Article

"Double Marginalization" and the Counter-Revolution Against Liberal Airline Competition

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SUMMARY/ABSTRACT:

In the last decade, the U.S Department of Transportation (DOT) has abandoned its previously liberal, market-oriented policies towards international airline competition. While the policies of the 1980s and 1990s were designed to maximize industry competitive dynamics so consumers could benefit from ongoing improvements in price and efficiency levels, recent DOT policies have sought to reduce competition and entrench the position of the largest carriers. These policies have already led to the consolidation of twenty-six previously independent transatlantic airlines into three collusive alliances that would be virtually immune from future competitive challenges; in 2009, the DOT initiated a process that could see twenty-three previously independent transpacific airlines consolidated into those three same collusive alliances. While the DOT proactively used "Open Skies" treaty negotiations in the 1990s to undermine the ability of governments to reduce consumer welfare through artificial competitive barriers, recent "Open Skies" negotiations with the EU and Japan reestablished that private, bilateral discussions between large legacy airlines and government officials could dramatically restructure international airline competition in favor of those established legacy carriers. While the DOT used antitrust immunity in the 1990s as a tool that allowed small competitors such as KLM and Northwest to offer consumers improved schedules and lower prices in previously underserved niche markets, since 2003 the DOT has used antitrust immunity to enhance the market power of the largest incumbents, leading to pricing shifts that appear to have created multi-billion dollar annual consumer welfare losses.

The abandonment of consumer welfare-based airline antitrust policies and the sudden shift to unprecedented levels of international airline concentration was made possible by the DOT's evisceration of traditional antitrust immunity evidentiary standards. The DOT's recent immunity grants to members of the Star, Skyteam and Oneworld alliances were based on willful non-enforcement of the Clayton Act market power test and the *Horizontal Merger Guidelines'* requirement that applicants present verifiable, case-specific evidence of public benefits in order to meet the 49 U.S.C. § 41308(b) stipulation that immunity be required by the public interest. The DOT has supplanted the need for verifiable, case-specific evidence with a series of arbitrary "rules" that ensure that almost any antitrust immunity proposal will be found to automatically produce public benefits without any risks of creating market power. The most important of these is "double marginalization," a rule which asserts that every time an immunity grant reduces international competition, consumer prices in certain connecting markets automatically fall fifteen to twenty-five percent, regardless of actual market or competitive conditions.

This paper describes the process by which the DOT has used rules such as "double marginalization" to eviscerate traditional antitrust evidentiary standards, and argues that none of the post-2003 consolidation of international aviation would have been possible if the traditional public benefits or market power tests and the traditional evidentiary standards had been enforced. The dispute over evidentiary standards surfaced in late 2009 when the Antitrust Division of the U.S. Department of Justice (DOJ) objected to the DOT having rubber-stamped the Star/Continental applicants' unsubstantiated benefit claims. The DOT emphatically rejected the DOJ's objections as an inappropriate interference with the DOT's aviation policy and bilateral negotiation prerogatives, a position that was more fully articulated in a recent Dean and Shane *Air and Space Lawyer* commentary, which claimed that all recent DOT decisions were fully consistent with longstanding pro-consumer, pro-competitive policies, and attacked the DOJ and Congressional critics of the DOT's antitrust approach as hostile to the interests of the US airline industry. This paper argues that the policies favoring extreme concentration and the effort to render the public benefits and Clayton Act tests meaningless reflect a major policy shift towards more active governmental management of airline industry structure, and represent a counter-revolution against the liberal airline competition policies of the 1990s.

I. EVIDENCE JUSTIFYING ATI GRANTS: "COPY/PASTE" AS ANTITRUST JURISPRUDENCE

Airlines applying to the DOT for antitrust immunity (ATI) must meet the strict section 41308 "required by the public interest" standard and prove that immunity "is necessary . . . to achieve important public benefits" that "cannot be achieved by reasonably available alternatives that are materially less anticompetitive."[1] The burden of proof for public benefits rests with the applicants,[2] and the *Horizontal Merger Guidelines*

1. 49 U.S.C. §§ 41308(b), 41309 (2006).
2. Joint Application of American Airlines, Inc., British Airways PLC, Finnair OYJ, Iberia

defines the evidentiary standards that efficiency claims used to meet the public benefits test must meet:

> [The applicants must] substantiate efficiency claims so that the Agencies can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), how each would enhance the merged firm's ability and incentive to compete, and why each would be merger-specific.
> Efficiency claims will not be considered if they are vague, speculative, or otherwise cannot be verified by reasonable means.[3]

Since ATI eliminates competition in the same manner that a full merger would, immunity cannot be granted unless the DOT conducts a Clayton Act test of whether ATI would create or increase market power.[4] The *Antitrust Guidelines* and the *Horizontal Merger Guidelines* define these standards, including the need for evidence demonstrating the absence of risk that it could "harm[ ] competition by increasing the ability or incentive . . . to raise price or reduce output" in any relevant market[5] and evidence that markets are fully contestable, so that "entry would be timely, likely, and sufficient in its magnitude and scope to deter and counteract the competitive effects of concern."[6]

ATI evidentiary standards became a public controversy in mid-2009 when the DOJ identified numerous instances where the DOT's Show Cause Order in the Star/Continental Application for antitrust immunity failed to support its findings with the "detailed and fact-intensive analysis" demanded by these evidentiary standards, including:

- "[T]he Applicants . . . made no showing that such entry [that could curb any anti-competitive abuse] would be timely, likely, or sufficient . . . ;"[7]
- "[t]he [DOT] Order contains no analysis of the competitive effects of immunizing the non-transatlantic international operations of Continental and United;"[8]
- "[t]he Applicants have failed to show that nonstop entry would prevent fare increases by Continental and its immunized Star ATI partners in overlap transatlantic markets;"[9]
- "DOT cites the Applicants' assertion that the A++ 'integrated' venture will enable its participants to 'pool resources to achieve substantial efficiencies and cost savings.' . . . In DOJ's view, it is not sufficient, however, merely to point towards claimed benefits; rather the Applicants need to demonstrate that immunity is *necessary* to achieve them. In this regard, the Applicants fall short;"[10]
- "[t]he Applicants present no evidence however, that customers will receive quantitatively or qualitatively different service if Continental receives antitrust immunity . . . compared to what would be provided if Continental merely interacted with the level of cooperation expected of any member of the broader, non-immunized Star Alliance;"[11]
- "[t]he Applicants also suggest, without evidentiary support, that consumers benefit from competition between alliances, particularly immunized alliances;"[12]
- "[t]he Applicants overemphasize the likelihood that immunity for the proposed alliance will substantially reduce double marginalization [extra markups imposed on joint fares]. . . . In fact using 2005-2008 data, DOJ has found that connecting fares offered by non-immunized alliances for transatlantic routes are no more expensive than fares offered by immunized alliances;"[13]
- "[t]he analysis underlying DOT's conclusions on carve outs is unclear. The Order declines to carve out the overlap transborder routes in which Continental and the Star ATI members currently compete on a nonstop basis, without citing evidence from the record describing the public benefits likely to result from coordination on these routes. . . . [T]he Order cites no evidence to support revoking the [Frankfurt-Chicago/Washington] carve outs beyond the Applicants own self-serving statements. The Applicants do not provide specific evidence or quantification of diminished efficiencies or consumer value, even though Star members have long operated carve outs imposed as part of prior immunity grants;"[14]
- "DOT dismisses concerns about the scope of the immunity on the grounds that the other Star partners have had global immunity with each other for many years. Therefore DOT concludes that it 'has enough information to analyze the alliance plans' and that restricting the scope here would unfairly disadvantage Continental. . . . DOT does not cite the 'other information' it relies upon to analyze the alliance plans, nor does it

Líneas Aéreas de España, S.A., Royal Jordanian Airlines under 49 U.S.C. §§ 41308-41309 for Approval of and Antitrust Immunity for Alliance Agreements, Joint Application of American Airlines, Inc. and British Airways, PLC under 14 C.F.R. Part 212 and 49 U.S.C. § 40109 for Amended Statements of Authorization, Docket No. OST-2008-0252, Order 2010-2-8 at 10 (Dep't of Transp. Feb. 13, 2010) [hereinafter Oneworld Show Cause Order].

3. U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES, at 30 (2010) [hereinafter HORIZONTAL MERGER GUIDELINES].

4. *See* Clayton Act § 7, 15 U.S.C. § 18 (2010).

5. U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS, at 3-4, 10 (2000).

6. HORIZONTAL MERGER GUIDELINES, *supra* note 4, at 28.

7. Air Canada, Austrian Group, British Midland Airways, Ltd., Continental Airlines, Inc., Deutsche Lufthansa AG, Polskie Linie Lotnicze Lot S.A., Scandinavian Airlines System, Swiss International Air Lines, Ltd.,TAP Air Portugal, United Airlines, Inc. 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 No. OST-2008-0234, Comments of the Dep't of Justice on the Show Cause Order at 8 (Dep't of Transp. June 26, 2009) [hereinafter Star/Continental DOJ Comments] (public version).

8. *Id.* at 18.

9. *Id.* at 25.

10. *Id.* at 29-30.

11. *Id.* at 30.

12. *Id.* at 33.

13. *Id.* at 35-36.

14. *Id.* at 37, 39.

> explain how Continental, or more significantly, consumers, would be harmed by the lack of global immunity."[15]

The Star/Continental cases brought to light an irreconcilable gap between the DOT and DOJ approaches to airline antitrust jurisprudence.[16] In Star/Continental, the DOT had not required the applicants to present verifiable, case-specific evidence, and did not undertake an independent, objective evaluation of the applicant's claims.[17] In fact the DOT Show Cause "finding" that immunity would create public benefits consisted of nothing more than a verbatim repetition of the claims in the application.[18] The DOT's public benefits methodology was literally nothing more than "copy and paste." The DOT's approach had been no more rigorous on the other major ATI cases of the past decade. But until the Star/Continental[19] and Oneworld cases[20] in 2009, no outside parties had ever commented as to whether these approaches were consistent with the law or established review standards.

The DOT attacked the DOJ evidentiary concerns in its Final Order as an inappropriate attempt to undermine its international aviation policies:

> Were we to suddenly change our antitrust immunity and public interest approach, as DOJ suggests, the credibility of the U.S. government with its international aviation partners would be significantly compromised and our ability not only to reach new Open-Skies agreements but also to maintain those agreements that we have already achieved would be undermined.[21]

15. *Id.* at 41 n.109.

16. *See generally* The Civil Aeronautics Board Sunset Act of 1984, Pub. L. No. 98-443, 98 Stat. 1703, 1703-1705 (1984). The Act divided airline antitrust responsibilities between the DOT and the DOJ, giving the CAB's authority to exempt international airlines from the antitrust laws (under certain conditions) to the DOT, but giving the DOJ authority over all mergers between US airlines. While the DOT has final authority, the DOJ is required to comment on all airline ATI cases, just as the DOJ is required to solicit DOT input on airline merger cases.

17. *See* Air Canada, Austrian Group, British Midland Airways, Ltd., Continental Airlines, Inc., Deutsche Lufthansa AG, Polskie Linie Lotneicze Lot S.A., Scandinavian Airlines System, Swiss International Air Lines, Ltd.,TAP Air Portugal, United Airlines, Inc. 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 No. OST-2008-0234, Order 2009-4-5 at 6-25 (Dep't of Transp. Apr. 7, 2009) [hereinafter Star/Continental Show Cause Order]; Air Canada, Austrian Group, British Midland Airways, Ltd., Continental Airlines, Inc., Deutsche Lufthansa AG, Polskie Linie Lotneicze Lot S.A., Scandinavian Airlines System, Swiss International Air Lines, Ltd.,TAP Air Portugal, United Airlines, Inc. 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 No. OST-2008-0234, Order 2009-7-10 at 10-11 (Dep't of Transp. July 10, 2009) [hereinafter Star/Continental Final Order].

18. *Id.* at 15-16.

19. *See id.* at 6 (summarizing comments made by outside parties).

20. *See* Oneworld Show Cause Order, *supra* note 3, at 7-8 (summarizing comments made by outside parties).

21. Star/Continental Final Order, *supra* note 18, at 11.

The DOT made no attempt to justify or explain the evidentiary approaches that the DOJ criticized, and only made minor concessions to the separate DOJ argument that overlapping, nonstop routes which would lose competition should be carved out of the final immunity grant.[22] Press reports suggested a heated dispute between the two departments that echoed these competing "antitrust evidentiary standards" versus "international aviation competition policy" positions, a debate that required mediation from President Obama's chief economic adviser, Lawrence H. Summers.[23] Filings in the Oneworld case use more measured language but the gap between the underlying antitrust approaches has not diminished.[24]

II. "Antitrust Evidentiary Standards" Versus "The Future of Global Aviation"

In a recent commentary in the American Bar Association's *Air and Space Lawyer*, Warren Dean and Jeff Shane presented a fuller articulation of the "aviation policy" side of this dispute.[25] The Dean and Shane commentary directly echoes the DOT's response to the DOJ's Star/Continental criticism, claiming an unbreakable link between the DOT's role in negotiating aviation treaties with foreign countries and its role in enforcing US antitrust laws, and defending the DOT's jurisdiction over airline ATI cases.[26] Dean and Shane point out that the current jurisdictional arrangements this linkage facilitated were the negotiations of the 1990s treaties: "If the U.S. government was to attempt through diplomacy to move its aviation trading partners coherently toward a more market-based and pro-competitive regime, it was essential that the antitrust exemption authority be vested in the agency primarily responsible for the development of U.S. international aviation policy."[27] They portray the dispute as a rearguard action led by the DOJ and certain Members of Congress against the liberal regime initiated by the original 1990s "Open Skies" treaties.[28] In Dean and Shane's view the DOJ and others

22. *See id.* at 18-21.

23. *See* Stephen Labaton, *Antitrust Chief Hits Resistance in Crackdown*, N.Y. Times, July 26, 2009, at A1.

24. *See* Oneworld Show Cause Order, *supra* note 3, at 8-9.

25. *See* Warren L. Dean, Jr. & Jeffrey N. Shane, *Alliances, Immunity and the Future of Aviation*, 22 Air & Space Law. 1, 1 (2010) [hereinafter Dean & Shane].

26. *See id.* at 18.

27. *Id.* The question is whether the DOT is still using its international ATI authority to create a "more market-based and pro-competitive regime" as it did in the 1990's.

28. *See id.* at 17; Defining Open Skies, Docket No. 48130, Order 92-8-13 at 1 (Dep't of Transp. Aug. 5, 1992) [hereinafter Defining Open Skies]. A full list of Open Skies aviation treaties is available on the Department of State website at http://www.state.gov/e/eeb/rls/othr/ata/114805.htm.

critical of recent ATI decisions were undermining what has been "a major aviation policy success story" because of their "outright hostility" to the interests of the US airline industry which had blinded them to the many "benefits" created by immunized alliances.[29]

Dean and Shane reframe the discussion away from the lax versus rigorous evidentiary standards question posed by the DOJ by claiming that the DOT's pro-alliance agenda is critical to the future of aviation.[30] They describe the 1992 U.S.-Netherlands "Open Skies" Agreement and the resulting Northwest/KLM alliance[31] as "the template for a major transformation of international aviation" and claim that the resulting "confluence of Open Skies agreements, alliances and ATI has spawned a fundamental reinvention of the global air transport industry," and even assert that "the emergence of alliances—and particularly immunized alliances—arguably has represented the most important development in the industry since the introduction of jet aircraft."[32] Even though the DOJ's comments were strictly limited to evidentiary standards and said absolutely nothing about any of the DOT policies Dean and Shane favor, they feel that the DOJ's comments threaten this "more efficient and competitive global aviation system" and the outcome of the DOT-DOJ dispute "will have profound implications for the future of commercial aviation."[33]

Dean and Shane do not directly acknowledge any of the DOJ's specific Star/Continental evidentiary concerns, but they assert that whatever objections the DOJ might have had are wrong because the DOT findings fully satisfied both the public benefits and the Clayton Act market power tests.[34] Thus, the two parties have used the same legal requirements and the same case evidence to reach exactly opposite conclusions— the DOJ said that the DOT's findings were hopelessly deficient while Dean and Shane say that the DOT's findings in Star/Continental were completely consistent with the law, and ATI could not have been granted in these cases unless these tests had been properly administered.[35] In order to

29. *See* Dean & Shane, *supra* note 26, at 1, 17.

30. *See id.* at 18-19.

31. Air Transport Agreement, U.S.-Neth., Oct.14, 1992, T.I.A.S. No. 11976; Northwest Airlines-KLM Royal Dutch Airlines Joint Application for Approval and Antitrust Immunity of an Agreement Pursuant to Sections 412 and 414 of the Federal Aviation Act, as amended, Docket No. 48342, Order 93-1-11 (Dep't of Transp. Jan 11, 1993) [hereinafter Northwest/KLM Final Order].

32. Dean & Shane, *supra* note 26, at 17-18.

33. *Id.* at 17.

34. *See id.*at 19-20.

35. Star/Continental DOJ Comments, *supra* note 8, at 29-30; Dean & Shane, *supra* note 26, at 19 ("ATI will be awarded only where the applicants can demonstrate that the public benefits likely to flow from the alliance will be significant - in keeping with the positive effects DOT described in its 1999 and 2000 reports - and that those benefits would not materialize without a grant of ATI").

make sense of the competing views about industry consolidation and the future of global aviation, it is necessary to explain these opposite and incompatible views about the case evidence required to show significant public benefits and the market power needed to sustain anti-competitive pricing.

III. "Aviation Policy Driven Bilaterals" Versus "Bilateral Driven Aviation Policy"

Dean and Shane's paper does not define the DOT's specific international aviation policy objectives that are being threatened by the DOJ and others, aside from these general references to the promotion of immunized alliances. There are no references to post-1999 DOT policy analysis of the virtues of increasing the size and market share of immunized alliances beyond their 1999 levels as these do not exist. They argue that the DOT's policies and its ATI decisions "have been a major public policy success story for consumers, global airline competition, and the airline industry itself;" although the article does not cite any post-1999 evidence of consumer/competitive benefits, or any significant industry service or productivity gains.[36]

The DOT policy objective at stake is the use of ATI to consolidate previously independent international airlines into three collusive alliances, a policy radically different from what the DOT was pursuing when it approved Northwest/KLM in the mid 1990s. Dean and Shane cite "DOT's savvy administration of its power to confer ATI"[37] as a major policy accomplishment, but are unwilling to openly admit that current ATI policy is designed to reduce competition, or to openly defend the new policy on the basis of evidence that the risks of reduced competition are fully offset by tangible consumer benefits. In fact, Dean and Shane are unwilling to admit that there has been any change in the DOT's international aviation competition policy despite the obvious contradiction between the DOT's current policy of active government intervention (via ATI) to massively reduce the number of international competitors, and the 1990s "market-based and pro-competitive regime" that they used as justification for an "aviation policy" driven approach to antitrust enforcement.[38]

Dean and Shane's defense of the linkage between the DOT's antitrust and bilateral negotiation authorities attempts to reverse the horse

36. Dean & Shane, *supra* note 26, at 21. The only objective (but pre-1999) evidence cited by Dean and Shane are DOT reviews of the mid 90's impacts of the original ATI grants. *Id.* at 19 n.27.

37. *Id.* at 21.

38. *Id.* at 18. The impacts of recent ATI decisions on concentration will be documented in section 5.

and the cart. In the 1990s, the DOT's bilateral negotiations were a means of implementing its "market-based" competition policies, policies that were grounded in traditional antitrust logic based on consumer welfare and industry efficiency, and closely aligned with the domestic competition policies enshrined in the Airline Deregulation Act.[39] Today, the DOT is conducting bilateral negotiations about the future structure of the international airline industry with other governments and the large incumbent carriers, and then tailoring antitrust findings to support those agreements.[40] Dean and Shane argue that competition (antitrust) decisions should be totally deferential to industry structure decisions reached during those private negotiations, even when those "policies" are not market-based, are not aligned with the consumer welfare/industry efficiency logic that is the basis of the Airline Deregulation Act, and cannot be justified on the basis of the objectives and benefits of 1990s aviation competition policies.[41]

Dean and Shane are advocating a fundamental shift from the mid-1990s approach - what could be termed "aviation competition policy driven bilaterals" - to "bilateral driven aviation competition policies," the opposite of the mid-1990s approach.[42] The large intercontinental alliance carriers such as United or Air France would naturally favor "bilateral driven competition policies" since they are ideally positioned to influence the officials responsible for these bilaterals and often participate directly in the bilateral negotiation process. The "aviation competition policy driven bilaterals" approach of the 1990s made the interests of the large intercontinental carriers subsidiary to broader issues of consumer welfare and overall industry efficiency.

IV. "Bilateral Driven Antitrust Enforcement" Versus "Evidence Driven Antitrust Enforcement"

The "antitrust evidentiary standards" counterargument that will be presented in the balance of this paper is that the DOT has radically redefined the traditional evidentiary standards, hollowing them out to the extent that almost any ATI/consolidation proposal being discussed by the

39. *See* U.S. Dep't of Transp. Office of Hearings Competitive Mktg. of Air Transp., Docket No. 36595, Order 82-12-85 at 131 (Dep't of Transp. Dec. 16, 1982) ("In enacting the Airline Deregulation Act, Congress directed that control of the air transportation system be returned to the marketplace. We have consistently held that a part of the return to market control is exposure of participants to the antitrust laws, as that exposure exists in unregulated industries.").

40. This was the approach that the liberal Open Skies regimes were designed to eliminate. *See* Clifford Winston & Steven Morrison, Evolution of the Airline Industry 147-50 (1995); Jeffrey N. Shane, Under Sec'y for Policy, U.S. Dep't of Transp., Air Transport Liberalization: Ideal and Ordeal 11-12 (Dec. 8, 2005).

41. *See* Dean & Shane *supra* note 26, at 19.

42. *See id.* at 21.

industry will automatically be found to produce significant public benefits and to pose no risk of anti-competitive pricing. Just as Dean and Shane have no post-1999 evidence supporting their policy preferences, none of the recent ATI applicants have presented any post-1999 evidence of actual public benefits, or the actual absence of market power.[43]

The traditional need for verifiable, case-specific evidence of public benefits has been nullified by a DOT position that ATI applications automatically create approximately fifteen to twenty-five percent in price reductions in connecting markets, in each and every case irrespective of market or competitive conditions.[44] This position is based on a theory of structural barriers to efficient pricing known as "double marginalization," a theory supported by a single study prepared by a paid advocate for one of the ATI applicants, and based solely (like Dean and Shane's policy arguments) on pre-1999 data.[45] The DOT has based all public benefits findings on this position, has simply ignored evidence that the logic and evidence underlying the rule is deeply flawed, and has ignored all recent evidence contradicting the rule.[46] The DOT also based its public benefit findings on a second rule establishing that claims the applicants will benefit from a grant of ATI can be accepted as proof of significant "public" benefits, even when the applicants have not documented or quantified the claims, and even where there is no evidence that overall consumer welfare or industry efficiency actually improved.[47] The DOT has abandoned the traditional need for pricing, entry barrier, and market contest-

43. *See, e.g.*, American Airlines-British Airways-Iberia-Finnair-Royal Jordanian Joint Application for Antitrust Immunity, Docket No. OST-2008-0252, Application (Dep't of Transp. Aug. 15, 2008) [hereinafter Oneworld ATI Application]; 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 No. OST-2008-0234, Application (Dept' of Transp. July 23, 2008) [hereinafter Star/Continental ATI Application].

44. *See* Oneworld Show Cause Order *supra* note 3, at 31, Ex. JA-19 (citing to Jan K. Brueckner & W. Tom Whalen, The Price Effects of International Airline Alliances, 43 J.L. & Econ. 503, 503-45 (2000) (estimating an average 25% fare reduction in antitrust-immune alliances generally and an average 15% fare reduction in anti-trust immune alliances for "behind-the-gateway" markets)); Jan K. Brueckner, *International Airfares in the Age of Alliances: The Effects of Codesharing and Antitrust Immunity*, 85 Rev. Econ. Stat. 105 (2003) (estimating a seventeen to thirty percent reduction effect in interline airfares from airline cooperation); W. Tom Whalen, A Panel Data Analysis of Code Sharing, Antitrust Immunity, and Open Skies Treaties in International Aviation Markets, 30 Rev. of Indus. Org. 39, 39-61 (2007)).

45. *See generally* Jan K. Brueckner & W. Tom Whalen, The Price Effects of International Airline Alliances, 43 J.L. & Econ. 503, 503-45 (2000).

46. The DOJ presented original statistical analysis contradicting the Brueckner and Whalen findings using 2005-2008 data in one case and updated 2008 data in another. Star/Continental DOJ Comments *supra* note 8, at 49; Joint Application of American Airlines, British Airways, Iberia, Finnair, Royal Jordanian under 49 U.S.C. §§ 41308 and 41309 for Approval of and Antitrust Immunity for Alliance Agreements, Docket No. OST-2008-0252, Comments of the Dep't of Justice at 26-27 (Dep't of Transp. Dec. 21, 2009) (public version).

47. *See* Oneworld Show Cause Order *supra* note 3, at 30-31.

ability evidence showing that ATI grants meet the Clayton Act market power test, because of a third arbitrary rule that market power cannot exist in any broadly defined market that has three competitors and an "Open Skies" treaty.[48]

By gutting, but not formally eliminating, the public benefit test of 49 U.S.C. § 41308(b) and the market power test of the Clayton Act, the DOT maintains the superficial appearance of following the law, while establishing a process whereby ATI and consolidation proposals can be approved much more rapidly. Because applicants no longer need to present verifiable, case/market-specific evidence, almost any plausible ATI proposal would automatically meet the redefined standards, and opponents cannot challenge applications based on case/market-specific evidence. As a result, both the DOJ and Dean and Shane can cite the same public benefits and market power requirements and reach completely opposite conclusions about the legitimacy of the DOT's recent ATI findings. Dean and Shane favor the DOT rules gutting these evidentiary standards because they favor much greater consolidation among international airlines, and recognize that the "aviation policy" objective of vastly increased consolidation could not be implemented under traditional standards.[49] However, Dean and Shane are unwilling to openly acknowledge that the DOT's pro-consolidation decisions depend on these new rules or that the DOJ and the other parties they attack in their article might have reasonable legal objections to the DOT's rules independent of any opinions about aviation policies or specific consolidation proposals.[50]

While "double marginalization" may seem like an arcane rule, it has already had a bigger impact on airline competition than anything that has occurred since the 1944 Chicago Convention established today's legal framework for international aviation. A brief review of the historical development of collusive (immunized) alliances and their impact on North Atlantic competition will provide some useful context for the subsequent discussion of how the DOT's recent ATI evidentiary rules were critical to the recent increases in industry concentration.

V. The Economics of Intercontinental Alliances

The economics and competitive dynamics of intercontinental airline markets are markedly different from shorter-haul domestic and regional

48. *See* Star/Continental Show Cause Order, *supra* note 18, at 2; Oneworld Show Cause Order *supra* note 3, at 3.

49. *See* Dean & Shane, *supra* note 26, at 20-21.

50. *See* Star/Continental DOJ Comments, *supra* note 8, at 8. As discussed in section 1, the DOJ's comments in the Star/Continental case were strictly focused on the DOT's failure to support its findings with evidence that met Horizontal Merger Guidelines standards; the DOJ did not offer any comments about the general merits of alliances or any DOT aviation policies.

markets.[51] All of the "aviation competition policy" and antitrust issues in these cases strictly apply to the intercontinental sector, which accounts for over half of the entire global aviation business. Any discussion of those issues must recognize that because of both natural and artificial barriers, it is much more difficult for "market forces" to discipline competitors and spur productivity in intercontinental markets.

Domestic/regional (narrow-body) carriers focus on much smaller market segments, and the "low cost" (LCC) models that dominate those markets are highly flexible, require relatively little startup capital, and can operate small networks efficiently. Intercontinental carriers have huge initial startup costs and require very large scale operations, including large fleets of wide-bodies, global marketing capabilities, and a very large hub-based route network in order to feed passengers onto and between those wide-body aircraft. Since these hubs must be in very large cities with a strong local demand for intercontinental travel, new entry into this sector has been entirely limited in recent decades to airlines based in newly developing economies in East Asia and the Persian Gulf.[52] These natural barriers are augmented by other totally artificial entry barriers established by governments in order to protect incumbent intercontinental airlines.[53] Most governments around the world have established highly liberal entry and pricing rules for domestic and regional markets, but actively intervene to rig market rules to protect the airline(s) serving as their "national champion" in intercontinental markets.[54]

51. Intercontinental markets are defined as city pairs more than 3000 miles apart. In almost all cases, Intercontinental service involves the use of long-haul, wide-body aircraft, although passengers often connect to these aircraft from short-haul, narrow-body aircraft that also carry domestic/regional passengers. Domestic/regional markets include "international" (cross-border) service operated on the same basis as domestic services (for example intra-EU, USA to Canada/Caribbean).

52. Only four of the traditional network airlines currently operating intercontinental services entered long-haul markets within the last fifteen years (Qatar, Ethiad (UAE), Jet Airways (India) and BMI (UK)), while only two large network carriers exited intercontinental markets in that period (TWA, Canadian). The handful of today's small, non-network carriers that first entered intercontinental markets in the last fifteen years (mostly leisure carriers such as Blue Panorama (Italy), Monarch (UK), and Air Tahiti Nui) was offset by the exit of other small non-network carriers (mostly flag carriers of small countries such as Olympic (Greece), JAT (Yugoslavia), and Tarom (Romania)). In several other cases there was a one-for-one replacement of national carriers providing longhaul service (Swiss for Swissair, TAM for Varig (Brazil), Aerosvit for Air Ukraine, and Conviviasa for VIASA (Venezuela)) that had no impact on the overall competitiveness of intercontinental markets.

53. *See* John M. Nannes, Deputy Assistant Attorney General Antitrust Div., U.S. Dep't of Justice, The Importance of Entry Conditions in Analyzing Airline Antitrust Issues 3-5 (July 20, 1999).

54. *Delta-Northwest Merger: Hearing before the Subcomm. on Aviation of the H. Transp. & Infrastructure Comm.*, 110th Cong. (2008) (statement of Hubert Horan).

Aviation Sector	% of RPMs/ Revenue	% of Enplanements	Business Models	Entry Barriers
Intercontinental (long-haul/wide-body)	**55%**	**30%**	Strictly via mega-hubs (JFK, ORD, FRA, CDG, HKG, SIN, etc).	**Huge** - need large fleet of wide-bodies plus hubs with short-haul feed, plus many government restrictions.
Domestic/Regional (short-haul/ narrow-body)	**45%**	**70%**	Various models possible, mostly "low cost" and point-to-point.	**Generally very low** - vast majority of markets have open entry/pricing.

Table 1[55]

Because of these natural and artificial barriers, intercontinental markets are not contestable. As shown in figure 1, there has been no growth in the number of intercontinental competitors in thirty years, even though this is the most profitable and fastest growing part of global aviation; all of the dynamic industry growth and increased competition observed in recent decades has been strictly limited to domestic and regional (narrow-body) markets.[56] All of the recent merger and immunity cases since 2003 are designed to increase consolidation within these already non-contestable intercontinental markets, and would have no impact on the over 700 airlines serving the forty-five percent of global demand in short-haul markets.[57] "Industry consolidation" advocates, following a process described in the balance of this section, are attempting to rationalize most of the 100 airlines serving the fifty-five percent of global demand in intercontinental markets into just three global alliance groups.

55. Traffic data in table 1 is from a proprietary database created by the author from raw data published in Int'l Air Transp. Ass'n, 52 World Air Transp. Statistics (2008) (on file with author) [hereinafter World Air Transp. Statistics (2008)].

56. *See* Hubert Horan, *If Consolidation Occurs, it Would Reverse Decades of Airline History*, Airlines Int'l, Jan. 2009, at 58. *See also* William Swan, *Misunderstandings About Airline Growth*, 13 J. of Air Transp. Mgmt. 3, 3-4 (2007). Swan reached a similar "industry consolidation is a myth" conclusion based on data showing growth in aggregate market demand and service levels had been achieved without any major increases in Herfindahl market concentration indexes. However, this analysis did not look at competitive entry/exit data, and thus would not have captured the enormous differences shown in figure 1 between the competitive dynamics of long-haul markets (where both entry and exit is extremely rare, and the net growth in the number of competitors is close to zero) and short-haul markets (with high levels of both entry and exit, and strong net growth in the number of competitors). *See infra* note 59.

57. See World Air Transp. Statistics (2008), *supra* note 56.

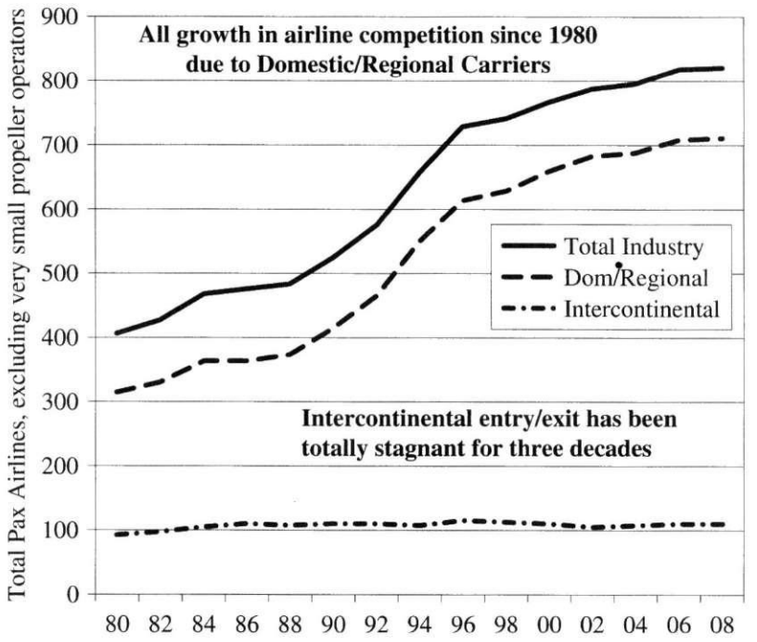

Figure 1[58]

The two types of alliances between intercontinental airlines have totally different economic and competitive characteristics, although Dean and Shane and most other observers discuss the benefits of "alliances" as if these distinctions did not exist.[59] Non-immunized "Branded Alliances" operate globally and emphasize products such as frequent flyer reciprocity, codesharing, common terminal and lounge facilities, and other forms of mutually beneficial interline cooperation that existed long before the current alliance structures were developed.[60] "Collusive Alliances" were first introduced in 1992, and are currently only found on the North Atlantic.[61] Since their members have antitrust immunity to collude on pricing

58. Data in the graph is from a proprietary database of all historical passenger airlines operating under unique aircraft operator certificates. Data includes all airlines operating aircraft with at least 50 seats and all airlines operating at least 15 smaller aircraft. The data does not reflect any reduced competition due to ATI; for example United and Lufthansa are counted as fully independent airlines (on file with author).

59. *See* Dean & Shane, *supra* note 26, at 17-18.

60. Star/Continental DOJ Comments, *supra* note 8, at 3-5.

61. The comments in this section are based on my experience developing the original Northwest/KLM alliance network that has served as the template for all subsequent North Atlantic alliances. This includes various internal market studies conducted that were used to better understand the competitive impacts of the initial alliance schedules and to justify further expansion of alliance operations. I also worked on the Swissair-Sabena-Delta alliance from the Euro-

and capacity, the Collusive Alliances require careful antitrust scrutiny while the Branded Alliances do not.

Branded Alliances —Global scope	Start Date	**Collusive Alliances** —Limited to North Atlantic	Start Date
Global Excellence (Delta)	1990 (x)	KL-led alliance (Northwest)	1992 (x)
Star (United, USAirways, Continental)	1997	SR-led alliance (Delta, later American)	1995 (x)
One World (American)	1998	LH-led alliance (United, USAirways, Continental)	1997
Skyteam (Delta, Northwest)	2000	AF-led alliance (Delta, Northwest)	2000
(x) defunct		BA-led alliance (American) *(U.S. members listed in parentheses)*	2010

Table 2[62]

The original Collusive Alliances developed in response to unique North Atlantic market conditions that are not found in any other intercontinental market.[63] In the early 1990s, seventy percent of the traffic on the North Atlantic was in city pairs that had good single-carrier schedules and a full range of discount fares.[64] This included not only the nonstop service operated in large "gateway" markets, but one-stop online service via large hubs on both sides of the Atlantic.[65]

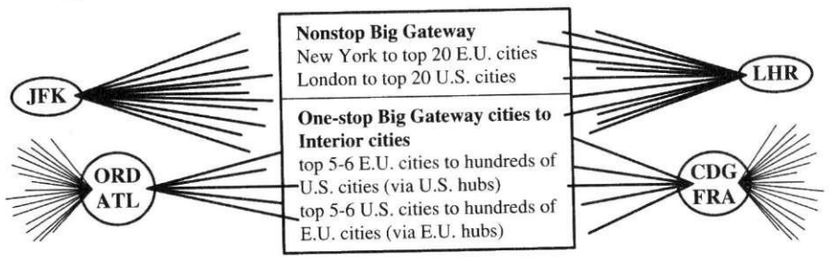

Figure 2[66]

The original three mid-1990s Collusive Alliances (Northwest/KLM, Delta/Swissair/Sabena and United/Lufthansa) succeeded by providing a

pean side, and helped shut down several unsuccessful airline alliances (Continental-America West, Qualiflyer). For a more detailed discussion of the competitive economics and public benefits of the original 1990s North Atlantic alliances, see my comment to the Oneworld application. *See* American Airlines, British Airways, Iberia, Finnair, Royal Jordanian Joint Application for Antitrust Immunity, Docket No. OST-2008-0252, Comments of Hubert Horan, at 7-9 (Dep't of Transp. Jan. 31, 2010) [hereinafter Horan Oneworld Comments].

62. *See* Horan Oneworld Comments, *supra* note 62.
63. *See id.*
64. *Id.*
65. *Id.*
66. *Id.*

high-quality online-equivalent service to the other thirty percent of the market, which had poor service and much higher fares—hundreds of city pairs linking U.S. Interior Cities to European Interior Cities such as St. Louis-Brussels or Milwaukee-Munich. The initial growth and profitability of the original three Collusive Alliances was based on a clear competitive advantage over traditional interline services in this important "double connect" market segment, just as other airlines had clear competitive advantage because of superior schedules in other nonstop and "single connect" market segments.[67] The benefits derived from these competitive advantages had been fully exhausted by the end of the 1990s as they had fully captured the traffic previously served by interline connections.[68] The volume of passengers using alliance "double connect" services also began to shrink because of the dramatic growth of superior nonstop and single connect services that resulted from normal industry capacity growth.[69]

Despite the clear success of the original mid-1990s Collusive Alliances, airlines made no attempt to introduce them to transpacific markets or elsewhere in the following fifteen years because the underlying "double connect" competitive advantage versus interline service in San Diego-Stuttgart type markets did not exist elsewhere.[70] North American and European traffic is highly dispersed among dozens of large secondary cities, but Asian, South Pacific and South American traffic is not, so "double connect" alliance services are of little value to consumers. Transpacific airlines cannot justify alliance development and management expenses on the basis of increased revenues from Cleveland-Chiang Mai or Baltimore-Busan type markets.

It should be emphasized that the central antitrust and industry structure question here is consolidation, not alliances. The original growth of immunized alliances occurred In the 1990s under highly competitive market conditions. The original Northwest/KLM alliance combined two carriers with four percent shares of the transatlantic market into a single competitor with an eight percent share.[71] In 2001, after the alliance net-

67. *Id.*
68. *Id.* at 9.
69. DOT Form 41 schedule T100 data compiled by the author show that the number of transatlantic nonstop flights doubled between the summer of 1991 and the summer of 2001, increasing from 168 to 323 per day, a seven percent compound annual growth rate (on file with author).
70. DOT DB1A data compiled by the author show that less than two percent of all transpacific traffic is in O&D markets that do not have online (single carrier) service, compared to the thirty percent of transatlantic traffic when immunized alliances were first introduced in the 1990s (on file with author).
71. Percentages based on DOT Form 41 schedule T100 seat capacity data compiled by the author (on file with author).

works were fully mature, the largest collusive alliance had only eighteen percent of the market, and the three collusive alliances combined had only a forty-two percent market share.[72] Upon approval of the Oneworld ATI application the market share of the three collusive alliances will have risen from forty-two to ninety-two percent, and can be expected to increase further since it is unlikely that carriers with market shares of five percent or less could survive independently.[73]

1993	1995	1997	1999	2001	2003	2005	2007	2009	2011
Top 3 Concentration of US-Continental Europe market (40 million annual pax)									
41%	47%	55%	56%	61%	67%	**85%**	**88%**	**98%**	**98%**
Top 3 Concentration of total North Atlantic market (55 million annual pax)									
42%	42%	45%	47%	47%	54%	68%	66%	**92%**	**98%**
number of total North Atlantic competitors with minimum departure share of 2%									
15	13	13	11	11	9	7	6	4	3

Figure 3[74]

Thus alliance development and industry consolidation on the North Atlantic must be broken into distinct pre-and post 2003 phases.[75] The high levels of concentration that could potentially help sustain anti-competitive behavior have only arisen in the last couple years, although the movement towards radical consolidation began in 2003, when Air France bid to acquire KLM. This eliminated the major source of price competition between European intercontinental hubs, eliminated the possibility that Northwest Airlines could survive independently,[76] and reduced the

72. Percentages based on DOT Form 41 schedule T100 seat capacity data compiled by the author (on file with author).

73. Seat share using DOT Form 41 Schedule T100 data compiled by the author (on file with author); 2009 shares assumes approval of Oneworld application; 2011 shares assumes other small network airlines cannot survive independently and are absorbed into the three large collusive groups. USAirways became a full member of the Star Alliance in 2004, and codeshares actively with other Star members. Although it has not applied for antitrust immunity, USAirways is not considered independent of the other immunized Star members as they have strong incentives not to undercut prices on overlapping routes, and DOT would readily grant full immunity if they applied for it. Similarly, the Northwest/KLM alliance is not considered independent of the Delta/Air France alliance in the four years between the Air France/KLM merger and the DOT's formal approval of combined Skyteam immunity.

74. *See* DOT Form 41 Schedule T100 data, *supra* note 74 (on file with author).

75. *See generally* S.C. Morrish & R.T. Hamilton, *Airline alliances – Who Benefits?*, 8 AIR TRANSP. MGM'T. L.J. 401 (2002) (summarizing the academic literature on pre-2003 alliance development). The summarized literature tends to conflate branded and collusive alliances, and generally fails to consider the competitive network advantages that are critical to the marketplace impacts of alliances.

76. The contract governing Northwest's alliance with KLM would not have been renewed past its 2012 expiration, as Delta had exclusive rights to be Air France's US alliance partner. The separate Northwest/KLM and Delta/Air France alliances continued to operate until 2009 but were not independent price competitors. Delta was able to acquire Northwest without any cash

number of meaningful competitors serving the forty million annual passengers in the US-Continental Europe market from three to two.[77] The formal DOT ATI applications that formalized the increase to a ninety-two percent concentration were filed between 2004 and 2008.[78] As will be discussed in section 10, those same airlines have already begun petitioning governments to permit the consolidation of twenty three previously independent transpacific competitors into those same three collusive alliance groups.

VI. GUTTING THE PUBLIC BENEFITS TEST (I): ESTABLISH A RULE THAT PRICES FALL WHENEVER COMPETITION IS REDUCED

The biggest and most important claim in the recent Oneworld case was that immediately following a grant of immunity, prices would immediately fall $257 per ticket in all connecting markets currently served on an interline basis by the applicants, creating an annual $92 million consumer benefit.[79] This is from the "elimination of double markups on codeshare segments"[80] that Dean and Shane cite, or "double marginalization" as it is called in the ATI cases.[81] This is the biggest single factor behind the DOT's antitrust jurisprudence, and the biggest single economic justification for intercontinental airline consolidation. If the DOT

payments to Northwest's shareholders; the stock swap implicitly valued Northwest at roughly the value of its cash and liquid assets on hand at the time of the merger agreement.

77. Number of annual passengers in the U.S.-Continental Europe market based on DOT Form 41 Schedule T100 data compiled by the author (on file with author).

78. *See* Oneworld ATI Application, *supra* note 44; Star/Continental ATI Application, *supra* note 44; Joint Application of Alitalia-Linee Aeree Italiane-Spa. Delta Air Lines, Inc., Czech Airlines, KLM Royal Dutch Airlines, Northwest Air Lines, Inc., and Société Air France under 49 U.S.C. §§ 41308 and 41309 for Alliance Agreements and for Approval of and Antitrust Ammunity. Docket No. OST-2004-19214, Application (Dep't of Transp. Sep. 24, 2004) [hereinafter Skyteam I ATI Application]; Joint Application of Alitalia-Linee Aeree Italiane S.p.A., Czech Airlines, Delta Air Lines, Inc., KLM Royal Dutch Airlines, Northwest Airlines, Inc., Société Air France under 49 U.S.C. §§ 41308 and 41309 for Approval of and Antitrust Immunity for Alliance Agreements, Docket No. OST-2007-28644, Application (Dep't of Transp. June 28, 2007) (resubmission of Skyteam I ATI Application) [hereinafter Skyteam II ATI Application]; Joint Application of The Austrian Group, British Midland Airways Limited, Deutsche Lufthansa Ag, Polskie Linie Lotnicze Lot S.A., Scandinavian Airlines System, Swiss International Air Lines Ltd., Tap Air Portugal, And United Air Lines, Inc. under 49 U.S.C. §§ 41308 and 41309 for Approval of and Antitrust Ammunity for Alliance Expansion Agreements and an Amended Coordination Agreement, Docket No. OST-2005-22922, Application (Dep't of Transp. Nov. 4, 2005) [hereinafter Star I ATI Application]; Joint Application of United Air Lines, Inc. And Air Canada under 49 U.S.C. §§ 41308 and 41309 for Approval of and Antitrust immunity for Commercial Alliance, Docket No. OST-1996-1434, Application (Dep't of Transp. June 4, 1996) (consolidated with Star I ATI Application on Apr. 27, 2006).

79. Oneworld ATI Application *supra* note 44, at 7, 24, Ex. JA-13, Ex. JA-17, Ex. JA-19 (on file with the author). The ticket amounts are redacted from the public version of the application.

80. Dean & Shane, *supra* note 26, at 19.

81. Oneworld Show Cause Order, *supra* note 3, at 5, 5 n.14, 30.

could not accept Oneworld's claim that ATI would eliminate $92 million in "double marginalization" burdens on consumers, the applicants would not have been able to demonstrate the significant public benefits needed to meet "required by the public interest" standard of 49 U.S.C. § 41308(b).[82] The entire question of whether recent ATI grants have actually generated significant public benefits, hinges on whether you believe, as Dean and Shane and the DOT do, that "double marginalization" automatically drives $200-$300 fare reductions for connecting traffic, regardless of market conditions.[83] The alleged efficiency gain from eliminating the "double marginalization" on connecting tickets is comparable to eliminating all of the airline wage and salary costs associated with those tickets.[84]

The entire "double marginalization" claim is based on a single 2000 journal article by Brueckner and Whalen; Brueckner (the principal author) was at the time and throughout the past decade served as a paid advocate for United Airlines.[85] ATI applicants and consolidation advocates claim that "double marginalization" has been documented in the economic literature,[86] but this literature is nothing more than follow-up pieces by Brueckner and Whalen making the exact same points as the

82. Oneworld ATI Application *supra* note 44, at 7, 24, Ex. JA-13, Ex. JA-19.

83. *See* Dean & Shane, *supra* note 26, at 19; Oneworld Show Cause Order, *supra* note 3, at 5, 5 n.14, 30.

84. *See* AMR Corp., Annual Report (Form 10-K), (Feb. 19, 2009), *available at* http://phx.corporate-ir.net/phoenix.zhtml?c=117098&p=irol-sec&control_selectgroup=Annual%20Filings (stating that wages, salaries and benefits accounted for twenty-six percent of American Airlines' total 2008 operating expenses).

85. Joint Application of Alitalia-Linee Aeree Italiane-S.p.A., Czech Airlines, Delta Air Lines, Inc., KLM Royal Dutch Airlines, Northwest Airlines, Inc., and Société Air France for Approval of and Antitrust Immunity for Alliance Agreements under 49 U.S.C. §§ 41308 and 41309, Joint Application of Delta Air Lines, Inc., KLM Royal Dutch Airlines, Northwest Airlines, Inc., Société Air France, Alitalia-Linee Aeree Italiane-S.p.A., and Czech Airlines for Statements of Authorization under 14 C.F.R. Part 212 (blanket code sharing), Docket No. OST-2004-19214, Order 2005-12-12 at 14 (Dep't of Transp. Dec. 22, 2005). *See* Jan K. Brueckner & W. Tom Whalen, *The Price Effects of International Airline Alliances,* 43 J.L. & Econ. 503, 503-44 (2000); Robert W. Moorman, *United Turns to Academics to Show Alliances Aid Consumers,* 153 Aviation Week & Space Tech. 56, 56 (2000) (disclosing Brueckner's paid advocacy role). Brueckner (who is currently on the faculty of University of California-Irvine) submitted testimony in support of Star Alliance positions in the Skyteam I and the Star I cases (on file with author). Since the original 2000, paper, Whalen (who is currently employed by the Department of Justice) has not published any comments about any specific merger, consolidation or antitrust immunity proposal.

86. *See* Oneworld Show Cause Order, *supra* note 3, at 5, 5 n.14, 30; *See* Daniel M. Kasper & Darin Lee, *Why Antitrust Immunity Benefits Consumers*, CPI Antitrust Chronicle, Sept. 2009, at 1, *available at* https://www.competitionpolicyinternational.com/sep-091 (A piece written by paid advocates for American Airlines claiming that "virtually every peer-reviewed academic study of immunized international alliances has concluded that, as a result of eliminating carriers' incentives to impose successive markups on fares for connecting tickets (the so called 'double marginalization' problem), alliances have led to lower fares and expanded output."). However,

original article;[87] no other published original research has ever documented the existence of "double marginalization."[88] The original 2000 paper describes a cross-section regression of 1997 transatlantic fares in alliance and non-alliance markets.[89] Brueckner (2003) repeated the original regression using 1999 data, which better identified the actual operator of codeshared flights; Whalen (2007) estimated slightly smaller impacts using a regression of eleven year (1990-2000) panel data instead of cross-section data from a single point in time.[90] These three regressions found fifteen to twenty-five percent lower fares in markets served by immunized alliances compared to markets served by traditional interline service or non-immunized codesharing.[91]

It is not surprising that a statistical analysis of the 1990's transatlantic

no peer reviewed articles written by anyone but Brueckner and Whalen have presented any original research on this question.

87. Jan K. Brueckner, *The Economics of International Codesharing: an Analysis of Airline Alliances*, 19 Int'l J. Indus. Org. 1475 (2001); Jan K. Brueckner, *International Airfares in the Age of Alliances: the Effects of Codesharing and Antitrust Immunity*, 85 Rev. Econ. Stat. 105 (2003); Jan K. Brueckner, *The Benefits of Codesharing and Antitrust Immunity for International Passengers, with an Application to the Star Alliance*, 9 J. Air Transp. Mgmt. 83 (2003); W. Tom Whalen, *A Panel Data Analysis of Code Sharing, Antitrust Immunity and Open Skies Treaties in International Aviation Markets*, 30 Rev. Indus. Org. 39 (2007).

88. *See* Morrish, *supra* note 76 (summarizing the pre-Brueckner/Whalen academic literature on airline alliance impacts). None of this academic literature found evidence of any alliance benefits from the elimination of "double marginalization" or any other "structural negative externalities." *See also* A. Jorge Padilla et al., *An Economic Analysis of the Efficiencies from the Creation of the Proposed Pacific Joint Venture*, Docket No. OST-2010-0059, at App. A (Dep't of Transp. 2010). The Padilla paper is a paid advocacy work supporting a United Airlines ATI application, prepared by the consulting firm LECG. Padilla reprints the Morrish-Hamilton list of alliance studies, adding the Brueckner/Whalen papers and papers by five other authors, none of which had found independent evidence of any alliance benefits from the elimination of "double marginalization" or any other "structural negative externalities." Four of these studies examine only non-immunized domestic U.S. or intra-E.U. alliances and are thus irrelevant to the Bruckner/Whalen thesis about immunized intercontinental alliances. The fifth is a paid advocacy study commissioned by American Airlines in support of the Oneworld application that focuses on pricing impacts from reduced competition in nonstop markets. The Padilla/LEGC survey excludes the recent research cited *infra* at note 106, which finds evidence that post-1999 alliances had harmed consumers.

89. Jan K. Brueckner & W. Tom Whalen, *The Price Effects of International Airline Alliances,* 43 J.L. & Econ. 503, 503, 506, 514, 528 (2000).

90. Jan K. Brueckner, *International Airfares in the Age of Alliances: the Effects of Codesharing and Antitrust Immunity*, 85 Rev. Econ. Stat. 105 (2003); W. Tom Whalen, *A Panel Data Analysis of Code Sharing, Antitrust Immunity and Open Skies Treaties in International Aviation Markets*, 30 Rev. Indus. Org. 39 (2007).

91. The results of the three statistical analysis are summarized at Horan Oneworld comments, *supra* note 62, at 6. Smaller (about fifteen percent) price reductions are alleged to occur when airlines that codeshare without immunity are granted ATI, whereas larger (about twenty-five percent) price reductions are alleged to occur when non-codeshared interline itineraries are converted to immunized codeshares. Oneworld could not identify codeshare versus non-codeshare distinctions among its actual 2008 interline passengers, and thus its $92 million annual public benefit claim assumed the smaller (fifteen percent) codeshare to ATI price reduction.

market identified consumer benefits; fares fell eight percent in the 1990s while capacity grew fifty-four pecent.[92] But Brueckner and Whalen made no attempt to isolate the impacts ATI might have on fares from the impacts of favorable supply/demand conditions or other important competitive and productivity factors,[93] and improperly attributed all of the observed variation to "cooperative pricing" among alliance partners.[94] Brueckner's and Whalen's papers do not mention any other factors that might have influenced pricing, and fail to demonstrate that their statistical analysis had isolated alliance impacts from other possible causes.[95]

The consumer benefits directly attributable to the original 1990s alliances were only found in the thirty percent of the market previously limited to traditional interline service and had been fully exhausted by the end of the decade.[96] This was the "double connect" market impact described earlier, which was called the "Alliance Network Effect" in the 1999/2000 DOT studies that Dean and Shane quote,[97] but this was not huge compared to the overall benefits transatlantic consumers realized in the 1990s. When DOT and ATI applicants use the Brueckner and Whalen regression coefficients to calculate alliance public benefits, they are assuming that none of the observed mid-1990s consumer benefits were due to market liberalization, supply/demand conditions, or carrier

92. Data from Schedules P12 and T100 of DOT Form 41, as compiled by the author for the same time period covered by the Brueckner and Whalen regressions, *supra* notes 90, 91 (on file with author).

93. These factors include market liberalization in Europe, increased transatlantic competition following the original "Open Skies" treaties, and major carrier productivity gains from a variety of sources including the privatization of British Airways, the recently integrated Air France-UTA-Air Inter hub in Paris, and the widespread introduction of 767 and A330 aircraft.

94. Brueckner & Whalen, *supra* note 90, at 504-06.

95. *See* Jan K. Brueckner & W. Tom Whalen, *The Price Effects of International Airline Alliances*, 43 J.L. & ECON. 503, 503-44 (2000); Jan K. Brueckner, *The Economics of International Codesharing: an Analysis of Airline Alliances*, 19 INT'L J. INDUS. ORG. 1475 (2001); Jan K. Brueckner, *International Airfares in the Age of Alliances: the Effects of Codesharing and Antitrust Immunity*, 85 REV. ECON. STAT. 105 (2003); Jan K. Brueckner, *The Benefits of Codesharing and Antitrust Immunity for International Passengers, with an Application to the Star Alliance* (2003), 9 J. AIR TRANSP. MGMT. 83 (2003); W. Tom Whalen, *A Panel Data Analysis of Code Sharing, Antitrust Immunity and Open Skies Treaties in International Aviation Markets*, 30 REV. INDUS. ORG. 39 (2007).

96. *See* Horan Oneworld Comments, supra note 62, at 7-9.

97. Dean and Shane, *supra* note 26, at 19. The 1999/2000 DOT studies correctly focus on the specific competitive network advantage created by the original mid-1990s alliances, but overstate the consumer benefits by failing to clearly distinguish between benefits created by capacity growth and other general factors, and benefits specifically attributable to alliance schedule and pricing coordination. *See generally* Jong-Hun Park & Anming Zhang, *An Empirical Analysis of Global Airline Alliances: Cases in North Atlantic Markets*, 16 REV. OF INDUS. ORG. 367, 382-83 (2000) (estimating smaller alliance consumer benefits but failing to clearly distinguish between immunized and non-immunized alliances).

productivity; they are assuming that 2010 market conditions are identical in every respect to 1995 market conditions.

As problematic as the regressions may be, the central antitrust problem is the "double marginalization" theory that Brueckner and Whalen put forward to explain the observed 1990s pricing/alliance correlations. Under this "double marginalization" theory, none of the benefits created by alliances have anything to do with the superior service Northwest/KLM offered in double connect markets or their competitive advantage versus poorly coordinated interline connections. They attribute all consumer benefits to a "structural negative externality"[98] that forces carriers to set interline prices that are suboptimal from the standpoint of both joint efficiency and market competitiveness. "Double marginalization" theory claims that if American and Iberia currently offer a joint fare from Madrid to Seattle, they will do so by separately "marking up" the separate Madrid-Chicago and Chicago-Seattle segment prorates without ever consulting one another as to what the resulting fare will be or considering whether that fare would be competitive against the Madrid-Seattle fares charged by others. "Double marginalization" is defined as a market failure, an insurmountable physical barrier to efficiency found in every airline's interline pricing function resulting in interline fares that are approximately fifteen to twenty five percent higher than ATI (or single carrier) fares in each and every case, regardless of market or competitive conditions or carrier productivity.[99] Under this theory, the only ways to reduce the structurally higher costs of interline pricing are merger or full immunity to collude on prices.[100] Thus, granting ATI automatically and immediately reduces these fares approximately fifteen to twenty five percent every time competition is reduced. Not under certain market conditions or if specific productivity gains were achieved, but huge consumer benefits follow automatically from each and every ATI grant organized along Northwest/KLM lines, just as night automatically follows day.

This theory is completely indefensible. "Double marginalization" does not exist, never existed, and has absolutely nothing to do with the

98. The structural negative externality explanation of the regression results can be found at Brueckner & Whalen, *supra* note 90, at 505-06; Jan K. Brueckner, *The Economics of International Codesharing: an Analysis of Airline Alliances*, 19 INT'L J. INDUS. ORG. 1475, 1477 (2001); Jan K. Brueckner, *International Airfares in the Age of Alliances: the Effects of Codesharing and Antitrust Immunity*, 85 REV. ECON. STAT. 105, 106 (2003); *The Benefits of Codesharing and Antitrust Immunity for International Passengers, with an Application to the Star Alliance*, 9 J. AIR TRANSP. MGMT. 83, 84-85 (2003). Whalen, *supra* note 87 omits any behavioral explanation, except by reference to earlier papers.

99. *See* Brueckner & Whalen papers, *supra* note 99.

100. *See* Brueckner & Whalen papers, *supra* note 99. The regression results showing smaller impacts in codeshare markets contradicts the theory; if carriers actually set interline fares in this manner the "double markups" should be identical in codeshare and non-codeshare cases.

actual legitimate benefits of immunized alliances. The "double marginalization" theory was created out of whole cloth—nothing in Brueckner and Whalen's statistical analysis supports this theory of interline pricing behavior, nor had they conducted any research on how airline interline pricing actually functions.[101] The theory not only ignores the possibility that favorable supply/demand and efficiency conditions influenced 1990s transatlantic prices but denies the existence of competitive network advantages and disadvantages, and explicitly assumes interline prices cannot be set at rational, revenue-maximizing levels. There are no insurmountable structural barriers to rational, efficient interline pricing; carriers can readily optimize interline pricing and traffic using "fare buckets" within revenue management system.[102] All of the observed limitations to interline pricing that Brueckner and Whalen improperly attribute to structural pricing barriers can be readily explained by rational, profit-maximizing behavior.[103] Even though interline fares are widely used by hundreds of airlines across the globe, none of these airlines has ever made any effort to correct the irrational pricing behavior that allegedly increases all interline prices fifteen to twenty-five percent above efficiency-maximizing levels.[104] No one independent of the DOT or the ATI applicants has ever claimed that "double marginalization" exists, and no other research ever produced findings supporting the Brueckner and Whalen theories. A number of researchers have found that ATI is no longer generating any

101. *See* Brueckner and Whalen, *supra* note 86.

102. Horan Oneworld Comments, *supra* note 62, at 12-15. Brueckner and Whalen incorrectly assume that airlines set interline fares with respect to the marginal operating costs of the flight legs involved; "double marginalization" is assumed to be the pricing "markups" above marginal cost. These costs are entirely "fixed" in the very-short-term time frame in which airline pricing decisions are actually taken; if airline prices were set with respect to marginal costs one would have seen enormous pricing volatility tracking fuel cost volatility in recent years.

103. *Id.* at 15-16. Short-haul domestic/regional carriers will rationally refuse interline fare arrangements with long-haul carriers unless their share of the joint fare reflects the much higher per-mile cost of short-haul flights, and exceeds what they could earn from the lowest discount fares in the local market. Long-haul carriers will rationally refuse interline fare arrangements if the fare split with the short-haul carriers reduces their portion of the joint fare below a level they could earn from alternate discount long-haul fares. The "structural negative externality" that is the heart of the Bruckner and Whalen paper is, in fact, the rational behavior of airlines refusing tickets with lower revenue yields in favor of tickets with higher revenue yields.

104. The claim that interline fares are artificially set fifteen to twenty-five percent above rational, joint-profit-maximizing levels because of double marginalization was first published in 2000. Brueckner & Whalen, *supra* note 86. If this claim were credible, there would be evidence of airlines seeking to find ways to minimize or eliminate the fifteen to twenty-five percent double marginalization penalty (via less complex means than immunized global alliances) in the past decade, because according to the theory any reductions in interline fares would increase profits. The double marginalization claim not only assumes that undocumented "structural negative externalities" led to irrational interline pricing practices, but assumes that carriers irrationally did nothing to mitigate unprofitable pricing practices once the "problem" had been identified in research commissioned by a major international airline.

consumer price benefits (much less the fifteen to twenty-five percent benefits claimed here), there is no evidence that any of the recent Star and Skyteam ATI grants generated any "double marginalization" consumer benefits in any connecting markets, and several studies have found evidence that consumers now pay higher fares in ATI markets than non-ATI markets.[105]

The DOT has converted "double marginalization" from a theory in one isolated paper, to an established antitrust rule that cannot be challenged on the basis of facts or logic. In the Oneworld case, the DOT explicitly rejected a detailed challenge to "double marginalization," even though it acknowledged DOJ comments that the link between "double marginalization" benefits and ATI had never been proven, did not dispute any of the observed flaws in the theory, and was unwilling to openly defend any of the logic or analysis on which the theory is based.[106] It nonetheless accepted the Oneworld applicants' $92 million annual consumer benefit claim solely on the basis of the Brueckner and Whalen theory.[107] Unquestioning acceptance of "double marginalization" is critical to Dean and Shane and other industry consolidation advocates because it establishes the automatic rule that each and every ATI application between network airlines will generate large public benefits and thus nullifies the *Horizontal Merger Guidelines* requirement for verifiable, case-specific evidence. If ATI automatically generates fifteen to twenty-five percent price reductions in any alliance structured along Northwest/KLM lines, regardless of market/competitive conditions or carrier productivity, then there is no need to produce case-specific evidence regarding the current marketplace or the actual pricing behavior or efficiency of the applicants. The DOT even rejected the claim that the Oneworld applicants had failed to demonstrate that the traffic base that they claimed would benefit from the $92 million savings were actually paying, as they claimed, fares $257 higher than comparable alliance or online traffic, or that these markets had any of the characteristics of the ones where

105. Oneworld ATI Application *supra* note 44, at Ex. JA-19. In analysis prepared on behalf of American Airlines in Skyteam I (2005) and Skyteam II (2006), Robyn and Reitzes of the Brattle Group replicated the analysis of alliance benefits conducted by the DOT in 1999/2000 (cited by Dean and Shane, *supra* note 26, at 19) and found no evidence of alliance consumer benefits after 1999. *See also* James Reitzes & Diana Moss, *Airline Alliances and Systems Competition*, 45 HOUS. L. REV. 293, 314-24 (2008). The DOJ presented original statistical analysis contradicting the Brueckner and Whalen findings using 2005-2008 data, Star/Continental DOJ Comments *supra* note 8, and using updated 2008 data, Joint Application of American Airlines, Inc., British Airways PLC, Iberia Líneas Aéreas de España, S.A., Finnair OYJ, Royal Jordanian Airlines under 49 U.S.C. §§ 41308 and 41309 for approval of and antitrust immunity for alliance agreements, Docket No. OST-2008-0252, Comments of the Department of Justice, at 22-24 (Dep't of Transp. Dec. 21, 2009).

106. Oneworld Show Cause Order, *supra* note 3, at 30-32.

107. Oneworld ATI Application, *supra* note 44, at 24, Ex. JA-17; *Id.* at 9, 32.

Brueckner and Whalen allegedly found the original 1990s "double marginalization" impacts.[108]

By establishing "double marginalization" as a settled antitrust rule, the DOT creates the superficial appearance that it is conducting a public benefits evaluation, when they have actually rendered the public benefits standard completely meaningless. "Double marginalization" - a rule that implicitly says that consumers benefit whenever competition is eliminated regardless of marketplace conditions - is inconsistent with any marketplace/economics-focused antitrust approach. But this approach is fully compatible with the "bilateral driven aviation policy" approach that Dean and Shane favor, where the antitrust regulator has extremely broad discretion over rules and evidentiary requirements.

VII. Gutting the Public Benefits test (II)—eliminate the "public" part of public benefits

Dean and Shane's central claim is that ATI has only been awarded once it has been objectively demonstrated that the public benefits will be of significant magnitude.[109] But they fail to provide any evidence that DOT benefit findings have been objectively demonstrated and further undermine their credibility by citing the exact list of public benefits that DOT "copy/pasted" from the Star/Continental application.[110] The listed claims are more reflective of a marketing press release than a serious analysis of competitive economics but can nonetheless help illustrate other steps DOT has taken to render the public benefits test meaningless:

- an expanded network serving many new cities;
- new online service, including both new routes and expanded capacity on existing routes;
- enhanced service options such as more routings, reduced travel times, expanded nonstop service in selected markets, new fare products, and integrated corporate contracting and travel agency incentives;
- enhanced competition due to the addition of a major new gateway, the elimination of multiple markups on code-share segments, and more vigorous competition between alliances;
- cost efficiencies;
- strengthened financial positions for the participating carriers; and
- substantial economic benefits to communities[111]

Dean and Shane acknowledge that public benefits must be demonstrably "significant," but without quantitative data there is no way to demonstrate "significance."[112] "Significant" public benefits in an airline ATI case would naturally occur in the form of observable price or capacity benefits. Northwest/KLM and the other original 1990s alliances clearly led to lower prices in certain markets and some increased transatlantic capacity.[113] If "improved schedule timings" or "increased efficiency" are actually significant, they would translate into price and capacity benefits. "Increased efficiency" is not a legitimate public benefit unless the gains allow the carrier to profitably expand or reduce prices, or to sustain capacity that would have been liquidated absent the efficiency gains. Despite abundant sources of industry data, none of the Star and Skyteam cases quantify any of the alleged benefits, and Oneworld only quantified two benefits and only did so because of the DOJ's evidentiary criticisms in the Continental/Star Alliance case.[114] Those two claims were the $92 million pricing benefit discussed above, based on the Brueckner and Whalen theory, and a $45 million benefit claim from increased nonstop service.[115]

In accepting the Oneworld $45 million nonstop benefit claim and the "network expansion" claims in prior cases, DOT willfully violated the *Horizontal Merger Guidelines* requirement that it must have evidence that the public benefits are highly likely to be realized and that it cannot accept claims that are "vague or speculative or otherwise cannot be verified by reasonable means" or are not clearly based on the grant of immunity.[116] The Oneworld applicants did not agree to actually operate increased service—they merely suggested the possibility that they might add flights.[117] Since approval of ATI does not obligate them to actually do so, these claims (or certainly some large portion of them) are purely speculative. The claim included new service on the Dallas-Fort Worth-Madrid route, which has been operated in the past without immunity, and was withdrawn when the recent economic recession began.[118] The DOT rejected Virgin Atlantic and DOJ arguments that this public benefit claim was illegitimate because restoration of this flight would have likely occurred without ATI.[119] There is no evidence on the record that any of the prior Star and Skyteam ATI approvals were directly responsible for net increases in transatlantic service that actually created material benefits

108. *See* Oneworld Show Cause Order, *supra* note 3 at 9, 30-32; Oneworld ATI Application, *supra* note 44 at 24, Ex. JA-17 (data on file with author). The ticket amounts are redacted in the public version of the application.

109. Dean and Shane, *supra* note 26, at 19-20.

110. *Id.* at 19.

111. *Id.* at 19 (quoting Star/Continental Show Cause Order, *supra* note 18, at 18-19).

112. *Id.* at 19.

113. Horan Oneworld comments, *supra* note 62, at 7-9.

114. Oneworld ATI Application, *supra* note 44, at 24; *See* Star/Continental ATI Application, *supra* note 44, at 23-50; Skyteam II ATI Application, *supra* note 79, at 16-43.

115. Oneworld ATI Application, *supra* note 44, at 24, Ex. JA-17.

116. Horizontal Merger Guidelines, *supra* note 4, at 31.

117. Oneworld ATI Application, *supra* note 44, at 24-25.

118. *Id.* at 24.

119. Oneworld Show Cause Order, *supra* note 3, at 31.

for consumers. Network expansion is one of the easiest benefit claims to document and quantify, and the ongoing lack of evidence that meets *Horizontal Merger Guidelines* standards suggests that the claims are fundamentally deficient.

As with "double marginalization," the list of alleged Continental/Star benefits that Dean and Shane quote[120] reflect DOT's desire to render the public benefit standard of 49 U.S.C. § 41308(b) completely meaningless by establishing an arbitrary rule that each any and every ATI application would meet. This DOT rule establishes that an applicant's assertion that it will benefit from a grant of ATI fully satisfies the "public benefits" standard of 49 U.S.C. § 41308(b), without requiring any evidence that consumers in general did not suffer because of offsetting detriments in other markets. The fact that platinum status members of United's frequent flyer program can now occasionally get first class upgrades on Continental flights does not mean that ATI created a benefit for the overall public in the form of more generous frequent flyer awards, but under the DOT's rule ATI has created "public benefits" as long as one United frequent flyer benefits. When Continental joined Star Alliance it created an expanded (Star) network with increased (Star) gateways, increased online (Star) service, expanded (Star) routing options, expanded (Star) corporate and frequent flyer programs, created some (intra-Star) cost efficiencies, and strengthened (Star) financial performance, even though all of these "benefits" were merely shifts to Star markets from other markets.[121] Every ATI application between network airlines with some degree of network overlap could claim the exact same "public benefits" (even the implausible merger of the Star, Skyteam and Oneworld alliances into a monopoly transatlantic collusive group) and is contrary to the notion that antitrust decisions should maximize consumer or overall economic welfare. As with "double marginalization" this automatically met rule eliminates the need for applicants to present any verifiable evidence about actual market, competitive or productivity impacts specific to their case, and thus eliminates the possibility that consolidation applications can be challenged on the basis of case/market specific evidence.

120. *See generally* Dean & Shane, *supra* note 26, at 19 (discussing public benefits produced by the award of antitrust immunity to the Star alliance).

121. *Id.*

VIII. Gutting the Clayton Act Market Power Test—Evaluate Anti-Competitive Pricing Risks Without Any Evidence About Pricing or Entry Barriers or Market Contestability

Dean and Shane correctly note that ATI cannot be granted unless they meet the Clayton Act test[122] showing that the application would not increase market power. As the DOT explained in the original Northwest/KLM case, the Clayton Act test requires the Department to consider whether the alliance agreements are likely to substantively reduce competition so that any of the applicants would be able to charge supra-competitive prices or reduce service below competitive levels.[123] To determine whether an alliance or comparable transaction is likely to violate the Clayton Act standard the department considers whether the transaction is likely to create or enhance "market power," which is defined as the ability to profitably maintain prices above competitive levels for a significant period of time or to reduce output and service quality below competitive levels:[124]

> "To determine whether a proposed alliance is likely to create or enhance market power, we primarily consider whether the alliance would significantly increase concentration in relevant markets, whether the alliance raises concern about potential competitive effects in light of other factors, and whether entry into the market would be timely, likely, and sufficient either to deter or to counteract a proposed alliance's potential for harm."[125]

Dean and Shane defend recent ATI grants on the basis that the DOT found no threat of market power but ignore the fact that none of the DOT's ATI decisions in the past decade included a Clayton Act test that actually presented or analyzed any pricing data or any evidence of the

122. Dean & Shane, *supra* note 26, at 19 (citing to Clayton Act, *supra* note 5).

123. Joint Application of Northwest Airlines and KLM Royal Dutch Airlines for Approval and Antitrust Immunity of an Agreement Pursuant to Sections 412 and 414 of the Federal Aviation Act, as Amended, Docket No. 48342, Order 92-11-27 at 13 (Dep't of Transp. Nov. 16, 1992) ("In determining whether the proposed transaction would violate the antitrust laws, we will apply the standard Clayton Act test used in examining whether mergers will substantially reduce competition in any relevant market. The . . . test requires us to consider whether the Agreement will substantially reduce competition by eliminating actual or potential competition between Northwest and KLM so that they would be able to raise prices above competitive levels or reduce service below competitive levels.").

124. Joint Application of American Airlines, Inc., Lan Airlines, S.A., and Lan Peru, S.A. for Antitrust Immunity, Docket No. OST-2004-19964, Order 2005-10-8 at 8 (Dep't of Transp. Oct. 13, 2005) ("To determine whether an alliance or comparable transaction is likely to violate the Clayton Act standard, the Department considers whether the transaction is likely to create or enhance "market power," defined as the ability to profitably maintain prices above competitive levels for a significant period of time or to reduce output and service quality below competitive levels").

125. *Id.*

future market contestability needed to eliminate the risk of supra-competitive prices.[126] A complete Clayton Act test cannot be laid out here, but several simple data points can illustrate the serious possibility that anti-competitive "market power" has already emerged on the North Atlantic, and that the DOT's failure to conduct legitimate Clayton Act tests is a serious abdication of its legal responsibility.[127]

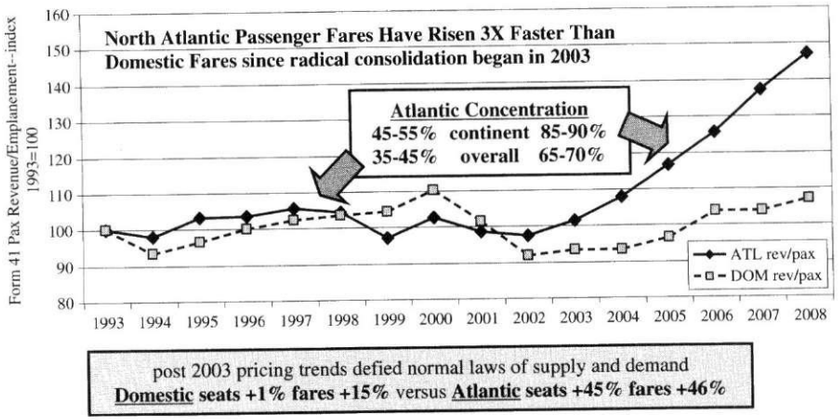

Figure 4[128]

Increased North Atlantic concentration has already increased prices towards supra-competitive levels. From deregulation until 2003, North Atlantic price trends closely tracked domestic price trends.[129] From 2003 onward, a totally new pattern emerged, with North Atlantic fares rising three times faster than domestic fares.[130] This fundamental shift in pricing behavior exactly tracks the move towards extreme North Atlantic concentration, which started when Air France bought KLM, previously

126. *See, e.g,* Oneworld Show Cause Order, *supra* note 3, at 18-20 (considering only briefly airport slot barriers on a handful of large nonstop routes at London Heathrow airport, the only time the DOT analyzed any evidence of entry barriers in any ATI case.)

127. *Proposed United-Continental Merger: Hearing Before Subcomm. on Aviation of the H. Transp. & Infrastructure Comm.*, 111th Cong. (2010) (statement of Hubert Horan) [hereinafter *Proposed United-Continental Merger* Comments].

128. Data in the graph is total Domestic and Atlantic entity totals for all US carriers are from DOT Form 41 as compiled by the author. Passenger revenue data are from Schedule P12, and the segment passengers data are from Schedule T100. Transatlantic revenue figures for non-US carriers are not publicly available, but since US flag carriers serve the identical markets with comparable schedules and capacity, the aggregate US carrier Atlantic unit revenue data shown in the graph should very closely track aggregate market levels. Capacity comparison is total Domestic and Atlantic entity seat capacity for all US and non-US carriers from Schedule T100 (on file with author).

129. *Proposed United-Continental Merger* Comments, *supra* note 128.

130. *Id.* at 3;

the largest single driver of price competition in European long-haul network markets. The market power already created by consolidation is much worse than the simple Atlantic/Domestic fare comparison suggests. Under normal, healthy competitive conditions, airline fares are highly responsive to changes in capacity. Domestic fares increased fifteen percent since 2003 because the industry did not add capacity.[131] When Atlantic capacity spiked in the late 1990s, average fares fell, even though this was the peak of the dot-com era.[132] But the market power created on the Atlantic in recent years meant normal supply/demand relationships would not work. Atlantic fares increased forty-six percent since 2003, even through capacity also increased forty-five percent.[133]

If 2008 capacity levels were operated under pre-2003 competition levels, 2008 Atlantic unit revenues might well been thirty to forty percent lower than observed, suggesting an annual consumer welfare loss due to increased market power of $9 to $12 billion.[134] Counterfactual historical analyses such as this are a bit complicated;[135] but even if one arbitrarily assumes that only half or less of the observed pricing shift is due to market power, consumer welfare losses have already been staggeringly large:

2008 Consumer Welfare	5%	$1.5 billion
Loss if increased	10%	$3.0 billion
North Atlantic Market Power	15%	$4.5 billion
increased fares by:	20%	$6.0 billion
	20%	$7.5 billion

A legitimate Clayton Act "market power/market contestability" analysis would also note that

—There are serious risks that the observed anti-competitive pricing trend will worsen after independent competition from Continental,

131. *Id.* at 2-3.

132. *Id.* at 2.

133. *Id.*

134. The total 2008 North Atlantic revenue base is conservatively assumed to be $30 billion, based on DOT Form 41 data compiled by the author, U.S. carrier Atlantic passenger revenue of $15,058 million, and a forty-six percent U.S. carrier share of combined total available seat miles. This estimate does not include non-passenger revenue or the portion of transatlantic ticket revenue flown on domestic U.S. or intra-EU connecting flights that would not be categorized as Atlantic revenue in Form 41 (on file with author).

135. A more detailed analysis would likely show relatively large consumer welfare losses in the connecting U.S.-Continental Europe markets where the duopoly of the Lufthansa and Air France-led collusive alliances have had an eighty-five percent share for over five years, and smaller welfare losses in other market categories. Some marginal, higher-cost capacity would have been withdrawn in a more competitive environment, although the increased competition may have driven industry productivity improvements, and share shifts favoring more efficient carriers. Lower fares would have also stimulated demand growth.

Iberia, Finnair and American is eliminated and concentration increases from sixty-five to eighty percent to ninety to ninety-five percent. Price competition in isolated large nonstop O&Ds must be evaluated separately, but figure 3 reasonably reflects the concentration in Continental Europe connecting markets, which account for the vast majority of North Atlantic traffic.

—As discussed in section 5, North Atlantic markets are not contestable. There is no possibility that future entry would be "timely, likely and sufficient either to deter or to counteract" anti-competitive behavior by the three dominant Collusive Alliances. A new entrant would require a major hub, tens of billions of dollars in new fleet investment and expensive access to highly constrained airports. The last successful entry on the North Atlantic was twenty three years ago.[136]

—Basic network airline economics create serious risks of cartel conditions in these markets—the three dominant Collusive Alliances would rationally match oligopoly capacity cuts and price increases because more aggressive competition could never displace existing hubs or capture significant market share.

—None of the increased concentration since 2003 is due to efficient airlines displacing inefficient ones or other "market forces;" it is strictly due to the artificial process of large airlines petitioning governments for reduced competition.[137]

Instead of Clayton Act tests based on case specific evidence of pricing behavior and market contestability, the DOT's findings are based on an arbitrary rule that assumes that consumer welfare in international airline markets is not threatened as long as at least three competitors operate under an "Open Skies" treaty, which is presumed to automatically protect consumers from the threat of market power.[138] Even though the EU-US Open Skies has facilitated increased concentration in a market that has not seen successful new entry in twenty-three years, the DOT simply asserts that the treaty "enhances competition and promotes new entry" and there is "no basis upon which the Joint Applicants could, as a result of this transaction, impose and sustain supra-competitive prices or

136. The last new entrant on the North Atlantic to successfully sustain a market position with at least one percent market share was Piedmont Airlines (now USAirways) which began Charlotte-London Gatwick service in 1987. *See 2 New Air Routes to Britain Approved*, LEXINGTON HERALD-LEADER, Apr. 24, 1987, at B2 (discussing federal approval of Piedmont Airlines to commence service between Charlotte, N.C. and London).

137. *See generally* Dean & Shane, *supra* note 26, at 19.

138. *See* Oneworld Show Cause Order, *supra* note 3, at 3 ("Under our established policy, the existence of an "open-skies" framework is a necessary predicate to our consideration of requests for antitrust immunity"); Star/Continental Show Cause Order, *supra* note 18 at 2 ("Under the Department's established policy, the existence of an "open-skies" regulatory framework is a necessary predicate to our consideration of requests for antitrust immunity").

reduce service levels below competitive levels."[139] Since collusive alliances automatically create consumer benefits, the DOT claims reducing competition via ATI actually benefits consumers by enhancing "inter-alliance competition."[140] Since the protection of airline consumer welfare only requires three serious competitors, the DOT's competitive "analysis" has been wholly limited to simple market share snapshots showing that no highly aggregated market groups (i.e. U.S. - Germany, the overall North Atlantic) are currently dominated by any one of these three competitors.[141] Despite the huge increases in market concentration shown in Figure 3, the DOT has approved ATI on the basis that it will "not materially alter the current competitive landscape or increase overall market share to any significant degree."[142]

As with the rules establishing public benefits on the basis of "double marginalization" and undocumented private carrier benefits, these rules render the Clayton Act test completely meaningless, since no ATI application (other than a merger between the three collusive alliances) would ever be found to create risks of supra-competitive pricing or otherwise threaten consumer welfare. Under these rules, ATI applicants would have no need to present verifiable, case-specific evidence that immunity would not create market power, and other interested parties would be unable to challenge applications on the basis of case/market-specific evidence of entry barriers, non-contestable markets or the supra-competitive prices.

IX. BREAKING THE LINK BETWEEN "OPEN SKIES" AND LIBERAL MARKET COMPETITION.

As Dean and Shane note, the 1990s "Open Skies" treaties were designed to supplant mercantilist bilateral treaties such as the U.S.-U.K. "Bermuda II" treaty,[143] whereby international airline markets were manipulated through backroom negotiations between the large incumbent carriers and government bureaucrats, with results heavily biased in favor of the short-term interests of those incumbent airlines. By eliminating many of the entry and pricing barriers that the bilateral negotiators

139. Star/Continental Show Cause Order, *supra* note 18, at 17.

140. Oneworld Show Cause Order, *supra* note 3, at 28 ("The enhanced inter-alliance competition is beneficial for consumers across many markets, in particular the hundreds of transatlantic markets in which the applicants become more competitive as a direct result of the alliance").

141. *See Id.* at 13-17; Star/Continental Show Cause Order, *supra* note 18, at 8 tbl.1.

142. Star/Continental Show Cause Order, *supra* note 18, at 7-8 ("The transaction does not materially alter the current competitive landscape or increase overall market share to any significant degree").

143. Dean & Shane, *supra* note 26, at 1. The Bermuda II treaty restricted entry into the U.S.-U.K. market between 1977 and 2008. *See* Air Transport Services Agreement, U.S.-U.K., June 22, 1977, T.I.A.S. No. 8641.

had previously used to distort or rig market outcomes, the U.S. Government's 1990's "Open Skies" policy and the European Union's 1990s market liberalization policies established maximization of aggregate consumer welfare and industry efficiency as the central objectives of international aviation policy.[144] They sought to establish the policy that airline winners and losers should be determined by consumers and investors, and the role of government should be limited to ensuring a level and fully competitive playing field. While one can criticize the shortcomings of specific regulatory and policy decisions, the overall benefits of these liberal policies can be measured using objective evidence of increased service, lower prices, carrier productivity and the like.

The reversal of this liberal "hands-off" approach began when the E.U. shifted to a more interventionist, pro-consolidation policy a decade ago, favoring the interests of the large E.U. "national champions," Lufthansa, Air France and British Airways, the leaders of the three Collusive Alliances that the EU expected to dominate a consolidated industry. The E.U. proactively supported the Air France/KLM merger that reduced the number of intercontinental network competitors in Continental Europe from three to two, but blocked a Ryanair-Aer Lingus merger that would have exposed the transatlantic routes of three "national champions" to aggressive price competition from Europe's lowest-cost operator.[145] The E.U. openly advocated "industry consolidation" and proactively supported combinations such as Air France-Alitalia, Lufthansa-Austrian and British Airways-Iberia.[146] The E.U. delayed a U.S. "Open Skies" treaty for five years with demands that the U.S. change its national ownership laws so that the three E.U. carriers could fully control their U.S. alliance partners, and this was a major E.U. demand during the recent Phase II treaty negotiations.[147]

144. *See* Defining Open Skies, *supra* note 29, at 3.

145. *See* Horan, *supra* note 55, at 7.

146. *Id.*

147. *See* Hubert Horan, *The EU-US Open Access Area: How to Realise the Radical Vision*, 70 AVIATION STRATEGY 1 (2003) (a detailed assessment of the prospects for major international aeropolitical liberalization); Hubert Horan, *Airline Consolidation: Myth and Reality*, 109 AVIATION STRATEGY 2 (2006) (an evaluation of airline mergers in the US, Europe and China, and the general trend towards consolidation); Hubert Horan, *The New EU-US Treaty and the Intercontinental Airline Consolidation Battle*, 113 AVIATION STRATEGY 1, 4-6 (2007); Allan I. Mendelsohn, *The USA and the EU - Aviation Relations: An Impasse or an Opportunity*, 29 AIR & SPACE LAW. 263, 264 (Nov. 2004). While the US and EU shared similar views about the use of ATI in industry consolidation, the EU took a more aggressive position on allowing direct foreign ownership and control. In the phase I negotiations, the EU argued that allowing full financial and management mergers between E.U. and U.S. carriers would generate €15bn in incremental revenue (more than the combined revenue of Northwest and Southwest) and 80,000 new jobs (more than the combined employment of Delta and Continental). The current twenty-five percent limit on foreign ownership of US airlines cannot be amended by treaty, only by an Act of Congress. The failure of the Phase II negotiations to produce major concessions on foreign ownership of US airlines was seen as a diplomatic defeat for the E.U. . *See* Pitita Clark, *Washington Wins Battle of Open Skies*, FINANCIAL TIMES, Mar. 26, 2010, at 10.

While the DOT never became an open, public advocate of intercontinental consolidation, by 2003 it had clearly abandoned the 1990s "hands-off" policies and shifted to an internal view that international airline industry structure should be proactively managed through bilateral discussions between government officials and the large Legacy airlines.[148] As noted earlier, the DOT has not produced any policy statements or analysis supporting either the general merits of vastly increased market concentration, or the specific merits of supporting claims such as "double marginalization" or "inter-alliance competition." However this anti-liberal shift can be reasonably inferred from the ATI findings discussed above, and from recent bilateral treaty results. While the State Department achieved several pro-consumer gains in the final treaty, E.U.-U.S. "Open Skies" is a major departure from the 1990s treaties as it is designed to facilitate increased consolidation, not increased competition, and it is designed to increase governmental influence over industry structure, not to increase the influence of consumers and investors.[149] Carriers have publicly claimed that DOT informally promised approval of the current ATI applications during the treaty negotiations as a *quid pro quo* for E.U. approval of open entry in the U.K. and Spanish markets without the ownership and control provisions the E.U. had demanded.[150] In the treaty the DOT agreed to align its airline antitrust rules and processes with E.U. rules and procedures, a requirement fully consistent with the "bilateral driven antitrust enforcement" approach advocated by Dean and Shane, and completely inconsistent with the view that the DOT is a neutral antitrust regulator obligated to follow the *Horizontal Merger Guidelines* and other traditional evidentiary requirements in deciding ATI cases.[151]

148. *See* Kenneth J. Button, *The Impact of the US-EU 'Open Skies' Agreement on Airline Market Structures and Airline Networks*, 15 J. AIR TRANSP. MGMT. 59, (2009) (providing additional background on the air political policy shifts of this period).

149. *See generally* Air Transport Agreement, U.S.-E.U., Apr. 30, 2007, 46 I.L.M. 470.

150. *See* Joint Application to Amend Order 2007-2-16, Docket No. OST-2008-0234, Response of the Joint Applicants to Comments of the Dep't of Justice at 8 (Dep't of Transp. July 6, 2009) ("Our nation's trading partners, both present and future, have relied on, and will rely on, the continued availability of ATI as the cornerstone of U.S. aviation policy. For example, the U.S.-EU Agreement negotiations included a Memorandum of Consultations that specifically promised prompt action on applications for expanded immunity such as that sought by the Joint Applicants here . . . Thus the Memorandum of Consultations is an acknowledgement of the aeropolitical reality that open skies and ATI are integrally linked and essentially refutes the DOJ's position that the Joint Application is not linked to open skies benefits. DOJ would have the Department renege on that promise.") (footnote omitted).

151. *See* U.S.-E.U. Open Skies Treaty, *supra* note 151; Dean & Shane, *supra* note 26, at 18; Button, *supra* note 150, at 64; HORIZONTAL MERGER GUIDELINES, *supra* note 4.

X. The new US-Japan bilateral— further corrupting "Open Skies" and further entrenching "bilateral driven antitrust enforcement"

The new U.S.-Japan treaty completes the breakdown of the historical link between "Open Skies" and liberal market competition. While all past "Open Skies" treaties required fully open and equal market access for all carriers, the new treaty maintains strict Japanese government control over slots at Tokyo's airports, including a provision that U.S. carrier access to the new runway capacity at Haneda Airport should be strictly limited to four flights that must depart between midnight and 6:45 am.[152] Instead of reducing governmental ability to distort airline competition or dictate industry structure, the new treaty was specifically designed to facilitate massive taxpayer subsidies to Japan Air Lines (JAL), and the consolidation of the four transpacific carriers with large Tokyo operations into two larger collusive groups that would threaten the survival of smaller competitors.[153] The 1990s treaties clearly weakened the ability of European governments to distort and rig aviation markets, but the new Japan treaty does absolutely nothing to weaken the Japanese government's control over aviation competition—control far greater than any European government ever had. The large carriers and the DOT clearly intend to pursue the same consolidation of transpacific aviation into the same three Collusive Alliances that now control the North Atlantic. While the early "Open Skies" treaties with the Netherlands and Switzerland were designed to pressure countries like Germany and France to liberalize aviation markets, the Japan "Open Skies" treaty is designed to

152. *See* 2010 U.S.-Haneda Combination Services Allocation Proceeding, Docket No. OST-2010-0018-0262, Order 2010-7-2 at 1 (Dep't of Transp. July 6, 2010) [hereinafter U.S.-Haneda Proceeding].

153. At the time the U.S.-Japan treaty was signed, multiple press reports in Japan and the U.S. indicated that JAL management and the Japanese Ministry of Transport strongly favored combining (via ATI) the large JAL and Delta/Northwest Tokyo hub operations. *See, e.g., JAL Likely to Choose Delta Over American*, Reuters, Dec. 18, 2009; *U.S., Japan Eye 'Open Skies'; but Competition Between American and Delta for JAL Could Derail Negotiations*, USA Today, Dec. 8, 2009, at 4B; *American, Partners Offer $1.1 Billion to JAL*, Associated Press, Dec. 3, 2009. This move (along with ATI for United, Continental and ANA) would have established a top two concentration level of ninety percent in the US-Japan market and made it extraordinarily difficult for American Airlines to remain a viable competitor. Shane served as a paid advocate on behalf of Delta's efforts to achieve immunity with JAL. *American, Partners Offer $1.1 Billion to JAL*, Associated Press, Dec. 3, 2009. Although this plan was not implemented after subsequent management changes at JAL, DOT would have been fully aware when they signed the treaty that it could directly lead to a massive increase in market concentration. *See American Flies High as JAL Stays Put*, Dallas Morning News, Feb. 10, 2010, at D1 (describing JAL decision to reject Delta merger after changes in management). Earlier in my career, I was responsible for Northwest's international network, including its large hub at Tokyo Narita, and am highly familiar with the economics of transpacific operations, and competition in the U.S.-Japan market.

pressure other Asian countries to eliminate competition from their hubs and carriers, and consolidate into groups led by the collusive alliance networks based at Tokyo.

Just as the words "double marginalization" automatically establish the "fact" of significant public benefits, the Japan treaty demonstrates the DOT rule that a treaty including the words "Open Skies" automatically establishes the "fact" of market contestability, which eliminates the need to examine any verifiable, case-specific evidence about market power. This rule will speed the process of industry consolidation on the Pacific since ATI applicants will not need to produce evidence, and applications cannot be challenged on the basis of evidence that huge artificial barriers to competition actually exist in the Japanese market.

More importantly for this discussion, the DOT agreed to provisions in the new Japan treaty that were specifically designed to entrench its evisceration of ATI evidentiary standards, and to thwart the ability of the DOJ or other parties to demand reviews of Pacific ATI applications based on market-specific data.[154] JAL entered bankruptcy protection on January 19th and filed for ATI with American Airlines on February 12th.[155] Under traditional evidentiary standards, ATI could not be granted without data as to the exact routes and capacity the alliance would operate, since there is no way to evaluate competitive issues or public benefits without knowledge of capacity levels and other specific changes that would occur as a result of ATI. It would also be impossible to evaluate ATI applications without hard data about public subsidies for JAL that could seriously distort competition.[156] But none of these things can be known with any certainty until a JAL reorganization plan is financed and approved, a process that could take several years.[157]

154. *See generally* Record of Discussions, U.S.-Japan, Dec. 2009, *available at* http://www.state.gov/documents/organization/133720.pdf.

155. Justin McCurry, *Japan Airlines files for bankruptcy protection*, The Guardian (London), Jan. 20, 2010, at 27; Joint Application of American Airlines, Inc. and Japan Airlines International Co., Ltd., Docket No. OST-2010-0034-0001, Application at 13-41 (Dep't of Transp. Feb. 12, 2010).

156. Press reports at the time the U.S.-Japan treaty was signed suggested the possibility of taxpayer subsidies to JAL as large as JPY800 billion ($8.8 billion). *See, e.g.*, Anthony Rowley, *Possible Lifeline Boosts JAL Shares; Airline Seeking Funds from Government-Backed Turnaround Agency*, The Business Times Singapore, Oct. 30, 2009 (Asian Pacific News).

157. The United Air Lines' reorganization required three years under a well established and highly transparent U.S. airline bankruptcy process, with which creditors were highly familiar, and was free of any direct political interference. *See Friendlier skies: Airline's Leaving Bankruptcy with Less Baggage, Brighter Future, CEO Tilton Says*, Chicago Sun-Times, Feb. 1, 2006, at 67. No Japanese company the size of JAL has ever undergone this type of bankruptcy restructuring. JAL's indebtedness is far greater than United Air Lines' indebtedness was, and the JAL bankruptcy is a major political issue in Japan. *United Delays Debt Repayments; Desperate Airline Offers Mechanics Revised Wage Concession Package*, San Francisco Chronicle, Dec. 3, 2002, at B1 (noting United debts of $920 million at bankruptcy filing); *JAL Heads for Bankruptcy with*

Nonetheless, the DOT specifically promised that ATI approvals and all other treaty implementation requirements would be in place by October 2010.[158] The Oneworld ATI application will have required nineteen months of review, even though the DOT has nearly twenty years of experience analyzing the impact of antitrust immunity on North Atlantic competitive issues.[159] Even though it has never considered Japan/transpacific industry structure issues before, and the Japanese market includes a range of problematic competitive issues not found in any European markets, the DOT is clearly confident that it can fully review both the JAL/American Airlines and the parallel United/Continental/All Nippon ATI application in six months.[160] This clearly signals that DOT has no intention of conducting an objective antitrust evaluation, and merely intends to rubber-stamp the two applications, a signal reinforced by the fact that neither application includes any substantive evidence regarding public benefits or market power risks.[161] With the artificial six month deadline, if DOJ or other parties demand a more rigorous evaluation, DOT can blame them for creating a major diplomatic row with the Japanese.

XI. The Counter-Revolution Against Liberal Airline Competition

Dean and Shane's article recites the successes of the DOT's highly liberal aviation policies in the 1990s in order to incorrectly imply that their ATI agenda is driven by the same market-oriented, consumer-welfare maximizing thinking as was behind domestic deregulation and the original "Open Skies" treaties.[162] The extreme consolidation of the North Atlantic and the impending consolidation of the Pacific are not only totally inconsistent with those past policy, but represents a counter-revolution against the liberal competitive policies of the 1980s and 1990s, and Dean and Shane are acting as advocates for the counter-revolutionaries. The post-2000 consolidation movement is not trying to update competi-

$16 Billion in Debt, Reuters, Jan. 13, 2010 (noting JAL debts of $16.3 billion at bankruptcy filing and that JAL bankruptcy is one of the largest corporate failures in Japan).

158. *See* U.S. Dep't of State, *U.S.- Japan Air Transport Agreement of December 14, 2009 Record of Discussions*, Dec. 11, 2009, *available at* http://www.state.gov/documents/organization/133720.pdf; Doug Cameron, *Japan Expects US To Decide On Airline Pacts By Oct 2010*, Dow Jones Newswires, Dec. 14, 2009, *available at* http://www.advfn.com/news_Japan-Expects-US-To-Decide-On-Airline-Pacts-By-Oct-2010_40760751.html#.

159. The first North Atlantic ATI application (Northwest-KLM) was filed in 1992. *See* NW/KLM Show Cause Order *supra* note 124, at 1.

160. *See* Horan, *supra* note 128, at 14.

161. *See* Joint Application of All Nippon Airways Co., Ltd., Continental Airlines, Inc. and United Air Lines, Inc., Docket No. DOT-OST-2009-0350, Application at 1-15 (Dep't of Transp. Dec. 23, 2009); Joint Application of American Airlines, Inc. and Japan Airlines International Co., Ltd., Docket No. OST-2010-0034, Application at 13-41 (Dep't of Transp. Feb. 12, 2010).

162. Dean & Shane, *supra* note 26, at 17, 19.

tion policy in light of observable marketplace or economic changes, but they are trying to reestablish the pre-deregulation world of governmentally managed competition, where international aviation was exempt from normal antitrust rules, and where the large incumbent carriers could privately lobby bureaucrats to rig markets so they could exploit market power that reduced both consumer welfare and long-term industry efficiency. If Dean and Shane seriously believe that consolidation around just three global competitors is the "future of aviation" and beneficial to consumers, they should argue their case openly, and they should be arguing for the repeal of the Airline Deregulation Act so that domestic consumers may enjoy the same benefits. If the DOT believes that recent alliances proposed in ATI applications really create significant public benefits without unduly increasing market power, they should be willing to accept the DOJ's challenge, and provide evidence that meets *Horizontal Merger Guidelines* standards.

Transatlantic competition: **Consolidation of twenty-six independent competitors into three collusive alliances almost complete**		*Transpacific competition:* **Consolidation of twenty-seven independent competitors into three collusive alliances began in 2008**	
Three surviving competitors	TWA (2002)	**Independent competitors in 2008:**	Hainan
Lufthansa-led	Alitalia (2002)	United	Cathay Pacific
collusive alliance	CSA Czech (2002)	American	China
Air France-led	USAirways (2004)	Continental (a)	Eva
collusive alliance	KLM (2004)	Northwest (a)	Philippine
British Airways-led	Air Canada (2005)	Delta	Malaysian
collusive alliance	Swissair/Swiss (2005)	Hawaiian	Singapore
Twenty-one competitors eliminated by governmental approval of ATI or merger	LOT Polish (2005)	Air Canada (a)	Thai
	TAP Air Portugal (2005)	Japan (b)	Qantas
	Turkish(2008)	All Nippon (b)	V Australia (b)
	Continental (2009)	Korean	Air New Zealand
	American (2010)	Asiana	Air Pacific
	Iberia(2010)	Air China	Air Tahiti Nui
Northwest (1993)	Finnair(2010)	China Eastern	*(a) competition already eliminated*
Sabena (1995)	**Two others not viable as independent competitors**	China Southern	*(b) application pending to eliminate competition*
Delta (1995)			
Austrian (1995)			
United (1997)			
SAS (1997)	Virgin Atlantic		
British Midland (2001)	Aer Lingus		

Table 4[163]

The DOT's "aviation policy" - the consolidation of all of the major international carriers into three collusive groups - is driving an extraordinary transformation of the industry's structure, one that will dwarf all of the competitive changes since deregulation. Radical consolidation is a

163. Horan, *supra* note 128, Ex. 5 at 7.

fundamentally anti-market agenda, as the resulting changes are not based on returns to capital from efficiency/productivity gains. The consolidation that began in 1993 and accelerated dramatically after 2003 resulted from large carriers petitioning governments for reduced competition; not from efficient carriers displacing inefficient ones or similar "market forces." The E.U.'s "national champion" policy explicitly uses alliances to prop up unprofitable flag carriers such as Alitalia, Austrian, SAS and LOT, and the Japanese government clearly believes that ATI-facilitated reductions in competition would help JAL survive.[164] Despite aggressive pro-consolidation publicity campaigns, private investors have been totally unwilling to risk their capital on any of the major airline combinations of the last five years,[165] since the capital markets know that there are no significant economic synergies to be exploited, and that the vast majority of airline mergers have been financial and competitive disasters.[166] This type of artificial consolidation entrenches old-line legacy companies, could distort domestic competition,[167] and reduces pressures to innovate and improve productivity.

This counter-revolution depends on "double marginalization" and the other arbitrary rules that the DOT has used to render the public benefits and market power test meaningless, and the counter-revolution would collapse if ATI applicants were required to use verifiable, case-specific evidence. As the original 1990s alliances demonstrated, traditional evidentiary standards are not an obstacle to consolidation proposals that generate legitimate economic synergies and consumer benefits without creating undo market power. But the post-2003 radical consolidation around three globally collusive alliances rests on a foundation of the willfully false claims embedded in "double marginalization." All recent consolidation totally depends on the DOT's insistence that fares automatically fall fifteen to twenty-five percent whenever ATI grants reduce competition regardless of market/competitive conditions, that 100% of transatlantic consumer welfare gains in the 1990s were due to ATI (and none of the gains were due to carrier productivity or favorable supply/demand conditions), and that a single study of 1990s transatlantic price changes sponsored by ATI applicants can be used to predict price changes twenty years later in any market anywhere on the globe.[168] By ruling that "double marginalization" and the other arbitrary rules are settled, unchallengeable fact, DOT expects to accelerate approval of the Japan and subsequent ATI cases and gives airlines an extremely low cost way to create market power and supra-competitive profits worldwide.

Aside from the impact on airline industry structure and consumer welfare, the counter-revolution replaces the concept of the DOT as an impartial enforcer of the antitrust laws with airline antitrust enforcement based on private, negotiations between the DOT, the large incumbent airlines, and other governments. Replacing "evidence driven antitrust enforcement" with "bilateral (or policy) driven antitrust enforcement" gives the DOT much more regulatory power and discretion than Congress ever intended, and greatly increases the risk of regulatory capture by the parties the DOT is supposed to be regulating. In the 1990s the DOT creatively used its combined antitrust and bilateral negotiation roles to significantly liberalize international airline markets. If the DOT is unwilling to abandon "double marginalization" and the counter-revolution against liberal competition, then perhaps Congress should consider shifting international antitrust authority to the DOJ, as it did for domestic aviation.

164. *See* Centre for Asia Pacific Aviation, *Japan Airlines and the future of global aviation: Japanese Government holds the Aces*, http://www.centreforaviation.com/news/2009/09/28/japan-airlines-and-the-future-of-global-aviation-japanese-government-holds-the-aces (last visited Oct. 21, 210); Hiroko Tabuchi, *Japan Airlines Is Told to Seek Public Bailout Funds*, N.Y. TIMES, Oct. 30, 2009, at B2.

165. The Delta-Northwest merger was a stock swap with no outside financing. *See Delta, Northwest shareholders give green light to merger*, CHICAGO TRIBUNE, Sep. 26, 2008, at C5. The USAirways-America West combination was a bankruptcy reorganization combining two airlines that would have otherwise liquidated. *See* Micheline Maynard, *US Airways and America West Plan to Merge*, N.Y. TIMES, May 20, 2005, at C1. Widely discussed mergers such as United-Continental and British Airways-Iberia could not find willing investors, even during the greatest financial bubble in world history.

166. *See* Horan, *supra* note 128, at 10. The only mergers between large airlines since the 1970s where acquisition and implementation costs were clearly justified by efficiency/productivity gains were ones creating large hubs (TWA-Ozark at St.Louis, Northwest-Republic at Minneapolis, Air France-Air Inter-UTA at Paris) or mergers implemented as part of a major bankruptcy restructuring (USAirways-America West, Lufthansa-Swiss).

167. Carriers such as Delta and Lufthansa are less efficient producers in many domestic (and intra-EU) markets compared to carriers such as Airtran or Easyjet; the risk is that they would use supra-competitive intercontinental profits to distort competition against those lower cost carriers in shorthaul markets.

168. *See* Horan, *supra* note 128, at 12.