Articles

Recent Developments in Aviation

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The U.S. airline industry generally has been enjoying excellent financial results, courtesy of the robust economy and the resultant demand for travel and air cargo service. There is increasing concern, though, that there is not enough infrastructure to support airline growth, and this summer's extraordinary flight delays and cancellations have raised alarms in Washington. Airline competition, too, is a top priority in Congress and the executive branch. Issues raised by the proposed United-US Airways merger, airport slots, the system of international aviation relationships, and ticket distribution through computer reservations systems and the Internet have dominated airline policymakers this year in Washington and will be an immediate concern to the new Congress and Administration.

Domestic Airline Concentration

A major debate over U.S. airline concentration has erupted over the May 24, 2000 announcement that United Air Lines, the largest U.S. airline, seeks to purchase US Airways, the sixth-largest and a major player in the northeastern U.S.[1] The deal, for which United would pay $4.3 bil-

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1. Initial merger documents were included in the May 30, 2000 Form 8-K filing of US

lion and assume $7.3 billion in debt and lease obligations, is being scrutinized by the Justice Department, the Department of Transportation ("DOT" or "Department"), and the European Union.

An interesting element of the deal is the proposed creation of a new airline, DC Air, to purchase and operate many of the Washington, DC assets now operated by United and US Airways. Robert Johnson, the founder of Black Entertainment Television, has agreed to pay $141.2 million for 222 airport slots at Washington Reagan Airport and leases of gates and other airport facilities. The proposal is intended to quell concerns that a combination of United, which dominates Washington Dulles International Airport, and US Airways, a key operator at Washington Reagan, would unduly limit airline competition in the Nation's capital. There has been widespread criticism, though, that the DC Air arrangement is too cozy—Johnson is a US Airways director, and his airline initially would rely on aircraft and crews leased from United and US Airways—and would not truly foster competition.

The DC Air proposal was challenged in late September by a competing bid from Continental Airlines. The unsolicited proposal, which United and US Airways have claimed they are precluded by their agreement from considering, would value the Washington, DC assets at 52% more than DC Air has agreed to pay—$215 million. Other airlines have also expressed an interest in various assets they feel might need to be divested if the United/US Airways transaction were to be approved.

The proposed combination of United and US Airways is still in its early stages and faces serious Congressional and regulatory scrutiny. US Airways shareholders, who were offered a substantial premium for their stock, have overwhelmingly approved the deal. United pilots, though, have some reservations, even though they reached a tentative contract with management after the merger was announced. In Washington, the reception also has been cool in some quarters. In Congress, for example, the Senate Judiciary Committee has held hearings on the matter, and the Senate Commerce Committee passed a controversial resolution with an uncertain future before the full Senate. That resolution would have the Senate express concern about the proposed merger "because of its potential to leave consumers with fewer travel options, higher fares, and lowered levels of service" and state its sense that "the potential consumer detriments from the proposed United Airlines-US Airways merger outweigh the potential consumer benefits."[2] Many expressing concerns about the deal see potential anticompetitive effects not only from the

Airways Group, Inc. with the Securities and Exchange Commission, *available at* http://edgar.sec.gov.

2. S. Res. 344, 106th Cong. (2000)(approved by committee Sep. 20, 2000).

United/US Airways merger, but from the possibility that the remaining, major U.S. airlines will feel the need to merge as a result.

AIRPORT SLOTS

This year Congress agreed on an approach to increase the number of take-off and landing "slots" available at four of the most congested U.S. airports—New York's LaGuardia and Kennedy International ("JFK") airports, Chicago's O'Hare International, and Washington Reagan Airport. The number of slots available at these airports has been regulated by the Federal Aviation Administration ("FAA") for decades,[3] but there has been growing criticism of the system in the last decade, particularly as to the effect of slot restrictions on airline competition. While slots initially were assigned to incumbent airlines, and managed by the FAA, a "buy-sell" rule introduced in the mid-1980s allowed the purchase and sale of slots. New entrants to these airports, though, benefitted little from the slot "market," and slots generally have concentrated in the hands of incumbents. After several years of difficult negotiations, Congress achieved a consensus on reducing and eventually eliminating most slot restrictions. The result is included in the Wendell H. Ford Aviation Investment and Reform Act for the 21st Century or, as it is colloquially known, "AIR-21."[4] Slot restrictions at Chicago O'Hare are being phased out entirely after July 1, 2002, and slot restrictions at New York's LaGuardia and JFK airports will be eliminated after January 1, 2007. AIR-21 also has paved the way to add new services at all four airports immediately through slot "exemptions" and, in the case of Washington Reagan, exemptions from a "perimeter" rule that restricts flights to and from that airport to a 1250-mile radius.[5] Slot exemptions were granted *en masse* during the spring and summer and required the Department to allocate new domestic service opportunities in a comparative proceeding, a rare exercise indeed.

New York's slot exemptions are perhaps the most controversial. AIR-21 provides for two types of slot exemptions to enhance competition between now and 2007. To implement these exemptions DOT has issued "blanket" exemptions under which any airline certifying compliance with exemption requirements automatically is entitled to operate new flights. One type of exemption allows "new entrants" and "limited incumbents" there (*i.e.*, airlines that, including the holdings of their codesharing partners and any historical holdings, hold or operate less than 20 slots and

3. *See* 14 C.F.R. Part 93, subparts K & S.

4. *See* Pub. L. No. 106-181, § 231 (2000), *to be codified at* 49 U.S.C. §§ 41714, 41716-18.

5. In addition to slot exemptions, the slot provisions of AIR-21 also liberalize slots for international service at O'Hare and provide for the preservation of certain O'Hare and New York air services to smaller airports.

slot exemptions at the airport) to receive slot exemptions for up to a maximum of 20 slots.[6] A second type of exemption is granted automatically for service proposals from any airline that will use aircraft with less than 71 seats and operate nonstop service between the airport and a nonhub or small hub market, so long as the proposal is for new service, for additional frequencies on an existing service, or for upgraded service by regional jets rather than turboprop aircraft.[7] There has been significant interest in the LaGuardia "regional jet" exemptions, largely from major airline incumbents and their commuter partners, but the new entrant/limited incumbent offerings also have shown healthy demand.

The Port Authority of New York and New Jersey is alarmed over the noise, capacity, and safety implications of expanded LaGuardia service. Since DOT has concluded that it is bound by AIR-21 to grant slot exemptions to all qualified applicants, the Port Authority has sought to take matters into its own hands. It announced a moratorium, effective October 1, on new flights at LaGuardia during peak travel hours. Airlines are said to be complying voluntarily, though this moratorium treads heavily on the line between Federal preemption of State and local airline regulation, on the one hand, and the limited right of airport operators under 49 U.S.C. § 41713 to exercise their own "proprietary powers." In the meantime, discussions between the Port Authority, the airlines, and the Federal government have been convened to resolve the issues.

Congress provided for the same two types of slot exemptions at Chicago O'Hare, but allowed only 30 exemptions for new entrants and limited incumbents (no numeric restriction was placed on "regional jet" exemptions[8]). Recognizing the traditional, statutory "public interest" test, DOT explained to potential applicants that if more than 30 exemptions were sought, it might consider "the service benefits that would be attained, the likely effect on competition, whether the proposed service would likely be operationally and financially viable, and, especially, the practical ability of the carrier to initiate service on a timely basis."[9] Just over one month later, DOT announced its award of 30 exemptions to carriers seeking a total of 51.[10] Eight slots were made available for Las Vegas service by America West (3) and National (5). Six slots were made available for each of three applicants: Spirit (to serve the Southeast U.S.),

6. LaGuardia: DOT Orders 2000-9-18, 2000-4-10 (DOT Docket OST-2000-7176). JFK: Order 2000-4-13 (Docket OST-2000-7178). DOT orders and docket filings, *available at* http://dms.dot.gov.

7. Orders 2000-9-18, 2000-4-11 (Docket OST-2000-7175).

8. Order 2000-4-14 (Docket OST-2000-7179).

9. Order 2000-4-15 at 2.

10. Orders 2000-9-28, 2000-5-20 (Docket OST-2000-7180).

Sun Country (Minneapolis-St. Paul), and Mesa (Columbus, Ohio), but two Sun Country slots were later reallocated to Spirit.

Controversy over expanded operations at Washington Reagan Airport had prevented Congressional slot relief for several years. The ultimate compromise – 12 slot exemptions for service to smaller airports within the 1250-mile "perimeter" established under Federal law to limit service to Reagan, and 12 exemptions for "outside-the-perimeter" service – provided very specific decisional factors and required significant Department effort. In early July the Department issued its decisions, whittling the applications for 60 within-perimeter slots and 44 outside-the-perimeter slots down to the 12-slot statutory maximum for each category.[11] Many of the applicants were not household names, but ultimately smaller airlines succeeded at the expense of the major airlines that also filed. No within-perimeter applicant received the full complement of slots it requested, but four airlines received modest allocations – American Trans Air (4 for Chicago-Midway service), Midway (2 for Raleigh-Durham), Midwest Express (2 for Des Moines), and Spirit (4 for the Southeast U.S.). Outside the perimeter, DOT declared America West the hands-down winner, granting it 6 slots for service to Nevada and Arizona; it awarded two slots each to Frontier and National for service to Denver and Las Vegas, respectively. What to do with the two slots left for a major airline? The Department awarded them to Trans World Airlines for Los Angeles service, noting TWA's smaller presence compared with the other majors who also applied—American, Delta, Northwest, and United.

Flight Delays and Congestion

Passengers traveling in the United States last summer experienced an extraordinary level of flight delays and cancellations, and many believe that the problems will get worse in the coming years. Demand for air travel has been increasing dramatically, buoyed by a vibrant economy and lower airfares. The capacity of the U.S. aviation system, though, has not been able to increase at the same rate, limited by airspace considerations, the effects of weather on air traffic, airport congestion, and airline practices. The results have been frustrating and costly for travelers; the National Business Travel Association estimates that flight delays have cost business travelers alone $5 billion and 1.5 million hours in the past year. While the extraordinary problems experienced this summer have catalyzed government and industry to find solutions, effective relief may still be years away – and some proposals, like partial reregulation of the

11. Orders 2000-7-1 and 2 (Dockets OST-2000-7181 and 7182).

industry, are unpalatable to many.[12]

Air traffic control. The FAA manages U.S. airspace, controlling the flow of air traffic to and from airports and through enroute sectors with a vast network of controllers, radars, voice and data communications, and computers essentially tasked with maintaining a safe distance between aircraft. While the air traffic control ("ATC") system provides excellent safety for the flying public, some criticize the FAA's ability to manage change and meet the demands placed on ATC by today's traffic levels. The FAA is developing a "free flight" program that will increase capacity and operating flexibility for airlines, but this will require significant enhancements in technology, such as aircraft-ground data links. To address concerns that FAA is hampered by Federal procurement and employment requirements, Congress has permitted some reform. However, calls for ATC privatization, as has occurred in Canada, continue. Short-term solutions to the ATC capacity problem include closer cooperation between the FAA and airlines in planning air traffic flows; new methods of dealing with "choke points" and weather; and expanding flights into less congested, lower altitudes, despite the increased fuel consumption.

Airports. Some feel that adding new runways to key airports is the most important step that can be taken to increase system capacity. Yet little expansion is in the works at major airports. Even when airports have enough space to add runways, the surrounding community often opposes expansion, and the process may involve years of legal challenges. United's CEO recently laid the summer's capacity problems directly at the feet of "NIMBY" (not in my backyard) community interests who have thwarted airport expansion. Others, though, recall airline opposition to airport expansion, on economic grounds, during the 1990s. If economic and political opposition to airport expansion can be overcome, this year's AIR-21 legislation should enhance the Federal funding available for aviation infrastructure projects. Options for short-term relief from airport congestion, though, are difficult to identify. As suggested above, airports may start to take "self-help" measures to limit operations. Federal Express Chairman and CEO Fred Smith has proposed Federal reregulation of airport slots and even auctioning those slots.

Airlines and their passengers also are responsible for aspects of today's capacity crisis. The "hub-and-spoke" system that evolved after deregulation causes airlines to schedule hub traffic in "connecting banks" of flights that arrive and depart at the same time. This approach causes traffic peaks that exceed the capacities of some airports, even when bad weather is not a factor. Moreover, airlines seeking to respond to con-

12. *Aviation Week & Space Technology* explored these issues in detail in its September 18, 2000 issue.

sumer demand are changing their operating principles, favoring more frequent service over higher-capacity aircraft and substituting regional jets for slower turboprop "commuter" aircraft, adding to congestion at the higher altitudes where larger jets fly. Disputes between pilots and executives over who will fly the regional jets, too, are part of broader labor-management issues that can affect airline operations, as slowdowns associated with United pilot negotiations demonstrated this summer. Solutions to airline-induced aspects of the capacity crisis that will not affect passengers are difficult to identify. American Airlines has announced that it will seek to "spread out" flights at its Dallas/Ft. Worth hub to lower peak traffic levels that cause congestion. Some have proposed that airlines receive antitrust immunity to discuss similar approaches between themselves across the country.

INTERNATIONAL AVIATION

Over the last few years agreements between carriers of different countries have begun to coalesce into global alliances. This year has seen some interesting turns in the development of the four major alliances. The Star Alliance, anchored in North America by United, Air Canada, and Mexicana, has remained intact and strong.[13] The Oneworld alliance anchored by American Airlines, though, is hitting turbulence.[14] After Canadian Airlines International withdrew from the alliance in the wake of its purchase by Air Canada, American was left with no North American partner. Its transatlantic ally, British Airways, even took a strong interest in a merger with KLM Royal Dutch Airlines; while the talks later failed, the move could have removed British Airways from Oneworld and into the arms of Northwest, Continental, KLM, and Alitalia, who share an unbranded alliance.[15] Delta Air Lines and Aeromexico are the North American anchors for the newly-branded "Skyteam" alliance.[16]

Seven years after the Department granted antitrust immunity to the first modern airline alliance, Northwest/KLM, it continues to immunize selected carrier alliances under 49 U.S.C. §§ 41308-09 to coordinate some price and service-related functions. To promote the signing by other countries of "open skies" bilateral agreements with the U.S. that do not restrict operations by either country's airlines, DOT effectively has condi-

13. Current Star Alliance (members are: Air Canada, Air New Zealand, All Nippon Airways, Ansett Australia, British Midland, Lauda Air, Lufthansa, Mexicana, SAS Scandinavian Airlines, Thai Airways International, Tyrolean Airways, United Airlines, and VARIG Airlines.)

14. Current Oneworld (alliance members are: Aer Lingus, American Airlines, British Airways, Cathay Pacific Airways, Finnair, Iberia, LanChile, and Qantas.)

15. *See No sign of 'Open Skies Accord,'* Financial Times, Oct. 10, 2000.

16. Current SkyTeam (alliance members are: Aeromexico, Air France, Delta, Korean Air, and CSA Czech Airlines.)

tioned antitrust immunity for international alliances on the existence of an open skies bilateral with the foreign partner's homeland. Over the last year DOT has immunized several new alliances in open skies markets. Some of these immunized agreements strengthen existing global alliances,[17] but others do not reflect active, intra-alliance partnerships.[18]

International civil aviation rights generally have been traded between countries on a bilateral basis since the Chicago Convention of 1944, but efforts are underway to attempt sweeping reform. In opening debate on a "move beyond the bilateral aviation system towards the utilization of the multilateral forum as a springboard towards plurilateralism," the U.S. evoked the history of the first Chicago Convention by holding a December 1999 conference on these issues in Chicago. Attended by transportation officials of 93 countries, the Conference resulted in a declaration that countries should work "to identify effective mechanisms to exchange opportunities among like-minded partners, including consideration of regional, multilateral and plurilateral systems" and "to create a framework that will allow additional partners to join in such exchanges of opportunities."[19]

Today, though, the United States remains confronted by bilateral limitations in many markets. Negotiations between the United States and the United Kingdom have, if anything, seen the parties drift farther apart in the last year. Both the dismissal of a long-pending application to immunize the American-British Airways relationship, and the failure of British Airways' talks with KLM Royal Dutch Airlines, have been linked to the failure to achieve progress on the U.S.-U.K. bilateral.[20] Across the Pacific Ocean, the opportunity for one new U.S. airline to serve the restricted U.S.-China market has generated substantial interest, particularly in light of the recent U.S. grant of permanent normal trading status to China.[21] Some observers have forecast United Parcel Service to win the coveted designation over applicants American Airlines, Delta Airlines, and Polar Air Cargo.

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17. *See Northwest Airlines, Inc. and Malaysia Airline System Berhad*, Order 2000-10-12; *Alitalia-Linee Aeree Italiane-S.p.A., KLM Royal Dutch Airlines, and Northwest Airlines, Inc.*, Order 99-12-5; *American Airlines, Inc. and Linea Aerea Nacional Chile, S.A.*, Order 99-10-20.

18. *See Scandinavian Airlines System and Flugleidir h.f.-Icelandair,* Order 2000-10-13; *American Airlines, Swissair, Swiss Air Transport Company, Ltd., and N.V. Sabena S.A.,* Order 2000-5-13.

19. Department of Transportation, *Conference Report - Aviation in the 21st Century, Beyond Open Skies Ministerial* (Dec. 1999), app. V.

20. *See Joint Application of American Airlines, Inc. and British Airways PLC*, Order 99-7-22; *sec n.14.*

21. *See U.S.-China Air Services 2001,* Docket OST-99-5539.

THE INTERNET AND COMPUTER RESERVATIONS SYSTEMS

The Internet has transformed the sale of airline tickets, often eliminating traditional travel agent services, lowering transaction costs, and allowing airlines to fill otherwise empty seats through low-price Internet deals. However, some travel industry analysts and government regulators fear that online travel services may engage in anticompetitive practices, such as forming exclusive contracts with airlines or otherwise controlling ticket pricing. The Orbitz travel site announced this year by its five major airline owners (accounting for the vast majority of domestic U.S. traffic) has generated the most concern. Orbitz claims that its business model and new technology will benefit consumers more than the industry's largest travel "portals," Sabre's Travelocity.com and Microsoft's Expedia.com. Critics argue, though, that Orbitz will drive Internet competitors from the market.

Congress and the Department of Transportation have been very interested in how the growing Internet market for airline ticket sales affects airline competition. DOT has expanded its periodic review of Computer Reservations Systems ("CRS") rules,[22] which have regulated the computerized information available to ticket agents since the mid-1980s, to consider Internet issues. This summer it requested comments on the "advisability of regulating airline distribution practices involving the Internet" and, more specifically, "whether airlines are able to participate in on-line services on reasonable terms; whether consumers have a reasonable opportunity to obtain non-deceptive information on airline services and to make bookings, and whether the Internet's use presents questions about the competitiveness of the airline and distribution industries."[23] Commenters offered a wide range of responses and proposals, from full-fledged application of the CRS rules, to Internet-specific rules, to rules specific to Orbitz, to no regulation at all.

The Orbitz business model was a prime topic of comments, particularly in relation to the availability of discount fares on Orbitz and on other Internet travel sites. This issue was raised earlier last summer after reports that Orbitz would be precluding airline participants from making discount fares available on any Internet travel site other than Orbitz. Orbitz explained how its technological and financial approach will benefit airlines and consumers as well as bring competition to an Internet market now dominated by Expedia and Travelocity. It also stated that its agreements with carriers simply require that they provide to Orbitz any fare offering they carry on their own Internet site or in other media; Orbitz

22. 14 C.F.R. Pt. 255.

23. Computer Reservations System (CRS) Regulations, 65 Fed. Reg. 45551 (Jul. 24, 2000)(supplemental advance notice of proposed rulemaking); Docket OST-1997-2881.

asserted that this gathering of fare information in one place is procompetitive.

Other commenters, including competitors Expedia and Travelocity, criticized Orbitz, arguing that its business model is designed to ensure that airlines control the Internet distribution of their product. They assert that the Orbitz "most-favored-nation" clause is anticompetitive because airlines will have no incentive to make low fares available on sites other than Orbitz, and those sites therefore will not be as attractive to consumers. One solution posited by the DOT Inspector General would require airlines to make fares available not only to Orbitz, but to any site that offered benefits similar to Orbitz.

Looking beyond Orbitz, comments on the concept of regulating Internet travel sites were mixed. Opponents of any Internet regulation cited the dangers in squelching the development of Internet travel markets and thereby limiting potential competition. Some commenters supported a more limited form of regulation than that applicable to traditional CRSs; one proposal would only require disclosure of or prohibit the bias of Internet flight displays in favor of particular airlines. Commenters also differed on what types of sites—airline-owned, travel agency-owned, or independent—should be regulated. A few commenters even proposed full-scale application of the CRS rules to Internet sites related to existing CRSs or purporting to be neutral.

Despite the interest in Internet ticket distribution, travel agents using traditional CRS systems continue to sell most airline tickets today. However, CRS rules were introduced when the major CRSs were owned by airlines. Therefore, the current rules apply only to "air carriers and foreign air carriers that themselves or through an affiliate own, control, operate, or market computerized reservations systems for travel agents in the United States. . . ."[24] Moreover, some special obligations are placed only on airlines, denominated "system owners," that own 5% or more of a CRS. This regulatory structure does not reflect current airline relationships with CRSs. Many airlines now have divested or reduced their CRS stockholdings, and some have formed new links by contracting to provide marketing or technical services to CRSs. Given this change in the CRS market, some commenters have proposed to extend the rules to all CRSs, while others have the rules extended to CRSs marketed by airlines, regardless of ownership. A few commenters have asserted that CRS regulations are no longer required because the airline ownership on which they were predicated is disappearing, and with the rise of Internet sites CRSs are no longer an "essential facility" to which all subscribers must have protected access.

24. *Id.*