# Regulatory Aspects of Airline Alliances

## A Case Study of *Star* Alliance

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# Abstract

The formation of airline alliances has been a distinctive feature of the airline business at the threshold of the new millennium. This is due to the framework of Bilateral Air Transport Agreements, which condition the grant of traffic rights to substantial ownership and effective control being vested in nationals of one of the contracting parties. Further regulatory aspects pertaining to airline alliances include competition law review, traffic rights, and slot allocation.

This thesis seeks to elucidate how *Star* had to adapt its strategic choices to this framework. The outcome will be that in particular the lack of regulatory convergence in competition law matters constitutes a hindrance to a global alliance such as *Star*. The issue of ownership and control might represent a further obstacle to an alliance intending to rely on mergers or major share holding, an ambition that *Star* has not nourished so far. Open Skies agreements in force between the U.S., Canada, and several member states of the European Union give alliances full commercial opportunities, unhindered by restrictive capacity or approval of fares provisions. The principles as regards slot allocation, on the other hand, have enabled alliances to build up their hubs as fortresses.

The issues of competition law, and ownership and control illustrate that it has become increasingly insufficient to rely on a merely bilateral approach to global problems. Eventually, satisfactory solutions may only be achieved on a multilateral level. The onus thus is on aviation regulators to come up with a more suitable framework for aviation in the next century.

Multilateralism, however, might turn out to herald the end to the alliance phenomenon. Once the bilateral strait jacket put aside, the aviation industry will consolidate like any other industry: by mergers, that is.

# Résumé

L'avènement d'alliances entre compagnies aériennes a été l'un des faits saillants dans le monde de l'aviation commerciale à la fin de ce millénaire. Ceci est surtout l'œuvre des innombrables accords bilatéraux qui conditionnent l'exercice de droits de traffic en fonction de la nationalité de la compagnie aérienne désignée. De surcroît, une telle alliance est aussi soumise au droit de la concurrence et aux principes régissant l'allocation de créneaux horaires.

La présente thèse s'efforce de démontrer comment une alliance globale comme *Star* a dû se conformer à son environnement réglementaire. Le manque d'harmonisation en matière de droit de la concurrence présente un obstacle à toute alliance désireuse d'offrir un produit global. C'est surtout ici que le bât blesse. Le principe de nationalité entrave une alliance qui souhaite renforcer les liens entre ses membres, soit par des fusions, soit par des participations croisées, une stratégie que *Star* n'a pas encore poursuivie. Néanmoins, les accords *Open Skies* permettent aux alliances d'opérer entre les continents européen et américain sans être soumises à des restrictions de capacité ou une approbation des tarifs. En dernier lieu, les règles juridiques applicables à la distribution des créneaux horaires ont permis aux alliances de défendre leur position dans leur *hub*.

Surtout le manque d'harmonisation quant à l'application du droit de la concurrence n'est pas conforme aux intérêts des compagnies aériennes. Seule l'approche multilatérale peut permettre à une alliance globale de prospérer.

Néanmoins, il se pourrait que le multilatéralisme scelle la fin du phénomène d'alliance. Dès que le cadre bilatéral sera dépassé, l'aviation devrait se consolider à travers de véritables fusions, et non plus par le biais d'alliances qui n'étaient jamais plus qu'un substitut, faute de mieux.

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# Introduction

"In the name of *Star Alliance*, we welcome you on board our flight from X to Z." Anyone who has recently traveled by air will have heard such an announcement (the name *Star Alliance* may, of course, be substituted by *OneWorld* or *Wing*, *Star Alliance*'s main competitors). Especially joint check-in facilities as well as a common logo have also contributed to making the public aware of the existence of airline alliances.

The phenomenon of airline alliances seems to be more tangible than ever before. This is not to say, however, that airline alliances are a current creation. On the contrary, there have been alliances between airlines throughout the last decades. One author even contends that the phenomenon may be traced back to as early as 1919, when six European airlines set up the International Air Traffic Association (IATA)[1]. Until very recently, these alliances were somewhat limited in scope and lacked cohesion. The development of modern marketing tools, such as Frequent Flyer Programmes[2], technical innovation (Computer Reservation Systems) and flight schedule patterns like hub and spoke have given a new significance to the term airline alliance. The need for global air travel against the background of a globalized economy has eventually brought about the advent of a new kind of alliance.

The first alliance agreement in the latter sense of the term was signed in 1993 between *KLM* and *Northwest*. In the following years, more and more airlines followed the example so that today there are at least five global alliance agreements (*OneWorld*, *Star*, *Qualiflyer*, *Sky Team* and *Wings*). This analysis shall focus essentially on the *Star Alliance*. Of course, this choice is a rather arbitrary one. Nonetheless, with today 12 members on four continents, *Star* is today arguably the most global of all alliances:

[1] *See* Michael Z. F. Li, *Distinct features of lasting and non-lasting airline alliances*, 6 JOURNAL OF AIR TRANSPORT MANAGEMENT 65 (2000).

*Lufthansa* of Germany, *SAS* of Denmark, Norway and Sweden, Chicago-based *United Air Lines* and Montreal-based *Air Canada*, *Thai*, the Brazilian carrier *Varig*, *Ansett Australia*, *Air New Zealand*, *ANA* of Japan, *Singapore Airlines*, *Austrian*, *British Midlands* and *Mexicana*, all combined, can boast to fly to 800 destinations in more than 120 countries on all continents, offering seamless traffic on a global scale.

The list is impressive. Nobody can tell, however, if this fragile web could not unravel itself as quickly as it was spawn. At second glance, even the term "alliance" connotes weakness. Historians know that military alliances are often the result of a momentary power balance and may quickly disappear if this balance is sensibly altered. More importantly, there is hardly any other economic sector in which alliances play an important role. When *Daimler-Benz* and *Chrysler* wished to cooperate, they merged, but if *Lufthansa* and *United Air Lines* want to join forces, they form an alliance. How might this difference in approach be explained? Globalization has been an overriding trend in our market economy at the end of this millennium, for car makers and airlines alike. But why this different strategic answer to the same concern?

The reason for that lies in the international framework of international aviation. Commercial traffic rights are exchanged between states on a bilateral basis, and only an airline from the other contracting party can avail itself of these rights[2].

Even if the existence of airline alliances itself has been largely contingent on the international organization of air transport, it should not be forgotten that a true global alliance (such as *Star*), which, in the first place, constitutes a legal means to sidestep the regulatory framework, will arguably end up modifying the latter. As global alliances want to compete in a more and more deregulated environment, without any artificial constraints, they are constantly prodding their respective governments (which are never oblivious to the industry's demands) into alleviating the regulatory burden. Fifty-five years after the Chicago Conference, which, by its merits as well as its shortcomings, has definitely shaped international aviation, delegations from all over the world gathered

[2] *See infra* 1.1.

once again in Chicago to make up their minds about aviation at the threshold of the new millennium[3]. This time, the proposal to create a Common Aviation Area was high on the agenda, the basic idea being to replace the bilateral framework by a single air space in which airlines are entitled to fly on every route they wish to cover with no restriction whatsoever. Gravitating first around the North Atlantic, the Common Aviation Area might later be joined by other countries or free trade areas, such as South East Asia, Australia or Mercosur.

At that stage, the question will be if airline alliances are here to stay or if they will be eventually replaced by mergers. Already today, still within the existing framework of bilateral agreements, some airlines believe the time has come for more integrated collaboration. *Swissair* will soon hold as much as 85% of *Sabena*, and *British Airways* and *KLM* have initiated merger talks recently. In the light of these developments, the very existence of the phenomenon of airline alliances is seriously in doubt. It may well be that in ten years time, airline alliances will be a thing of the past.

In the meantime, airline alliances will continue to be the subject of discussion of air lawyers and airline strategists alike. Much of the interest for this issue stems from the fact that an airline alliance exemplifies very well the content of today's air law. The issue of traffic rights, substantial ownership and effective control, competition law, liability issues, consumer protection: all these topics are somewhat related to airline alliances.

Discussing the issue of airline alliances is a very difficult endeavor, as the subject is multifaceted and, maybe short-lived. Here, only some of the aforementioned issues are singled out in order to exemplify in what manner global alliances are subject to the international framework and in how far global alliances may end up shaping the latter.

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[3] On the invitation of U.S. Secretary of Transportation Rodney E. Slater, the aviation world discussed several aviation related topics in Chicago in December 1999. One panel focused on strategic airline alliances. Most participants here agreed that both airlines and passengers benefit from alliances. It called upon government entities "to pursue a convergence of rules". Another panel discussed the future of bilateral agreements. Although "nothing of significance was accomplished in Chicago" (Joan M. Feldman, *Useful posturing*, AIR TRANSPORT WORLD, February 2000, at 69), the meeting illustrates in how far the future of aviation is intertwined with the concept of airline alliances and the overcoming of the existing bilateral framework.

Each of these issues could be the subject of a thorough study, but, due to the limited space available for a thesis, cannot be dealt with here in an exhaustive manner.

The first three chapters are meant to introduce the reader to the legal and economic background of airline alliances. Chapter 4 is dedicated to the issue of competition law. It will touch upon competition law review in the U.S. and Europe and identify several problems which are plaguing *Star Alliance*. Chapter 5 then deals with the subject of traffic rights. It will highlight bilateral air transport agreements between Europe, the U.S., and the South East Asia. Chapter 6 addresses the issue of substantive ownership and control, which might see important changes in the light of recent development, such as the merger talks between *British Airways* and *KLM*. Chapter 7 then briefly analyzes the legal principles pertaining to slot allocation, which in the hub and spoke context are of significance to global alliances.

# Chapter 1: The Legal Background

International aviation has been shaped by the Chicago Convention of 1944 and, thereafter, by the emergence of Bilateral Air Transport Agreements. Any analysis of the contemporary phenomenon of airline alliances must include a short presentation of how this legal background happened to influence on the strategic thinking of global airlines.

## 1.1 Bilateral Air Transport Agreements and the Grant of Traffic Rights

### 1.1.1 The Principle of Sovereignty over the Airspace

The recognition of complete and exclusive sovereignty of any state over the airspace above its territory constitutes a well-established principle of International Public Law. Even though this principle was already recognized well before as customary law[4], it was officially enshrined in Art. I of the Paris Convention[5]. The same principle is reconfirmed by Art. 1 of the Chicago Convention[6], which adds in its Art. 6 that "no scheduled air international air service may be operated over or into the territory of a contracting state except with the special permission or authorization of that state".

The Chicago Conference also sought to address the issue of international commercial aviation. Delegations considered the adoption of two legal documents. The International Air Transit Agreement[7] was to grant First[8] and Second Freedom[9] traffic rights to any

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[4] For more insight into the history of the sovereignty principle, *see* I.H.PH. DIEDERIKS-VERSCHOOR, AN INTRODUCTION TO AIR LAW 2 (1991).

[5] Art I of the Convention provides: "Every Power has complete and exclusive sovereignty over the airspace above its territory". *See* Convention Relating to the Regulation of Aerial Navigation, signed October 13, 1919, 11 LNTS 173.

[6] Convention on International Civil Aviation, signed December 7, 1944, 15 U.N.T.S. 295, ICAO Doc. 7300/6 [hereinafter *Chicago Convention*].

[7] *See* International Air Services Transit Agreement, December 7 1944, (entered into force January 30 1945), 84 U.N.T.S. 389, 59.

[8] The first freedom is the right to fly and carry traffic nonstop over the territory of the grantor state. *See* BIN CHENG, THE LAW OF INTERNATIONAL AIR TRANSPORT, 14 (1962). *E.g.* the German carrier *Lufthansa* enjoys First Freedom rights when overflying Belgian territory between Frankfurt and London.

contracting party. The second agreement, the International Air Transport Agreement[10], dealt with Third[11], Forth[12] and Fifth Freedom[13] rights.

The International Air Transit Agreement has been signed by 100 countries. In contrast, the International Air Transport Agreement, originally signed by the U.S., but not by the U.K., is of no practical significance, as many contracting parties have denounced it, so that today only eleven countries are bound by it[14].

This failure has often been ascribed to the diverging views among the delegations present at Chicago. The U.S. in particular advocated the exchange of traffic rights without any restrictions on fares or capacity, whereas the U.K., joined by further Commonwealth countries, favored tighter control on international air traffic[15].

### 1.1.2 Bilateralism

In the absence of a multilateral framework for commercial aviation, states desiring to engage in international air transport had to sign bilateral agreements, permitting their national carriers to commence scheduled flights to points in the territory of the contracting party.

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[9] The second freedom is the right to make stops within the territory of a contracting party for non-traffic related purposes. *See id.* at 14. If a *Lufthansa* flight stops at Gander, Nfld, in order to allow for refueling, the German airline avails itself of Second Freedom rights.

[10] *See* International Air Transport Agreement, *opened for signature* December 7 1944, 171 U.N.T.S. 387.

[11] This term denotes the right of an airline to carry passengers and cargo from its home country to the grantor state. *See* BIN CHENG, THE LAW OF INTERNATIONAL AIR TRANSPORT 14 (1962). *Lufthansa*'s flight from Frankfurt to Montreal uses Third Freedom traffic rights.

[12] This is the right to pick up traffic at the grantor's state and to carry it to the home state of the airline. *See id.* at 14. *Lufthansa*'s flight from Montreal to Frankfurt is an example of Fourth Freedom traffic.

[13] Fifth Freedom is the right to carry traffic from the grantor state to a third foreign state and vice versa. *See* BIN CHENG, THE LAW OF INTERNATIONAL AIR TRANSPORT 14-5 (1962) (who uses the terms 'anterior point Fifth Freedom' and 'intermediate point Fifth Freedom'). *Compare* H. WASSENBERGH, PRINCIPLES AND PRACTICES IN AIR TRANSPORT REGULATION 173 (1993) (distinguishing 'fill-up Fifth Freedom' and 'pick-up Fifth Freedom'). *See generally* Mathieu Weber & John Dinwoodie, *Fifth freedom and airline alliances. The role of 5th freedom traffic in an understanding of airline alliances*, 6 JOURNAL OF AIR TRANSPORT 51 (2000).

[14] Among them, with the notable exception of the Netherlands, no major aviation power.

[15] *See* RIGAS DOGANIS, FLYING OFF COURSE, THE ECONOMICS OF INTERNATIONAL AIRLINES 26 (1991).

Not long after the closing of the Chicago Conference, in 1946, the first bilateral air transport agreement was signed between the U.S. and the UK on Bermuda Island[16]. As the U.S. and the UK were the most important aviation powers at that time, the Bermuda Agreement exerted enormous influence on bilateral aviation relations in general. Especially the fact that it was the fruit of a compromise between the liberal view of the U.S. and the more restrictive approach of the UK made it a model for other bilaterals[17].

Another, more restrictive approach was adopted by the Communist countries as well as several Developing Countries. This type of agreement, sometimes referred to as the predetermination model, differs in that it contains capacity restrictions as well as, sometimes, a pooling agreement between the designated carriers.

Thirty years later, the British government took the aviation world by surprise by announcing its intention to denounce the Bermuda-Agreement of 1946. The UK estimated that the Agreement conferred more advantages to the U.S. than to the UK. The denunciation of the Bermuda Agreement of 1946 marked the end of an era. Its successor – later dubbed Bermuda II[18] – failed to shape international aviation in the same manner as its predecessor had done three decades ago.

The entering into force of the new Bermuda Agreement was, in hindsight, somewhat overshadowed by what first appeared to be a merely domestic issue. In 1978, the U.S. Congress enacted the Aviation Deregulation Act, finishing off with the forty year-old legacy of the Civil Aviation Board, or CAB. After the U.S. domestic market was

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[16] Agreement between the United States and the United Kingdom relating to air services, signed at Bermuda, February 11, 1946, 3 U.N.T.S. 253, 60 Stat. 1499, TIAS No. 1507, Bevans 726.

[17] The main features of the Bermuda Agreement of 1946 are: - double approval of fares, - determination of routes in a separate schedule, - no capacity restrictions. Art. I of the Annex to the Bermuda agreement grants traffic rights to the designated carriers of both signatories "the use on the said routes at each of the places specified therein of all airports", referring to the schedule in Art. III of the Annex. According to Art. II, rates to be charged "...shall be subject to the approval of the Contracting Parties". In the case that the parties fail to reach an agreement on the applicable fares, the same article provides for a dispute settlement procedure. On the other hand, the Bermuda Agreement does not restrict capacity – a major concession made by the UK to the U.S.

[18] *See* Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the United States of America concerning Air Services, signed at Bermuda, July 23, 1977, TIAS 8641, UST 5367.

completely deregulated, the U.S. Administration sought to achieve also the liberalization of international aviation. For two decades, it has been U.S. policy to promote the conclusion of Open Skies Agreements, the corresponding concept to deregulation. Open Skies Agreements do not provide for any restrictions on Third, Fourth and Fifth Freedom travel. Fares are only subject to the double disapproval by aviation authorities from both countries, if the fares are anti-competitive[19].

### 1.1.3 Regionalism

The current bilateral framework of international aviation is perceived by many as a straight jacket impeding commercial aviation from growing and satisfying the customer's demand for global air service[20]. Some countries, sharing mostly a common history and air policy, have decided to create an aviation area, in which traffic rights are granted to all participating countries on a reciprocal basis.

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[19] The U.S.-German Bilateral Air Transport Agreement might serve as an example. In Art. 3 (1), it provides for multiple designation: "Each contracting party shall have the right to designate as many airlines as it wishes to conduct international air transportation in accordance with this agreement and to withdraw or alter such designations." In a typical Open Skies-Agreement, there are no restrictions on capacity or frequencies. With respect to this, Art 8 (2) disposes that "[e]ach contracting party shall allow each designated airline to determine the frequency and capacity of the international air transportation it offers, based upon commercial consideration in the marketplace". Lastly, price fixing within an Open Skies environment is only subject to *double disapproval* by aviation authorities of the two contracting parties. Art. 10 of the U.S.-German bilateral tackles price fixing in its Art. 10:

> (1) Each Contracting Party shall allow prices for international air transportation to be established by each designated airline based upon commercial consideration in the marketplace. Intervention by the contracting parties shall be limited to:
>  1. prevention of unreasonably discriminatory prices or practices;
>  2. protection of consumers from prices that are unreasonably high or restrictive due to the abuse of a dominant position; and
>  3. protection of airlines from prices that are artificially low because of direct or indirect governmental subsidy or support.
>
> (2) Neither party shall take unilateral action to prevent the inauguration or continuation of a price proposed to be charged or charged... If either contracting party believes that any such price is inconsistent with the considerations set forth in paragraph (1) of this article, it shall request consultations and notify the other contracting party of the reasons of its dissatisfaction as soon as possible. These consultation shall be held not later than 30 days after receipt of the request... If the contracting parties reach with respect to a price for which a notice of dissatisfaction has been given, each contracting party shall use its best efforts to put that agreement into effect. Without such mutual agreement, the price shall go into effect or continue in effect."

[20] For the merits and failures of the bilateral system, *see* Marek Zylicz, INTERNATIONAL AIR TRANSPORT LAW 142-3(1992).

### 1.1.3.1 The European Community

The most integrated regional framework has been established by the European Community. The European Commission has enacted numerous regulations and directives in order to harmonize operating conditions for European Airlines. However, the most notable regulation is Council Regulation 2408/92, which requires member states to permit any air transport undertaking with a valid license[21] to operate on any intra-Community route. After a transitional period expiring on April 1st, 1997, a European Community carrier is also entitled to cabotage – that term refers to air transport between two airports within the territory of the same state[22]. Thus, since 1997, any airline from a member state of the European Union may operate domestic air service in any other member state. Few carriers have so far ventured to offer this kind of service. However, in the framework of an airline alliance, the right to cabotage could turn out to be economically appealing, especially in connection with code-sharing[23].

### 1.1.3.2 The Andean Pact

The Andean Pact was signed in 1969 by Colombia, Venezuela, Ecuador, Peru and Bolivia. Since 1991, it also includes an aviation related chapter, granting carriers from member states Third, Forth and Fifth Freedom rights, thus creating a common aviation area in South America[24].

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[21] Common guidelines on the granting of operating licenses are set forth in European Community Regulation 2407/92 (OJ L 240/1).

[22] Sometimes, it is suggested that the enacting of Council Regulation 2408/92 (OJ L 240/8) would constitute an infringement of Art. 7 of the Chicago Convention. This question does not lie within the scope of this analysis. In this respect, *see* JOHN BALFOUR, EUROPEAN COMMUNITY AIR LAW 67 (1995).

[23] *See infra* 2.2.1.

### 1.1.3.3 Single Aviation Market (between Australia and New Zealand)

Australia and New Zealand, building on a common historic heritage and close economic ties[25], have agreed to lift all restrictions on flights between the territories of the two countries as well as within each of them, which includes cabotage and Fifth Freedom beyond rights[26].

### 1.1.3.4 MERCOSUR

MERCOSUR is a free trade area set up in 1991 between several South American countries. Today, this organization counts Argentina, Brazil, Chile, Paraguay and Uruguay as its members. On December 17, 1996, at a presidential meeting held in Fortaleza, MERCOSUR member states signed an Air Transport Agreement. This agreement grants Third and Forth Freedom traffic rights as regards scheduled air services. However, the 1996-agreement still preserves many features of the Bermuda-type, *e.g.* with respect to capacity and fares[27].

### 1.1.3.5 The Proposal of a Transatlantic Common Aviation Area

The most far-reaching proposal so far with respect to regionalism is the proposal to create a Transatlantic Common Aviation Area (TCAA). In 1995, the Association of European Airlines (AEA) put forward this idea in a policy statement. Shortly hereafter, this concept was also embraced by the Council of Ministers of the European Community. In 1999, the AEA reiterated its position in a new policy statement[28]. In Chicago, at the conference "Beyond Open Skies", the TCAA was also endorsed by the Vice President of the European Commission, Loyola de Palacio.

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[24] *See* Decision 297, Gaceta Oficial del Acuerdo de Cartagena, June 12, 1991.
[25] *See* Free Trade Agreement, signed August 31, 1965, ATS 1966 No. 1 and Australia New Zealand Closer Economic Relations Trade Agreement, signed January 1, 1983, and Exchange of Letters, March 28, 1983, ATS 1983 No. 2.
[26] *See* Australia-New Zealand Single Aviation Market Arrangements, 1996.
[27] *See* Rogelio N. Maciel, *Opening Southern Skies*, 22 AIR & SPACE LAW 73, 74 (1997).

The TCAA, according both to the AEA and the Commission, is to contain several key elements. First and most importantly, the proposal consists in the establishment of a transatlantic area where airlines from all parties shall have unrestricted traffic rights. The TCAA would also include a more liberal stand on airline ownership and coordination on the issue of soft rights, the latter including, *inter alia*, the harmonization of competition law enforcement.

It remains to be seen if TCAA will one day become a reality. It seems that recently, this concept has gained some momentum[29]. It may well be, however, that the time is not yet ripe for so sweeping a proposal[30].

### 1.1.3.6 Further Proposals

The Arab Civil Aviation Commission (ACAC) has brought forward the proposal to liberalize inter-Arab air traffic over a period of 5 years, gradually phasing out restrictions with regard to Third, Forth and Fifth Freedom. The proposal has met fierce resistance from carriers such as *Egyptair* and *Saudi Arabian*. Other carriers, including *Royal Air Maroc*, *Royal Jordanian* and *Emirates*, on the other hand, have shown support[31].

ASEAN member states (initially, Indonesia, Malaysia, the Philippines, Singapore, and Thailand, with Brunei, Vietnam, Laos and Myanmar later joining) have also sought to set

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[28] *See Towards a Transatlantic Common Aviation Area*, AEA Policy Statement, September 1999.
[29] It is reported that the issue was discussed at the 1999 Chicago Aviation Conference "Beyond Open Skies". The Vice President of the European Commission, Loyola de Palacio, qualified the idea of TCAA as "a blue print which will pave the way towards a more efficient regulatory system for international air transport in the world. *See Beyond Open Skies*, Speech delivered by Loyola de Palacio at Chicago, December 6, 1999, Speech/99/204. The concept was also endorsed by the president of the Air Line Pilots Association (ALPA), Douane Woerth and the Secretary General of the International Chambre of Commerce, Maria Livanos Cattaui.
[30] Whereas EU officials seek to go ahead on the issue, the U.S. has shown a lot of caution. *See* Jens Flottau, *U.S. Maintains Cautious Attitude toward TCAA*, AVIATION WEEK & SPACE TECHNOLOGY, May 29, 2000, at 42.
[31] *See* Tom Gill, *Opening Arab Skies*, AIRLINE BUSINESS, June 1999, at 47.

up an integrated aviation area. However, the project has not yet materialized, the aviation interests of the countries concerned being too diverging[32].

### 1.1.4 Multilateralism

International aviation has been entrusted to a specialized agency of the UN, the International Civil Aviation Organization (ICAO). This entity, however, has been limited to deal primarily with technical and safety related aspects of aviation[33].

Even if multilateralism was rejected at the Chicago Conference in 1944, the idea has resurfaced recently. In 1992, multilateralism was on the agenda of the ICAO council, which held a world-wide air transport colloquium. The meeting helped to identify advantages and shortcomings of the bilateral system[34]. The 1994 Worldwide Air Transport Conference discussed, *inter alia*, the ownership and control issue. The ICAO Air Transport Regulation Panel recommended that a combination of criteria such as principal place of business and headquarters could be used to further broaden the ownership and control criterion[35].

Furthermore, some advocate that commercial aviation and in particular the question of hard rights be included in the GATS[36]. For the time being, GATS does not concern "hard rights" such as traffic rights. This proposal, however, has met resistance at ICAO[37] and IATA[38].

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[32] *See* HONG HU, OPEN SKIES AND ITS IMPACT ON THE ASIA-PACIFIC REGION, Thesis McGill (unpublished), 114 (1997).

[33] *Dresner & Tretheway* are of the opinion that the post World War II transport regime did not allow any room for ICAO with respect to economic regulation (Martin Dresner & Michael W. Tretheway, *ICAO and the Economic Regulation of International Air Transport*, 17-2 ANNALS OF AIR AND SPACE LAW 195, 201 (1992). Nonetheless, ICAO has hosted several Worldwide Air Transport Conferences, where economic issues were contemplated.

[34] R.I.R. ABEYRATNE, LEGAL AND REGULATORY ISSUES IN INTERNATIONAL AVIATION 30 (1996).

[35] *See* Recommendation ATRP/9-4.

[36] *See i.e.* Richard Janda, *Passing the Torch: Why ICAO Should Have Economic Regulation of International Transport in the WTO*, 21 ANNALS OF AIR AND SPACE LAW 409 (1995).

[37] For more details *see* Ruwantissa Abeyratne, *Competition in North American aviation – challenges and options*, [2000] TAQ 172, 180-181.

[38] In its Annual Report 2000, IATA stated that GATS "is not the means for fundamental regulatory reform" and that "applying principles such as Most Favored Nation-treatment could even hold back air transport

## 1.2 Substantial Ownership and Effective Control

The requirement of substantial ownership and effective control has had a tremendous impact on international aviation. It has been an obstacle to transnational mergers between airlines. As a result, in the airline business, globalization has not brought about multilateral companies in the same way as it has in other fields of economic activities. In this respect, it is fair to state that aviation does not resemble any other business – a statement which is more and more contested today.

### 1.2.1 From the International Perspective

To be precise, the substantial ownership and effective control-requirement made its first appearance in 1944 at the Chicago Conference. Fearing that traffic rights could eventually fall into the hands of airlines controlled by enemy states, the U.S. sought to ensure that only designated carriers from one of the contracting states would operate on these routes. Therefore, both the International Air Services Transit Agreement[39] and the International Air Transport Agreement[40] established that

> [e]ach Contracting State reserves the right to withhold or revoke a certificate or permit to an air transport enterprise of another State in any case where it is not satisfied that substantial ownership and effective control are vested in nationals of a Contracting State.

As a rule, almost all bilaterals contain the same requirement. To cite just one example, Art. 6 of the appendix to Bermuda I states that

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liberalization". The question whether or not air transport should be brought within the purview of the WTO is discussed in length by Ruwantissa Abeyratne, *Would Competition in Commercial Aviation Ever Fit into the WTO?*, 61 J. AIR L. & C. 793 (1996).

[39] International Air Services Transit Agreement, entered into force January 30, 1945, 84 U.N.T.S 389.

[40] International Air Transport Agreement, opened for signature December 7, 1944, 171 U.N.T.S. 387.

> [e]ach Contracting State reserves the right to withhold or revoke the exercise of the rights specified in the Annex to this Agreement by a carrier designated by the other Contracting Party in the event that it is not satisfied that substantial ownership and effective control of such carrier are vested in nationals of either Contracting State[41].

In the ensuing years, state practice deviated from this formulation, stipulating instead that substantial ownership and effective control must be vested in nationals "of the other contracting state". This clause is nowadays referred to as the standard ownership and control clause. It is still inserted in any bilateral, even one of the Open Skies-type.

Today, this requirement is meant, among other things, to prevent airlines from third countries to benefit from this bilateral exchange of commercial opportunities. Any nation party to a bilateral agreement can be assured that only a carrier from the contracting party has access to its international routes. Some countries still feel that such a protection of their national carrier is vital to their own aviation interests.

It is worthy of note that there are some widely recognized exceptions to the principle. Some airlines are jointly owned by governments or nationals from more than just one country[42]. Such a carrier may be designated by any one of the countries concerned.

Furthermore, following ICAO Resolution A 24-12, some countries have accepted the 'Community of Interest' concept, according to which one state might designate an airline from a neighboring state[43]. However, these examples only represent minor exceptions to a well-established principle.

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[41] Agreement between the Government of the United Kingdom and the Government of the United States of America, Relating to Air Services between Their Respective Territories, signed at Bermuda, February 11, 1946, 3 U.N.T.S. 253, 60 Stat. 1499, TIAS No. 1507, Bevans 726.

[42] Examples of the foregoing are: *SAS* (Sweden, Denmark and Norway), *Air Afrique* (Benin, Burkina Faso, Central African Republic, Chad, Congo, Ivory Coast, Mali, Mauritania, Niger, Senegal and Togo) and *BWI* (regrouping several countries in the West Indies).

[43] *See* Rigas Doganis, *Relaxing Airline Ownership and Investment Rules*, 21 AIR & SPACE LAW, 267 (1996).

It is likely that, today, some carriers still operate under a specific bilateral even though they are no longer substantially owned or effectively controlled by nationals from the contracting party concerned. In that event, the other contracting party is entitled to revoke or withhold the operating license in question. Whether or not it will do so, is a political question[44] and will depend, *inter alia*, on its bargaining position and the perceived benefits and disadvantages of negotiating a new bilateral.

### 1.2.2 Domestic Legislation

The nationality clause may also be found in national legislation. Here, the state concerned implements on the one hand the requirement pursuant to the bilateral agreements to which it is party. On the other hand, however, domestic issues play their role, too. It should not be forgotten that having their own flag carrier fills a lot of countries with pride, or, how an official of the European Community has put it: "Aviation is a sexy thing and ownership control has been a Viagra"[45].

#### 1.2.2.1 U.S. Legislation

In U.S. law, the nationality requirement goes back to the Air Commerce Act of 1926, which limited foreign participation in a U.S. carrier to 49% of the voting shares or one third of the board members[46]. The Civil Aeronautics Act of 1938, however, even adopted a more restrictive approach, requiring U.S. ownership of a U.S. carrier to amount to at least 75% of the voting shares[47]. This requirement was incorporated into the Federal Aviation Act of 1958, which still reflects the current state of the law.

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[44] When *Aerolinas Argentinas* was for about 65% in the hands of a Spanish holding company SEPI (an additional 10% being held by *Iberia*), the U.S., after obtaining minor concessions as a *quid pro quo* from the Argentinian government, declared that it did not intent to invoke the nationality clause. *See* H. Peter van Fenema, *Ownership Restrictions: Consequences and Steps to be Taken*, 23 AIR & SPACE LAW 63, 65 (1998).

[45] Rene Fennes, of DG VII, is quoted by Karen Walker, *The Great Global Debate*, AIRLINE BUSINESS, September 1999, at 96.

[46] *See* David Arlington, *Liberalization of Restrictions on Foreign Ownership in U.S. Air Carriers: The United States Must Take the First Step in Aviation Globalization*, 59 J. AIR L. & COM. 133, 139 (1993).

[47] *See id.* at 142.

The Federal Aviation Act provides that the Secretary of Transportation may issue a certificate of public convenience and necessity to a citizen of the U.S.[48]. Another proviso of the same act contains the definition of who may be considered a U.S. citizen. Section 1301(16) sets forth that citizen of the U.S. means

(a) an individual who is a citizen of the U.S. or one of its possession, or
(b) a partnership of each member is such an individual, or
(c) a corporation or association created or organized under the laws of the U.S. or of any state, territory, or possession of the U.S., of which the president and two-thirds or more of the board of directors and other managing officers thereof are such individuals and in which at least 75% of the voting interest is owned or controlled by persons who are citizens of the U.S. or of one of its possessions[49].

It is striking that this clause appears to be silent on the problem of effective control, if the latter is exerted by other means than membership in the board of governors. This gap, however, was closed by the CAB and, after its dismantling, by its successor, the Department of Transportation itself, which construed the nationality requirement broadly[50].

The reasons behind the relatively strict implementation of the nationality principle in U.S. domestic law are multifold: First, when the Air Commerce Act was enacted, security concerns prevailed. The U.S. wanted to ensure that commercially operated aircraft could be requested in times of war to serve as an auxiliary air force fleet[51]. Today, security concern have been joined by the wish to protect its own aviation industry. Furthermore,

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[48] 49 U.S. Code § 41102.
[49] 49 U.S. Code § 1301(16).
[50] *See* Department of Transportation, *In re Intera Arctic Services*, August 18, 1987, DoT Order No. 87-8-43, where the Department refused to grant a license to a carrier on the ground that in its board of director served U.S. citizens, who were employees of a foreigner, who, himself, held a majority of the non-voting shares. Thus, the Department concluded that the company would be under effective control of a foreigner, dismissing the application for an operating license for a domestic carrier.
[51] *See* David T. Arlington, *Liberalization of Restrictions on Foreign Ownership in U.S. Carriers: The U.S. Must Take the First Step in Aviation Globalization*, 59 JALC 133, 139 (1993).

U.S. carriers and in particular labor unions always contend that the nationality clause is still needed today to protect jobs.

### 1.2.2.2 European Legislation

In the framework of the European Community, licensing conditions have been harmonized by Council Regulation 2407/92[52]. This Regulation establishes the "substantive ownership and effective control"-requirement, which must be respected community-wide by all Member States. It is noteworthy that the Regulation, instead of using the term "substantial ownership", uses the expression "majority ownership"[53]. At any rate, pursuant to the Regulation, an operating license may only be granted to a carrier, the capital of which is held to more than 50% by one or more Member States or citizens thereof. Furthermore, the carrier must be effectively controlled by Member States or their nationals. In Art. 2 (g), the Regulation defines "effective control" as

> a relationship constituted by rights, contracts or any other means which, either separately or jointly and having regard to the considerations of fact or law involved, confer the possibility of directly or indirectly exercising a decisive influence on an undertaking, in particular by
> (a) the right to use all or part of the assets of an undertaking;
> (b) rights or contracts which confer a decisive influence on the composition, voting or decisions of the bodies of an undertaking or otherwise confer a decisive influence on the running of the business of the undertaking[54].

For the sake of completeness, it should be mentioned that the Regulation provides for certain exceptions, with respect to *SAS*, *Britannia* and *Monarch*. Control over these carriers, however, must not pass to any person of a non-member state, if this person has a

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[52] Council Regulation 2407/92, O.J. No. L 240/1.
[53] State practice over the years has consisted in interpreting substantial ownership as meaning majority ownership.
[54] *Id.* at Art. 2(g).

significant interest in a carrier of a non-member state[55]. This provision is aimed at preventing any community carrier from becoming a kind of a Trojan Horse to a non-community carrier seeking access to the single market[56].

Furthermore, by providing that the nationality requirement is "without prejudice to agreements and conventions to which the Community is a contracting party"[57], the regulation leaves room for agreements with third countries, in which both parties might agree on waiving the nationality requirement.

For the Member States, Council Regulation 2407/92 has replaced national legislation[58]. This means that in no Member State, more stringent conditions than those established by the Regulation may be required from any air carrier[59].

### 1.2.2.3 Canada

The Canadian position on the question of substantive ownership and effective control does not differ in substance from that of the U.S. Art. 55 of the Canada Transportation Act[60] defines Canadian as a

> Canadian citizen or a permanent resident within the meaning of the Immigration Act, a government in Canada or an agent of such a government or a corporation or other entity that is incorporated or formed under the laws of Canada or a province, that is controlled in fact by Canadians and of which at least *seventy-five per cent*,

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[55] *Id.* Annex III.
[56] *Cf.* JOHN BALFOUR, EUROPEAN COMMUNITY AIR LAW 37 (1995).
[57] EC Council Regulation 2407/92, OJ L240/1, at Art. 4(3).
[58] Such as, in the case of Germany, § 20 LuftVG.
[59] *See* Joachim Rosengarten & Klaus-Dieter Stephan, *The Licensing of German Air carriers in Germany under Regulation 2407/92*, 23 AIR & SPACE LAW, 67 (1998).
[60] An Act to Continue the National Transportation Agency as the Canadian Transportation Agency, to consolidate and revise the National Transportation Act, 1987, and the Railway Act and to Amend or Repel Other Acts as a Consequence, assented to May 29th, 1996, Chapter C-10.4 (hereinafter *Canadian Transportation Act*).

> or such lesser percentage as the Governor in Council may by regulation specify, of the voting interests are owned and controlled by Canadians (emphasis added)[61].

The same requirement must be contained in the Articles of Association of Air Canada pursuant to the Air Canada Public Participation Act[62]. Art. 6(1b) of this act lays down that the Articles of Continuance shall contain, among other things,

> provisions imposing constraints on the issue, transfer and ownership...of voting shares of the Corporation to prevent non-residents from holding, beneficially owning or controlling, directly or indirectly, otherwise than by way of security only, in the aggregate voting shares to which are attached *more than twenty-five per cent of the votes* that may ordinarily be cast to elect directors of the Corporation (emphasis added)[63].

The same Act also limits the percentage of shares to be held by a single person – natural person or corporation - to 10%[64]. This proviso turned out to be the stumbling block for the holding company *ONEX*, which in 1999 launched an unsuccessful take over bid for *Air Canada*, failing to camouflage that it would eventually hold more than 10% of the voting shares.

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[61] *Id.* at Art. 55.
[62] An Act to provide for the continuance of Air Canada under the Canada Business Corporations Act and for the issuance and sale of shares thereof to the public, assented to August 18, 1988, Chapter A-10.1 (hereinafter *Air Canada Public Participation Act*).
[63] *Id.* at Art. 6(1)(b).
[64] *See id.* Art. 6(1)(a).

# Chapter 2: Some Economical Aspects of Airline Alliances

## 2.1 Why Airline Alliances?

The aforementioned international regulation of air transport has been one of the main reasons behind the emergence of airline alliances.

### 2.1.1 Airline Consolidation and Hub and Spokes

In a more and more deregulated economy, there has been an obvious trend toward airline consolidation. This may be exemplified best in the U.S. market. In 1984, 15 carriers accounted for 90% of the domestic market. In 1989, however, the same share was held by only eight airlines[65]. Some carriers disappeared or were taken over after filing for bankruptcy (for example, *Braniff*, *Pacific Express* and *Northeastern*)[66]. Other carriers vanished from the airscape due to outright mergers (*e.g. Delta* took over *Western*, *TWA* acquired *Ozark*, and *Continental*, *Texas* and *Eastern* merged into one company)[67].

The same trend also emerged in Canada[68] and, domestically speaking, in Europe[69].

Consolidation went hand in hand with another trend – hubbing. The idea behind the concept of hub and spoke is to offer as many city pairs as possible by scheduling flights through one airport – the hub. Thereby, a flight linking two airports directly is replaced by two connecting services. Hubbing provides airlines with considerable economies of

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[65] *See* PAT HANLON, GLOBAL AIRLINES – COMPETING IN A TRANSNATIONAL INDUSTRY 187 (1996) [hereinafter *Global Airlines*].

[66] For an exhaustive list *compare* M. Brenner, *Airline Deregulation – A Case Study in Public Policy Failure*, 16 TRANSPORT. L. J. 179, 183 (1988). For Bankruptcy in aviation *see in general* J.S. Heuer & M.H. Vogel, *Airlines in the Wake of Deregulation: Bankruptcy as an Alternative to Economic Regulation*, 19 TRANSPORT. L. J. 247 (1991) [hereinafter Heuer *et al.*, *Airlines in the Wake of Deregulation*](The author states that "*... bankruptcy more adequately serves the entire airline industry than direct government regulation...*").

[67] *Id.* at 287.

[68] For the situation in Canada, *see generally* T.H. Ohm, W.T. Stanbury & M.W. Tretheway, *Airline Deregulation in Canada and its Economic Effects*, Working Paper, Faculty of Commerce and Business Administration, University of B.C., PETER HANLON, GLOBAL AIRLINES, *supra* note 63, at 189-90.

scale: adding just one spoke offers a multitude of new city pair links through the hub airport. Therefore, it is often said that hub and spoke-networks have a multiplying effect[70].

### 2.1.2 Airline Consolidation Internationally

In most other business sectors, the industry responded to globalization by mergers. In contrast to the U.S. domestic airline market, where mergers have taken place, there has been no significant transnational merger in the airline business[71]. The reason for that lies in the bilateral organization of air transport, and more in particular in the above requirement of national ownership and control as contained in all bilateral agreements.

The substantial ownership and effective control-clause represented heretofore a major impediment for transnational mergers between airlines. Any merger results in the loss of nationality of one of the carriers concerned, and could result in the loss of traffic rights. That uncertainty is a crucial impediment to mergers and to the consolidation that could result therefrom. The answer to that impediment has been the airline alliances in their present form (which do not affect the nationality of the airlines concerned).

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[69] *See* PAT HANLON, GLOBAL AIRLINES, *supra* note 65, at 192.

[70] *See id.* at 71-2 (The author illustrates this with a mathematical formula: adding on spoke achieves n(n+1):2 new city pair connections). Hub and Spoke networks are most efficient if schedules are coordinated in order to allow for several waves of connecting services, *see* Nigel Dennis, *Scheduling issues and network strategies for international airline alliances*, 6 JOURNAL OF AIR TRANSPORT MANAGEMENT 75 (2000). On the other hand, hubbing is blamed for airport congestion and delay problems, *see* M. Brenner, *Airline Deregulation*, *supra* note 66, at 168, 171.

[71] However, the Chicago Convention has been sympathetic toward the creation of multinational airlines. Art. 77 provides:

> Nothing in this Convention shall prevent two or more contracting states from constituting joint air transport operating organizations or international operating agencies and from pooling their air services on any routes or in any regions, but such organizations or agencies and such pooled services shall be subject to all the provisions of this Convention, including those relating to the registration of agreements with the Council.

These consortia have been limited mostly to neighboring countries, *i.e.* SAS (Sweden, Denmark and Norway), Air Afrique (Benin, Burkina Faso, Central African Republic, Chad, Congo, Ivory Coast, Mali, Mauritania, Niger, Senegal and Togo) and BWI (regrouping several countries in the West Indies). These examples may not be compared to mergers between international airlines, as the starting point is completely different. A merger presupposes the existence of several airlines operating independently.

Whether this reasoning will still stand in the next century seems to be increasingly doubtful. In June 2000, *British Airways* announced that it is exploring the prospects of a merger with the Dutch carrier *KLM*[72]. Such a transaction, if agreed to by the two airlines concerned, might have a strong impact on the current shape of international aviation and might, in the long term, mark the end of today's insistence on national ownership and control and of the resulting alliances. This prospect shall be evaluated throughout this study.

The bilateral organization of international aviation is not the only factor, which hindered international mergers between airlines.

It is also true that, often, aviation is not perceived as a service like any other. An airline flies the flag of its country of origin, serving thereby as an "ambassador on wings"[73]. States are sometimes loath to see their flag carrier being merged into a foreign airline.

Moreover, it must also be kept in mind that air transport is considered by many as a public service[74], necessary for the economical development of a country. These reasons have also proven to be an obstacle to outright mergers.

In conclusion, it is fair to say that globalization could not take place in the airline sector. Though the benefits of mergers also apply in this field, the bilateral framework, forced airlines to stop short of outright mergers. In this respect, "alliances form the next best instrument"[75], providing a number of cost and revenue advantages comparable to those resulting from mergers.

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which then decide to form one company. An airline under Art. 77, however, is created as a multinational company from the very beginning.

[72] *See BA Explores a Merger with KLM*, THE WALL STREET JOURNAL, June 5, 2000, at A21.

[73] The concept of the flag carrier is particularly strong in new states. It has nonetheless never been absent in Europe. When British Airways replaced its Union Jack-design by a modern cosmopolitan one, the public outcry forced it to fly the British flag again.

[74] *See* JACQUES NAVEAU, AIRLINE ALLIANCES – LEGAL ASPECTS AND THE IMPACT ON THE ORGANIZATION OF AIR TRANSPORT 3 (1999) [hereinafter *Airline Alliances*].

The different features of airline alliance shall be presented in the following.

## 2.2 Some Selected Features of Airline Alliances

Global alliances may vary as to their scope and structure. Nevertheless, all of them contain at least one or even more of the following features.

### 2.2.1 Code-Sharing Agreement

Every airline has been allocated, pursuant to IATA Resolution 762, a two or three letter designation code, which is used in timetables and on tickets to identify the carrier. Under a Code-Sharing Agreement, one party, which actually operates a certain service, allows another party to display the same service under its own designator[76]. The practice of code-sharing emerged in the domestic U.S. market, where it was used primarily between a large carrier and a commuter or regional airline. Apparently, code-sharing can be traced back to the 1960s, when it was initiated by *Allegheny Airlines*[77] and *Henson Aviation*, a commuter airline[78]. Nowadays, code-sharing is a common practice at the international level too. It facilitates feeder traffic to be funneled through an international hub and seems to enlarge the network of the code-sharing partners, without a single flight being added to the schedule. Hence the airlines' interest for this marketing and sales practice. Even though the passenger might benefit from code-sharing, *i.e.* due to more convenient connections and single check-in, it has come under criticism, as it is perceived by some to be anti-competitive[79] or even misleading to consumers[80]. Furthermore, it raises several

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[75] *See* Onno Rijsdijk, *EC Aviation Scene*, 25 AIR & SPACE LAW 76 (2000).
[76] *See* JACQUES NAVEAU, AIRLINE ALLIANCES, *supra* note 74, at 26.
[77] Which was later merged into *U.S. Airways*.
[78] *See* Stephen Harris, Jr. & Elise Kirban, *Antitrust Implications of International Code-sharing Alliances*, 23 AIR & SPACE LAW 166, 167 (1998).
[79] *Cf.* United States General Accounting Office, Airline Deregulation – Barriers to Entry Continue to Limit Competition in Several Key Domestic Markets, GAO/RCED-97-04, at 19 [hereinafter *GAO-Report*] ("...Code-sharing agreements...work to eliminate potential competitors by foreclosing connecting traffic from new airlines that do not have such agreements. As a result, code-sharing allows an incumbent to strengthen its position at a hub even further.").
[80] *See* JACQUES NAVEAU, AIRLINE ALLIANCES, *supra* note 74, at 26.

regulatory issues, such as traffic rights, airline liability and under competition law[81], which will be analyzed later. It is worthy of note that a code-sharing agreement is often accompanied by a blocked space agreement. Moreover, it is most efficient when combined with a Computer Reservation System (CRS)[82]. As a CRS today gives preference to an online connection over interlining, code-sharing helps the airlines concerned to fill the first computer screen, from which most of the bookings are made[83].

### 2.2.2 Blocked Space Agreement

A blocked-space agreement often comes hand in hand with a code-sharing agreement. It consists in the allocation of a number of seats on a specified flight by one airline to another. The latter will then sell these seats in its name (under its code) and through its own distribution system[84]. Sometimes, analysts distinguish two features: In a closed blocked space-agreement, the number of seats sold is specified, so that the purchasing carrier bears the risk of not filling all the seats. In an open blocked space-agreement, however, both airlines sell seats on a first come, first served basis. Here, the commercial risk remains on the shoulders of the operating airline[85].

### 2.2.3 Franchising

The next form of cooperation worthy of note is franchising. Also common to other goods and services, the term franchising connotes in aviation the permission given by one airline to another to use its name, aircraft livery and brand image[86]. Franchising is above all a form of cooperation used between big carriers and smaller feeder airlines. *Lufthansa*,

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[81] *See* Stephen Harris, Jr. & Elise Kirban, *Antitrust Implications of International Code-Sharing Alliances*, 23 AIR & SPACE LAW 166 (1998) [hereinafter Stephen Harris *et al.*, *Antitrust Implications*].
[82] *See* R.I.R. ABEYRATNE, LEGAL AND REGULATORY ISSUES OF COMPUTER RESERVATION SYSTEMS AND CODE SHARING AGREEMENTS IN AIR TRANSPORT 120 (1995) [hereinafter R.I.R. Abeyratne, Legal Issues of CRS] (The author points out that code-sharing is advantageous to the participating carriers in that it improves connections). *See also* PAT HANLON, GLOBAL AIRLINES, 105 (1995).
[83] *See infra* 2.2.7.
[84] *See* Dawna L. Rhoades & Heather Lush, *A typology of strategic alliances in the airline industry: Propositions for stability and duration*, 3 JOURNAL OF AIR TRANSPORT MANAGEMENT 109, 110 (1997).
[85] *See* Stephan Harris *et al.*, *Antitrust Implications*, *supra* note 79 at 170-171.
[86] *See* PAT HANLON, GLOBAL AIRLINES, *supra* note 65, at 95.

for instance, entered into a franchising agreement with *Augsburg Airways* under the brand name *"Team Lufthansa"*. According to the terms of the agreement, *Augsburg Airways* is to operate some domestic routes at its own cost, but under quality control by *Lufthansa*[87]. Similar arrangements exist with *Contact Air*, *Rheintalflug*, *Air Littoral* and *Cimber Air*.

### 2.2.4 Mutual Recognition of Frequent Flyer Programs (FFP)

An FFP is a special travel incentive offered today by each major airline[88]. It works in the following way: Any given passenger, by purchasing his ticket, accumulates points or miles according to the distance traveled and the class of service chosen[89]. He can then redeem his points by exchanging them against tickets for air travel or any other kind of reward. *American Airlines* was the first airline to launch such a loyalty scheme in 1981[90] and most of all the other major airlines followed suit. In the framework of airline alliances, the alliance partners pledge to honor even miles/point earned on flights of a partner airline. Thereby, the network on which any given passenger can acquire loyalty points is considerably enlarged. FFPs have long been identified as a terrific tool in the hands of airlines to tie their clientele, especially high-yield business travelers. A survey undertaken by the General Accounting Office illustrates that more than half of all passengers chose their flights according to the FFP in which they participated[91]. Obviously, the more partners in the FFP, the more attractive it is for the passengers.

### 2.2.5 Flight Schedule Coordination

Code-sharing as such may be rather inefficient, unless the participating carriers coordinate their flight schedules. The pattern of hub and spoke requires coordination between incoming and leaving connecting flights, so that passengers can be offered

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[87] *See* R.I.R. Abeyratne, *Strategic Alliances of Airlines*, 17 TRADING LAW 506, 510 (1998).
[88] In the case of *Star Alliance*, each airline entertains its own loyalty scheme, *i.e.* Aeroplan (*Air Canada*), Air Points (*Air New Zealand*), Mileage Club (*ANA*), Global Rewards (*Ansett*), Miles & More (*Lufthansa*), EuroBonus (*SAS*), Royal Orchid (*Thai*), Mileage Plus (*United Air Lines*) and Smiles (*Varig*).
[89] *See* PAT HANLON, GLOBAL AIRLINES, *supra* note 65, at 45.
[90] This FFP was called *Aadvantages*.

convenient connections. Furthermore, airlines, by harmonizing their schedules, seek to avoid overlapping connections[92].

### 2.2.6 Equity

In 1996, 16% of all alliance agreements were accompanied by exchange of equity[93]. One advantage of purchasing shares is that it "demonstrates commitment, and assures the other airline of a serious interest in a long-term relationship"[94]. However, equity has not really turned out to be an impediment to any airline leaving an alliance. *Singapore* and *Austrian* both left *Atlantic Excellence/Qualiflyer* and subsequently joined *Star Alliance* even though *Swissair* held a 10% stake in *Austrian* and a – arguably negligible – 0.6% in *Singapore*. There is certainly a percentage of share holding high enough to scare off potential suitors. On the other hand, in this case, share holding then becomes a risky investment if the partially owned carrier experiences financial difficulties or has to file for bankruptcy protection.

If equity swapping once was perceived as an effective exit barrier aimed at making alliance commitments irreversible, other forms of cooperation might even promise more success. It has previously been pointed out to the example of *Austrian*. It is striking that this airline, albeit leaving *Qualiflyer*, decided to continue its participation within *Qualiflyer's* FFP. Apparently, a legal provision as regards FFP achieved what 10% of shares failed to do.

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[91] *See* GAO-Report, *supra* note 79, at 19.
[92] *See generally* Nigel Dennis, *Scheduling issues and network strategies for international airline alliances*, 6 JOURNAL OF AIR TRANSPORT MANAGEMENT 75 (2000).
[93] *See* Dawna L. Rhoades & Heather Lush, *A typology of strategic alliances in the airline industry: Proposition for stability and duration*, 3 JOURNAL OF AIR TRANSPORT MANAGEMENT 109, 112 (1997). The most notable examples of equity links are: *Singapore* holds 3% of *Delta* and 2.7% of *Swissair*, *Swissair* holds 10% of *Austrian*, 3% of *Delta*, 0.6% of *Singapore*, 49.5% of *Sabena*, *Delta* holds 2.7% of *Singapore*, 4.5% of *Swissair*, *KLM* holds 30.0% of *Braathens*, 26% of *Kenian*, *SAS* holds 40% of *British Midland*, *Iberia* holds 10% of *Aerolinas Argentinas*, *Air France* holds 4.0% of *Royal Air Maroc*, 1.5% of *Austrian*. *See "Hold your horses!"*, AIRLINE BUSINESS, June 1998, at 46-47.
[94] *See* PAT HANLON, GLOBAL AIRLINES, *supra* note 65, at 199.

Often enough, non-strategic cooperation such as the setting up of joint sales counters might even be more difficult to unravel than any legal ploy[95]. It should not be forgotten either that the termination of any alliance agreement will be subject to the payment of penalty fees – also often a deterrent to leaving an alliance.

Corresponding visions for the future certainly constitute the best cement for any alliance. Few alliances, however, have achieved this "cultural fit". Some might feel that good personal relations between the respective CEOs of alliance member is the first step toward establishing a long-lasting bond – a very ephemeral one, if taking into account that CEOs must constantly respond to their major share holders.

### 2.2.7 Computer Reservation Systems (CRS)

A CRS is not only a device for travel agents to book flights, but also a tool for incumbent airlines to thwart new entry to the market. Generally speaking, CRSs are nothing else than databases that allow the user – the travel agent – to check certain information (like schedules and fares), to make instant reservations and to issue the ticket[96]. In order to understand the thrust of CRSs, it must be kept in mind that approximately 80% of all flight booking are made via CRSs and that out of these, 75% are made from the first screen[97]. Today, there are five major CRSs: *American's Sabre*, *Apollo* (by *United Airlines*), *Amadeus* (by *Air France*, *Lufthansa*, *Iberia* and *Sabena*), *Galileo* (by *British Airways*, *KLM*, *Alitalia*, *Swissair*, *Austrian*, *Air Lingus* and *TAP Air Portugal*) and *Abacus* (by *Cathay Pacific*, *Singapore* and *All Nippon Airways*, among others).

CRSs turn out to be lucrative to airlines for two reasons. First, they generate revenues, as there is a booking fee levied on any ticket emitted with the help of the CRS. Second and even more importantly, airlines operating a CRS can try to increment ticket sales on

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[95] *See* GRAHAM HORWARTH & THOMAS KIRSEBOM, THE FUTURE OF AIRLINE ALLIANCES 41 (2000).
[96] *See* Note, *The Legal and Regulatory Implication of Airlines Computer Reservation System*, 103 HARV. L. REV. 1930 (1990).

their own flights by rendering their CRS biased, so that it prefers the flights of its host airline to the detriment of its competitors.

Initially, the different CRSs were overtly biased. This prompted regulators to promulgate rules aiming to protect the consumer by outlawing any preferential treatment by the CRS in favor of its host airline. However, airlines soon found ways to bypass these restrictions. One of these is the above-mentioned practice of code-sharing. Code-sharing enables airlines to clutter CRS screens with one same connection under different flight numbers. Today, this practice has also been significantly reduced due to regulatory interventions.

Nonetheless, the issue of CRS is never absent from any negotiation on airline alliances. Sometimes, an airline, in the framework of an alliance, agrees to adopt the CRS already in use by most of its partners[98]. Moreover, offering as much connections as possible might give an alliance a competitive edge over its competitors[99].

## 2.3 The Benefits of Alliances

An alliance may be beneficial to its member in two ways: by increasing revenues and reducing costs.

Concerning revenue enhancement, several aspects might be identified. First, an alliance gives its participating airlines access to more markets. In practice, an alliance member may advertise services to parts of the world, whereto it does not offer services on its own. Indeed, alliance membership enhances the timetable of any given airline without any additional flight being offered.

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[97] *See* PAT HANLON, GLOBAL AIRLINES, *supra* note 65, at 55. It is possible, however, that this number is set to rise with the advent of online-internet booking.

[98] *Qantas* adopted *Galileo*, operated, among others, by *British Airways*, its partner in *OneWorld*.

[99] This might be not only because of the shear number of connecting flights offered, but also because one of the same is the most convenient one in terms of flight time.

This pattern is even furthered by flight schedule coordination. By coordinating their respective flight plans, alliance members are in a position to offer more and also more convenient connections. They can thus even increase services on key routes, such as between their hubs, thereby scaring off competitors on their home turf.

Airline alliances can also offer their clients access to a greater number of airport lounges around the world. Instead of relying on the facilities of the airline he travels on, the passenger can also use those of the other alliance members.

In sum, airline alliances can offer to their customers a more appealing product than non-allied carriers. When it comes to seamless traffic and global air transport, their competitors will find it increasingly difficult to compete with their inferior interlining-based products. Therefore, it might well be that alliances increase their revenues on the back of non allied carriers.

This is in part confirmed by the findings of a recent study by *Gemini Consulting*, which revealed that some airlines contemplate joining an alliance in order not to be left on their own[100].

On the other hand, the formation of an alliance might even bring about cost savings by allowing for economies of scale. It is suggested that alliance members could make savings of around 2%[101].

In particular, close collaboration between alliance members might spell out cost savings through standardization and joint procurement. Standardized cockpit and cabin designs would allow airlines to swap their aircraft whenever seasonal demand for air transport is low. Moreover, joint aircraft purchase by alliance members would give them more market power, enabling them to force prices down[102].

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[100] *See* GRAHAM HOWARTH & THOMAS KIRSEBOHM, THE FUTURE OF AIRLINE ALLIANCES 14 (2000).
[101] *See* Kevin O'Toole, *Reworking the Model*, AIRLINE BUSINESS, November 1999, at 79.
[102] One example of joint aircraft purchase is the joint order by *Swissair*, *Sabena* and *Austrian* of Airbus A-330s in 1996. It is noteworthy, however, that joint procurement might be more interesting to small carriers

Pooling maintenance facilities was a means by which airlines cooperated already at a time when alliance was not yet the buzzword in commercial aviation. In the early 1970's, several airlines formed two consortia, *KSSU* (by *KLM*, *SAS* and *Swissair*) and *Atlas* (with *Air France*, *Lufthansa*, *Sabena* and *Alitalia* participating). These two endeavors were disbanded recently, but the basic idea is as valid today as it was several years ago. Today, airlines share maintenance bases and flight simulators or specialize in one particular type of aircraft, leaving maintenance of the others to fellow airlines, thereby reducing cost for the stocking and purchasing of spare parts.

Further savings may be achieved within an alliance by the setting up of joint sales offices, alliance-wide advertising and sales promotion, in the field of insurance premiums and airport handling, as well as yield management.

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than for the larger ones. It was pointed out that alliance members could even reap more profits by acquiring aircraft at discounted prices and by selling them back at market prices to leasing companies. *See* in this respect Michael Allen & Steven Casley, *Fleet Planning for Alliances*, AIRLINES INTERNATIONAL, 1999, at 10.

# Chapter 3: A New Star is Born – Focus on *Star Alliance*

Arguably, the most advanced airline alliance is *Star*, an entity encompassing today 12 members, as of July 1, 2000.

## 3.1 Some Key Figures on *Star Alliance*

The *Star Alliance* evolved out of close-knit relations between *Lufthansa*, *United Airlines*, *SAS*, *Air Canada* and *Thai* in May 1997. At the inception, the thrust of this partnership was somewhat limited in scope, as it focused merely on code-sharing, mutual FFP acknowledgement and common lounge access. In the ensuing years, this partnership, which was soon baptized the *Star Alliance*, not only took on new members, but also moved toward more integration[103]. In October 1997, the Brazilian airline *Varig* joined *Star*. The next enlargement of *Star* occurred in March 1999, when the Australian *Ansett* and *Air New Zealand* were taken onboard. Japanese *All Nippon Airways* (*ANA*) became *Star's* 9th member in October 1999. At *ANA's* acceptance ceremony on October 15 1999, it was announced that *Singapore Airlines*, already a code-sharing partner of *Lufthansa* since 1998 and heretofore member of the *Qualiflyer Group*, would join *Star* in 2000[104]. Like *Singapore*, *Austrian Airlines* also left *Qualiflyer* to become a full-fledged *Star* member on July 1 2000[105]. The Mexican carrier *Mexicana Airlines* and *British Midland* also joined *Star* in July 2000.

All airlines combined, *Star* can boast to serve more than 800 destinations in more than 130 countries[106]. Even without *British Midland* and *Mexicana*, these statistics suggest

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[103] *See* Michael A. Taverna, *Star Alliance Approaches Next Phase of Collaboration*, AVIATION WEEK & SPACE TECHNOLOGY, August 23, 1999, at 58 [hereinafter Michael A. Taverna, *Star Alliance Approaches Next Phase*].

[104] *See* Micheal A. Taverna, *Star Signs Up Singapore, Sets Air Canada Defense*, AVIATION WEEK & SPACE TECHNOLOGY, October 25, 1999, at 28.

[105] *See* Michael A. Taverna, *Star Adds Austrian, Mulls Air Canada Move*, AVIATION WEEK & SPACE TECHNOLOGY, September 27, 1999, at 43. It is noteworthy two regional carrier, affiliated to Austrian, *LaudaAir* and *Tyrolean*, will accompany the Austrian flag carrier.

[106] *See* http://www.star-alliance.com/isroot/SA/htmen/0_2-04-07-2000c.htm.

that *Star* members combine a market share of 20.6% of world traffic, making it the strongest airline alliance in terms of market share[107] and size[108].

According to *Star's* founding members, the forming of the alliance has increased profits up to 10% for all of the airlines concerned[109]. Extra business generated by the alliance is estimated by *Lufthansa* to have added US $ 275 million to the revenues of Germany's flag carrier[110].

## 3.2 The *STAR* Constellation: Brief Presentation Of Some Of *Star's* Members

### 3.2.1 *Lufthansa*

Germany's flag carrier today serves 340 destinations out of its main hub, Frankfurt Rhein-Main, one of the busiest airports in the world. *Lufthansa's* close ties with *SAS* evolved later into the *Star Alliance*. This German-Scandinavian relationship is strengthened by the fact that a senior executive of *SAS* serves as a member of *Lufthansa's* supervisory board. Beyond *Star*, *Lufthansa* code-shares with *CSA*[111], *Air Baltic*, *Adria Airways*[112] and, more importantly, *South African Airways*[113][114]. *Lufthansa's* activities also include counseling for other foreign airlines, such as *Garuda* of Indonesia, *PAL* of the

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[107] *See Alliance Survey*, AIRLINE BUSINESS, July 1999, at 37. *Star's* most ferocious competitor, *OneWorld* combines 17.8% of world traffic, but has hitherto failed to get approval and anti-trust immunity. *Wing* accounts for 10.8% of world traffic and *Qualiflyer* for 9.9%.

[108] *See* Michael A. Taverna, *Star Alliance Approaches Next Phase*, *supra* note 103, at 58.

[109] *See* Geoffrey Thomas, *Star Alliance Founders Say Membership Means Profits*, AVIATION WEEK & SPACE TECHNOLOGY, May 17, 1999, at 64.

[110] *See* Michael A. Taverna, *Star Alliance Approaches Next Phase*, *supra*, at 58. The added revenues for *United* and *SAS* are US $ 200 million and 59 million, respectively. Therefore, Lufthansa seems to have reaped the most out of Star. Simple coincidence or not, Lufthansa may also be considered the driving force behind *Star* and *Lufthansa's* CEO Juergen Weber its father.

[111] On routes from Prague to Frankfurt, Stuttgart, Hamburg, Düsseldorf, Cologne-Bonn, Hanover and Munich.

[112] On Frankfurt-Ljubljana and Munich-Ljubljana. This cooperation also includes joint ground handling and the sharing of passenger lounges.

[113] On all flights between Johannesburg and Frankfurt and Cape Town and Frankfurt. *SAA* and *Lufthansa* offer 86 over all code sharing connections between Germany and South Africa. Moreover, both carriers have agreed on joint FFP and ground handling. Despite these close ties, Lufthansa has failed so far in its efforts to court *SAA* on behalf of *Star*. Instead, the South African carrier chose to move closer to *Qualiflyer*.

[114] *See Alliance Survey*, AIRLINE BUSINESS, July 1999, at 55.

Philippines, and *Mexicana*[115]. Moreover, *Lufthansa* is majority shareholder of the world's leading airline caterer, *Sky Chefs*.

### 3.2.2 *United Air Lines*

*United* is the world's leading airline in terms of fleet size, daily departures and passengers. From its hubs at Chicago and Denver, *United* carried 87 million passengers in 1999[116]. *United* code-shares with *Emirates* between London Heathrow and Dubai and with *Saudi Arabian Airlines* on the route New York-Jeddah[117].

In May 1999, *United Air Lines* announced its intention to buy a majority stake in *U.S. Airways*, the fourth biggest U.S. carrier[118]. The deal, which still hinges on approval by the U.S. Justice Department, might begin a new round of airline consolidation in the U.S. market[119]. If the deal is to go ahead, many analysts believe that it will bolster *Star Alliance*[120]. However, at any rate, the proposed take over still faces many obstacles, such as labor resistance and antitrust[121].

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[115] *See* Michael A. Taverna, *PAL Looks To Lufthansa For Help in Turnaround*, AVIATION WEEK & SPACE TECHNOLOGY, July 5, 1999, at 38.
[116] *See* http://www.star-alliance.com/isroot/SA/htmen/o_2-04-07-2000c.htm.
[117] *See Alliance Survey*, AIRLINE BUSINESS, July 1999, at 65.
[118] *See Huge UAL-US Air Deal Quickly Faces Many Obstacles*, THE WALL STREET JOURNAL, May 25, 1999, at A1.
[119] In reply to the *United* take over bid, *American Airlines* has already begun exploratory talks with *Northwest* and *Continental* about a possible merger. *See American Explores a Deal for Northwest*, THE WALL STREET JOURNAL, June 5, 2000 at A5 (which advances that *American Airlines'* objective is to "pile on so much concentration in the airline industry that *no* transactions end up taking place").
[120] *See Europe's Airlines Face Upheaval As U.S. Deal Shuffles Alliances*, THE WALL STREET JOURNAL, May 25, 1999, at A12.
[121] To alleviate antitrust concerns, *UAL* has proposed to spin off the Washington-New York shuttle, in form of a new company, DC Air. *See Questions Mount about DC Air, Set to Be Biggest Carrier at Reagan*, THE WALL STREET JOURNAL, May 25, 2000, at A16. After the merger between *United* and *U.S. Air*, the two carriers combined would accommodate 62% of all passengers at Washington-Dulles and 39% at Washington National 40%.

### 3.2.3 *SAS*

*SAS* is also one of *Star's* founding fathers. Its relation with *Lufthansa* was the key stone of what later became *Star*. *SAS* code-shares with *Icelandair*[122], *LOT Polish Airlines*[123] and *Maersk*. *SAS* recently initiated a close relationship with *Estonian Air*, including FFP participation, joint ground handling and access to lounges[124].

### 3.2.4 *Air Canada*

The forth founder of *Star*, *Air Canada* constituted the object of a hostile take over bid by the Canadian company *ONEX*, which intended to merge *Air Canada* with the second international Canadian carrier, *Canadian Airlines*, and make it join the competing *OneWorld* alliance. Bolstered by its partners, *United* and *Lufthansa*[125], *Air Canada* launched a counter bid on Canadian and proposed to repurchase up to 35% of its own stocks[126]. *ONEX's* take-over bid fell apart, however, when the Quebec Superior Court held that the bid was illegal in that it violated Art. 6 (1) a of the Air Canada Public Participation Act, pursuant to which no single person may hold more than 10% of the voting shares of *Air Canada*. More than a simple take-over battle, *ONEX's* bid is perceived by many as the first confrontation between competing alliances. Therefore, *Air Canada* has now taken over *Canadian*, the latter joining *Star* in due course

### 3.2.5 *Thai*

Albeit the 5th founding member of *Star*, its presence in *Star* seems to be an unsafe bet for the time being. *Thai* is said to be very unhappy with the fact that *Singapore Airlines* was admitted as a new member, as the latter competes within the alliance with *Thai* on

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[122] Between Rekjavik and Copenhagen, Oslo, Stockholm and to Hamburg via Copenhagen.
[123] Between Copenhagen and Wroclaw.
[124] *See Alliance Survey*, AIRLINE BUSINESS, July 1999, at 61.
[125] *Lufthansa* would purchase *Air Canada's* preferred shares worth Can $ 140 million and guarantee Can $ 150 in loans. *United* would buy Can $ 90 million of *Air Canada's* convertible shares, and provide Can $ 190 million in a sale and lease back deal concerning three A-330 aircraft. *See* Barbara Beyer, *Affecting Competition And Alliances*, THE AVMARK AVIATION ECONOMIST, December 1999, at 4.
[126] *See* Michael A. Tavernia & Geoffrey Thomas, *Star Signs Up Singapore*, *supra* note 104, at 29.

the routes between Europe and Australia. Moreover, the Thai government seeks to sell 20% of its 93% participation in the Thai carrier. *Lufthansa* is expected to tender jointly with *Singapore*, but if the competing bid by *OneWorld* members *British Airways* and *Qantas* were given preference, *Thai* might be forced to leave *Star*[127].

### 3.2.6 *Ansett Australia*

*Ansett* joined *Star* in March 1999. It was one of the two Australian carriers to operate under the official "Two Airline-Policy", which was terminated in 1990[128]. 50% of *Ansett's* shares are held by *Air New Zealand*, which also holds a right of first refusal on the remaining half[129]. *Singapore Airlines*, which had an eye on the 50% held by *Ansett's* other major share-holder, *Brierly Investments Ltd.*, eventually failed in its attempt to buy itself into the *Australian Airline*[130]. Recently, this remaining half of *Ansett* was acquired instead by *Air New Zealand*, the former ending up being a fully-owned subsidiary of the latter[131]. *Ansett* code-shares with Taiwan-based *EVA Air*[132] and with *Malaysia Airlines*[133]. Moreover, it has agreed to mutual FFP recognition with *South African Airlines*[134].

### 3.2.7 *Air New Zealand*

*Air New Zealand*, *Star Alliance* member since March 1999, operates from its major hubs at Auckland and Sydney, the latter thanks to the Single Aviation Area. It now owns 100% of *Ansett Australia*[135].

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[127] *See id.* at 29.
[128] *See* Sinha, D. & Sinha, T., *The Effects of Airline Deregulation: The Case of Australia*, WORLD COMPETITION, at 82.
[129] *See* Geoffrey Thomas, *New Zealand Backer Holds Key to Ansett*, AVIATION WEEK & SPACE TECHNOLOGY, August 2, 1999, at 43.
[130] *See* Geoffrey Thomas, *Rebuffed Abroad, SIA Decides To Spend at Home*, AVIATION WEEK & SPACE TECHNOLOGY, August 2, 1999, at 42 [hereinafter Geoffrey Thomas, *Rebuffed Abroad*].
[131] *See* Geoffrey Thomas, *Singapore Airline Buys Into Air New Zealand*, AVIATION WEEK & SPACE TECHNOLOGY, April 17, 2000, at 78.
[132] On Taipei-Sydney and Taipei-Brisbane.
[133] On routes from Malaysia via Melbourne and Sydney to Adelaide, Cairns, Canberra, Hobart and Gold Coast.
[134] *See Alliance Survey*, AIRLINE BUSINESS, July 1999, at 46.

### 3.2.8 *All Nippon Airways*

*All Nippon Airways*, behind *JAL* the second Japanese carrier, represents *Star's* stronghold in Japan since October 1999. Before joining *Star*, *ANA* already entertained a well-established relationship with some of *Star's* leading carriers, such as *Air Canada*, *Lufthansa*, *SAS*, *United* and *Thai*.. It can boast, *inter alia*, an extensive network in East Asia.

### 3.2.9 *Singapore Airlines*

*Singapore* became a *Star Alliance* member effective April 1 2000. This is seen by many as a major boost to *Star*, which now dominates the Asian market[136]. Before joining *Star*, *Singapore* participated in the *Qualiflyer* group, which includes *Swissair* and *Delta*. Interestingly enough, even cross-participation between these three carriers proved to be insufficient to keep *Singapore Airlines* in the *Qualiflyer* orbit[137]. *Singapore*, which also has a fully-owned subsidiary, *Silk*, has recently engaged in a close relationship with *Virgin Atlantic*. Furthermore, *Singapore* is currently seeking fifth freedom rights from the UK from London Heathrow[138].

*Singapore Airlines* was very keen on acquiring a major stake in another member airline of *Star Alliance*. In 1999, it sought to purchase shares of *Ansett Australia*, but failed in doing so because *Air New Zealand* held a right of first refusal on 50% of *Ansett's* parts, thus thwarting any *Singapore* participation. *SIA* ended up acquiring 8.4% of *Air New Zealand* itself[139]. Now it seems that *Singapore*'s stake in *Air NZ* will be bigger than previously expected.

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[135] *Supra* 3.2.6.
[136] *See* Michael A. Taverna, *Star Signs Up Singapore*, *supra* note 104, at 28.
[137] *Singapore* held 3.0% in *Delta* and 2.7% in *Swissair*, whereas 2.7% of its shares where owned by *Delta* and 0.6% by *Swissair*. *See "Hold your horses!"*, AIRLINE BUSINESS, June 1998, at 46 *et seq*.
[138] *See* Daniel Solon, *BM becomes a Star ally*, THE AVMARK AVIATION ECONOMIST, December 1999, at 6.
[139] *See* Geoffrey Thomas, *Singapore Airlines Buys Into Air New Zealand*, AVIATION WEEK & SPACE TECHNOLOGY, April 17, 2000, at 78. The longer-term objective of *Singapore* is said to hold eventually up to 40% of *Air New Zealand's* shares, pending on a change in New Zealand's legislation.

### 3.2.10 *Austrian Airlines*

*Austrian Airlines*, another renegade from the *Qualiflyer Group*, formally changed allegiance in July 2000, when it was admitted to *Star*. The Austrian flag carrier, which was said to be dissatisfied with the way *Qualiflyer* was working, will be accompanied by two affiliate carriers, *Lauda Air* and *Tyrolean*[140].

### 3.2.11 *British Midland*

*British Midland* announced that it would join *Star* this summer. Although being a relatively small airline in comparison to fellow *Star Alliance* members[141], it might turn out to be strategically important to *Star*, as it controls 14% of all slots at London Heathrow, a capacity-constrained airport[142]. This brings *Star Alliance*-owned slots to 27%, runner-up only to *OneWorld* with 44% of slots[143]. 40% of *British Midland's* shares are already held by *Star* member *SAS*. As part of the deal, *Lufthansa* will purchase 20% from *SAS*[144]. *Star* might gain additional clout on the North Atlantic, when a new U.S.-UK bilateral will eventually come into force. Under the current Bermuda II-Agreement, the number of British airlines to serve the U.S from London is limited to two, *British Airways* and *Virgin Atlantic*. If *British Midland* is granted traffic rights on the North Atlantic, *Star* may use London Heathrow as an additional hub. In any case, *British Midland's* CEO Bishop, has campaigned hard in that respect, hitherto without success[145].

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[140] *See* Michael A. Taverna, *Star Adds Austrian, Mulls Air Canada Move*, AVIATION WEEK & SPACE TECHNOLOGY, September 27, 1999, at 43.

[141] With a fleet of 57 aircraft, it serves 31 destinations in 12 countries, *see* http://www.star-alliance.com/isroot/SA/htmen/0_2-04-07-2000c.htm.

[142] *See* John D. Morrocco, *Star Alliance Boosts Presence at Heathrow*, AVIATION WEEK & SPACE TECHNOLOGY, November 15, 1999, at 39.

[143] *Id.* at 39, Daniel Solon, *BM becomes a Star ally*, THE AVMARK AVIATION ECONOMIST, December 1999, at 5. Therefore, Star's presence at Heathrow is much stronger as that of *OneWorld* at *Lufthansa's* hub, Frankfurt.

[144] *See* John D. Morrocco, *Star Alliance Boosts Presence at Heathrow*, AVIATION WEEK & SPACE TECHNOLOGY, November 15, 1999 at 39.

[145] It is reported in the press, however, that *British Midland* has already placed options on two Boeing 767-300s and two Airbus A-330-200s and secured licenses from the British Civil Aviation Authority to operate to four U.S. destinations, *see id.* at 39.

### 3.2.12 *Mexicana*

*Mexicana*, which joined *Star* in July 2000, operates a large domestic network at serves several destinations in Central America and the Caribbean, opening *Star's* door to this part of the world.

## 3.3 The Content of *Star Alliance*

### 3.3.1 The Cooperative Features of *Star Alliance*

The *Star Alliance* basic agreement contains many of the elements which have already been laid down in general above[146]. Before presenting them in more detail, it should be mentioned that part of the alliance agreements is confidential and therefore, cannot be explained here. Furthermore, it is sometimes submitted that the agreement as such, with the exception of the confidentiality clause, is not even legally binding[147]. Be it as it is, the *Star Alliance* agreement, apparently, did not contain a very efficient clause preventing any of the members from dropping out. After *Onex* launched its hostile take-over bid over *Air Canada*, the latter hastily agreed to new clauses containing also a penalty fee for the termination of the alliance agreement, as a sort of "poison pill", in the language of M & A analysts.

Coming back to the basic features of the *Star Alliance* agreement, it emerges that many of its features are not particularly innovative, reflecting instead a common approach of the whole airline industry toward alliances[148].

Alliance members pledge to coordinate their networks as well as their flight schedules in order to achieve a maximum of useful connecting services[149]. They also agree to

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[146] *See supra* 2.2

[147] In a meeting with McGill students, *Air Canada's* vice-president said that never so much money has been spent on a non-binding document.

[148] *See in general* JACQUES NAVEAU, AIRLINE ALLIANCES, *supra* note 74, at 29.

harmonize marketing and advertisement strategies, envisaging in the long term a common brand.

Like many other alliances, the main thrust of *Star* is to offer a great deal of code-sharing flights[150].

Moreover, alliance members will cooperate with respect to pricing, seat configuration and yield management.

They also agree to a mutual recognition of FFPs.

### 3.3.2 The Ownership Structure of *Star Alliance*

The merits of share holdings within alliance agreements have been analyzed before[151]. This chapter is about *Star's* approach toward cross ownership.

Within *Star Alliance*, there is still few cross ownership. Currently, *Air New Zealand* holds a 100% stake of *Ansett*[152]. *Singapore Airlines* recently acquired 8.4% of *Air New Zealand*, with the long term perspective of owning up to 40% of the latter. Moreover, *Thai* is due to be partially privatized. The government of Thailand, which to date owns 93% of the shares of its flag carrier, has announced that it will look for a strategic partner to take over 10% of *Thai's* shares. Thereupon, *Singapore* and *Lufthansa* have shown their interest in bidding for these shares.

In Europe, *SAS* still holds 40% of *British Midland's* shares. It has agreed, however, to sell 20% to fellow alliance member *Lufthansa*.

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[149] Not all connecting services are indeed useful. *See* in this respect Nigel Dennis, *Scheduling issues and network strategies for international airline alliances*, 6 JOURNAL OF AIR TRANSPORT MANAGEMENT 75 (2000).

[150] For an exhaustive list, *see* Commission notice concerning an alliance agreement between *Lufthansa*, *United* and *SAS*, OJ C 289/9, 11-2.

[151] *See supra* 2.2.7.

After *Lufthansa* and *United* bailed out *Air Canada* during the take over battle with *ONEX*, the two airlines each hold 7% of *Air Canada*. It is not clear if *Air Canada* will repurchase these shares as soon as financially possible.

The foregoing sketch of *Star's* ownership structure demonstrates that equity swapping is not yet a strategic choice embraced by *Star Alliance* members. Cross ownership, where it exists, seems to remain purely accidental, especially if compared to a diagram of the *Qualiflyer Alliance*[153].

## 3.4 *Star Alliance* in Comparison to its Competitors

### 3.4.1 Competing Airline Alliances

The *Star Alliance* is not the only airline alliance. Today, there are possibly as much as 400 alliances[154]. Most of these, however, are limited in scope or have only regional significance. There are only a handful of global alliances, which deserve to be presented here.

One of the oldest and most integrated alliances is the *Wings* alliance[155]. This alliance evolved out of a partnership between *KLM* and *Northwest* which dates back to 1993. Another U.S. carrier, *Continental*, coordinates with the two *Wings* airlines, even though talks between *KLM* and *Continental* over a joint venture are stalled for the time being[156]. Furthermore, *KLM* attempted to set up a "near-merger venture" with *Alitalia*, bringing the Italian carrier closer to the *Wings* alliance. The two airlines sought to relinquish as much as possible their individual business identities and operate joint flights under a common

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[152] *See supra* 3.2.6.

[153] *Swissair* holds 10% of *Austrian*, 0.6% of *Singapore* and 4.6% of *Delta*, but alliance agreements with these three carriers have all gone sour. Furthermore, *Swissair* holds 49.5% of *Sabena* (soon 84%), 20% of *TAP*, 20% of *South African Airways* and 37.6% of *LOT*. *See* GRAHAM HOGARTH & THOMAS KIRSEBOHM, THE FUTURE OF AIRLINE ALLIANCES 103 (2000).

[154] Airline alliances are presented annually by *Airline Business*, the latest survey being published July 1999.

[155] *See* James Ott, *Wings Partners Seek Ways To Maintain Alliance Edge*, AVIATION WEEK & SPACE TECHNOLOGY, August 23, 1999, at 61.

[156] *See* James Ott, *Alliances Spawn a Web Of Global Networks*, AVIATION BUSINESS & SPACE TECHNOLOGY, August 23, 1999, at 52.

flight code[157]. However, this endeavor collapsed recently, *KLM* pulling out of the joint venture with the Italian partner.

In 1996, a second alliance (*Atlantic Excellence*) emerged around *Swissair* and *Sabena*. This group also comprised *Austrian Airlines*, *Delta* and *Singapore*. Although these carriers cemented their contractual link by taking up shares, the future of this alliance is uncertain. *Austrian* and *Singapore* have left *Atlantic Excellence* for *Star*, whereas *Delta* forged closer ties with *Air France*. *Swissair* has also formed a pan-European alliance, which currently encompasses *TAP Air Portugal*, *Turkish Airlines*, *AOM*, *Crossair* and *Air Littoral*[158].

The *OneWorld*-Alliance was established in September 1998. It accommodates *British Airways*, *American Airlines*, *Cathay Pacific*, *Qantas*, *Finnair* and *Iberia*. *Lan Chile* is to join in 2000. *OneWorld* has failed to obtain approval and anti-trust immunity by the U.S. Department of Transportation, placing it at a disadvantage in comparison to *Wings* and *Star*[159].

A fifth pole has just been established recently. Its core is constituted by *Delta* and *Air France*[160]. Together with *Aero Mexico* and *Korean Airlines*, they disclosed the name of their alliance agreement in June 2000: *Sky Team*.

### 3.4.2 Global or Integrated? – Different Concepts of Alliances

These six major alliances differ in shape and integration. On the one hand, there is *Star Alliance*, with 12 member airlines world-wide and an extensive network of routes, permitting seamless travel on a global scale, but with a "one size fits all" – approach.

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[157] *See* Pierre Sparaco, *Alitalia, KLM Launch Near-Merger Venture*, AVIATION WEEK & SPACE TECHNOLOGY, August 9, 1999, at 34.

[158] *See* Pierre Sparaco, *Swissair Expands Partnership Network*, AVIATION WEEK & SPACE TECHNOLOGY, August 23, 1999, at 56. *Austrian*, also a former member, left *Qualiflyer* for *Star*, accompanied by two affiliated carriers, *Tyrolean* and *Lauda Air*.

[159] *See* Edward H. Phillips, *OneWorld Late, But Powerful*, AVIATION WEEK & SPACE TECHNOLOGY, August 23, 1999, at 62.

The other extreme is embodied by the *Wings* alliance, with *KLM* advocating a "near-merger" structure between few, but willing airlines with "cultural-fit". Here, the purpose is to harmonize and stream-line as far as possible the way of doing business, eventually arriving at an integrated management structure.

Both concepts have their benefits and inconveniences. A global alliance with numerous members (such as *Star*) might find it increasingly difficult to keep everybody on board happy. With so many members, the decision-making process becomes very complex, as every member has to endorse the business choices to be taken. Thereby, the process of defining a common alliance strategic becomes a very cumbersome endeavor. The difficulties tend to augment with any new member added to the alliance. Maybe even former competitors will find themselves side by side in the same alliance, straining inner-alliance bonds to a limit. Moreover, a multi-member alliance will face the problem to forge common service standards. Failing to do so might entail the dilution of the former individual brand name into a common product which is not recognized as such by the customer.

The question is whether or not these disadvantages are outweighed by the global network schedule only a multi-member alliance may offer.

Smaller but more integrated alliances will experience less difficulty in accommodating everybody. Member alliances will agree more easily on common quality standards and long-term strategies. On the other hand, it is obvious that they cannot compete with the foregoing alliance type in offering the same global product. Furthermore, any alliance agreement might be eventually terminated, if the share holding structure or the regulatory framework change dramatically. In this case, the break up will entail more serious

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[160] *See* Anthony L. Velocci, Jr & Pierre Sparaco, *Delta/Air France Alliance Alters Industry Landscape*, AVIATION WEEK & SPACE TECHNOLOGY, June 28, 1999, at 26.

consequences, such as costly wind-up of common sales counters and representations or brand confusion[161].

### 3.5 *Star's* Prospects for the Near Future

*Star Alliance* can boast today as much as 12 members – more than its competitors. *Star* already counts members on every continent, with the exception of Africa. However, some black spots remain on the map. *Lufthansa* is said to be interested in a Chinese airline joining *Star Alliance*. Otherwise, *Star* might have reached the zenith when it comes to membership – admitting a new member could very well create overlap in service and weaken the coherence of the alliance.

In particular, it might be a problem for *Star* to accommodate at the same time *Singapore* and *Thai*, two former competitors and both offering their respective hubs – Singapore and Bangkok – as gateways for travel from Europe to Australia. It is said that *Thai*, a founding member of *Star*, was reluctant to see its main Asian rival – *Singapore Airlines* – be admitted to the alliance, fearing that the newcomer would be a ferocious competitor even within *Star*. *Lufthansa's* decision to move its South East Asian hub from Bangkok to Singapore also contributed to *Thai's* bitterness, the latter claiming to lose more than 16 million US$ per year due to *Lufthansa's* decision.

The decision of the Thai government to sell 23% of its shares in the Thai carrier, of which 10% are set to go to a strategic partner, has added another dimension to the uncertainties surrounding *Thai's* future in the *Star Alliance*[162]. Mid July 2000, the Thai government has announced a postponement of *Thai's* partial privatization, a step which

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[161] *See* GRAHAM HORWARTH & THOMAS KIRSEBOM, THE FUTURE OF AIRLINE ALLIANCES 41 (2000) (who estimate the cost increase to be 5-9% in case of a split up).

[162] A similar issue might soon emerge in the Mexican market: *Mexicana* is controlled by a state holding company, *Cintra*, which also controls *Aero Mexico*. If *Cintra* is to be sold as a whole, the future allegiance of any of the two Mexican carriers is uncertain. *Cintra* is currently 63% owned by the Mexican state. *See* Jens Flottau, *Uncertainties Underlie Mexican Market*, AVIATION WEEK & SPACE TECHNOLOGY, May 29, 2000, at 43.

analysts ascribe to the doubts regarding *Thai's* future alliance allegiance[163]. *Thai* is being courted by *OneWorld* and *Sky Team*, both alliances seeking to make *Thai* switch sides.

This current issue exemplifies very well the dilemma of a global multi-member alliance such as *Star*. Even more, admitting new members will further complicate the decision making process, which still relies on such a loose structure as a common management board[164].

In the meantime, some members might wish to strengthen relations with selected fellow alliance members. Within *Star*, the link between *Lufthansa* and *SAS* has always played a pivotal role. Being members of a bigger alliance does not prevent the two carriers from redefining their bilateral bonds. Thereby, they might even reap further economies of scale, which could, in the long run, be the forerunner of a merger, the regulatory framework permitting.

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[163] *See Thai International's Star Alliance Dilemma*, AVIATION WEEK & SPACE TECHNOLOGY, July 17, 2000, at 55.

[164] *See* Michael A. Taverna, *Star Alliance Approaches Next Phase of Collaboration*, AVIATION WEEK AND SPACE TECHNOLOGY, August 23, 1999, at 59.

# Chapter 4: A Star under Scrutiny – *Star Alliance* and Competition Law

The phenomenon of airline alliances has been mostly analyzed from the angle of competition law. Here, everything boils down to one question: Are alliances anti-competitive or not? The *Star Alliance*, for instance, has come several times under the scrutiny of competition watchdogs such as the Department of Transportation in the U.S. or the European Commission in the EU.

## 4.1 Introduction to Competition Law

### 4.1.1 Competition Law in the U.S.

*Sedes materiae* in the U.S. is the Sherman Act and the Clayton Act. The former[165] was enacted in 1890 at a time when people and Congress were worried about the monopolistic practices of the *Standard Oil Company* and several Railway Companies. § 1 of the Sherman Act declares illegal

> [e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of commerce among the several States, or with foreign nations....

§ 2 of the same act declares guilty of a felony

> [e]very person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations...

These two sections complement each other. § 1 requires a restrictive agreement between at least two persons, whereas § 2 applies to unilateral conduct. In 1914, the Sherman Act

was complemented by the Clayton Act[166], which declared several practices, such as discriminatory pricing or mergers, illegal, but not a felony.

The infringement of both Acts may entail criminal sanctions (if criminal proceeding have been initiated), or, in private suits, injunctive relief and the award of treble damages. Moreover, the plaintiff may also recover a reasonable attorney's fee from the defendant. These sanctions constitute a successful deterrent against anti-competitive behavior.

Aviation, however, differs from any other service in that airlines can be shielded from the application of competition law by the granting of *antitrust immunity*. To be precise, the Federal Aviation Act provides for two, sometimes concomitant, measures: the aforementioned *antitrust immunity* for and *approval* of an airline alliance. Pursuant to § 41309 of the Act[167],

> [t]he Secretary of Transportation shall *approve* an agreement, request, modification, or cancellation...when the Secretary finds it is not adverse to the public interest.

Furthermore, according to § 41308 of the Act,

> [w]hen the Secretary of Transport decides it is required by the public interest, the Secretary...may exempt a person affected by the order from the antitrust laws to the extent necessary to allow the person to proceed with the transaction specifically approved by the order and with any transaction necessarily contemplated by the order.

The latter is referred to as antitrust immunity. It falls, like approval, within the purview of the competencies of the Department of Transportation. However, the Department of Justice, entrusted with the enforcement of antitrust law in general, still retains most of its

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[165] 26 Stat. 209 (1890), as amended, 15 U.S.C.A. §§ 1-7.
[166] 38 Stat. 730 (1914), as amended, 15 U.S.C.A. §§ 12-27.
[167] 49 U.S.C. Sect. 41309.

responsibilities. This means that, in the event an alliance has not been granted antitrust immunity by the Department of Transportation, the Department of Justice is empowered to bring the violation of both the Sherman Act and the Clayton Act to an end, by using the aforementioned relief. However, if an application for the granting of antitrust immunity has been filed by airlines with the Department of Transportation, only the latter is responsible, the Department of Justice being limited to a merely advisory role[168]. Antitrust immunity and approval, as set forth in §§ 41308 and 41309, only apply to foreign air transportation, which is the title of chapter 413 of the Act. In matters of domestic aviation, the Department of Justice is exclusively competent[169].

An issue of foremost importance in the field of airline alliances is the question of external application of competition law. In the landmark decision *United States v. Aluminium Co. of America*[170], judge Learned Hand held that U.S. antitrust law applied, if the anti-competitive agreement is both intended to affect U.S. commerce and its performance is shown to actually have had that effect[171]. This so-called "effects-test" was later clarified by the Foreign Trade Antitrust Improvements Act, pursuant to which the Sherman Act only applies if the anti-competitive conduct had a direct, substantial and reasonably foreseeable effect[172].

### 4.1.2 The European Law

In the European Union, the basic rules of competition law are set forth in the Treaty Establishing the European Community, as amended by the Amsterdam Treaty. Art. 81 § 1 of the Treaty (ex Art. 85) declares incompatible with the common market

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[168] G. Porter Elliot, *Antitrust at 35,000 Feet: The Extraterritorial Application of United States and European Community Competition Law in the Air Transport Sector*, 31 GEO. WASH. J. INT'L L. & ECON. 185, 199 (1998).

[169] This duality of functions with respect to aviation antitrust is a relict from the past. Under the Federal Aviation Act of 1958, the Civil Aeronautics Board was responsible for the granting of approval and antitrust immunity. After the CAB ceased to exist on January 1, 1985, by the virtue of the Deregulation Act, as amended by the Sunset Act [§ 1601 (b) (1) (C)], the CAB's authority had to be divided between the two Departments. *See* PATRICIA M. BARLOW, AVIATION ANTITRUST 35 (1988).

[170] 148 F. 2d 416 (2[d] Cir. 1945).

[171] *Id.* at 444.

[172] Pub. L. No 97-290, tit. IV, 96 Stat 1246 (1982) (codified in scattered sections of 15 U.S.C.).

> [...] all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the Common Market.

Such an agreement, as a principle, is void by virtue of Art. 81 § 2 of the Treaty. However, in derogation to this principle, Art. 81 § 3 of the Treaty allows an agreement, which falls within the scope of the above-mentioned subparagraph, but which "contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit..." to be exempted from competition law. Such an exemption can be granted individually or in form of a bloc exemption[173].

In the field of air transport, the Council passed in 1987 for the first time a Council Regulation enabling the Commission to pass block exemptions on certain issues[174]. This enabling regulation was renewed several times[175]. Block exemptions existed with respect to joint planing and co-ordination of airline schedules, consultations on rates and fares, joint operations on new, less busy scheduled air services, slot allocation, and common operation of CRSs[176]. Art. 81 of the Treaty is analogous to Section 1 of the Sherman Act.

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[173] *See also* BERNARDINE ADKINS. AIR TRANSPORT AND E.C. COMPETITION LAW 62 *et seq.* (1994).
[174] Council Regulation No. 3976/87 of 14 December 1987 (OJ L 374/9).
[175] By Council Regulations 2344/90 and 2411/92.
[176] *See* Commission Regulation 1617/93 on the application of Art. 85(3) of the Treaty to certain categories of agreements, decisions and concerted practices concerning joint planning and co-ordination of schedules, joint operations, consultations on passenger and cargo tariff rates on scheduled air services and slot allocation at airports (OJ L 155/18) and Council Regulation 83/91 on the application of Art. 85(3) of the Treaty to certain categories of agreements between undertaking relating to Computer Reservation Systems for air transport services (OJ L 10/9). Commission Regulation 1617/93 (OJ L 155/18) was due to expire at the end of June 1998. By virtue of Commission Regulation 1083/99, the bloc exemptions as regards tariff consultation and slot allocation has been extended until June 30, 2001, the Commission considering their long-term future. However, there is no legal basis anymore for bloc exemptions pertaining to joint planning and coordination of schedules.

Art. 82 § 2 prohibits "any abuse by one or more undertakings of a dominant position within the Common Market insofar as it may affect trade between member states". This provision contains a similar principle as Section 2 of the Sherman Act.

When the Rome Treaty was signed in 1957, it was silent on the question of mergers. This gap in antitrust legislation was filled in 1990 by the Council Regulation 4064/89, which entered into force October 30, 1990[177]. This regulation applies to mergers, acquisitions and certain ventures between firms with a combined worldwide turnover of more than 5,000 million ECU, where at least two of the firms have a combined turnover of more than 250 million ECU in the EC, but do not earn more than two-thirds of their turnover in a single member state[178].

Whereas thereby the merger regulation resolves the question of extraterritorial application of competition law to mergers and acquisitions, the same question had to be settled by the jurisprudence of the European Court of Justice with regards to Art. 81 of the Treaty. Under its "place of implementation" test, European competition law applies even when the parties have no physical presence in the Community and engage in conduct exclusively outside the Community, so long as the place of implementation of the conduct lies within Community borders[179].

Art. 81 of the Treaty has been implemented by the enacting of Council Regulation 3975/87 as of December 14 1987[180]. This Regulation sets forth the procedure for the application of Competition Law in the field of aviation. However, Council Regulation 3975/87 contains an important *lacuna*: It only applies to air transport between EU Member States, leaving unaffected the traffic between Member States and third countries[181]. This has seriously impinged on the European Commission's efforts to

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[177] Council Regulation 4064/89 (OJ L 180/1).
[178] *See id.* at Art. 1.
[179] *See* Joined Cases 89, 104, 114, 116, 117 and 125 to 129/85, *Ahlstrom Osakythio v. Commission*, 1988 E.C.R. 5193, [1988] 4 C.M.L.R. 901 (1988).
[180] Council Regulation No. 3975/87 of 14 December 1987 (OJ L 374) as amended by Council Regulation No. 1284/91 (OJ L 122) and No. 2410/92 (OJ L 240).
[181] *See id.* at Art 1(2): "This regulation shall apply only to international air transport between Community airports".

scrutinize airline alliances. Therefore, the Commission may only rely on Art. 85 of the Treaty, which, somewhat paradigmatically, holds that the Commission "shall ensure the application of the principles laid town in Art. 81 and 82" and that it shall investigate cases of suspected infringement of these principles "in cooperation with the competent authorities of the Member States". Furthermore, if the Commission finds that there has been an infringement, it shall *propose* appropriate measures to bring it to an end (emphasis added)". At the same time, the member states, pursuant to Art. 84 of the Treaty, "shall rule on the admissibility of agreements, decisions and concerted practices in accordance with the law of their country and the provisions of Art. 81...and Art. 82".

This duality of competence has already entailed a serious conflict between Brussels and London. Therefore, it is understandable that the Commission desperately seeks the enacting of a new Regulation, providing for the heretofore lacking legal basis for Community action[182]. It has recently proposed the enacting of a new regulation aimed at extending the scope of Council Regulation 3975/87[183] to include air transport between Community airports and third countries.

### 4.1.3 Other National Legislation

In the meantime, national Competition Law of any EU Member State may purport to apply to any given international airline alliance. Recently, for instance, it was reported in the press that the British Competition Commission is to investigate on the proposed Air Canada – Canadian merger, which was not a concern to the European Commission[184].

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[182] Karel van Miert, the former Commissioner for Competition, stated that "unfortunately, the Commission does not have the same type of investigation and enforcement powers it has in other industries". *See* Karel van Miert, *Competition Rules and the Single Market in Aviation*, INTERNATIONAL BUSINESS LAWYER, February 2000, at 52.

[183] *See* COM(97) 218 final, which proposes the deletion of Art. 1(2) of Council Regulation No. 3975/87 (OJ L 374).

[184] *See Britain Sets watchdog on Air Canada*, GLOBE AND MAIL, May 2, 2000, at B1.

Of course, global alliances such as Star may also face scrutiny by further competition watchdogs, such as in Canada, Japan and Australia[185]. This holds true especially as some observers foresee for the next years a proliferation of competition laws around the world[186]. This could equal, in the case of the *Star Alliance*, a proliferation of diverging decisions.

## 4.2 The Existing Jurisprudence on *Star Alliance*

This analysis shall focus exclusively on the decisions concerning *Star* taken by the Department of Transportation in the U.S. and the European Commission.

### 4.2.1 Antitrust-Immunity and Approval under U.S. Competition Law

*Star's* member carriers sought antitrust-immunity and approval for three bilateral cooperation agreements. *United* and *Lufthansa* applied jointly in 1996. In the same year, *United* also filed for antitrust immunity together with its Canadian ally, *Air Canada*. These two cooperation agreements were both granted immunity and approval. On December 1999, *United* applied jointly with *Air New Zealand*. This application is still pending[187].

#### 4.2.1.1 *United Air Lines* and *Lufthansa*[188]

The agreement between *United Air Lines* and *Lufthansa* was granted approval and antitrust-immunity pursuant to U.S.C. §§ 41308 and 41309 on May 21, 1996. In doing so,

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[185] On June 11, 1998, the Australian Competition and Consumer Commission (ACCC) granted approval to the alliance agreement between *Ansett Australia*, *Air New Zealand* and *Singapore*. The approval will be valid for five years. *See* Michael S. Simons, *Global Airline Alliances – Reaching out to New Galaxies in a Changing Competitive Market – The Star Alliance & OneWorld*, 65 JOURNAL AIR LAW AND COMMERCE, 314, 317 (2000).

[186] *See* David Knibb, *Double Standard*, AIRLINE BUSINESS, March 1999, at 32.

[187] *United* and *Air New Zealand* envisage to coordinate their route and schedule planning and establish marketing integration.

[188] *See* U.S. Department of Transportation Joint Application of United Air Lines, Inc. and Deutsche Lufthansa, A.G. d/b/a Lufthansa German Airlines for Approval of and Antitrust Immunity for an Alliance

the Department of Transportation followed a Show-Cause Order[189] of May 9, 1996, in which it had already tentatively determined that the *United Air Lines-Lufthansa* alliance could go ahead. On the issue of approval, the Department of Transportation found that the alliance would not reduce competition in the U.S.-Europe, Europe-Germany, and behind- and beyond-gateway markets. Therefore, and as the two airlines are unlikely to proceed with their agreement without antitrust immunity, the Department also granted the latter. However, like the Show-Cause Order, the Final Order is subject to conditions and is limited to a five year period[190]. The most important elements of the Final Order are as follows:

1. First, the antitrust immunity does not extent to pricing, inventory or yield management coordination, or pooling of revenues, with respect to local U.S.-point-of-sale passengers flying nonstop between Chicago/Frankfurt and Washington/Frankfurt[191]. With respect to this traffic, the two carriers have to continue to compete. This requirement is aimed at protecting time-sensitive business passengers on these two routes against price gauging. On twelve further city-pairs, the Department of Transportation did not find any barriers to entry[192]. Even more, the Department underlined that entry to the U.S.-German Market would be both possible and likely[193].

2. Furthermore, *Lufthansa* and *United Air Lines* were instructed by the Department of Transportation to refrain from participating in any International Air Transport Association (IATA) tariff coordination that discusses fares and rates on the U.S. to Germany and U.S. to Netherlands-market[194].

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Expansion Agreement pursuant to 49 U.S.C. §§ 41308 and 41309, Docket OST-96-1116, May 21, 1996 [hereinafter DoT United-Lufthansa Final Order Docket OST-96-1116].

[189] Order 96-5-12.

[190] *See* United-Lufthansa Final Order Docket OST-96-1116, *supra* note 188, at 1.

[191] *See id.* Appendix A at 1. *But see id.* Appendix A at 2 which explicitly includes antitrust-immunity on these two routes with respect to corporate fare products as well as group fare products.

[192] Atlanta-Frankfurt, Boston-Frankfurt, Chicago-Düsseldorf, Chicago-Munich, Dallas/Fort Worth-Frankfurt, Houston-Frankfurt, New York-Düsseldorf and Frankfurt, Los Angeles-Frankfurt, Miami-Frankfurt, Newark-Frankfurt and San Francisco-Frankfurt, *see* United-Lufthansa Final Order Docket OST-96-1116, *supra* note 188, at 8.

[193] *See id.* at 8.

[194] *See id.* at 13.

3. Part of the Final Order on the *United Air Lines-Lufthansa* cooperation is dedicated to the issue of cooperation in CRS-services. The Department of Transportation had initially expressed concern that U.S. CRSs could not compete in the European market. During the proceedings, *American Airlines* and *TWA* had complained that some major German travel agents affiliated with *Lufthansa* were refusing to participate in *Sabre* and *WorldSpan*, *American's* and *TWA's* CRSs. The Department of Transportation, however, shrugged off these complaints by stating that there was no sufficiently related or direct link between the refusal to participate in the above-mentioned CRSs and *United* and *Lufthansa's* joint application for anti-trust immunity[195].

4. Lastly, *Lufthansa* was directed to provide a full-itinerary Origin-Destination Survey of Airline Traffic for all passenger activities that include a U.S. point[196].

#### 4.2.1.2 *United Air Lines* and *Air Canada*[197]

Shortly after the filing of an application by *United* and *Lufthansa*, on June 4, 1996, the U.S. carrier applied jointly with *Air Canada* for approval of and antitrust immunity for their commercial agreement. Subject to certain conditions, the Department of Transportation granted approval and antitrust immunity on September 19, 1997.

1. First, the immunization shall not cover pricing, inventory or yield management coordination, or pooling of revenues, with respect to local U.S.-point-of sale passengers flying nonstop between Chicago/Toronto and San Francisco/Toronto[198]. As in the *Lufthansa-United* decision, the Department was concerned about the anti-competitive effects of a close *United-Air Canada* cooperation on those routes, where prior to the agreement, the two participating carriers already possessed a very strong market presence. Delta filed objections to the Show-Cause Order on the ground that

[195] *See id.* at 14.
[196] *See id.* at 17.
[197] *See* U.S. Department of Transportation, Joint Application of United Air Lines, Inc. and Air Canada under 49 U.S.C. §§ 41308 and 41309 for approval of and antitrust immunity for commercial alliance agreement, Final Order, Docket OST-96-1434, September 19, 1997 [hereinafter United-Air Canada, DoT Final Order, Docket OST-96-1434].

its U.S. to Toronto-flights would be seriously affected by the granting of antitrust-immunity. The Atlanta-based carrier argued that the grant of immunity *prior to elimination of phase-in restrictions* (emphasis added) would provide United and Air Canada a competitive advantage over other U.S. carriers[199]. The Department of Transportation, however, refuted Delta's complaint. It underlined that all restrictions on frequencies between Canada and the U.S. were, according to the U.S.-Canadian Bilateral, due to expire on February 23, 1998 (that is, 5 months after the granting of the antitrust immunity), adding that delaying the effectiveness of immunity in the meantime would serve no significant public interest purpose[200].

2. Moreover, the Department of Transportation explicitly states that this antitrust immunity does not include operation under a common brand or name, such as *Star*. If the applicant carriers were to operate under the label *Star* in a manner implying they act as a single entity, they would have to submit a new application for immunization[201].

3. The Department of Transportation also requires *United* and *Air Canada* to refrain from operating joint all-cargo services[202].

4. It should be also mentioned that the above-mentioned immunity only holds for five years. That means that in five years, the two applicant carriers have to file again for antitrust-immunity.

#### 4.2.1.3 Concluding Remarks

In sum, the above-mentioned decisions by the Department of Transportation illustrate the liberal U.S. stand on airline alliances. It should not be forgotten, however, that the

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[198] *See id.* Appendix A at 1.
[199] *See id.* at 7. Delta, referring to the U.S.-Canadian Bilateral, illustrated its complaint by pointing out that it had been unable to increase its own frequencies to Toronto, as new entry to Toronto's slot-controlled Lester Pearson-Airport is currently restricted to two daily round trips.
[200] *See id.* at 14.
[201] *See id.* at 17.

conclusion of a liberal Open Skies-Agreement has always been a *conditio sine qua non* for the granting of antitrust immunity. Therefore, the signing of the German-U.S. Bilateral on May 23, 1996[203] paved the way for antitrust immunity for the *Lufthansa-United Air Lines* cooperation[204] just in the same way as the 1995 Canada-United States Bilateral[205] rendered the commercial agreement between United and Air Canada possible. On the other hand, an alliance agreement between *American* and *British Airways* has so far failed in getting antitrust-immunity, because British-U.S. negotiations on the signing of an Open Skies-Agreement remain stalled for the time being.

### 4.2.2 The European Commission Notice Concerning the *Lufthansa-SAS-United* Alliance

On September 18, 1996 the European Commission initiated an investigation into the alliance between *Lufthansa*, *SAS* and *United Air Lines*. In a notice[206], published in July 1998, it has come to the preliminary view that the above-mentioned agreement violates ex Art. 85 (today Art. 81) of the Treaty. After issuing its preliminary view, the Commission may proceed by finalizing its views in a proposal under Art. 84 (ex Art. 89) of the Treaty[207]. In the notice, it proposes several remedies, which, if adopted by the carriers concerned, might, in the view of the European Commission, bring an end to the alleged infringement of Art. 81 of the Treaty. These remedies are as follows:

1. Most importantly, the European Commission invites the three airlines to give up a certain number of frequencies on the Frankfurt-Chicago and Frankfurt-Washington

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[202] *See id.* at 18.
[203] Protocol between the United States of America and the Federal Republic of Germany to Amend the Air Transport Agreement of July 7, 1995, May 23, 1996.
[204] More precisely, Germany preconditioned its signature of the Bilateral on the subsequent granting of antitrust immunity and approval of the *Lufthansa-United* alliance. *See* Stephen Harris, Jr. & Elise Kirban, *Antitrust Implications of International Code-sharing Alliances*, 23 AIR & SPACE LAW 166, 174 (1998).
[205] Air Transport Agreement between the Government of Canada and the Government of the United States of America, February 24, 1995.
[206] Commission notice concerning the alliance between Lufthansa, SAS and United Airlines, 98/C 239/04, OJ C 239/5 30.7.1998 [hereinafter Commission notice 98/C 239/04].
[207] It has already been mentioned *supra* that, with respect to airline alliances involving carriers from third countries (*i.e.* non European Community member states), the Commission has only authority to investigate and to propose a solution, the member states remaining competent to issue a decision, too.

route[208]. On these two routes, where total annual travel is greater than or equal to 120,000 passengers and on which the alliance operates more than 12 frequencies per week, *Lufthansa* and *United* should, if so requested by any competitor, give up frequencies so as to allow competitors to operate up to 55% on the specified route[209]. According to the flight schedule valid at that time, the total amount of frequencies to be abandoned to the benefit of a competitor are seven for the Frankfurt-Chicago route and five for the Frankfurt-Washington route. The two airlines are furthermore required to give up the corresponding slots, if slots are not freely available at the respective hub airports (which, in the case of Frankfurt and Chicago O'Hare, indeed happen to be heavily congested and therefore, slot regulated)[210].

2. Furthermore, the European Commission requires the three carriers to make slots available at Frankfurt and Copenhagen on the request of competitors, so as to enable the latter to hold up to 55% on routes between these airports and the U.S. The total number of slots to be given up without any kind of compensation, be it financial or not, is 69 for Frankfurt and 15 for Copenhagen[211]. The alliance has to give up airport facilities as far as it is needed to effectively use the slots.

3. Furthermore, the European Commission also tackled the problem of Frequent Flyer Programs. According to Brussels, the three airlines should either refrain from pooling their FFPs in respect of transatlantic travel, or open up their FFPs to airlines, which do not entertain their own FFPs[212].

4. The European Commission also requires the three carriers to agree to interlining with any airline which intents to penetrate the market[213].

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[208] The same city pairs have been identified as pivotal in the Department of Transportation's decision on the *Lufthansa-United* application for antitrust immunity and approval.
[209] *See* Commission notice 98/C 239/04, *supra* note 206, at 5.
[210] *See id.* at 6.
[211] *See id.* at 7.
[212] *See id.* at 8.
[213] *See id.* at 9.

5. Lastly, the European Commission notice also contains an undertaking to be fulfilled by the EU member states concerned, *i.e.* Germany, Denmark and Sweden, namely to authorize any Community carrier established in the European Economic Area to operate direct and indirect services between any airport in their territory and the United States[214]. Speaking in terms of freedoms of the air, this requirement would mean that, according to the European Commission, any carrier based in the European Community must have Seventh Freedom[215] rights from any point in these member states to the U.S.[216].

## 4.3 A Critical Analysis of Competition Law Issues Facing *STAR*

We have just analyzed the competition law framework in which a global alliance like Star must operate. Will this framework turn out to be a stumbling block for *Star*? What is the situation of *Star* in comparison to its main rivals? The following purports to answer these questions.

### 4.3.1 The Competition Law Hurdle

#### 4.3.1.1 A Different Philosophy

It is easily recognizable in the above-mentioned decisions that the Department of Transportation on the one hand and the European Commission on the other do not share a common approach toward global alliances.

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[214] *See id.* at 9.

[215] Seventh Freedom is the right to carry passengers and cargo from one point in the territory of a foreign state to a point within the territory of another state without returning to or departing from its home base. *E.g.* in the foregoing decision of the European Commission, a carrier like *Air France* must have the right to carry passengers from Frankfurt to Chicago (*i.e.* Seventh Freedom rights).

[216] The European Commission is of the view that the lack of Seventh Freedom rights between any member state of the European Union and the U.S. constitutes a distortion of competition and a violation of the non-discrimination principle. According to Brussels, the non-discrimination principle entails the right for any Community carrier to operate Seventh Freedom traffic between the EU and the U.S.. This is also the reason why the European Commission has brought legal action against those states which have concluded Open Skies agreements with the U.S. (these lawsuits are still pending) and why it is so keen on a mandate to negotiate on behalf of European member states on the issue of hard rights.

The Department of Transportation, in its report "Global Deregulation Takes Off", underlined that "airline alliances are the only way to provide improved, more competitive services" and that alliances "provide a number of other advantages, such as market presence, experience, and expertise of the partners in their respective homelands"[217].

The pro-alliance stance of the current U.S. administration can also be illustrated by quoting *Charles A. Hunnicutt*, former Assistant Secretary for Aviation and International Affairs with the U.S, Department of Transportation, who privately stated that "international alliances have further enhanced, not reduced, competition"[218]. This view is reflected in the Final Order on the *United-Lufthansa* alliance. The Department of Transportation only required the applicants to refrain from pricing and yield management coordination on the Frankfurt to Chicago and Frankfurt to Washington route for local U.S. point of sale passengers[219].

This contrasts with the position of the European Commission, which required *Lufthansa* and *United*, concerning the same two city pairs, to give up 55% of frequencies and to relinquish the corresponding slots[220]. Karel van Miert, the former Commissioner for Competition at the European Commission, has already expressed concern about perceived anti-competitive effects of airline alliances, fearing that these alliances "will eventually lead to higher fares and reduced services" for consumers in the U.S. and Europe[221]. Another aspect of the point of view of the European Commission is the issue of external competence in aviation matters, which is dealt with *infra*[222].

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[217] U.S. Department of Transportation, Global Deregulation Takes Off, first report, December 1999, at 5.
[218] *See* Charles A. Hunnicutt, *Aviation Liberalisation: a U.S. View*, INTERNATIONAL BUSINESS LAWYER, February 2000, 55, 60.
[219] *See* Final Order United-Lufthansa, Docket OST-96-1116, *supra* note 186, Appendix A at 1.
[220] *See* Commission Notice, 98/C 239/04, *supra* note 206, at 5.
[221] *See* Karel van Miert, *Competition Rules and the Single Market in Aviation*, INTERNATIONAL BUSINESS LAWYER, February 2000, at 52.
[222] *See infra* 4.3.1.2.

#### 4.3.1.2 Diverging Policies

Furthermore, it is worthy of note that competition law issues have served on both sides of the Atlantic as a vehicle for the pursuit of general aviation related policies.

Since deregulation in domestic aviation, the U.S.' international aviation policy consisted in promoting the conclusion of Open Skies-Agreements with the U.S. The Department of Transportation continues to consider the conclusion of liberal Open Skies-Agreement as a pre-condition to the granting of antitrust-immunity[223] and approval of any international airline alliance[224]. This has been a very strong incentive for several countries to sign Open Skies-Agreements with the U.S. The Netherlands, home to *KLM*, a long-time champion of Sixth Freedom traffic and a strong believer in liberalized air services, were the ideal candidate to conclude the first Bilateral of the Open Skies-type in October 1992[225]. Shortly hereafter, on January 1, 1993, the *KLM-Northwest* alliance was granted approval and antitrust immunity. In 1995, further European countries concluded Open Skies Agreements with the U.S.[226] Henceforward, the U.S., having encircled the

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[223] *See* Department of Transportation, Joint Application of American Airlines, Inc. and British Airways plc., Order No. 97-3-34, March 21, 1997 (the Department of Transportation stated: "Under our established policy and practice, we will not grant approval and antitrust immunity without an Open Skies-agreement...We are unwilling to approve and immunize an alliance if other airlines are unable to provide effective competition to the alliance partners." It is interesting to note that one author has called this the "carrot and stick"-approach. *See* G. Porter Eliot, Antitrust at 35,000 Feet: The Extraterritorial Application of United States and European Community Competition Law in the Air Transport Sector, 31 GEO. WASH. J. INT'L L. & ECO. 185, 213 (1997).

[224] The Department of Transportation has set forth the criteria, which, in its view, characterize a true Open Skies-Agreement. Among these are: - open entry on all routes, - multiple designation, - unrestricted capacity, - double disapproval. *See* Department of Transportation, *In re Defining Open Skies*, Order No. 92-813, August 5, 1992.

[225] Agreement to Amend the Air Transport Agreement, as amended, and the Protocol Relating to the United States-Netherlands Air Transport Agreement of 1957, as amended, signed October 14, 1992, T.I.A.S. No. 11976.

[226] These countries are: Luxembourg (*See* Agreement Amending the Air Transport Services Agreement of August 19, 1986, signed June 6, 1995 [unpublished]),Finland (*See* Amendment to the Air Transport Agreement of March 19, 1949, signed June 9, 1995 [unpublished]), Austria (*See* Agreement amending the Agreement of March 16, 1989, effected by Exchange of Notes, June 14, 1995 [unpublished]), Switzerland (*See* Air Transport Agreement Between the Government of Switzerland and the Government of the United States of America, signed June 15, 1995 [unpublished]), Denmark (*See* Agreement Amending the Agreement of December 16, 1944, as amended, signed June 16, 1995 [unpublished]), Norway (*See* Amendment to the Agreement of October 6, 1945, as amended, signed June 16, 1995 [unpublished]), Sweden (*See* Agreement Between the United States of America and Sweden Amending the Agreement of December 16, 1944, as amended, effected by exchange of notes, June 16, 1995 [unpublished]), and Belgium (*See* Amendment to the Air Transport Agreement of October 13, 1980 Between the Government

more important European aviation countries Germany, France and the U.K., were in a strong bargaining position vis a vis these countries. In 1996, after *Lufthansa* had financially recovered and entered into an alliance agreement with *United*, Germany was finally in the position to accept the concept of Open Skies with the U.S.. The signing of a new German-U.S. Open Skies Agreement, on May 23, 1996 was even slightly preceded by the granting of antitrust-immunity and approval of the *United-Lufthansa* cooperation agreement, which occurred on May 21, 1996. Italy was the next member state of the European Union to adhere to Open Skies, signing a new bilateral agreement with the U.S. in 1999[227], the prospect of having the Italian carrier enter into an alliance with *KLM* and *Northwest* being the incentive for the Italian government. The last member state of the European Community to accept the concept of Open Skies was Portugal, which signed an Open Skies Agreement with the U.S. on December 22, 1999[228].

Political issues also determine the agenda of the European Commission. The latter has taken up a proposition, initially advanced by the Association of European Airlines, to establish a Transatlantic Common Aviation Area, or TCAA. As there is not yet a legal basis for Community action on external aviation[229], the Commission hence has utilized any occasion to lobby for the granting of a mandate to negotiate on behalf of the European Community on the issue of traffic rights (so-called hard rights). This issue was not absent from the European Commission's Notice on the alliance between *Lufthansa*, *United* and *SAS*. In the Notice, the Commission orders the Member States concerned as

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of the United States of America and the Government of Belgium, as amended, effected by exchange of notes, September 5, 1995 [unpublished]). At approximately the same time, on June 14, 1996, the U.S. Department of Transportation granted antitrust immunity and approval to an alliance agreement by Delta, Austrian, Sabena and Swissair.

[227] *See* Agreement Supplementing the Air Transport Agreement of June 22, 1970, as amended, effected by exchange of notes, December 30, 1998 and February 2, 1999 (unpublished). Consequentially, *Alitalia*, *KLM* and Northwest were granted antitrust immunity and approval on December 3, 1999. *See* U.S. Department of Transportation, Final Order, December 3, 1999, Order 99-12-05, docket OST-1999-5674.

[228] *See* Air Transport Agreement between Portugal and the United States of America, signed December 22, 1999 (unpublished).

[229] The European Commission first argued that Art. 113 of the Treaty must be considered to be the legal basis in matters of external aviation relations. This proviso covers the conclusion of tariff and trade agreements within the scope of the European Common Commercial Policy. The European Court of Justice, however, contradicted this view (*See* Opinion 1/94 CMLR I 205 [1995]). It is now recognized that the European Commission has to rely instead on Art. 84(2), which provides for a Council decision to determine to what extent or by what procedure the Community exercises its competence in the field of aviation. For more detail *see* ANDREAS LOEWENSTEIN, EUROPEAN AIR LAW 107 *et seq.* (1991).

well as Norway to "authorize any Community carrier established in the EEA to operate direct and indirect services between any airport in their territory (*i.e.* that of Germany, Denmark and Sweden) and the United States[230]". This undertaking would, in the eyes of the Commission, "substantially increase the scope for competition". The problem is, however, that any member state, acting individually, is in no position to unilaterally grant traffic rights to carriers based in another member state of the European Union, without the endorsement of the U.S.[231]. On the other hand, in a common aviation area, like the TCAA, any community carrier could legally operate from any point in the European Union to the U.S.. This means in practice that, if this condition is to prevail, for the time being, the alliance cannot go ahead as such unless the European Commission is granted a mandate to negotiate hard rights on behalf of the European Community[232]. It must be stressed once again that the notice of the European Commission constitutes a proposal as to how the proposed alliance may go ahead. Before the Commission finalizes its views in a binding decision, *Star Alliance* has to operate in an environment of uncertainty, which certainly is detrimental to any business activity.

The question is, however, whether a decision on an airline alliance is the right place to deal with the issue of external competence. Preconditioning the approval of an airline alliance to undertakings of member states renders an alliance contingent on a factor not within its reach.

Generally speaking, the pursuit of general policy objectives to the detriment of an airline is deplorable in that it makes an alliance – in this case *Star* – the battleground of

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[230] *See* Commission Notice 98/C 239/04, *supra* note 206, at 9.

[231] If a member state designates a carrier from another member state for air transport from its territory to an airport in the U.S., the U.S. could then avail itself of its right to withhold the grant of a license to the designated airline, *i.e.* pursuant to Art. 4(1)(a) of the new U.S.-German bilateral (Protocol between the Government of the United States of America and the Government of the Federal Republic of Germany to Amend the Air Transport Agreement of July 7, 1955, signed May 23, 1996 [unpublished]), which states that "[e]ither contracting party may revoke, suspend, or limit the operating authorizations or technical permissions of an airline designated by the other contracting party where...substantial ownership and effective control of the airline are not vested in the other contracting party, the other contracting party's nationals (...), or both...".

[232] Another solution might be that the U.S. begins to grant Seventh Freedom rights as to passenger services, which it has so far refused to do.

an underlying transatlantic trade conflict, which should rather be settled by governments than by airlines.

Lastly, it is questionable that the Commission will eventually achieve its political goal. All Member States must agree on the terms of the agreement, and unanimity seems far from being guaranteed. One more reason which makes the Commission's requirement hard to accept.

### 4.3.2 The Definition of the Relevant Market

The delimitation of the relevant market is a very important issue in competition law. In defining the relevant market, Washington and Brussels have adopted more or less the same approach. Both define the relevant market for airline alliances quite narrowly. It has already been mentioned that both competition watchdogs showed particular concern for the Frankfurt-Washington and Frankfurt-Chicago routes. Both the Commission and the Department of Transportation focus on the hub-to-hub-connections for time-sensitive business travelers. Both contend that these passengers cannot renounce non-stop flights. Therefore, they arrive at the conclusion, with respect to these city-pairs, that *United* and *Lufthansa* shall not indulge in pricing or yield management coordination (these restrictions were imposed by the U.S. Department of Transportation)[233], and shall relinquish up to 55% of their gateway-to-gateway flights, if so requested by a competitor (that was the bottom line of the European Commission's Notice[234]).

The question, however, arises as to whether such a narrow approach is really warranted. It has already been pointed out by one author that the idea according to which time-sensitive passengers have no choice but to take the non-stop service comes from the U.S. domestic market, a concept not easily transferable to international long-haul connections[235]. It is indeed questionable whether transatlantic travelers are equally

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[233] *See* Final Order, Lufthansa – United, Docket OST-96-1116, *supra* note 188, Appendix A at 1.
[234] *See* European Commission Notice, 98/C 239/04, *supra* note 206, at 5.
[235] *See* Greg A. Sivinski, *International Airline Alliances: Competition Policy and Procedure*, INTERNATIONAL BUSINESS LAWYER, February 2000, at 68 [hereinafter *International Airline Alliances*].

restrained as U.S. domestic passengers. For transatlantic travelers, one-stop connections might be a serious alternative to non-stop flights. This might hold true in particular with respect to travel out of Frankfurt: other European hubs, such as Amsterdam-Schiphol, Paris Charles de Gaulle, and London Heathrow are well located to serve as one stop-gateways for traffic from Europe to Chicago and Washington[236]. Furthermore, Frankfurt, as a hub, differs from Paris or London in that it has a relatively insignificant geographical home basis (the Rhein-Main area is a financial center, home to a busy stock exchange and the European Central Bank, but its population is only approximately one million)[237]. Frankfurt serves as a hub for transatlantic passengers more than it supports itself on home-grown demand. Therefore, the relevant market – Frankfurt to Washington or Chicago might turn out to be insignificant.

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[236] This may be confirmed by a look into the current time table. *Lufthansa* and *United* offer four non-stop services between Frankfurt and Chicago:
FRA 08.35 – OHD 10.20
FRA 10.05 – OHD 12.05
FRA 13.45 – OHD 15.50
FRA 17.20 – OHD 19.35
The following flights by competing carriers might constitute convenient replacements:
Air France (via CDG):
FRA 07.25 – OHD 12.15
FRA 13.50 – OHD 18.05
Sabena (via BRU):
FRA 08.00 – OHD 13.05
The situation is similar on the Frankfurt to Washington, D.C. route:
Lufthansa/United:
FRA 10.25 – IAD 13.25
FRA 12.35 – IAD 15.15
FRA 13.25 – IAD 15.55
FRA 17.10 – IAD 19.50
Air France (via CDG):
FRA 10.40 – WAS 15.45
FRA 13.50 – WAS 18.50
Sabena (via BRU):
FRA 08.00 – IAD 13.45
FRA 10.10 – IAD 15.15
On the other hand, the Commission's view may hold true with respect to hub-to-hub connections out of London Heathrow. *But see* George Sivinski, *International Airline Alliances*, *supra* note 235, at 68.

[237] London and Paris, on the other hand, besides boasting a population of over ten million, is a political, financial and economical capital city. Furthermore, for air travel to and from Heathrow, there might not be a serious one-stop alternative, due to its geographical situation between continental Europe and America.)

### 4.3.3 Competition Law Review Under Several Jurisdictions

#### 4.3.3.1 The Issue

Any given global airline alliance – like *Star* – may be subject to scrutiny in several jurisdictions. The most important of these, of course, are the U.S. and the EU. However, it has already been mentioned that under Art. 85 (ex Art. 89)[238] of the Treaty, with regards to air transport to and from third counties, the European Commission only shares its competence with the member states, which, pursuant to Art. 84,

> shall rule on the admissibility of agreements, decisions and concerted practices and on abuse of a dominant position in the common market *in accordance with the law of their country* (emphasis added) and with the provisions of Art. 81, in particular paragraph 3, and of Art. 82.

This dual system might cause further trouble in the near future, if and when the national competition authorities openly contradict Brussels' position.

Furthermore, it must not be forgotten that more and more countries today have their own antitrust-legislation and authorities, some of which have already scrutinized airline alliances (like Canada and Australia). Over the next decade, some observers even forecast a proliferation of competition law around the world[239]. These nations might be tempted to assert control over airline alliances as well.

The problem lies above all in the possibility of antitrust agencies arriving at diverging conclusions. The worst case scenario materialized in the 80s, when the so-called *Laker* affair stretched transatlantic relations in matters of civil procedure to a limit, with the

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[238] Art. 85 paragraph 1 reads: "Without prejudice to Art. 84, the Commission shall ensure the application of the principles laid down in Articles 81 and 82. On application by a member state or on its own initiative, and in cooperation with the competent authorities in the Member States, who shall give it their assistance, the Commission shall investigate cases of suspected infringement of these principles. If it finds that there has been an infringement, it shall propose appropriate measures to bring it to an end."

airlines concerned under an obligation to please two antagonistic courts in the U.S. and the U.K.[240].

Even if such a jurisdictional imbroglio is not likely to repeat itself, the problem of antitrust review under different jurisdictions is a real one and as such, has already been decried by airlines all over the world.

### 4.3.3.2 The Remedies

This problem has also been identified by scholars[241]. Several proposals aimed at reducing the current frictions have been advanced.

The most audacious refers to the World Trade Organization (WTO) as an appropriate forum for devising common rules on competition[242]. Even though the General Agreement on Trade in Services[243] provides the WTO with a stringent dispute settlement mechanism[244], the U.S. has hitherto shown reluctance to embrace such a far-reaching proposition.

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[239] *See* David Knipp, *Double Standards*, AIRLINE BUSINESS, March 1999, at 32, quoting William Kovacic, a visiting law professor at Georgetown University.

[240] On November 24, 1982, defunct *Laker Airways*, represented by its liquidator, laid conspiracy charges against several aircraft manufacturers and airlines before the U.S. District Court for the District of Columbia. *British Airways*, one of the defendants, then filed a writ before the High Court of Justice (U.K.), asking for a declaration of non-liability and a permanent injunction refraining *Laker* from continuing legal proceedings in the U.S., which was subsequently granted. Shortly hereafter, *Laker* sought a temporary restraining order from the U.S. District Court, which it then obtained, banning further defendants to obtain similar relief in the U.K. For more details, *see* PATRICIA M. BARLOW, AVIATION ANTITRUST, 184-91 (1987). Many antitrust cases have been the battleground so far for an overriding transatlantic conflict on civil procedure issues. This conflict was mainly about if the Hague Convention (Convention on Taking of Evidence Abroad in Civil and Commercial Matters, 23 U.S.T. 2555, T.I.A.S. No. 7444) supersedes Pretrial Discovery as set forth by the Federal Rules of Civil Procedure. Blocking statutes and claw back-provision were common features at that time.

[241] *See* Kathleen Lutz, *The Boeing-McDonnel Douglas Merger: Competition Law, Parochialism, and the Need for a Globalized Antitrust System*, 32 GEO. WASH. J. INT'L L. & ECON. 155, 171 (1999).

[242] *See* Leon Brittan, A Framework for International Competition, Address delivered at World Competition Forum, Davos, Switzerland, February 3, 1992.

[243] *See* General Agreement on Trade in Services, Annex IB, Agreement Establishing the World Trade Organization, signed at Marrakesh, April 15, 1994, 33 ILM 1125 at 1140.

Another proposal envisions the elaboration of an international code and the establishment of a supranational enforcement agency. This very far-reaching idea was first advanced by the Munich Group, a group of scholars, as early as 1993[245].

A further approach consists in the harmonization of national competition laws. Proponents of this idea argue that information flow and conversation might help to bring national rules closer to each other[246].

States have come up with a more pragmatic way of handling the competition issue. By signing bilateral agreements, they seek to harmonize relations between their respective antitrust enforcement agencies. The most notable example[247] of this approach is a 1998 agreement between the U.S. and the European Community[248]. Recent agreements of a

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[244] In accordance with Art. XXIII of the Agreement, any member that considers that another member fails to meet its specific obligations under the GATS may call upon the Dispute Settlement Board. The latter may then authorize the plaintiff state to suspend certain obligations.

[245] The proposed code is reproduced in 64 ANTITRUST & TRADE REG. REP. (BNA) No. 1628, at S-1.

[246] *See* Eleanor M. Fox, *Towards World Antitrust and Market Access*, 91 AM. J. INT'L L. 1,13 (1997).

[247] For the sake of completeness, it should be mentioned that several agreements have been signed before, *i.e.* between the U.S. and West Germany (*sic*), the U.S. and Australia, the U.S. and Canada. These agreements are limited in scope and do not provide for positive comity.

[248] Agreement between the European Communities and the Government of the United States of America on the application of positive comity principles in the enforcement of their competition laws, *entered into force* June 18, 1998, OJ L 173/28 (1998). The meaning of the notion "positive comity" is circumscribed in Art. III of the Agreement, which provides that

> [t]he competition authorities of a Requesting Party may request the competition authorities of a Requested Party to investigate and, if warranted, to remedy anti-competitive activities in accordance with the Requested Party's competition laws. Such a request may be made regardless of whether the activities also violate the Requesting Party's competition laws, and regardless of whether the competition authorities of the Requesting Party have commenced or contemplate taking enforcement activities under their own competition laws.

The less innovative Art. IV puts forth what may be described as *Negative Comity*:

> 1. The competition authorities of the Parties may agree that the competition authorities of the Requesting Party
> will defer or suspend pending or contemplated enforcement activities during the pendency of enforcement activities of the Requested Party.
> 2. The competition authorities of a Requesting Party will normally defer or suspend their own enforcement activities in favor of enforcement activities by the competition authorities of the Requested Party when the following conditions are satisfied:
> (a) the anti-competitive activities at issue:
> (i) do not have a direct, substantial and reasonably foreseeable impact on consumers in the Requesting Party's territory; or

similar type have been concluded between the European Community and Canada[249] and between the U.S. and Mexico[250].

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(ii) where the anti-competitive activities do have such an impact on the Requesting Party's consumers, they occur
principally in and are directed principally towards the other Party's territory;
(b) the adverse effects on the interests of the Requesting Party can be and are likely to be fully and adequately investigated and, as appropriate, eliminated or adequately remedied pursuant to the laws, procedures, and available remedies of the Requested Party. The Parties recognize that it may be appropriate to pursue separate enforcement activities where anti-competitive activities affecting both territories justify the imposition of penalties
within both jurisdictions; and
(c) the competition authorities of the Requested Party agree that in conducting their own enforcement activities, they will:
(i) devote adequate resources to investigate the anti-competitive activities and, where appropriate, promptly pursue adequate enforcement activities;
(ii) use their best efforts to pursue all reasonably available sources of information, including such sources of information as may be suggested by the competition authorities of the Requesting Party;
(iii) inform the competition authorities of the Requesting Party, on request or at reasonable intervals, of the status of their enforcement activities and intentions, and where appropriate provide to the competition authorities of the Requesting Party relevant confidential information if consent has been obtained from the source concerned. The use and disclosure of such information shall be governed by Article V;
(iv) promptly notify the competition authorities of the Requesting Party of any change in their intentions with respect to investigation or enforcement;
(v) use their best efforts to complete their investigation and to obtain a remedy or initiate proceedings within six months, or such other time as agreed to by the competition authorities of the Parties, of the deferral or suspension of enforcement activities by the competition authorities of the Requesting Party;
(vi) fully inform the competition authorities of the Requesting Party of the results of their investigation, and take into account the views of the competition authorities of the Requesting Party, prior to any settlement, initiation of
proceedings, adoption of remedies, or termination of the investigation; and
(vii) comply with any reasonable request that may be made by the competition authorities of the Requesting Party.
When the above conditions are satisfied, a Requesting Party which chooses not to defer or suspend its enforcement activities shall inform the competition authorities of the Requested Party of its reasons.
3. The competition authorities of the Requesting Party may defer or suspend their own enforcement activities if fewer than all of the conditions set out in paragraph 2 are satisfied.
4. Nothing in this Agreement precludes the competition authorities of a Requesting Party that choose to defer or suspend independent enforcement activities from later initiating or such activities. In such circumstances, the competition authorities of the Requesting Party will promptly inform the competition authorities of the Requested
Party of their intentions and reasons. If the competition authorities of the Requested Party continue with their own investigation, the competition authorities of the two Parties shall, where appropriate, coordinate their respective investigations under the criteria and procedures of Article IV of the 1991 Agreement.

[249] Agreement between the European Communities and the Government of Canada Regarding the Application of their Competition Laws, *entered into force* July 10, 1999, OJ L 175/50 (1999).

#### 4.3.3.3 Concluding Remarks

As more and more countries assert their competence with regards to antitrust review of global alliances, it will become increasingly cumbersome for alliance to face scrutiny in different jurisdictions. Some kind of understanding between the competition law authorities is needed to ensure a minimum of certainty for airlines. Most of the aforementioned proposals are politically not acceptable and therefore doomed for oblivion. However, cautious steps have already been taken to facilitate coordination between the competent authorities, as it is evidenced by the bilateral agreement reached by the U.S. and the EU. It is fair to say that this might set an example for other countries as well. Furthermore, it must not be forgotten that the European proposal to create a Transatlantic Common Aviation Area also encompasses coordination between the European Commission on the one and the U.S. Department of Transportation on the other side on soft rights, such as competition law issues.

### 4.3.4 Competition Law and the Strategic Position of *STAR*

The question arises as to how *Star* will be affected by the conditions set forth in the Final Order by the U.S. Department of Transportation and the notice of the European Commission.

#### 4.3.4.1 The Impact on *Star Alliance*

Competition law issues are something like a mixed bag for *Star Alliance*. First, as regards the relinquishing of slots[251], *Star* is even in a better position than its main rival, *OneWorld*.

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[250] *See* News Release Department of Justice, *DoJ and FTC Sign Antitrust Agreement with Mexico*, July 11, 2000.
[251] *See supra* 4.2.2.

The European Commission intends to force *Star* to give up a total of 84 slots at Frankfurt and Copenhagen. However, these slots are to be made available to a competitor, which intends to serve the respective market. It might well be that such a competitor never turns up.

The total amount of slots to be abandoned by *Star* contrasts sharply with the forced relinquishing of 267 slots by *Star's* competitor, *OneWorld*. *OneWorld's* executives persist in saying that this is too costly a condition to fulfill.

It remains to be seen if *Star* will further benefit from such a relative leniency. Today, with *British Midland* joining *Star* and the proposed merger between *United* and *U.S. Airways* on the horizon, the honeymoon might soon be over.

More importantly, the requirement that community carriers must enjoy Seventh Freedom rights between the European Community and the U.S. may turn out to be a ticking time bomb for *Star*[252]. If this condition is reiterated in a final decision by the European Commission the three carriers cannot go ahead with their alliance agreement. This requirement might also contribute to sharpening the conflict on competition law application between the U.S. and EU to the detriment of the alliances.

Further uncertainties lie in the fact that antitrust immunity and approval under U.S. law expire in 2001. By then, the U.S. policy on international airline alliances might come under scrutiny in a new administration.

#### 4.3.4.2 The Practical Meaning of Antitrust Immunity for the *Star Alliance*

Following the Final Order of May 21, 1996, concerning *Lufthansa* and *United*, and that of September 19, 1997, with respect to *Air Canada* and *United*, two of *United's* pivotal agreements have been granted immunization. This means that *United* may coordinate its flight plan with both *Air Canada* and *Lufthansa* on all flights. In the hub-and-spoke

[252] *See supra* 4.2.2.

context, coordination of flight schedules is the key to enabling member airlines to benefit the most from their alliance[253].

Thereby, immunization gives *Star* a competitive edge over its most significant competitor, the *OneWorld* Alliance with *British Airways* and *American Airlines*. Both carriers filed jointly for antitrust immunity in 1997. As negotiation between the UK and the U.S. on a liberal open skies-pact have not yet come to a conclusion, the U.S. Department of Transportation has refused to grant the two carriers antitrust immunity. Eventually, on July 30, 1999 it dismissed the joint application of *British Airways* and *American Airlines*[254]. Gaining immunity would have allowed both carriers to coordinate their flights at hubs in London Heathrow and Chicago O'Hare. Instead, the two carriers can only rely on features such as developing joint purchasing strategies and operating joint lounges. One senior executive for *OneWorld* is reported as saying that, without immunization, "you can't compete with the likes of the *Star Alliance*[255]." For the time being, *British Airlines* and *American Airlines* will have to limit their partnership to fields where antitrust immunity is not required[256]. Negotiations between the U.S. and the UK on a new bilateral were resumed in November 1999. In April 2000, both parties cleared the first obstacle by reestablishing direct air service between Pittsburgh and London Heathrow[257]. It remains to be seen when both parties will eventually conclude a new bilateral which corresponds to the U.S. criteria of an Open Skies agreement.

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[253] There are connecting flights at *United's* hub, Chicago O'Hare, for passengers from Frankfurt to destinations such as Birmingham (Al.), Cedar Rapids, Charlotte, Cincinnati, Cleveland, Colorado Springs, Columbus (Oh.), Dallas-Ft. Worth, Dayton, Denver, Des Moines, Detroit, Grand Rapids, Greensboro, Houston, Indianapolis, Kansas City, Knoxville, Las Vegas, Lincoln, Los Angeles, Madison, Memphis, New Orleans, Omaha, Orlando, Phoenix, Pittsburgh, Portland (On.), Sacramento, Saginaw, Salt Lake City, San Antonio, St. Louis, and Wichita. Via Washington Dulles International, *United* and *Lufthansa* offer one stop-connections to Atlanta, Boston, Charleston, Charlotteville, Cleveland, Denver, Ft. Myers, Greenville, Hartford, Indianapolis, Miami, Nashville, New Orleans, Newport News, Norfolk (Va.), Orlando, Raleigh-Durham, Roanoke, Rochester, Savannah, and Syracuse.

[254] *See* Department of Transportation News Release http://www.dot.gov/affairs/1999/dot11299.htm.

[255] *See* Edward H. Phillips, *OneWorld Late, But Powerful*, AVIATION WEEK & SPACE TECHNOLOGY, August 23, 1999, at 62.

[256] *American Airlines* has antitrust immunity as regards its cooperation with *Canadian International* (which, following the take over-bid by *Air Canada*, will leave *OneWorld*) and with *Lan Chile*.

[257] Pittsburgh has been without direct air service to the British capital since October 31, 1999. In January 2000, Rodney E. Slater, the U.S. Transportation Secretary expressed his disappointment with this situation. *See* News Release, January 28, 2000, http://www.dot.gov/affairs/2000/dot1800.htm. On March 30, 2000, the U.S. and UK have reached an understanding that will permit restoration of Pittsburgh-London air service. *See* News Release, April 3, 2000, http://www.dot.gov/affairs/2000/dot7300.htm.

There are, however, two further transatlantic alliances, which have been granted antitrust immunity. *KLM's* relationship with *Northwest* was immunized as early as 1993. In 1995, an alliance agreement between *Delta*, *Swissair*, *Sabena* and *Austrian Airlines* received antitrust immunity. The latter alliance has been disbanded since, *Delta* opting for a commercial agreement with *Air France* instead, which has not been granted immunity so far. This leaves *Star Alliance* with one immunized competitor, *Wings*.

## 4.4 Conclusion and Outlook

Any alliance with global ambitions will have to face scrutiny under competition law, in particular under U.S. and European Community legislation.

Regulators not only apply different laws, but also have diverging views as to whether or not airline alliances are anti-competitive and pursue different policies.

The uncertainties resulting thereof are perceived by airlines to be detrimental to their business interests. Competition law authorities should seek to harmonize their views and come up with common guidelines.

In particular the concept of regulatory convergence, as contained in the AEA proposal to establish a TCAA, addresses most of the airlines' grievances: It brings about certainty and provides for the implementation of a harmonized policy as regards alliances, thereby defusing any frictions between Washington and Brussels.

# Chapter 5 – The *Star Alliance* and Bilateral Air Transport Agreements

It has already been submitted before that the phenomenon of airline alliances has been influenced mostly by the existing framework of bilateral aviation agreements in the world. In the following, it shall be demonstrated how strategic choices of the *Star Alliance* were and still are influenced by the bilaterals currently in force.

## 5.1 Focus on Selected Bilateral Agreements

Today, around 3000 bilateral air transport agreements are in force worldwide. Here, only some of them – albeit the most important for the *Star Alliance* – shall be presented.

### 5.1.1 The North Atlantic Region

#### 5.1.1.1 U.S. and Europe

Since the U.S. signed its first Open Skies-Agreement with a member state of the European Community, namely the Netherlands, on October 14, 1992[258], it has concluded several bilaterals of this type with member states of the European Community. The only major exception, apart from France, remains the United Kingdom, which still has a restrictive bilateral with the U.S.

a) The Scandinavian Countries

On June 16, 1995, the U.S. concluded liberal Open Skies-Agreements separately with Sweden[259], Denmark[260] and Norway[261], the three countries which are home to *Star-Alliance* member *SAS*.

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[258] Agreement to Amend the Air Transport Agreement, as amended, and the Protocol Relating to the U.S.-Netherlands Air Transport Agreement of 1957, as amended, signed October 14, 1992, T.I.A.S. No. 11976.

[259] *See* Agreement between the U.S. and Sweden Amending the Agreement of December 6, 1944, as amended, effected by exchange of notes, June 16, 1995 (unpublished).

b) Germany

Germany and the U.S. signed an Open Skies-agreement on May 23, 1996[262]. This agreement bears all the hallmarks of a liberal bilateral as it does not provide any restriction on destinations, routes and capacity. On the other hand, it grants Sixth freedom rights including change of gauge and the guarantee of equivalent treatment to Germany[263].

c) The United Kingdom

The UK-U.S. bilateral[264] remains restrictive in comparison to the Open Skies agreements the U.S. has concluded with other members of the European Union. In particular, it restricts the number of designated carriers which may operate on routes to London Heathrow to just two from both contracting parties. It has already been mentioned before that therefore, the U.S. has hitherto refused to grant antitrust immunity and approval to *British Airways* and *American Airlines*, dismissing the application of these two carriers on July 30, 1999. Since then, *Stars* enjoys a competitive advantage over its main competitor, *OneWorld*, in that the latter cannot engage in flight schedule cooperation and the like. Hence *Star's* silent satisfaction with the stalled Anglo-American negotiation on a new aviation pact. This may change for good, however, after *British Midland* joins *Star* in summer 2000. As said before, the current bilateral – Bermuda II – limits the number of airlines that each signatory may designate on any route from Heathrow to the U.S. to two carriers. In this respect, the UK has designated *British Airways* and *Virgin*. *British Midland* appears to be interested in serving the U.S. from Heathrow[265] – which it cannot

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[260] *See* Agreement Amending the Agreement of December 16, 1944, as amended, signed June 16, 1995 (unpublished).

[261] *See* Amendment to the Agreement of October 6, 1945, as amended, signed June 16, 1995 (unpublished).

[262] Protocol between the United States of America and the Federal Republic of Germany to Amend the Air Transport Agreement of July 7, 1995, with related route schedule, signed May 23, 1996, 32 (unpublished).

[263] The U.S. agreed to grant German carriers the same rights in the U.S. as it is prepared to give to any other Member State of the European Community.

[264] Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the United States of America concerning Air Services, signed July 23, 1977, TIAS 8641, UST 5367.

[265] It is reported in the press *that British Midland* has been granted a route license by the U.K. Civil Aviation Authority and that it has placed options on two Boeing 767-300s and two Airbus A330-200s, four

according to Bermuda II. If British Midland could offer direct service to the U.S. from London Heathrow, *Star Alliance* would be allowed to operate Heathrow as a secondary hub for transatlantic traffic. Its presence at Europe's busiest airport might even be further enhanced by the proposed take over of *U.S. Airways* by *United.* Currently, *U.S. Airways* operates to and from the U.S. out of London Gatwick, as it holds no traffic rights to Heathrow under Bermuda II.

#### 5.1.1.2 Canada and Europe

Like its neighbor south of the border, Canada also began recently to conclude liberal Open Skies Agreements with selected countries. On November 5, 1996, Canada and Germany signed a new bilateral, "operating in an Open Skies environment[266]". This agreement provides unlimited access for carriers from both countries to any city in Canada and Germany and provides for a liberal prize-setting mechanism[267].

#### 5.1.1.3 The U.S. and Canada

On February 24, 1995 the U.S. and Canada signed a new bilateral air traffic agreement, bringing about Open Skies for the world's largest bilateral passenger market. For several years, Canada sought to replace the old 1966 agreement, which had set out particular point-to-point routes for the designated carriers, giving a significant advantage to the American mega-carriers to the detriment of their Canadian competitors[268]. After a three year-long phasing-in period, each designated carrier benefits from unrestricted access to any airport, the restrictions to pre-determined city pairs under the former agreement being thereby abolished. However, traffic rights do not include cabotage, Art. I(2) excluding the latter explicitly. Pursuant to Art. V, prices set by any given airline may only be disallowed if the signatories concur in doing so.

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long-haul aircraft in total. *See* John D. Morrocco, *Star Alliance Boosts Presence at Heathrow*, AVIATION WEEK & TECHNOLOGY, November 15, 1999, at 39.

[266] *See* Transport Canada, Press Release 173/96, "Canada and Germany Conclude Liberalized Air Agreement".

[267] *See id.*

In a study dedicated to the impact of the new bilateral air transport agreement, the U.S. Department of Transportation declared that between 1995 and 1998, the total U.S.-Canada traffic has increased 37.2%[269]. Second, and more important for this study, the signing of this new bilateral has paved the way for the granting of antitrust immunity for and approval of the cooperation between *Air Canada* and *United*. Furthermore, it permitted *Air Canada* more access to U.S. cities, enabling the Canadian carrier to introduce new city pairs to its flight plan. In this respect, the new agreement must be considered beneficial for both *Air Canada* and *United*.

#### 5.1.1.4 Concluding Remarks

The current Open Skies-Agreements in force represent a fertile breeding ground for *Star Alliance*. Under the principle of double disapproval, the carriers are allowed to offer competitive fares. Furthermore, all carriers may add new services and new flights without being hindered by capacity restrictions.

In the event that the U.S. signs a more liberal bilateral with the U.K., *Star* will lose its privilege, vis-à-vis *OneWorld*, of being the only immunized alliance. In this case, however, *Star* is set to gain access to the London Heathrow-U.S. market, enabling the member airlines to funnel passengers on the North Atlantic through the well-poised London airport.

### 5.1.2 The Pacific Region

Today, *Star Alliance* counts members in several South-East Asian countries as well as in Australia. The following is meant to characterize the approach that these countries have taken with respect to bilateral relations.

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[268] *See* Michael W. Lacy, *Freedom in the Air: The 1995 Canada – United States Bilateral Air Transport Agreement*, 20-2 ANNALS OF AIR & SPACE LAW, 139, 143-145, French summary at 161.
[269] *See* U.S. Department of Transportation, The Impact of the New U.S.-Canada Aviation Agreement at Its Third Birthday, February 1998, at 2.

### 5.1.2.1 Japan

Japan is home to one *Star Alliance* member – *All Nippon Airways*. Japan has shown a lot of reluctance to embrace the U.S. concept of Open Skies. Under the former U.S.-Japan bilateral[270], only two U.S. carriers were given access to the Japanese market. This bilateral was amended in 1998 by a Memorandum of Understanding[271]. Pursuant to the new agreement, each country can designate two ("incumbent") passenger-cargo carriers as well as four further airlines[272]. The U.S. has designated *United* and *Northwest* as incumbents and *Delta*, *American Airlines* and *Continental* under the new Memorandum of Understanding. This means that, among others, two *Star Alliance* members can operate between Japan and the U.S.: *ANA* and *United*. However, the new Memorandum of Understanding does not correspond yet to the U.S. concept of Open Skies[273]. Therefore, *ANA* and *United* are not in a position to apply for antitrust immunity with the U.S. Department of Transportation.

The German-Japanese Bilateral Air Transport Agreement is equally restrictive[274]. It only grants traffic rights on certain routes[275] and the fare-setting mechanism is that of double approval[276].

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[270] Civil Air Transport Agreement Between Japan and the U.S., signed August 11 1952, 212 U.N.T.S. 27, No. 1080.

[271] *See* Agreement Relating to and Amending the Civil Air Transport Agreement of August 11, 1952, as amended, effected by exchange of notes, April 20, 1998 (unpublished). For more details, *see also* Yoshinori Ide, *Recent Developments in Air Transport Relations between Japan and the United States*, [2000] TAQ, 16, 25.

[272] *See* Agreement Relating to and Amending the Civil Air Transport Agreement of August 11, 1952, as amended, effected by exchange of notes, April 20, 1998 (unpublished), Part I B 1. (a): Each Party may designate [...] up to four airlines, including any airlines, other than incumbent combination airlines, [...] to operate combination services as non-incumbent combination airlines."

[273] The new Memorandum of Understanding still provides for capacity restrictions. *See id.*at Part I B 2. and 3. It also limits Fifth Freedom operations between Japan and Asia, which shall not exceed, in terms of passenger-miles, the amount of total Third and Forth Freedom passenger traffic. The same formula also applies to any Japanese carrier on routes with intermediate points in Asia or beyond points in America. *See id.* at Part I A.

[274] *See* Agreement between the Federal Republic of Germany and Japan for Air Services, BGBl. 1962, II 174.

[275] *See id* at Art. 2.

[276] *See id.* at Art. 11.

In addition to that, it is noteworthy that the most serious issue for aviation in Japan is airport congestion. Without any significant increase in airport capacity, new entry to Japanese gateways will be severely restricted for practical reasons.

### 5.1.2.2 Singapore

Singapore, home to *Star Alliance* member *Singapore Airlines*, continues to be a gateway for air travel between Europe and Australia. Since it began code-sharing with *Lufthansa* in 1998, *SIA* offers connecting service for a *Lufthansa*-flight from Frankfurt to destinations in Australia such as Adelaide, Brisbane, Melbourne, Perth and Sydney[277]. In this respect, *Singapore Airlines* competes with another *Star alliance* member, *Thai*.

Due to its geographic location and the relatively small home demand for air transport, Singapore has always favored a liberal approach to international air transport. In April 1997, Singapore was the first Asian country to sign an Open Skies-Agreement with the U.S.[278]. This bilateral follows the example of agreements signed between the U.S. and European States[279]. On the other hand, however, the bilateral in force between Australia and Singapore, still corresponds to the Bermuda I – type[280]. It contains a schedule enumerating the routes on which designated carriers from both countries can operate. Furthermore, the fare-setting mechanism differs from Open Skies-Agreements in that the bilateral refers to the rate-fixing machinery of the International Air Transport Association, subject to double approval of Aviation Authorities of both countries[281]. The same also applies to the German-Singapore Bilateral Air Transport Agreement[282].

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[277] LH 778/786 from Frankfurt to Singapore connects with SQ 6380 to Adelaide, SQ 6382 to Brisbane, SQ 6384 to Melbourne, SQ 6388 to Perth and SQ 6390 to Sydney.
[278] *See* Air Transport Agreement Between the Government of the United States of America and the Government of the Republic of Singapore, signed April 8, 1997 (unpublished).
[279] *See* U.S. Department of Transportation, Press Release, *U.S. signs Open Skies-Agreement with Singapore; offers Open Skies to all of East Asia*, April 8, 1997, http://www.dot.gov/affairs/1997/dot4897.htm.
[280] Agreement between the Government of the Commonwealth of Australia and the Government of the Republic of Singapore relating to Air Services, signed November 3, 1967, ATS 1967 No. 25.
[281] *Id.* Art. IX.
[282] *See* Agreement between the Federal Republic of Germany and the Republic of Singapore for air services between and beyond their respective territories, signed February 15, 1969, BGBl. 1971 II 183.

### 5.1.2.3 Thailand

Like Singapore, Thailand also serves as a gateway for air travel between Europe and Australia[283]. Thailand has not yet embraced the American concept of Open Skies. In May 1996, following the denunciation of the former bilateral by Thailand in 1989[284], Thailand and the U.S. reestablished their bilateral aviation relationship by signing a new bilateral[285]. This agreement still restricts capacity to 31 passenger flights per week by U.S. carriers. The designated Thai carrier is entitled to serve eight cities in the U.S., instead of one previously. The Thai-Australian bilateral[286] contains basically the same wording as the Singapore-Australian bilateral. Its schedule, as modified by an Exchange of Notes in 1985[287], sets forth routes to five destinations in Australia for the designated carrier of Thailand. In this respect, the latter enjoys the same traffic rights as Singapore Airlines to and from Australia. The German-Thai bilateral[288] is rather restrictive, too. Designated airlines only enjoy Third and Forth Freedom rights on routes specified by a schedule[289]. Rates shall be fixed bearing in mind cost of operation and reasonable profits, subject to the double approval of aviation authorities in the contracting parties[290].

### 5.1.2.4 Concluding Remarks

Air transport in South East Asia remains more restricted than around the North Pacific. This stems not only from the regulatory framework, but also from capacity restraints due

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[283] *Lufthansa* flights LH 744, 702, and 772 from Frankfurt connect at Bangkok with services to Auckland (TG 6306), Brisbane (TG 6324), Melbourne (TG 6322), Perth (TG 6306) and Sydney (TG 6322).

[284] Just prior to the denunciation of the bilateral by the Thai government, Thai operated for weekly flights to the U.S. against 30 by U.S. carriers. *See* RIGAS DOGANIS, FLYING OFF COURSE – THE ECONOMICS OF INTERNATIONAL AIRLINES 73 (1991).

[285] *See* Air Transport Agreement Between the Government of the United States of America and the Government of the Kingdom of Thailand, signed May 8, 1996 (unpublished). *See also* U.S. Department of Transportation, Press Release, *U.S., Thailand reestablish aviation relations*, January 19, 1996, http://www.dot.gov/affairs/1996/thag.htm.

[286] Agreement between the Government of the Commonwealth of Australia and the Government of the Kingdom of Thailand relating to Air Services, February 26, 1960, ATS 1960 No. 4.

[287] Exchange of Notes constituting an Agreement between the Government of Australia and the Government of the Kingdom of Thailand to amend the Schedule to the Agreement relating to Air Services of 26 February 1960, September 3, 1982 – May 17, 1984, ATS 1985 No. 29.

[288] *See* Air Transport Agreement between the Federal Republic of Germany and the Kingdom of Thailand, signed March 5, 1962, BGBl. 1965 II 2.

[289] *Id.* at Art. 2.

to congested airports, such as occurring in Japan. Secondly, it is noteworthy that Asian countries still lack a regional organization in the field of aviation. South East Asian countries do not share the same approach toward concepts such as Open Skies[291] or the idea to establish a regional market. For the time being, this does not constitute an impediment for airline alliances to offer connecting services through local hubs. However, in the medium and long term, the willingness of countries to open up their market and to agree to Open Skies might turn out to be a kind of litmus-test for alliances, when these have to chose one particular airline over another.

This regulatory framework does not appear to have a significant negative impact on *Star Alliance*. In any case, the existing bilaterals in force permit *Star* to build hubs at Bangkok and Singapore for air travel from and to South-East Asia and Australia. On the other hand, the bilaterals in force with Japan do not permit the same with respect to Tokyo, capacity constraints there being a further hindrance.

This contrasts with the relative freedom airlines enjoy over the North Atlantic, where the merits of Open Skies have already convinced many countries to adopt a liberal approach toward international aviation.

### 5.2 The Issue of Code-Sharing

The practice of code-sharing raises regulatory questions with respect to traffic rights. It has been debated at length if all the code-sharing partners are required to possess traffic rights on a particular route, or if code-sharing only represents a marketing tool for which no particular authorizations are needed. Today, there is unanimity between states that at least some kind of authorization is needed.

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[290] *Id.* at Art. 11.
[291] *See supra* 4.3.2 and 4.3.3.

### 5.2.1 Definition of Code-Sharing

Under a code-sharing agreement, one airline allows another airline to publish one of its flights under its own two- or three-letter designator code. Today, code-sharing is practiced world-wide and is often one of the features of an airline alliance-agreement. When code-sharing made its first appearance, scholars considered it to be a mere marketing tool[292]. They often compared code-sharing to interlining, for which no particular traffic rights were required. However, state practice quickly contradicted this view. Generally speaking, states appear to require that both code-sharing partners have the specific traffic rights for the route, on which they code-share. Some states even go further by requiring a specific authorization for this purpose.

### 5.2.2 Underlying Traffic Rights

Today, it appears to be generally accepted that airlines desiring to engage in code-sharing must possess the underlying traffic rights. Such an approach was adopted, for instance, by the Administrative Court of Cologne, when it upheld a decision by the German Department of Transportation to refuse the granting of a license for *Northwest* in respect to a code-sharing flight operated by *KLM* on the grounds that the former had not been designated by the U.S. under the U.S.-German bilateral[293].

For European Community carriers operating within the Community, code-sharing is always permitted. Council Regulation 2408/92 opens domestic routes to any Community carrier beginning April 1, 1997. In its Art. 7, this regulation explicitly grants Community carriers the right, with a permit, to combine airline services and use the same flight number.

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[292] *See* Klaus Günther, *Legal Implications of Code-Sharing Services – A German Perspective*, 22 AIR & SPACE LAW, 8 (1997).

[293] *See* Verwaltungsgericht Köln, October 1, 1993, ZEITSCHRIFT FÜR LUFT- UND WELTRAUMRECHT, 363 (1994).

Today, Star alliance members code share on several intra-European routes. The largest network of code-sharing flights exists between *Lufthansa* and *SAS*, between Germany and Scandinavian airports as well as on inner-Scandinavian and domestic routes[294].

On other routes, *Star Alliance* members may only practice code-sharing if they are entitled under the bilateral air transport agreement in force to operate the route under their own name. *Lufthansa*, for instance, code-shares with *Thai* and *Singapore Airlines* on routes between Singapore and Bangkok on the one side and Australia on the other. *Lufthansa*, as the designated German carrier, enjoys traffic rights to Australia on the basis of the German-Australian bilateral[295] and an exchange of notes[296], determining the access points in Australia.

Code-sharing, however, is only permitted on national flights between two cities within any single state when the flight in question is a connecting flight. Otherwise, the foreign carrier would need Eighth Freedom rights, or cabotage, which have not yet been granted by bilateral air transport agreements[297].

### 5.2.3 A Specific Authorization

In 1988, the U.S. Department of Transportation came up with a specific requirement concerning code-sharing services. According to 14 CFR 212.9 of the Department of Transportation's Regulations, foreign air carriers shall obtain a statement of authorization for, among other things, a long term wet-lease. Section 212.2 includes in the definition of a wet-lease "operations where the lessor is conducting services under a blocked space or

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[294] Between Stockholm and Helsinki, Oulo, Tampere and Turku, between Copenhagen and Stockholm.
[295] Agreement between the Commonwealth of Australia and the Federal Republic of Germany, signed May 22, 1957, ATS 1959 No. 2.
[296] Exchange of Notes constituting an Agreement between the Government of Australia and the Government of the Federal Republic of Germany to further amend the Route Schedule to the Agreement relating to Air Transport, and Exchange of Notes, of 22 May 1957, July 28, 1995, October 3-4, 1996 (unpublished).
[297] United and Air Canada code-share with Lufthansa on certain domestic flights from Frankfurt to Berlin, Bremen, Cologne-Bonn, Dresden, Düsseldorf, Hamburg, Hannover, Leipzig, Munich, Nuremberg and Stuttgart.

code-sharing arrangement". Thus, before operating code-sharing flights, the carriers concerned must obtain the necessary approval by the Department of Transportation.

It must not be forgotten that this represents an additional requirement. Foreign carriers interested in code-sharing with U.S. carriers must in any case hold the underlying traffic rights. In its decision on a code-sharing arrangement between *British Airways* and *American Airlines*, the Department of Transportation underlined that the U.S.-UK bilateral did not contain any automatic authorization of code-sharing. Even though the carriers possessed the underlying traffic rights, they were required to apply for a specific authorization, which the Department understood as a precedent for further applications concerning code-sharing operations.

However, it has become common place today for U.S. Open Skies Agreement to explicitly grant this specific authorization. The U.S.-German bilateral of May 23, 1996, for instance, amends the former agreement by explicitly allowing code-sharing between airlines from both contracting parties[298]. If one designated airline under the U.S.-German agreement is to code-share with a carrier from a third country, the bilateral allows code-sharing under the condition of reciprocity, which means that this third country has to allow also such a kind of arrangement[299].

An example of the latter situation is a code-sharing agreement between *Lufthansa* and *SAS* on routes from Stockholm to Chicago (operated by *SAS*) and from Frankfurt to Houston (operated by *Lufthansa*), which was granted approval by the U.S. Department of Transportation on March 24, 1999[300]

[298] *See* U.S-Germany agreement, *supra* note 260, Art. 1(9), amending Art. 9(6) i.
[299] *See* U.S.-Germany agreement, *supra* note 260, Art. 1(9), amending Art. 9(6) ii.
[300] U.S. Department of Transportation, Notice of Action Taken, Docket OST-99-5212.

## 5.3 Conclusion and Outlook

The foregoing has demonstrated that on the North Atlantic, *Star* can already enjoy full commercial opportunities. Airlines are not subject to capacity restrictions, and under the principle of double disapproval of fares, they can offer competitive fares.

In South East Asia, *Star* operates in a more restrictive environment, depending on the country concerned. Here, capacity restrictions and double approval of fares may still apply.

The latter does only constitute a minor hindrance to Star, especially if bearing in mind that bilaterals may easily be amended if the contracting parties so wish.

The fact that traffic rights are still negotiated on a bilateral basis has not proven to be a major obstacle either. If bilateralism is increasingly questioned today, this is more so due to the lack of regulatory convergence as regards soft rights, *i.e.* competition law issues, than to the issue of traffic rights. A multilateral or regional framework, such as the EC, certainly allows for more flexibility, this flexibility, however, is scarcely utilized by airlines for the time being[301].

It is still to early to tell if the bilateral framework for the exchange of traffic rights will be replaced by a multilateral or regional approach. Several aviation areas have already been established[302], which differ in scope and significance. The AEA, in its statement on the TCAA, recommends that airlines "enjoy unrestricted commercial opportunities to conduct the business of air transport anywhere within the TCAA", an objective which the AEA admits "cannot be achieved from the outset".

It has been submitted before that the issue of traffic rights is not as vital to the alliances as regulatory convergence on competition law enforcement. Therefore, it would be

[301] *Lufthansa* code-shares with *SAS* on selected routes within Scandinavia on the basis of Seventh Freedom rights. *See supra* 5.2.2.
[302] *See supra* 1.3.

detrimental to the airlines' interests if the issue of traffic rights delayed the implementation of regulatory convergence, a somewhat likely scenario given the reluctance of the U.S. to grant Seventh Freedom or cabotage rights in passenger services.

# Chapter 6: Who Owns a Star? – The Issue of Substantial Ownership and Effective Control

## 6.1 Substantial Ownership and Effective Control and Its Implications on Airline Alliances

It has been submitted before that the requirement pursuant to which an airline must be substantially owned and effectively controlled by nationals of the designating country constituted the major impediment to cross border mergers like the ones that occurred in any other business sectors. This, however, does not purport to claim that the idea of transnational mergers has been completely absent in the airline industry. Be it as it is, it is still true that the nationality principle is one of the major concerns when airline strategists discuss mergers.

### 6.1.1 In the U.S.

To date, there have been two European carriers showing interest in acquiring a substantial share of a U.S. carrier: *KLM* in *Northwest* and *British Airways* in *U.S. Airways*. In both cases, the bidding European airlines at least had to amend their proposal – if the project was not even an outright failure.

In 1989, *KLM* initially intended to purchase 56.74% of a holding company called "*Wing*", which was to buy *Northwest*. The deal also included the setting up of a three member financial advisory team by *KLM*, whose advise *Northwest* was supposed to heed. As the Department of Transportation had serious doubts about *Northwest* not being a U.S. company any more, *KLM* came up with a new proposal: It would only purchase 25%

of "*Wings*" equity and the idea of creating an advisory body was dropped. Consequently, the Department allowed KLM to go ahead[303].

Just 18 months later, *Northwest* asked the Department of Transportation that it allay the requirements of its previous decision on the matter. Eventually, the Department allowed *KLM* to hold 49% of the holding company, "*Wings*"[304].

In 1992, *British Airways* mulled a proposal to invest in the U.S. carrier *U.S. Airways*. The London-based airline originally proposed to acquire 44% of U.S. Air's stocks and to nominate 12 out of 16 board members. Out of the 44% in shares, 21% would be Convertible Preferred Shares transferable into voting equity. Amid an extreme politization of the issue, it appeared that the Department of Transportation was unwilling to give the planned transaction the go-ahead. Preempting the probable dismissal of its initial proposal by the Department, *British Airways* decided to revoke its offer[305].

These two affairs illustrate that, U.S. wise, there is little room for consolidating transatlantic airline alliances by purchasing shares of U.S. airlines. On the other hand, however, the same restrictions do not apply to intra-American mergers. Consequently, several U.S. carriers are currently exploring the possibility to take up equity in fellow carriers. Following the example of *United Air Lines*, which proposed to bail out *U.S. Airways*, *American Airlines* is said to have engaged in talks with *Northwest* discussing the prospects of a major participation of the latter by the former[306]. Lifting the nationality

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[303] *See* Department of Transportation, *In re Acquisition of Northwest Airlines, Inc.*, Order No. 89-9-51, September 29, 1989.

[304] *See* Department of Transportation, *In re Acquisition of Northwest*, Order No. 91-1-41, January 23, 1991. *See also* David T. Arlington, *Liberalization of Restrictions on Foreign Ownership in U.S. Carriers: The U.S. Must Take the First Step in Aviation Globalization*, 59 JALC 133, 157 (1993) (who adds that this decision "appeared to be the beginning of an era where the DoT would adapt the U.S. airline industry to the international industry as a whole").

[305] *Id.* at 185.

[306] *See American Explores a Deal for Northwest*, THE WALL STREET JOURNAL, June 5, 2000, at A3. The Wall Street Journal reports that executives of *American Airlines* have made "preliminary overtures" about bidding for *Northwest*. Long time plagued by labor unrest, *Northwest* is coveted by *American* mostly due to its lucrative Asian routes (*Northwest* boasts a mini-hub at Tokyo) and its participation in *Continental*. Furthermore, *Northwest* has considerably improved on time-performance, according to a survey published monthly by the Department of Transportation. *Continental*, however, has recently announced that it intents to buy back Northwest's stake in *Continental*.

threshold to 49% would enable European carriers to inject fresh money into some of the U.S. carriers and help to strengthen a strategic alliance between the European and the U.S. member airlines. However desirable, a change in the U.S. legislation remains for the time being very unlikely, in particular just prior to a U.S. presidential election.

### 6.1.2 In Europe

When analyzing the impact of EC Regulation 2407/92 on strategic alliances, two scenarios should be distinguished:

Firstly, the Regulation bars any non-Community carrier from acquiring 50% or more of the voting equity of a Community carrier or to exercise effective control on the latter by any other means. In putting the threshold at 50%, European law permits more substantial participation than the U.S. The European version of the nationality principle has been put to the test once, when *Swissair* proposed to take a major stake in the Belgian carrier *Sabena*[307]. *Swissair's* proposal suggested that the Swiss carrier would own 49.5% of the voting rights in *Sabena*, just short of the threshold established by Regulation 2407/92. *Swissair* would also appoint five out of the twelve members of *Sabena's* board of directors. The European Commission held that *Sabena's* proposal complied with the requirements of majority ownership and effective control[308]. *Swissair* raised its stake in April 2000 to 85%. The air-political consequences of this step still remain unclear.

Furthermore, Community Regulation does not provide for any limit on intra-Community mergers among airlines. Any Community carrier may, if it so wishes, legally acquire any stake in another Community carrier. This idyllic picture is blurred in case the coveted carrier holds traffic rights from one Member State of the European Community to a third country. According to the bilaterals still in force today, the latter might point out to the fact that the designated carrier under the bilateral is not substantially owned

[307] Previously, a fully-owned subsidiary of *Air France*, *Finacta*, held 37.5% of *Sabena's* voting shares.
[308] It has been put forward that this finding was in contradiction with the Commission's position on the applicability of the Merger Regulation 4064/89. According the Commission, the transaction fell within the

and effectively controlled by nationals of the designating state and consequently revoke its operating license. To day, not a single transaction has found a way to circumvent this regulatory hurdle. The first carriers to give it a try might be *British Airways* and *KLM*. These carriers are said to be "exploring" a possible merger[309]. It remains to be seen how the two carriers attempt to deal with the nationality requirement. The main problem will be to ensure that, if *British Airways* acquires a majority participation in *KLM*, the latter does not lose its traffic rights to third countries. Much will depend on the attitude of the signatories of Netherlands' bilaterals. Will they endorse the merger? Will they seek a general or air-political concession by the Netherlands?

### 6.2 The Strategic Position of *STAR*

As the industry enters a new phase of consolidation this summer, it remains to be seen if *Star* members join the party and begin discussing merger or major participations. It seems that for the time being, all airlines are waiting to see the outcome of the talks initiated between *KLM* and *British Airways*.

The *Onex* take-over bid has shown to the world that the existing airline alliances are fragile beings. Swapping equity not only demonstrates commitment, but also helps to build links between the carriers concerned.

Whether or not the nationality principle constitutes a hindrance for airline alliances, depends on their respective ambition. The above example[310] of *KLM* acquiring stakes in *Northwest* shows that an integrated alliance still has to build its strategy around ownership and control. *Star Alliance*, which still relies on a looser relationship between independent carriers[311], is not set to be much affected.

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scope of the Merger Regulation, which implies that Swissair has the means to exercise decisive influence on Sabena. *See* Berend Crans & Onno Rijsdijk, *EC Aviation Scene*, 21 AIR & SPACE LAW 33, 37 (1996).

[309] *See BA Explores a Merger with KLM*, THE WALL STREET JOURNAL, June 5, 2000, at A21.

[310] *See supra* 6.1.1.

[311] *See supra* 3.4.2 and 3.5.

*United* launched a take over bit on *U.S. Airways* without any external support from *Star Alliance* members. As one of the mega-carriers, its balance sheet seems to be up to the task. When *United* and *Lufthansa* stepped in the fray as "White Knights" to defend fellow airline *Air Canada*, their joint contribution not even comes close to the 25% benchmark set up by the Canada Transportation Act and the Air Canada Public Participation Act[312].

The question of ownership and control became somewhat acute in the case of *British Midlands*. To date, this company is still owned at 40% by *SAS*. After *British Midland's* adhesion to Star in summer 2000, Lufthansa will acquire 20% from its Scandinavian partner[313]. However tempting the idea, both *Star Alliance* members refrain from enlarging their stake in *British Midland*, lest the latter loses traffic rights with third countries.

It remains to be seen in how far the talks between *British Airways* and *KLM* will have an impact on airline consolidation in Europe as a whole. Any merger between two of the biggest carriers may only succeed if the question of substantial ownership and effective control can be settled. If the merger goes ahead, it is set to serve as an example for further consolidation. Basking in the glow of having created the strongest alliance so far, *Star's* members cannot afford to be indifferent to a *rapprochement* between the European anchors of its main alliance competitors, *OneWorld* and *Wings*. In such a scenario, *Lufthansa* would be faced with the question if it should further deepen its relationship with *SAS*, or if it should instead advocate closer collaboration with another alliance, eventually entailing another cross-border merger.

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[312] Expo Investment Partnership, L.P, set up by *United* and *Lufthansa*, will own 7% of *Air Canada's* equity in the form of Class A convertible non-voting preferred shares. *See* Barbara Beyer, *Affecting competition and alliances*, THE AVMARK AVIATION ECONOMIST, December 1999, at 2.

[313] *See* Daniel Solon, *becomes a Star ally*, THE AVMARK AVIATION ECONOMIST, December 1999, at 5.

## 6.3 Conclusion and Outlook

The issue of ownership and control has already induced alliances to amend their strategy as to share holding. As such, it continues to be the crucial obstacle on the way toward airline mergers.

Whether or not this constitutes an impediment to an airline alliance depends on its ambitions. Those favoring an integrated structure, like *KLM*, still have to build their arrangements around the ownership and control principle.

*Star Alliance* still seems to refrain from closer integration. This lack of ambition explains why Star is less likely to be restricted by the nationality principle.

Other carriers, in particular *KLM*, which has initiated talks with *British Airways* on a possible merger, feel the need to go further ahead and question the ownership and control principle. These current merger talks have the merit to put the issue of ownership and control high on the agenda. The nationality requirement is perceived by many in the airline business to be outlived and inadequate. Pressure to do away with it has already gained momentum and will continue to do so. The question is whether those still opposed to a softening up of substantive ownership and effective control will be strong enough to stem the tide.

Nonetheless, the advocates of the existing nationality requirement remain very strong. In particular developing countries are anxious to keep the status quo. Firstly, to many countries, to have a national flag carrier is a question of pride. Secondly, these countries feel that sustainable development requires the presence of a national carrier which remains attached to the concept of public service. A further adept of this school of thought is the U.S. Department of Defense. The Pentagon remains fearful of an erosion of its Civil Reserve Air Fleet program, or CRAF[314]. Until now, in a case of emergency, the U.S. Air Force relies on commercial aviation for up to 93% of troop movements and 41%

[314] *See* Karen Walker, *The great global debate*, AIRLINE BUSINESS, September 1999, at 96.

of cargo transport. Security concerns may eventually prevail over the interests of the U.S. mega-carriers. Furthermore, the braking force of organized labor should not be underestimated, either. Labor resistance, especially by pilots, has often constituted a major pitfall for well-elaborated merger proposals. It will also be an obstacle to the removing of the nationality requirement.

On the other hand, the idea of liberalizing the nationality requirement finds more and more supporters every day. Frederick Reid, an officer at *Delta Air Lines*, sums up the trend by stating that so far, no airline "felt this issue to be vital to its strategic interests, but alliances have raised the temperature[315]". Not only airlines, but also government officials consider the advantages of an easing of the nationality requirement. The issue was also on the agenda of a conference convened in Chicago in December 1999 by U.S. Transport Secretary Rod Slater. In the aftermath of airline consolidation in Canada, the Canadian Transport Secretary David Collenette also indicated that Canada might be willing to lift restrictions on foreign investment in Canadian carriers.

Some countries have even preceded the U.S. and Canada. In 1997, Brazil raised the limit to 49% and Peru even to 70%[316]. Moreover, it is not yet predictable how *Sabena* will operate under Belgian bilaterals while owned by *SAir*, the parent company of *Swissair*. If Belgium's contracting parties do not challenge *Sabena's* nationality as a Belgium carrier, this may set an important precedent, the nationality principle eventually falling into oblivion. In this respect, the years ahead might prove to be decisive for the future of substantial ownership and control and thus for the prospects of the consolidation and restructuring of the international airline industry.

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[315] Quoted *id.* at 98.

[316] *See* James Ott, *Pressures Build for New Slant On Aviation Agreement*, AVIATION WEEK & SPACE TECHNOLOGY, November 9, 1998, at 65.

# Chapter 7: *Star Alliance* and Slot Allocation

Airports represent the necessary infrastructure for air transport. Today, airports face enormous difficulties in trying to match the growth of the air transport industry. More and more airports experience congestion, and scheduling patterns of airlines even exacerbate the problem. The hub and spoke-system has also permitted airlines to enjoy a monopolistic position at their hub, thwarting new entry and, to a lesser extent, foreshadowing possible strains between alliances and airports.

## 7.1 The Factual Background: Hub and Spoke and Scheduling through Hubs

Over the last decade, air traffic growth world wide has fluctuated around 7%. This explains only in part why the world's largest airports today face capacity shortages. To meet future demand for air travel, new airports mushroom, and existing airports seek to accommodate an ever-growing number of passengers by building new runways and opening new terminals.

Increasing demand for air transport may be blamed only in part for airport congestion. The adoption of the hub and spoke-system as a scheduling pattern by major airlines has also played a significant role. Today, hubbing is a common phenomenon of air transport in the U.S. as well as in Europe. It has already been mentioned that hub and spoke networks permit airlines to serve more city pairs than a linear network could do[317].

In order to further maximize their yields, airlines seek to arrange flights between the hub and the spokes in several waves, entailing even more capacity demand for airport authorities at peak times. Airlines attempt to connect as many flights as possible within the Minimum Connecting Time. In practice, this means that long periods of time with minimal traffic alternate with peak periods, where the airport is bustling with activity[318].

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[317] *See supra* 2.1.1.

[318] *See* Richard Janda, *Auctioning Airport Slots: Airline Oligopoly, Hubs and Spokes, and Traffic Congestion*, 25 ANNALS OF AIR & SPACE LAW 153, 157 (1993).

Albeit a pre-alliance phenomenon, hub and spoke patterns are increasingly adopted in the framework of alliances as well. In the long term, secondary hubs in an alliance will see their long haul traffic decrease and will end up as a feeder airport for the main hub. This may be exemplified in the case of Copenhagen: Previously *Scandinavian's* main hub, Copenhagen cannot boast nonstop service to Los Angeles and Hong Kong any longer[319].

Airport congestion may bring about further problems. It has probably contributed to a rise in flight delays in the last two decades[320]. In the hub and spoke context, punctuality is a serious issue, as belated incoming flights might hold back departing aircraft in order to allow passengers to connect, thus multiplying the delays[321]. Even more, the soaring flight activity at certain airports at certain peek hours increases the risk of collisions, either mid-air or on the ground.

In the absence of viable structural solutions, airports are forced to cope with the current situation. U.S. airports have already adopted new approach procedures. Furthermore, it has become inevitable to ration slots.

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[319] *See* Nigel Dennis, *Scheduling issues and network strategies for international airline alliances*, 6 JOURNAL OF AIR TRANSPORT MANAGEMENT 75, 79 (2000).

[320] Flight delays are also caused by inadequate airport infrastructure and air traffic control problems.

[321] *See* Martin Brenner, *Airline Deregulation - A Case Study in Public Policy Failure*, 16 TRANSPORT. L. J. 179 (1988). Consumer complaint about delays prompted the Department of Transportation in 1987 to require airlines to disclose data on their on-time performance. *See* 14 CFR Part. 234 for Department of Transportation regulations. A flight is on-time, if it arrives at the gate no more than 15 minutes after the scheduled arrival time shown in the CRS. *See* 14 CFR 234.2. A U.S. airline must disclose its on time-performance on the request of a potential customer. *See* 14 CFR 234.11. It is reported that in the following years, the figures did improve. However, this does not prove a decrease in airport congestion. This rather illustrates that airlines have begun to publish more realistic flight schedules.

## 7.2 The Issue of Slot Allocation[322]

A slot is a period of time during which an airline may use the runway of any given airport either for landing or take-off. Capacity restraints at airports do not concern solely the runways. Other airport facilities, such as gates, customs and immigration, and ground handling, are also restricted.

Slots are allocated to airlines on the basis of different sets of rules. Some of them stem from the industry's own representative body, the International Air Transport Association (IATA). The IATA has published guidelines for slot allocation, the Scheduling Procedures Guide[323]. One of the most important principles for slot allocation is the "grandfather's rights" principle, also referred to as the principle of historic precedence. This principle simply means that when an airline already holds a certain slot at a certain time, it is entitled to retain it in the future. This principle is complemented by the "use it or lose it" principle, which holds that in the case a slot is not used most of the time, it must be handed back to airport coordinators in order to be reallocated. On the international level, slot allocation takes place in the framework of IATA's Schedule Coordination Conferences, which are held twice a year between airline and airport coordinators under the auspices of IATA. These conferences represent an appropriate forum for coordination and exchange of slots[324]. The issue of slot allocation has also been dealt with on a national level. In the following, two regulations pertaining to slot allocation shall be presented: those of the U.S. and the European Community .

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[322] This chapter is only meant to cover the issue of slot allocation as far as it pertains to airline alliances. At a time when slots are a scarce resource, the issue deserves to be also elucidated from other angles, such as the issue of ownership over slots and commercial transactions with respect to slots. *See* in general R.I.R. Abeyratne, *Management of Airport Congestion through Slot Allocation*, 6 JOURNAL OF AIR TRANSPORT MANAGEMENT 29 (2000), R.I.R. Abeyratne, *Consequences of Slot Transactions on Airport Congestion and Environmental Protection*, 5 JOURNAL OF AIR TRANSPORT MANAGEMENT 31 (1999). *See also* David Starkie, *Allocating Airport Slots: A Role for the Market*, 4 JOURNAL OF AIR TRANSPORT MANAGEMENT 111 (1998) (on the economical aspects) and Sabine J. Langner, *Contractual Aspects of Transactions in Slots in the United States*, 2 JOURNAL OF AIR TRANSPORT MANAGEMENT 151 (1995) (from the point of view of the law of contracts).

[323] *See* International Air Transport Association, Scheduling Procedures Guide, 15th edition, July 1993.

[324] As a matter of fact, it must be kept in mind that any flight presupposes two slots.

### 7.2.1 In the U.S.

In 1986, the United States' Department of Transportation enacted for the first time regulations concerning slot allocation. These regulations apply to "High Density Traffic Airports", of which currently exist four (New York-John F. Kennedy, New York-La Guardia, Chicago-O'Hare and Washington-National). The United States regulations follow in some aspects the IATA principles on slot allocation. Their backbone are the aforementioned "grandfather's rule"[325] and the "use it or lose it" rule[326]. Any slots, which have become available by whatever reason shall be reattributed by ways of a lottery. Such a lottery may be attended by all U.S. carriers already operating to the airport concerned as well as those which wish to do so, if they notify in advance[327].

However, in one aspect, the U.S. system is particular: The Department of Transportation's regulations distinguish between national and international slots. International slots are those set aside for flights where either take-off or landing occurs at a foreign point[328]. Such a slot, pursuant to Federal Regulations, may not be bought, sold, leased or otherwise transferred except on an one-to-one basis. Slots, however, which do not fall within the scope of this section "may be bought, sold or leased for any consideration and any time period and they may be traded in any combination"[329].

Consequently, foreign carriers cannot do any transactions with their slots except to swap them. This means that an international slot is not a commodity in the same way as a national slot.

Many airlines perceive this differential treatment as detrimental to their doing business at U.S. airports. In particular Canadian carriers lobbied hard to see it removed. The issue

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[325] *See* 14 CFR 93.215: "Each air carrier...holding a permanent slot..., as evidenced by the records of the air carrier and commuter operator scheduling committee, shall be allocated those slots subject to withdrawal under the provision of this subpart."
[326] *See* 14 CFR 93.227: "Except as provided [in other paragraphs of this section], any slot not utilized 65% of the time over a 2 month period shall be recalled by the FAA."
[327] *See* 14 CFR 93.225 for more details.
[328] *See* 14 CFR 93.217.
[329] *See* 14 CFR 93.221.

was later settled in the 1995 Air Transport Agreement between Canada and the U.S.[330]. The Agreement provides in Section 1 of the Annex II that

> [e]xcept as otherwise provided in this Annex and in Section 5 of Annex V, Canadian and United States airlines shall be subject to the same system for slot allocation at United States high density airports as are U.S. airlines for domestic services.

This demonstrates how far the distinction between international and national slots has already become an air-political *quid pro quo*.

### 7.2.2 In the European Community

In the European Community, Council Regulation 95/93[331] is dedicated exclusively to the issue of slot allocation. It sets up a legal framework which resembles somewhat the IATA guidelines.

A form of coordination of slot allocation shall take place at any airport within the European Community where airlines representing more than 50% of all operations consider that the existing capacity is insufficient for actual or planned operations at certain periods[332]. In that case, an airport coordinator, appointed by the member state and assisted by a coordination committee, shall ensure that the slot allocation takes place in a non-discriminatory and transparent way[333].

The Council Regulation also sets forth the principles which should guide the coordinator in allocating slots. According to Art. 8(1), "a slot that has been operated by an air carrier as cleared by the operator shall entitle that air carrier to claim the same slot

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[330] Air Transport Agreement between the Government of Canada and the Government of the United States of America, signed February 24, 1995 (unpublished).
[331] European Council Regulation 95/93, OJ 141/1.
[332] *Id.* Art. 3(3).
[333] *Id.* Art. 4(2).

in the next equivalent scheduling period[334]. This is the aforementioned "grandfather's rule". Like the "use it or lose it" rule, Art. 10(3) provides that a slot which has not been used for at least 80% does not entitle the respective airline to keep it during the next scheduling period[335]. Such a slot will go to a pool of slots, together with newly created slots or slots that have been given back voluntarily by an airline. The slots in the pool will be reallocated to applicant carriers, but 50% of these must be attributed to new entrants[336]. In this respect, the European framework differs from the U.S. Regulations, which do not reserve a favorable treatment for new carriers.

## 7.3 Critical Appraisal

Given the scarcity of airport resources such as, above all others, runway capacity, a slot has become, at various key airports, a precious asset. When carriers such as *TWA* and *PanAm* experienced financial problems, *United* and *American* did not hesitate to covet their traffic rights to London as well as the corresponding slots. When the European Commission scrutinized *Star Alliance* and *OneWorld*, it quickly determined that both alliances had to give up slots at congested airport to render their agreements compatible with competition law[337]. These two incidents illustrate the importance of slots for today's aviation.

The grandfather's rule helps incumbent carriers to build their hubs as fortresses and to defend them against their competitors. *Star Alliance*, for instance, controls 70% of Frankfurt's slots. If these slots are used, they cannot be reallocated to other airlines.

In such a situation, the only way to gain new slots at a slot-restricted airport is to take over an incumbent carrier. When *British Midland* joins *Star* in summer 2000, it will

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[334] *Id.*
[335] *Id.*
[336] *Id.* Art 10(7).
[337] *See supra* 4.2.2 and 4.3.5.1

contribute 13% of slots at London Heathrow, raising *Star's* percentage of slots at London's main airport to 26.7%, as compared to 44.5% by *OneWorld*[338].

Another way to ease slot scarcity would be to build new airport facilities. However, this does not often represent a feasible solution, as in a densely populated Europe, environmental concerns such as noise problems are not easy to overcome. Often, carriers at hub airport also have the legal leverage to prevent the building of new airport facilities.

This means in practice that today's alliances can be sure to retain their dominant positions at their key hub airports. The only challenge might eventually come from regulatory bodies such as the European Commission[339].

A new approach toward slot allocation is just being considered by Japanese aviation authorities. It is reported that they intent to take away slots from incumbent carriers (*ANA*, *JAL*, and *JAS*) in order to redistribute them according to a rating systems, which takes into account quality of service[340]. This idea would not be to the liking of *Star Alliance*, or any other global alliance.

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[338] *See* Daniel Solon, *BM becomes a Star ally*, THE AVMARK AVIATION ECONOMIST, December 1999, at 5.
[339] *See supra* 4.2.2 and 4.3.5.1.
[340] *See* Nicholas Ionides, *Slow change*, AIRLINE BUSINESS, February 2000, at 43.

# Conclusion and Outlook: Airline Alliances in the Next Millennium

## 8.1 Airline Alliances under the Current Regulatory Framework

In several aspects, airline alliances pay tribute to the regulatory framework of commercial aviation. Their very existence is due to the ownership and control principle, which requires that an airline may only avail itself of traffic rights under a certain bilateral air transport agreement if it is substantially owned and effectively controlled by nationals of the designating country. Thus, airlines refrained from mergers, as they feared to lose traffic rights as a consequence. This restrains in particular those alliances which intend to integrate their organizational structure.

All airline alliances have been subject to scrutiny under competition rules. As every nation applies its own guidelines and pursues its own interests, alliances are under an obligation to please several competition law authorities at the same time. This approach has been identified as one of the major obstacles faced by airline alliances. It is submitted that regulatory convergence is needed to alleviate the burden on any global alliance. The 1998 agreement between the EU and the U.S.[341] has shown that gradual progress is possible. The TCAA concept also addresses this issue.

In today's Open Skies environment, alliances enjoy full commercial opportunities in the most important markets of the world. Even more restrictive agreement in force with countries in South East Asia only have a minor impact on alliance agreements. As regards traffic rights, a multilateral approach is not as vital to the interests of global alliances as with respect to competition law issues.

The legal framework governing slot allocation at congested airports in the U.S. as well as in Europe still benefits today's alliances. Under the *grandfather* rule, an incumbent

[341] Agreement between the European Communities and the Government of the United States of America on the application of positive comity principles in the enforcement of their competition laws, *entered into force* June 18, 1998, OJ L 173/28.

airline is assured of retaining its current slots, which means that an alliance is well poised to defend its dominant position at its hub airports. In such a context, slots may only be acquired by a competitor by taking over an incumbent carrier. The European Commission has become aware of this problem, forcing the alliances to relinquish slots at key airports.

At the threshold to the new millennium, airline alliances are a dominant phenomenon in international aviation. In the fast evolving regulatory context, the question arises as to whether alliances are here to stay.

## 8.2 The Future of Airline Alliances

Alliances have always been an *ersatz* for real mergers. As mergers are poised to become a feasible option for airlines, is the phenomenon of airline alliances doomed for oblivion?

### 8.2.1 Mergers Instead of Alliances?

It is true that alliances are nothing but a poor surrogate for permanent restructuring. Any other industry has witnessed mergers (even in a very sensitive sector such as defense technology), but only commercial aviation had and still has to rely on weaker structures such as loose alliances between independent entities.

The regulatory environment, in particular the substantial ownership and effective control clause, is still perceived by many to prevent full-fledged trans-border mergers. Nonetheless, two attempts have recently emerged, eschewing the constraints put up by bilateral air transport agreements.

As mentioned before, the first is by the Swiss *SAir* Group, parent company of *Swissair*, which is set to raise its capital stake in the Belgian carrier *Sabena* up to 85%[342].

[342] *See Britsh Air and KLM Expected to Confirm Discussions on Deal*, THE WALL STREET JOURNAL, at A3.

Furthermore, *British Airways* and *KLM* are holding talks in order to explore the prospects of a merger between the two companies[343].

Much depends on the outcome of these endeavors. If *Sabena* and *KLM* can come out of the fray unharmed by air-political retaliation, the two mergers are set to change the shape of the airline industry for good. In that case, many other airlines will feel the need to follow these two precedents. When mergers finally become a feasibility in the airline business as well, airline alliances will probably cease to be the main feature of airline consolidation.

However, this evolution will be a gradual one. Many carriers are still government owned. It will take time to do away with several decades of flag carriers and government involvement in air transport.

### 8.2.2 The Future of *Star Alliance*

Within *Star Alliance*, there is still room for closer ties between the participating carriers. *Singapore Airlines'* latest shopping spree in Australia has amply demonstrated this. With *Ansett* and *Air New Zealand*, the Singapore based carrier might intensify the already existing ties, ending up in a single entity, as soon as, airpolitically speaking, the time becomes ripe for trans-national airline consolidation.

Another pole might emerge between *SAS* and *Lufthansa*. This German-Scandinavian relationship, the spinal cord of *Star Alliance*, may already rely on inter-governance ties. As both carriers already operate in an aviation area such as the European Community and entertain a route network without too much overlap, they might seek further synergies in a full-blown merger.

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[343] *See id.* and Pierre Sparaco, *British Airways, KLM Pursue Merger*, AVIATION WEEK & SPACE TECHNOLOGY, June 12, 2000. A similar attempt was made in 1992, when both sides apparently could not agree on valuation issues. If successful, *BA* and *KLM* would create the biggest European airline as to passengers flown. However, many roadblocks still lay ahead, such as antitrust and ownership and control.

With the foregoing exceptions, it is probable that only few consolidation will actually take place within *Star Alliance* in the short term. There is still some reluctance within its members to embrace a more integrated approach. Furthermore, several carriers, like *Thai* and *Mexicana* are still largely owned by governments and therefore unlikely to be dissolved in another company by merger.

## 8.3 The Impact of Global Airline Alliances on International Aviation

Airline Alliances of the likes of *Star* or *OneWorld* are global players, shaping international aviation just as much as the sovereign states or other regulators. Some trends appear to be already emerging, the most important of which shall be illustrated in the following:

### 8.3.1 Impact on Fifth Freedom and Cabotage[344]

Fifth freedom traffic has often been a difficult issue in aviation related negotiations, because it is seen as traffic primarily belonging to the carriers of the two countries between which it is carried. This is even more so with respect to cabotage[345]. Even today, all Open Skies-agreements proposed by the U.S. still exclude cabotage rights[346]. In the age of airline alliances offering truly global services, however, these air-political concepts have received a new meaning.

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[345] The AEA's proposal to establish a Transatlantic Common Aviation also includes cabotage rights. It is obvious, however, that there will be fierce resistance in the U.S. against cabotage, in particular by Congress and Labor. *See* for a critical assessment of TCAA's prospects Joan M. Feldman, *Useful posturing*, Air Transport World, February 2000, at 62, Karen Walker, *Sans Frontiers?* , AIRLINE BUSINESS, February 2000, at 34.

[346] Art. 2(2) of the German-U.S. bilateral provides that

> "...[n]othing in this Article shall be deemed to confer on the airline or airlines of one contracting party the rights to take on board, in the territory of the other contracting party, passengers, their baggage, cargo, or mail carried for compensation and destined for another point in the territory of that other contracting party." *See* Protocol between the United States of America and the Federal Republic of Germany to Amend the Air Transport Agreement of July 7, 1995, with related Route Schedule, signed at Milwaukee, May 23, 1996.

Other bilaterals tend to contain an identical provision.

In the last years, many carriers have abandoned their minihubs in Europe, such as Frankfurt for *Delta* (acquired from an ailing *TWA*) or Lyon Satolas for *American*, which served as Fifth Freedom gateways to further European destinations. Instead, they have increased hub to hub services within the Alliance[347].

The reason for this lies in the fact that travel density on such flights was simply too low. In the case of *Delta*, its market recognition was insufficient to fill up the Fifth Freedom flights with local intra-European travel[348].

In the framework of a global alliance, it is more lucrative to rely on a code-sharing partner for connecting service. The latter may easily fill up his short-haul flight with its own clientele. Thereby, alliances could even increase their hub-to-hub services in the last five years[349].

The same reasoning may also apply, by analogy, to cabotage travel. Today, in the case of *Star Alliance*, *Lufthansa* carries connecting passengers from the U.S. and Canada on its own flights, under a code-share agreement with *United Air Lines* and *Air Canada*, to any destination in Germany. Furthermore, these two carriers will not see any reason for competing with *Lufthansa* on the German domestic market. Therefore, there is no tangible interest for these two carriers to be granted cabotage rights in Germany. The same is also true with respect to connecting services within the U.S. or Canada.

Thus, Fifth Freedom and cabotage traffic rights have lost much of their commercial appeal for today's global airlines. Even if these might give the airline alliances more flexibility, alliances could also do without.

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[347] *Delta's* 5th freedom minihub in Frankfurt by code-sharing services via its *Air France partner's* hub, Charles de Gaulle. *See* Nigel Dennis, *Scheduling issues and network strategies for international airline alliances*, 6 JOURNAL OF AIR TRANSPORT MANAGEMENT 75, 77 (2000).

[348] *See* Mathieu Weber & John Dinwoodie, *Fifth freedom and airline alliances. The role of Fifth freedom traffic in an understanding of airline alliances*, 6 JOURNAL OF AIR TRANSPORT MANAGEMENT 51, 56 (2000).

### 8.3.2 International Aviation and Developing Countries

It is probable that today's global alliances will deepen the divide between developing countries and developed countries with respect to commercial aviation.

It is striking that *Star Alliance* has failed so far to take one African carrier on board. There are only two carriers from the Black Continent who appeared to be attractive enough to be courted by the existing alliances: *South African Airlines* and *Kenyan Airways*. Otherwise, African aviation, today in dire straits[350], does not seem to be ready for joining any of the global alliances. Furthermore, the question arises as to what the African airline could give to the alliance.

At the same time, the practice of interlining, which constituted for a long time the backbone of international aviation, is on the defensive. Today, most of the existing alliances are able to offer global transportation to and from almost any given destination in the world. Due to special revenue sharing provisions, the alliances may also offer more competitive fares than under interlining. Therefore, interlining with airlines outside the alliance has substantially declined[351].

This may have a negative impact on aviation to and from the African continent. Without any strong presence in today's global alliances, African carriers still must largely rely on interlining. Therefore, some parts of Africa are still precluded from cheap and efficient air transport.

Besides Africa, there are further black spots on the alliances' network maps, such as the new independent republics in Middle Asia, India, Pakistan and China. In these countries,

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[349] *See* Nigel Dennis, *Scheduling issues and network strategies for international airline alliances*, 6 JOURNAL OF AIR TRANSPORT MANAGEMENT 75, 77 (2000): Star alliance increased its daily frequency between Frankfurt and Chicago from two to four services.

[350] The problems of African aviation have been identified by Mr. Coulibaly, the Transportation Minister from Côte d'Ivoire, speaking at one of the panels of the Chicago Conference, December 1999 in Chicago as the following: - fragmented markets, inadequate intra-African air services, inadequate infrastructure, safety and security shortcomings. *See* http://www.faa.gov/dotconf/PANELA.html.

the phenomenon itself is still eyed with a certain suspicion. It remains to be seen how and when, if ever, alliances eventually bring benefits to these parts of the world.

### 8.3.3 Airline Alliances and Multilateralisation of Air Transport

Airline alliances are global in nature, but still have to work in a narrow bilateral framework. It becomes increasingly obvious that this framework fails to meet the airlines' needs. In particular as regards competition law, a multilateral framework is desirable[352].

The proposal to establish a Transatlantic Common Aviation Area, put forward first by the Association of European Airlines and then embraced by the European Commission and Commissioner Loyola de Palacio in particular, responds to the major concerns of the current alliances. As it stands today, especially in including cabotage, the proposal is certainly over-ambitious. However, the odds are that a compromise is still possible.

European airlines endorse the TCAA proposal. There U.S. counter parts, on the other hand, still seem to resent the idea. For the time being, there is not yet a common approach by European and U.S. carriers. This is set to change when business objectives will begin to be defined on the alliance level. When alliance members unanimously voice their concerns about the inefficiencies of today's aviation system, they might pave the way for a limited agreement on the TCAA idea.

A limited TCAA might then be joined by further countries or free trade areas, such as the Tasmanian market between Australia and New Zealand or the ASEAN countries.

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[351] *See* James Ott, *Alliances Spawn a Web of global Networks*, AVIATION WEEK & SPACE TECHNOLOGY, August 23, 1999, at 52.
[352] *See supra* 4.4.

In the year 2000, a multilateral framework still remains a visionary concept. But, in the words of *KLM's* CEO, Leo van Wijk, aviation needs a vision[353]. In this respect, *Star's* architects would most certainly agree.

[353] *See* Karen Walker, *Sans Frontiers?* , AIRLINE BUSINESS, February 2000, at 35.

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