

Metal Neutrality and the Nation-Bound Airline Industry

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The system of trade in international aviation services is a product of post-World War II economic nationalism. It has resulted in an international airline industry in which international airlines are effectively 'nation-bound', because their operations all must begin and end in their home countries.

The growth of branded global alliances and the evolution of US and European aviation policies are accelerating rapidly. As part of its deregulation policy, the US has used the possibility for antitrust immunity (ATI) for cooperative marketing arrangements with national carriers that accept Open Skies liberalization.

Recent developments in US policy now require airlines seeking such immunity to commit to operate joint ventures that are 'metal neutral'. A metal neutral joint venture is structured so that partners in the venture are indifferent as to which operates the 'metal' (aircraft) when they jointly market services. The metal neutral requirement is a work in progress but holds the potential to diminish economic nationalism and alter the nation-bound nature of aviation operations.

1. BACKGROUND

Deregulation of the international airline industry is a continuing evolutionary process that began in 1978 with the US domestic industry.¹ Although the process is now more than thirty years old, it is by no means complete. However, in the last few years, airline liberalization has picked up considerable speed. This accelerating process is rapidly injecting the airline industry into a global economy based upon commercial principles that are either unknown in the airline industry or the antithesis of its traditional economic foundations.

So far, the ability of airlines to accommodate themselves to these radically different economic and regulatory environments has depended on a variety of factors including geography, scope, and the ability of airline management to operate in the old regulated context while, at the same time, taking advantage of the rapidly expanding opportunities of the global economy.

Major airlines with strong geographic locations and substantial scope possess considerable advantages. But they are facing an array of new airline models that take advantage of the new opportunities without the burden of a legacy of pre-deregulation labour structures, commitments, practices, and consumer expectations. As the pace of deregulation

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¹ 'Act to amend the Federal Aviation Act of 1958, to encourage, develop, and attain an air transportation system which relies on competitive market forces to determine the quality, variety, and price of air services, and for other purposes'. 92 Stat. 1705.

accelerates, there is real danger that certain airlines may be vulnerable if they linger too long in the comfort zones of traditional airline nation-bound commercial structures.

What exactly is meant by nation-bound? A bit of history will aid in understanding this concept and its implications for an industry that is not yet part of the global economy.

In 1944, as World War II was ending, the Allies met at Bretton Woods for the United Nations Monetary and Financial Conference. The purpose of the conference was to create the structure of the post-war international economy. The central theme of the Bretton Woods Conference was the need to avoid a return to 'economic nationalism', that is, economic policies based upon domestic control of the economy, labour, and capital formation, often with the imposition of tariffs and regulations on the movement of labour, goods, and capital.²

Economic nationalism was seen by the US and other nations as a factor in the Great Depression, as well as in the aggression that led to war.³ The Bretton Woods Conference and subsequent meetings led, in the post-war years, to the creation of the World Bank, the International Monetary Fund (IMF), the General Agreement on Tariffs and Trade (GATT), as well as the evolutionary process that led to the creation of the World Trade Organization (WTO) – in short, a multilateral system of increasingly more open world trade in goods, and later in services, that led to what we today call the global economy.

However, commercial aviation was specifically excluded from this system of improved world trade.

Later, the same year as the Bretton Woods Conference, post-war international aviation was dealt with separately. In December 1944, the Allies again met, this time in Chicago, to develop the international regime for international trade in aviation services. In an about-face, this conference and subsequent meetings went in the opposite direction. Instead of the expanding liberal multilateralism that was initially proposed by the US, the Chicago meeting led to a restrictive bilateral exchange of service rights based increasingly on the principles of economic nationalism.

Thus, despite the fact that international airlines fly to many parts of the world, they are not truly global enterprises. Airlines do not participate in the global economy in the same manner as other industries. Unlike other forms of international trade, the provision of international aviation services is substantially limited by restrictive trade barriers based on such things as nationality-based safety oversight, severe limitations on foreign market access, and cross-border ownership.

All international airline commercial operations require specific government-to-government permissions. With a few recent exceptions, international airlines continue to access global markets through a system of government-negotiated bilateral air transport service agreements that provide access to 'gateways' in distant locations, but not to the local air transport markets.

² For an in depth discussion of economic nationalism, see Michael A. Heilperin, *Studies in Economic Nationalism* (Publications De L'institut Universitaire De Hautes Etudes Internationales – N° 36 (Geneva: Librairie E. Droz, 1960)).

³ Lori Lyn Bogle, *The Cold War: Origins of the Cold War, the Great Historical Debate* (London: Routledge, 2001), 282.

Even with the most liberal intergovernmental agreements in effect today, with very limited exceptions, all international airline operations are effectively required to begin and to end in the home country. This is what is meant by describing the industry as being nation-bound. The major international airlines enter foreign markets with one foot always firmly planted on their home territories.

By contrast, other industries have been participating in a world of diminishing economic nationalism. Cato Institute's Tom G. Palmer describes this process in terms of 'the diminution or elimination of state-enforced restrictions on exchanges across borders and the increasingly integrated and complex global system of production and exchange that has emerged as a result'.⁴

As a result of this history, major international airlines rely to a substantial degree on the business of providing globalized industries links to their far-flung markets and resources, while the airlines themselves operate within a nation-bound system that even now continues to resemble mercantilism. As can be seen, it is a system that restricts international airlines' flexibility in the manner in which they provide access to the very markets that their corporate customers are increasingly exploiting.

Until recently, airlines and governments were slow to respond to this dichotomy. But in recent years, the pace of change has been accelerating. At the governmental level, the US and Europe have made the first tentative steps away from the bilateral system. Government-approved access to international gateways is becoming more open. Government review of rates and fares has all but been eliminated.

2. BRANDED GLOBAL ALLIANCES

With government support, international airlines have been developing strategies to overcome the limitations of this bilateral system. Some airlines have been able to use their geographic location to carry passengers to and beyond their home market hubs. New airlines – particularly those based in the Middle East – have combined this to-and-beyond-the-home-hub strategy with the economics of a low-cost home labour market and the absence of legacy commitments.

The principal strategy developed by traditional major carriers has been participation in a Branded Global Alliance (BGA). Today, there are three major BGAs, known as The Star Alliance, oneworld, and SkyTeam.⁵ Nearly fifty of the world's airlines participate in one or another of these alliances with varying degrees of cooperation.

However, it is important to keep in mind that these developments and strategies are being implemented against the background of a system that is still very much based on bilateral economic nationalism. This results in a world where different governments and

⁴ 'Globalization Is Grrreat!', Cato's Letter, vpl 1, 2, Fall 2002.

⁵ Star Alliance is composed of twenty-eight major airlines including United Airlines, Lufthansa, Air Canada, ANA, Swiss, SAS, BMI, etc.; oneworld contains eleven major airlines including American Airlines, British Airways, JAL, Iberia, Qantas, etc., and SkyTeam has thirteen major airlines including Delta, Air France/KLM, Alitalia, Aeroflot, China Southern, AeroMexico, etc.

their national carriers are deploying a patchwork of varying liberalizing and restrictive initiatives.

For example, at the time this article is being written, Canada and the UAE are involved in a serious diplomatic riff over Canada's refusal to increase Emirates Airline's access to the Canadian Market. Lufthansa and Air France (AF) are encouraging their governments to do the same.⁶

On the one hand, the US has an 'Open Skies' policy that exchanges – on a bilateral-by-bilateral basis – free access to US gateways. On the other hand, the US has some of the most restrictive regulations on domestic access and foreign ownership.

In Europe, the EU has been pursuing an aggressive policy aimed at diminishing bilateralism. However, in the case of aviation, the EU must share its negotiations with the aeronautical authorities of each of its Member States. Many of these Member States and their national airlines are less enthusiastic about the EU's goals.

In Asia, the vast distances and emerging Indian and Chinese markets are relative new comers to the liberalizing trends, with the Chinese still reluctant to ease up on its economic nationalistic instincts.

This bilateral system creates an effective global chessboard, with the airlines as the chess pieces moving in the squares that are the different bilateral areas according to the special rules created by their geography and their governments' position and power. In a time of rapid liberalization, successful airline managers must play their position according to the rules as they are today and as they may be in the near future.

To move this analogy a bit further, it will help to focus on the implications for the participation of the fifty or so major carriers in one of the three BGAs.

As with deregulation, alliance development and participation are an evolving process. The alliance a carrier joins at one time and the relative position it assumes at the beginning will not be the same alliance or relative position that the carrier will participate in at another time. This suggests the need for caution, while, at the same time, the increasing pace of industry deregulation also increases the imperatives to join an alliance.

As these strategies evolve, some airlines may find that they and/or their governments have taken a path that puts them at a competitive disadvantage further down the road. Sticking with traditional airline business practices may make sense at one moment but turn into a competitive dead end at another.

The choices are not simple. There are three BGAs, each with different strengths in different markets around the world.

Each of the alliances has developed distinctly different strategies. Star Alliance has developed its brand identity to the extent that the Star livery is being introduced alongside the traditional livery of the participating members. SkyTeam has made substantial advances in the area of network integration. Oneworld's key carriers have traditionally been leaders in some of the world's most desired destinations.

⁶ See, e.g., Colin Kenny, 'Drop the Gloves with UAE, Canada Doesn't Need to Stand for the Abuse Coming from This Tiny Mideast Bully', *Ottawa Citizen Special*, 8 Jan. 2011.

Not only is the choice in alliance important, the level of participation in a BGA involves a wide variation in commitment and cooperation among the different members. In turn, the level of cooperation and commitment also is a function of an evolving set of government rules and oversight. Recent US Department of Transportation (DOT) decisions are dramatically affecting the shape of these alliances, forcing significant changes that will affect all the participants in ways unforeseen when they first joined their alliance.

3. THE IMPACT OF DEREGULATION AND DEMANDS OF THE GLOBAL ECONOMY

In the regulated era, the major world airlines participated in a system of uniform rates and fares that were set through the agency of the International Air Transport Association (IATA) and sanctioned by governments on a bilateral basis. In this era, airline passengers and shippers accessed destinations around the world from national market to national market through a system of interline transfers between airlines. Under multilateral rules set by IATA, all airlines charged and received an agreed share of the uniform interline.

In a deregulated world, where rates and fares are no longer uniformly set, such a system is no longer an effective or reliable means to serve today's fast-paced business travel or modern budget conscious tourism. The global trend toward airline local and regional deregulation, privatization of national airlines, and growth of local low cost airline competitors has forever altered the old ways. Moreover, these trends have affected the former economic stability of the major national airlines and limited their willingness to support unprofitable routes and services.

Nevertheless, the demands of the global economy require convenient and reliable access to all the markets of an expanding world economy. Development of the BGAs has been a response to these changing circumstances. However, as noted, these alliances are an evolving strategy that is very much a work in progress. A brief look at this evolutionary process provides an important perspective.

These BGAs have grown from the original modern cross-border airline alliance based on antitrust immunity (ATI) developed by KLM Royal Dutch Airlines (hereinafter 'KLM') and its partner Northwest Airlines (NW). This breakthrough agreement was part of the US's first Open Skies agreement negotiated with the Netherlands in 1992.

Since that time almost twenty years ago, the US has negotiated over 100 Open Skies agreements.⁷ The Open Skies agreements have established a new international commercial framework for the US that represents an overlay within the bilateral system. This new framework eliminates restrictions on international route rights, number of designated airlines, capacity, frequencies, or types of aircraft.

It limits pricing regulation based on 'double-disapproval pricing' in which a fare can be disallowed only if both governments concur and then only for certain, specified reasons intended to ensure competition. It establishes key doing-business protections, including the

⁷ For the complete list of Open Skies agreements, see <www.state.gov/e/eeb/rls/othr/ata/114805.htm>.

right to establish sales, convert earnings, and remit them in hard currency; ground-handling freedoms, including ground transport of air cargo; and guaranteed access to customs services with non-discriminatory user charges based on costs.

Of particular significance for this article, these Open Skies agreements include provisions for cooperative marketing arrangements by which airlines may enter into code-sharing, leasing, and other cooperative arrangements.⁸

As an inducement for Open Skies agreements, the US has conditioned approval of ATI for airline alliances on the existence of an Open Skies agreement among the countries of the parties to the agreements. This encouragement of cooperative marketing arrangements has evolved into the three highly competitive air transport networks of planetary scope that link travellers and shippers to the far corners of today's world markets. The immediate benefits are quite obvious. Airlines that participate in the BGAs are able to offer their customers easy and efficient access to and from a broad choice of global destinations on one of these networks.

4. DIFFERENTIATED LEVELS OF ALLIANCE PARTICIPATION AND INTEGRATION

However, as noted above, the nearly fifty airlines participating in these alliances participate at different levels of network marketing and operational integration. The more integrated participants have been granted ATI from one of the world's most strict competition regimes, that is, the US 'antitrust' laws.

Those airlines with ATI are able to legally set prices, allocate routes, and otherwise operate as though they are one airline. But not all grants of ATI are the same. Among the airlines with ATI, some have been granted immunity that is global in extent and some are limited to specific markets such as 'The North Atlantic'. Recently, as discussed below, a new element has been introduced to ATI that is termed 'metal neutrality'.

Airlines that do not have ATI can participate in the alliances' networks and some marketing programmes but are prohibited from even discussing price, route allocation, or anything else that would make them less aggressive competitors with their partners. In other words, the alliances are made up of partners who can legally cooperate and partners who are required to compete with each other.

Until recently, such differences were of little consequence. Despite the right to use ATI to operate as though the partners were one airline, few took advantage of the opportunity. For over a decade after ATI was introduced, only KLM and NW had achieved 'metal neutrality', a term that the US DOT defined as:

an industry term meaning that the partners in an alliance are indifferent as to which operates the 'metal' (aircraft) when they jointly market services. Without a metal neutral sales environment, the partners have a strong economic incentive to book passengers on their own aircraft in order to retain a larger share of the revenue for themselves, which may not be in the best interest of the consumer or

⁸ For an overview of Open Skies provisions, see <www.state.gov/e/eeb/rls/fs/2009/119760.htm>.

the alliance as a whole. Metal neutrality may be achieved through revenue and/or comprehensive benefit sharing arrangements.⁹

During this initial period, aside from KLM and NW, the remaining alliances and their participating carriers preferred to operate within a framework of looser cooperation, with ATI providing only a comfort zone for discussing rates, fares, and routes.

However, this began to change as a result of the 2004 Air France KLM merger. At that time, KLM and NW had one ATI alliance and Delta Airlines (hereinafter 'Delta'), AF, Alitalia, Czech, and Korean Airlines had another ATI alliance. AF and KLM were now, for competition purposes, essentially one airline. However, NW did not have ATI for any discussions that involved Delta, AF, Alitalia, Czech, or Korean Airlines (the same was true vice versa).

5. THE INTRODUCTION OF THE METAL NEUTRAL CONDITION

As a consequence, in September 2004, NW and KLM, along with Delta, AF, Alitalia, and Czech – now all members of SkyTeam – applied for approval to consolidate their respective ATI agreements.¹⁰ Initially, the DOT rejected the application citing a number of reasons including the lack of sufficient specific public benefits to warrant approval.¹¹

However, in April 2007, the EU and the US entered into their initial Open Skies air transport agreement.¹² This provided an opportunity for SkyTeam, in June 2007, to once more approach the DOT for consolidation of their respective ATI agreements, on the North Atlantic, this time citing their plan to enter into a 'metal neutral' joint venture.

This time, the DOT approved the application stating:

the Joint Applicants now supply a detailed joint venture agreement that integrates international operations to such an extent as to suggest **metal neutrality** and seamless travel across one joint network. The proposed alliance is likely to result in the introduction of new capacity and greater availability of discount fares across the entire joint network – benefits that we tentatively find to be substantial in the circumstances of this case. Building on the highly integrated common bottom line arrangement in the Northwest/KLM alliance, the four-way joint venture represents a significant shift in the way in which SkyTeam plans to deliver benefits to the traveling and shipping public [emphasis added].¹³

⁹ US DOT Joint Application of American Airlines, Inc.; British Airways PLC; Finnair OYJ; Iberia Líneas Aéreas De España, S.A.; Royal Jordanian Airlines, under 49 USC 41308–41309 for approval of and antitrust immunity for alliance agreements; Show Cause Order 13 Feb. 2010.

¹⁰ In this application, the parties did not include Korean airlines and chose to limit their application to the North Atlantic market. See Joint Application of Alitalia-Línea Aeree Italiane-S. P.A. Delta Air Lines, Inc.; Czech Airlines; KLM Royal Dutch Airlines; Northwest Airlines, Inc.; Société Air France, under 49 USC 08 41308 and 41309: Ost-2004-19214-1 Joint Application for Approval of and Antitrust Immunity for Alliance Agreements 24 Sep. 2004.

¹¹ SkyTeam, Docket OST-2004-19214, Show Cause Order 2005-12-12 at 2, 30, and 37 (22 Dec. 2005).

¹² See Air Transport Agreement Official Journal of the European Union, L134 (vol. 50, 25 May 2007).

¹³ Show Cause Order Joint Application of Alitalia-Línea 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 USC 41308 And 41309 Docket Ost-2007-28644.

Since that case, subsequent decisions make it appear that a metal neutral joint venture has now become a DOT prerequisite for a grant of ATI. The DOT has conditioned subsequent ATI approvals for other alliances with the specific requirement for metal neutrality.

Thus, in July 2009, in connection with the Star Alliance, the DOT granted ATI to the global agreement of Air Canada, Austrian Airlines, British Midland Airways, Continental Airlines, Lufthansa, LOT, SAS, TAP, and United Airlines, stating:

DOT tentatively approved this application, conditioned upon the implementation of a revenue-sharing agreement that is structured to create '**metal neutrality**' – a commercial environment in which joint venture partners share common economic incentives to promote the success of the alliance over their individual corporate interests. We affirm that tentative finding. By pooling resources to improve the overall service offering, and by sharing financial gains and losses, we find that the partners are able to harmonize the global network and become indifferent as to which of them collects the revenue or operates the aircraft over a given itinerary. They are thus able to focus their efforts on gaining the customer's business by providing the best available fare, schedule, and routing between two cities. We therefore affirm our tentative finding that granting antitrust immunity in this case is necessary to enable carriers to achieve merger-like efficiencies and deliver public benefits that would not otherwise be possible [emphasis added].¹⁴

Shortly thereafter, in February 2010, in the case of oneworld, the DOT tentatively approved the request for ATI of American Airlines, British Airways, Finnair, Iberia, and Royal Jordanian Airlines. This time, the DOT went so far as to instruct the parties to make specific changes to their agreement in order to achieve the level of metal neutrality desired by the DOT. In their Show Cause Order, the DOT stated:

In the recent SkyTeam and Star cases . . . we required the applicants to make a strong showing that immunity is justified to achieve specific, demonstrable public benefits at the time the immunity is requested . . . Our analysis of public benefits turned on the extent to which the partners had aligned their economic incentives and achieved **metal neutrality** . . .

We tentatively find that, without changes to the joint venture agreement, the applicants will fall short of meeting the standard . . . Thus, the record does not yet show that the applicants have aligned their economic incentives and made their best efforts to achieve **metal neutrality**, which would be in the best interest of consumers in this case.

Therefore, as a condition of obtaining a final grant of immunity, we tentatively find that it is necessary for the applicants to make changes to the JBA to eliminate these concerns. We provide the applicants with additional guidance to make these changes [emphasis added].¹⁵

As a result of the these decisions, major participants in SkyTeam, Star Alliance, and oneworld have been compelled to enter into metal neutral joint ventures within eighteen

¹⁴ Final Order Joint Application of Air Canada; The 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 Air Lines, Inc., to Amend Order 2007-2-16 under 49 USC 41308 and 41309 so as to Approve and Confer Antitrust Immunity Docket OST-2008-0234, 10 Jul. 2009.

¹⁵ Joint Application of American Airlines, Inc.; British Airways Plc; Finnair Oyj; Iberia Líneas Aéreas De España, S.A.; Royal Jordanian Airlines, under 49 USC 41308-41309 for Approval of and Antitrust Immunity for Alliance Agreements Docket Dot-Ost-2008-0252.

months of approval of their ATI in order to retain their ATI. Each of their approvals is conditioned with language similar to the following:

We direct the Joint Applicants, within eighteen months of the date of issuance of this order, to file with the Director of the Office of Aviation Analysis the following as evidence that the joint venture has been implemented:

- a. A verified statement in Docket _____ attesting that the . . . joint venture has been executed and implemented pursuant to the terms described in the Joint Application . . .
- b. A complete and unredacted execution copy of the . . . joint venture agreement with appendices.

Unless the Joint Applicants make the filings described . . . above, the authority herein shall expire and the grant of antitrust immunity shall be automatically withdrawn.¹⁶

Recently, the DOT tentatively decided to reject a request for ATI between Delta and Virgin Blue. This request involving a relatively small carrier was not very controversial, and many similar requests had routinely been granted in the past. In making its tentative decision, the DOT cited its precedent in the original SkyTeam decision and stated:

We have emphasized the high standard necessary to justify a grant of immunity and the need for applicants to demonstrate that substantial public benefits are likely to be produced at the time the immunity is requested. For example, in the SkyTeam case in 2005, we tentatively denied a request for antitrust immunity because there was both insufficient information in the record to make a complete assessment of public benefits and the competitive conditions were in flux. There, as in this case, the Department identified barriers to integration that we believed reduced the incentives of the airlines to integrate their operations and pass on the benefits of immunized cooperation to consumers.¹⁷

As can be seen, these developments are quite recent. They have resulted in a dramatic change in the foundations of the BGAs. Until now, such alliance agreements were generally loose affairs. Often they were little more than agreements to agree. Now the DOT is insisting on binding agreements that require the sharing of revenues in a way that may not be based on who operates the aircraft.

6. THE NEED TO ADJUST TO THE REALIGNMENT OF ALLIANCE RELATIONSHIPS

This is such a dramatic change that one must wonder whether all the parties fully understand that they are committing themselves to binding agreements that are not easily changed and that are enforceable in US courts. The industry has little experience with such agreements and yet they involve companies with substantially diverse and different legal cultures.

Moreover, many of the non-immune airlines who joined one of the three BGAs at a time when each of the partners participated with fair degree of independence are suddenly confronted with a new situation. They are facing the prospect of relying on the networks of

¹⁶ Final Order Joint Application of Air Canada; The 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 Air Lines, Inc., to Amend Order 2007-2-16 under 49 USC 41308 and 41309 so as to Approve and Confer Antitrust Immunity Docket OST-2008-0234, 10 Jul. 2009.

¹⁷ Order to Show Cause Joint Application of Delta Air Lines, Inc.; Virgin Blue Airlines Pty Ltd; Virgin Blue International Airlines Pty Ltd D/B/A V; Australia Pacific Blue Airlines (NZ) Ltd; Pacific Blue Airlines (Aust) Pty Ltd, under 49 USC 41308-41309 for approval of and antitrust immunity for alliance agreements Docket DOT-OST-2009-0155.

major partners who are legally required to behave as essentially one combined network that is legally obligated to compete – as though they are one entity – against their smaller partners within the same alliance.

In addition, it appears that all future requests for ATI will require participation in a metal neutral joint venture before it can go forward. At this writing, it is not at all clear that there will be opportunities for the smaller non-immune partners to participate equally in the joint venture network to which they have committed.

To make matters more interesting, in the past – with some minor exceptions – the major partners with ATI tended to be centred on the North Atlantic market. Now, both Star Alliance and oneworld senior partners United and American Airlines have received ATI for metal neutral joint ventures with Japanese carriers ANA and JAL, respectively. These approvals came on the heels of the December 2009 US-Japan Open Skies Agreement. Thus, the American carriers in two of the three BGAs are in the process of negotiating two separate sets of metal neutral joint ventures with their key European and Pacific partners.

Now American Airlines is required – under the terms of its ATI orders – to finalize separate global metal neutral joint ventures with BA and JAL, individually. However, BA and JAL, although both members of oneworld, do not possess ATI with each other. Likewise, United Airlines is finalizing a metal neutral joint venture with ANA, on the one hand, and a separate metal neutral joint venture with its European Star partners, on the other. And, again, ANA and its Star European partners do not have ATI with each other.

This situation contrasts somewhat with SkyTeam. As noted above, Delta, AF, Alitalia, Czech, and Korean Airlines enjoy ATI.¹⁸ Moreover, the Korean ATI pre-dates the metal neutral requirement. Thus, unlike its European counterparts in Star and oneworld, SkyTeam's European partners enjoy ATI with both North Atlantic and Pacific Partners.

This situation creates a rather intriguing exercise in antitrust law. Under US antitrust law, absent ATI, the exchange of internal pricing, route, or market allocation information represents a *per se* violation of the antitrust law. However, because a metal neutral joint venture involves close cooperation and revenue sharing, parties to such a joint venture will be closely sharing significant internal pricing and route allocation information.

This means that the US partners in Star Alliance and oneworld will be aware of substantial details of both their European and Pacific partners' pricing and market allocation details. However, their immunity does not extend to any cross sharing of the information. In other words, American Airlines remains subject to the full penalties of the antitrust laws if it reveals information it learns from JAL to BA, or vice versa. Partners receiving such information from American airlines also will be liable.

This puts the two US carriers in Star Alliance and oneworld in an interesting position within the alliances. On the one hand, they will be the most informed of their partners on the commercial and economic status and plans of their European and Pacific partners.

¹⁸ Order Granting Approval and Antitrust Immunity for Alliance Agreements Joint Application of Delta Air Lines, Inc.; Korean Air Lines Co., Ltd; Société Air France; Alitalia-Linee Aeree Italiane-S.P.A.; Czech Airlines, under 49 USC 41308 and 41309 for Approval of and Antitrust Immunity for Alliances Agreements Docket Ost-2002-11842 27 Jun. 2002.

On the other hand, they have to be careful not to inappropriately share that information with the wrong partner.

7. NATION BOUND AIRLINES IN A WORLD THAT IS ROUND

However, as noted at the beginning, international airlines are 'nation-bound'. Viewed from the perspective of an airline that begins and ends all its operations in its home country, the European-Pacific, the US-Pacific, and the North Atlantic markets are viewed as three separate and distinct markets. Little role is seen for US carriers in the Pacific-European traffic streams or for the Pacific carriers in the Europe-US streams or for the Europeans in the US-Pacific routes.

At first blush, this suggests that it should not be too difficult to keep the Pacific and Atlantic markets separate. However, as we have observed, the pace of change from both government and industry is accelerating. At this time, the Chinese have yet to enter into an Open Skies arrangement with either the US or Europe. Similarly, there is no Open Skies regime between Europe and Japan. However, it is interesting to consider what might happen if and when an Open Skies accord is reached.

The principal Chinese carriers are already participating in the BGAs without Open Skies or ATI. ATI is an inducement that the US offers to countries that enter into an Open Skies agreement. It is reasonable to assume that at some time – perhaps in the not too distant future – China and the US will enter into an Open Skies agreement.

China Southern, as a member of SkyTeam, might be expected to seek ATI. If SkyTeam follows the example it set with Korean Airlines, then China Southern could seek ATI not only with Delta but also with AF-KLM. This would result in all the parties being involved in a metal neutral joint venture that could include a far more integrated approach to the previously nation-bound views of Pacific and Atlantic markets. If the carriers are required to have joint ventures designed so that it does not matter which carrier operates the 'metal' (aircraft) when they jointly market services, what happens when the joint venture includes operations that circle the globe?

However, competition law does not begin and end with the US. The EU too must play a role. Will the EU accept a metal neutral joint venture involving its territories? To date, there have been reports that key Member States are reluctant to have the EU negotiate Open Skies Agreements with key aviation partners such as China and Japan.

For now, much of this is speculation. The metal neutral joint ventures are being constructed and their different structures and impact on the marketplace are yet to be seen. Airlines are still nation-bound. Legacy labour and commercial structures create a degree of inertia that keeps them bound.¹⁹ The process of deregulation is continuing – as is globalization of the world economy.

¹⁹ The collective bargaining principles underlying labour relations of many major airlines were developed in the era of regulation, when fare setting required uniform government approval and attention to competitive costs was not a

The BGAs are global alliances, and their goal is to transport passengers and shipments seamlessly around the globe. The requirement for metal neutrality for the major partners encourages the development of seamless service models that are indifferent to the nationality of the airline.

Currently, the BGA's structures and participants have been – to a large extent – ad hoc devices that allow nation-bound airlines to transport customers across a global network. But the expansion of the BGAs also has led to an increasingly deregulated environment in which new aviation business models – without legacy structures and costs – are making substantial inroads that threaten the existing industry leaders.

This has placed a burden on the legacy airlines to develop efficiencies and new approaches to stay competitive. Baggage fees, reduced services, and higher load factors are stopgap measures at best.

8. SPECULATIONS ON THE FUTURE

The DOT has seen metal neutrality and global ATI as a vehicle for providing significant benefits to the consumers as well as to the airlines. As the DOT noted in its approval of the Star Alliance:

The Department concludes that by sharing risks and optimizing the joint network, the alliance members will give consumers more travel options, shorter travel times, reduced fares at the margin, and will likely accelerate the introduction of new capacity worldwide, placing pressure on competing alliances and non-aligned carriers to add capacity as well. Thus, we find that granting immunity beyond transatlantic markets will enhance the ability of immunized Star carriers to cooperate globally outside of the joint venture and will assist the Joint Applicants in their efforts to formulate joint ventures in other regions of their combined networks, thereby promoting greater service benefits to consumers.²⁰

The potential for a metal neutral joint venture composed of European, Asian, and US airlines suggests that there may be value in a more structured approach to the BGA concept, rather than just being a facilitator for member airlines. In the future, the BGA could be a vehicle for freeing the nation-bound airlines. BGAs have the potential to become efficient operators of the backbone of global aviation networks and, as such, effective competitors against the new business models.

In this connection, there is no reason to suggest that the metal neutral joint venture concept is limited to the current three alliances. Nor is this article intended to suggest that a metal neutral joint venture linking the Atlantic and Pacific markets is inevitable. On the contrary, the inertia created by the nation-bound aviation legacy is very strong.

market function. These labour principles and other commercial practices such as in house operations like maintenance and handling adopted during the regulation era are referred to as legacies of regulation.

²⁰ Final Order Docket OST-2008-0234.

In the near term, it is more likely that Asian and US carriers will develop their metal neutral alliances separately from those of the US and Europe. If so, then the antitrust issues discussed above will be an interesting factor. If separate metal neutral joint ventures become the rule, it appears that US carriers will find themselves in a unique position in providing access to global aviation networks.

This also should be seen against a backdrop in which the Pacific market is undergoing a seismic transition with China, now the world's number two economy, offering the broadest growth opportunities anywhere in the world.

In addition, as discussed above, there are over fifty airlines participating in the three BGAs. When they first joined, it is unlikely that they fully considered the consequences of the fact that they now find themselves involved with partners who are involved in metal neutral joint ventures.

As noted at the outset, the BGAs – despite the opportunity provided by the various ATI approvals – have been slow to embrace metal neutrality. This is because revenue sharing can be very difficult among airlines of disparate sizes, markets, and cultures. Now, the carriers are being compelled to adopt this approach. But each of the players has different levels of experience in metal neutral joint ventures. As they evolve, this difference in experience may have an impact on their respective competitive positions.

For example, Delta is headed by a chief executive officer, Richard Anderson, who – as a lawyer at Northwest almost twenty years ago – was an architect of the first metal neutral joint venture. This experience is no doubt reflected in the fact that the SkyTeam European carriers were the first of the BGAs to meet the DOT-imposed eighteen-month deadline for executing their metal neutral joint venture.

By contrast, BA and AA were late to the table with respect to ATI. Their ATI came nearly twenty years after Northwest-KLM and nearly twelve years after United Airlines and Lufthansa. They have a considerable learning curve to make up.

Looking at the chess board and considering the players' present positions, we can see some possible moves. The Japanese market has only two major international carriers, both of whom have been granted ATI with two of the three major American players. These two partners are currently negotiating metal neutral joint ventures. In the meantime, Delta has a substantial stake in the Japanese and Pacific markets. It will want to defend itself against this new competitive threat.

If the Star and oneworld partners approach their relationship from a nation-bound perspective, the impact of the Japanese joint venture will be mainly felt in the US-Japan market. On the other hand, if either of the US Star or oneworld partners uses this opportunity to create a Pacific joint venture with their Japanese partner, this could pose a competitive threat to other players in the Pacific as well.

In either case, Delta has a real incentive to change the competitive landscape in the Pacific. As discussed above, Delta's experience with metal neutral joint ventures could be put to use if its Chinese partner could successfully press its government to adopt an Open Skies agreement with the US, sooner rather than later.

In the event of a Chinese Open Skies Agreement, it is interesting to speculate on the potential moves. A nation-bound approach would mirror the US-Japanese Open Skies Agreement, with the Chinese carriers seeking ATI with their US Alliance partners. On the other hand, if the EU's more conservative Member States set the EU in motion, a Chinese Open Skies Agreement with both the US and the EU could be possible. Such an agreement could substantially weaken the economic nationalism that fosters the nation-bound strategies that tether the industry.

Under such an arrangement, the BGAs could construct European-Pacific-US metal neutral joint ventures, creating global networks that are resistant to economic nationalism. In such a world, competition among the alliances should cause the competitors to seek business structures and practices that make their networks more reliable and efficient.

This could lead to the elimination of State-enforced restrictions on exchanges across borders and an increasingly integrated and complex global system of production and exchange, involving the addition of regional partners and specialized services to the network. In effect, this could bring the industry into the global economy.

On the other hand, the forces of economic nationalism in international aviation still inhibit government actions. Nation-bound strategies remain firmly entrenched.

Nevertheless, a US-China Open Skies Agreement remains a goal of US and China policy, with ATI for a metal neutral joint venture offered as a key inducement. The tantalizing question is whether EU policy and European carriers will be in a position to take advantage of the opportunity to create a US-European-Pacific metal neutral joint venture when the opportunity is offered.

Author's note: As this article went to press, there are already new developments in the alliance strategies. All Nippon Airways and Lufthansa announced on February 24, 2011 that they are seeking antitrust immunity from the Japanese government on routes between Japan and Europe. There are few details available but press reports quote President and CEO Shinichiro Ito as saying, 'By forging this closer cooperation with one of our partner airlines in the Star Alliance, we will significantly enhance our ability to serve customers throughout Europe and offer new choice and convenience for passengers. We are looking forward to our application being approved', *Aviation Daily*, 24 February 2011.