

Riding the Merger Wave: Strategic Alliances in the Airline Industry

Svetlana Mosin*

INTRODUCTION

There are over 500 airline alliances worldwide.¹ The number of alliances has increased about twenty-five per year for the last decade.² In 1999, there were \$6.8 billion worth of global airline merger and acquisition transactions.³ The number of alliances is accelerating because of the competitive intensity caused by the alliance movement itself.⁴ Although strategic airline alliances provide benefits for consumers and efficiencies for airlines, some believe alliances will become *de facto* cartels, business combinations that coordinate activities and capacities, eventually reducing competition and increasing prices.⁵ This essay explores the United States (“U.S.”) antitrust enforcement policies regarding strategic alliances and compares two situations involving alliances: the successful

* University of Denver College of Law, J.D. candidate 2001; Boston University, B.A. in Psychology and B.S. in Communication, 1997; career interests in both litigation and antitrust.

1. See Michael Miller, *The Last Word: Airlines Jump on the Alliance Bandwagon*, 13 AIRLINE FIN. NEWS 45 (1998).

2. See William Kolasky Jr., *Antitrust Enforcement Guidelines for Strategic Alliances*, 1063 PLI/CORP. 499, 501 (1998).

3. See Scott Gawlicki, *Virtual Mergers: With traditional mergers difficult to pull off, airlines finding creative ways to consolidate*, INVEST. DEALERS DIGEST, Jan. 31, 2000.

4. See Miller, *supra* note 1.

5. See *id.*

Northwest Airlines/KLM Royal Dutch Airlines ("KLM")/Alitalia-Linee alliance, and the abandoned British Airways/American Airlines alliance.

AIRLINE ALLIANCES GENERALLY

Foreign regulations prohibit foreign ownership of U.S. carriers.⁶ For example, non-U.S. investors cannot own more than twenty five percent of an U.S. airlines' voting stock.⁷ The nature of these and other restrictions has forced airlines to form strategic alliances.⁸ Alliances consist of two categories, equity alliances and joint venture alliances.⁹ In equity alliances, airlines take equity or part ownership in other carriers.¹⁰ In joint venture alliances, airlines have route specific marketing arrangements.¹¹ The alliances differ in degree. While some only have joint marketing plans, others are seen as a quasi-merger, sharing vital business data, such as prices, strategic plans and capacity.¹²

Members of an alliance desire to create a seamless integration of procedures, products and services to benefit the traveler.¹³ The objective is to add value to each member's offerings while achieving economies of scale by reducing capital expenditures and overall costs through more efficient use of assets.¹⁴ For example, alliance members may save capital expenditures by reducing an airline's fleet.¹⁵ Consumers benefit most when the alliance shares end-to-end routes as opposed to overlapping routes.¹⁶ Most often, "these alliances are largely contractual and involve code sharing, coordination of routes and scheduling, integration of marketing and advertising, joint product development, coordinated frequent flyer programs, and other integration that will help increase network efficiency."¹⁷ Code sharing involves the sharing of designator codes, assigned by the International Air Transport Association.¹⁸ These designator codes, that both identify the carrier and provide a number representing the flight and destination, are used for reservations, schedules

6. See Gawlicki, *supra* note 3.

7. See *id.*

8. See *id.*

9. See Kolasky, *supra* note 2.

10. See *id.*

11. See *id.*

12. See Anna Wilde Matthews & Daniel Michaels, *British Airways Deal Could Be Grounded*, WALL ST. J. EUR., July 29, 1999.

13. See Michael S. Simons, *Aviation Alliances: Implications for the Qantas-BA Alliance in the Asia Pacific Region*, 62 J. AIR L. & COM. 841, 843 (1997).

14. See *id.*

15. See *id.*

16. See Kolasky, *supra* note 2, at 503.

17. *Id.*

18. See Simons, *supra* note 13, at 849.

and other commercial purposes.¹⁹ These arrangements enable carriers to sell and market seats on the same flights operated by the code-sharing partner.²⁰ Consumers can then travel on multiple carriers as if flying on one airline.²¹

ANTITRUST ENFORCEMENT

Airline alliance partners share price, planning strategy and other confidential corporate information. These activities are subject to the antitrust laws that prohibit anticompetitive behavior. Parties in proposed alliances must receive the approval of both the carrier's country and the host country. In the U.S., air carriers must receive approval from both the Department of Transportation ("D.O.T.") and the Department of Justice ("D.O.J.").

DEPARTMENT OF TRANSPORTATION

From its creation in 1938, until promulgation of the Airline Deregulation Act of 1978, the Civil Aeronautics Board ("C.A.B.") regulated most commercial aviation activities.²² In particular, the C.A.B. regulated "routes, rates, mergers, acquisitions, consolidations, interlocking relationships and intercarrier agreements."²³ When regulating mergers and acquisitions, the C.A.B. had authority to grant antitrust immunity.²⁴ The Airline Deregulation Act phased out most of the C.A.B. jurisdiction and granted D.O.T. authority over mergers, consolidations, acquisitions, and intercarrier agreements on January 1, 1985.²⁵

The D.O.T. currently exerts jurisdiction over international intercarrier agreements.²⁶ Air carriers seeking to form an alliance are required to seek D.O.T.'s approval.²⁷ D.O.T. will approve the agreement, or grant the parties antitrust immunity, provided D.O.T. determines the exemption is required by the public interest.²⁸ The D.O.T. must determine the agreement is not adverse to the public interest and not in violation of the statute before granting approval.²⁹ The D.O.T. may not approve agreements that substantially reduce or cause competitive harm unless the

19. *See id.*

20. *See id.*

21. *See* PAUL STEPHEN DEMPSEY & LAURENCE E. GESELL, AIR TRANSPORTATION: FOUNDATIONS FOR THE 21ST CENTURY 270 (1997).

22. *See id.* at 275.

23. *Id.*

24. *See id.*

25. *See id.*

26. *See* 49 U.S.C. § 41308 (1999).

27. *See* 49 U.S.C. § 41309(a)(b) (1999).

28. *See* 49 U.S.C. § 41308(b) & 41309(b) (1999).

29. *See id.* *See also*, *Comments of Department of Justice on the Joint Application of British*

agreement is necessary to address a serious transportation need or to achieve important public benefits that cannot be met by reasonably available alternatives that are materially less anticompetitive.³⁰ Although a reviewing court will usually defer to D.O.T.'s expertise, D.O.T. may not grant an antitrust exemption to actions that are anticompetitive.³¹

DEPARTMENT OF JUSTICE

In 1989, Congress vested D.O.T.'s merger jurisdiction to the D.O.J.³² The D.O.J. evaluates airline mergers, acquisitions, consolidations and interlocking relationships.³³ D.O.J. evaluates airline alliances as it does mergers and acquisitions in other U.S. industries.³⁴ Nevertheless, D.O.T. has jurisdiction over code-share agreements, fare regulations and international intercarrier agreements.³⁵ Both D.O.T. and D.O.J. apply the antitrust laws when determining whether a proposed alliance is anticompetitive and should be blocked.³⁶

U.S. antitrust law developed from the public outcry against corporate trusts.³⁷ These trusts allowed competitors to combine and set prices.³⁸ The first antitrust law, the Sherman Act, was adopted in 1890.³⁹ Section One of the Sherman Act prohibits "contract[s], combination[s] . . . or conspirac[ies] in restraint of trade or commerce among the several States, or with foreign nations . . ." ⁴⁰ Likewise, mergers and acquisitions are subject to Section One if they constitute a contract, combination or a conspiracy.⁴¹ Section Two of the Sherman Act prohibits monopolization or attempted monopolization.⁴² The first Supreme Court case decided under the Sherman Act was *United States v. E.C. Knight Co.*, where the Supreme Court held the government failed to demonstrate that the sugar trust's monopoly was a direct restraint of trade.⁴³

Airways and American Airlines (visited Feb. 5, 2000) <<http://www.usD.O.J./atr/public/comments/1777.htm>> [hereinafter *Comments*].

30. See 49 U.S.C. § 41309(b) (1999).

31. See *Aloha Airlines v. Hawaiian Airlines*, 489 F.2d 203, 211 (9th Cir. 1974).

32. See DEMPSEY & GESELL, *supra* note 21, at 276.

33. See *id.*

34. See *id.*

35. See *id.*

36. See *Comments, supra* note 29 (referring to *United States v. Penn-Olin Chem. Co.*, 378 U.S. 158, 170 (1964)).

37. See E. THOMAS SULLIVAN & HERBERT HOVENKAMP, *ANTITRUST LAW, POLICY AND PROCEDURE* 27 (4th ed 1999).

38. See *id.*

39. 15 U.S.C. § 1 (1999).

40. 15 U.S.C. § 2 (1999).

41. *Id.*

42. *Id.*

43. *United States v. E.C. Knight Co.*, 156 U.S. 1, 16 (1895).

Congress passed the Clayton Act in 1914.⁴⁴ The Clayton Act prohibits mergers or acquisitions that may substantially lessen competition or tend to create monopolies.⁴⁵ The original Clayton Act condemned a corporation's acquisition of another corporation's stock if the acquisition's effect was to substantially lessen the competition between the two companies.⁴⁶ The Clayton Act was amended in 1950 through the Celler-Kefauver Amendments.⁴⁷ The amendments changed the language to read "substantially to lessen competition" and to include both stock and capital acquisitions.⁴⁸ Whereas the Sherman Act prohibits activities that *actually* restrain trade, the Clayton Act is directed at preventing activities that *may tend* to restrain trade.⁴⁹

There are two types of offenses under the Sherman Act, *per se* offenses and rule of reason. The Supreme Court has defined *per se* unlawful agreements as agreements having the sole objective to restrain competition and enhance or maintain prices.⁵⁰ These agreements, "because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable . . ." ⁵¹ Price fixing, market division, boycotts, bid rigging and tying arrangements have been found *per se* illegal.⁵²

All antitrust-violative conduct which does not consist of a *per se* offense is judged by the rule of reason, or the reasonableness of the activity.⁵³ Even if the activity is otherwise unlawful, if a court determines the action is ancillary to some lawful activity and it is procompetitive, the action may not violate the antitrust laws.⁵⁴ The rule of reason involves a balancing test.⁵⁵ The government must first show the agreement is likely to substantially lessen competition.⁵⁶ Afterwards, the proponents of the agreement must prove the agreement has procompetitive benefits.⁵⁷ If the proponents are successful, the burden shifts back to the government to prove the competitive benefits would occur absent the agreement.⁵⁸

44. 15 U.S.C. §§ 12-27 (1999).

45. See 15 U.S.C. § 18 (1999).

46. See SULLIVAN & HOVENKAMP, *supra* note 37, at 818.

47. See *id.*

48. *Id.*

49. See 15 U.S.C. § 18 (1999).

50. See *United States v. Addyston Pipe & Steel Co.*, 85 F. 271 (6th Cir. 1898), *aff'd*, 175 U.S. 211, 243 (1899).

51. See *Northern Pac. R.R. Co. v. United States*, 356 U.S. 1, 5 (1957).

52. SULLIVAN & HOVENKAMP, *supra* note 37, at 187.

53. See *id.* at 189.

54. See *National Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679, 690-92 (1978).

55. See *id.* at 690.

56. See Kolasky, *supra* note 2, at 506.

57. See *id.*

58. See *id.*

MERGER GUIDELINES

In 1992, D.O.J. and the Federal Trade Commission ("F.T.C.") outlined their enforcement policy concerning horizontal acquisitions and mergers through the Horizontal Merger Guidelines.⁵⁹ "The unifying theme of the Guidelines is that mergers should not be permitted to create or enhance market power or to facilitate its exercise."⁶⁰ Market power is a seller's ability to profitably maintain prices above competitive levels for a significant period of time.⁶¹ Both D.O.J. and F.T.C. will usually prohibit a merger or a strategic alliance if the market in which the parties compete is heavily concentrated.⁶² Market concentration is a function of the number of firms in a market and their respective market shares and is a useful indicator of the likely competitive effects of a proposed merger.⁶³ Both D.O.J. and F.T.C. use the Herfindahl-Hirschman Index ("HHI") of market concentration to evaluate the degree of concentration attributable to a merger or acquisition. HHI is determined by summing the squares of the individual market shares of all market participants.⁶⁴ In evaluating horizontal mergers, agencies will calculate the pre-merger and post-merger market concentration.⁶⁵ HHI are divided into three categories: unconcentrated (HHI below 1000), moderately concentrated (HHI between 1000 and 1800) and highly concentrated (HHI above 1800). Mergers in unconcentrated and moderately concentrated markets are least likely to lessen competition, thus mergers in these markets will not be contested.⁶⁶ Mergers in highly concentrated markets that increase the HHI by 100 points or more are presumed to be anticompetitive, which can only be overcome by a showing the merged entity will be unable to have market power.⁶⁷ Mergers and strategic alliances in concentrated markets will usually require agency investigation.

BILATERAL AIR TRANSPORT AGREEMENTS

In addition to conducting a merger analysis, D.O.T. requires the airline's host country to have a bilateral air transport agreement with the U.S. before granting antitrust immunity to the strategic alliance.⁶⁸ France

59. *Horizontal Merger Guidelines*, 57 Fed. Reg. 41,552 (1992).

60. *Id.* at 41,553.

61. *Id.*

62. *See id.* at 41,558.

63. *See id.*

64. *Id.* at 41,557.

65. *See id.* at 41,558.

66. *See id.*

67. *See id.*

68. *See Joint Application of American Airlines and British Airways*, D.O.T. Order 99-7-22 (1999), available in 1999 WL 561619 (D.O.T.).

and Germany formulated the first air transport agreement in 1913.⁶⁹ By the 1990's, "1,200 bilateral agreements between nearly 200 nations around the world [had been established], including more than 70 U.S.-negotiated agreements."⁷⁰ The U.S. began to advocate the liberalization of aviation markets in the 1970's.⁷¹ Aviation liberalization agreements are frequently called open skies agreements.⁷² The D.O.T. has defined open skies as having the following elements:

Open entry on all routes;

Unrestricted capacity and frequency on all routes;

Unrestricted route and traffic rights (the right to operate service between any point in the U.S. and any point in the European country, including no restrictions as to intermediate and beyond points);

Double-disapproval pricing in third and fourth freedom markets (whereby both governments must disapprove a proposed rate, else it becomes effective);

Liberal charter arrangement (the least restrictive charter regulations of the two governments would apply, regardless of the origin of the flight);

Liberal cargo regime (criteria as comprehensive as those defined for the combination carriers);

Conversion and remittance arrangement (carriers would be able to convert earnings and remit in hard currency promptly and without restriction);

Open code-sharing opportunities;

Self-handling provisions (right of a carrier to perform/control its airport functions going to support its operations);

Procompetitive provisions on commercial opportunities, user charges, fair competition and intermodal rights; and

Explicit commitment for nondiscriminatory operation of and access for computer reservations systems.⁷³

For example, on November 11, 1998, U.S. Transportation Secretary Rodney E. Slater and Italian Minister of Transport and Navigation Tizi-

69. See DEMPSEY & GESELL, *supra* note 21, at 305.

70. *See id.*

71. *See id.*

72. *See id.*

73. *See In the Matter of Defining "Open Skies"*, D.O.T. Order 92-8-13 (1992), available in 1992 WL 204010 (D.O.T.).

ano Treu initialed an open skies agreement.⁷⁴ This agreement enables U.S. and Italian airlines to operate to all cities in both countries, with no restrictions on the number of flights they operate or the prices they can charge.⁷⁵ The 1998 agreement supplants the U.S.-Italy 1990 agreement allowing U.S. and Italy to create new U.S. gateways to Italy and expand air service and customer choice in the U.S.-Italy market.⁷⁶ Since the 1990 agreement, traffic in the U.S.-Italy market has grown by seventy percent.⁷⁷ The D.O.T. used the new open skies agreement as a means to tentatively award Delta Airlines authority to open a new U.S. gateway to Italy with Atlanta-Rome service.⁷⁸ On December 6, 1999, Rodney Slater and Tiziano Treu signed the open skies agreement into law following the D.O.T.'s grant of antitrust immunity to the Alitalia and KLM Royal Dutch Airlines alliance. The creation of the open skies agreement has enabled Northwest, American Airlines, United Airlines, Continental Airlines and UPS to seek authority for new or expanded service in the U.S.-Italy market.⁷⁹

THREE ATTEMPTED AIRLINE ALLIANCES

KLM/Northwest

Northwest Airlines ("Northwest"), headquartered in Minneapolis-St. Paul, is a major carrier with significant operations in the Pacific and several trans-atlantic routes. KLM is the principal carrier in the Netherlands. In 1989, KLM purchased Northwest's holding company, NWA Inc., recently renamed Northwest Airlines Corp., by Wings Holdings.⁸⁰ In 1992, KLM and Northwest applied to the D.O.T. for antitrust immunity for an agreement whereby the two carriers would integrate their services and operate as if they were a single carrier.⁸¹ Under their agreement, KLM and Northwest would integrate their operations by entering into a number of agreements, including joint marketing, schedule and pricing coordination, inventory management, the creation of a unified travel agency commission program, pooling of revenue, and the use of

74. See *Transportation Secretary Slater Announces U.S.-Italy Open Skies Agreement*, available in 1998 WL 789058 (D.O.T.).

75. See *id.*

76. See *1999 U.S.-Italy Combination Service Case*, D.O.T. Order 99-4-21 (1999), available in 1999 WL 261567.

77. See *id.*

78. See *D.O.T. Tentatively Selects Delta for New U.S.-Italy Service*, available in 1999 WL 90219 (D.O.T.).

79. See *U.S. Transportation Secretary Slater Signs U.S.-Italy Open Skies Agreement*, available in 1999 WL 1124007.

80. See *Joint Application of Northwest Airlines and KLM Royal Dutch Airlines*, D.O.T. Order 92-11-27, available in 1992 WL 352834 (D.O.T.).

81. See *id.* at *3.

joint trademarks and branding.⁸²

In determining whether this alliance would be anticompetitive, D.O.T. first noted the open skies agreement with the Netherlands.⁸³ The open skies accord permits any U.S. carrier to serve any point in the Netherlands from any point in the U.S. and allows any Dutch carrier to serve any point in the U.S. from the Netherlands.⁸⁴ The D.O.T. believed this accord would encourage more competitive service to the Netherlands and encourage other European countries to liberalize their bilateral agreement with the U.S.⁸⁵

Using Clayton Act's Section 7 analysis, D.O.T. inquired whether the alliance would "substantially lessen competition" by eliminating actual or potential competition in the relevant market.⁸⁶ Northwest and KLM currently operate nonstop service between Amsterdam and Detroit and Amsterdam and Minneapolis-St. Paul.⁸⁷ Northwest also operates flights to Amsterdam from Boston, while KLM serves Amsterdam from Atlanta, Baltimore-Washington, Chicago, Houston, Los Angeles, New York City and Orlando.⁸⁸ The D.O.T. found Northwest and KLM represent 4.1 and 3.9 percent of the total seats offered in the U.S.-Europe market, ranking eighth and ninth among trans-Atlantic carriers in total seat share.⁸⁹ A combined Northwest and KLM would rank fifth in the market in seat share.⁹⁰ The alliance would result in an unconcentrated market with a HHI of 974.⁹¹

The only possible lessening of competition could be the Amsterdam/Detroit and Amsterdam/Minneapolis-St. Paul market, where the parties compete with one another.⁹² The D.O.T. found that other carriers would unlikely enter this market because "no other carrier besides Northwest has a hub at either U.S. gateway."⁹³ However, D.O.T. found that Northwest and KLM would unlikely exert market power because of carriers such as British Airways and Air France, who offer connecting service from Detroit and Minneapolis-St. Paul.⁹⁴ Moreover, because D.O.T. reviews applications using the public interest standard, it found the possible

82. *See id.*

83. *See id.*

84. *See id.*

85. *See id.*

86. *See id.* at *7.

87. *See id.* at *11. The only markets where KLM and Northwest are actual competitors are transatlantic markets. *See id.*

88. *See id.*

89. *See id.* at *10.

90. *See id.* at *7.

91. *See id.* at *10.

92. *See id.* at *12.

93. *Id.*

94. *See id.*

anticompetitive effects are outweighed by the public benefits of offering better service and the airlines operating more efficiently.⁹⁵ After comment and review, D.O.T. approved the strategic alliance on January 11, 1993.⁹⁶ Northwest Airlines began to add KLM nonstop flights to Amsterdam in September of 1994.⁹⁷ The KLM/Northwest joint venture resulted in, "traffic [rising] 10% more than other transatlantic routes in the years 1992 to 1993 and doubl[ing] the total industry traffic growth of 7%."⁹⁸ Flights to Europe also increased "from 70 to 136."⁹⁹ Consequently, the alliance's revenue in 1993 amounted to \$16 billion.¹⁰⁰

KLM/Northwest/Alitalia-Linee

In November of 1999, Alitalia-Linee Aeree Italiane-S.P.A. ("Alitalia") filed an application for antitrust immunity to join the KLM/Northwest Airlines alliance.¹⁰¹ D.O.T. first noted that U.S. and Italy initiated an open skies agreement. D.O.T. further explained: "[t]he predicate for our approval and grant of antitrust immunity for the Northwest-Alitalia alliance is the existence of the expansive, new aviation agreement between the United States and Italy."¹⁰² The proposed agreement provided for a virtual merger, the coordination of all functional and operational activities, although allowing the airlines to retain their individual ownership and control.¹⁰³

D.O.T. found four carriers provide nonstop service from the U.S. to Italy.¹⁰⁴ Alitalia provides more nonstop service from the U.S. to Italy than any other carrier, comprising thirty-eight percent of the U.S./Italy market.¹⁰⁵ Northwest and KLM do not provide nonstop service to Italy, but only provide connecting service to Italy over Amsterdam.¹⁰⁶ However, the U.S. and Italy recently negotiated a new open skies agreement providing for unrestricted competitive opportunities in the U.S./Italy market.¹⁰⁷ Alitalia is not a major competitor of Northwest or KLM on

95. See *Joint Application of Northwest Airlines and KLM Royal Dutch Airlines*, D.O.T. Order 93-1-11, available in 1993 WL 12266 (D.O.T.) at *8.

96. *Id.* at *1.

97. See Simons, *supra* note 13, at 855.

98. See *id.* at 854.

99. See *id.* at 855.

100. *Id.*

101. See *Joint Application of Alitalia-Linee Aeree Italiane-S.P.A., KLM Royal Dutch Airlines and Northwest Airlines*, D.O.T. Order 99-11-20, available in 1999 WL 1080151 (D.O.T.) at *1.

102. *Id.*

103. See *id.* at *2.

104. See *id.* at *6.

105. See *id.*

106. See *id.*

107. See *id.*

trans-atlantic routes.¹⁰⁸ The combined entities' market share for nonstop passenger service in the U.S.-Europe market would be ten percent.¹⁰⁹ The HHI would increase from 1,307 to 1,342, an increase of concentration by 2.7 percent.¹¹⁰ This increase is based on the assumption that no new entry would occur in the U.S.-Europe market.¹¹¹ However, given the nature of the new open skies agreement, significant increases in competition are expected.¹¹²

The relatively low probability of anticompetitive effects was balanced with the public benefits of the transaction. The alliance would enable Northwest to begin nonstop flight service between Minneapolis and Italy and between Detroit and Italy.¹¹³ The initiation of these services would "richly benefit the people of Minneapolis, Detroit and their service areas by bringing substantially improved service to Italy."¹¹⁴ Based on these and other public benefits and the unlikelihood of anticompetitive effects, D.O.T. approved the alliance on December 3, 1999.¹¹⁵

This alliance was Europe's first cross-border merger since 1996.¹¹⁶ However, "delays in developing a joint hub at Milan's new Malpensa Airport" have stalled the approved alliance.¹¹⁷ KLM is delayed in transferring flights from Linate Airport to Malpensa Airport.¹¹⁸ The Italian government obstructed the transfer in December 1999 after receiving criticism from rival airlines.¹¹⁹ The delay is currently costing Alitalia around \$30 million per month.¹²⁰ If the problem is not solved within two to three months, the merger may unravel.¹²¹

American Airlines and British Airways

American Airlines and British Airways are two of several carriers in the Oneworld alliance.¹²² However, in order for British Airways and American Airlines to code-share on areas where they compete, they must

108. *See id.* at *8.

109. *See id.*

110. *See id.* at *8-9.

111. *See id.* at *9.

112. *See id.*

113. *Id.* at *6.

114. *Id.* at *7.

115. *See Joint Application of Alitalia-Linee Aeree Italiane S.P.A., KLM Royal Dutch Airlines and Northwest Airlines*, D.O.T. Order 99-12-5, available in 1999 WL 1102232 (D.O.T.).

116. *See* Bruce Barnard, *KLM-Alitalia Joint Venture in Jeopardy*, J. COM., Feb. 10, 2000.

117. *Id.*

118. *See id.*

119. *See id.*

120. *See id.*

121. *See id.*

122. *See* Daniel Michaels, *Airlines to Seek U.S. Antitrust Waiver*, WALL ST. J. EUR., Nov. 19, 1999, at 6.

apply to D.O.T. for antitrust immunity.¹²³ British Airways and American Airlines both serve London's Heathrow Airport from the U.S.¹²⁴ On January 10, 1997, American Airlines and British Airways filed an application for antitrust immunity in order to strengthen their current alliance.¹²⁵ On January 7, 2000, almost three years after the initial application, D.O.T. determined additional information was necessary in order to conduct the required public interest evaluation.¹²⁶

The American Airlines and British Airways alliance proposal is significantly different from others, as the U.S. and the United Kingdom ("U.K.") do not have an open skies accord, and American Airlines and British Airways are direct competitors in a highly concentrated market. Under the current U.S./U.K. treaty, ("Bermuda II"), only two U.S. airlines, American Airlines and United Airlines, and two U.K. airlines, British Airways and Virgin Atlantic, are allowed to operate direct, scheduled flights between the U.S. and London's Heathrow airport.¹²⁷ Allowing the alliance to proceed would leave Heathrow, the world's busiest international airport, with three carriers.¹²⁸

Further, American Airlines and British Airways are direct competitors in three markets: nonstop service, service to Heathrow Airport and service to JFK Airport.¹²⁹ According to D.O.J., nonstop service is a separate market because time sensitive travelers would not switch to connecting service in response to a price increase in nonstop service.¹³⁰ Moreover, frequent flyer preferences, corporate discount programs and service factors (such as schedule convenience) is evidence that connecting

123. *See id.*

124. *See id.* American Airlines, United Airlines, Virgin Atlantic and British Airways are the only carriers with scheduled service to London's Heathrow Airport from the U.S. *See id.* Bermuda II, the current U.S./U.K. bilateral treaty prohibits other airlines from serving the U.S./Heathrow route. *See id.* Trans-World Airlines, Northwest Airlines, Delta Airlines, Continental Airlines, US Airways and American Airlines also fly to London's Gatwick airport. *See id.*

125. *See Joint Application of American Airlines and British Airways*, D.O.T. Order 97-3-34, available in 1997 WL 129026 (D.O.T.).

126. *See Joint Application of American Airlines and British Airways*, D.O.T. Order 2000-1-8, available in 2000 WL 29395 (D.O.T.) at *2. U.K. regulators forced the airlines to release 267 weekly slots at Heathrow and Gatwick Airports before the alliance would be approved. *See also*, Terry Maxon, *Airline Alliance Progresses: European Regulators Outline Restrictions on British Airways-American Proposal*, DALLAS MORNING NEWS, July 9, 1998, at 1D. Combined, British Airways and American Airlines have 5,013 slots at Heathrow and Gatwick Airports. *See id.* However, British Airways was unwilling to relinquish any slots "because it believes it will lose more by doing so than it would gain by deepening its alliance with American Airlines." Matthews & Michaels, *supra* note 12.

127. *See U.K., U.S. Officials Start Talk on Transatlantic Air Links*, DOW JONES INT'L NEWS, Jan. 28, 2000.

128. *See id.*

129. *See Comments, supra* note 29.

130. *See id.*

service is not a reasonable substitute for nonstop service.¹³¹ D.O.J. also believed service to Heathrow Airport is another separate market due to its location.¹³² Two airports serve London: Gatwick Airport and Heathrow Airport.¹³³ While Gatwick airport is sixty-four minutes from the central London business district, Heathrow is thirty-eight minutes away.¹³⁴ According to D.O.J. time sensitive travelers would not switch from Heathrow airport to Gatwick airport if there were a price increase on air service to Heathrow Airport.¹³⁵ D.O.J. also classified service to JFK airport as a possible relevant market. Although relative price information from New York's international airports is not clear, D.O.J. found many business passengers prefer JFK Airport to Newark Airport.¹³⁶

Additionally, British Airways and American Airlines are direct competitors on several U.S./Heathrow routes. British Airways and American Airlines serve flights from Boston, New York, Miami, Chicago, Dallas and Los Angeles to Heathrow Airport.¹³⁷ Combined market shares for these routes would be 100 percent for Boston, Dallas and Miami, 80 percent for Chicago, 60 percent for New York and 53 percent for Los Angeles.¹³⁸ The post merger HHI for each route is 10,000 for Boston, Dallas and Miami, 6,750 for Chicago, 4,037 for New York and 1,578 for Los Angeles.¹³⁹ Given the highly concentrated nature of the U.S./Heathrow market, the proposed alliance would substantially lessen competition.¹⁴⁰

British Airways and American Airlines are not giving up. On January 20, 2000, the airlines and U.S. and British air transport officials initiated talks aimed at improving air relations between the two countries.¹⁴¹ Officials created a proposal, called a mini-deal or Bermuda 2 ½.¹⁴² The mini-deal would enable US Air to receive a Pittsburgh-Heathrow slot,

131. *See id.*

132. *See id.*

133. London's Gatwick Airport handles approximately thirty million passengers annually and has 102 airlines serving over 280 destinations. *See Airport Facts and Figures* (visited Feb. 23, 2000) <<http://www.baa.co.uk/domino/baa/baanet.html>>. London's Heathrow Airport handles over sixty million passengers annually and has over 90 airlines serving approximately 200 destinations. *See id.*

134. *See Comments, supra* note 29.

135. *See id.*

136. *Id.*

137. *See id.*

138. *See The Antitrust Implications of the Proposed British Airways-American Airlines Alliance, Congressional Testimony before the Antitrust, Business Rights and Competition Subcomm. of the Senate Subcomm. on the Judiciary* (1997) (statement of Barry Simon, Senior Vice President, Int'l Continental Airlines) available in 1997 WL 10569895.

139. *See id.*

140. *See Comments, supra* note 29.

141. *See Daniel Michaels, U.S.-U.K. Aviation Talks Offer Hope for Progress*, Wall St. J. Eur., Jan. 26, 2000, at 2.

142. *See id.*

enable British Airways to obtain a limited code-share agreement with American Airlines and enable a couple of U.S. carriers at Gatwick Airport to secure landing slots at Heathrow Airport.¹⁴³ The mini-deal would also allow British Midland to start four new daily services to the U.S. from Heathrow Airport.¹⁴⁴

Despite these efforts, recent news sources report U.S. and U.K. talks have failed.¹⁴⁵ In response, British Midland applied with D.O.T. for an antitrust exemption to code share on United Airline's flights into Heathrow airport from seven U.S. cities on January 31, 2000.¹⁴⁶ Meanwhile, British Airways and American Airlines are still urging U.S. and U.K. officials to liberalize air transport agreements, in order for D.O.T. to approve their proposed alliance.¹⁴⁷

CONCLUSION

Consumers will see more airline alliances in the next decade. Although air alliances provide efficiencies for air providers and enable them to better compete in international markets, some alliances may still cause competitive harm to consumers, and will have to be blocked. For instance, allowing British Airways and American Airlines to deepen their alliance at Heathrow Airport may significantly concentrate the market, leaving only three significant carriers setting prices, resulting in higher prices for consumers. However, encouraging alliances in unconcentrated or moderately concentrated markets may enable airlines to save capital expenditures and gain other efficiencies leading to lower prices. Moreover, alliances in these markets may enable air carriers to enter new mar-

143. Carl Mortished, *Open Skies Dogfight Brings Bad Blood Across the Atlantic*, TIMES OF LONDON, Feb. 11, 2000, at 33. British Airways would be allowed to code-share with American Airlines because the mini-deal would lift Bermuda II's restrictions at Heathrow Airport. *See id.*

144. *See* Michaels, *supra* note 141.

145. *See U.K.: B. Midland, United Seek More Flight Links*, REUTERS ENGLISH NEWS SERV., Feb. 1, 2000.

146. *See id.* Lufthansa, the largest airline in Germany, purchased a twenty percent stake in British Midland from Scandinavian Airlines in November, 1999. Daniel Michaels, *British Midland Changes U.K. Market*, WALL ST. J. EUR., Nov. 10, 1999, at 7. Lufthansa is also partnered with United Airlines in the Star Alliance. *See id.* The Star Alliance also includes Scandinavian Airlines, Air Canada, Thai Airways and Singapore Airlines. *See id.* Lufthansa purchased the twenty percent stake in order to expand its landing slots at London's Heathrow Airport. *See id.* Adding British Midland's fourteen percent share to the alliance enables Star to control twenty four percent of the landing slots at Heathrow Airport. *See id.* However, although both United Airlines and British Midland can fly from Heathrow Airport, only United Airlines is allowed to fly from Heathrow to the United States. *Lufthansa Irks British Airways with Courtship*, WALL ST. J. EUR., Oct. 21, 1999, at 14. Although British Midland has applied to initiate a code-share agreement with United Airlines, and therefore seek entry into the U.S./Heathrow market, Bermuda II may foreclose any such opportunities. *See id.*

147. *See U.K., U.S. Officials Start Talks on Transatlantic Air Links*, *supra* note 127.

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kets or to expand service to additional destinations thereby increasing consumer choice in air travel.

Liberalizing air markets through bilateral treaties remain an important element in the success of strategic alliances. Bilateral air treaties ensure the airline marketplace remains competitive. Because each alliance is unique, regulatory agencies should closely scrutinize proposed alliances to insure pro-competitive alliances producing consumer benefits are approved.

