

Clear skies

Roger Fones, partner, and Jonathan Linde, associate, at Morrison & Foerster LLP in Washington, DC, explain why airline alliance benefits are achievable without antitrust immunity

Alliances are joint ventures that enable airlines to combine their route networks, offering passengers the equivalent of single-carrier service between numerous domestic and international city pairs. Among airlines, the conventional wisdom is that immunity from US antitrust laws is crucial if alliance partners are to cooperate with each other effectively and efficiently. And, by liberally granting antitrust immunity to airline alliances over the past 14 years, the Department of Transportation has done little to alter this misconception.

But that may be changing. After conferring immunity on numerous airline alliances, in 2005 the department refused to grant the SkyTeam alliance expanded immunity for transatlantic service. This pullback of immunity by the department was not an isolated event. The International Air Transport Association has for decades enjoyed antitrust immunity for its members to meet and agree on passenger fares. Following a similar initiative in Europe, however, the department is now proposing to withdraw immunity for IATA's 'tariff conferences'.

Meanwhile, the risk of a successful antitrust challenge to an airline alliance continues to decrease as the US courts and enforcement agencies recognise that most joint ventures, even between competitors, are pro-competitive. Only last term, the Supreme Court unanimously ruled that joint marketing of gasoline by Shell and Texaco was not subject to the strict per se rule against price fixing.

ANTITRUST IMMUNITY JURISDICTION AND STANDARDS

The Federal Aviation Act requires airlines to obtain approval from the Department of Transportation before implementing alliance agreements, and also permits the department to exempt alliance agreements from US antitrust laws. The Department of Justice, which enforces the antitrust laws and generally opposes exemptions from them, advises the Department of Transportation on most immunity applications, either informally or on the record with written comments. The DoJ, however, has no decision-making authority on whether

any particular immunity request should be approved (which undoubtedly helps explain why so many of them have been granted).

The Department of Transportation may confer antitrust immunity on anti-competitive agreements if it finds that the agreement promises countervailing public benefits that cannot be achieved without immunity. In alliance cases, however, it has often concluded that a proposed alliance would be pro-competitive, but granted immunity anyway. It has explained:

"It is not our policy to confer antitrust immunity simply on the grounds that an agreement does not violate the antitrust laws. We are willing, however, to grant immunity if the parties to such an agreement would not otherwise go forward without [immunity] [...]"

The department frequently satisfied this last requirement in alliance cases by relying on the subjective representations of the applicants that they would not proceed with their pro-competitive alliance without immunity, an approach that gave the review process a certain aura of medieval 'oath-taking'.

ANTITRUST IMMUNITY AND OPEN SKIES

The Department of Transportation's original policy reasons for granting antitrust immunity to international alliances have become less compelling over time. A little history is helpful. On the heels of deregulation in 1978, US mainline and regional airlines first began entering into commercial 'codesharing' agreements. Initially, the practice was limited to mainline carriers placing their two-letter codes (eg, UA for United) on certain flights operated by their regional airline affiliates. Carriers expanded the practice to encompass 'reciprocal' codesharing where the partners share two-letter airline codes of each other on selected flights, so that each carrier appears to offer a wider array of flights and destinations.

By the early 1990s, codeshare service had evolved beyond a simple marketing gimmick to something more tangible and substantial – a better coordinated, more 'seamless' travel experience for the passenger. Nowhere was the potential for recipro-

cal codesharing – and improving the quality of air service – greater than in multi-jurisdictional foreign travel.

At the same time, the Department of Transportation was undertaking a new initiative to liberalise foreign aviation markets, beginning with Europe. In exchange for 'open skies' treaties that would permit US carriers essentially free access to foreign markets, the department would approve and immunise the increasingly lucrative reciprocal codesharing agreements between US airlines and airlines from open skies countries. In the 1995 US Statement of International Air Transportation Policy, the department said it would (i) withhold benefits from countries not willing to liberalise their aviation regimes; (ii) limit their airlines' access to the US market; and (iii) restrict their airlines' commercial relations with US airlines.

It's not surprising, then, that the first grant of antitrust immunity to an airline alliance was directly linked to the successful negotiation of the US's first open skies agreement – the 1992 US–Netherlands Memorandum of Consultations. Northwest and KLM requested immunity for their alliance shortly thereafter, and all parties expected the department to approve the application in recognition of the memorandum. In its order, the department explained that "it would be contrary to the spirit of the accord with the Netherlands" to deny the application, and that approval would "encourage other European countries to agree to liberalized aviation agreements."

The department's open skies strategy could hardly have worked better. Subsequent to the *Northwest/KLM* decision, nearly every application for antitrust immunity submitted by US and foreign airline partners has been tied to the achievement of a corresponding open skies agreement. The department was approving pro-competitive joint ventures – granting them unnecessary (and therefore virtually costless) antitrust immunity – all in exchange for open skies. As icing on the cake for the US, the department also conditioned each grant of alliance immunity upon the alliance partners withdrawing from IATA tariff conferences concerning their alliance markets.

Today, the department has achieved impressive success with open skies. The US has entered into 78 open skies agreements, which include almost every major European, Asian and Latin American trading partner. Although there are notable excep-

tions, such as Japan, China, Brazil and the UK, the mutual economic benefits of open skies have been demonstrated and widely recognised by other countries.

A CHANGE OF TONE

The Department of Transportation has started to signal a more rigorous review of alliance immunity. In the *SkyTeam* decision, which was unrelated to any new open skies agreements, it rejected SkyTeam's request for expanded immunity. In its decision, the department said "the public interest requires a strong showing that immunity is justified to achieve specific, demonstrable public benefits at the time immunity is requested," and that the applicants "failed to show that the proposed transaction will provide sufficient public benefits to warrant an extraordinary grant of antitrust immunity," explaining that "the alleged benefits of immunity are largely obtainable without antitrust immunity." Thus, the department rejected as legally insufficient an alliance's professed subjective fear of antitrust liability for pro-competitive conduct.

The same theme can be found in the department's December 2006 approval of Star Alliance's request for expanded antitrust immunity to cover new members from four countries recently entering into, or soon to enter into, open skies agreements with the US. The decision reiterates that the department will not accept subjective statements from carriers that they will not proceed without immunity "at face value". Rather, it seems to be positioning itself to require a more sophisticated and objective analysis of genuine antitrust risks. It also noted that because "the antitrust laws permit competitors to engage in joint ventures that are pro-competitive, we think it is unlikely that alliance agreements, if implemented, would be found to violate the antitrust laws." Thus, the days when oath-taking is sufficient to win immunity may be numbered.

NO DEPENDENCE ON IMMUNITY

For a number of reasons, airlines may think that this is unwelcome news. First, it is widely believed that immunised alliances can generate higher profits than non-immunised codeshare agreements. Second, some carriers may still be concerned that providing integrated, non-immunised services with other airlines will automatically expose them to liability under US antitrust laws, the application of which they believe to be not only complex, but unpredictable. A third and related concern is that non-immunised alliance operations will invite baseless, but still costly, litigation.

None of these concerns should dissuade carriers from entering bona fide alli-

ance relationships without immunity. First, although immunity may be positively correlated with alliance success and profitability, this is likely to be because of past practice and erroneous beliefs. There is no evidence that immunity causes alliances to succeed. Commercial success flows from pro-competitive network integration and managerial coordination to lower costs, improve service and increase efficiency.

Among airlines, the conventional wisdom is that antitrust immunity is crucial

Second, US antitrust laws are not nearly as unpredictable as many believe. In particular, they are well developed on matters related to acceptable joint venture activity. Indeed, the US enforcement agencies have published guidelines for joint ventures between or among competitors. According to the guidelines, agreements and conduct pursuant to legitimate joint ventures are reviewed under the rule of reason:

"If [...] however, participants in an efficiency-enhancing integration of economic activity enter into an agreement that is reasonably related to the integration and reasonably necessary to achieve its pro-competitive benefits, the Agencies analyze the agreement under the rule of reason, even if it is of a type that might otherwise be considered per se illegal."

The Supreme Court's unanimous and clearly articulated 2006 decision in *Texaco Inc v Dagher* echoed the view of the enforcement agencies – that the per se rule against price fixing does not apply to legitimate joint venture activities – and should increase the comfort level of carriers contemplating legitimate alliance relationships with other carriers. In *Dagher*, the court confirmed what most of the antitrust bar already assumed:

"When persons who would otherwise be competitors pool their capital and share the risks of loss as well as the opportunities for profit [...] such joint ventures [are] regarded as a single firm competing with other sellers in the market. As such, though [defendants']

pricing policy may be price fixing in a literal sense, it is not price fixing in the antitrust sense."

The court explained that the per se rule may apply only to competitive restraints on "nonventure activities" instead of a practice that "involves the core activity of the joint venture itself". In *Dagher*, the 'core activity' of the venture included agreeing on the price of the joint venture's product.

Make no mistake, under US law alliance members are not allowed to improve their profitability by eliminating significant competition between them (eg, by colluding to increase fares or reduce capacity in overlapping city pairs). Stated differently, carriers may not form an alliance as a mere pretext to eliminate competition.

Generally, however, existing airline alliances are precisely the sort of pro-competitive joint venture at issue in *Dagher*. Studies have repeatedly shown that airline collaboration on an end-to-end basis creates genuine value for consumers: lower fares, tighter connections and efficient baggage handling and transfer — in short, 'seamless service'. End-to-end alliances have also consistently led to increased ticket sales and revenues for the alliance carriers and their shareholders.

Even carriers with networks that overlap to a significant extent can forge alliances that focus on markets where their networks are either complementary, or, even if combined, lack substantial market power. With a little care in structuring the alliance relationship, and sensitising key employees to applicable legal constraints, non-immunised alliances should be able, at minimal risk, to reap virtually all of the benefits of immunised alliances.

Finally, the fear of private antitrust litigation, although perhaps understandable given the high stakes and treble damages concerned, is largely unwarranted. The potential revenue benefits flowing from pro-competitive carrier collaboration will normally far exceed the financial risk posed by such lawsuits. There has yet to be a consumer class action or other antitrust suit challenging a bona fide alliance or joint venture in the airline industry. Private class action litigation seeking treble damages under the antitrust laws is almost always brought in situations where the per se rule applies, because the rule relieves the plaintiffs of the substantial burden of proving anti-competitive harm occurred. In the wake of *Dagher*, which rejected per se treatment of pricing agreements between parties to a bona fide joint venture, it is even less likely that spurious lawsuits against bona fide alliances will be brought and, if brought, survive summary judgment.