



Why Airline Antitrust Immunity Benefits Consumers

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Any analysis of immunized airline alliances must begin by recognizing that, unlike most other global businesses, airlines are precluded by a host of laws and regulations in the United States and abroad from acquiring control of foreign airlines and from carrying domestic traffic in other countries.³ These barriers to investment and market entry effectively preclude any single carrier from building a global network using its own network resources and aircraft and thus pose a particular problem for the airline industry, which has become an increasingly network-based business since deregulation. As a result, the only way a U.S. airline can provide convenient connections, common service standards, lounge access, and frequent flyer credits for its customers traveling internationally to points that the U.S. carrier cannot itself serve is by forming an alliance with a foreign carrier. Likewise, foreign carriers must rely on alliances with U.S. carriers to provide their customers access to routes that the foreign carrier cannot serve for legal or economic reasons.

Because these joint ventures involve cooperation between actual or potential competitors, airlines must obtain a grant of antitrust immunity (“ATI”) from the U.S. Department of Transportation (“DOT”) and foreign competition authorities before implementing their alliance. In reviewing requests for antitrust immunity, DOT applies the antitrust standards that would be applied to a proposed merger between the carriers seeking ATI—i.e., whether the alliance would “substantially reduce or eliminate competition”—and imposes conditions (e.g., divestitures or “carve outs”) when required to cure competitive problems. If the Department concludes that the proposed alliance would not substantially reduce or eliminate competition or be otherwise adverse to the public interest, it can grant ATI if immunity is required to allow the transaction to proceed.⁴

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The views expressed in this editorial are those of the authors and do not reflect those of LECG, LCC or any other of its experts.

³ Such traffic is referred to as “cabotage” traffic.

⁴ For a thorough description of DOT’s standards for awarding antitrust immunity, see Final Order, Joint Application of Air Canada, The Austrian Group, British Midland Airways Ltd, Continental Airlines, Inc., Deutsche

In evaluating immunized alliances, the U.S. DOT has recognized these fundamental characteristics of international aviation. Thus, DOT observed that "...[N]o airline, however strong, is able to efficiently provide service with its own aircraft and crew to every destination its customers require. Using the transatlantic market as an example, there are several hundred cities in the U.S. and also in Europe that will never have the benefit of nonstop service. [Alliances] are the only practical way to provide better service to thousands of passengers in long distance, low-density international markets."⁵ The same DOT analysis concluded that "Multinational alliances have fueled enormous increases in connecting traffic," that "...newly stimulated traffic accounts for a large proportion of alliance growth" and that "... traffic growth substantially increased after the airlines began fully implementing the alliances after receiving immunity."⁶

In addition, virtually every peer-reviewed academic study of immunized international airline alliances has concluded that, as a result of eliminating carriers' incentives to impose successive mark-ups on fares for connecting tickets (the so called "double marginalization" problem), alliances have led to lower fares and expanded output. For example, a 2003 study by Professor Jan Brueckner of the University of California-Irvine found that a codesharing alliance without ATI results in fares that are 8-17 percent lower than interline tickets, but that codesharing plus immunity results in fares that are 17-30 percent lower than interline tickets.⁷ And a more recent study by a U.S. Department of Justice economist found that while non-immunized alliances were associated with a 29-41 percent increase in capacity, immunized alliances were associated with capacity increases of 51-77 percent.⁸ Hence, notwithstanding a 250 percent increase in the inflation-adjusted price of jet fuel since the formation of the signing of the first antitrust immune alliance (Northwest-KLM in 1993), for example, inflation-adjusted transatlantic yields (i.e., prices per mile) have remained flat (down by 1 percent).

In light of the widely acknowledged legal and economic barriers that exist in international aviation markets and the demonstrated consumer benefits of immunized alliances, recent Congressional concerns about alliances are somewhat puzzling.⁹ On closer examination,

Lufthansa Ag, Polskie Linie Lotnicze Lot S.A., Scandinavian Airlines System, Swiss International Air Lines Ltd., Tap Air Portugal, United Air Lines, Inc. to Amend Order 2007-2-16 under 49 U.S.C. §§ 41308 and 41309 so as to Approve and Confer Antitrust Immunity, Docket OST-2008-0234, page 3. (July 10, 2009).

⁵ See U.S. Department of Transportation, Office of the Secretary, *International Aviation Developments, Global Deregulation Takes Off (First Report)*, (1999).

⁶ *Ibid.*

⁷ See Jan Brueckner, *International airfares in the age of alliances: The effects of codesharing and antitrust immunity*, 85 R. ECON. & STAT, 105-118 (2003).

⁸ See W. Tom Whalen, *A panel data analysis of code-sharing, antitrust immunity, and open skies treaties in international aviation markets*, 30 R. INDUS. ORG., 39-61 (2007).

⁹ For example, House Transportation and Infrastructure Committee Chairman James L. Oberstar (Minn.) introduced a bill in the U.S. Congress that would sunset all existing antitrust immunity grants made by the U.S. Department of Transportation, thereby threatening to unravel the network of international airline alliances that has developed over the past decade. In introducing the bill, Congressman Oberstar asserted that he had "become increasingly concerned with the decline of competition in international markets, particularly between the United States and Europe. These markets used to be served by independent carriers from most European countries, and by a number of U.S. carriers. Increasingly, the market has come under control of three alliances composed of one or more

such concerns appear to be based on a misreading of changes in the nature of transatlantic air service that critics mischaracterize as reductions in competition on routes between the United States and Europe.

The New York-Paris route, for example, was recently cited as a market that had experienced a decline in competition.¹⁰ But in 1990, the New York(JFK/EWR)-Paris route was served on a daily basis by five carriers, while two other carriers (e.g., Egyptair, Pakistan International) offered 2 flights per week. The U.S. carriers serving the route in 1990 included American, which is still serving the market, Pan Am, which dropped out of this market after it went bankrupt in the early 1990s — well before the first transatlantic alliance agreement had even been signed—and TWA, which, after multiple trips through Chapter 11 bankruptcy was acquired by American Airlines in 2001.

Of the carriers still serving the route, Air France has increased its flights from 4 per day to 6 per day, while American has increased its service from 1 to 2 flights per day; and Continental increased from 1 daily round trip in 1990 to 3 per day in 2009.¹¹ In addition, a new entrant carrier, Openskies, now operates 2 flights per day on the route, up from none in 1990. Thus, there are a total of five airlines serving the NYC-Paris route in July 2009—the same number that served the route in 1990—and they operate more daily flights than were offered in 1990. This makes it difficult to credibly argue that consumers were better off in 1990 compared to 2009, particularly since the six daily frequencies operated by SkyTeam partners Delta/Air France offer are spread throughout the day and provide travelers with more convenient schedule options as well as better connections on both ends of the route.

A second concern of ATI critics is illustrated by a 2005 study of immunized alliances conducted by the Brattle Group,¹² which pointed to a reduction in American Airlines' connections with Air France following the grant of antitrust immunity for Delta Air Lines and Air France and concluded that "there is evidence that immunized alliances have undertaken actions that raise their rivals' costs of interlining at certain alliance-dominated hubs." But as we demonstrated in 2005,¹³ American had already begun to reduce interline connections with Air France at Paris' Charles De Gaulle airport ("CDG")—and had also begun to increase significantly the number of European connections made on its own oneworld alliance—well before the alleged actions by Air France had begun.

Thus, while American's interline connections with Air France at CDG fell by 13,760 passengers during the Brattle Group study's period, American's interline connections with its

U.S. carriers and several European carriers." See Oberstar introduces airline antitrust bill, Congressional Press Release, (February 4, 2009).

¹⁰ *Ibid.*

¹¹ Prior to the onset of the current economic crisis, Air France offered six daily flights between JFK and Paris, but temporarily scaled back flights in response to lower demand.

¹² Report of James D. Reitzes, Dorothy Robyn, & Kevin Neels (The Brattle Group), Docket No. OST-2004-19214, (June 24, 2005).

¹³ See Declaration of Daniel M. Kasper & Darin Lee in the U.S. Department of Transportation Docket No. OST-2004-19214, July 2005, available at http://www.lecaviation.com/thought_leadership/Kasper%20Lee%20SkyTeam.pdf.

European alliance partners increased by nearly seven times that amount (i.e., nearly 95,000) over that same period—which is precisely what American’s alliance with those carriers was intended to accomplish. In short, the far more plausible (and pro-competitive) explanation for the change in interline connections is that American chose to shift its connecting passengers to its alliance partners.

Based on the empirical evidence, it seems clear that global airline alliances and antitrust immunity have produced to date enormous benefits for consumers, both in terms of lower fares and more convenient, integrated service. Revoking the antitrust immunity, which was granted after thorough reviews by competent competition authorities in both the United States and European Union, could thus be expected to have adverse and far reaching implications for the quality, convenience, and price of international air services.