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TURKISH AVIATION ACADEMY

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Antitrust Law and Airline Alliances

Module 23

Istanbul Technical University
Air Transportation Management, M.Sc. Program
Air Law, Regulation and Compliance Management
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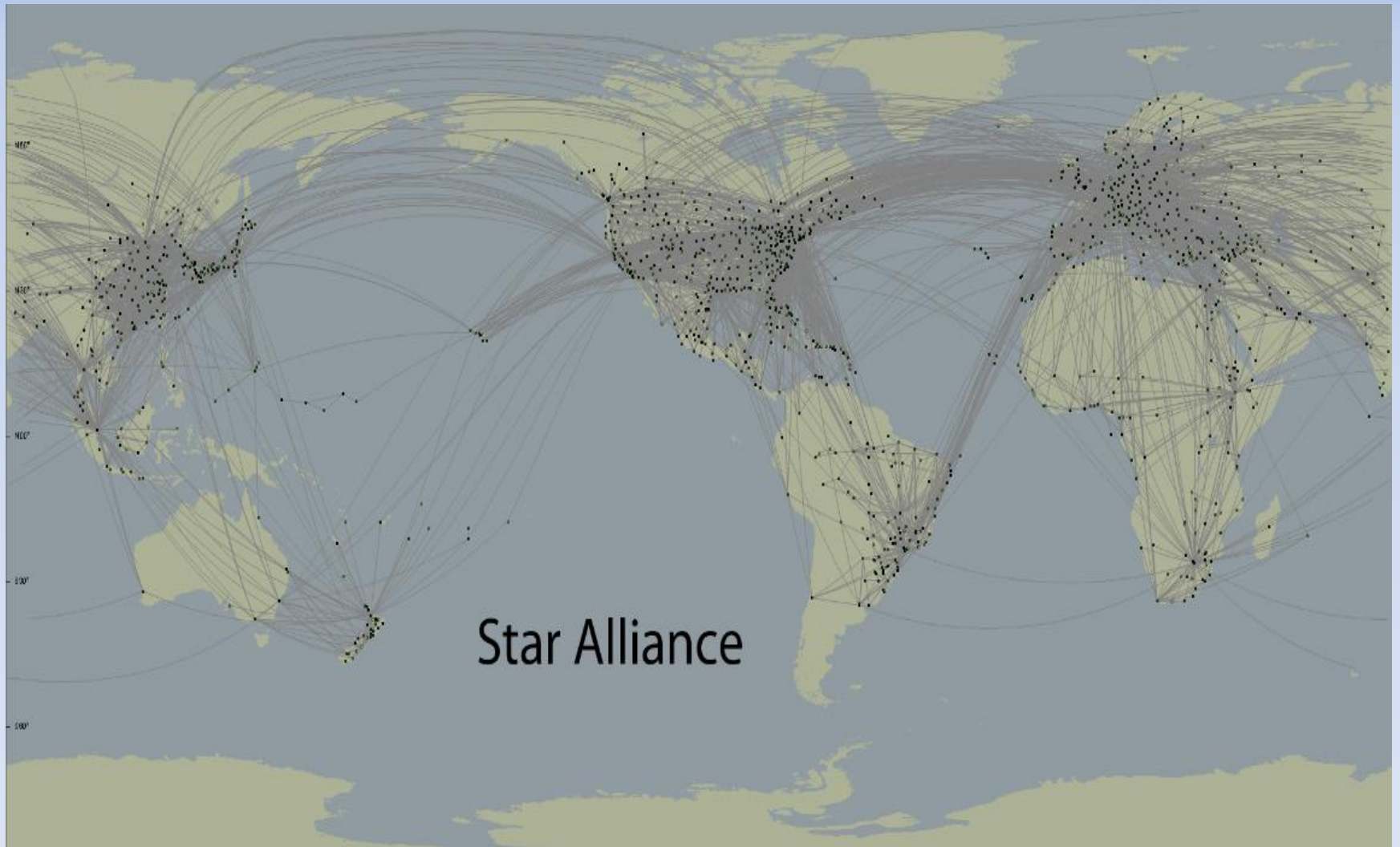
Outline

- Trends in Airline Alliances
- Legal and Economic Reasons
- Antitrust Law and Enforcement
- Antitrust Issues with Airline Alliances
- The British Airways-American Case Study

Trends in Airline Alliances

Domestic and international markets

- The U.S. Congress deregulated domestic markets in 1978; similar action followed in Canada and the EU in the 1980s and early 1990s
 - For 50 years, most governments tightly regulated three key economic parameters: business entry, routes, and prices
 - In many cases, such as the UK, France, and here in Canada, governments actually owned all or most of the companies
- International flights were unaffected by domestic deregulation
 - A complex web of bilateral air service agreements, completely separate from other world trade rules
 - The basic rule: everything is banned, unless expressly permitted by bilateral ASAs
 - A recent trend of greater liberalization of international air service via open skies agreements



Alliances vary in scope and breadth

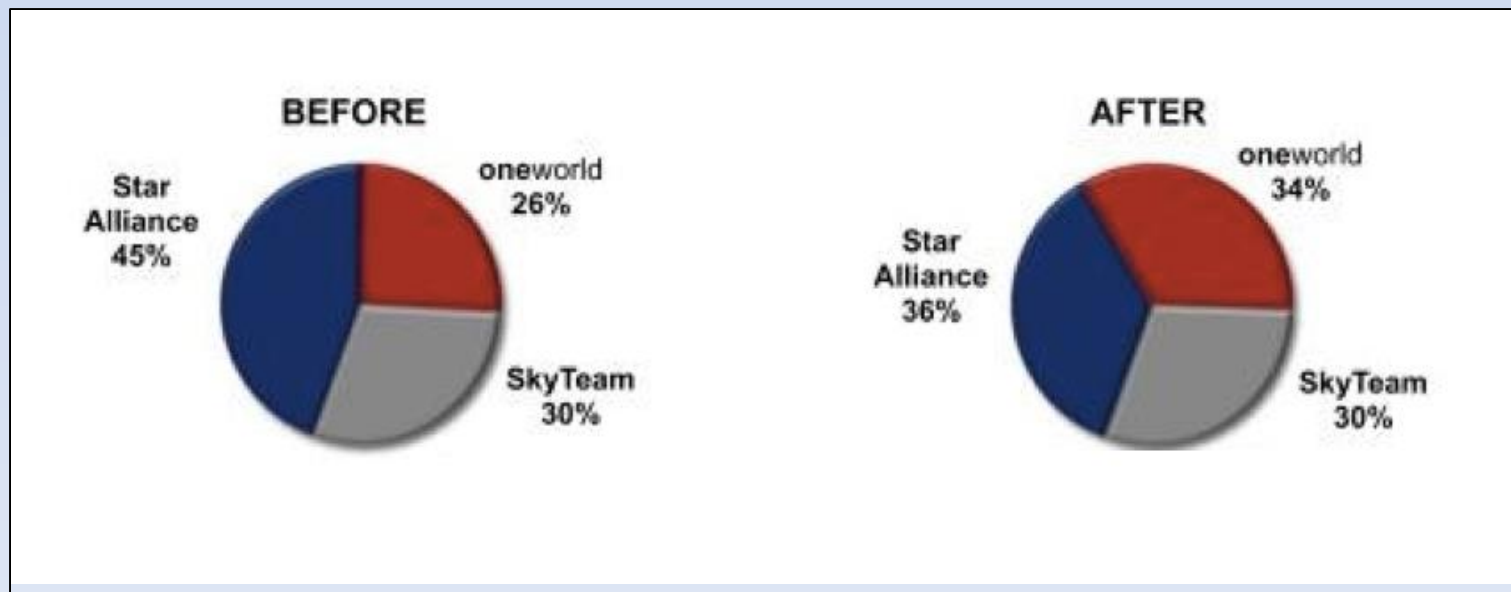
- Multilateral global alliances
 - Star Alliance, SkyTeam and oneworld
- Bilateral alliances
 - the foundation of the three global alliances
- Alliances with immunity from antitrust laws in the U.S. and EU
 - Highly integrated forms of cooperation (bilateral or multilateral)
 - Metal-neutral joint ventures

Alliances vary in scope and breadth

- Low-cost carriers have also begun to ally, with other LCCs and with network airlines
 - E.g. WestJet and Cathay Pacific codeshare
- Equity alliances
 - E.g. Etihad's equity partnerships with Air Berlin (29%), Jet Airways (24%), and others

Global alliances

- US Airways' exit from the Star alliance, following its merger with American in 2013, shifted the balance between the three global alliances.



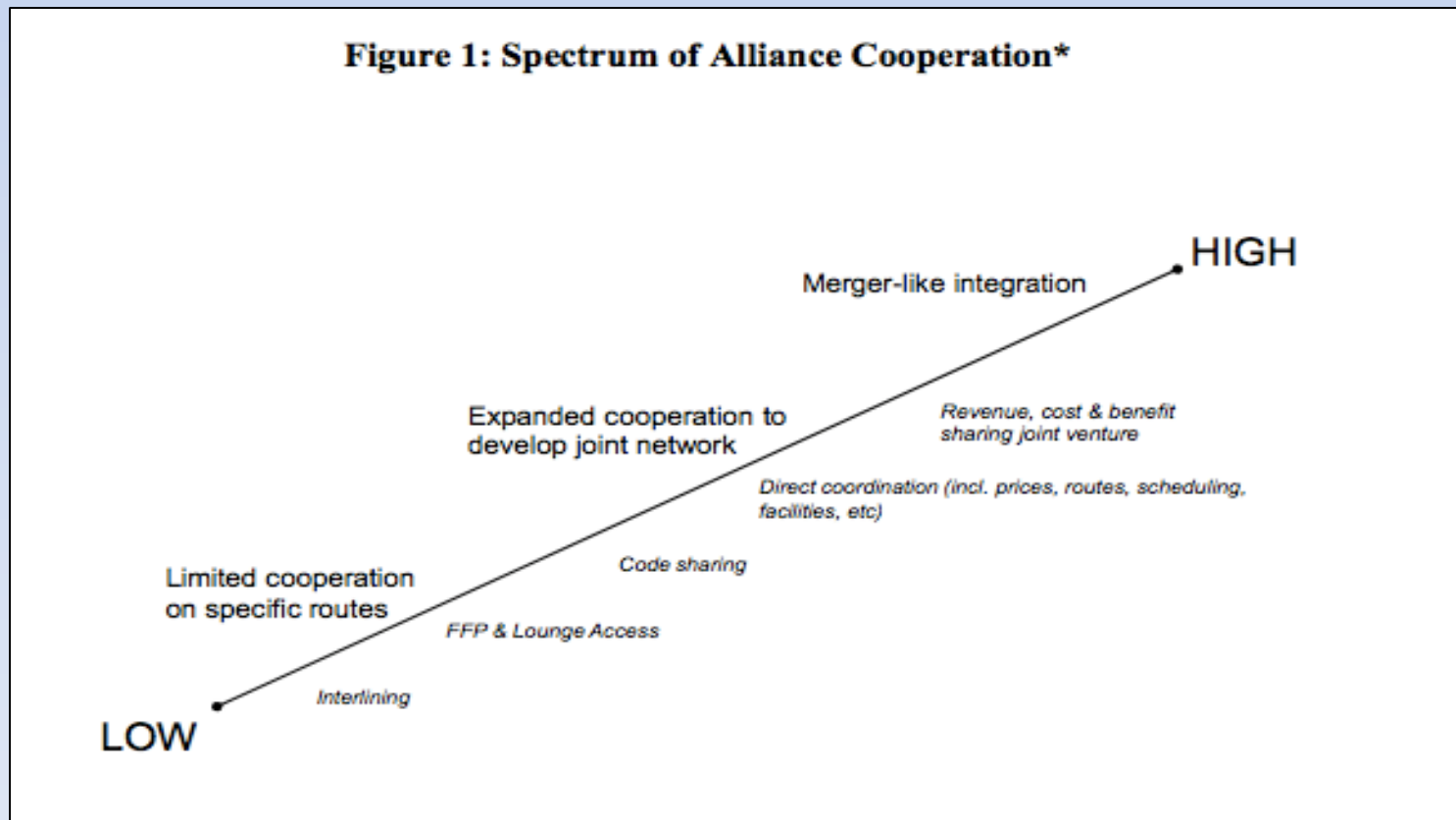
*Source: US Airways' presentation to
Bank of America Global Transportation Conference, May 2013*

Legal and Economic Reasons



Definition

- An alliance is a horizontal cooperation arrangement between airlines that is not a merger.



Source: A Report by the EC and US DOT , November 2010

Legal reasons

- International airlines are subject to a complex web of government regulation. Cross-border airline mergers are uneasy due to:
 - Controls on foreign investment
 - Provisions of bilateral agreements that may prevent the merged carrier from operating international service
 - but permit codesharing or other types of alliance cooperation



Economic reasons

- Airlines benefit from economies of scope, scale and density
 - bigger networks are better (higher revenues and potentially lower costs)
- Broader “virtual networks” can be built with little capital and much less risk compared to operating your own aircraft

Commercial reasons

- Global distribution systems (Amadeus, Travelport and Sabre)
 - Electronic platforms where much air travel is sold
 - Display parameters favor online connections, placing such flights at the top of the screen
- Perceived attractiveness of these “codeshare” connections enabled by alliances

Commercial reasons



- Airline alliances are also a response to intensifying competition
 - Competition for high-value passengers has intensified in recent years
 - Opportunities to sell services and expertise to other airlines
 - For example, American Airlines provides ground-handling services to Iberia at New York and Chicago

Antitrust Law and Enforcement

Antitrust regimes

- Antitrust law enforcement in application to airline alliances varies from jurisdiction to jurisdiction; alliances may be addressed under:
 - Merger control provisions of antitrust laws
 - Immunity regime
 - Cartel provisions of antitrust laws
 - Civil provisions of antitrust laws

Antitrust regimes in select jurisdictions

Australia	<p>Merger: Merger control if alliance involves acquisition of shares or assets (no control test).</p> <p>Immunity: If alliance is restrictive, application for authorisation (antitrust immunity) to the ACCC.</p> <p>Cartel: Residuary <i>ex post</i> enforcement under cartel rules.</p>
Canada	<p>Merger: Merger control if caught under broad merger definition (significant interest).</p> <p>Cartel: Otherwise subject to scrutiny under ‘agreements between competitors’ with no specific exemption mechanism.</p>
European Union, Iceland, Norway, Switzerland¹⁵⁶	<p>Merger: Merger control only if alliance is a full-function JV (control test).</p> <p>Cartel/self-assessment: Self-assessment under cartel law and horizontal guidelines, and <i>ex post</i> enforcement if restrictive agreement.</p>
Turkey	<p>Merger: Merger control if alliance is full-function joint venture (control test).</p> <p>Exemption: Possible application to the Competition Authority for individual exemption.</p> <p>Cartel: Absent exemption, <i>ex post</i> enforcement under restrictive agreements.</p>
United States	<p>Merger: Merger control if alliance is long-lasting JV between competitors (no control test; exempted if ‘investment only’).</p> <p>Immunity: Antitrust immunity regime: upon voluntary application - assessment and grant by Department of Transportation.</p> <p>Cartel: Absent merger immunity, <i>ex post</i> enforcement under cartel law and horizontal guidelines.</p>

U.S. antitrust regime for international airline alliances

- The U.S. DOT has the statutory authority to review intl alliances and grant immunity
- Under U.S. law, an alliance will be approved if it is in the public interest. Even if competition is reduced, alliances may be allowed if:
 - “1) the agreements are necessary to meet a serious transportation need or achieve important public benefits, and
 - 2) if that need or those benefits cannot be met or achieved by reasonably available alternatives that are materially less anticompetitive.”

EU antitrust regime for international airline alliances

- The DG for Competition of the European Commission is responsible for reviewing alliances
 - On 1 May 2004, the EC obtained explicit jurisdiction to investigate the provision of air transport services between the EU and third countries.
 - National competition authorities have a joint responsibility to enforce Article 101 TFEU.

EU antitrust regime for international airline alliances

- Article 101(1) TFEU
 - “prohibits all agreements between undertakings and concerted practices which may affect trade between Member States and which prevent, restrict or distort competition within the internal market.”

Antitrust Issues

Purported benefits for airlines

- Airlines enter into alliances because of
 - greater economies of scale, scope, and density
 - reduced costs as a result of consolidating redundant operations
 - higher revenue as a result of enhanced competitive position wherever possible as markets are liberalized
 - nationality rules (which prohibit multinational ownership) and cabotage (which prohibits foreign carriers from flying domestic traffic).

Purported benefits for consumers

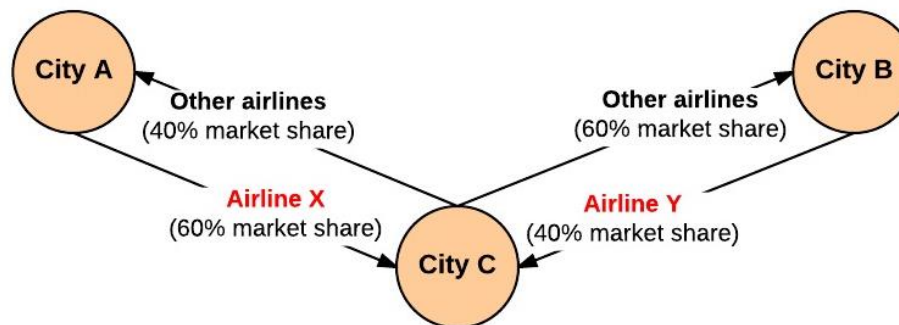
- Passengers may benefit from better access to larger networks
 - Seamless connections
 - Less time between connecting flights
 - Quicker access to gates
 - Combined loyalty programs
 - Ability to collect/redeem points on partner airlines
 - Reciprocal lounge access

Network overlap

Overlapping Networks



Complimentary Networks



Problematic alliances

- Competition concerns are more likely to arise when alliance partners
 - have overlapping networks
 - coordinate on sensitive parameters
 - price, capacity, schedules and route decisions
 - pool revenues, costs and profits
- And when barriers to entry/expansion by competing airlines are high
 - Limited infrastructure access (slots, gates, feeder traffic)
 - Dominant position of allied airlines (hub airports, FFPs)

Remedies

- Remedies in the case of airline alliances resemble merger remedies
 - Slot and gate divestitures
 - Obligation to codeshare, enter into interline agreements or provide access to feeder traffic
 - Carve outs (specific to alliances)
 - E.g. United States and Canada
 - Typically apply to hub-to-hub non-stop routes where carriers exercise significant market power post-alliance
- Airlines argue that remedies reduce efficiencies and cost savings that would result from an alliance

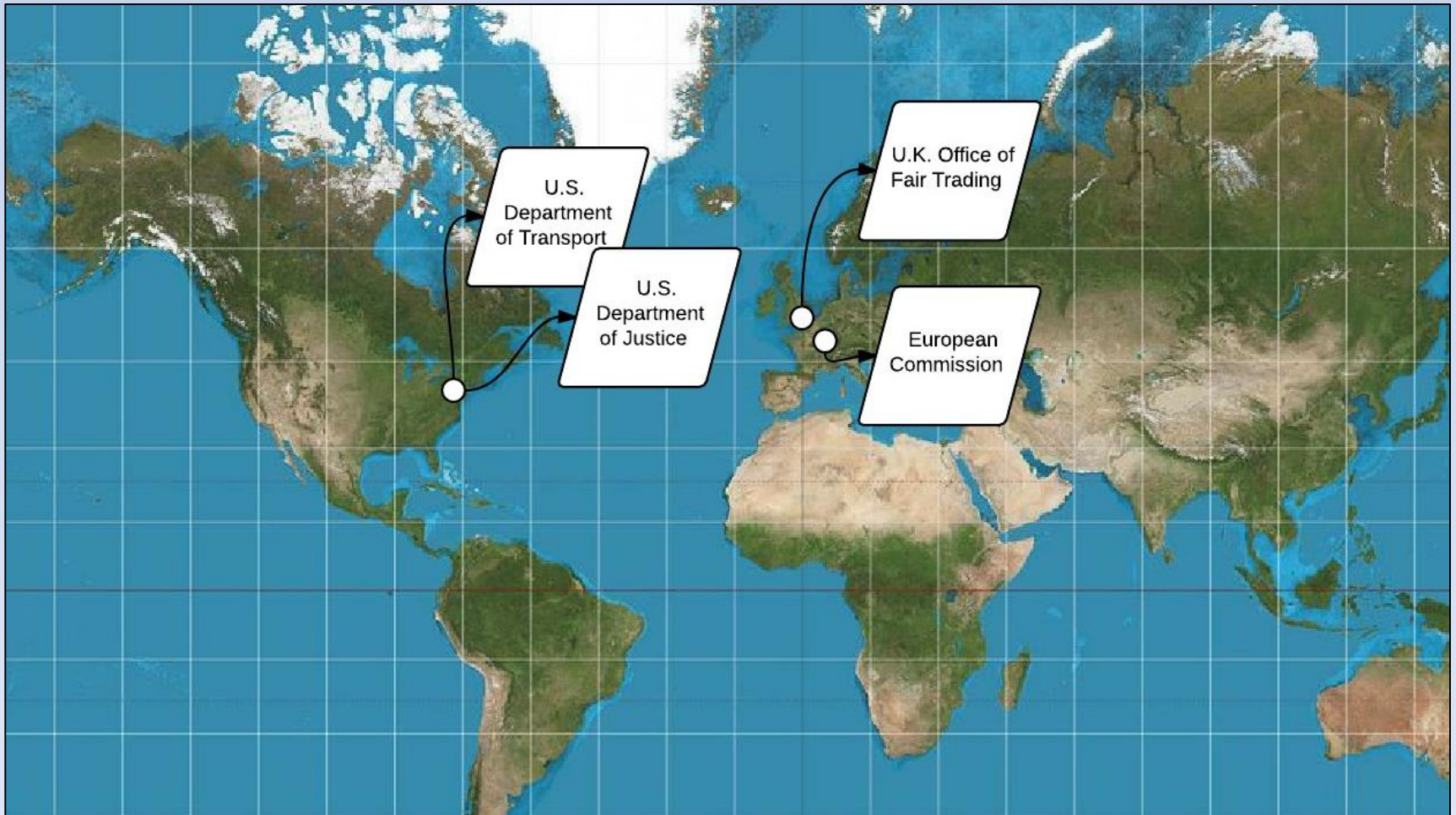
The BA / AA Case Study

First attempt

- AA/BA attempted an alliance in 1996
 - Joint venture following KLM-Northwest, UA-LH-SAS, Delta-Sabena-Swissair-Austrian
 - Code share agreement
 - Integration beyond code share
- Regulatory environment
 - Restrictive US-UK bilateral ASA
 - London's Heathrow was slot constraint



Which agencies have jurisdiction?



Outcome

- The 1997 immunity request was based on anticipation of liberalization of the Bermuda II Treaty between the U.S. and the U.K.
 - US DOJ concluded that there were significant competition concern, in particular on 6 U.S.-U.K non-stop routes
 - US DOT dismissed application when it became clear that liberalization was unlikely

Second attempt

- In 2001, AA/BA filed for ATI again
- Regulatory analysis diverged in a number of respects
 - Relevant market definition
 - Non-stop city pairs
 - Level of competition on those city pairs
 - Disagreement with respect to non-stop and connecting service being separate markets
 - Efficiencies
 - US DOJ and EC agreed that efficiencies would not offset harm to consumers

Remedies

- Regulatory agencies on both sides of the Atlantic requested remedies to ease entry on problematic routes
 - EC: divestiture of slots without compensation + other remedies
 - UK OFT: divestiture of slots + access to FFP
 - US DOJ: divestiture of slots + carve out hub-hub markets
 - US DOT: open skies agreement + divestiture of slots (224 weekly slots at Heathrow!) + carve out (Chicago-London and Dallas-London)

Outcome

- Rod Eddington (BA CEO) and Don Carty (AA Chairman and CEO):

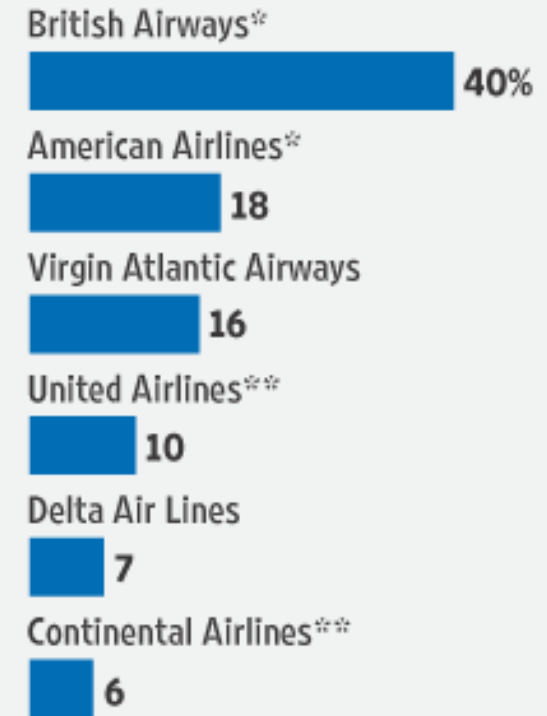
"We will not do this deal at this price. We made it clear from the start that we would not conclude the deal if the regulatory price was too high. Regrettably this has proved to be the case."

Third attempt

- More recently, AA / BA-Iberia reapplied for alliance immunity
- Approved in 2010 with conditions
 - US DOT: divestiture of 4 pairs of daily slots at LHR (versus 16 pairs in 2002), no carve outs
 - EC: divestiture of slots at LHR and JFK + competitors can sell tickets on JV flights

Competitive Skies

Market share for airlines flying between the U.S. and London's Heathrow Airport, October 2010



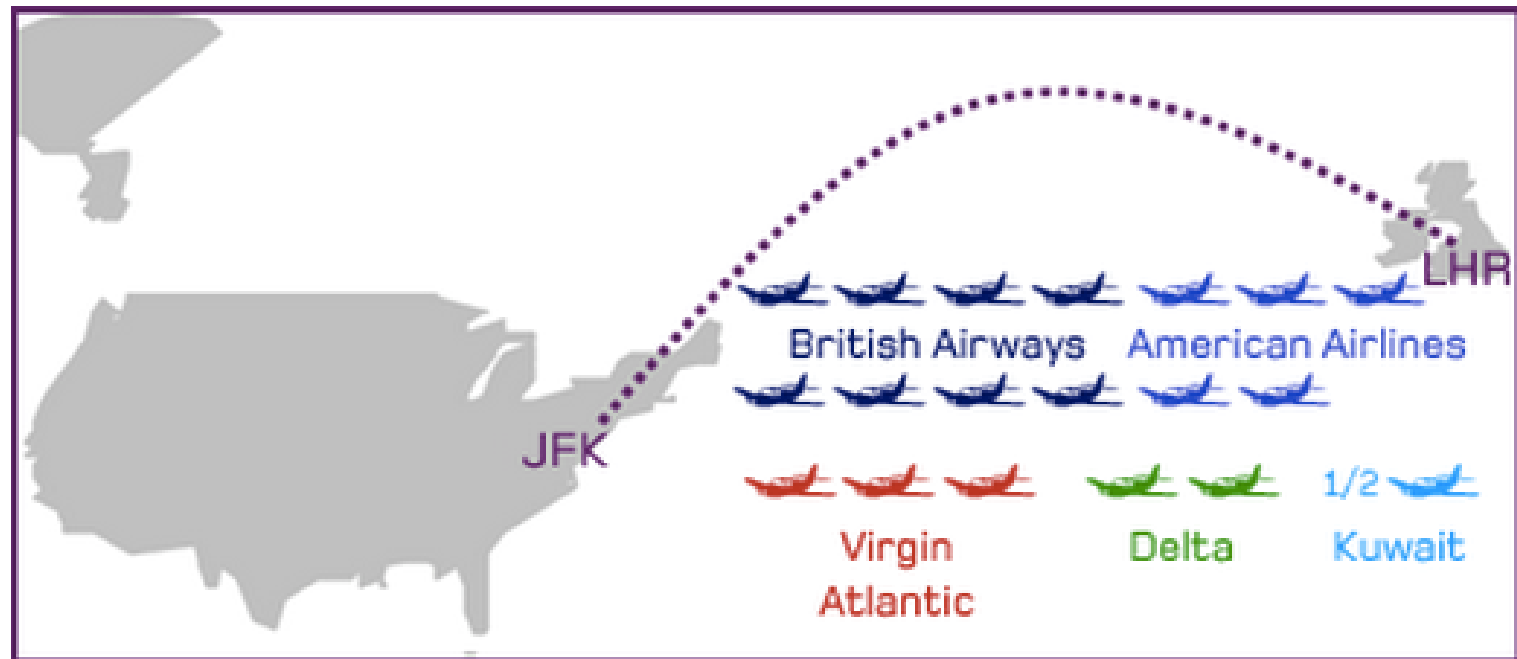
*Joint venture partners **Merged Oct. 1

Source: OAG

Not everyone is happy...

Sir Richard Branson, President of Virgin Atlantic:

"Make no mistake a BA/AA alliance third time around would still be bad for passengers, bad for competition and bad for the UK and US aviation industry".



Conclusion

- Reviews should be coordinated and joint procedural aspects should be improved between regulatory agencies
 - US DOT and EC are taking steps to coordinate their review processes
- Regulatory reviews may impose a large burden on carriers
 - Data and information requests
 - Remedies