabotage) air transport and prohibits the discriminatory authorization of cabotage rights to a foreign airline.¹⁷

The post-World War II era experienced a proliferation of bilateral air transport agreements, beginning with the so-called

¹³ Convention on International Civil Aviation, Dec. 7, 1944, 61 Stat. 1180, 15 U.N.T.S. 295.

¹⁴ *Id.* art. 1.

¹⁵ *Id.* art. 5.

¹⁶ *Id.* art. 6.

¹⁷ See *id.* art. 7. “Cabotage involves permitting foreign carriers to operate commercial segments of their flights within another country. This can be part of a routing which takes the foreign carrier back to its own country or the operation of a purely domestic flight within a foreign country.” Dennis Foerster, *Caged Birds in Open Skies: Comments on the Emergence of a Dominant Carrier*, 1 ASPER REV. INT’L BUS. & TRADE L. 171, 181 n.32 (2001).

Bermuda I agreement between the United States and United Kingdom in 1946. For four decades, the Bermuda I agreement was the model for bilateral air transportation agreements concluded worldwide, though many States departed from the United States insistence on an explicit prohibition of capacity predetermination and pooling.¹⁸ Government oversight back then was largely promotional and protectionist in emphasis, focusing on avoiding “destructive competition” and on achieving a balance between economic health for airlines and safe, efficient, and reasonably-priced service for consumers. In the three decades following World War II, the United States pursued a bilateral negotiating policy which emphasized an equitable exchange of economic benefits (i.e., a trading of operating rights having approximately equal market value).¹⁹ During this era, intercarrier agreements on tariffs under the auspices of the International Air Transport Association (IATA) were the norm.²⁰

Pricing and entry were regulated in the United States with the creation of the Civil Aeronautics Board (CAB) in 1938, which continued until deregulation in 1978.²¹ Deregulation was designed to encourage price and service competition between airlines. Yet, as we shall see, antitrust immunity enables competitors to collude on pricing, capacity, and other components of service.

In the wake of the Airline Deregulation Act of 1978, the United States concluded the first of its “liberal” bilateral air transport agreements.²² Pricing provisions in these new first gen-

¹⁸ As we shall see below, the USDOT has since insisted on “metal neutral joint ventures” as the price for conferring antitrust immunity. *See infra* Part III(D). Those joint ventures usually include pooling of revenue or profits.

¹⁹ Frank E. Loy, *Bilateral Air Transport Agreements: Some Problems of Finding a Fair Route Exchange*, in *THE FREEDOM OF THE AIR* 174–75 (Edward McWhinney & Martin A. Bradley eds., 1968).

²⁰ PAUL STEPHEN DEMPSEY, *LAW & FOREIGN POLICY IN INTERNATIONAL AVIATION* 40–43 (1987).

²¹ Paul Stephen Dempsey, *The Rise and Fall of the Civil Aeronautics Board—Opening Wide the Floodgates of Entry*, 11 *TRANSP. L.J.* 91, 115–16 (1979).

²² Liberal bilateral air transport agreements were concluded during 1978 between the United States and the Netherlands, Belgium, and Israel. Between 1978 and 1980, the United States concluded and signed eleven new “open skies” Benelux-type bilaterals or amendments to existing bilateral air transport agreements. Their tariff provisions encouraged low tariffs, set by individual airlines on the basis of forces of the marketplace without reference to the ratemaking machinery of IATA. P.P.C. Haanappel, *Bilateral Air Transport Agreements—1913–1980*, 5 *INT’L. TRADE L.J.* 241, 261–62 (1980); Amir Ali Majid, *Impact of Current U.S.*

eration “open skies” bilaterals placed an emphasis on the encouragement of low fares set by individual carriers on the basis of forces in the marketplace, without reference to the IATA ratemaking machinery.²³ These bilaterals were characterized by their opportunities for pricing flexibility,²⁴ unrestricted capacity,²⁵ multiple designations,²⁶ access to interior U.S. markets for foreign-flag carriers,²⁷ new fifth-freedom rights,²⁸ country-of-origin charter rules,²⁹ and elimination of discrimination and unfair

Policy on International Civil Aviation, 32 ZEITSCHRIFT FÜR LUFT-UND WELTRAUMRECHT [ZLW] 295, 299 (1983) (Ger.).

²³ P.P.C. HAANAPPEL, PRICING AND CAPACITY DETERMINATION IN INTERNATIONAL AIR TRANSPORT 42 (1984).

²⁴ See Stanley B. Rosenfield, *International Aviation: A United States Government-Industry Partnership*, 16 INT'L LAW. 473, 478 (1982); Richard H. Klem & Douglas V. Leister, *The Struggle for a Competitive Market Structure in International Aviation: The Benelux Protocols Take United States Policies a Step Forward*, 11 L. & POL'Y INT'L BUS. 557, 573-74 (1979). The pricing regimes of the first generation liberal bilaterals are of two principal types. Country-of-origin pricing (concluded originally in the bilaterals between the United States and the Netherlands and the United States and the Federal Republic of Germany) allows the nation in whose territory the flight originates to set the rate. See *id.* at 569. The most liberal provision, double disapproval pricing (concluded first in bilaterals between the United States and Belgium, Korea and Israel), allows the carrier's proposed rate to go into effect unless both nations object. See *id.* at 573. Layered on top of this regime was a Memorandum of Understanding concluded between the United States and the European Civil Aviation Conference (ECAC), which established a zone of reasonableness within which market conditions will set the rate.

²⁵ “The right to fly any number of seats and any number of frequencies would be determined by the carrier, based solely on market conditions.” Rosenfield, *supra* note 24, at 478.

²⁶ Multiple designations refers to the ability of a State to designate more than one of its flag carriers to serve a particular route.

²⁷ For example, direct access to Miami, Atlanta, Dallas/Fort Worth, San Juan, Anchorage, and San Francisco was given to Germany; Atlanta and three additional cities were conferred to Belgium; and rights between Korea and New York, Korea and Los Angeles, and Tokyo and Los Angeles were given to South Korea. *Review of U.S. International Aviation Policy: Hearing Before the Subcomm. on Investigations and Oversight of H. Comm. on Public Works and Transportation*, 97th Cong. 33-249 (1981) (statement of William T. Seawell, Chairman and CEO, Pan American World Airways). Another commentator summarized examples of foreign access to interior United States points even more generously by saying that “Germany has rights to 12 U.S. cities and has named 10 thus far, the United Kingdom has rights to name 20 U.S. cities and has listed 17 so far on their major route.” *Id.* at 424 (statement of Donald C. Comlish, Vice President of International Affairs, Air Transport Association).

²⁸ Fifth-freedom rights enable an airline to carry traffic between two countries outside its own State as long as the flight originates or terminates in its own State. See Rosenfield, *supra* note 24, at 479.

²⁹ Under this provision, charter flights are governed by the rules of the nation in which the flight originates.

methods of competition.³⁰ They typically provided for either country-of-origin³¹ pricing or mutual disapproval³² pricing, the latter being the more liberal of the two. Prior to the sunset of the Civil Aeronautics Board in 1984, the United States also threatened revocation of IATA's antitrust immunity, causing IATA to divide itself in two—a trade association for non-tariff activities and a traffic conference for ratemaking activities.³³ The major Benelux States (i.e., the Netherlands³⁴ and Belgium³⁵) were the first to embrace the pro-competitive approach of the United States by entering into liberal bilateral air transport agreements, which surrendered restrictions on entry, capacity, and pricing in exchange for access to lucrative interior U.S. markets.³⁶ Of course, airlines that focus on sixth freedom³⁷ traffic would naturally favor liberal access to markets, and small States with few major airports face little risk to their flag carriers in trading unlimited access. By expeditiously authorizing multiple U.S. flag entrants, the CAB hoped to put pressure on other European governments in close geographic proximity to jump aboard the competitive bandwagon so as to avoid the loss of leisure and business travelers to Brussels and Amsterdam and the loss of sixth freedom traffic flown over these cities by Sabena and KLM, respectively.³⁸

³⁰ Richard H. Klem & Douglas V. Leister, *The Struggle for a Competitive Market Structure in International Aviation: The Benelux Protocols Take United States Policies a Step Forward*, 11 L. & POL'Y INT'L BUS. 557, 573–74 (1979); Paul Stephen Dempsey, *The International Rate and Route Revolution in North Atlantic Passenger Transportation*, 17 COLUM. J. TRANSNAT'L L. 393, 415 (1978); Majid, *supra* note 22, at 299–300.

³¹ Under country-of-origin pricing provisions, governmental authorities can unilaterally disapprove a fare proposed by a carrier only if the route in question originates within its own territory. *See* Klem & Leister, *supra* note 30, at 569.

³² Under mutual disapproval pricing provisions, neither State may disapprove and suspend a proposed rate unless the other also disapproves of the rate in question. In the event that the two States fail to agree, the carrier's proposed rate becomes effective. *See id.* at 573–74.

³³ DEMPSEY, *supra* note 20, at 42.

³⁴ Protocol Amending the Air Transport Agreement of 1957, Neth.-U.S., Mar. 31, 1978, T.I.A.S. No. 1507.

³⁵ Agreement Amending the Air Transport Services Agreement of 1946, Belg.-U.S., Dec. 12–14, 1978, T.I.A.S. No. 9207.

³⁶ C.A.B. Order No. 78-9-2 (Sept. 1, 1978).

³⁷ Under sixth freedom rights, an airline has the right to carry traffic between two foreign countries via its own State. (Sixth freedom can also be viewed as a combination of third and fourth freedoms secured by the State from two different countries).

³⁸ CAB Chairman Marvin Cohen subsequently noted the success of this approach. *Review of U.S. International Aviation Policy: Hearing Before the Subcomm. on*

In 1977, President Jimmy Carter appointed economist Alfred Kahn as Chairman of the CAB.³⁹ That set in motion promulgation of the Airline Deregulation Act of 1978, which deregulated domestic pricing and entry and liberalized international markets.⁴⁰ Kahn responded to the British refusal to embrace the United States' "open skies" ideology with an approach of, "let's stick it to the Brits—let's put pressure on the Germans through Amsterdam."⁴¹ With the opportunity to engage in pricing competition and serve interior U.S. points, Sabena and KLM began to draw traffic away from their neighbors and to obtain significant increases in market shares and tourist revenue.⁴²

By the mid-1980s, the United States had concluded liberal bilaterals with Belgium, Costa Rica, Finland, Israel, Jordan, Jamaica, South Korea, Thailand, Taiwan, and Singapore.⁴³ But still, major European States were resistant; meanwhile, the European Union (EU) Commission in Brussels began to liberalize air transport by regulatory fiat.⁴⁴

Investigations and Oversight of H. Comm. on Public Works and Transportation, 97th Cong. 567-864 (1981) (statement of Marvin S. Cohen, CAB Chairman).

³⁹ See Michael Arria, *The Surprising Collection of Politicos Who Brought Us Destructive Airline Deregulation*, ALTERNET (July 3, 2016, 1:43 PM), <http://www.alternet.org/labor/how-liberals-deregulated-airline-industry> [<https://perma.cc/2YBY-NRB5>].

⁴⁰ See Airline Deregulation Act of 1978, Pub. L. No. 95-504, 92 Stat. 1705.

⁴¹ ANTHONY SAMPSON, *EMPIRES OF THE SKY: THE POLITICS, CONTESTS AND CARTELS OF WORLD AIRLINES* 145 (1984).

[T]he U.S. government saw [the new liberal pro-competitive bilaterals] as a means of putting pressure on recalcitrant governments in the same geographic area. Thus, under this "encirclement" theory, the United Kingdom was to be pressured by expansion of air service to and via Belgium and The Netherlands. Not too much later a new agreement with South Korea was intended to put pressure on Japan.

MELVIN A. BRENNER ET AL., *AIRLINE DEREGULATION* 13 (1985) (citation omitted).

⁴² *Review of U.S. International Aviation Policy: Hearing Before the Subcomm. on Investigations and Oversight of H. Comm. on Public Works and Transportation*, 97th Cong. (1981). In 1977, Sabena was given the right to fly to Atlanta. No British carriers could begin service under Bermuda II to this important sunbelt city until 1980. See Robert R. Gray, *The Impact of Bermuda II on Future Bilateral Agreements*, 3 AIR L. 17, 21 (1978).

⁴³ Peter Haanappel, *An Analysis of U.S. Deregulation of Air Transport and Its Inferences for a More Liberal Air Transport Policy in Europe*, Comm. on Econ. Aff. & Dev.: Council of Eur. Doc. at 52 (1985).

⁴⁴ See Paul Stephen Dempsey, *Competition in the Air: European Union Regulation of Commercial Aviation*, 66 J. AIR L. & COM. 979, 1010-18 (2001); Paul Stephen Dempsey, *European Aviation Regulation: Flying Through the Liberalization Labyrinth*, 15 B.C. INT'L & COMP. L. REV. 311, 321-22 (1992).

In 1992, the USDOT began to pursue a second generation of even more liberal “open skies” agreements rather indiscriminately. In a reprise of its 1978 strategy, the United States would begin again, with the Dutch, in a rebounded effort to open the skies with Europe’s Big Three—Germany, France, and the United Kingdom. The USDOT identified the basic elements that constitute the essential components of an “open skies” bilateral air transport agreement:

1. Open entry on all routes
2. Unrestricted capacity and frequency on all routes
3. Unrestricted route and traffic rights, that is, the right to operate service between any point . . . , including no restrictions as to intermediate and beyond points, change of gauge, routing flexibility, coterminalization, or the right to carry Fifth Freedom traffic
4. Double-disapproval pricing in Third and Fourth Freedom markets, and price leadership in third country markets to the extent that the Third and Fourth Freedom carriers in those markets have it
5. Liberal charter arrangement (the least restrictive charter regulations of the two governments would apply, regardless of the origin of the flight)
6. Liberal cargo regime (criteria as comprehensive as those defined for the combination carriers)
7. Conversion and remittance arrangement (carriers would be able to convert earnings and remit in hard currency promptly and without restriction);
8. Open code-sharing opportunities
9. Self-handling provisions (right of a carrier to perform/control its airport functions going to support its operations)
10. Procompetitive provisions on commercial opportunities, user charges, fair competition and intermodal rights
11. Explicit commitment for nondiscriminatory operation of and access for computer reservation systems.⁴⁵

In November 1992, the USDOT gave Northwest/KLM preliminary antitrust immunity to create the first integrated international intercarrier alliance.⁴⁶ “Final approval was given only days

⁴⁵ In the Matter of Defining “Open Skies,” Order No. 92-8-13, at 3–6 (U.S. Dep’t of Transp. Aug. 5, 1992).

⁴⁶ PAUL STEPHEN DEMPSEY, *EUROPEAN AVIATION LAW* 172 (2004). “Some speculated the decision was predicated on the \$100,000 contribution Northwest co-chairman Gary Wilson had made to Bush’s committee to re-elect the President in

before the inauguration of Bill Clinton as President in January 1993.”⁴⁷ The alliance enabled these two airlines to draw enormous traffic from their rivals in the Trans-Atlantic market. The aim was strategic. If KLM bled enough traffic from its nearby rivals, those airlines might lobby their governments to conclude “open skies” agreements with the United States so that they too could enjoy antitrust immunity with U.S. airlines.

The “divide and conquer” strategy began to work. By 1995, the United States had concluded “open skies” agreements with nine additional European countries. Germany fell in 1996, followed by the Czech Republic, Italy, Portugal, the Slovak Republic, Malta, Poland, and, in 2002, France. With the signing of an “open skies” agreement with India on January 15, 2005, the United States had concluded “open skies” agreements with sixty-seven States worldwide, including fifteen of the twenty-five EU members.⁴⁸ By 2017, the United States had concluded “open skies” bilateral air transport agreements with more than 120 States.⁴⁹

Although a public interest rationale for approving the first alliance antitrust immunity between Northwest and KLM had been to “promote competition by furthering our efforts to obtain less restrictive aviation agreements with other European countries,”⁵⁰ the USDOT continued to grant antitrust immunity profligately long after all the major European dominos had fallen. By 2007, the United States had concluded an “Open Skies Plus” agreement with the EU, opening up all city-pairs between the United States and EU for all U.S. and European airlines.⁵¹ The “Plus” part of the agreement included liberalization of foreign ownership rules that the USDOT embraced with a proposed regulation to skirt around the legislative prohibition, but Congress quickly and decisively aborted this proposed regu-

August 1992. In contrast, four years earlier he had contributed to Democrat Michael Dukakis’ Presidential campaign.” *Id.* at 172 n.64.

⁴⁷ *Id.* at 172.

⁴⁸ John Byerly, Deputy Assistant Sec’y for Transp. Affairs, U.S.-EU Aviation Relations—Charting the Course for Success, Remarks to the International Aviation Club (July 13, 2004).

⁴⁹ PAUL STEPHEN DEMPSEY, PUBLIC INTERNATIONAL AIR LAW 698–99 (2d ed. 2017).

⁵⁰ *Joint Application of Alitalia-Linee Aeree Italiane-S.p.A. et al.*, DOT Order 2008-4-17 (2008); *Joint Application of Northwest Airlines, Inc. and KLM Royal Dutch Airlines*, DOT Order 93-1-11 (1993).

⁵¹ DEMPSEY, EUROPEAN AVIATION LAW, *supra* note 46, at 725–27.

lation.⁵² Antitrust immunity no longer became a means of facilitating “open skies” bilaterals; paradoxically, it became a means of facilitating creation of anticompetitive alliances of a particular type: “metal neutral joint ventures.”⁵³

III. AIRLINE ALLIANCES

Since the dawn of commercial aviation, airlines have engaged in cooperative relationships. In part, these arrangements have been necessary to move passengers and freight beyond airline route systems. Interlining has long been an essential component of international air travel. For many decades, IATA served as facilitator of fare and capacity coordination between airlines. In recent decades, however, antitrust scrutiny has forced IATA to retreat in facilitating cooperation in areas of parallel routes, though it continues to facilitate end-to-end coordination.

- Intercarrier agreements take many forms, including:
- ticketing-and-baggage agreements;
- joint-fare agreements;
- dry leases;
- wet leases;
- reciprocal airport agreements;
- blocked space relationships (capacity purchase agreements);
- computer reservations systems joint ventures;
- joint sales offices and telephone centers;
- e-commerce joint ventures;
- frequent flyer program alliances;
- code-sharing;
- coordination of pricing and scheduling;
- pooling of traffic and revenue; and
- Metal Neutral Profit Sharing Joint Ventures⁵⁴

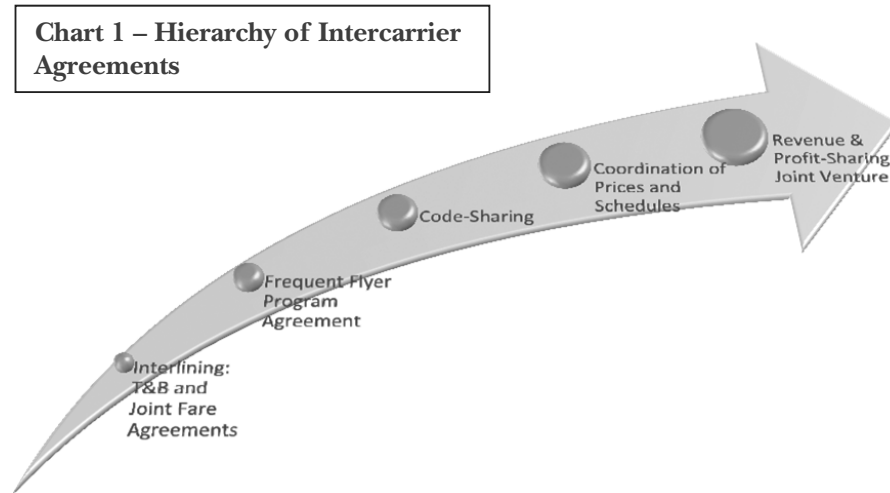
Chart 1 depicts the hierarchy of intercarrier agreements, with those at the left end being less integrated (and less anticompetitive) vis-à-vis those on the right.

⁵² *Id.*

⁵³ See discussion *infra* Part III.D.

⁵⁴ DEMPSEY & GESELL, *supra* note 6, at 647.

Chart 1 – Hierarchy of Inter-carrier Agreements



A. ANTITRUST & COMPETITION: A SUCCINCT SUMMARY OF U.S. & EU LAWS

Competition and antitrust laws attempt to ensure that competitors compete fairly so that price and service levels are responsive to consumer demand, prices drop to marginal costs, and consumer welfare is enhanced. Law in this area seeks to:

- Prohibit collusion between competitors that restrain trade, such as price-fixing;
- Prohibit monopolization through mergers or acquisitions; and
- Prohibit monopolization through anticompetitive means, such as predation or abuse of a dominant position.

The United States has promulgated several such laws, including:

- Sherman Antitrust Act of 1890;
- Clayton Act of 1914;
- Robinson-Patman Act of 1936;
- Federal Trade Commission Act of 1938; and
- Civil Aeronautics Act of 1938 (Federal Aviation Act of 1958).

Similarly, Article 101 of the Treaty on the Functioning of the European Union (TFEU) prohibits “all agreements between undertakings, . . . which may affect trade . . . and which have as their object or effect the prevention, restriction or distortion of competition”⁵⁵

⁵⁵ Article 101 provides:

Examples include:

- Price-fixing;
- Limitation or control of production;
- Shared markets or sources of supply;
- Applying dissimilar conditions to equivalent transactions, placing other trading parties at a competitive disadvantage; and
- Making the conclusion of contracts subject to approval by others without commercial justification.

In the EU, companies found guilty of such activities may face a fine of up to ten percent of annual turnover.

1. The following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market, and in particular those which:

(a) directly or indirectly fix purchase or selling prices or any other trading conditions;

(b) limit or control production, markets, technical development, or investment;

(c) share markets or sources of supply;

(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

2. Any agreements or decisions prohibited pursuant to this Article shall be automatically void.

3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:

- any agreement or category of agreements between undertakings;
- any decision or category of decisions by associations of undertakings;

- any concerted practice or category of concerted practices, which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

(a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;

(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

Treaty on the Functioning of the European Union art. 101, Mar. 25, 1957, 2012 O.J. (C 326) 47.

B. RESTRAINT OF TRADE

It is unlawful in many countries around the world for competitors to agree to fix prices or divide territory. In the United States, Section 1 of the Sherman Act prohibits combinations and conspiracies in restraint of trade.⁵⁶ To prevail on a claim that a horizontal agreement among competitors restrains trade, the plaintiff must prove:

1. defendants engaged in a conspiracy;
2. that restrained trade;
3. in the relevant market; and
4. competitors suffered injury.⁵⁷

The U.S. Supreme Court has identified three methods of assessing whether a horizontal agreement violates Section 1 of the Sherman Act:

1. the *per se analysis*, for restraints which are obviously anticompetitive, such as price-fixing, territorial allocations, group boycotts, or tying arrangements;
2. the *quick-look analysis*, for restraints with some procompetitive justification; and
3. the *rule of reason* test, for restraints whose net impact on competition is difficult to determine.⁵⁸

An aggrieved party must prove the restraint is unreasonable or, in other words, harmful to competition. The purpose of the antitrust laws is to protect competition, not to protect individual competitors.⁵⁹ Thus, it is not enough to show that the restraint caused a competitor to suffer economic injury. To determine whether the agreement has an adverse effect on competition, courts examine factors such as reduced output, increased prices, and decreased quality.⁶⁰ In the United States, horizontal collu-

⁵⁶ Sherman Act, 15 U.S.C. § 1 (2017).

⁵⁷ See *Law v. Nat'l Collegiate Athletic Ass'n*, 134 F.3d 1010, 1016 (10th Cir. 1998).

⁵⁸ See *Cal. Dental Ass'n v. F.T.C.*, 526 U.S. 756, 779-81 (1999); see generally *F.T.C. v. Ind. Fed'n of Dentists*, 476 U.S. 447 (1986); *Palmer v. BRG of Ga., Inc.*, 498 U.S. 46 (1990); *Cont'l Airlines v. United Airlines*, 277 F.3d 499 (4th Cir. 2002).

⁵⁹ See Kate Markhvida, *Antitrust and Competition Law*, in *ROUTLEDGE HANDBOOK OF PUBLIC AVIATION LAW* 308 (Paul Stephen Dempsey & Ram S. Jakhu eds., 2017).

⁶⁰ See *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 553-55 (2007); *Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 212 (1993); *Atl. Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 338 (1990); *Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104, 117-18 (1986); *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 598 (1986); *Virgin Atl. Airways Ltd. v. British Airways*

sion can result in criminal prosecution by the Justice Department, or a civil suit brought by a competitor or consumer in which treble damages are potentially recoverable by the aggrieved party.

As an example of unlawful collusion in the aviation sector, the air cargo fuel surcharge litigation proved enormously expensive for airlines. The conspiracy to fix fuel surcharges began in 1996 when IATA passed Resolution 116ss on fuel surcharges. However, the USDOT denied antitrust immunity. Nevertheless, a number of air carriers continued to coordinate fuel surcharges. But since the charges were not tied to distance flown, they were not correlated with fuel consumption. Fuel prices fell in 2001, but the surcharges continued.

In the early years of the new millennium, Lufthansa and its subsidiary Swiss International turned “state’s evidence” so as to enter the corporate leniency program. They revealed that a number of airlines (including Lufthansa, Lan Chile, Air France, British Airways, Japan Airlines, Korean Airlines, American Airlines, SAS, Asiana Airlines, Polar Air, Cathay Pacific, Atlas Air, and Cargolux) had conspired to impose uniform fuel and security surcharges. In 2006, law enforcement officers raided the offices of several airlines.⁶¹ Twenty airlines and four executives pled guilty and paid fines. British Airways and Korean Airlines paid fines totaling \$300 million in settlement of a DOJ investigation.⁶²

As of 2011, twenty-two airlines and twenty-one airline executives had been charged with unlawful price fixing.⁶³ More than \$1.8 billion in criminal fines were imposed, and four executives were sent to prison. More than one hundred civil class action lawsuits were filed by private plaintiffs in the United States alone, resulting in settlements of nearly half a billion dollars. By 2012, fines totaled almost \$2 billion. As Table 1 reveals, the EU Commission imposed fines of €776 million on eleven air cargo

PLC, 257 F.3d 256, 264 (2d Cir. 2001). *See also* Shubha Ghosh & Darren Bush, *Predatory Conduct and Predatory Legislation: Exclusionary Tactics in Airline Markets*, 45 Hous. L. Rev. 343, 350–52 (2008).

⁶¹ William M. Hannay, *The Air Cargo Antitrust Conspiracy*, TERRALEX 1–2, terralex.org/calendar/event/4083c84eea/downloadfile?fileid=27c52bf9a3 (last visited Feb. 21, 2018).

⁶² *Id.*

⁶³ *Id.*

carriers that participated in the scheme from December 1999 to February 2006.⁶⁴

Table 1 - Fines Imposed by the European Union on Airlines for Price-Fixing on Fuel Surcharges

	Fine (€)*	Reduction under the Leniency Notice
Air Canada	21 037 500	15%
Air France	182 920 000	20%
KLM	127 160 000	20%
Martinair	15 400 000	50%
British Airways	104 040 000	10%
Cargolux	79 900 000	15%
Cathay Pacific Airways	57 120 000	20%
Japan Airlines	35 700 000	25%
LAN Chile	8 220 000	20%
SAS	70 167 500	15%
Singapore Airlines	74 800 000	0
Lufthansa	0	100%
Swiss International Air Lines	0	100%

⁶⁴ Press Release IP/17/661, European Commission, Antitrust: Commission Re-Adopts Decision and Fines Air Cargo Carriers €776 Million for Price-Fixing Cartel (Mar. 17, 2017), http://europa.eu/rapid/press-release_IP-17-661_en.htm [<https://perma.cc/8VQA-DXGA>]. However, the conscious parallelism allegation did not fare well in a case alleging collusion between Delta Airlines and AirTran to fix prices on baggage fees. The court noted, “Plaintiffs need not allege the existence of collusive communications in ‘smoke-filled rooms’ in order to state a § 1 Sherman Act claim. Rather, such collusive communications can be based upon circumstantial evidence and can occur in speeches at industry conferences, announcements of future prices, statements on earnings calls, and in other public ways. . . . [U]nlawful conspiracies may be inferred when collusive communications among competitors precede changed/responsive business practices, such as new pricing practices.” *In re Delta/AirTran Baggage Fee Antitrust Litig.*, 733 F. Supp. 2d 1348, 1360–61 (N.D. Ga. 2010) (citations omitted). Nonetheless, the court concluded, “Even when viewed in the light most favorable to plaintiffs, the evidence in this case simply does not permit a reasonable factfinder to infer the existence of a conspiracy, as it does not tend to exclude the possibility that the alleged conspirators acted independently.” See Joyce Hanson, *Delta, AirTran Score Win In Bag-Fee MDL*, LAW360 (Mar. 29, 2017, 4:22 PM), <https://www.law360.com/articles/907594/delta-airtran-score-win-in-bag-fee-mdl> [<https://perma.cc/GS8A-SE2K>].

C. MERGERS & CONSOLIDATIONS

Mergers raise antitrust concerns as well. Market concentration may reduce competition causing consumers to suffer higher prices and poorer service. Approximately one hundred States around the world have promulgated pre-merger notification legislation. Requirements range from simple notification to intensive investigations. Typically, jurisdictional thresholds are determined by the size of the transaction. Merger reviews may include transaction suspension, non-suspension, or hybrid approaches depending upon potential impact of the transaction on the economy. The principal concern is whether, post-merger, the entity will have market power to raise prices. Cross-border ownership is constrained by nationality rules in many States. Foreign ownership in U.S. airlines has been limited to twenty-five percent voting stock since the 1920s.⁶⁵ In the EU, foreign ownership by non-EU citizens is restricted to forty-nine percent. Most bilateral air transport agreements also allow a State to prohibit another State's airlines from enjoying traffic rights under the bilateral if the airline's nationals do not have "substantial ownership and effective control."⁶⁶ However, these requirements are often waived.⁶⁷ Table 2 reveals foreign ownership restrictions in several States.

⁶⁵ To qualify as a U.S. flag carrier, U.S. citizens must: (1) hold at least 75% of the voting equity; (2) hold at least 51% of non-voting equity; and (3) effectively "control" the airline. See *U.S. Air Carriers*, U.S. DEP'T OF TRANSP., <https://www.transportation.gov/policy/aviation-policy/licensing/US-carriers> [<https://perma.cc/7BNE-BHHY>] (last visited Jan. 25, 2018). Foreign ownership restrictions are not unique to aviation and exist in broadcasting, telecommunications, electric and nuclear power production, shipping, and banking.

⁶⁶ Section 5 of the Transit Agreement and Section 6 of the Transport Agreement provide: "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" See *International Air Services Transit Agreement* art. 1, sec. 5, *opened for signature* Dec. 7, 1944, 59 Stat. 1693, E.A.S. No. 487. "Like their predecessors, modern 'Open Skies' bilaterals require that 'substantial ownership and effective control' be vested in the nationals of the state designating the airline, and that failure to meet this requirement . . . would entitle either nation to revoke, suspend or limit the operations of the offending airline." Paul Stephen Dempsey, *Nationality Requirements and Cabotage Restrictions in International Aviation: Sovereignty Won and Sovereignty Lost*, 20 *STUD. AIR & SPACE L.* 129, 134 (2006).

⁶⁷ The United States typically waives the nationality requirements for airlines holding their operating certificates from States that satisfy FAA Category I safety/security requirements, and have concluded an "Open Skies" bilateral with the United States.

Table 2 - Status of Foreign Ownership Restrictions for Airlines in Selected Countries⁶⁸

EU	49%
Australia	49% for international (25% single); 100% for domestic
Canada	25% of voting equity (15% single)
Japan	33.33%
New Zealand	49% for international; 100% for domestic
United States	25% of voting equity; 1/3 of board at maximum; cannot be chairman of board

But, domestic airline mergers are possible. Prior to 1985, airline mergers and acquisitions in the United States required approval from the CAB. Approval automatically conferred antitrust immunity. Between the sunset of the CAB on December 31, 1984, and 1989, airline mergers were regulated by the USDOT. Thereafter, airline mergers would be handled like mergers in any other industry, scrutinized by the Federal Trade Commission (FTC) and DOJ under the Clayton Act. Since 1989, airline mergers have been subject to Section 7 of the Clayton Act.⁶⁹

But for the few years the USDOT had jurisdiction, the USDOT never met a merger it did not like, approving each of the twenty-one merger applications submitted to it, even those to which the DOJ vigorously objected (i.e., Northwest-Republic and TWA-Ozark). Though the pace of airline mergers slowed after the DOJ obtained jurisdiction, the pace picked up again as financial distress and bankruptcies increased after the turn of the twenty-first century.

The Clayton Act prohibits a person “engaged in commerce or in any activity affecting commerce” from acquiring “the whole or any part” of a business if the acquisition may substantially “lessen competition” or “tend to create a monopoly.”⁷⁰ The FTC and DOJ evaluate the relevant geographic and product market, using reasonable interchangeability or cross-elasticity of demand analysis. Although market share and concentration levels are rel-

⁶⁸ ALEX COSMAS ET AL., FRAMING THE DISCUSSION ON REGULATORY LIBERALIZATION: A STAKEHOLDER ANALYSIS OF OPEN SKIES, OWNERSHIP AND CONTROL 2 (2008). These authors also found no significant increase in transatlantic service levels subsequent to conclusion of “Open Skies” bilateral air transport agreements. See Alex Cosmas et al., *The Effects of Open Skies Agreements on Transatlantic Air Service Levels*, 16 J. AIR TRANSP. MGMT. 222, 222–24 (2010).

⁶⁹ See Clayton Act, 15 U.S.C. § 18 (2017).

⁷⁰ See *id.* at 15 U.S.C. §§ 12–27; 29 U.S.C. §§ 52–53.

evant, they are not conclusive. Instead, courts examine the market's structure, history, and future; the characteristics of the customers; the trends toward concentration; the existence of competitors; and the barriers to entry.⁷¹ Also examined is whether the merger or acquisition create or enhance market power? This is more likely where the merging entities are direct competitors (known as horizontal mergers). The FTC and DOJ have developed Horizontal Merger Guidelines.⁷² Table 3 lists the major U.S. airline mergers which have transpired since airline deregulation in 1978:

⁷¹ See *Brown Shoe Co. v. United States*, 370 U.S. 294, 343–45 (1962); *United States v. Phila. Nat'l Bank*, 374 U.S. 321, 362 (1963); see also Robert A. Skitol & Kenneth M. Vorrasi, *The Remarkable 50-Year Legacy of Brown Shoe Co. v. United States*, ANTITRUST (2012), [http://files.drinkerbiddle.com/Templates/media/files/Outside%20Publications/Skitol-Vorrasi-Article-in-Antitrust-\(Spring%202012\).pdf](http://files.drinkerbiddle.com/Templates/media/files/Outside%20Publications/Skitol-Vorrasi-Article-in-Antitrust-(Spring%202012).pdf) [<https://perma.cc/T3Z8-BYBT>].

⁷² See generally U.S. Dep't of Justice & F.T.C., *Horizontal Mergers Guidelines* (2010), <https://www.ftc.gov/sites/default/files/attachments/mergers/100819hmg.pdf> [<https://perma.cc/SV4N-PRQJ>]; see also Keith N. Hylton, *Brown Shoe Versus the Horizontal Merger Guidelines*, 39 REV. INDUS. ORG. 95, 95 (2011).

Table 3 – Selected U.S. Major Airline Mergers
Since Deregulation⁷³
(acquired carrier on left)

1979	National – Pan Am
1980	Seaboard – Flying Tigers
	Hughes Airwest – Republic
1982	Continental – Texas International
1985	Frontier – People Express
	Muse – Southwest
1986	Pan Am – United
	Republic – Northwest
	Ozark – TWA
	Eastern – Texas Air
	People Express – Texas Air
	Western – Delta
	Horizon – Alaska
1987	Air Cal – American
	PSA – USAir
	Piedmont – USAir
1988	Flying Tigers – Federal Express
1997	AirTran – ValuJet
1998	Reno Air – American
2001	TWA – American
2004	USAirways – America West
2008	Northwest – Delta
2009	Midwest – Republic
	Frontier – Republic
2010	Continental – United
2011	AirTran – Southwest
2013	American – USAirways
2015	TNT Express – FedEx
2016	Southern Air – Atlas Air
	Virgin America – Alaska Airlines

The merger of United and Continental Airlines drew antitrust fire from a number of concerned citizens. During the trial, their expert witnesses identified three alternative relevant markets: (1) network carriers competing for business travelers; (2) airport-pairs; and (3) the U.S. airline industry as a whole.⁷⁴ As to

⁷³ For a more complete list, see DEMPSEY & GESELL, *supra* note 6, at 232.

⁷⁴ *Malaney v. UAL Corp.*, No. 3:10-CV-02858-RS, 2010 WL 3790296, at *7 (N.D. Cal. Sept. 27, 2010).

the first category, the court concluded, “. . . because the plaintiffs have failed to show why LCCs should be excluded from a market for business passengers . . . network carriers catering to business passengers simply does not fly as a viable relevant geographic and product market for purposes of Section 7 analysis.”⁷⁵ As to airport-pairs, the court found that “competition from adjacent airports disciplines pricing and must be considered when defining the relevant market. . . . [G]iven the substantial evidence suggesting city-pairs [may be the appropriate market], plaintiffs’ effort to establish anything else never leaves the gate.”⁷⁶

As to the third alternative proffered by plaintiffs (the “national market”), the court noted that it was unclear how a flight from San Francisco to Newark competed with a flight from Seattle to Miami.⁷⁷ The pound of flesh surrendered for DOJ acquiescence in the merger was for the merged carrier to lease slots for eighteen round-trip flights to Southwest Airlines at Newark International Airport.

In August 2013, the DOJ and six state Attorney Generals filed suit to block the merger of US Airways and American Airlines.⁷⁸ They noted that after the Delta-Northwest and United-Continental mergers, American, Delta, and United ceased challenging the others’ nonstop fares with lower connecting fares and also marched in lock-step on ancillary fees. US Airways provided connecting price competition. Concentration at Washington Reagan Airport, where the combined carrier would hold sixty-nine percent of the landing slots, was also of concern.⁷⁹

By October, a settlement had been reached with the DOJ. The pound of flesh surrendered by the carrier for antitrust acquiescence was the sale of 104 slots at Ronald Reagan Washington International Airport, a promise to maintain service to small and mid-size cities from Reagan, the sale of two gates at Chicago O’Hare International Airport, and the maintenance of hubs at

⁷⁵ *Id.* at *9.

⁷⁶ *Id.* at *11.

⁷⁷ *Id.* at *12.

⁷⁸ *Justice Department Files Antitrust Lawsuit Challenging Proposed Merger Between US Airways and American Airlines*, U.S. DEP’T OF JUST. (Aug. 13, 2013), <https://www.justice.gov/opa/pr/justice-department-files-antitrust-lawsuit-challenging-proposed-merger-between-us-airways-and> [<https://perma.cc/FJ3D-7ASC>].

⁷⁹ Roger W. Fones, *Airline Consolidations and Competition Law—What Next?*, 10 FIU L. REV. 447, 451 (2015).

New York Kennedy, Charlotte, Chicago, Los Angeles, Miami, Philadelphia, and Phoenix for three years.

Since 1991, the United States and the EU have coordinated regulatory review on transatlantic mergers, acquisitions, and alliances. For example, Boeing's acquisition of McDonnell-Douglas was reviewed by the EU Commission.⁸⁰ Under the EU Merger Control Regime, "A concentration which would significantly impede effective competition, in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position, shall be declared incompatible with the common market."⁸¹

Although transatlantic mergers are prohibited by the statutory restrictions on foreign ownership, as discussed above, major cross-border airline mergers (e.g., Air France/KLM, British Airways/Iberia, Lufthansa/Austrian) have still been concluded within the EU. Middle Eastern air carriers also have purchased significant minority stakes in a number of European carriers (e.g., Etihad Airways purchased significant equity in Air Berlin and Alitalia).⁸² Table 4 reveals several of the major non-US airline acquisitions:

⁸⁰ See DEMPSEY, EUROPEAN AVIATION LAW, *supra* note 46, at 118–26.

⁸¹ Council Regulation 139/2004 of Jan. 20, 2004, EC Merger Regulation, 2004 O.J. (L24) 1, 7.

⁸² See Robert Wall & Rory James, *Etihad to Buy 49% Stake in Alitalia*, WALL ST. J. (June 25, 2014, 1:49 PM), <https://www.wsj.com/articles/etihad-to-buy-49-stake-in-alitalia-1403685852>. However, by 2017, Etihad began to retreat from its profligate investment strategy as it lost \$1.87 billion, much of which was attributable to writing down its collapsing investments in Air Berlin and Alitalia. Robert Wall, *Air Berlin Files for Bankruptcy Protection After Biggest Investor Ends Support*, WALL ST. J. (Aug. 15, 2017, 9:19 AM), <https://www.wsj.com/articles/air-berlin-files-for-insolvency-after-biggest-investor-ends-support-1502797334>.

Table 4 – Selected Major Non-U.S. Airline Acquisitions

<i>Date</i>	<i>Acquired Airline</i>	<i>Acquiring Airline</i>	<i>Percentage</i>
2000	Canadian Airlines	Air Canada	100%
	Ansett Australia	Air New Zealand	100%
2001	JAS	Japan Air Lines	100%
2004	KLM	Air France	100%
2005	Swiss	Lufthansa	100%
2008	JetBlue	Lufthansa	19%
	BMI	Lufthansa	100%
2009	Austrian Airlines	Lufthansa	100%
	Germanwings	Lufthansa	100%
	Brussels Airlines	Lufthansa	45%
2010	Iberia	British Airways	100%
2011	TAM	LAN	100%
	Iberia	British Airways	100%
	Air Berlin	Etihad	29%
2012	Air Seychelles	Etihad	40%
	Aer Lingus	Etihad	3%
2013	Air Serbia	Etihad	49%
	Jet Airways	Etihad	24%
	Darwin Airlines	Etihad	34%
2014	Alitalia	Etihad	49%
	Darwin Airline	Etihad	34%
	Aer Lingus	British Airways	100%
2016	Virgin Australia	Etihad	22%
	Brussels Airlines	Lufthansa	100%

Singapore Airlines has launched new airlines targeting various market niches—Scoot, Tiger Airways, and Silk Air. Some Southeast Asian airlines (e.g., Tiger Airways and Air Asia) are also setting up branded affiliates in nearby countries. For example, Air Asia operates companies in Malaysia, Indonesia, Japan, and India. LATAM operates several airlines in Latin American countries, including Chile, Brazil, Argentina, Ecuador, Paraguay, and Peru. Thus, airline ownership and nationality are becoming increasingly blurred, despite the “foreign ownership

and effective control” provisions⁸³ in air transport agreements and in domestic laws.⁸⁴

D. AIRLINE ALLIANCES & ANTITRUST IMMUNITY

Intercarrier agreements have long been a feature of international aviation. Airlines routinely agree to share ticketing, boarding, baggage handling, catering, maintenance services, gates, lounges, and reciprocal frequent flyer programs. Interline relations also require an agreement on ticketing and baggage, as well as an end-to-end pricing agreement. In recent years, however, airlines have sought, and regulators have conferred, anti-trust immunity on agreements in competitive markets, addressing issues which otherwise would be deemed collusive and unlawful, such as:

- coordination of routes and scheduling;
- coordination of pricing and inventory management;
- joint marketing and distribution; and

⁸³ The “substantial ownership and control” requirements are found in the bilateral air transport agreements, the multilateral transit and transport agreements, and the MALIAT (Kona) Accord. Almost all bilateral air transport agreements and multilateral transit and transport agreements require that carriers designated thereunder “be substantially owned and effectively controlled” by citizens of the State that issues them an operating certificate. For example, Section 5 of the Air Transit Agreement, and Section 6 of the Air Transport Agreement, both provide, *inter alia*: “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” See International Air Services Transit Agreement art. 1, sec. 5, *opened for signature* Dec. 7, 1944, 59 Stat. 1693, E.A.S. No. 487. Hence, there is no concept of “flags of convenience” in aviation as there is in maritime law. The United States has waived the nationality requirements for airlines registered in States that meet FAA Category I safety and security requirements and that concluded an open skies bilateral agreement with the United States.

⁸⁴ Examples include:

- Alliances: e.g., Star, SkyTeam, and Oneworld;
- Metal Neutral Joint Ventures: e.g., United-Air Canada-Lufthansa;
- Multiple Hubs: e.g., Lan hubs in Argentina, Ecuador, Peru, and Chile; TACA hubs in El Salvador, Costa Rica, and Peru; Lufthansa Italia hubs in Milan; EasyJet hubs in Geneva, Madrid, Milan, and the UK;
- Mergers and Acquisitions: e.g., Lufthansa acquired Austrian, Swiss, BMI, and Brussels;
- Minority Ownership: e.g., Delta in Virgin Atlantic; Lufthansa in JetBlue; Etihad in Air Berlin; Alitalia in Jet Airways; and
- Joint Ventures: e.g., Qantas established Jetstar in Singapore; Singapore Airlines established Tiger in Australia; Air Asia operates affiliates in Thailand, Malaysia, and Indonesia.

- revenue, cost, and profit sharing.⁸⁵

The European Commission may exempt a restrictive alliance if it concludes that the overall benefits of the transaction outweigh its anticompetitive effects and if those benefits will be enjoyed by consumers. Specifically, the EU evaluates the following criteria:

- (a) the agreement must contribute to improving the production or distribution of goods or promote technical or economic progress, (b) consumers must receive a fair share of the resulting benefits, (c) the restrictions imposed by the agreements must be indispensable to the attainment of these objectives, and (d) the agreements must not afford the parties the possibility of eliminating competition in respect of a substantial part of the products or services in question.⁸⁶

Recognizing that alliances may reduce competition, the EU Commission focuses on potential barriers to new competitive entry. These include:

- Regulatory barriers, such as government pricing restrictions for indirect flights or the unavailability of necessary traffic rights;
- Slot shortages at congested airports;
- Increased frequencies resulting from the cooperation;
- Network effects resulting from joint frequent flyer, travel agency or corporate customer incentive schemes or reduced third carrier access to transfer passengers;
- “Behavioural” barriers arising from possible predatory pricing or predatory capacity tactics.⁸⁷

In reviewing the Star Alliance relationship between United, Lufthansa, and SAS, the EU Commission concluded:

indirect flights . . . could constitute suitable alternatives to non-stop services on long haul routes . . . [, and the] alliance partners offered to surrender slots at Frankfurt airport to allow new air services (either direct or indirect) on the routes concerned. . . . In addition, new entrants using the slots, if they operate a non-

⁸⁵ Kate Markhvida, *supra* note 59, at 317–18.

⁸⁶ EUROPEAN COMMISSION & U.S. DEP’T OF TRANSP., TRANSATLANTIC AIRLINE ALLIANCES: COMPETITIVE ISSUES AND REGULATORY APPROACHES 14 (2010). *See generally* Joos Stragier, Deputy Head of Unit DG Competition, Address at the European Air Law Association Annual Conference: Current Issues Arising with Airline Alliance (Nov. 5, 1999), http://ec.europa.eu/competition/speeches/text/sp1999678_en.html [<https://perma.cc/W3C6-FNHR>].

⁸⁷ Michael Gremminger, *The Commission’s Approach Towards Global Airline Alliances—Some Evolving Assessment Principles*, 1 EC COMPETITION POL’Y NEWSL. 75, 78 (2003).

stop service, will be admitted to the parties' frequent flyer programme [sic] and offered interlining facilities.⁸⁸

While collusion (e.g., price fixing) and mergers are subject to the jurisdiction of the DOJ, the DOT may confer antitrust immunity for airlines in international markets. It appears that anti-trust immunity for the three U.S. members of the international aviation alliance cartel relieves carriers from the consequences of violations of at least two of the three principal targets of anti-trust law: (1) collusion; (2) monopolization; and (3) predation.

Airlines have several motivations for creating alliances. These include:

- the desire to achieve greater network economies of scale, scope, and density;
- the desire to reduce costs by consolidating redundant operations;
- the need to improve revenue by reducing the level of competition wherever possible as markets are liberalized; . . .
- the desire to skirt around the nationality rules (which prohibit multinational ownership) and cabotage (which prohibits foreign carriers from flying domestic traffic)⁸⁹;
- [the] ability to provide more capacity and enter new markets without having to make large capital expenditures for aircraft purchases or airport infrastructure;
- [the] ability to generate thousands of new 'on-line' [sic] city-pair combinations;
- [the] ability to extend the reach and scope of their frequent flyer programmes [sic] to enhance consumer loyalty;
- [the] ability to generate . . . [additional] passengers per flight;
- [the ability to enhance market power at hub airports making it more difficult for new entry into the network's markets];
- [the ability to sell and market jointly to corporate customers];
- [the] ability to capture market share from non-aligned competitors;

⁸⁸ Press Release IP/02/1569, European Commission, Commission Closes Probe into KLM/NorthWest and Lufthansa/SAS/United Airlines Transatlantic Air Alliance (Oct. 29, 2002).

⁸⁹ Paul Stephen Dempsey, Dir. at Inst. of Air & Space L. McGill Univ., Lecture on Airline Alliances 12 (2011), https://www.mcgill.ca/iasl/files/iasl/Workshop_6-Dempsey.pdf [<https://perma.cc/2DHY-YQ8Q>].

- [the] ability to fix prices with competitors in dominant markets;
- [the] ability to reduce competitive capacity in key markets to improve yields;
- [the achievement of] a reduction in the costs of equipment and services from third party vendors as a result of greater bargaining power of pooled purchases;
- [the] reduction airport handling, airport operations, selling and ticket costs as a result of economies of scale and the sharing of support services;
- [the ability to reduce travel agent and GDS costs as a result of enhanced oligopsony market power]; and
- [the] ability to pool costs and revenue to share risks and rewards.⁹⁰

Yet, many of these alleged benefits can be obtained without immunity. End-to-end ticketing, baggage, and joint fare agreements preceded alliances by decades and do not pose the concerns that horizontal agreements pose. Reciprocal sharing of lounges and frequent flyer programs can likely also be accomplished without antitrust immunity. The nefarious conduct immunity adds is collusion on fares, frequency, and capacity in competitive markets, all of which are manifestly anticompetitive. Alliances can also drain traffic from non-aligned competitors, which further reduces consumer choice.

Three global alliances have emerged—Star, SkyTeam, and Oneworld. As of May 2017, these three alliances accounted for seventy-six percent of U.S.-Europe seat capacity.⁹¹ Table 5 provides data on their respective market shares.

Table 5 – Airline Alliances, Relative Size

	Star			Skyteam			Oneworld		
	2005	2010	2015	2005	2010	2015	2005	2010	2015
Airlines	n.a.	26	27	n.a.	13	20	n.a.	12	14
Passengers (million)	348	545	641	321	384	665	223	298	557
Countries	139	181	192	137	169	177	135	145	161
Destinations	795	1,130	1330	685	815	1062	599	679	1016

⁹⁰ DEMPSEY, EUROPEAN AVIATION LAW, *supra* note 46, at 154–55 (citations omitted); *see also* Andrew Light, *European Airline Industry Review*, SALOMON SMITH BARNEY at 32 (Oct. 20, 2000).

⁹¹ *See The US Department of Transportation Gets Tough on Antitrust Immunity*, 26 GOV'T AFFAIRS J. EMIRATES 1, 2 (May 2017), https://cdn.ek.aero/downloads/ek/pdfs/open_sky/Open_Sky_May_26.pdf [<https://perma.cc/P6T6-ZTDR>].

Pursuant to the Federal Aviation Act, the USDOT may exempt an intercarrier agreement from the antitrust exposure “to the extent necessary to allow the person to proceed with the transaction” if it concludes the exemption is required by the public interest.⁹² In approving an application for antitrust immunity, the USDOT must conclude that the agreement will not enable the participating airlines to eliminate actual or potential competition which might enable them to raise price above, or reduce services below, competitive levels. Nevertheless, the USDOT may approve an intercarrier agreement that substantially reduces competition if the agency finds the agreement is “necessary to meet a serious transportation need or to achieve important public benefits” that cannot be realized “by reasonably achievable alternatives that are materially less anticompetitive.”⁹³ Among the public benefits that have been identified by the USDOT have been international comity and foreign policy considerations.

In determining whether to issue antitrust immunity to an intercarrier agreement, the USDOT ostensibly asks the following questions:

- Would the intercarrier agreement substantially reduce or eliminate competition or facilitate the abuse of market power? Would the agreement result in an increase of market concentration? The burden of proof on these questions lies with the opponent(s) of the transaction.
- If the agreement would have such adverse competitive consequences, the USDOT asks whether the agreement is necessary to meet serious transportation needs or achieve important public benefits? The burden of proof on this question lies with the applicant(s).
- If the USDOT concludes that the transaction would meet serious transportation needs or important public benefits, it evaluates whether those needs or benefits can be achieved by reasonably available alternatives that are materially less anticompetitive? The burden of proof on this question lies with the opponent(s) to the transaction.
- The USDOT also asks whether the agreement is required by the “public interest”? The agency is authorized to exempt the agreement from the antitrust laws “to the extent neces-

⁹² 49 U.S.C. §§ 41308, 41309; *see also* DEMPSEY, EUROPEAN AVIATION LAW, *supra* note 46, at 174 (citations omitted).

⁹³ 49 U.S.C. § 41309(b)(1)(A), (B); 14 C.F.R. Part 212.

sary to allow the applicant(s) to proceed with the transaction” if it finds the exemption is required by the “public interest.” Among the public interest criteria deemed essential to the issuance of antitrust immunity, the USDOT insists that the foreign airline’s domicile State has concluded an “open skies” agreement with the United States. The USDOT also examines whether the alliance will benefit travelers by enabling the allied airlines to offer better and more efficient service, or “new on-line services” [sic]?⁹⁴

If the application for antitrust immunity contemplates a joint venture that resembles a merger, the agency claims to use the Clayton Act analysis, which includes the following questions:

- Will the intercarrier agreement substantially reduce competition and/or enable the increase and abuse of market power?
- Will it cause potential competitive harm?
- Will new competitive entry by other airlines into the market be sufficient to counteract competitive harm?⁹⁵

In applying these criteria, the USDOT has concluded that “the pro-competitive effect of global alliances is particularly evident in the case of the behind- and beyond-markets where integrated alliances with coordinated connections, marketing, and services can offer competition well beyond mere interlining. Integrated alliances can, in short, offer a multitude of new on-line [sic] services to thousands of city-pair markets, on a global basis.”⁹⁶ They do this through the deceptive practice of “code-sharing,” whereby the allied carriers place their flight number on another airline’s flight.⁹⁷ USDOT has praised code-sharing as “an important source of new entry, new service, lower fares, and competition,” and “the pro-competitive and pro-consumer features of code-share agreements.”⁹⁸

⁹⁴ See Dempsey, Lecture on Airline Alliances, *supra* note 89, at 21, 23.

⁹⁵ See *id.*

⁹⁶ *Application of American Airlines et al.*, DOT Order 2000-4-22, at 9 (2000).

⁹⁷ For a list of DOT approved code-shares as of July 31, 2016, see U.S. DEP’T OF TRANSP., CODE SHARE REPORT (2016) <https://www.transportation.gov/sites/dot.gov/files/docs/July%202016%20Code%20Share%20Report.pdf> [http://perma.cc/N55D-9KHP].

⁹⁸ *Joint Application of United Air Lines, Inc., and All Nippon Airlines, Ltd.*, DOT Order 99-8-14 (1999). Jan K. Brueckner, *A Panel Data Analysis of Code-Sharing, Antitrust Immunity, and Open Skies Treaties in International Aviation Markets*, 30 REV. INDUS. ORG. 39 (2007); Harumi Ito & Darin Lee, *Domestic Code Sharing, Alliances, and Airfares in the U.S. Airline Industry*, 50 J.L. & ECON. 355 (2007); Jong-Hun Park & Anming Zhang, *An Empirical Analysis of Global Airline Alliances: Cases in North*

However, code-sharing connections are not actually online services. They are merely interline operations pretending to be something they are not. Moreover, preferential interlines masquerading as on-line services effectively steal traffic from non-preferential interlines, thereby adversely affecting both competition and consumer convenience.

The USDOT has defended its insistence that competition is not impacted negatively through the issuance of antitrust immunity by emphasizing the opportunity for new entry presented by “open skies” bilateral air transport agreements, as well as the “competitive discipline afforded by competing U.S. hubs and existing competition from one-stop and connecting services. . . .”⁹⁹ In one decision, the USDOT stated, “Because of the open-skies accords, any U.S. carrier may serve any of these foreign markets from any point in the United States.”¹⁰⁰

Nonetheless, despite the theoretical opportunity for new entry afforded by the “open skies” bilateral air transport agreements, the ability of a new entrant to successfully provide sustainable competitive service is handicapped if it does not maintain a connecting hub at least at one end of the city-pair spoke. Moreover, one-stop and connecting services are manifestly inferior to non-stop operations. Nevertheless, the USDOT sanguinely insists that, “a significant element in antitrust analysis is the extent to which facilitating airline integration (through antitrust immunity or otherwise) can enhance overall competitive conditions.”¹⁰¹

If intercarrier agreements are as pro-competitive as the USDOT insists, why do they require immunity from the antitrust laws? The USDOT confesses that if it did not issue antitrust immunity, the approved alliances “might be exposed to liability under the antitrust laws. . . .”¹⁰² But, they would only be exposed to liability under the antitrust laws if their activities were anticompetitive, not because they were pro-competitive.

Atlantic Markets, 16 REV. INDUS. ORG. 367 (2000). Other studies suggest that code-sharing has resulted in consumer price increases. See, e.g., Armantier & Richard, *Evidence on Pricing from the Continental Airlines and Northwest Airlines Code-Share Agreement*, ADVANCES IN AIRLINE ECONOMICS 1, Elsevier Publisher, 91–109 (2006); P. Gayle, *An Empirical Analysis of the Competitive Effects of the Delta/Continental/Northwest Codeshare Alliance*, 51 J.L. & ECON. 743 (2008).

⁹⁹ *Application of American Airlines et al.*, DOT Order 2000-4-22, at 10 (2000).

¹⁰⁰ *American Airlines and the TACA Group Reciprocal Code-Share Services Proceeding*, DOT Order 97-12-35, at 19 (1997).

¹⁰¹ *Application of United Airlines et al.*, DOT Order 99-8-14, at 53 (1999).

¹⁰² *Applications of American Airlines et al.*, DOT Order 97-6-30, at 53 (1997).

The USDOT has confessed, “The practice of excluding airlines from participating in a particular code-share arrangement can have adverse public consequences because code-sharing can provide a primary, if not the only, method of entering or expanding service in many international aviation markets.”¹⁰³ Indeed, with immunized intercarrier agreements, the participating carriers are authorized to exclude non-alliance member airlines from their preferential code-shares. But as noted above, the USDOT insists that “open-skies” bilaterals will ameliorate the anticompetitive consequences of alliances. Paradoxically, the agency has confessed, “While we continue to have concerns about the impact of exclusivity provisions in markets that are not governed by open-skies agreements, we are satisfied . . . that code-share exclusivity provisions would not inhibit competition or otherwise adversely affect the public interest.”¹⁰⁴

In order to dull some of the more oppressive anticompetitive impacts of immunized alliances, the USDOT has sometimes imposed certain conditions upon them and limited them to five year terms (though USDOT has never refused to renew them beyond their five year terms). For example, the agency has occasionally withheld antitrust immunity from “pricing, inventory or yield management coordination or pooling of revenues, with respect to unrestricted coach-class fares or any business or first-class fares” in certain specified city-pair markets dominated by allied airlines.¹⁰⁵

Early USDOT issuances of antitrust immunity included “carve outs,” whereby the dominant city-pairs at which the allied carriers maintained hub operations were exempted from antitrust immunity. Former Deputy Assistant Attorney General R. Hewitt Pate observed that,

When antitrust immunity has been sought, we have recommended that USDOT “carve out” certain unrestricted fares involving these city pairs from the order granting antitrust immunity For example, the [Antitrust] Division recommended that seven city pairs be carved out of the Delta/Swissair/Sabena/Austrian alliance (Atlanta-Zurich, Atlanta-Brussels, Cincinnati-Zurich, New York-Brussels, New York-Geneva, New York-Vienna, and New York-Zurich); one for the American/Canadian Air alliance (New York-Toronto); two for the United/Lufthansa

¹⁰³ *Joint Application of United Air Lines, Inc., and All Nippon Airlines, Ltd.*, DOT Order 99-8-14 (1999).

¹⁰⁴ *Id.*

¹⁰⁵ *Application of American Airlines et al.*, DOT Order 2000-5-13 (2000).

alliance (Washington-Frankfurt and Chicago-Frankfurt); and two for the United/Air Canada alliance (Chicago-Toronto and San Francisco-Toronto).¹⁰⁶

More recently, however, the USDOT has alleged that carve-outs inhibit alliance efficiencies and has decided to no longer impose “carve-outs” and remove many “carve-outs” that it had imposed in earlier decisions.¹⁰⁷

Exclusive dealing clauses in code-sharing agreements have been rejected unless the country that the carrier will operate to and from has concluded an “open skies” bilateral air transport agreement with the United States.¹⁰⁸

The USDOT turned a sharp corner in 2005 when it announced that antitrust immunity for alliances would no longer be granted unless the carriers created “metal-neutral joint ventures,”¹⁰⁹ arguably the least competitive alternative short of an outright merger. In other words, the USDOT was insisting on further anticompetitive collusion as a prerequisite for antitrust immunity.

What is metal neutrality? The USDOT defines it as

an industry term meaning that the partners in an alliance are indifferent as to which operates the ‘metal’ (aircraft) when they jointly market services. Without a metal-neutral sales environment, the partners have a strong economic incentive to book passengers on their own aircraft in order to retain a larger share of the revenue for themselves, which may not be in the best interest of the consumer or the alliance as a whole. Metal neutrality may be achieved through revenue and/or comprehensive benefit sharing arrangements.¹¹⁰

As the USDOT further noted,

¹⁰⁶ *International Aviation Alliances: Market Turmoil and the Future of Airline Competition: Hearing Before the Subcomm. on Antitrust, Competition, and Bus. Fts. of the S. Judiciary Comm.*, 107th Cong. 11–12 (2001) (statement of R. Hewitt Pate, Deputy Assistant Attorney General, Antitrust Division).

¹⁰⁷ U.S. DEP’T OF TRANSP., *Airline Alliances Operating with Antitrust Immunity*, 2, 4, 6–7, 10, 12 (last updated May 10, 2017), <https://www.transportation.gov/sites/dot.gov/files/docs/mission/office-policy/aviation-policy/9906/170104-all-immunized-alliances-05102017.pdf> [<https://perma.cc/C3F2-2A9L>]. See, e.g., *Joint Application of Air Canada, the Austrian Group et al.*, DOT Order 2009-7-10, at 20 (July 10, 2009).

¹⁰⁸ See, e.g., *Application of American Airlines et al.*, DOT Order 99-6-6 (1999).

¹⁰⁹ See generally *Joint Application of Alitalia-Linee Aeree Italiane-S.p.A. et al.*, DOT Order 2005-12-12, at 2, 30, 37 (Dec. 22, 2005).

¹¹⁰ *Joint Application of American Airlines, British Airways PLC et al.*, DOT Order 2010-2-8, at 4 n.6 (Feb. 13, 2010).

We have emphasized the high standard necessary to justify a grant of immunity and the need for applicants to demonstrate that substantial public benefits are likely to be produced at the time the immunity is requested. For example, in the SkyTeam case in 2005, we tentatively denied a request for antitrust immunity because there was both insufficient information in the record to make a complete assessment of public benefits and the competitive conditions were in flux. There . . . the Department identified barriers to integration that we believed reduced the incentives of the airlines to integrate their operations and pass on the benefits of immunized cooperation to consumers.¹¹¹

Remarkably, U.S. regulators insist that in order to receive antitrust immunity, the participating must establish “metal neutral joint ventures.” Yet such an arrangement is the most anticompetitive alternative short of an outright merger. With a straight face, the USDOT acknowledges that, although antitrust immunity authorizes alliance members to fix prices and ration capacity, the agency insists that consumers somehow benefit from such joint ventures in the form of lower prices.¹¹²

Normally, antitrust analysis assumes that reduced competition can create market power in which service declines and/or prices increase. But, the USDOT analysis stands this presumption on its head.

The USDOT assumes that antitrust immunity is necessary for airlines to eliminate “double-marginalization.” To explain the problem antitrust immunity seeks to remedy, the following is a simplified example. First, assume Carrier X operates from A to B, and Carrier Y operates from B to C. Carrier X’s nonstop fare between A and B is \$50, and Carrier Y’s nonstop fare between B and C is also \$50. They may offer interline service between A and C as a combination of their two point-to-point fares for \$100. Further, assume they compete with Carrier Z, which operates nonstop from A to C but offers a nonstop fare between A and C for \$90. Then, assume a passenger wants to fly from A to C. Carrier Z offers a nonstop fare \$10 lower than the combined XY fare of \$100, and Carrier Z offers a nonstop on-line flight as opposed to the XY interline connection. In this example, Carriers X and Y will sell virtually no seats in the A to C market until

¹¹¹ *Joint Application of Delta Airlines, Inc., Virgin Blue Airlines et al.*, DOT Order 2010-9-4, at 2 (Sep. 8, 2010).

¹¹² See Paul Stephen Dempsey, *Recent Books on International Law: Book Review: The Principles and Practice of International Aviation Law*, 110 AM. J. INT’L L. 159, 161–62 (2016).

Carrier Z's planes are full, and passengers are "spilled" to the XY interline service. So, if Carriers X and Y want to participate meaningfully as competitors on the A to C route, Carrier X and Y will have to lower their respective point-to-point fares. This is usually done through typical ticketing-and-baggage and joint-fare agreements whereby the carriers will honor each other's tickets, provide through baggage handling from origin to destination, and provide a through combined fare. Assume Carriers X and Y agree to lower their fares to \$40 on interline customers, combining X's A to B \$40 fare with Y's B to C \$40 fare results in a through interline fare of \$80. Now, the same customer wanting to fly from A to C has a choice: (1) an interline fare on Carriers X and Y with a connection in B of \$80; or (2) a nonstop fare on Carrier Z of \$90. Some passengers will pay a premium for the higher nonstop fare;¹¹³ others will opt for the less-convenient itinerary for a lower price. To add one more layer of complexity to an intercarrier agreement, if Carriers X and Y also want to mislead the customer into believing their interline flight is an on-line flight, they can code-share so that both X and Y will falsely appear to fly between A and C.

No doubt, lowering the fare from A to C by twenty percent would enhance consumer welfare. However, the USDOT seems to believe that prorating interline fares cannot be accomplished without antitrust immunity. But in fact, carriers have engaged in joint fare agreements in international aviation since the 1920s under the auspices of IATA. Intercarrier agreements on fares on end-to-end city-pairs have never created the antitrust heartburn caused by pricing discussions on parallel routes.

Further, in granting antitrust immunity, the USDOT has repeatedly relied on a study produced by an airline industry consultant that alleged consumer savings of between fifteen and twenty-five percent resulting from double marginalization.¹¹⁴ This theory is "supported by a single study prepared by a paid advocate for one of the [antitrust immunity] applicants, and

¹¹³ In fact, seventy-six percent of passengers in the trans-Atlantic market fly non-stop even though prices are more than eight percent higher than connecting fares. William Gillespie & Oliver M. Richard, *Antitrust Immunity Grants to Joint Venture Agreements: Evidence from International Airline Alliances*, 78 ANTITRUST L.J. 443, 454 (2012).

¹¹⁴ Jan K. Brueckner & W. Tom Whalen, *The Price Effects of International Airline Alliances*, 43 J.L. & ECON. 503, 521 (2000).

based solely . . . on pre-1999 data.”¹¹⁵ Essentially, the USDOT has adopted a presumption that prices fall whenever competition is circumscribed,¹¹⁶ which is about as counterintuitive as any economic policy embraced by a government agency. Industry expert Hubert Horan explained the fallacy of such specious reasoning:

Under this theory [of double-marginalization], the only ways to reduce the structurally higher costs of interline pricing are merger or full immunity to collude on prices. . . . This theory is completely indefensible. “Double marginalization” does not exist, never existed, and has absolutely nothing to do with the actual legitimate benefits of immunized alliances. The “double marginalization” theory was created out of whole cloth . . .¹¹⁷

Assuming, for the sake of argument, that double marginalization was an interline joint-fare problem that could only be remedied by antitrust immunity (which it is not), that is no justification to authorize airlines to collude on pricing, scheduling, and capacity on parallel point-to-point routes.

By 2008, the DOJ had had enough. It issued a fifty-five-page objection to the issuance of additional antitrust immunity to Star Alliance on grounds that the purported benefits alleged by the USDOT had not been established. The DOJ found that the benefits alleged from immunized elimination of “double-marginalization” did not exist and that “connecting fares offered by non-immunized alliances for transatlantic routes are no more expensive than fares offered by immunized alliances.”¹¹⁸ Further, DOJ economists have studied the allegations of consumer benefits resulting from airline antitrust immunity and concluded that the data does not support such a claim. They found that “grants of immunity to participants in international alliances . . . have harmed consumers by raising prices on many routes and have not delivered the benefits that the participants claimed at the DOT.”¹¹⁹

In response, two former senior USDOT apologists published an article boasting that “the emergence of alliances—and particularly immunized alliances—arguably has represented the most

¹¹⁵ Hubert Horan, “Double Marginalization” and the Counter-Revolution Against Liberal Airline Competition, 37 *TRANSP. L.J.* 251, 261 (2010).

¹¹⁶ *See id.* at 269–76.

¹¹⁷ *Id.* at 273–74.

¹¹⁸ *See Comments on Joint Application of Air Canada et al.*, DOT Order to Amend 2007-2-16, at 35-36 (June 26, 2009).

¹¹⁹ Gillespie & Richard, *supra* note 113, at 443, 467.

important development in the industry since the introduction of the jet aircraft.”¹²⁰ In other words, the emergence of an anticompetitive global aviation cartel is the most important development in the industry since the introduction of jet aircraft. That cartel consists of three immunized alliances, each of which has significantly reduced competition between its members and taken traffic from non-aligned competitors. Why one would speak about creating a global cartel with such pride is perplexing. The *Economist* said it best:

This lack of competition is partly the result of collusion sanctioned by regulators. On transatlantic routes members within each of the world’s three big alliances—Star, [O]neworld and SkyTeam—share costs and agree on prices

[The USDOT] has not only given its blessing to the rise of alliances, but actually requires airlines to collude fully within each of their groupings, and to share costs and agree on prices

America’s main antitrust regulator, the Department of Justice (D[O]J), is rightly sceptical [sic] of the notion that collusion benefits consumers. It objected to the creation and expansion of the three transatlantic cartels, only to be ignored by the [USDOT], which it cannot overrule on such matters. Earlier this year an unofficial study by two of the D[O]J’s economists crunched the most recent data available, and reached the opposite, and more plausible, conclusion: that fewer competitors means higher fares, as one would expect. The proponents of consumer-friendly cartels still find that the data support their theory. But if such drastically opposing conclusions can be drawn simply by shuffling the figures a different way, it is surely best to believe the outcome that most accords with common sense. A pity, then, that the [USDOT] shows no sign of doing so.

Blessing the cartels across the Atlantic and Pacific was a mistake, and should be reversed. Since the [USDOT] seems unlikely to do that, Congress should hand its remaining antitrust powers to the more pro-competition D[O]J.¹²¹

By 2010, the highest levels of integration under antitrust immunity in “metal neutral” joint ventures had been achieved by the following airlines:

- Air Canada, Lufthansa, and United-Continental (for Star);

¹²⁰ Warren L. Dean & Jeffrey N. Shane, *Alliances, Immunity and the Future of Aviation*, 22 AIR & SPACE LAW. 1, 17–18 (2010).

¹²¹ *Open the Skies*, ECONOMIST (Nov. 12, 2011), <http://www.economist.com/node/21538149> [<https://perma.cc/6TDG-2VAJ>]. This position is largely echoed in Charles N.W. Schlagen, *Differing Views of Competition: Antitrust Review of International Airline Alliances*, 2000 U. CHI. LEGAL F. 413, 414–15, 443–46 (2000).

- Air France-KLM, Alitalia, and Delta (for SkyTeam);
- American, British Airways, and Iberia (for Oneworld).¹²²

Table 6 lists the active intercarrier relationships that enjoy antitrust immunity as of 2017. Note that the global alliances were reduced from four to three after Air France acquired KLM in 2004, folding KLM into the SkyTeam alliance. Northwest was left without a major European alliance partner, leading to Delta's acquisition of Northwest in 2008. The three alliances (SkyTeam, Star, and Oneworld) collectively account for more than eighty percent of the passenger traffic flying between the United States and EU.¹²³ Note also, that the tentacles of immunized alliances have now extended beyond the transatlantic U.S.-EU market, spreading to Asia and Australia.

Table 6 – Active Alliances Immunized by USDOT¹²⁴

<i>Sky Team</i>	<i>Star</i>	<i>Oneworld</i>	<i>Other</i>
Delta/Air France-KLM/Alitalia/Czech/Korean	United/Air Canada /Brussels/Lufthansa /Swiss/Austrian/SAS /LOT/TAP	American/Lan Airlines/Lan Peru American/British Airways/Iberia/ Finnair/Royal Jordanian	SAS/Icelandair Delta/Virgin Australia
Delta/Virgin Atlantic /Air France-KLM/Alitalia	United/Air New Zealand United/Asiana United/All Nippon Airways United/COPA	American/Japan Air Lines	

Finally, at the end of the Obama Administration in November 2016, the USDOT issued two decisions that appeared to reflect some measure of newly discovered caution with respect to the Pandora's box it had opened. Regarding the first decision, Delta Air Lines and Aeromexico sought antitrust immunity for a metal neutral joint venture.¹²⁵ Although Mexico had concluded an "open skies" bilateral air transport agreement with the United States, the USDOT expressed concern with the lack of trans-

¹²² See EUROPEAN COMMISSION & U.S. DEP'T OF TRANSP., TRANSATLANTIC AIRLINE ALLIANCES: COMPETITIVE ISSUES AND REGULATORY APPROACHES 7–8 (2010).

¹²³ Gillespie & Richard, *supra* note 113, at 443, 446.

¹²⁴ This data is as of January 2017. *Airline Alliances Operating with Antitrust Immunity*, *supra* note 107.

¹²⁵ *Joint Application of Delta Air Lines & Aerovias de Mexico, S.A. DE C.V.*, DOT Order 2016-11-2, at 1–3 (Nov. 4, 2016).

parency in slot allocations at Mexico City's Benito Juarez International Airport (MEX) and that the two carriers controlled nearly fifty percent of the slots at that airport, which might enable them to exert market power at MEX and New York's John F. Kennedy Airport (JFK). It therefore conditioned the grant of antitrust immunity by requiring the carriers to surrender twenty-four pairs of slots at MEX and six slots at JFK to U.S. or Mexican low-cost carriers, while also limiting approval to a five-year term.¹²⁶

Also in November 2016, the USDOT denied the application of American Airlines and Qantas for antitrust immunity on grounds that if approved, the allied carriers would account for nearly sixty percent of United States-Australia traffic, and the largest market share in nearly 200 city-pairs, enabling the alliance to exert market power. Emphasis was placed on the unique geographic and demographic characteristics of the United States-Australia market, as few passengers connect via intermediate points, and there is limited flow within or beyond Australia. For the first time, the USDOT concluded that "many public benefits from customer service coordination could be obtained through traditional arms-length cooperation such as codesharing."¹²⁷ The USDOT also recognized that immunizing alliances often has the "effect of limiting access to their networks by competitors or independent airlines."¹²⁸ The USDOT further concluded that the proposed alliance "would substantially reduce or eliminate competition at the network, country-pair, and city-pair levels . . ." and enable the applicants to "unreasonably exclude present and future competitors from the market."¹²⁹ The USDOT found that the proposed benefits alleged by the applicants were "likely to be limited, delayed, or ultimately not realized at all, due to a lack of adequate competition to discipline the alliance."¹³⁰

It remains to be seen whether this represents a long-overdue epiphany in public policy or merely just more restrictive decisions limited to the unique factual circumstances posed by these two applications.

¹²⁶ *Id.*

¹²⁷ *Joint Application of American Airlines & Qantas Airways*, DOT Order 2016-11-16, at 2 (Nov. 18, 2016).

¹²⁸ *Id.* at 17.

¹²⁹ *Id.* at 18.

¹³⁰ *Id.* at 19.

IV. ANALYSIS

The competitive landscape in international aviation has changed enormously during the last decade and a half. Massive mergers have reduced competition as, in the United States, seven major network airlines have been reduced to three. Further, in the EU, the British Airways, Lufthansa, and Air France conglomerates too have reduced network competition. The regulators have insisted on “metal-neutral joint ventures” as the price of admission for antitrust immunity. Three carriers on each side of the Atlantic now dominate transatlantic traffic in “metal neutral joint ventures” with antitrust immunity. In fact, the USDOT’s insistence on “metal neutral joint ventures” as the price for admission to antitrust immunity, coupled with the consolidation of major airlines on both sides of the Atlantic, has created the global oligopoly of Star, SkyTeam, and Oneworld. As the DOJ’s analysis has revealed, the market power that emerged from this antitrust abdication has resulted in consumer harm.

Meanwhile, many major U.S. and EU alliance airlines complain about the alleged subsidies received by the Middle East airlines, which operate from countries without State aid prohibitions. Several U.S. and EU airlines seek a roll back from the ubiquitous “open skies” bilateral air transport agreements with the United Arab Emirates (UAE) and Qatar.¹³¹ Airlines are also immune from General Agreement on Trade in Services (GATS) anti-dumping prohibitions.¹³² The result has been a regulatory mess with no clear solutions.

The USDOT has embraced a largely schizophrenic approach to airline competition. On one hand, it has concluded liberalized “open skies” air transport agreements with more than 120 States.¹³³ On the other hand, it has also enabled airline competitors to fix prices and limit capacity on common routes. Although the former enhances competition, the latter does the opposite. If “open skies” is the competitive Dr. Jekyll, antitrust immunity is the anticompetitive Mr. Hyde.

¹³¹ The United States has an arsenal of regulatory, statutory, and treaty countermeasures it could employ should it conclude that the competition provided by the Gulf carriers is unfair. See DEMPSEY, *supra* note 20, at 121–64.

¹³² See DEMPSEY, PUBLIC INTERNATIONAL AIR LAW, *supra* note 49, at 881–83.

¹³³ James Reitzes & Diana Moss, *Airline Alliances and Systems Competition*, 45 HOUS. L. REV. 293, 294–96, 303–05 (2008).

Code-sharing and antitrust immunity exist as a means to skirt around the statutory foreign ownership restrictions. While the USDOT has significantly liberalized those restrictions, permitting, via regulatory fiat, foreign equity investment of up to forty-nine percent non-voting stock, thereby diluting the statutory requirement that no more than twenty-five percent of U.S. airline voting stock may be owned by foreign citizens, and U.S. airlines must be owned and controlled by U.S. citizens. USDOT efforts to bend these rules further have been prohibited by Congress. These statutory prohibitions, as well as the “significant ownership and control” requirements in many bilateral air transport agreements, prohibit mergers of U.S. airlines with foreign carriers. It is clear that the USDOT is using antitrust immunity to allow carriers to violate the antitrust laws; in effect, it is also using antitrust immunity to enable carriers to breach the statutory foreign ownership and cabotage prohibitions.¹³⁴ Beyond flaunting the statutory prohibitions, the anticompetitive impact of code-sharing and antitrust immunity is also troublesome. More than one airline has had to abandon international nonstop markets once an immunized code-share alliance has been authorized.¹³⁵ The loss of competition has translated into higher fares for consumers.¹³⁶ For example, soon after the United/Lufthansa Star alliance was given antitrust immunity, Delta closed its Frankfurt hub, TWA dropped its New York-Frankfurt flights, and American Airlines withdrew from Miami-Frankfurt and Chicago-Dusseldorf.¹³⁷

Once the USDOT approved the British Airways/American Airlines Oneworld alliance, US Airways was left without a major European partner. TWA was also without membership in a major alliance. Both carriers’ financial position worsened as transatlantic interline traffic demand softened. TWA produced a study entitled *The Anticompetitive Nature of Airline Alliances*¹³⁸ before it fell into bankruptcy. After Delta abandoned Swissair

¹³⁴ “Code-sharing does not violate the letter of U.S. law because the airplane actually carrying passengers within the United States is owned and operated by U.S. nationals. It does, however raise questions as to whether the spirit and intent of U.S. law is violated.” Howard Kass, *Cabotage and Control: Bringing 1938 U.S. Aviation Policy into the Jet Age*, CASE W. RES. J. INT’L L. 143, 164 (1994).

¹³⁵ Linda Goldberg, *International Airline Partnerships Are Drawing Praise—And Some Flak*, HOUS. CHRON., Jan. 10, 1999, at 1.

¹³⁶ RIGAS DOGANIS, *THE AIRLINE BUSINESS IN THE 21ST CENTURY* 75 (2001).

¹³⁷ Scott McCartney, *Are Airline Alliances Bad News for Consumers?* WALL ST. J., Jun. 17, 1997, at B1.

¹³⁸ Goldberg, *supra* note 135.

and Sabena in favor of the Skyteam alliance with Air France, both Swissair and Sabena collapsed into bankruptcy. Airlines not allowed to join the three major global alliances often lose traffic to the cartel.

“The telephone regulators insist on ‘seamless interconnectivity.’ The airline regulators allow ‘preferential connectivity.’”¹³⁹ Seamless connectivity enables more competitors to enter the market for network services; preferential connectivity can effectively circumscribe the ability of new competitors from exchanging traffic with dominant providers.

Are alliances pro-competitive, or anticompetitive? Proponents of alliances point to the following consumer benefits:

- Beyond-segment competition;
- “One-stop travel purchase services;
- Joint frequent flyer benefits;
- Reciprocal airport lounge access;
- Seamless connectivity of passengers and luggage; and
- Coordinated arrival and departure scheduling.”¹⁴⁰

One must remember that the statutory language involving the issuance of antitrust immunity to an anticompetitive agreement requires that immunity only be conferred when it is necessary to meet a serious transportation need or important public benefits, and there is no less-anticompetitive alternative. This author submits that all of the aforementioned public benefits can be achieved without serious threat of antitrust enforcement. It is collusion of airlines on pricing, entry, capacity, frequency, and marketing in competitive markets where antitrust immunity has the most value to the carriers but also poses the most significant burden on both consumers and competitors.

Alliances, particularly those involving code-sharing, price fixing, and capacity rationalization, can reduce competition¹⁴¹ in

¹³⁹ Dempsey, Lecture on Airline Alliances, *supra* note 89, at 33. Although the airline regulators embrace preferential connectivity with partner common carriers, the telephone regulators embrace nondiscriminatory connectivity with non-partner common carriers.

¹⁴⁰ DEMPSEY, EUROPEAN AVIATION LAW, *supra* note 46, at 154 (citation omitted).

¹⁴¹ “[A]irline alliances result in fewer remaining competitors with less overlap and thus less inclination to compete on prices. . . . As a result of the large airline alliances, competition has already diminished on some routes to gateway European cities dominated by alliances.” Stephen McShea, *The “Dominant Position” Doctrine and the European Union’s Response to the British Airways/American Airlines Alliance*, 23 B.C. INT’L & COMP. L. REV. 71, 87 (1999).

ways that injure competitors¹⁴² and consumers.¹⁴³ Code-sharing itself can be a predatory weapon,¹⁴⁴ resulting in higher fares or the foreclosure of competitors from markets,¹⁴⁵ while deceiving consumers into purchasing a product different from that actually being provided.¹⁴⁶ Thus, awarding antitrust immunity to competing airlines results in the loss of independent competitors and in higher fares.¹⁴⁷

¹⁴² “This form of systems competition, the hub-and-spoke model, creates serious anticompetitive concerns as alliances protect their respective hubs through predatory pricing or the threat of pricing below cost.” W. Robert Hand, *Continental Joins the (All)Star Alliance: Antitrust Concerns with Airline Alliances and Open-Skies Treaties*, 33 HOUS. J. INT’L L. 641, 678 (2011).

¹⁴³ “[T]here can be little doubt that airline executives see alliances, especially when they involve code-sharing and capacity rationalisation [sic], as a way of reducing or limiting competition.” RIGAS DOGANIS, *THE AIRLINE BUSINESS* 95 (2d ed. 2006).

¹⁴⁴ See DEMPSEY, *EUROPEAN AVIATION LAW*, *supra* note 46, at 156.

¹⁴⁵ U.S. Deputy Assistant Attorney General Pate stated that code-sharing “can result in market allocation, capacity limitations, higher fares, or foreclosure of rivals from markets, all to the injury of consumers.” *Id.* (citation omitted).

¹⁴⁶ “Code sharing is unnecessary for, indeed irrelevant to, any legitimate purpose or actual service. Code sharing doesn’t enable an airline to fly to any more places. It just enables the airline to mislead travellers [sic] into thinking that they fly to places they don’t. I call that fraud.” Edward Hasbrouck, *Airline Alliances and Code-Sharing*, HASBROUCK.ORG <https://hasbrouck.org/articles/alliances.html> (last updated Jan. 30, 2006).

¹⁴⁷ Gillespie & Richard, *supra* note 113, at 443, 444, 468

The evidence shows that a grant of antitrust immunity to two competing non-stop carriers in a trans-Atlantic route has a fare effect that is equivalent to the loss of an independent competitor, and fares are significantly higher in routes with fewer independent competitors. This finding supports the normal antitrust presumption that eliminating or substantially reducing competition through collaboration or merger enhances the market power of the remaining suppliers and leads to higher prices, harming consumers. . . . [T]he loss of competition in trans-Atlantic routes with non-stop service as a result of antitrust immunity grants adversely affects consumers.

Alan Coles, chairman of the Guild of Business Travel Agents, stated, “Airlines say that alliances can reduce costs, but we have seen no evidence of prices coming down as a result.” See DEMPSEY, *EUROPEAN AVIATION LAW*, *supra* note 46, at 178 (citation omitted).