International Airline Alliances:

Competition/Antitrust Law and International Air Transportation

In this article Dr. Angela Cheng-Jui Lu, explains that limitations of foreign ownership and control under bilateral air transport service agreements result in the formation of airline alliances. Airline alliances enable inter-national air carriers to co-operate efficiently and integrate service networks without merging with one another. These cross-border operations lead to conflicts over the application of the different competition and antitrust laws. Without a unified global anti-trust law the airline industry must consider regional and/or bilateral approaches governments may use to enable a fair and free competition.

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Part I: Background to the Development of Transatlantic Airline Alliances

International air transport is an industry with special characteristics. It has long been strongly affected by public interest policies and the national heritage of sovereign States. From the 1940s to the 1970s, governments chose to protect this young industry in domestic air transport markets from excessive competition while maintaining a certain level of rivalry to promote efficiency. In the international air transport market, the fixing of rates and conditions, the limitation or control of the supply of transport services and the sharing of the traffic market were government-controlled. It gave a strong impression of protectionism: to protect national flag carriers.

With regard to international market access, the Chicago Convention of 1944[1] provided and continues to provide a multilateral legal framework for the air traffic rights of commercial air carriers. Article 1 of the Chicago Convention emphasizes that every State has complete and exclusive sovereignty over the airspace above its territory. Article 6 of the Chicago Convention also provides that no scheduled international air service may be operated over or into the territory of a contracting State, except with the special permission or other authorisation of that State, and in accordance with the terms of such permission or authorisation. As a result, the exchange of traffic rights to obtain international market access for the airlines concerned is subject to bilateral negotiation between Governments. In addition, how much capacity can be carried by one flight, which air carriers are designated to fly on which routes and the air fares that air carrier can charge its passengers are controlled by bilateral air transport service agreements. Therefore, scheduled commercial carriers cannot compete freely on an international basis under the Chicago Convention regime.

…since the bilateral regime and restrictions on foreign ownership for the airline industry continue to exist, the solution provided by the airline industry for these needs is the formation of alliances.

Another special characteristic of the international air transport industry that resulted from the bilateral regime is the existence of national carriers with limited foreign ownership and control. In particular, one party to a bilateral agreement has the right to revoke, suspend, limit or add conditions to the operating authorisations or technical permissions given to an airline designated by the other party, if substantial ownership and effective control of that airline are not vested in such other party, the other party's nationals, or both[2] Hence, mergers and take-overs between air carriers with divergent nationalities are still difficult and may be challenged by third parties, based on the above ownership and control criteria.

Part II: Formation of Transatlantic Airline Alliances

From the 1980s onwards, the international tendency towards a market economy has resulted in privatisation of national carriers, and the deregulation and liberalisation of the domestic airline industry in many countries, especially in the United States ("US") and the European Community ("EC"). In keeping with this trend, airlines seek to expand their market access and strengthen their market position in order to be more competitive in the market; it is their intention to provide better consumer services in accordance with the demands of the market, like private-owned companies in other industries. Furthermore, there has also been an emergence of more liberal bilateral air transport service agreements between countries with a loosening of the limitations on capacity, designation, routes and fares for scheduled international air transport services. The "open skies" agreement promoted by the United States completely removes these restrictions.

With globalisation, the above-mentioned expansion and competition have extended to the international air transport market. However, Presently, there are four major transatlantic alliances: NW/KLM, LH/United/SAS/Austrian/BMI Airlines, Delta/Air France/Alitalia/ CSA and BA/AA. All four transatlantic alliances are working on further expansion by inviting airlines based in different national markets outside the US and the EC to join them. At present, these alliance groups together carry over 70 percent of all world passenger traffic.[3] Over 80 percent of carriers around the globe have some form of co-operation with one another as alliances and new or revised alliance agreements are coming out at the rate of approximately 70 per year.[4]

Via international alliances, airlines can integrate networks of products, services and standards between two or more carriers. Such integration allows the alliance carriers to operate more efficiently: for example, by eliminating duplication of costs to offer better services to their customers and by competing on an international basis in order to increase revenue and profit. Through alliances, inter- national air carriers can achieve the above-mentioned goals without mergers and take-overs while staying within the limitations under the bilateral regime such as the restrictions on substantial ownership and effective control of a national carrier.

Part III: Conflicts over Applications of European Community Competition Law and United States Antitrust Law to Transatlantic Airline Alliances

The existence of international airline alliances and the conduct of major airlines across national borders raise serious competition concerns. Presently, the US and the EC have the most well-developed air transport industries and also have the most complete competition law regimes in the world. Both the US and the EC apply their competition laws to transatlantic airline alliances for the purpose of preventing anti-competitive practices resulting from their operations. The applications of different domestic competition rules to a single international economic activity trigger enormous conflicts, increase legal costs and decrease legal certainty for the international airline industry.

The differences in and conflicts over such applications of EC competition law and US antitrust law to transatlantic airline alliances are many and can be illustrated by the following two examples:

1. Definition of relevant market. The US antitrust authority takes the whole service network into account while defining the relevant market in order to evaluate whether there are anti-competitive practices triggered by these alliances. On the other side of Atlantic, the EC competition authority concentrates on hub-to-hub routes and certain specific route markets instead of taking the whole service network into account.
2. Conditions for granting antitrust immunity/exemption. In general, the US antitrust authority grants immunity to an airline alliance if there are open skies agreements between the US and alliance partners' home countries, and if the authority believes that there will be no reduction of competition

'Wings' in motion? Photo: Ben Pritchard

within certain relevant markets. In contrast, the EC authority focuses on ensuring that there will be enough competitors and that it is possible for them to enter certain relevant markets. Thus, the frequency of flights operated by alliance partners to and from certain EC-based airports and the number of slots used by alliance partners at certain EC hub airports may need to be reduced.

The differences in the applications of the US and EC competition law to transatlantic alliances in the air transport sector is just the beginning. As more and more States apply their domestic competition laws to international alliances, the conflicts over such applications to international airlines' economic activities will escalate.

Part IV: Future Trends

The historical, economic, political and legal background that created the bilateral regime for international air transportation in 1944 has changed. The airline industry is now doing its utmost to become more competitive and to continue to be able to participate in the international air transport market. From the point of view of the airline industry, governments and legal regimes should catch up with the world trend of globalisation and allow a market economy to exist in international air transport. However, governments should continue to safeguard public interest and safety, to pursue the attainment of maximum consumer welfare and to protect airlines from anti-competitive practices.

While the ultimate goal may be a mature market economy in international air transport with a unified global antitrust law to safeguard fair and free competition, the realisation of that goal will take time and effort. The conflicts in the applications of existing competition laws to the operations of transatlantic airline alliances are an example of the problems faced by many inter- national businesses and the solutions that the airline industry finds for such conflicts may become models for the development of future international law.

Line up in sequence for an alliance. Photo: Andy Vanderheyden.

It is interesting to consider what the ideal legal regime would be, especially in terms of competition law, for international air transport. However, without a unified system of global antitrust law, the airline industry must consider regional and/ or bilateral approaches that governments may use to give inter national air carriers the fair opportunity to compete freely. The following are a few proposed approaches:

Regional co-operation. The different applications of varying domestic antitrust/competition laws to the economic activities of international air carriers need to converge. For example, the concept of the Trans-Atlantic Common Aviation Area ("TCAA") between the United States and the European Community has been proposed by the Association of European Airlines and supported by the European Commission. Within the TCAA, countries would agree upon common substantive and procedural rules governing anti-competitive practices.

Bilateral comity agreements (taking the positive comity agreements between the European Commission and the United States as an example). At the very least, the present positive comity agreements on a bilateral basis should be expanded to cover the international air transport sector in order to allow competent authorities in this sector, such as the US Department of Transportation, to co-operate with competition authorities of other countries or regions. More binding force should be given to such agreements instead of such agreements being treated as administrative agreements that are not superior to any existing laws.

1. The Convention on International Civil Aviation, ICAO Doc. 7300/6, 6th ed., Montreal, 1980. [Hereinafter Chicago Convention.]
2. Article 3, para.1. b, Air Transport Agreement between the Government of Canada and the Government of the United States of America. Other bilateral agreements may contain slightly different versions of this provision without materially affecting the meaning or purpose.
3. International Air Transport Association Government & Industry Affairs External Relations, Regulatory Developments 1999, 12th Meeting of the Aviation Regulatory Watch Group, Geneva, 24-25 June 1999, at 13.
4. Alliance Analysis, "Playing for Posit," Airline Business, (July 2001): 40.