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III. Aviation

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A. Introduction

In an industry that sees its share of turbulence, the past year was anything but smooth for aviation. Just as fuel prices began to stabilize, the global economic downturn caused passenger numbers to decline sharply. The decline in cargo traffic was even steeper. As revenues began to nosedive, some carriers ceased flying altogether while others sent aircraft into storage and cut back on the number of flights. A few airlines staked their survival on some form of merger or combination. Domestically, the industry witnessed Delta's acquisition of Northwest Airlines, creating what is by most standards the world's largest air carrier. Internationally, the three major airline alliances added to their members and deepened their level of coordination. The result of these trends was an industry with fewer operators and enhanced airline groupings.

Recently, influential policymakers have begun to speak out against a perceived decrease in competition resulting from the push towards industry consolidation. Legislation has been introduced in Congress limiting tie-ups among airlines. While airlines have argued for flexibility in structuring their arrangements, critics

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are concerned about the effect on fares and services. The outcome of this debate will play a large role in determining the structure of the industry in the future.

B. Delta–Northwest Merger

On April 14, 2008, Delta Air Lines, Inc. and Northwest Airlines, Inc. announced that they had entered into a definitive agreement to merge the two airlines. Following a review of the transaction, the U.S. Department of Justice (DOJ) announced at the end of October 2008 that it was ending its investigation of the proposed deal, effectively clearing the merger.[1] Under the merger plan, Northwest became a wholly owned subsidiary of Delta.

During the post–merger transition period, Northwest and Delta will integrate their business activities, employees, and route networks into a single entity, with all operations ultimately conducted under the Delta brand name. At the end of the transition period, Northwest will cease to exist as a separate air carrier. The combined operations will constitute the largest air carrier in the world by most commonly used measures, surpassing American Airlines, United Air Lines, the Air France-KLM Group, and Lufthansa in annual traffic.

1. Review by Competition Authorities

The transaction was reviewed primarily by the Antitrust Division of the Department of Justice. In addition, and in cooperation with the DOJ, the attorneys general of several states reviewed the proposed merger in a working group organized under the auspices of the National Association of Attorneys General. The transaction was also subject to review by the European Commission as well as the competition authorities of several nations. The European Commission approved the deal on August 6, 2008.

The merger was challenged in private litigation brought in the United States on behalf of twenty-eight individuals who alleged that the combination would reduce competition and result in higher air fares. The suit, which had been pending in federal court in California for five months, was voluntarily dismissed with prejudice once DOJ terminated its review of the transaction.[2]

In the years since deregulation, DOJ's track record generally has been to oppose mergers in the airline industry. For example, DOJ announced in 2001 that it planned to challenge the proposed acquisition of US Airways by United Air Lines, which prompted the parties to abandon the transaction. Between 2001 and the Delta–Northwest transaction, DOJ had cleared only two significant airline mergers, American's acquisition of the assets of TWA and America West's acquisition of US Airways, but in each case the acquisition target was in extreme financial distress and would have likely faced liquidation in the absence of a merger.

1. Statement of the Department of Justice's Antitrust Division on Its Decision to Close Its Investigation of the Merger of Delta Air Lines Inc. and Northwest Airlines Corporation (2008-10-29).

2. D'Augusta v. Northwest Airlines Corp. and Delta Air Lines, Inc., 3:2008cv03007 (N.D. Cal. June 18, 2008).

Additionally, in the case of America West–US Airways, there was very little competitive overlap between the two airlines.

The Delta–Northwest merger marked the first real test of airline merger policy since the failed United–US Airways bid. However, the airline industry has changed significantly since 2001. Perhaps most important from the perspective of competition analysis, the low fare segment of the industry has grown substantially during the past decade and now accounts for almost a third of all domestic traffic. Virtually all major markets provide service by one or more low cost carriers. Indeed, if measured by the total number of passengers enplaned per year, Southwest Airlines, a low fare carrier, was the largest domestic U.S. airline in 2008. This low fare carrier growth has come at the expense of the six remaining legacy carriers, five of which, including Delta and Northwest, have been forced to restructure in bankruptcy in order to remain viable.

In conducting its review, DOJ examined whether the proposed transaction would result in a substantial reduction in competition in any relevant market. In the airline industry, DOJ has traditionally treated city-pair routes as the relevant market. Prior to approval from DOJ, Delta and Northwest stated their view that the proposed transaction would not result in a reduction of competition because the networks of the two carriers are complementary and have relatively little overlap. However, there was some overlap between the networks on certain city-pair routes and DOJ, in clearing the transaction, necessarily made a determination of whether the reduced competition on those routes was substantial enough to warrant a challenge.

At the time of the merger announcement, the parties had stated that the proposed transaction would result in as much as $2 billion in annual synergy benefits, either in the form of enhanced revenue opportunities or opportunities for cost reductions. Under DOJ's merger guidelines, DOJ may take into account the effect of efficiencies that may result from the transaction. During the course of its review, DOJ likely assessed whether, and to what extent, the synergy benefits claimed by the parties were cognizable under the merger guidelines. As with most DOJ investigations, many of the relevant facts of the Delta–Northwest transaction that DOJ relied upon in reaching its determination were not made public.

Nevertheless, in closing its investigation of the transaction, DOJ determined that the proposed merger is likely to produce substantial efficiencies that will benefit consumers and is not likely to substantially lessen competition. DOJ also noted that the two airlines will compete with a number of other legacy and low cost airlines on the vast majority of nonstop and connecting routes where they previously competed with each other.

2. Department of Transportation and FAA Review

Both the DOT and the Federal Aviation Administration (FAA) also reviewed aspects of the Delta–Northwest merger.

Under DOT policy and precedents, a merger of two airlines results in a de facto transfer of the acquired airline's international routes. Transfers of international route authority are ordinarily subject to DOT review and approval. Therefore, the

parties filed an application with DOT to approve the transfer of Northwest's international routes to Delta. On January 15, 2009, the DOT approved the transfer of route authorities and other economic authorities held by Northwest and its regional air carrier subsidiaries.

With DOJ and DOT approvals in hand, the two airlines are currently working with the FAA to make the transition to a single air carrier certificate and operations specifications, a process that is expected to take up to eighteen months. During the interim period, Northwest will retain its corporate identity as a subsidiary of Delta and continue to operate under its own certificate. The parties submitted a plan to the FAA for the transition process, which the FAA approved in September 2008.

3. Labor Integration

One of the significant risk factors in an airline merger is the need to integrate the labor groups of the two carriers into a combined workforce. The airline industry has a long history of labor disharmony resulting from this process because workers from one company or the other feel aggrieved by decisions on seniority integration or other matters. The America West–US Airways merger is the latest case study to demonstrate how significant disputes between work groups, particularly the pilots, have affected operational performance and delayed the full realization of the potential synergies of that transaction.

In the case of Delta–Northwest, the merger presented unique issues because, with the exception of its pilots, Delta is nonunion. In contrast, Northwest may be the most heavily unionized airline in the United States with all major work groups covered by a collective bargaining agreement.

The pilots of both airlines are represented by the Air Line Pilots Association (ALPA). In an effort to avoid the problems encountered in earlier airline mergers, Delta and Northwest attempted to deal with pilot integration issues before agreeing to merge. The parties succeeded in negotiating a new post-merger joint collective bargaining agreement (JCBA) with the leadership of the two pilot groups, but the pilot groups were not able to reach agreement on the critical issue of seniority integration. The pilots for both airlines ratified the JCBA in August 2008, and the seniority integration issue was submitted to a special three-member arbitration panel for resolution. On October 30, 2008, one day after the merger's consummation, the JCBA became effective. On December 8, 2008, the arbitration panel delivered its decision on seniority integration. Under this decision, pilots will be ranked on a new seniority list based on a staffing formula and the aircraft flown by each pilot.

Seniority and representation issues must be resolved with other groups of employees. The first issue that must necessarily be determined is whether a work group will be represented by a union. Two unions, the Association of Flight Attendants, which represents Northwest's flight attendants, and the International Association of Machinists and Aerospace Workers, which represents Northwest's airport employees and other categories of ground employees, have not announced when they will seek to resolve the issues of representation and seniority integration.

Elections will likely be held among the members of each craft to determine if the employees wish to be represented by the union currently representing the Northwest employees, or if they wish not to be represented as is the case today at Delta. Those elections will be supervised by the National Mediation Board pursuant to the Railway Labor Act, which governs labor relations in the airline industry. At the time this report was prepared, seniority and representation issues had been resolved for about 25 percent of the combined workforce.

C. Continental–Star Alliance

In July 2008, Continental Airlines and the members of the Star Alliance[3] filed a joint application with the DOT proposing to add Continental to their network.[4] Star is one of three major international airline alliances, the other two being SkyTeam (Delta/Northwest/Air France/KLM) and oneworld (American Airlines/British Airways). After the Delta–Northwest merger, Continental decided to end its affiliation with SkyTeam in order to join Star. The application filed with DOT includes a request for immunity from U.S. antitrust laws so that Continental may coordinate its services with the other members of the Star Alliance.

1. International Airline Alliances and the DOT Review Process

Airline ownership laws in the United States and elsewhere generally prohibit majority control of a commercial air carrier by foreign entities. Because cross-border ownership is impermissible, airlines have attempted to give wider scope to their operations through alliances with other carriers. These alliances are essentially joint ventures, involving varying degrees of cooperation among the participants. In their most developed form, the alliances involve coordination by airlines on routes, scheduling, capacity, and fares.

This level of coordination in an international airline alliance requires approval from the DOT, which has been assigned antitrust authority over such matters pursuant to 49 U.S.C. §§ 41308 and 41309. DOT's review of such arrangements proceeds in two steps. First, DOT must determine whether to approve the proposed alliance agreement under 49 U.S.C. § 41309, which requires DOT to conduct an analysis of the impact the agreement will have on competition. In making this analysis, DOT applies the Clayton Act test to determine the potential anticompetitive effects of the alliance agreements and whether they are balanced by other factors, including the possibility of new entrants in the affected markets, that would counteract any potential for competitive harm.

If DOT concludes that the alliance agreements should be approved, it then proceeds to the second step of its analysis: whether it should use its authority under

3. Air Canada, Austrian Group, British Midland Airways, Lufthansa, LOT Polish Airlines, Scandinavian Airlines System, TAP Air Portugal, and United Air Lines.

4. Joint Application to Amend Order 2007-2-16 under 49 U.S.C. §§ 41308 and 41309 so as to Approve and Confer Antitrust Immunity, Docket OST-2008-0234, *available at* http://www.airlineinfo.com/ostdocket2008/ost080234.html.

49 U.S.C. § 41308 to grant antitrust immunity to the alliance. A prerequisite for granting antitrust immunity is that an open skies aviation bilateral agreement must be in place between the United States and the licensing country of each non-U.S. airline member in the relevant alliance. DOT's position is based on the view that an open skies agreement removes any bilateral restrictions on entry in the markets affected by an airline tie-up, allowing for the possibility of competing service from other operators and reducing the likelihood that approval of antitrust immunity will result in a loss of competition.

Occasionally, DOT imposes conditions that the alliance members are required to fulfill in order to gain approval for the proposed arrangement. As a general matter, DOT has been favorably disposed to requests for antitrust immunity.

2. Continental–Star Alliance Application

Continental and the existing members of the Star Alliance (referred to as the joint applicants) presented DOT with a plan for joint management of sales and marketing efforts, aircraft capacity (seats), scheduling, and pricing with revenue sharing on certain routes. Within the larger umbrella of the Star Alliance, a core group of airlines, including Air Canada, Continental, Lufthansa and United Air Lines, will engage in a joint venture involving even closer cooperation. The objective of their plan is so-called metal neutrality; by pooling resources and sharing gains and losses, the participants of the core group aim to be indifferent as to which carrier actually operates the aircraft on a given service. The joint applicants argued that the proposed arrangement is essential if the Star Alliance is to cope with volatile fuel prices and compete successfully with the other major airline alliances.

Certain elements of the joint applicants' plan attracted opposition from the industry. In the DOT application proceeding, Delta expressed its concern that the proposed addition of Continental to the Star Alliance would lead to reduced intergateway competition between Continental's transatlantic services at Newark and United's transatlantic services in Washington, D.C.[5] Delta urged DOT to limit the geographic scope of the proposed alliance and carve out certain city-pairs from any grant of antitrust immunity. Objections to the application were also filed by the industry trade groups representing travel agents.[6] They warned that DOT approval of the application would enhance the already considerable bargaining leverage of the Star Alliance, giving it virtual monopsony power over travel agent fees and commissions.

3. Tentative DOT Approval

DOT tentatively approved the Continental–Star Alliance agreements and granted the joint applicants antitrust immunity.[7] DOT concluded that the addition

5. Answer of Delta Air Lines (Nov. 26, 2008).
6. Answer of the American Society of Travel Agents and the Interactive Travel Services Ass'n (Nov. 26, 2008).
7. DOT Order 2009-4-5 (Apr. 7, 2009).

of Continental as a Star member would not substantially reduce competition in the airline industry.

DOT first considered the effect of the proposal on regional markets, primarily focusing on transatlantic services where the proposed alliance would have the greatest impact. DOT determined that Continental's decision to leave the SkyTeam network and join Star would result in a shift in transatlantic market share of 8.5 percent. Although the shift would mean that the Star Alliance would move from second to first in terms of transatlantic traffic (at SkyTeam's expense), DOT concluded that the overall level of inter-alliance competition between the United States and Europe would be largely unchanged.

DOT then analyzed the proposal's effect on specific country-pair and city-pair markets. After examining the effect of the combination on traffic between the United States and several European Union countries, DOT concluded that adding Continental to Star would enhance Star's ability to compete in markets where SkyTeam, oneworld, or both have a strong presence. DOT found that in many other U.S.-EU markets, Continental's inclusion in the Star grouping would have little or no market share effect. However, concerned about the impact the proposal would have on competition between the United States and Canada, DOT ordered the joint applicants to carve-out from any immunized arrangement the Chicago–Toronto and the San Francisco–Toronto markets.

Lastly, DOT considered the impact of the Continental–Star tie-up on competition in the domestic airline market. DOT was particularly concerned about the effect on domestic services from the sharing of proprietary information between Continental and United within the Star arrangement. To address this concern, the joint applicants had included certain confidentiality guidelines in their proposal that limited the type of information that Continental and United could share. In its decision tentatively approving the Continental–Star application, DOT required Continental and United to adhere to the confidentiality guidelines.

DOT's tentatively approved the joint applicants' request in a show cause order. Interested parties may respond to the decision with arguments as to why DOT should not finalize its tentative decision, after which the agency will issue a final determination.

D. FAA Reauthorization Legislation

Every few years, Congress takes up legislation reauthorizing funding for the FAA. The FAA reauthorization bill has become the principal means for Congress to interject itself into aviation policymaking. Until recently, multiyear reauthorizations for the FAA meant that Congress might go two or three years without focusing on aviation issues. However, due to industry infighting over aviation-related taxes and fees, the FAA reauthorization process has broken down, and the FAA has been forced to operate under a series of short-term extensions of its authority. As a result, Congress has considered FAA reauthorization legislation in each of the last two sessions.

This year's reauthorization process has seen a change in emphasis. While the industry battle over taxes and fees has by no means been resolved, members of Congress have stepped forward with some of their own legislative initiatives. In the absence of any notable aviation proposals from the Obama administration, congressional consideration of this year's version of the FAA reauthorization bill has dominated debate within the industry.

As suggested by its tentative decision regarding the Continental–Star Alliance application, DOT has taken a fairly liberal stance on alliance requests for antitrust immunity. DOT has encountered formidable opposition from Representative James Oberstar, Chairman of the House Transportation and Infrastructure Committee. As part of this year's FAA reauthorization process, Congressman Oberstar proposed legislation that many believe will have a chilling effect on antitrust immunity for international airline alliances.[8]

Congressman Oberstar has moved to curtail airline alliances out of concern over their effects on competition. In a speech describing his legislation, Oberstar claimed that the U.S.-Europe aviation market is dominated by the three airline alliances that operate over the North Atlantic: Star, SkyTeam, and oneworld.[9] According to Oberstar, these airline networks currently control 87 percent of the traffic between the United States and Europe. Oberstar also cited statistics showing that SkyTeam controls 75 percent of the market between New York (JFK) and Paris, while the Star Alliance carries 85 percent of the traffic between Chicago and Frankfurt. The result, in Oberstar's view, has been a decline in the number of carriers operating across the North Atlantic and a corresponding rise in fares.

Congressman Oberstar has included in the proposed FAA reauthorization bill a sunset provision for international airline antitrust immunity. Under this proposal, antitrust immunity for an international airline grouping could not extend more than three years from the date that the sunset provision is enacted. Each alliance would be required to reapply for antitrust immunity in accordance with any revised policies DOT may have adopted. Oberstar's version of the reauthorization bill also would require the General Accounting Office to review DOT antitrust immunity determinations for international airline alliances and examine whether exempting such arrangements from U.S. antitrust law has resulted in public benefits or negatively affected competition.

Oberstar's proposals have met with considerable opposition. The Air Transport Association (ATA), the trade association for large airlines, estimated that the proposal would lead to the loss of 15,000 aviation-related jobs. ATA also stated that it would be grossly unfair if DOT were to withdraw antitrust immunity after the members of an alliance had spent substantial resources to create a carrier network offering expanded online service options to the travelling public.[10] The EU

8. H.R. 915.

9. Remarks of Rep. James L. Oberstar delivered before the International Aviation Club (Mar. 23, 2009).

10. Letter dated March 3, 2009, from James May, President and Chief Executive Officer of the Air Transport Association, to Rep. James L. Oberstar.

criticized the proposal as an attack on "carefully constructed agreements among airlines that are designed to offer customers a better and more seamless global product."[11]

At the time of this writing, the House of Representatives was still considering the FAA reauthorization bill, including Oberstar's proposal restricting international airline alliances. Chances for passage by the House and subsequent approval by the Senate are unclear.

E. Airline Price-Fixing Investigation

Antitrust concerns were also at the center of a wide-ranging DOJ investigation into rate-setting among foreign airlines. In April 2008, DOJ obtained the first of several plea bargains by airline executives who agreed to criminal fines and imprisonment for their role in a conspiracy to fix prices for international cargo shipments on certain routes to and from the United States. The executives have been charged, inter alia, with participating in meetings in the United States for the purpose of monitoring and enforcing adherence to previously agreed-upon rates in violation of section 1 of the Sherman Act.

The investigation started four years ago with an FBI raid on airline offices in the United States searching for evidence of collusion among industry participants in the setting of fuel surcharges for cargo shipments. The effort has since broadened to include other allegations of price-fixing in the air cargo industry and with respect to passenger services as well. The investigation has netted the largest fines ever sought by DOJ in a criminal antitrust matter. The first criminal fines were imposed in August 2007, with British Airways and Korean Air Lines each agreeing to pay $300 million for conspiring to fix cargo rates and passenger fuel surcharges on services to and from the United States. Eight additional airlines have also agreed to plead guilty to price-fixing charges.

As part of their plea bargains with DOJ, airlines that have admitted their involvement in the price-fixing conspiracy also agreed to cooperate with the ongoing investigation. Airline employees thought by DOJ to have participated in price-fixing activities have been forced to retain their own counsel. The investigation is ongoing, and additional jail terms appear likely. The DOJ has emphasized that foreign airlines and their executives will not escape prosecution under the Sherman Act if they engage in price fixing that affects the sale of its services in the United States.

A number of class action civil lawsuits have been brought against the alleged participants in the price-fixing conspiracy. A consolidated class action proceeding on behalf of shippers is currently pending before the Eastern District of New York, alleging Sherman Act violations with respect to the setting of air cargo rates. Class action litigation also has been instituted against many of the same

11. Letter dated March 18, 2009, from John Bruton, Ambassador of the European Union to the United States of America, to Ray LaHood, Secretary of the U.S. Department of Transportation.

airlines with respect to passenger fares. No further proof is required to establish complicity in price-fixing activities for airlines that have previously entered into plea bargains with DOJ. Their plea bargains constitute an admission of their liability, and the only issue that remains is one of damages.

Two of these defendants were the first to cooperate with DOJ's price-fixing investigation and each has been provisionally accepted by the Antitrust Division as an "antitrust leniency applicant." Under a recent amendment to the Sherman Act, these airlines can only be held liable for the actual damages of the class action plaintiffs, rather than the treble damages normally available in such cases.[12] The other defendants in the class action litigation do not share in such protection. Any class action settlements could be in the range of hundreds of millions of dollars, in addition to the fines already imposed by DOJ.

12. Pub. L. No. 108-237, 118 Stat. 661, Title II, Subtitle A, § 213(b) (codified in note accompanying 15 U.S.C. § 1).