

## Airline Alliances, Antitrust Immunity and Mergers in the United States

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### I. Introduction

#### A. Airline Alliances are Under Attack

For the past two decades, the Department of Transportation (“DOT”) has followed tandem policies of open skies and antitrust immunity that have led to 94 bilateral and multilateral open skies aviation agreements, including the United States-European Union open skies agreement that became effective on March 30, 2008.<sup>2</sup> These policies have fostered effective global expansion of U.S. carrier networks through international antitrust immunity (“ATI”) approvals on over 25 occasions, while outright transnational mergers remain prohibited by statutory restrictions on foreign ownership of U.S. airlines. Government experts and independent economists alike have documented substantial benefits from such multinational immunized alliances in open skies markets. For example, DOT reports in 1999 and 2000 demonstrated that multinational immunized alliances lead to pro-competitive changes in industry structure, consumer benefits in the form of improved service and price reductions, and contributions to local and national economies.<sup>3</sup> DOT’s 2000 report concluded that “broad-based strategic alliances . . . are the principal driving force behind transatlantic price reductions and traffic

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<sup>2</sup> See Air Transport Agreement between the United States and the European Community, 2007 O.J. (L 134) 4-41, *available at* [http://ec.europa.eu/transport/air\\_portal/international/pillars/global\\_partners/doc/us/agreement\\_oj\\_%201134\\_2007.pdf](http://ec.europa.eu/transport/air_portal/international/pillars/global_partners/doc/us/agreement_oj_%201134_2007.pdf).

<sup>3</sup> See International Aviation Developments: Transatlantic Deregulation: The Alliance Network Effect (“DOT Second Report”), U.S. Department of Transportation, Office of the Secretary (Oct. 2000), at 2-3, 5; International Aviation Developments: Global Deregulation Takes Off (“DOT First Report”), U.S. Department of Transportation, Office of the Secretary (Dec. 1999), at 14-15.

gains.”<sup>4</sup> A study prepared by the Brattle Group for the EU in 2002 calculated a 10% increase in transatlantic capacity under U.S. open skies agreements and concluded that consumer surplus is maximized through a combination of open skies and encouraging firms to engage in “deep alliances.”<sup>5</sup> In a 2004 report, GAO concluded “open skies agreements have benefited airlines and consumers. Airlines benefited by being able to create integrated alliances with foreign airlines.... Consumers benefited by being able to reach more destinations with ‘on-line’ service, and from additional competition and lower prices.”<sup>6</sup>

Despite these positive findings, immunized alliances are now under attack on both sides of the Atlantic.<sup>7</sup> If these attacks succeed, open skies could well close again, fares could increase as consumer convenience decreases, airline networks could shrink, and mergers (whether domestic or transnational) may replace them, bringing potential disruptions and loss of employment.

## **B. Attacks on Antitrust Immunized alliances have come from the U.S. Congress, the Department of Justice and European regulators**

### ***1. Congressional Measures Against Antitrust Immunity***

On December 19, 2008, leaders of the Senate Committee on the Judiciary wrote to the outgoing Secretary of Transportation and Attorney General urging DOT to consult with the Department of Justice and “grant further antitrust

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<sup>4</sup> DOT Second Report, at 5. See also Remarks of Susan McDermott, Deputy Assistant Secretary For Aviation and International Affairs, Office of the Secretary, U.S. Department of Transportation, to the International Air Cargo Association Conference, Washington, D.C., Sep. 29, 2000 (“[a]lliance-based networks are the principal driving force behind transatlantic price reductions and traffic gains.” *Id.*)

<sup>5</sup> The Impact of an EU-US Open Aviation Area, Brattle Group (December 2002). See Jan K. Brueckner, Evaluation of the Latest Star Alliance Applications for Antitrust Immunity, Aug. 16, 2006; Jan K. Brueckner, An Evaluation of the SkyWings Antitrust-Immunity Application, June 24, 2005; Jan K. Brueckner, International Airfares in the Age of Alliances: The Effects of Codesharing and Antitrust Immunity, *The Review of Economics and Statistics* 85, Vol. 85, No. 1 (Feb. 2003); Jan K. Brueckner, The Benefits of Codesharing and Antitrust Immunity for International Passengers, with an Application to the Star Alliance, *Journal of Air Transport Management*, Vol. 9, Issue 2 (Mar. 2003); and Jan K. Brueckner, The Economics of International Codesharing: An Analysis of Airline Alliances, *International Journal of Industrial Organization*, Vol. 19, Issue 10 (Dec. 2001).

<sup>6</sup> U.S. Gov’t Accountability Office, *Transatlantic Aviation: Effects of Easing Restrictions on U.S.-European Markets*, Report to Congressional Requestors, GAO-04-835 at 6 (July 2004), *available at* <http://www.gao.gov/new.items/d04835.pdf>.

<sup>7</sup> “*Why is Antitrust Immunity Suddenly An Issue?*” by Randy Bennett, Patrick Murphy and Jack Schmidt, *Aviation Daily*, online edition at 5 (July 10, 2009).

immunity sparingly” and only in “rare circumstances where parties show that competition must be supplanted to serve the public interest.”<sup>8</sup> The Senators reiterated their concerns to the Obama Administration on June 8, 2009, urging incoming DOT Secretary LaHood not to “take final action on any antitrust immunity, especially the United, Continental, and Lufthansa application, until the Justice Department has had a full opportunity to submit formal comments as to the competitive effects of a specific proposal.”<sup>9</sup> On February 3, 2009, Congressman James L. Oberstar, Chairman of the Committee on Transportation and Infrastructure, introduced H.R. 831,<sup>10</sup> which calls for the Comptroller General to conduct a study of the legal requirements and policies used by the Secretary of Transportation to decide whether to approve proposed international airline alliances and to grant antitrust immunity.<sup>11</sup> The bill also automatically invalidates any prior grant of immunity three years after the bill’s effective date and prohibits renewal unless the DOT Secretary determines to adopt recommendations by the Comptroller General concerning new standards for authorizing international airline alliances and granting antitrust immunity. Language in the free-standing Oberstar bill is also included as Section 424 to H.R. 915,<sup>12</sup> the FAA Reauthorization Bill of 2009, which was passed by the House on May 21, 2009.<sup>13</sup>

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<sup>8</sup> Letter from Sen. Patrick Leahy, Chairman of Senate Committee on the Judiciary, Sen. Herb Kohl, Chairman of Senate Subcommittee on Antitrust, Competition Policy and Consumer Rights, Sen. Arlen Specter, Ranking Republican Member of Senate Committee on the Judiciary and Sen. Orrin Hatch, Ranking Republican Member of Senate Subcommittee on Antitrust, Competition Policy and Consumer Rights, to Honorable Michael B. Mukasey, Att’y General, U.S. Dept. of Justice and Honorable Mary Peters, Secretary, U.S. Dept. of Transportation (Dec. 19, 2008).

<sup>9</sup> June 8, 2009 Letter from Sen. Herb Kohl, Chairman of Senate Subcommittee on Antitrust, Competition Policy and Consumer Rights, Sen. Orrin Hatch, Ranking Republican Member of the Senate Committee on the Judiciary and Sen. Patrick Leahy, Chairman of the Senate Committee on the Judiciary, to Hon. Eric Holder, Att’y General, U.S. Dept. of Justice and Hon. Ray LaHood, Secretary, U.S. Dept. of Transportation (June 8, 2009).

<sup>10</sup> H.R. 831, 111<sup>th</sup> Cong. (2009).

<sup>11</sup> A copy of the free-standing amendment is attached as Exhibit A to this paper.

<sup>12</sup> H.R. 924, 111<sup>th</sup> Cong. (2009).

<sup>13</sup> On July 14, 2009, the Senate introduced the FAA Air Transportation and Modernization and Safety Improvement Act, which omits the Oberstar language on antitrust immunity. S. 1451, 111<sup>th</sup> Cong. (2009). The Senate Commerce Committee has also recently expressed its concern that any “[u]nexpected changes in [DOT’s] policy [on reviewing applications for ATI] could trigger unanticipated reactions that may adversely affect the current competitive market” and “would be a great setback for both consumers and aviation policy.” Press Release, U.S. Senate Committee on Commerce, Science & Transportation, Rockefeller and Hutchison Press DOT on Antitrust Immunity Cases Abrupt Policy Changes Could Jeopardize Open Skies Agreements, (Jul. 17, 2009), *available at* [http://commerce.senate.gov/public/index.cfm?FuseAction=PressReleases.Detail&PressRelease\\_id=7d46ab21-aaed-4bf8-8cb2-ff9010230495&Month=7&Year=2009](http://commerce.senate.gov/public/index.cfm?FuseAction=PressReleases.Detail&PressRelease_id=7d46ab21-aaed-4bf8-8cb2-ff9010230495&Month=7&Year=2009).

## **2. Increased DOJ Opposition to Antitrust Immunity**

DOJ has always been hostile to ATI for global airline alliances, but its opposition is becoming more vocal. In her debut appearance, Assistant Attorney General for Antitrust, Christine A. Varney, left no doubt that the Obama Administration would ratchet up its antitrust enforcement.<sup>14</sup> At a Senate hearing in mid-June, Attorney General Eric Holder announced that DOJ wanted greater input on the Continental/Star application before DOT. On June 26, 2009, almost three months after DOT had tentatively approved expansion of the immunized Star Alliance to include Continental, DOJ filed formal comments urging DOT to deny the broad requested antitrust immunity and instead grant more limited immunity with carveouts.<sup>15</sup>

## **3. EU Investigation and Proposals to Replace Immunized Alliances with Transnational Mergers**

On April 20, 2009, the European Commission opened two formal antitrust proceedings concerning the proposed agreements to coordinate pricing, capacity, schedules and revenue sharing among Air Canada, Continental, Lufthansa and United, on the one hand, and British Airways, American and Iberia, on the other hand.<sup>16</sup> A recent speech by the United Kingdom's Secretary of State for Transport before the International Aviation Club of Washington underscored the EU's "headline objective of liberalizing all foreign ownership in airlines to give European and American carriers a bigger home market and the ability to operate like any other competitive international company."<sup>17</sup> The EU has an ongoing investigations of oneworld and SkyTeam as well.<sup>18</sup>

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<sup>14</sup> See Varney, Christine A., "Vigorous Antitrust Enforcement in this Challenging Era," Remarks before the Center for American Progress (May 11, 2009).

<sup>15</sup> See Comments of the Department of Justice in Response to Order to Show Cause ("DOJ Comments"), Joint Application of Continental Airlines, Inc., et. al. ("Expanded Star Application"), Docket DOT-OST-2008-0234-0239, filed June 26, 2009.

<sup>16</sup> Press Release, Antitrust: Commission opens formal proceedings against certain members of Star and oneworld airline alliances (Apr. 20, 2009), *available at* <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/09/168>.

<sup>17</sup> Hoon, Geoff MP, "Three steps to a better future," Remarks before the International Aviation Club, Washington, D.C. (May 5, 2009).

<sup>18</sup> Competition: Commission confirms sending Statement of Objections to members of SkyTeam global airline alliance, European Commission Memo 06/243 (Jun. 19, 2006) *available at* <http://ec.europa.eu/competition/antitrust/cases/decisions/37984/memo.pdf>. See also David Robertson, *Europe puts airline alliances in the dock over transatlantic co-operation*, Business Times Online (Apr. 21, 2009), *available at* [http://business.timesonline.co.uk/tol/business/industry\\_sectors/transport/article6136212.ece](http://business.timesonline.co.uk/tol/business/industry_sectors/transport/article6136212.ece).

## II. The Current Statute and Regulatory Process

### A. DOT Has The Lead On Antitrust Immunity for Alliances; DOJ Leads on Airline Mergers

DOT has the ultimate statutory authority for approving airline alliances and granting related antitrust immunity.<sup>19</sup> Under 49 U.S.C. § 41309(b), the Department is required to “approve an agreement . . . when the Secretary finds it is not adverse to the public interest and is not in violation of [the federal aviation statutes].”<sup>20</sup> Pursuant to 49 U.S.C. § 41308, the Department may grant antitrust immunity to agreements approved under 49 U.S.C. § 41309 if it finds that immunity is required by the public interest. The Department’s established policy is to grant antitrust immunity to inter-carrier agreements based on findings that: (i) the agreements would not substantially reduce or eliminate competition; (ii) the parties would not proceed with the transaction without ATI; and (iii) antitrust immunity is required in the public interest.<sup>21</sup> In assessing the public benefits of granting ATI, the Department considers “among other things, international comity and foreign policy factors.”<sup>22</sup> By established policy, DOT has held that “the existence of an ‘open-skies’ regulatory framework between the U.S. and the foreign carriers’ homelands is a necessary predicate to [its] consideration of requests for antitrust immunity.”<sup>23</sup>

In contrast to this subsidiary role in airline antitrust immunity cases,<sup>24</sup> DOJ has sole antitrust enforcement authority to review mergers in the airline industry.<sup>25</sup>

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<sup>19</sup> 49 U.S.C. § 41308(b) (2009). See also DOT Report to Congress: Administration of Aviation Antitrust Functions (May 1987).

<sup>20</sup> 49 U.S.C. § 41309(b) (2009).

<sup>21</sup> See, e.g., DOT Order 2009-4-5, Expanded Star Application, Docket DOT-OST-2008-0234-0193, issued Apr. 6, 2009, at 6; DOT Order 2006-12-17, Joint Application of The Austrian Group, et. al., Docket DOT-OST-2005-22922-0050, issued Dec. 19, 2006, at 8; DOT Order 2005-10-8, Joint Application of American Airlines, Inc., at al., DOT-OST-2004-19964-0007, issued Oct. 9, 2006, at 6-7; DOT Order 2004-4-10, Joint Application of American Airlines, Inc., et. al., DOT-OST-2003-16530-0007, issued Apr. 7, 2006, at 5-6; and DOT Order 2002-1-6, Joint Application of Delta Airlines, Inc., et. al., DOT-OST-2001-10429-0036, issued Jan. 18, 2002, at 3.

<sup>22</sup> DOT Order 2009-4-5, at 6.

<sup>23</sup> See, e.g., Order 2009-7-10, Expanded Star Application, DOT-2008-0234-0253, issued July 10, 2009, at 2.

<sup>24</sup> See note 17, supra. Nevertheless, applicants are likely to routinely consult and/or meet with DOJ throughout the DOT review process since DOJ may, although it is not required to do so, file comments voicing any objections on the public docket. See e.g., DOJ Comments.

<sup>25</sup> See 15 U.S.C. §§ 45(a); and 46(a) (2009).

Under Section 7 of the Clayton Act,<sup>26</sup> which is the same test DOT uses to review airline alliance agreements and grant ATI, DOJ must determine whether a proposed combination will enhance or facilitate the exercise of market power.<sup>27</sup> As is the case with other industries, DOJ relies on the analytical framework set forth in its Horizontal Merger Guidelines<sup>28</sup> (the “Guidelines”) to evaluate airline merger proposals. Given the nature of the industry, the federal pre-merger notification and review requirements of the Hart-Scott-Rodino Antitrust Improvements Act<sup>29</sup> (“the HSR Act”) will likely apply to most airline combinations.<sup>30</sup>

## **B. The Regulatory Process for Review of Airline Alliances and Grants of Antitrust Immunity for Alliances.**

In determining whether an immunized alliance arrangement “substantially reduces competition” under 49 U.S.C. § 41309, DOT “appl[ies] the Clayton Act test—the same standard used to predict the competitive effects of a proposed merger,”<sup>31</sup> by:

consider[ing] whether...[a]lliance [a]greements are likely to substantially reduce competition and facilitate the exercise of market power—that is, to allow the...[a]pplicants to profitably charge supra-competitive prices or reduce service or quality below competitive levels in any relevant market. To determine whether an alliance is likely to create or enhance market power, [DOT] primarily consider[s] whether the alliance would significantly increase market concentration, whether the alliance raises concerns about potential anticompetitive

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<sup>26</sup> Clayton Antitrust Act, 38 Stat. 730 (1914)(as amended)(codified at 15 U.S.C. §§ 12-14 to 19, 21, and 22 to 27 (2009)). See also Section II.A infra.

<sup>27</sup> See discussion in Section II.B, supra; see also McDonald, J. Bruce, Deputy Assistant Attorney General, Antitrust Division, U.S. Department of Justice, Remarks before the Regional Airline Association, President's Council Meeting (“McDonald Remarks”) (Nov. 3, 2005), *available at*: <http://www.usdoj.gov/atr/public/speeches/217987.htm> (“[m]arket power is the ability to profitably raise prices over the long term, without losing sales such that the price increases become unprofitable.” Id.)

<sup>28</sup> United States Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines (rev. Apr. 8. 1997, Washington DC). See also Section II.C, infra.

<sup>29</sup> Pub .L. No. 94-435, 90 Stat. 1383 (1976) (codified at 15 U.S.C. §§ 15c-15h; 18a; and 66 (2009)).

<sup>30</sup> See Section II.C infra.

<sup>31</sup> Order DOT Order 2009-4-5, at 6-7 (citing DOT Order 92-11-27, In the matter of the acquisition of Northwest Airlines by Wings Holdings, Inc., issued Nov. 20, 1992, at 13; and DOT Order 2008-4-17, Joint Application of Alitalia-Linee Aeree Italiane-S.p.A., et. al., Docket DOT-OST-2007-28644-0174, issued Apr. 9, 2008, at 5).

effects in light of other factors, and whether new entry into the market would be timely, likely, and sufficient either to deter or counteract a proposed alliance's potential for harm.<sup>32</sup>

While the applicants seeking approval of alliance agreements and requesting ATI must "submit evidence establishing the transportation need or public benefits," it is opposing parties who bear the "burden of showing that the agreement or request would substantially reduce or eliminate competition and that less anticompetitive alternatives are available."<sup>33</sup>

In addition to generally setting forth the consumer and pro-competitive benefits to be derived from a grant of antitrust immunity and submitting copies of the underlying agreements, applicants also typically include material responsive to the document requests and interrogatories DOT has issued in prior proceedings in an effort to expedite the process by anticipating the agency's questions about the transactions at issue.<sup>34</sup> As applications for ATI typically contain highly sensitive information relating to international strategy, performance and planning, confidential treatment for certain portions of these submissions is requested<sup>35</sup> and granted<sup>36</sup> as a matter of course. After its initial review of the application, the next step is usually for DOT to request additional information,<sup>37</sup> which generates supplemental filings by the applicants themselves complying with that request, and is also often followed by wrangling between the applicants and other interested parties over whether DOT should require additional submissions from the applicants.<sup>38</sup>

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<sup>32</sup> DOT Order 2009-4-5, at 7.

<sup>33</sup> DOT Order 2009-7-10, at 3.

<sup>34</sup> See, e.g., Joint Application of Continental Airlines, Inc., et. al., Expanded Star Application, Docket DOT-OST-2008-0234-0001, filed July 23, 2008, at 101.

<sup>35</sup> See, e.g., Joint Motion of Continental Airlines, Inc. et. al., Expanded Star Application, Docket DOT-OST-2008-0234-0003, filed July 23, 2008.

<sup>36</sup> See, e.g., DOT Notice Providing Access to Documents, Expanded Star Application, Docket DOT-OST-2008-0234-0006, issued July 24, 2008, (access only permitted to those filing an affidavit under 14 C.F.R. § 302.12 stating that: "(1) the affiant is counsel for an interested party or an outside independent expert providing services to such a party; (2) the affiant will use the information only for the purpose of participating in this proceeding; and (3) the affiant will disclose such information only to other persons who have [also] filed a valid affidavit." Id., at 1-2).

<sup>37</sup> See, e.g. DOT Order 2008-10-3, Expanded Star Application, Docket DOT-OST-2008-0234-0067, issued Oct. 8, 2008.

<sup>38</sup> See, e.g., Expanded Star Application, Docket DOT-OST-2008-0234 (pleadings filed between October 27 and November 10, 2008).

Once the applicants have submitted all of the required additional information and documents, the next step is for DOT to issue a notice finding the application substantially complete and establishing a procedural schedule.<sup>39</sup> The procedural schedule will set forth dates for interested parties to comment on the now-complete application, as well as for answers to those comments and further replies.<sup>40</sup> Following the expiration of the comment period and submission of any responsive pleadings, as applicable, DOT will issue a show cause order stating its tentative conclusions and setting deadlines for submissions of any objections and answers thereto.<sup>41</sup> Based on its consideration of those pleadings, DOT will issue a final order<sup>42</sup> affirming and/or modifying its show cause order.<sup>43</sup> While petitions for reconsideration of a final order approving alliance agreements and granting ATI will be considered,<sup>44</sup> such a petition will not stay the effectiveness of the final order unless specifically ordered by the DOT decisionmaker.<sup>45</sup>

Although DOT is required by 49 U.S.C. 41710 to “make a final decision on the matter no later than the last day of the sixth month that begins after the date the matter is submitted,”<sup>46</sup> DOT entertained DOJ’s comments on the most recent Star Alliance Application almost a month after this deadline had passed.<sup>47</sup>

### **C. The Regulatory Process for Review of Airline Mergers.**

In evaluating airline industry combinations, DOJ uses an integrated five-part framework that assesses:

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<sup>39</sup> See, e.g., DOT Order 2008-11-8, Expanded Star Application, Docket DOT-OST-2008-0234-0067, issued November 12, 2008. A survey of DOT antitrust immunity proceedings indicates the time periods given for objections and answers have varied widely, from seven to twenty-eight calendar days, and from three to seven business days, respectively. See U.S. Dept. of Transportation, Immunized Alliances, *available at* [http://ostpxweb.dot.gov/aviation/X-50%20Role\\_files/immunizedalliances.htm](http://ostpxweb.dot.gov/aviation/X-50%20Role_files/immunizedalliances.htm).

<sup>40</sup> Id. (any further responsive pleadings or those filed outside of this established procedural schedule will require a grant of leave to file).

<sup>41</sup> See, e.g., DOT Order 2009-4-5.

<sup>42</sup> See, e.g., DOT Order 2009-7-10.

<sup>43</sup> See, e.g., Expanded Star Application (pleadings filed between April 9 and June 26, 2009 in Docket DOT-OST-2008-0234).

<sup>44</sup> See 14 C.F.R. § 302.14(a)(2) (2009); see also 14 C.F.R. §§ 303.05, 303.06 (2009).

<sup>45</sup> See 14 C.F.R. § 302.14(a)(2) (2009).

<sup>46</sup> See 49 U.S.C. § 41710 (2009).

<sup>47</sup> See DOT Order 2009-7-10, at 21. See also Section III.B infra.



(1) the relevant market (city-pairs in the case of airlines); (2) the potential anticompetitive effects resulting from a merger or acquisition; (3) the likelihood and impact of other airlines possibly entering a market and counteracting any anticompetitive effects; (4) “efficiencies” (benefits) that a merger would bring—for example, consumer benefits from an expanded route network—and (5) whether one of the airlines proposing to merge would fail and its assets exit the market in the absence of a merger or acquisition.<sup>48</sup>

Thirty days after the parties’ initial reporting of their proposed transaction under HSR Act requirements,<sup>49</sup> DOJ will typically issue a second request for information.<sup>50</sup> Following certification of substantial compliance with DOJ’s second request, a final 30-day waiting period begins.<sup>51</sup> Ideally, the parties will be able to resolve any anticompetitive concerns with DOJ prior to the expiration of the waiting period,<sup>52</sup> which they may agree to extend if it would benefit the negotiations. In the event DOJ finds the merger anticompetitive and any remedies offered by the parties to be inadequate, it must obtain a court order to delay the closing.<sup>53</sup> While the most recent major airline merger—of Delta and Northwest in 2008, received DOJ’s

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<sup>48</sup> U.S. Gov’t Accountability Office, *Airline Industry: Potential Mergers and Acquisitions Driven by Financial and Competitive Pressures*, Report to the Subcommittee on Aviation Operations, Safety, and Security: Committee on Commerce, Science, and Transportation, U.S. Senate, GAO-08-845, at 5 (July 2008), *available at* <http://www.gao.gov/new.items/d08845.pdf> (“the Guidelines make clear that DOJ does not apply this framework as a step-by-step progression, but rather as an integrated approach in deciding whether the proposed merger or acquisition would create antitrust concerns.” *Id.*, at 34)

<sup>49</sup> Under HSR requirements, a proposed airline merger that involves the acquisition of voting securities or assets valued in excess of \$65.2 million must be reported to DOJ. *See* 15 U.S.C. 18a (2009) (in practice, this requirement will apply to virtually any combination of major air carriers).

<sup>50</sup> Absent such a request for additional information, the parties may close the proposed transaction. *See* 15 U.S.C. § 18a(b). *See e.g.*, Press Release, Statement by the Assistant Attorney General R. Hewitt Pate Regarding the Closing of the America West / US Airways Investigation, U.S. Dept of Justice, June 23, 2005, *available at* [http://www.usdoj.gov/atr/public/press\\_releases/2005/209709.htm](http://www.usdoj.gov/atr/public/press_releases/2005/209709.htm). DOJ later noted that “[t]he America West-USAir merger is an example of the kinds of mergers that may easily avoid antitrust problem” and that it “may be a good model for an antitrust-ready merger of regional carriers that seek to combine to expand their footprint and use their low cost structure to compete more vigorously against legacy carriers.” McDonald Remarks, *supra*.

<sup>51</sup> *See* 16 C.F.R. § 803.20 (2009).

<sup>52</sup> GAO-08-845, at 34, n. 41 (“[a]ny restructuring of a transaction—e.g., through a divestiture—is included in a consent decree entered by a court, unless the competitive problem is unilaterally fixed by the parties prior to the expiration of the waiting period (called a “fix-it first”).” *Id.*).

<sup>53</sup> *See* 15 U.S.C. § 18a(f).

blessing,<sup>54</sup> DOJ last intervened to block such a transaction by opposing the combination of U.S. Airways and United in 2001, which it found to “violate antitrust laws by reducing competition in several areas.”<sup>55</sup>

Although DOT’s direct authority to regulate airline mergers passed to DOJ with the repeal of former Section 408 of the Federal Aviation Act, DOT nonetheless exercises jurisdiction over two areas affecting airline mergers: route transfers and fitness reviews.<sup>56</sup> DOT precedent holds that an acquisition of stock where one entity would control two airlines with international routes is “a *de facto* certificate transfer” requiring approval pursuant to 49 U.S.C. § 41105.<sup>57</sup> If two airlines merge, the acquired airline’s routes would be transferred to the surviving airline and DOT has jurisdiction. Certificates for international routes may be transferred only if DOT approves the transfer as “consistent with the public interest” and so certifies to the relevant House and Senate committees<sup>58</sup> with a report analyzing the effects of the transfer on “the viability of each carrier involved in the transfer; competition in the domestic airline industry; and the trade position of the United States in the international air transportation market.”<sup>59</sup> While DOT requires only 30 days’

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<sup>54</sup> See Press Release, Statement of the U.S. 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, U.S. Dept. of Justice, Oct. 29, 2008, *available at* [http://www.usdoj.gov/atr/public/press\\_releases/2008/238849.htm](http://www.usdoj.gov/atr/public/press_releases/2008/238849.htm).

<sup>55</sup> See Press Release, Department of Justice and Several States Will Sue to Stop United Airlines from Acquiring US Airways: Deal Would Result in Higher Air Fares for Businesses and Millions of Consumers, U.S. Dept of Justice, July 27, 2001, *available at* [http://www.usdoj.gov/atr/public/press\\_releases/2001/8701.htm](http://www.usdoj.gov/atr/public/press_releases/2001/8701.htm) (among the areas in which DOJ determined competition would be so reduced were: hub-to-hub nonstop markets, international routes, corporate and government business and airline service concentration).

<sup>56</sup> See 49 U.S.C. § 41110 (an air carrier must “continue to be fit, willing, and able to provide the transportation authorized by [its] certificate); see also 14 C.F.R. § 204.5 (an air carrier proposing to undergo a substantial change in ownership must file data in support of its continuing fitness to be reviewed by DOT’s Air Carrier Fitness Division).

<sup>57</sup> See e.g., DOT Order 2008-10-29, Joint Application Delta Air Lines, Inc., et. al., DOT-OST-2008-0163-0002, issued Oct. 30, 2008, at 1. In practice, parties typically obtain exemption operate as separate entities under the common ownership pending the Department’s final action on the *de facto* route transfer application. See id.; DOT Order 2001-9-16, Joint Application of Atlas Air Worldwide Holdings, Inc., et. al., DOT-OST-2001-10238-0005, issued Sep. 25, 2001, at 4; and DOT Order 99-4-5, Joint Application of Fine Air Services Corp., et. al., DOT-OST-1999-5196-0006, issued Apr. 9, 1999, at 4.

<sup>58</sup> Senate Committee on Commerce, Science and Transportation and House Committee on Transportation and Infrastructure.

<sup>59</sup> 49 U.S.C. § 41105 (2009).

advance notice of a “substantial change” in ownership,”<sup>60</sup> controversial changes—such as those involving significant foreign investment,<sup>61</sup> are often reported well in advance to avoid the potentially drastic consequences of an adverse fitness finding.<sup>62</sup>

#### **D. Limits on Foreign Ownership and Control of U.S. carriers.**

The federal aviation statute requires that an air carrier must be owned and controlled by U.S. citizens. The statutory definition of a “citizen of the United States”<sup>63</sup> has three mutually exclusive definitions: (i) an individual must be a citizen of the United States; (ii) a partnership must be comprised of partners who as individuals/entities are citizens of the United States;<sup>64</sup> or (iii) a corporation or association organized under the laws of the United States (or one of its territories), of which the president and at least two-thirds of the board of directors and other managing officers are U.S. citizens, which is under the actual control of U.S. citizens, and in which at least 75% of the voting interest is owned or controlled by U.S. citizens.<sup>65</sup> In all cases, even if mathematical tests are met, DOT will assess actual control (*i.e.*, a non-US citizen’s “ability to influence the actions of an air

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<sup>60</sup> See Notice, Notification Requirements Concerning Substantial Changes in Ownership and Operations, U.S. Dept. of Transportation, July 21, 1998. A “substantial change” in ownership is defined as “[t]he acquisition by a new shareholder or the accumulation by an existing shareholder of beneficial control of 10 percent or more of the outstanding voting stock in the corporation.” 14 C.F.R. § 204.2(l)(3) (2009).

<sup>61</sup> See DOT Order 2004-5-10, In the Matter of the Citizenship of DHL Airways, Inc. n/k/a ASTAR Air Cargo, Inc., Docket DOT-OST-2002-13089-0605, issued May 13, 2004, at 2-3 (case involving third-party complaints alleging that the post-acquisition carrier failed to comply with DOT’s citizenship requirements were filed during the informal fitness review process).

<sup>62</sup> In an extreme case, DOT could require the air carrier to discontinue operations until the fitness issues are resolved to its satisfaction.

<sup>63</sup> 49 U.S.C. § 40102(a)(15) (2009).

<sup>64</sup> In the case of a partnership, regardless of the number of total number of partners, DOT has historically viewed the inclusion of even one foreign partner (even a limited partner) as “tainting” the entire partnership thus rendering that entity as foreign for purposes of the citizenship analysis. See *e.g.*, DOT Order 99-8-12, Application of New Air Corporation (n/k/a Jet Blue Airways Corp.), Docket DOT-OST-1999-5616-0017, issued Aug. 20, 1999, at 3, n. 4.

<sup>65</sup> If an owner of a corporation or member of an LLC is an entity (as opposed to an individual), the same citizenship test is applied to each entity in the chain of ownership until the ultimate ownership interest is traced back to individuals. Thus, if any entity fails the citizenship test, all entities below it in the chain of ownership would also fail the citizenship test. See *e.g.*, DOT Order 2006-12-23, Application of Virgin America, Inc., DOT-OST-2005-23307-0725, issued Dec. 27, 2006, at 11.

carrier”) by examining the “totality of the circumstances.”<sup>66</sup> Some of the factors DOT will examine in determining actual control include, but are not limited to, a carrier’s “capital structure, management, and contractual relationships.”<sup>67</sup>

Nevertheless, in recognizing that “past interpretations of the citizenship requirement have imposed harmful burdens on U.S. carrier access to investment capital,” DOT has “informally liberaliz[ed]” its traditional approach to evaluating an air carrier’s citizenship in certain limited circumstances, such as when Hawaiian Airlines emerged from bankruptcy in 2005.<sup>68</sup> In what is often referred to in the aviation industry as the “Hawaiian” approach or structure, ownership interests in any foreign investment entity are “multiplied out” to reflect the total beneficial foreign ownership therein (rather than using DOT’s stricter, traditional analysis),<sup>69</sup> and the resulting U.S. ownership and control must meet the statutory test for corporations.<sup>70</sup> Provided that the interests of the foreign investors are genuinely

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<sup>66</sup> Actual Control of U.S. Air Carriers, NPRM, U.S. Dept. of Transportation, 70 Fed. Reg. 67389, 67390 (Nov. 7, 2005). In this rulemaking, DOT proposed to modify by regulation the standards it would apply in initial and continuing fitness cases to determine whether “actual control” by U.S. carriers exists. The proposal, which was eventually withdrawn after it drew fire from labor, Congress and some airlines, would have allowed foreign citizens to control all decisions other than those related to corporate governance, safety and security, and the Civil Reserve Air Fleet. See Actual Control of U.S. Air Carriers, Withdrawal of Certain Proposed Amendments, U.S. Dept. of Transportation, 71 Fed. Reg. 71106 (Dec. 8, 2006). See also Actual Control of U.S. Air Carriers, SNPRM, U.S. Dept. of Transportation, 71 Fed. Reg. 26425, 26427-26429 (May 5, 2006)(detailing opposition and concern about the proposal).

<sup>67</sup> 70 Fed. Reg. at 67390 (listing seven factors common to DOT’s decisions addressing actual control: “(1) [c]ontrol via supermajority or disproportionate voting rights; (2) negative control/power to veto; (3) buyout clauses; (4) equity ownership; (5) significant contracts; (6) credit agreements/debt; and (7) family relationships/business relationships”) (citing Letter from Kenneth M. Mead, Dept. of Transp. Inspector General, to Honorable Don Young, Chairman of the House Transportation and Infrastructure Committee (Mar. 4, 2003).

<sup>68</sup> 71 Fed. Reg. at 26428. See also DOT Order 2007-3-16, Application of Virgin America, Inc., Docket DOT-OST-2005-23307-15046, issued March 20, 2007 (wherein DOT stated that it “cannot ignore the ongoing evolution of new financial instruments or the realities of international finance; [and that] these matters should be accordingly considered when applying the law”(citing DOT Order 91-1-41, In the Matter of the Acquisition of Northwest Airlines by Wings Holdings, Inc., issued January 23, 1991 at 5.)

<sup>69</sup> See note 64, supra.

<sup>70</sup> See Letter from Karan K. Bhatia, Assistant Secretary for Aviation and Int’l Affairs, U.S. Dept. of Transportation, to Jonathan B. Hill (Mar. 7, 2005)(the “Hawaiian Letter”), at 2. When Hawaiian Airlines emerged from bankruptcy in 2005, its ownership structure included foreign investment entities that, under DOT’s traditional interpretation of its citizenship requirements, would have caused Hawaiian to fail the U.S. citizenship test.

and obviously passive,<sup>71</sup> and highly diffuse—with no single foreign investor holding more than a very small interest, a new U.S.-citizen LLC structured as a *de jure* corporation is then established and interposed between the air carrier and each foreign investment entity.<sup>72</sup> Under this so-called Hawaiian structure, the new LLC(s) will own and control the voting stock in the air carrier (or its parent). All the voting interest in the new LLC must be held by independent U.S. managers having a genuine financial interest, and any remaining interest held by the foreign investment entities must be non-voting.<sup>73</sup>

Although DOT is known to have used the Hawaiian approach in determining citizenship of other U.S. carriers, its application has rarely been discussed in public documents since the 2005 Hawaiian Letter. One docketed case in which DOT applied the Hawaiian test, however, was in Virgin America’s initial application for economic authority to operate as a U.S. air carrier. There, DOT initially determined Virgin America to be ineligible to use this “multiplying-out” approach,<sup>74</sup> but subsequently applied the Hawaiian standard and found that the new carrier was owned and controlled by U.S. citizens after substantial concessions were made to Virgin America’s ownership and management structure.<sup>75</sup>

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<sup>71</sup> See *id.*, at 1 (DOT has interpreted this to mean “that...none of the new investors demonstrates any incentive, or indicium of ability, to exercise actual control of the airline.” *Id.*). Accord DOT Order 2006-12-23, Application of Virgin America, Inc., DOT-OST-2005-23307-0725, issued Dec. 27, 2006, at 11.

<sup>72</sup> See Hawaiian Letter, at 2 (because DOT analyzes the citizenship of LLCs on a *de facto* basis based on their structure, it is “essential that the LLCs be structured like corporations...rather than partnerships, to avoid a single foreign participant tainting the LLC as a foreign “partner.” *Id.* (one example is a LLC’s ownership being denominated in stock. *Id.*). As long as the LLC would satisfy the citizenship requirements if it was structured as a corporation, DOT was willing to treat it as a U.S. citizen. See *id.*).

<sup>73</sup> See *id.* DOT has only accepted this approach if “the U.S. managers are in fact independent decision makers and are not obliged to follow the dictates of the offshore entities that they manage with respect to [the air carrier], whether because of fiduciary duty or any other reason.” *Id.* at 2.

<sup>74</sup> See DOT Order 2006-12-23, at 11 (“find[ing] that [because the] foreign interests [in Virgin America were] neither diffuse nor passive — due to the extensive involvement of, and financial interest held by, Sir Richard Branson and the Virgin Group,” DOT was required to examine the carrier’s citizenship using its traditional analysis. See *id.*)

<sup>75</sup> See Order 2007-3-16, at 51-53 (such measures included, but were not limited to, the complete walling-off certain foreign investors from having any interest whatsoever in Virgin America. See *id.*, at 52.). It should be noted, however, that Virgin America’s citizenship has again been called into question in a petition filed by Alaska Airlines requesting that DOT institute a public investigation into that carrier’s citizenship. See Petition of Alaska Airlines, Inc., Docket DOT-OST-2009-0037 (the matter remains pending as of this writing).

### III. Recent Alliance Decisions Reflect Current DOT/DOJ Policies

In May 2008, after the U.S.-EU open skies agreement became effective, DOT granted members of the SkyTeam alliance six-way antitrust immunity to coordinate schedules and prices, and to operate as though they were one carrier.<sup>76</sup> On July 10, 2009, the already-immunized Star ATI Alliance of United, Air Canada, Austrian, bmi, LOT, Lufthansa, Scandinavian, Swiss and TAP, received DOT-approved expansion to include Continental, and DOT also approved and granted ATI to a new joint venture among Continental, United, Lufthansa and Air Canada.<sup>77</sup> And, American and its foreign partners (British Airways, Finnair, Iberia, Royal Jordanian) are seeking immunity for a subset of carriers from the oneworld alliance.

#### A. DL/NW/SkyTeam

The 2008 SkyTeam II application for antitrust immunity involved a merger of two existing immunized alliances, each involving a U.S. carrier. As noted above, an earlier attempt by the applicants for ATI in SkyTeam I had failed because the applicants did not show that sufficient public benefits would result from the merger of the two immunized networks.<sup>78</sup> The networks of each alliance overlapped to a

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<sup>76</sup> See DOT Order 2008-5-32, Joint Application of Alitalia-Linee Aeree Italiane-S.p.A., et. al., Docket DOT-OST-2007-28644-0185, issued May 22, 2008 (this case, known as “SkyTeam II” resulted in Delta/Northwest, Air France, KLM, Alitalia, and Czech becoming members of the same immunized alliance and the merger of Delta and Northwest effectively combined two separate global ATI alliances). Continental remains a non-immunized member of SkyTeam until October 25, 2009, when it plans to transition to Star. A previous attempt to gain immunity for Delta, Northwest, Alitalia, Czech, KLM and Air France (“SkyTeam I”) had failed because the SkyTeam members did not “show that their alliance would provide sufficient public benefits to warrant an extraordinary grant of antitrust immunity.” Order 2006-2-1, Joint Application of Alitalia-Linee Aeree Italiane-S.p.A., et. al., Docket DOT-OST-2004-19214-0202, issued Feb. 6, 2006, at 3.

<sup>77</sup> DOT first granted United and Lufthansa ATI to coordinate pricing, scheduling and other activities as part of their Alliance Expansion Agreement, subject to conditions and carve outs for the Frankfurt-Chicago/Washington routes, the only routes then served by both airlines on a nonstop basis. See DOT Order 96-5-27, Joint Application of United Air Lines, Inc. and Deutsche Lufthansa A.G. d/b/a Lufthansa German Airlines, Docket DOT-OST-1996-1116-0026, issued May 21, 1996. The two carriers instituted revenue sharing in 2003, when they changed the name of the venture to the Atlantic Plus (“A+”) Alliance. United, Air Canada, Lufthansa and six other Star members (Austrian, BMI, LOT, SAS, Swiss and TAP) received global ATI in 2007. See Order 2007-2-16, Joint Application of the Austrian Group, et. al., Docket DOT-OST-2005-22922-0055, issued Feb. 13, 2007. See also DOT Order 97-9-21, Joint Application of United Airlines, Inc. and Air Canada, DOT-OST-1996-1434-0033, issued Sep. 19, 1997)(grant of ATI to United and Air Canada).

<sup>78</sup> See note 74, *infra*. SkyTeam I was the first attempted merger of two immunized alliances. In SkyTeam II, DOT found that “each alliance had developed separate and mutually exclusive benefit sharing arrangements that were not reconciled in the [SkyTeam I] application.” Order 2008-4-17, at 2.

large extent.<sup>79</sup> In contrast to the SkyTeam I approach, the SkyTeam II application featured a joint venture between Delta, Northwest, Air France and KLM that, when implemented, would bring all transatlantic services they offer under control of the joint venture.<sup>80</sup> The venture attempted to align economic interests of the participants in a way that creates “metal neutrality,” which means that rather than competing among themselves for a greater share of revenue by trying to carry passengers on their own aircraft, the participants agree to pool revenues and costs so that they are indifferent about which participant operates the service.<sup>81</sup>

DOT’s decision to grant ATI to Delta/Northwest/SkyTeam, which was completed after the two U.S. SkyTeam members announced plans to merge into the world’s largest airline, hinged largely on the existence of the four-way, merger-like joint venture that DOT concluded, when it is fully implemented, will likely produce operating efficiencies and cost reductions on a larger scale than the previous SkyTeam arrangements and “likely result in the introduction of new capacity and greater availability of discount fares.”<sup>82</sup>

Because the joint applicants had limited the scope of their immunized activities to transatlantic routes and sought only transatlantic ATI, DOT’s award of immunity was limited to transatlantic routes under their agreements.<sup>83</sup> Additionally, because the SkyTeam carriers were not ready to implement their four-way joint venture immediately, DOT continued to impose carve outs in the Atlanta-Paris CDG and Cincinnati-Paris CDG markets pending full implementation of the joint venture.<sup>84</sup> These carve outs had previously been imposed in the Delta/Air France/Alitalia/Czech/Korean alliance, but not the Northwest/KLM alliance.<sup>85</sup> No

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<sup>79</sup> In the show cause order, DOT estimated, based on the evidence presented, that approximately 85% of bookings on the Northwest/KLM network involved travel to cities served by the Delta/Air France/Alitalia/Czech network, and approximately 82% of bookings on the Delta/Air France/Alitalia/Czech network involved travel to cities served by Northwest and KLM. See Order 2008-4-17, at 14.

<sup>80</sup> See id.

<sup>81</sup> See DOT Order 2008-5-32.

<sup>82</sup> DOT Order 2008-4-17, at 15.

<sup>83</sup> See id., at 1.

<sup>84</sup> See id., at 10. As DOT explained there, “In several past cases involving nonstop overlaps [among alliance partners], we have only been willing to approve the agreements provided that the parties avoid coordinating the sale of tickets to time-sensitive travelers in the nonstop markets who might not otherwise have viable connecting options. These so-called “carve outs” preclude the alliance partners from coordinating fares for unrestricted coach, business, and first class traffic for the U.S.–point of sale. The carve-out conditions do not affect nonstop overlaps that may occur subsequent to the transaction.” Id. at 9.

<sup>85</sup> See id. at 10.

carve outs were imposed in the nonstop overlaps that were newly created by the SkyTeam II transaction (Atlanta-Amsterdam, Detroit-Paris CDG, and New York JFK-Amsterdam) or that could have been imposed in the interest of consistency in light of original Northwest/KLM nonstop overlaps (Detroit-Amsterdam and Minneapolis-Amsterdam).<sup>86</sup>

In view of the current “size and complexity” of the SkyTeam alliance and its anticipated “increasingly complex cooperation in the future, DOT imposed new annual reporting requirements on the SkyTeam members.<sup>87</sup> While the additional benefits of each incremental network expansion to an alliance may decrease as existing networks expand to cover more points,<sup>88</sup> the numbers of new points connected are significant, and competing alliances need approximately the same scope to compete effectively.

## **B. Continental/United/Star**

The existing Star Alliance includes more than 20 U.S. and foreign airlines, with a subset of nine members (the “Star ATI Alliance”) that have DOT authority to coordinate on an immunized basis. Two of the Star ATI members, United and Lufthansa, have another alliance agreement (the “Atlantic Plus” or “A+” agreement) that provides for a greater level of integration than found in the arrangements between the Star ATI members at large, for which DOT has also granted global antitrust immunity. The recent joint application of Continental and the existing Star ATI carriers sought Continental’s inclusion as a member of the Star ATI Alliance agreement on a global basis, as well as ATI for an integrated joint venture within the broader alliance among Continental, United, Air Canada and Lufthansa expanding on the immunized A+ Alliance (the “A++ Alliance”), providing for those four carriers to engage in joint pricing, sales and marketing, and revenue sharing on transatlantic routes. The A++ Alliance is based on the same “metal neutrality” present in the SkyTeam II case, and DOT looks with favor on such deep alliances.<sup>89</sup>

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<sup>86</sup> Id. at 10.

<sup>87</sup> See DOT Order 2009-5-11, Joint Application of Alitalia-Linee Aeree Italiane-S.p.A., et. al., Docket DOT-2007-28644-0193, issued May 19, 2009, at 2-3.

<sup>88</sup> See, e.g., Comments of Hubert Horan, Expanded Star Application, Docket DOT-OST-2008-0234-0245, filed July 3, 2009 at 5.

<sup>89</sup> See e.g., DOT Order 2008-4-17, at 14.



DOT has previously said that any proposal to link two major U.S. carriers under a single grant of ATI raises novel issues,<sup>90</sup> although the award of antitrust immunity in SkyTeam II, involving Delta and Northwest, set the precedent for doing so.<sup>91</sup>

DOT's Show-Cause Order tentatively granting ATI found that an expanded immunized Star ATI Alliance including Continental would have "substantial public benefits" including:

(1) an expanded network, serving many new cities; (2) new online service, which includes the likelihood of new routes and expanded capacity on existing routes; (3) enhanced service options, such as more routings, reduced travel times, expanded nonstop service in select markets new fare products, and integrated corporate contracting and travel incentives; (4) enhanced competition due to the addition of a major new gateway, Newark, as well as the elimination of multiple mark-ups on code-share segments and more vigorous competition between the alliances; (5) cost efficiencies; and (6) a strengthened financial position for the carriers.<sup>92</sup>

DOT determined that these benefits will be achieved without a substantial reduction in competition because the Joint Applicants' networks are complementary, rather than overlapping, and the addition of Continental's market share to that of the existing Star ATI Alliance carriers would not "materially alter the current competitive landscape or increase overall market share to any significant degree."<sup>93</sup>

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<sup>90</sup> DOT Order 2005-6-1, Joint Application of Alitalia-Linee Aeree Italiane-S.p.A., et. al., Docket DOT-2004-19214-0086, issued June 1, 2005, at 2 (citing Order 2004-11-15, Joint Application of Alitalia-Linee Aeree Italiane-S.p.A., et. al., Docket DOT-2004-19214-0023, issued Nov. 18, 2004, at 4.).

<sup>91</sup> See DOT Order 2008-5-32.

<sup>92</sup> DOT Order 2009-4-5, at 18-19.

<sup>93</sup> Id. at 7-8. Continental itself accounts for only 2.7% of available seats. OAG Worldwide (Mar. 2009). There is less overlap and more network expansion in CO/Star than in DL/NW/SkyTeam. Continental and United have no nonstop overlap on international routes, and there is little global overlap among Continental and the other immunized Star carriers. Continental's international service is concentrated at its New York/Newark and Houston hubs, while United's international service is concentrated at Chicago, Los Angeles, San Francisco and Washington, D.C. United's international gateways serve primarily the west coast, Midwest and mid-Atlantic regions, while Continental's U.S. gateways serve the northeastern and southwestern regions.

In this case, DOT found the record substantially complete on November 12, 2008,<sup>94</sup> which is considered the date the matter is submitted for purposes of calculating the six-month statutory deadline for final DOT action.<sup>95</sup> Thus, the statutory deadline for DOT's final decision in the case was May 31, 2009. That date passed without a final decision, however, and almost one month later (and three months after DOT tentatively approved the application in the show-cause order), DOJ submitted formal comments on the application.<sup>96</sup>

Recognizing the last two decades of DOT decisions granting antitrust immunity to the largest airlines in the world but apparently ignoring the fact that SkyTeam II immunity had been granted after the U.S.-EU agreement became effective, DOJ suggested that the door on antitrust immunity should be shut once the homelands of foreign alliance members sign such an open skies agreement.<sup>97</sup> Contrary to DOT's analysis and conclusions in the show-cause order, DOJ contended that DOT should deny global antitrust immunity to Continental's Star activities, impose carve-outs for certain transatlantic and transborder routes and continue existing United/Lufthansa carve-outs. The Joint Applicants vigorously objected to DOJ's contentions, urging DOT to finalize its show-cause order "with all deliberate speed."<sup>98</sup> American, also commented, raising "serious concerns about DOJ's request that the Department depart from the precedent set in the SkyTeam II docket" by "asking [DOT] to retreat from its alliance policy."<sup>99</sup>

On July 10, 2009, DOT made final its tentative findings in the show-cause order and approved the alliance agreements adding Continental to the existing Star ATI Alliance involving Air Canada, Austrian, bmi, LOT, Lufthansa, SAS, Swiss, TAP, and United and, within that broader alliance, approved the integrated A++ joint venture agreement involving Air Canada, Continental, Lufthansa and United. The approval added the same reporting requirements recently applied to the SkyTeam alliance, required implementation of the A++ joint venture within 18 months and imposed some (but not all) of the carve outs that had been sought by

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<sup>94</sup> See DOT Order 2008-11-8.

<sup>95</sup> See 49 U.S.C. § 41710.

<sup>96</sup> See DOT Notice Establishing a Supplemental Comment Period, Expanded Star Application, Docket DOT-OST-2009-0234-0241, issued June 26, 2009.

<sup>97</sup> See DOJ Comments at 2.

<sup>98</sup> Response of the Joint Applicants to Comments of DOJ, Expanded Star Application, Docket DOT-OST-2008-0234-0247, filed July 6, 2009, at 52.

<sup>99</sup> Response of American to Comments of DOJ, Expanded Star Application, Docket OST-2008-0234-0248, filed July 6, 2009, at 1.

DOJ,<sup>100</sup> although those carve outs automatically terminate within nine months of new entry on carved-out routes.<sup>101</sup> DOT rejected DOJ's suggestion that because the U.S. now has an open skies agreement with the EU, U.S. foreign policy goals are no longer served by granting the Continental/Star application as well as DOT's contention that the Joint Applicants would proceed without immunity.<sup>102</sup> DOT also refused to restrict the global grant of immunity, as requested by DOJ. Instead, DOT found "that granting immunity beyond transatlantic markets will enhance the ability of immunized Star carriers to cooperate globally outside of the joint venture and will assist the Joint Applicants in their efforts to formulate joint ventures in other regions of their combined networks, thereby promoting greater service benefits to consumers."<sup>103</sup> DOT also found it inappropriate to address the United ALPA Master Executive Council's suggestion of requiring a revenue-sharing formula under which the revenue taken by any U.S. carrier closely correlate to that carrier's share of the pooled capacity, since other parties had not had a chance to address it.<sup>104</sup>

### C. oneworld

Less than one month after the Continental/Star application was submitted, American, British Airways, Finnair, Iberia, and Royal Jordanian filed their own application seeking antitrust immunity for their oneworld alliance.<sup>105</sup> When American and British Airways unsuccessfully sought ATI in 2002,<sup>106</sup> there was little hope of a U.S.-EU open skies agreement, and the two applicants held the vast majority of the valuable slots and operations between London's Heathrow Airport and the U.S. With the U.S.-EU open skies agreement now in place that provides for new entry at Heathrow and other European airports, and immunity having been granted to the other two leading global alliances (SkyTeam and Star), the oneworld carriers optimistically predicted favorable action on their ATI application by Halloween 2009, despite requests for additional documents and persistent

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<sup>100</sup> DOT did not adopt carve-outs in the New York-Zurich or New York-Halifax markets that were sought by DOJ. See Order 2009-7-10, at 18-21.

<sup>101</sup> See id. (the new service must also be nonstop and consist of at least five weekly roundtrips).

<sup>102</sup> See id., at 1-4.

<sup>103</sup> Id., at 22.

<sup>104</sup> Id., at 25.

<sup>105</sup> Docket DOT-OST-2008-0252, Joint Application of American Airlines, Inc., et. al., Docket DOT-OST-2008-252-001, filed Aug. 15, 2008. American currently has separate ATI with Finnair. See DOT Order 2002-7-39, Joint Application of American Airlines, Inc. and Finnair OYJ, Docket DOT-OST-2002-12063-0008, issued July 30, 2002.

<sup>106</sup> See DOT Order 2002-4-4, U.S.-U.K.-Alliance Case, DOT-OST-2001-11029-0125, issued Apr. 4, 2002.

opposition from British Airways' rival Virgin Atlantic, claiming *inter alia* that approval would give American and its British oneworld partner a "stranglehold on London Heathrow-U.S. services."<sup>107</sup> That prediction came before the Obama Administration's emphasis on antitrust enforcement and DOJ's public position in the Continental/Star proceeding, which could have implications for the pending oneworld application as well, as American's July 6 response to DOJ's Comments in the Continental/Star case suggests.<sup>108</sup>

#### IV. Will Transnational Mergers Involving U.S. Airlines Be Permitted?

The ultimate question is whether transnational mergers involving U.S. airlines will be permitted, and if so, when. The European Community, its airlines, and the financial markets clamor for transnational mergers. The EU desire for further liberalization was seen in UK Transport Minister Geoff Hoon's talk before the International Aviation Club in Washington, D.C., and the need for cross-border investment was one of the topics discussed during a third round of negotiations on a second state agreement as provided under Article 21 of the U.S.-EU open skies agreement in late June.<sup>109</sup>

Around the world, India permits 49% foreign ownership of its scheduled airlines (and 74% of its non-scheduled airlines)<sup>110</sup> and Australia permits 49% foreign investment in its airlines.<sup>111</sup> The recently-concluded Canada-EU open skies agreement permits nationals of each party to own up to 49% of the voting equity of

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<sup>107</sup> Answer of Virgin Atlantic, Joint Application of American Airlines, Inc., et. al., Docket DOT-OST-2008-0252-3289, filed May 18, 2009, at 63.

<sup>108</sup> See note 99, supra.

<sup>109</sup> Press Release, The United States Mission to the European Union, U.S., EU Hold Third Round of Air Transport Talks (June 26, 2009) *available at* [http://useu.usmission.gov/Dossiers/Transportation/June2609\\_Air\\_Transport\\_Statement.asp](http://useu.usmission.gov/Dossiers/Transportation/June2609_Air_Transport_Statement.asp).

<sup>110</sup> 2002 Investment Climate – India, U.S. Department of State Bureau of Economic, Energy and Business Affairs *available at* <http://www.state.gov/e/eeb/rls/othr/ics/2009/117442.htm>. Foreign-direct investments ("FDI") is limited to 49% under the automatic route for air transport services including domestic scheduled passenger airlines. For non-scheduled/chartered/cargo airlines, the FDI limit is 74%. Helicopter services are allowed 100% FDI on automatic approval basis. Foreign airlines are allowed to own the equity of companies operating helicopter services/cargo services, however, they may not make either a direct or indirect investment in an Indian domestic airline. See id.

<sup>111</sup> See U.S.-Australia Memorandum of Consultations & Open Skies Agreement, signed Feb. 14, 2008, *available at* <http://www.state.gov/documents/organization/114817.pdf>. For Australian international airlines other than Qantas, foreign ownership levels are set out in Section 11A of the Air Navigation Act of 1920, which indicates, subject to government approval, that foreign persons can have relevant interests (as defined in Section 608 of the Corporations Act 2001) in shares in an Australian international airlines that represent in total no more than 49% of the total value of the issued share capital of that airlines. See id.

the other party's airlines as soon as national laws so permit, and the Canadian government has already introduced a proposal increasing permissible foreign ownership of Canada's airlines from 25% to 49%, while maintaining its requirement that Canadian citizens have actual control.<sup>112</sup> Brazil's Civil Aviation Council recently approved legislative language lifting the cap on foreign ownership of voting shares in Brazilian airlines from 20% to 49%.<sup>113</sup>

In the U.S., however, various forces remain opposed to relaxation of the foreign investment limits. For example, U.S. labor remains opposed to transnational mergers for fear of lost jobs and less favorable working conditions. These concerns are reflected in a May 15, 2009 letter from the United pilots to DOT and DOJ, urging protection of American jobs and delay of any action until ALPA has a chance "to addresses all issues concerning American workers and American jobs."<sup>114</sup>

Transnational mergers also raise national defense considerations, in an era of heightened national security concerns. The U.S. airline Civil Reserve Air Fleet ("CRAF") supports Department of Defense ("DOD") airlift requirements in emergencies when needs cannot be met with the military aircraft fleet. Under CRAF, commercial airlines contractually pledge that certain aircraft will be ready for activation when needed by the U.S. government. Allowing increased foreign investment or transnational mergers raises questions about foreign ability to control or terminate CRAF commitments, thereby undermining the program. Many of these concerns, including those raised by DOD, surfaced in DOT's ill-fated rulemaking to relax the statutory "actual control" standard.<sup>115</sup>

Any significant change requires Congressional action, and the rise of protectionist sentiments in Congress, as seen by the Oberstar bill, make it unlikely that we will see liberalization of foreign ownership and control limits anytime soon.

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<sup>112</sup> See Canada-EU Open Skies Agreement, signed May 6, 2009, Art. 4; and Annex 2; see also Matthew Saltmach, *Europe and Canada Reach 'Open Skies' Pact on Air Travel*, available at [http://www.nytimes.com/2009/05/07/business/global/07skies.html?\\_r=1&scp=1&sq=Canada-EU%20Open%20Skies%20Agreement&st=cse..](http://www.nytimes.com/2009/05/07/business/global/07skies.html?_r=1&scp=1&sq=Canada-EU%20Open%20Skies%20Agreement&st=cse..)

<sup>113</sup> See *Brazil moves to raise foreign investment cap*, ATW Daily News (July 17, 2009), available at <http://atwonline.com/news/story.html?storyID=17210>.

<sup>114</sup> See Letter from United Airlines Master Executive Council to Hon. Eric Holder and Hon. Ray LaHood (May 15, 2009), at 2.

<sup>115</sup> See 71 Fed. Reg. at 26434.

## EXHIBIT A

**To direct the Comptroller General to conduct a study of the legal requirements and policies followed by the Department of Transportation in deciding whether to approve international... (Introduced in House)**

HR 831 IH

111th CONGRESS  
1st Session  
**H. R. 831**

To direct the Comptroller General to conduct a study of the legal requirements and policies followed by the Department of Transportation in deciding whether to approve international alliances between air carriers and foreign air carriers and grant exemptions from the antitrust laws in connection with such international alliances, and for other purposes.

### IN THE HOUSE OF REPRESENTATIVES

#### I. February 3, 2009

Mr. OBERSTAR introduced the following bill; which was referred to the Committee on Transportation and Infrastructure, and in addition to the Committee on the Judiciary, for a period to be subsequently determined by the Speaker, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned

#### A BILL

To direct the Comptroller General to conduct a study of the legal requirements and policies followed by the Department of Transportation in deciding whether to approve international alliances between air carriers and foreign air carriers and grant exemptions from the antitrust laws in connection with such international alliances, and for other purposes.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

#### II. SECTION 1. ANTITRUST EXEMPTIONS.

(a) Study- The Comptroller General shall conduct a study of the legal requirements and policies followed by the Department in deciding whether to approve international alliances under section 41309 of title 49, United States Code, and grant exemptions from the antitrust laws under section 41308 of such title in connection with such international alliances.

(b) Issues To Be Considered- In conducting the study under subsection (a), the Comptroller General, at a minimum, shall examine the following:

(1) Whether granting exemptions from the antitrust laws in connection with international alliances has resulted in public benefits, including an analysis of

whether such benefits could have been achieved by international alliances not receiving exemptions from the antitrust laws.

(2) Whether granting exemptions from the antitrust laws in connection with international alliances has resulted in reduced competition, increased prices in markets, or other adverse effects.

(3) Whether international alliances that have been granted exemptions from the antitrust laws have implemented pricing or other practices with respect to the hub airports at which the alliances operate that have resulted in increased costs for consumers or foreclosed competition by rival (nonalliance) air carriers at such airports.

(4) Whether increased network size resulting from additional international alliance members will adversely affect competition between international alliances.

(5) The areas in which immunized international alliances compete and whether there is sufficient competition among immunized international alliances to ensure that consumers will receive benefits of at least the same magnitude as those that consumers would receive if there were no immunized international alliances.

(6) The minimum number of international alliances that is necessary to ensure robust competition and benefits to consumers on major international routes.

(7) Whether the different regulatory and antitrust responsibilities of the Secretary and the Attorney General with respect to international alliances have created any significant conflicting agency recommendations, such as the conditions imposed in granting exemptions from the antitrust laws.

(8) Whether, from an antitrust standpoint, requests for exemptions from the antitrust laws in connection with international alliances should be treated as mergers, and therefore be exclusively subject to a traditional merger analysis by the Attorney General and be subject to advance notification requirements and a confidential review process similar to those required under section 7A of the Clayton Act (15 U.S.C. 18a).

(9) Whether the Secretary should amend, modify, or revoke any exemption from the antitrust laws granted by the Secretary in connection with an international alliance.

(c) Report- Not later than one year after the date of enactment of this Act, the Comptroller General shall submit to the Secretary of Transportation, the Committee on Transportation and Infrastructure of the House of Representatives, and the Committee on Commerce, Science, and Transportation of the Senate a report on the results of the study under subsection (a), including any recommendations of the Comptroller General as to whether there should be changes in the authority of the Secretary under title 49, United States Code, or policy changes that the Secretary can implement administratively, with respect to approving international alliances and granting exemptions from the antitrust laws in connection with such international alliances.

(d) Adoption of Recommended Policy Changes- Not later than one year after the date of receipt of the report under subsection (c), and after providing notice and an opportunity for public comment, the Secretary shall issue a written determination as to whether the Secretary will adopt the policy changes, if any, recommended by the Comptroller General

in the report or make any other policy changes with respect to approving international alliances and granting exemptions from the antitrust laws in connection with such international alliances.

(e) Sunset Provision-

(1) IN GENERAL- An exemption from the antitrust laws granted by the Secretary on or before the last day of the 3-year period beginning on the date of enactment of this Act in connection with an international alliance, including an exemption granted before the date of enactment of this Act, shall cease to be effective after such last day unless the exemption is renewed by the Secretary.

(2) TIMING FOR RENEWALS- The Secretary may not renew an exemption under paragraph (1) before the date on which the Secretary issues a written determination under subsection (d).

(3) STANDARDS FOR RENEWALS- The Secretary shall make a decision on whether to renew an exemption under paragraph (1) based on the policies of the Department in effect after the Secretary issues a written determination under subsection (d).

(f) Definitions- In this section, the following definitions apply:

(1) EXEMPTION FROM THE ANTITRUST LAWS- The term 'exemption from the antitrust laws' means an exemption from the antitrust laws granted by the Secretary under section 41308 of title 49, United States Code.

(2) IMMUNIZED INTERNATIONAL ALLIANCE- The term 'immunized international alliance' means an international alliance for which the Secretary has granted an exemption from the antitrust laws.

(3) INTERNATIONAL ALLIANCE- The term 'international alliance' means a cooperative agreement between an air carrier and a foreign air carrier to provide foreign air transportation subject to approval or disapproval by the Secretary under section 41309 of title 49, United States Code.

(4) DEPARTMENT- The term 'Department' means the Department of Transportation.

(5) SECRETARY- The term 'Secretary' means the Secretary of Transportation.