Order 99-8-14

UNITED STATES OF AMERICA
DEPARTMENT OF TRANSPORTATION
OFFICE OF THE SECRETARY
WASHINGTON, D.C.

Issued by the Department of Transportation
on the 18th day of August, 1999

SERVED: August 18, 1999

Joint Application of **UNITED AIR LINES, INC. and** **ALL NIPPON AIRWAYS CO., LTD.** for Statements of Authorization pursuant to 14 CFR Part 212 (formerly Parts 207 and 212) (U.S.-Japan Code Sharing)	**Undocketed**
Joint Applications of **AIR FRANCE and** **DELTA AIR LINES, INC.** **AIR FRANCE and** **CONTINENTAL AIRLINES, INC./** **CONTINENTAL EXPRESS, INC.** for Statements of Authorization pursuant to 14 CFR Part 212 (formerly Parts 207 and 212) (U.S.-France Code Sharing)	**Undocketed**[1]
Joint Application of **DELTA AIR LINES, INC. and** **AEROVIAS de MEXICO, S.A. de C.V.** for Exemptions and Statements of Authorization (U.S.-Mexico Code Sharing)	**Dockets OST-99-5593** **99-5573** **98-4577** **97-3289** **97-2161**

[1] The joint application of Air France and Delta was undocketed. The Petition for Reconsideration of Order 99-5-2 is docketed in OST-99-5726.

Joint Application of **UNITED AIR LINES, INC. And COMPANIA MEXICANA de AVIACION, S.A. de C.V.** For an exemption under 49 U.S.C. §40109 and a statement of authorization under 14 C.F.R. Part 212 (U.S.-Mexico code sharing)

**Dockets OST-97-3237
99-5582**

ORDER ON RECONSIDERATION

<u>Summary</u>

By this order, we grant the petitions of Delta Air Lines, and United Air Lines and Compania Mexicana de Aviacion for reconsideration of Orders 99-5-2 and 99-6-6, and upon reconsideration, have decided to remove conditions imposed by those orders that preclude the U.S./foreign carrier partnerships from having exclusive arrangements with respect to their code-share services. In response to United's additional request, we will also remove a similar condition imposed on our approval of the United/All Nippon Airways (ANA) code-share operations. In addition, we will *sua sponte* remove a similar condition imposed on our approval of the Continental/Air France code-share operations.

<u>Background</u>

By Order 99-5-2, the Department imposed certain conditions on several code-share arrangements, including those between Delta and Air France and between Continental Air Lines and Air France to preclude those U.S. airlines and Air France from exercising the exclusivity provisions of their code-share agreements. The Department also affirmed its earlier decision to condition the code-share operations by United and All Nippon Airways to preclude exclusive dealings between those carriers for their code-share services. By Order 99-6-6, the Department similarly conditioned the code-share arrangements between Delta and its partner, Aeromexico, and United and its partner, Mexicana.

<u>Petitions for Reconsideration</u>

On May 25, 1999, Delta petitioned the Department for reconsideration of Order 99-5-2 to the extent that the order imposed exclusivity conditions on Delta's code-share arrangement with Air France. On June 22, 1999, Delta filed a petition for reconsideration of Order 99-6-6 to the extent that order imposed exclusivity conditions on Delta's code-share arrangement with Aeromexico. On June 24, 1999, United and Mexicana filed a joint petition for reconsideration of Order 99-6-6 to the extent that the Department imposed exclusivity conditions on their code-share arrangement.

United filed an answer to Delta's petition regarding its code-share arrangement with Air France, stating that it supports Delta's petition for withdrawal of the exclusivity condition, provided that the Department also reconsiders and withdraws its exclusivity condition on United's code-share arrangement with All Nippon Airways. United incorporated the arguments in its previous filings with the Department with respect to its code share with All Nippon Airways.

Delta filed an answer in support of the United/Mexicana petition.

From a general standpoint, the petitioners contend that the Department should not interfere with the carriers' contractual provisions regarding exclusivity, arguing that such provisions are not contrary to the public interest or inconsistent with antitrust law. They further contend that the Department's policy of presumptive disapproval in non-open skies situations unnecessarily limits the benefits that can be achieved through the code-share arrangement, and is inconsistent with long-standing Department precedent to permit agreements unless the Department finds, based upon substantial evidence, that the agreements would conflict with important aviation policy objectives. However, if the Department, nonetheless, decides to continue to examine such provisions in the context of code-share approvals, then they argue that our decisions must demonstrate and articulate more fully how the exclusivity provisions at issue would adversely affect competition to warrant the conditions imposed. Delta further suggests that an important change in policy of the type involved in Order 99-5-2 regarding exclusivity provisions should not be implemented through an *ad hoc* process, but rather in a rulemaking proceeding in which industry-wide comments are obtained.

With respect to the particular cases at issue--France and Mexico--they contend that the Department has failed to make decisions based on a developed record supported by substantial evidence, and that, absent compelling public interest findings, there is no basis to nullify the exclusivity provisions. Rather they state that the Department's decisions relied solely on the absence of open-skies agreements with France and Mexico and failed to consider material facts that would rebut the presumption against exclusivity clauses. Specifically, they cite the generally liberal agreements between the U.S. and the countries at issue that promote competition; the high level of competitive services in the markets already from direct services as well as code-share operations; recent agreements between the U.S. and the countries involved to expand the liberalized regimes to promote even more competitive services; and the fact that in none of the markets at issue do the U.S. carriers have a dominant market share. In particular, with respect to Mexico, Delta and United contend that they need exclusive relationships with their Mexican partners to compete effectively with the dominant carriers in the market, American Airlines and Continental Airlines. They further argue that neither the Department nor any interested party has presented any evidence of harm from the arrangements to any other carrier or the public. Finally, they state that the conditions imposed on their arrangement are inconsistent with the expectations of the Governments of France and Mexico when they entered into liberalized arrangements with the U.S. Taking into consideration all of these factors, the parties contend that the Department should reconsider its decisions with respect to France and Mexico and, upon reconsideration, should withdraw the exclusivity conditions imposed on their code-share arrangements. United, in its various pleadings, makes and reiterates similar arguments with respect to its code share with ANA, and with respect to the bilateral arrangement with Japan.

Decision

We have decided to grant the petitions for reconsideration filed in the above-captioned proceedings and to allow Delta/Air France, Continental/Air France, Delta/Aeromexico, United/Mexicana, and United/ANA to implement exclusivity provisions contained in marketing agreements for the U.S.-France, U.S.-Mexico, and U.S.-Japan markets.

These proceedings, which stem from our recent reevaluation of the use of exclusivity provisions in our international aviation markets, do not involve a new issue. *See Continental/Alitalia*, Orders 94-9-4 and 94-10-27. However, it has become more significant with the enormous growth of airline-to-airline code-sharing agreements over the last few years. U.S. and foreign airlines are now parties to over a hundred of these agreements serving thousands of international aviation markets. Code sharing is a popular method of operation in the aviation industry because, by allowing the parties to sell seats on each other's flights, it enhances airline efficiency, growth, and market access. As such, code sharing is an important source of new entry, new service, lower fares, and competition in our international aviation markets.

We review code-sharing agreements pursuant to Part 212 of our regulations, 14 CFR Part 212, which requires us to find that a particular agreement is in the public interest before we may approve it. We have relied, among other factors, on the pro-competitive and pro-consumer features of code-share agreements to approve many of them, after reviewing their terms.

In recent months our reviews have raised questions about provisions in some code-sharing agreements that prohibit the parties from doing business with other airlines, except as provided for in the agreement.

Petitioners argue that these "exclusivity" clauses provide an important basis for allowing parties in a cooperative marketing arrangement to invest in systems, training, marketing, facilities, new services, and other activities necessary to make the arrangement a success. It is also argued that exclusivity provisions actually increase competition by denying airlines that dominate the market the opportunity to increase their market leadership by taking a "free ride" on the code shares of other airlines. See Delta's Mexico Petition, at 9-10 and United/Mexicana Petition, at 7.

However our detailed examination of this issue presents a much more complex picture.
It shows that code share exclusivity provisions can have different effects on different markets, depending on such important factors as market structure and the competitive positions of the parties in those markets, and the terms of the bilateral agreement between the countries involved. The competitive structure of a particular aviation market is heavily influenced by the nature of the bilateral aviation relationship governing it.

Our examination of the exclusivity issue shows that the practice of excluding airlines from participating in a particular code-share arrangement can have adverse public consequences because code sharing can provide a primary, if not the only, method for entering or expanding service in many international aviation markets. This is especially true in markets that are governed by restrictive bilateral agreements. It is in these markets that exclusivity provisions can serve to inhibit new entry, expansion and competition because of the lack of effective alternatives for serving the markets available to excluded airlines, and, therefore, the lack of effective choices for consumers. As we have said previously, it is in these markets that we are most likely to find that exclusivity provisions are anticompetitive, inconsistent with our liberal aviation policies and otherwise not in the public interest.

On the other hand, we have also found that it is less likely that exclusive dealing would materially interfere with service and competition in open-skies markets because these markets usually provide consumers with effective alternatives to exclusive code-share arrangements. Nonetheless, exclusivity provisions in open-skies markets can raise serious concerns where they serve to entrench the market power of code-share partners that already have a significant share of that market. *See American/TACA*, Orders 97-12-35 and 98-5-26.

We have relied on these considerations to develop parameters for facilitating our review of exclusivity provisions under Part 212. We believe that those parameters are needed because of the growing number and importance of exclusivity provisions in code-share agreements and because interested persons have requested guidance on this issue.

In Order 99-5-2, we indicated that we would generally not prohibit exclusivity code-share provisions in open-skies markets, but generally not allow these provisions in restrictive markets. As to the latter, there must be convincing evidence that exclusivity is in the public interest notwithstanding *prima facie* limitations on service and competition in the applicable markets.

In Orders 99-5-2 and 99-6-6 we declined to approve exclusivity provisions affecting a number of our international aviation markets, including those involving France, Japan, and Mexico. We found that none of these markets is governed by an open-skies relationship and that the parties had not persuaded us that approval would be in the public interest.

Several carriers with code-share arrangements in those markets have asked us to reconsider that decision. In part, they have presented new arguments and facts. In addition, we have evaluated the bilateral restrictions in those markets in the context of the actual market conditions, and in terms of our international aviation policy, in determining that the overall public interest warrants allowing of the specific exclusivity provisions in these particular arrangements.

However, we reject arguments that we should adopt a *laissez-faire* approach to exclusive dealings between and among airlines in international air transportation. It is not in the public interest to ignore any feature of a code-share agreement that could interfere with competition or otherwise undermine the ability of consumers to benefit from the opportunities created by our aviation relationships. For that reason, we will continue to assess the merits of code-share exclusivity provisions on a case-by-case basis in light of the terms of the overall arrangement and of the special facts and circumstances affecting each market, such as its structure, the positions of the parties in those markets, and the nature of the bilateral aviation relationship governing it.

We reaffirm our conclusion that open-skies agreements provide the most effective protection against the potentially adverse effects of exclusivity provisions and that restricted aviation markets provide the least amount of public protection. At the same time, we recognize that not all bilateral agreement provisions have the same effect and not all market conditions are similar for either open-skies or restricted markets. We will thus continue to look at how the market operates in fact, the overall terms of the code-share arrangement, and our international aviation policy to determine the balance in the public interest.

In this regard, it is significant that the United States has worked closely with the Governments of France, Japan, and Mexico to open significantly our aviation relationships.

Several of the factors discussed above are readily apparent in the U.S.-Mexico market. Our aviation agreement with Mexico provides the opportunity for competition in every U.S.-Mexico transborder city-pair market. In addition, there are no limits on the capacity that carriers can offer in the markets and no *de facto* limits on airport capacity. While there are price constraints and limits on code sharing in the agreement, there is in fact strong price competition and full code-share opportunity. The charter market, for example, is open with 25 percent of the passenger traffic, providing strong price competition. The Mexico agreement has designation limits for 3rd and 4th freedom markets, and limits on routes that may also serve 5th freedom markets. Nevertheless, 13 carriers have code-share flights in the Mexico market, and Mexico is served from almost every region of the U.S., with service by 11 U.S. carriers and 7 foreign carriers.[2] Nine third-country airlines account for only 2.6 percent of the total traffic.[3] In the overall Mexico market, there are over 1200 weekly roundtrips, with over 4000 flights, including code shares in both directions.[4] U.S. carriers carry 60 percent the U.S.-Mexico traffic, with Delta and United carrying only 4 percent of the total market each. Their partners, Aeromexico and Mexicana, carry 14 and 21 percent, each.[5] On balance, therefore, we believe that the Delta/Aeromexico and United/Mexicana code-share arrangements in the context of the U.S.-Mexico agreement and actual market conditions and structure support allowing of the exclusivity provisions in these arrangements.

Our negotiations with the Government of France have also led to a significant market-opening transition agreement, as a clear step toward an even more open relationship. Our most recent aviation agreement with France eliminates all restrictions on airline operations between the two countries in 3rd and 4th freedom markets in 2003. It also allows airlines to significantly increase service in the market during the transition period to an open transatlantic regime. Over that period, U.S. and French airlines can serve new markets, add substantial additional capacity to the market, and otherwise contribute to meeting the pent-up demand for more air service. In addition, we continue to have a good aviation relationship overall with France, with opportunities for expanding travel options between the two countries. Even with the limited restrictions during the transition on designations and frequencies, 8 U.S. airlines from 15 U.S. gateways and 2 French airlines serving 10 U.S. gateways now provide scheduled passenger service in the U.S.-France markets.[6] The U.S. is able to designate an additional airline now, and after April 2000, the only limit on designations will be in the New York-Paris market, which is limited to 5 U.S. carriers until April 2003. There are now almost 300 weekly roundtrips in the U.S.-France

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2 *Official Airline Guide, Worldwide Edition,* January 1999.

3 U.S. Department of Transportation T-100 data, 12 months ended August 1998.

4 *Official Airline Guide, Worldwide Edition,* January 1999.

5 U.S. Department of Transportation T-100 data, 12 months ended August 1998.

6 *Official Airline Guide, Worldwide Edition,* August 1999.

market.[7] While Paris' Charles de Gaulle airport, which all U.S. airlines will be serving, is slot controlled, we are aware of no major problems by U.S. carriers in instituting their authorized services. Pricing is currently country-of-origin, but that restriction is eliminated for 3rd and 4th freedom traffic next April and for 5th freedom traffic in April 2003. There are open code-share opportunities, except for certain time-limited restrictions involving operations by same-country airlines and via third countries with third-country airlines. The only significant restriction in the agreement severely limits passenger or combination 5th freedom service with no expiration. There is, however, significant alternative service to Europe through major third-country networks and open-skies markets. Air France, the primary French flag airline available as a code-share partner, carries 40 percent of the traffic. Its partners, Delta and Continental, carry 10 percent and 9 percent each, and U.S. carriers carry over 55 percent of the market.[8] Again, on balance, however, we believe allowing the exclusivity provisions in the code-share agreements between Air France and Continental and Delta would not unduly restrict competition in light of circumstances above and would be consistent with our international aviation policy and the public interest.

Our most recent aviation agreement with Japan also clears the way for significant new public benefits. That accord provides for the largest increase in capacity in the history of the U.S.-Japan market, and the elimination of many restrictions on airline operations previously imposed. As a result, U.S. and Japanese airlines can serve new markets and can increase capacity. The Japanese agreement, however, does still contain significant restrictions on competitive opportunities, and when combined with severe airport capacity restraints, make the weighing of the public and policy benefits against potential competitive restraints of code-share exclusivity a much closer balance. The agreements create two classes of carriers--incumbents, of which United and, recently, ANA are included, with few restrictions; and "MOU" carriers with far greater restrictions. There are no frequency, route, or 5th freedom limits on incumbent carriers. MOU carriers are restricted as to designations and to 5th freedom service. There are significant price restrictions. However, there are extensive code-share opportunities, including those involving third countries. There is also extensive service now to Japan and ample charter opportunities. Six U.S. airlines and 2 Japanese airlines provide scheduled passenger service in the U.S.-Japan markets to 16 U.S. gateways.[9] U.S. airlines carry almost 60 percent of the market, with the largest share, approximately 25 percent, being carried by Northwest; United carries approximately 16 percent of the traffic.[10] Japan Air Lines carries the largest Japanese share with nearly 30 percent of the market; ANA carries approximately 7 percent of the traffic.[11] There are over 500 weekly round trips in the U.S.-Japan market, excluding Guam/Saipan-Japan services.[12] Based on these circumstances, we believe that on balance, our international aviation policy supports allowing the exclusivity provision contained in the UA/ANA code-share arrangement and that such a provision would not, in these circumstances, unduly hinder competition in the liberalized U.S.-Japan market, and thus would be consistent with the public interest.

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7 *Official Airline Guide, Worldwide Edition,* August 1999.

8 U.S. Department of Transportation T-100 data, 12 months ended February 1999.

9 *Official Airline Guide, Worldwide Edition,* August 1999.

10 U.S. Department of Transportation T-100 data, 12 months ended March 1999.

11 U.S. Department of Transportation T-100 data, 12 months ended March 1999.

12 *Official Airline Guide, Worldwide Edition,* August 1999.

Moreover, our new aviation agreements with Mexico, France, and Japan, while different in the kind and amount of competitive opportunities permitted, provide for new entry and new airline cooperative arrangements that increase competition and help meet the burgeoning demand for better air service. In this respect, all three aviation relationships create the opportunity for new major code-sharing services, which provide substantial new opportunities for improved service, choice, and competition in a large number of markets covered by each agreement. In combination with the actual market conditions and structure existing today, and consistent with our international aviation policy, our new substantially more open aviation relationships with France, Mexico, and Japan provide the market structure needed to offset the potentially anticompetitive effects of exclusive dealings between these carriers in each of the affected markets.

Finally, there has been no showing that the exclusive dealing between and among parties in any of these markets has prevented any other airline from competing effectively in these markets. Thus, while we continue to have concerns about the impact of exclusivity provisions in markets that are not governed by open-skies agreements, we are satisfied on the basis of the information now before us that allowing these code-share exclusivity provisions would not inhibit competition or otherwise adversely affect the public interest. Therefore, we will modify Orders 99-5-2 and 99-6-6 to reflect this determination.

ACCORDINGLY,

1. We grant the petitions of Delta Air Lines, and United Air Lines, Inc. and Compania Mexicana de Aviacion, S.A. de C.V. in the above captioned proceedings for reconsideration of Orders 99-5-2 and 99-6-6, and upon review, remove the conditions imposed in those orders regarding exclusive dealings between the parties;

2. Consistent with the decision in this order, we amend the August 7, 1998 approval of the United/All Nippon Airways code-share operations, as amended by Order 99-5-2, to remove Condition (b) (which precluded exclusive dealings between the parties);

3. Consistent with the decision in this order, we withdraw the exclusivity condition imposed in Order 99-5-2 on approval of the Continental/Air France code-share operations;

4. To the extent not granted, we deny all other requests for relief in the captioned proceedings regarding the issue of exclusivity; and

5. We will serve this order on United Air Lines, Inc.; Continental Airlines, Inc.; Delta Air Lines, Inc.; All Nippon Airways Co., Ltd.; Société Air France; Compania Mexicana de Aviacion, S.A. de C.V; Aerovias de Mexico, S.A. de C.V.; the Ambassadors of Japan, Mexico, and France in Washington DC; the U.S. Department of State (Office of Aviation Negotiations), and the Federal Aviation Administration.

By:

A. BRADLEY MIMS
Acting Assistant Secretary for
Aviation and International Affairs

(SEAL)

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