Collusive Alliances and Intercontinental Competition

Hubert Horan
Airneth/European Aviation Club
Den Haag 8 December 2011
Brussels 9 December 2011

My perspective on consolidation

Consolidation via Alliance Antitrust Immunity

- Developed original NW/KL alliance network
- Also managed from European (SR/SN) side
- Shut down multiple unprofitable alliances

Consolidation via Merger

- Direct experience with economic plans, results
- Direct experience with true Cross-Border mergers

Active involvement with current consolidation

- Congressional and DOT testimony
- recent Transportation Law Journal article

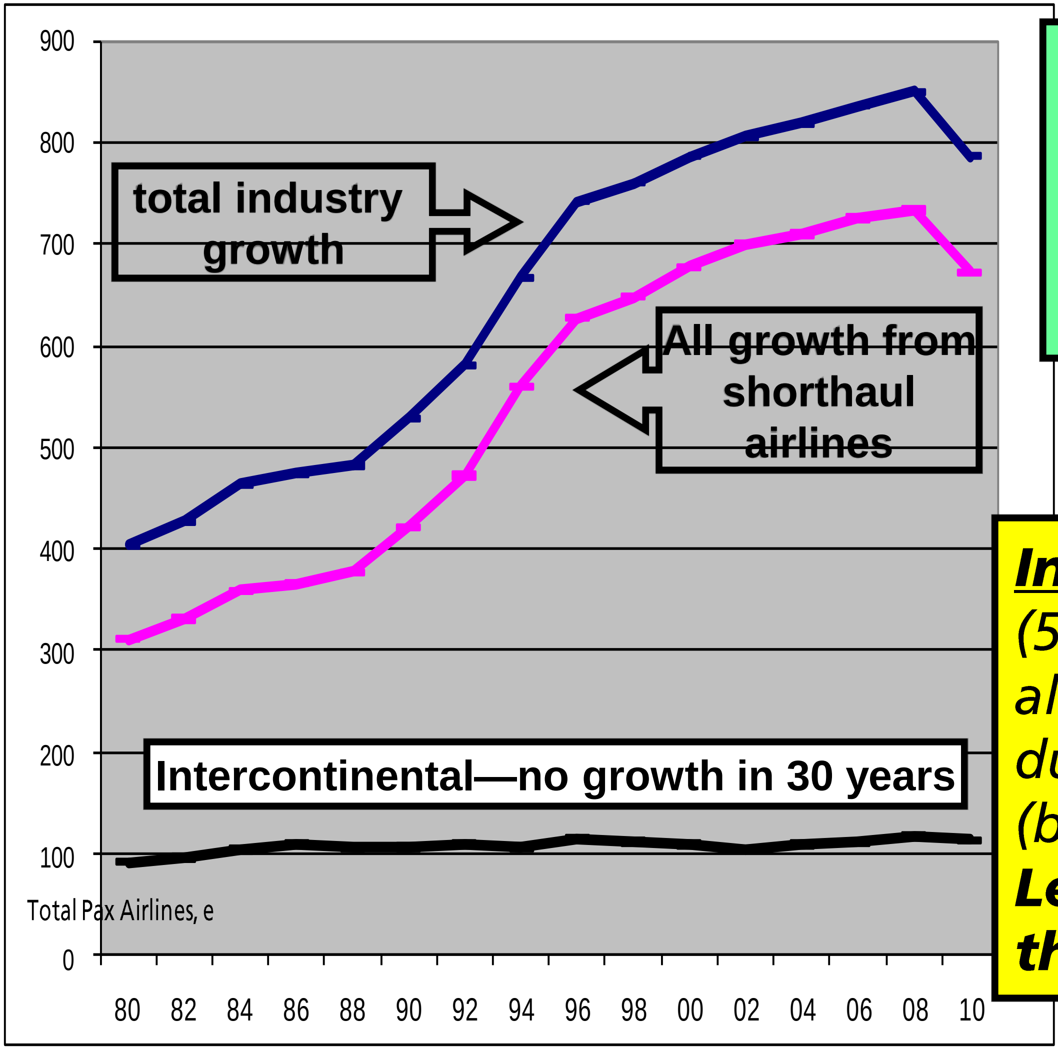
Counter-revolution against liberal international airline competition

- **Intercontinental consolidation since 2003—biggest structural shift in industry history---was wholly anti-competitive**
  - Totally dissimilar to pro-consumer ATI of mid 90s
  - Unlike shorthaul/regional markets, Intercontinental sector always competitively deficient
  - Billions in anti-competitive pricing power created
  - Synergy claims false; Regulatory justification fraudulent
- **End of liberal, market-based competition means industry efficiency will likely decline**
  - Legal protections gone; Cartelization spreading globally
  - Growing threat of cross-border regulatory arbitrage

Issue is role of alliances in consolidation, (not alliances per se)

Alliances	***Collusive Alliances*** (with antitrust immunity—same competitive impact as merger)	*Not "Branded" Alliances (no one objects to Star Alliance frequent flyer reciprocity, lounge sharing)*
And Global	***Intercontinental*** *(longhaul)**markets***— 55% of global revenue—exclusive focus of consolidation movement	*Not regional/ shorthaul markets*— 45% of global revenue—no calls for consolidation
Competition	***Alliances driving high concentration and Cartelization*** industry structure impact	*Not original 1990s alliance interline codesharing links*

"Industry Consolidation" Movement: we need fewer Intercontinental airlines



Regional/shorthaul sector
(45% of global revenue)
All industry growth—
intensely competitive ***but no calls for consolidation***

Intercontinental sector
(55% of global revenue)
always competitively deficient due to huge entry barriers (both political, economic)
Lets merge everyone into just three global competitors!

IC consolidation strictly North Atlantic; First (mid 90s) phase was pro-consumer

Original mid-90s ATI did create Consumer Benefits

- Thousands of markets got online service, discount fares for the first time

original alliance benefits KL-NW (92) and SR-DL (95): fully exhausted by 1999

- Alliance connections totally displaced traditional interline connections
- Consumer benefits only on North Atlantic markets; not pursued elsewhere

Original Collusive Alliances—still robust competition

	1991	1993	1995	1997	1999	2001
Concentration-total North Atlantic market (55 million annual pax)						
top 3 share	35%	42%	42%	45%	47%	47%
number of US-EU competitors with minimum departure share of 2%						
	15	15	13	13	11	11

Post 2003 phase: no consumer benefits; permanent Cartel created

Two separate "consolidation" processes

Total North Atlantic	1991		2001		2012
Concentration-top 3	51%	mostly market forces	47%	Totally Artificial Consolidation	98%
# Competitors (>2%)	15		11		3

- All market exits since 93 totally artificial—big carriers petitioned government to reduce competition

26 competitors merged into a permanent Cartel

Delta	Air France	SAS
Northwest	KLM	Alitalia
United	Lufthansa	Swiss
Continental	British Air	LOT
USAirways	Iberia	TAP
American	Brussels	CSA
TWA	Air Canada	Turkish
Finnair	Aer Lingus	BMI
Austrian	Virgin	

the North Atlantic Cartel

LH-led Collusive Alliance

AF-led Collusive Alliance

BA-led Collusive Alliance

assumes last 3 airlines (US,VS,EI) unable to survive as small indepedents and join Cartel groups after approval of BA/AA

Post-2003 Cartelization: biggest shift in industry history, with more to come

Pacific:
Sham US-Japan "Open Skies"

- **Unlike original 90s "Open Skies" designed to massively reduce competition, facilitate subsidies, slot rules and other distortions**

Delta	Air France
Northwest	KLM
United	Lufthansa
Continental	British Air
USAirways	Iberia
American	Brussels
TWA	Air Canada
Finnair	Aer Lingus
Austrian	Virgin
SAS	TAP
Alitalia	CSA
Swiss	Turkish
LOT	BMI

26 trans-Atlantic carriers

LH-led Collusive Alliance

AF-led Collusive Alliance

BA-led Collusive Alliance

26 trans-Pacific carriers

Delta	Singapore
Northwest	Thai
United	Malaysian
Continental	JAL
American	ANA
Hawaiian	Korean
Cathay Pac	Asiana
Air China	China
China East	EVA
China South	Qantas
Hainan	Air NZ
Air Canada	V Australia
Philippines	Air Pacific

worldwide:
artificial market power is key

- **Cartel using its control of longhaul access to the huge EU/US markets**

Intercon: conditions to let the market decide "how many airlines" don't exist

LIBERAL COMPETITIVE CONDITIONS CAREFULLY ENGINEERED IN MOST DOMESTIC/SHORTHAUL MARKETS	BUT TRULY LIBERAL CONDITIONS NEVER ESTABLISHED IN INTERCONTINENTAL MARKETS
Pricing/market entry freedom	Pricing/market entry freedom
Access to capital markets	Access to capital markets
No artificial competitive barriers	~~No artificial competitive barriers~~
Transparent financial reporting	~~Transparent financial reporting~~
Open corporate control market	~~Open corporate control market~~
Strong antitrust rules, enforcement	~~Strong antitrust rules, enforcement~~
Efficient bankruptcy process ?	~~Efficient bankruptcy process~~
No political barriers to exit— no carriers "Too Big To Fail"	~~No political barriers to exit— no carriers "Too Big To Fail"~~
Objective: Maximum consumer/efficiency gains economy-wide (not interests of specific companies/employees)	~~Objective: Maximum consumer/efficiency gains economy-wide (not interests of specific companies/employees)~~

Consumers, investors decide "how many airlines"

Governments, entrenched incumbents decide "how many airlines"

Claims of big "scope/scale synergies" from consolidation are false

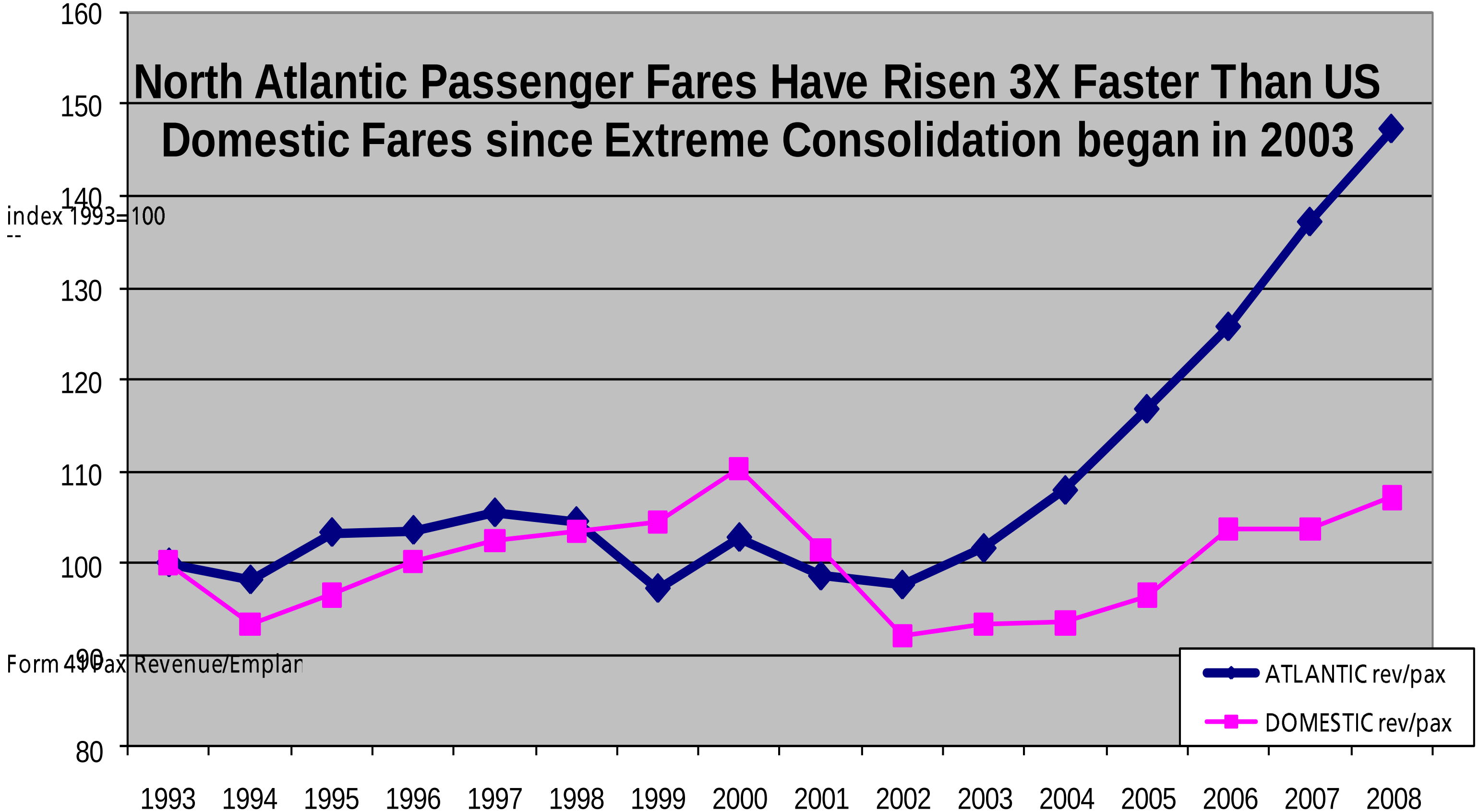
Hub City Synergy *but all 20 years ago*	
82—CO/TI	✖
86—TW/OZ	✓
86—NW/RC	✓
87—BA/BR	✓
89—AF/UT/IT	✓

Also some successes in bankruptcy cases (HP/US, LH/LX)

"Scope+Scale Synergy" Mergers *All failed—few synergies, huge costs*			
79—PA/NA	✖	88—CO/EA	✖
85—PE/FL	✖	88—US/PI	✖
86—AA/OC	✖	98—SR/SN	✖
87—DL/WA	✖	98—KL/AZ	✖
87—CO/PE	✖	00—AA/TW	✖
87—US/PS	✖	00—UA/US	✖

Recent mergers (KL-AF, DL-NW, UA-CO) claiming huge efficiencies not found in <u>any</u> previous merger
--and provided no evidence to support merger claims

Post-2003 Consolidation has created huge anti-competitive market power



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Biggest shift in industry history in less than 10 years----three key drivers

#1-EU shift from liberal to "managed" competition purely anti-competitive 2003 KL/AF merger

- **Brussels proactively driving consolidation**
- **Rig markets to favor "National Champions" (LH/AF), weaken LCCs; subsidies for weak (AZ, OS, OA, LX)**
  - totally different merger rules for AF, FR
  - US Open Skies delayed 5 years—wanted more mergers
- **KL/AF: no synergies/consumer benefits; ends EU longhaul competition, establishes Cartel; forces USA consolidation**

#2—staged sequence of follow-on ATI/mergers; DOT willingness to disobey law, use fraudulent evidence

#3—huge "Consolidation is Inevitable" PR campaign

All ATI Consumer Benefits findings based on willful DOT regulatory fraud

"Double Marginalization"—ATI automatically reduces fares 15-25%
--sole basis of $90 million annual Oneworld consumer benefits claim

- **Falsely claims that physical barriers force interline carriers to always set fares $200-300 higher than online/ATI connecting fares**
- **Falsely claims that ATI always and automatically cut connecting fares $200-300 regardless of market/competitive conditions**
  - "Double Marginalization" violates laws of supply and demand
- **False "rule" that reducing competition <u>always</u> reduces prices designed to nullify both the law and rules of evidence**
  - Every ATI application automatically justified; no need for case-specific evidence
- **False claims fabricated by one UAL consultant in one paper; DOT claims "rule" justified by multiple, independent researchers**
  - based on regression of 1990s data that is totally unrelated to the pricing claim
- **No evidence of <u>any</u> pricing benefits from any ATI grant since 90s**
  - No actual consumer pricing evidence submitted in any recent ATI case
  - DOT uses fraudulent "rule" as basis for rejecting evidence of higher prices

All recent Star/Skyteam/Oneworld ATI depended on DOT's disregard for the law

- **DOT disobeyed Clayton Act requirement for market power test**
  - No ATI decision had any of the pricing data, entry barrier or market contestability evidence needed to show ATI would not create market power
- **DOT disobeyed legal requirement that ATI cannot be granted without proof of "public benefits"**
  - Private benefits to applicant (i.e. consolidation benefits Star Alliance) used by DOT as demonstration of "public benefits"
  - DOT accepted "improved frequent flyer program" claims as proof of "public benefits" even though frequent flyer benefits <u>decreased</u>
  - DOT public benefits "findings" not based on any objective data or analysis; just "copy/pasted" applicants unsubstantiated claims
- **Newest DOT regulatory fraud—"metal neutrality" designed to extend collusion to large overlapping nonstop O&Ds**
  - Previous ATI cases had carve-outs, given pricing risks in LHR-ORD type markets
  - DOT established new "rule" based on false claim that "metal neutral" alliances cannot function if any routes excluded
  - Rule based on paper by same consultant who fabricated "Double Marginalization"

“Industry Consolidation movement”-- successful misinformation/PR campaign

Inevitable trend towards industry consolidation	Industry growing for decades “Trend” just biggest Atlantic carriers
Industry consolidation driven by market forces	All from government actions; Capital markets not interested
Consolidation OK—lots of competition remains	shorthaul competitive; Intercon always stagnant/getting and worse
Consolidation justified by big scale/scope synergies	No previous merger found synergies; United isn’t too small to compete
ATI always drives lower consumer fares	No verifiable evidence of any consumer benefits since 1999
Alliances create FF and other consumer benefits	Branded alliance benefits falsely attributed to Collusive Alliances

There has been no independent (regulatory, media, academic) scrutiny of these “Industry Consolidation” claims

Counter-revolution against liberal international airline competition

	90s: Global Liberalization	Today: Intercon Cartelization
Who determines number of competitors?	Consumers, investors in the open marketplace	Governments, entrenched incumbents via private "backroom" discussions
Capital flows, efficiency gains	From less-efficient to more-efficient	More-efficient at mercy of less-efficient (but Too Big To Fail)
Legal/regulatory objective	consumer welfare, long-term industry efficiency, "level-playing field"	Protect/enrich a handful of private companies, especially "national champions"
Legal/regulatory approach	Neutral umpire enforcing transparent rules using objective data/evidence	Undermine law/precedent with fraudulent evidence; opaque rules applied arbitrarily
Role of "Open Skies"	Facilitate new entry, reduce cross-border and artificial barriers	Facilitate reduced competition and regulatory arbitrage; increased protection of weak;
Driver of airline success	Efficiency, service quality, network strength	Ability to capture regulators; control of alliance access

Looking forward given tomorrow's highly illiberal environment

Continuing, artificial consolidation --many moves unthinkable 10 years ago

- **reducing trans-Pacific from 26 to 3 competitors**
- **BA acquiring BMI; only 4 carriers for entire USA**
- **crude Canadian/German anti-EK protectionism**

Negative outlook for markets and industry --stagnant competition means declining efficiency

- **Competition weakens further—3 alliance competition unsustainable**
- **LHR-based Oneworld uncompetitive with continental duopoly**
- **squeeze of small alliance members and domestic LCCs**

growth of cross-border regulatory arbitrage threatens financial/consumer/safety protections

- **UAL IAD-MAD precedent; Qantas offshoring; Tiger safety lapses**