Global Alliance Strategy

Post deregulation, the legacy carrier business model on both sides of the Atlantic is predicated on a “from anywhere to everywhere” consumer proposition. However, no airline is able to efficiently serve every destination its customers require with its own aircraft. Additionally, few city-pairs can generate sufficient demand on a daily basis to sustain non-stop service. To meet the demands of customers, carriers must seek commercial partners that can help them provide greater network coverage and increase service options.

Legacy carriers on both sides of the Atlantic now face substantial and growing competition from LCCs on short- and medium-haul routes. Legacy carriers are increasingly dependent on revenues from long-haul international services to sustain the viability of their networks. Legacy carriers have two main challenges: expanding their global networks, and making their overall costs more competitive with the growing LCC sector.

To address these challenges, legacy carriers continue to broaden and deepen their global network integration with alliance partners, tapping traffic flows that are not yet subject to LCC competition. The advent of significant LCC competition on transatlantic routes would put further pressure on legacy carrier business models and place more importance on the network as a comparative advantage.

Airlines enter into cooperative arrangements for a variety of reasons, and the details of those arrangements vary widely depending upon the markets in which, and the partners with whom they cooperate. While there are no definitive categories or labels, cooperation can be generally characterised as taking the form of either a “tactical” or a “strategic” alliance.

Carriers may form tactical alliances to address a specific deficiency in their networks. Tactical alliance agreements typically involve only two carriers and cover a limited number of routes, with the principal objective of providing connectivity to each carrier’s respective networks. Tactical alliances often involve at least one independent carrier that is not a member of a larger strategic alliance.
While tactical alliances are still rather common, many carriers providing international service increasingly prefer to join one of the three branded strategic alliances – Star Alliance, SkyTeam, or oneworld – which are also commonly referred to as the “global alliances.”

Members of the global alliances coordinate on a multilateral basis to create the largest possible worldwide joint network. The global alliance model generally applies to the entirety of member airlines’ networks and offers a much wider scope for revenue synergies. While a "basic" level of cooperation is required by members of a global alliance – generally involving standard code-share agreements, cooperation on FFP and lounge access – some alliance members seek higher levels of cooperation to enhance the benefits of the alliance.

**U.S. Antitrust Regime for International Airline Alliances**

The alliance agreements, which nearly always include a code-sharing component, are frequently accompanied by requests for relief from the antitrust laws, which otherwise might prevent the carriers from cooperating on certain aspects of their joint services, such as fares and capacity, as though they were a single airline. Major code-sharing and alliance arrangements require careful examination in terms of their impact on competition in both domestic and international markets.

Major U.S. and foreign air carriers may, under 49 U.S.C §§ 41308-41309, request a grant of immunity from the U.S. antitrust laws to operate certain commercial alliances. Immunity allows these airlines to coordinate their fares, services and capacity as if they were a single carrier in these markets, subject to certain conditions.

When evaluating these applications, the Department of Transportation (DOT) normally engages in a two-step analysis of foreign air transportation agreements submitted for its approval.

- The DOT first determines under § 41309(b) whether the agreements are adverse to the public interest because they would substantially reduce or eliminate competition (the “competitive analysis”). If the DOT makes that affirmative determination, § 41309(b)(1)(A) directs it to decide whether they are nevertheless necessary to meet a serious transportation need or to achieve important public benefits; U.S. foreign policy goals are a key element of these benefits. If it makes that finding, and also finds that those public benefits cannot be met or achieved by reasonably available and materially less anticompetitive alternatives, the DOT must approve the agreements pursuant to § 41308(b). Section 41309(c)(2) provides that a party opposing approval has the burden of showing that the agreement or request would
substantially reduce or eliminate competition and that less anticompetitive alternatives are available. On the other hand, the party seeking approval of the agreement or request must establish the transportation need or public benefits.

- If, however, the DOT does not find the agreements to be adverse to the public interest, § 41309(b) directs it to approve them. In that event, the DOT next decides whether there are sufficient public benefits to grant immunity under 49 U.S.C. § 41308(b) (the “public benefits analysis”). In that subsection, Congress has given the Department the authority to exempt airlines from the antitrust laws to the extent necessary to allow a proposed transaction to proceed, provided that the exemption is required by the public interest. While the public interest determination under both §§ 41309(b) and 41308(b) entails a comparison of anti-competitive effects and public benefits, the standard in § 41308(b) (“required by” rather than “not adverse to”) is higher.

A grant of antitrust immunity is not automatically given to applicants. Moreover, an alliance which has received immunity is required to comply with the operating constraints and reporting requirements specified in the final order.

**The Commission's Assessment of Transatlantic Airline Alliances**

As the enforcer of the EU competition rules, the Commission may initiate an alliance investigation on its own initiative if there are concerns that the cooperation may infringe EU competition law or as a result of a complaint. The main EU competition rules are laid out in Articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU).

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. However, an agreement which restricts competition escapes the prohibition under Article 101(1) TFEU if it creates sufficient benefits meeting the criteria of Article 101(3) TFEU. These criteria, which are cumulative, are as follows:

(a) the agreements 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.

Article 102 TFEU prohibits the abuse of a dominant position within the internal market or a substantial part of it. Abuses are commonly divided into exclusionary abuses, which exclude competitors from the market, and exploitative abuses, where the dominant company exploits its market power by, for example, charging excessive prices. Article 102 TFEU does not contain an equivalent exception for anticompetitive agreements as set out in Article 101(3) TFEU, whereby a firm’s conduct may be deemed legal because of benefits for consumers. However, a dominant company may be able to show that its conduct, which may prima facie appear abusive, is - in light of the circumstances of the case - objectively justified and proportionate.

Prior to 1 May 2004, the Commission did not have full procedural powers in relation to agreements covering provision of air transport services to and from third countries. On 1 May 2004, there were two fundamental changes to the EU competition regime.

- The *first change* was specific to air transport, namely the Commission obtained jurisdiction as of that date to investigate air transport services between EU and third countries in accordance with the generally applicable procedural framework.

- The *second change* was of broader application, as Member State courts and national competition authorities obtained the power to apply in full Article 101 TFEU. Enforcement of the EU competition rules is now the joint responsibility of the Commission and the national competition authorities of the Member States which as of 1 May 2004 together form the European Competition Network (ECN).

**Comparison of the EU and U.S. Regimes**

There are a number of fundamental differences in the regulatory approaches on each side of the Atlantic. More specifically, the differences are manifest in four areas:

- the competition regime applicable to aviation,

- mandates of the respective competition authorities,

- tests for competition review,

- procedure.
The Competition Regime Applicable to Aviation

The most striking difference between the EU and U.S. competition regimes is in the approach taken with respect to the airline industry as opposed to other sectors of the economy in competition law terms. In the United States the approach remains one of "regulatory exception". While DOJ is responsible for enforcing the antitrust laws across all industries, including the airline industry, DOT has authority to make limited grants of ATI from those laws. Thus, airlines may seek ATI from DOT to coordinate their international operations. Because requests for ATI may raise important competitive issues, in practice DOT and DOJ work together to assess the competitive effects of international airline alliances.

In the EU, in the past, air transport services were also subject to exceptional treatment in terms of competition law with multiple block exemptions. The more recent trend, however, has been alignment of the substantive and procedural rules for transport services with those generally applicable. There are presently no sector-specific competition rules in aviation and the same Commission department – the Directorate General for Competition – is charged with the application of EU antitrust and merger rules.

Mandates

The mandates of the Commission and DOT in the field of competition differ in two respects.

While DOT's authority is limited to the transport industry, the Commission has the authority to enforce competition rules across all industries, whether mergers, cooperative agreements, unilateral conduct or State aid is involved.

On the other hand, DOT has both specific competition powers and the authority of a general regulator and policy maker in the U.S. transport industry. In the Commission, however, these two areas of competence are split between two Commission services. While the Directorate General for Competition is charged with enforcement of EU competition rules, the Directorate General for Transport and Mobility is responsible for general transport policy.

Tests

The legal tests applied by the two authorities to their assessment of alliances are also different. The test applied by the Commission is laid out in Articles 101 and 102 TFEU. The main task of the Commission is to apply and enforce the competition rules, thereby ensuring that alliances do not produce harm to consumers.
The test applied by DOT, on the other hand, is a broader test of public interest under its statutes. DOT must consider the broader implication of any grant of ATI not only on the public but also specifically on the air transport industry. The public interest test gives DOT broader discretion in its decision making.

Procedures

An important procedural difference between the EU and U.S. systems is that, in the United States, the process of reviewing and making a decision on ATI applications occurs before alliances are implemented. Carriers are however not required to apply for ATI in any instance. As is the case with many other industries, airlines have the option of proceeding with commercial cooperation at their own risk and subject to traditional antitrust enforcement by the DOJ and other agencies. Airlines can, and often do, form alliances with varying degrees of integration absent a grant of ATI.

In the EU, after 1 May 2004 there is no possibility for carriers to notify agreements to the Commission for approval. Carriers must instead themselves conduct an assessment of whether their cooperation is in breach of EU competition rules. The Commission or a national competition authority may, however, in the exercise of their discretion, open an investigation (either ex-officio or following a complaint) both into proposed or implemented cooperation if there are sufficient indications that the cooperation may violate the EU competition rules.

Another difference is that the procedures followed by DOT involve a public record, by means of a “docket” system, which allows interested parties and the public to view evidence and application materials being considered by DOT. The Commission’s procedures, on the other hand, are not public. Parties that are subject to the Commission’s investigation have rights of defence and thus a right to access the Commission’s file.