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Final Descent? The Future of Antitrust Immunity in International Aviation

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It is no secret that the Department of Justice (“DOJ”) and the Department of Transportation (“DOT”) traditionally have not seen eye to eye on the issue of antitrust immunity in international aviation. This year is no different. Indeed, 2009 has brought arguably the widest rift between the agencies since the modern era of immunity grants began following the conclusion of the U.S.-Netherlands Open Skies agreement in 1992. The lightning rod of course was Continental Airlines’ bid to join the Star Alliance, including its request to team with United in the so-called Atlantic Plus-Plus (“A++”) joint venture—an integrated and (now) immunized agreement involving Air Canada, Continental, Lufthansa, and United.

The A++ agreement not only elevated the serious disagreements between DOJ and DOT on whether, and in what circumstances, air carriers should be immune from the antitrust laws, but it saw the rise of significant Congressional opposition to the mere concept of antitrust immunity, with a key Member of Congress proposing legislation to phase out current grants of antitrust immunity. Meanwhile, carriers remain caught in the middle of the agency positions, arguing on the one hand that competing carriers’ immunity requests should be limited or denied, but not so forcefully as to jeopardize their own calls for immunity. Given DOJ’s and DOT’s deep-seated and very public differences of opinion over antitrust immunity, as well as Congress’s readiness to jump into the fray, antitrust immunity in international aviation finds itself at a crossroads.

There can be little doubt that DOT’s policy objective of using antitrust immunity as a tool to achieve Open Skies agreements and unlock aviation markets around the world has been a success. Open Skies agreements, if not the norm in today’s international aviation marketplace, are no longer curious outliers. DOT’s policy certainly has facilitated this transition. But has antitrust immunity as a central component of U.S. policy in international aviation run its course, particularly in light of the well-known potential costs of a structure that approves of coordination among competitors? Does antitrust immunity on the whole still have the potential to improve service and generate benefits for U.S. consumers?

To analyze these questions, this article proceeds by first outlining the statutory standards under which DOT must consider both international aviation alliances and requests for antitrust immunity. The next section provides a broader context to the debate over antitrust

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immunity, discussing current efforts in Congress to limit it. We then discuss the recently concluded Star Alliance immunity proceeding. Finally, the article identifies four benefits that are likely to be unique to antitrust immunity, arguing that antitrust immunity can still serve a valuable role in the international aviation landscape, but acknowledging that immunity must be used as a tool with great care.

I. STATUTORY STANDARDS

Though enforcement of the antitrust laws in the aviation industry typically resides with DOJ, Congress has created a departure from traditional processes by giving DOT authority under certain circumstances to grant antitrust immunity in international aviation. DOT's analysis of international aviation agreements proceeds in two steps. Under 49 U.S.C. 41309(b), DOT first must determine whether foreign air transportation agreements are adverse to the public interest because they would substantially reduce or eliminate competition. If so, DOT may approve the agreement only if the agreement is "necessary to meet a serious transportation need or to achieve important public benefits (including international comity and foreign policy considerations); and the transportation need cannot be met or those benefits cannot be achieved by reasonably available alternatives that are materially less anticompetitive."

If DOT approves an agreement under the analysis outlined above, it then has the authority under 49 U.S.C. § 41308(b) to exempt airlines from the antitrust laws, but only if the public interest *requires* it—a standard higher than the "not adverse to" standard in section 41309(b).² Thus, if carriers seek antitrust immunity, which gives them the ability collectively to set fares and schedules in particular markets free from antitrust scrutiny, the carriers must file with DOT, and DOT must evaluate the application under a more rigorous standard. It is for this reason that DOJ has stated that "exemptions from the antitrust laws should be strongly disfavored."³

II. CONGRESS CHIMES IN

As noted above, one important change in the antitrust immunity debate in 2009 from years past is the activity within Congress to pass legislation to curtail antitrust immunity. Leading the charge has been Congressman James Oberstar, the Chairman of the House Transportation and Infrastructure Committee. On February 3, 2009, Congressman Oberstar introduced a bill in Congress directing the Comptroller General of the United States (the director of the Government Accountability Office) to conduct a study concerning antitrust exemptions in international aviation, including, among other things, whether granting immunity in connection with international airline alliance agreements has resulted in public benefits and whether antitrust immunity has resulted in reduced competition, increased prices in markets, or other adverse effects.⁴

² 49 U.S.C. § 41308(b) (2009).

³ Star Alliance, OST-2008-0234, Comments of the Department of Justice on the Show Cause Order (June 26, 2009) at 1.

⁴ H.R. 831 111th Congress at § (b) (2009).

More importantly, the bill calls for sunsets of antitrust immunity—specifically that each immunity grant would cease to be effective three years after it was granted and require the DOT to reauthorize the immunity at that time.⁵ Though this bill has not received a vote at either the subcommittee or committee level, Congressman Oberstar did ultimately succeed in inserting these exact provisions introducing a sunset on antitrust immunity into the FAA Reauthorization bill that passed the House on May 21, 2009.⁶ No companion measure has yet passed the Senate, and it appears as though the Senate version of the FAA Reauthorization bill does not contain an antitrust immunity review provision as does the House version.⁷

Congressman Oberstar justifies his rationale for imposing a sunset and review on antitrust immunity because he believes that antitrust immunity is serving as a proxy for mergers. He argues that because of antitrust immunity, the transatlantic market is now served by only three carriers, in the form of alliances, rather than by a larger number of competitors. But Congressman Oberstar's views are not universal in Congress. The Chairman and Ranking Member of the Senate Commerce, Science, and Transportation Committee, Senators Jay Rockefeller and Kay Bailey Hutchinson, have urged DOT not to reverse course in its policy of analyzing and granting immunity applications because “[u]nexpected changes in policy could trigger unanticipated reactions that may adversely affect the current competitive market.”⁸

III. A STAR IN TWO DIFFERENT LIGHTS

Nowhere are the diverging views on antitrust immunity more apparent than in the DOT's recent grant of immunity allowing Continental to join a group of nine Star Alliance carriers operating transatlantic routes. In its competitive analysis pursuant to 41 U.S.C. 41309, DOT analyzed markets by region (*i.e.*, the U.S.-E.U. market), by country-pair (*e.g.*, U.S.-Germany, U.S.-Switzerland, etc.), and by city-pair (*e.g.*, New York-Zurich, Washington-Frankfurt, etc.). DOT also analyzed potential impacts on domestic competition and the competitive dynamics of east-coast U.S. gateways. In its Show Cause Order in the matter on April 7, 2009, DOT found that the new alliance's market share in the U.S-Europe market would be 31.7 percent versus 23.2 percent in the previous Star Alliance framework that did not include Continental.⁹

On a country-pair level, DOT was swayed by the fact that Star would become a more competitive choice vis-à-vis competing alliances in five of the top ten country-pair markets: France, Ireland, Italy, the Netherlands, and Spain. Thus, DOT believed that the grant of immunity would serve to increase inter-alliance competition.¹⁰ Finally, with respect to city-pair markets, DOT noted that the proposed alliance does not include any nonstop overlaps in

⁵ *Id.* at § (e).

⁶ H.R. 915 111th Congress at § 426 (2009).

⁷ S.1451 111th Congress (2009).

⁸ Press Release, Rockefeller and Hutchinson Press DOT on Antitrust Immunity Cases (July 17, 2009).

⁹ Star Alliance, OST-2008-0234, Order to Show Cause 2009-4-5 at 7-8 (2009).

¹⁰ *Id.* at 9.

international markets between Continental and United, but that there are fourteen city-pair markets in which Continental would overlap with another immunized carrier in Star Alliance.¹¹

In past cases, one way DOT has addressed competition on the city-pair level is through the use of carve-outs, by which carriers would be immunized with respect to pricing and coordination activities on all except specific city-pair routes.¹² DOT did so again in this proceeding. In its initial Show Cause Order, DOT removed existing carve outs on the Chicago/Washington-Frankfurt markets subject to the carriers' fully implementing their proposed joint venture agreement within 18 months. DOT's rationale in not imposing any transatlantic carve outs in the Show Cause Order was that doing so would prevent the carriers from realizing efficiencies arising from cost savings in "sales, marketing, and distribution, as well as reductions in operating and fixed costs from incremental traffic flows, higher load factors, common pricing, joint scheduling and route planning, and harmonization of information technology systems."¹³ On the basis of its analysis under each market definition, DOT concluded that it should grant antitrust immunity to the applicants.¹⁴

In response to the DOT's tentative Show Cause Order, DOJ reached the conclusion that DOT should not grant immunity. Central to its analysis was the fact that DOJ views nonstop service as a separate product market.¹⁵ Given that conclusion, DOJ went on to analyze market shares on nonstop overlap routes, particularly ex-New York City airports. DOJ concluded that DOT granting immunity would reduce competition by increasing the market share of the new immunized Star Alliance and that, as a result, fares would increase. Specifically, DOJ stated that research showed that fares paid by nonstop passengers would increase 15 percent in 2:1 markets and 6.6 percent in 3:2 markets.¹⁶ DOJ expressed similar concerns on transborder routes between the United States and Canada in which Continental and Air Canada would have significant overlaps.

DOJ also raised concerns about spillover from the immunity grant having potential adverse effects on competition in the domestic market; that is, that the carriers' ability to share information and coordinate prices and schedules in transborder and transatlantic markets would carryover implicitly into the domestic U.S. market in which the carriers are not immunized. Similarly, DOJ contended that the immunity grant will lessen competition on non-immunized international routes, particularly in the U.S.-China market. Finally, DOJ argued that: 1) the litigation risks that the carriers cite do not constitute a compelling reason to grant immunity, 2) carriers and DOT inflate the importance of inter-alliance competition, and 3) immunity will not advance open skies because the U.S.-E.U. Open Skies agreement has already been executed and is very unlikely to be withdrawn.

¹¹ *Id.* at 10.

¹² *See e.g.*, Delta-Austrian-Sabena-Swissair, OST-1995-618, Final Order 96-6-33 (1996); United-Lufthansa, OST-1996-1116, Final Order 96-5-27 (1996).

¹³ Show Cause Order, *supra* note 9 at 12.

¹⁴ *Id.* at 18.

¹⁵ Star Alliance, OST-2008-0234, Comments of the Department of Justice on the Show Cause Order (June 26, 2009) at 20-21.

¹⁶ *Id.* at 25.

In its Final Order, DOT responded to DOJ's minimization of the importance of litigation risk by noting that DOJ has refused to legitimate activities taken in furtherance of a lawful airline alliance by guaranteeing that DOJ would not challenge the activities.¹⁷ Likewise, DOT noted that changing its approach to antitrust immunity would reduce the credibility of the U.S. government in negotiating future open skies agreements – “[w]ere we to suddenly change our antitrust immunity and public interest approach, as DOJ suggests, the credibility of the U.S. Government with its international aviation partners would be significantly compromised and our ability not only to reach new Open-Skies agreements but also to maintain those agreements that we have already achieved would be undermined.”¹⁸

DOT also dismissed DOJ's concerns about domestic spillover, noting that it addressed the issue in its grant of immunity to Skyteam in 2008 and was convinced proper safeguards could be implemented to prevent such spillover.¹⁹ Furthermore, DOT stressed the importance of inter-alliance competition, noting “immunized alliance members can jointly utilize their combined resources at airports that serve as hubs for other alliances, thereby increasing the ability of one alliance to compete at the hub airports of another alliance.”²⁰

Ultimately, DOT retained many of the provisions of its Show Cause Order, but did make some significant changes, particularly with respect to carve outs.²¹ Where the Show Cause Order prescribed two carve outs that would remain (Chicago/San Francisco-Toronto) and two that would expire when the parties completed formation of their full joint venture within 18 months (Chicago/Washington-Frankfurt), the Final Order displayed sensitivity towards DOJ's concerns in particular markets. The list of carve outs in the Final Order includes: New York-Copenhagen, New York-Geneva, New York-Lisbon, New York-Stockholm, Cleveland-Toronto, Houston-Calgary, Houston-Toronto, New York-Ottawa, and any U.S.-Beijing operations. In the New York transatlantic market, DOT will grant immunity in the carved out market if a new entrant enters the market with a minimum of five weekly roundtrips for nine consecutive months. The DOT imposed the same condition on the U.S.-Canada transborder carve outs and the U.S.-Beijing carve out as well.

This seeming retreat by DOT evinces two principles. First, though not acknowledging that nonstop service constitutes a separate market,²² DOT was persuaded by DOJ that adverse effects may befall customers if immunity is granted in markets in which both carriers serving a city-pair with nonstop service are granted immunity (two-to-one markets). Second, DOT implicitly recognized the uniqueness of the Chinese market because even though multiple carriers currently have unused route rights (*e.g.*, Delta and US Airways), the United States does not have an Open Skies agreement with China, and allowing immunity for Continental and United has significant anticompetitive potential for passengers in the Beijing markets.

¹⁷ Final Order, *supra* note 3 at 12.

¹⁸ *Id.* at 11.

¹⁹ *Id.* at 17-18.

²⁰ *Id.* at 17.

²¹ *Id.* at 26-30.

²² *Id.* at 17.

IV. CHARTING THE DESTINATION

Having noted the obvious disagreement among not only the agencies but also among members of Congress, the key question remains: Has immunity ceased to be a pro-competitive tool in international aviation? While the potential adverse effects of exempting firms from the antitrust laws are not to be taken lightly, and further econometric analysis using recent fare data will certainly assist in answering this question, there appear to be at least four potential benefits that continue to arise from grants of antitrust immunity over and above what would be available from traditional alliance agreements that include basic codesharing and more limited cooperation.

First, because the United States still lacks an Open Skies agreement with many important commercial partners (*e.g.*, Japan, China, and Brazil), antitrust immunity still retains an important role as an incentive to persuade foreign governments to conclude Open Skies agreements with the United States.

Second, antitrust immunity allows for the elimination of double-marginalization negative pricing externalities that occur absent immunity. As DOT notes, “[d]ouble marginalization, also called multiple mark-ups, occur when two airlines have basic interline or codeshare arrangements to handle multiple segments but are unwilling to cooperatively price the combined itinerary for the consumer. . . . However, in a “metal-neutral” sales environment, with revenue- or benefit-sharing, the airlines can balance risks and benefits for the benefit of the consumer and alliance as a whole. The airlines are willing to cooperatively price itineraries because they share the same incentive to make the sale and share the revenues.”²³ Predictably, though some reduction in negative double marginalization externalities may possibly be achieved through codesharing, full antitrust immunity ensures its elimination as it makes carriers truly indifferent between carrying a passenger itself versus a partner.

Third, antitrust immunity has been shown to incentivize carriers to enter markets they would otherwise not enter or to cooperate to serve routes on which they would not cooperate absent immunity. There is significant economic evidence that the grant of antitrust immunity “increases carriers’ economic incentives to codeshare on a broader basis.”²⁴ Put simply, when carriers can agree on markets to serve and prices to charge, the carriers will face lower costs of traffic diversion. This, in turn, aligns their interests to codeshare to a greater number of destinations. Codesharing agreements in the absence of immunity are often negotiated on a specific city-pair basis. In contrast, with immunity, carriers have a much broader universe of possible destinations to which they can effectively codeshare.

Finally, antitrust immunity has brought greater stability to the industry than was present prior to its broader implementation. This is not to say that carriers do not exit alliances

²³ *Id.* at 12 n. 48.

²⁴ Skyteam II, OST-2007-28644, Joint Application for Approval of and Antitrust Immunity for Alliance Agreements (June 28, 2007) at 35.

and immunized relationships do not terminate. While airline cooperation agreements are naturally fragile, agreements among non-immunized carriers are particularly so. For example, British Airways' first alliance with a U.S. carrier was with United in the 1980s. It then invested a significant sum in US Airways in the 1990s, possessed a cooperation agreement with America West until America West's purchase of US Airways, and has partnered with American in the Oneworld alliance since February 1999. Immunity fosters trust between carriers, which then enables the carriers to jointly cooperate and deliver the cost, distribution, and demand-side efficiencies that DOT cited in its decision to grant the Star Alliance immunity. Furthermore, as noted by the applicants and DOT in the Star Alliance case, even though certain activities may be legal under the antitrust laws, carriers may affirmatively elect not to undertake these activities for risk of toeing the line of the antitrust laws (*e.g.*, joint purchasing).

V. CONCLUSION

Antitrust immunity in international aviation remains as contentious a topic today as it was at the conclusion of the United States' first Open Skies agreement with the Netherlands in 1992. DOJ and DOT continue to take very different positions on the issues, and certain members of Congress seem intent on legislating changes. But even after nearly two decades of an international aviation policy that successfully has opened numerous markets, many important markets remain restricted. Indeed, with the U.S. government seeking Open Skies agreements with many nations that remain restricted, such as Japan and Israel, antitrust immunity remains a meaningful bargaining chip for U.S. negotiators.²⁵ Moreover, as noted, antitrust immunity can have important benefits beyond those that can be achieved through non-immunized alliance agreements and basic codesharing. Since the grant of antitrust immunity, for example, Continental has already announced additions of new service and resumptions of former service to link with its new partners (*e.g.*, Houston-Edmonton, Houston/Cleveland-Washington Dulles), creating the very service and consumer benefits advocates associate with immunity.

²⁵ John Byerly, *The Sky's the Limit*, http://blogs.state.gov/index.php/entries/aviation_negotiations/ (Aug. 26, 2009 16:30 EDT).