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Order 99-5-2



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

Issued by the Department of Transportation  
on the 3<sup>rd</sup> day of May, 1999

Served: May 5, 1999

Joint Application of

**UNITED AIR LINES, INC. and  
ALL NIPPON AIRWAYS CO., LTD.**

**Undocketed**

for Statements of Authorization pursuant to  
14 CFR Part 212 (formerly Parts 207 and 212)  
(U.S.-Japan Code Sharing)

Joint Applications of

**AIR FRANCE and  
DELTA AIR LINES, INC.**

**Undocketed**

**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)

Joint Application of

**NORTHWEST AIRLINES, INC. and  
AIR CHINA INTERNATIONAL CORP.**

**Undocketed**

for Statements of Authorization pursuant to  
14 CFR Part 212 (U.S.-China Code Sharing)

**ORDER ON REVIEW AND RECONSIDERATION**

## **Summary**

By this order, we grant petitions for review and reconsideration of various actions taken regarding exclusivity arrangements on code-share operations. Upon review, we affirm our actions in the matters of United Air Lines/All Nippon Cargo (affirmed in part), and Northwest Airlines, Inc./Air China International Corp. In addition, upon further review and reconsideration, we are imposing a similar exclusivity condition upon the statements of authorization granted to Air France and Delta Air Lines, Inc. and Air France and Continental Airlines, Inc./Continental Express for code-share authority in the U.S.-France market.

## **Background**

In recent months, the Department has acted on various requests from U.S. carriers for code-sharing authority with foreign carriers whose cooperative arrangements have included matters of exclusivity. Petitions for review have been filed concerning some of these matters. The actions concerning the above-captioned code-sharing authorities are described below.

On May 8, 1998, the Director, Office of International Aviation, under assigned authority, approved the joint applications of (1) Compagnie Nationale Air France (now Société Air France)<sup>1</sup> and Delta Air Lines, Inc., and (2) Air France and Continental Airlines, Inc./Continental Express, Inc. for statements of authorization under Parts 207 (since recodified as Part 212) and 212 of our regulations to permit mutual code-sharing operations in the U.S.-France market. These approvals were silent on the issue of exclusivity, even though the relevant code-share agreements between the applicants contain certain exclusivity provisions.

On August 7, 1998, the Director, Office of International Aviation, under assigned authority, approved the joint application of United and All Nippon Airways for Statements of Authorizations pursuant to Parts 207 and 212 to conduct code-share operations in the U.S.-Japan market. That approval specifically precluded United and ANA from giving any force and effect to any exclusivity provision in their arrangement which would restrict “ANA’s participation in the code sharing, frequent flyer program or lounge access program of another U.S. flag carrier or United’s participation in the code sharing, frequent flyer program or lounge access program of another Japanese flag carrier.”<sup>2</sup>

On October 16, 1998, the Department approved the joint application of Northwest Airlines, Inc. and Air China International Corp. for Statements of Authorization under Part 212 to conduct code-share operations in the U.S.-China market. That approval specifically precluded Northwest and Air China from exercising the exclusivity provisions of their commercial cooperation agreement to the extent that those provisions would prevent Northwest and Air China from entering into cooperative service arrangements with U.S. and Chinese air carriers that have not been designated to provide combination services in the U.S.-China market. The Department’s

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<sup>1</sup> On December 4, 1998, counsel for Air France informed the Department that Air France’s official corporate name had been changed from Compagnie Nationale Air France to Société Air France.

<sup>2</sup> Condition (b) attached to the approval of Statement of Authorization, dated August 7, 1998.

decision stated that “we concluded that such a condition is necessary to maximize competition in this limited-entry market.”<sup>3</sup>

### **Petitions for Reconsideration and Review of Staff Action**

(a) Reconsideration of United/ANA Statement of Authorization

On August 17, 1998, United filed a petition for review of staff action concerning the United/ANA Statement of Authorization approvals. United urges the Department to reconsider and eliminate the condition on the United/ANA code share in light of the unconditional approval of the contemporaneous code shares of Continental, Delta and Air France, which are also subject to various exclusivity terms, and maintains that such review is required in light of the more restrictive nature of the U.S.-France bilateral agreement as compared with that between the U.S. and Japan. United further argues that, as the basis for imposing the condition, the Department simply cited the American Airlines’ TACA case (Order 98-5-26) and that the anticompetitive concerns recited as the basis for conditioning the American/TACA agreements are not present in the U.S.-Japan market.

Continental and Delta filed separate answers to United’s petition, and United filed a consolidated reply.<sup>4</sup>

Continental argues that the approval of Continental/Air France code sharing has no bearing on the approval of the United/ANA code-share agreement. Continental states that the U.S.-France bilateral agreement is not “highly restrictive,” and the U.S.-Japan agreement is not “more competitive,” as United claims. Rather, it maintains that the U.S.-France bilateral agreement permits unlimited code sharing between U.S. and French carriers and that Japan may be more liberal with respect to third-country code sharing, but France is clearly more liberal for operations by U.S. carriers. Continental also argues that United is wrong that paragraph 8(a) of the Continental/Air France code share agreement is an exclusivity provision similar to the United/ANA exclusivity provision conditioned by the Department, maintaining that the Continental/Air France provision gives each party the right to enter into another code-share arrangement, although the other party can opt out. Continental maintains that the Department’s action on United’s petition should have no effect on the Department’s recent Continental/Air France code-share approvals.

Delta supports United’s petition insofar as it urges the Department not to impose a uniform prohibition against exclusivity terms in all code-share arrangements, but to consider the issue of conditions on a case-by-case basis. Delta opposes United’s petition to the extent that it requests the Department prohibit use of limited so-called exclusivity provisions in the Delta/Air France code-share agreement and further opposes imposition of a prohibition against exclusivity clauses on an across-the-board basis, stating rather that each code-share arrangement should be evaluated on a case-by-case basis. Delta maintains that the U.S.-France agreement is more competitive than the U.S.-Japan agreement and contains none of the competition factors present in the American-

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<sup>3</sup> Page 3 Notice of Action Taken Docket OST-98-3901 and Undocketed, October 16, 1998.

<sup>4</sup> United’s reply was accompanied by a motion for leave to file an otherwise unauthorized document. We will grant the motion.

TACA case. Delta urges the Department not to adopt a new policy of imposing a non-exclusivity condition as a standard condition on all code-share arrangements.

On reply, United states that Continental's arguments raise another aspect of the Department's disparity of treatment of exclusivity arrangements, specifically noting that the agreement attached to the Continental/Air France application relates only to code sharing and there are no terms in the agreement relating to matters such as frequent flyer participation or lounge access whereas the contractual recitals describing their relationship state that their alliance will include not only code sharing but also "frequent flyer program participation, joint marketing programs and other mutually agreed to agreements." To the extent that Continental/Air France may have agreed to any exclusivity, United argues, those terms were not included in their arrangement. United argues that if it had drafted its ANA code-share agreement as Continental had done with Air France, the Department's condition would not have applied to frequent flyer programs and lounge access. Thus, United maintains that it is unfair to United for the Department to adopt such conditions on exclusivity arrangements on the basis of the drafting structure of the agreements filed with DOT. United argues that there is no regulatory need for the Department to condition exclusivity arrangements relating to purely commercial matters such as frequent flyer participation and lounge access and that, unlike code sharing, cooperation in these other areas does not affect a carrier's competitive entry to a route.

Regarding both Continental's and Delta's arguments that the competitive conditions in the U.S.-France market would not warrant any condition on exclusivity, United states that both "same country" and "third-country" code sharing are far more liberal under the U.S.-Japan than under the U.S.-France agreement. United concludes that there is no basis to condition the code-share exclusivity term in the United/ANA agreement by comparing the U.S.-Japan and U.S.-France bilateral agreements.

(b) Reconsideration of Northwest/Air China Statement of Authorization

On October 23, 1998, Northwest filed a petition for review of staff action concerning the exclusivity condition attached to the Northwest/Air China Statement of Authorization approval, seeking reversal of that action.<sup>5</sup> Northwest maintains that the condition on its approval limits the enforcement of an already limited exclusivity provision and as such will expose Northwest and Air China to "free riders" who have not made investments that underlie the arrangement and that the action will harm the public interest by discouraging investment in improved air service. Northwest notes that courts have normally found exclusive dealing agreements to be procompetitive. Northwest further argues that the Department action is contrary to law in that the Department has approved a far broader exclusivity provision between American and China Eastern. Northwest maintains that, because limited exclusivity provisions are essential to achieve the public interest benefits of international code-sharing arrangements, the staff's action will likely lead to a decrease in code-share arrangements and the policy must be reviewed. Northwest notes that there were no objections to the exclusivity arrangement and that the staff's adopting and

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<sup>5</sup> Unlike United's petition, which sought review of an action of the Director, Office of International Aviation, Northwest's petition seeks review of a final decision of the Department, taken by the Assistant Secretary of Aviation and International Affairs. Accordingly, it should properly have been styled a "Petition for Reconsideration." We will treat it as such.

applying a new rule or standard for code-share arrangements is procedurally prejudicial to Northwest and a departure from the American-China Eastern precedent without explanation.

On November 5, 1998, United filed a petition for reconsideration of the October 16, 1998 Notice regarding Northwest/Air China, concerning the condition imposed on the exclusivity clause in the Northwest/Air China arrangement. United argues that exclusivity clauses such as in the Northwest/Air China and United/ANA contracts are procompetitive and fully consistent with antitrust laws. It maintains that the conditions imposed by the Department on the exclusivity clauses are inconsistent with applicable antitrust precedents, will undermine, rather than promote competition and, on reconsideration, should be removed. United argues that there can be no justification based on the level of competition for imposing a stricter exclusivity condition on cooperation between United and ANA than is imposed on cooperative arrangements between U.S. and Chinese carriers. United maintains that the Department's sole focus in reviewing exclusivity clauses should be on whether such clauses foreclose U.S. airlines from the relevant inter-continental air travel market: in the Northwest/Air China case, the U.S.-China trans-Pacific market and in the case of United/ANA, the U.S.-Japan trans-Pacific market. United maintains that "exclusivity promotes competition by making the Northwest/Air China and the United/ANA networks more effective competitors against, in the case of U.S-China services, the American Airlines/China Eastern network and the Delta/China Southern network . . . and in the case of U.S.-Japan services, the American/JAL network and the Northwest/Japan Air Services network . . ." The inconsistent treatment of the Department regarding these code shares, United maintains, is arbitrary and capricious, and the current policy of the Department and staff has not been articulated. If the Department is not prepared to withdraw entirely the condition imposed by the staff on the United/ANA exclusivity clause, then United urges that the same more limited condition imposed by the Department on the Northwest/Air China code-share exclusivity clause be imposed on that between United and ANA. If modifications of the United/ANA condition to conform to that imposed on Northwest/Air China are not adopted, then United urges the Department to impose the same broader condition on the Northwest/Air China exclusivity clause as that imposed on United/ANA.

## **Decision**

As noted in the Summary above, we decline to adopt the view of some of the parties that all constraints on exclusivity provisions are unjustified. We agree, however, that it would be inconsistent to impose conditions limiting such provisions on the two transpacific code-sharing arrangements at issue here, when we have not done so with regard to the Air France code-shares, which are similar, but not identical, in the restrictive conditions and structures of their markets. We accordingly here condition those approvals as well.<sup>6</sup>

We first address the parties' arguments regarding judicial precedent in the antitrust area, and its application here. The parties cite various decisions that stand for the proposition (among others) that exclusivity in the context of "vertical" integration is generally tolerated by our antitrust laws. This argument is not compelling here for at least two reasons.

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<sup>6</sup> In light of our decision here, we will also consider by separate action whether to impose similar conditions on other code-sharing arrangements, such as the American-China Eastern relationship, that include exclusivity provisions. American and China Eastern recently filed for renewal of their authorization.

First, we question whether the roles played by airlines in various markets are such that a code-sharing arrangement represents only simple vertical integration. If vertical integration typically might involve the merger of a product's manufacturer with its retailer, it may be possible to characterize interline traffic feed under a code-share as a similar process of transferring the seat "produced" by the operating carrier to the carrier "retailing" that seat to its passenger. In fact, however, the competitive dynamics of code sharing are far more complex. Both carriers (rather than just one) may be feeding traffic to each other, while they may also continue to compete by serving the same markets with their own aircraft; in addition, of course, they will be competing in some fashion with other carriers, some with their own code-sharing arrangements. Finally, external strictures imposed by restrictive bilateral regimes further complicate the analogy. These circumstances create a competitive environment far more intricate than the usual "exclusive dealership" problem of vertical integration.<sup>7</sup>

More significant, however, is the fundamental issue of the scope of our discretion in reviewing applications for statements of authorization to code-share, which are subject to a public-interest test. Antitrust considerations are certainly relevant to such review, but they are far from the only relevant criteria; we may find a particular relationship undesirable on aviation competition grounds even though it might withstand challenge under the antitrust laws. The applicable standards of review thus may partially overlap, but they do not coincide.<sup>8</sup>

In determining whether a condition is appropriate, the most fundamental factor is the bilateral relationship between the United States and the particular foreign carrier's homeland. This issue extends beyond the normally simple inquiry articulated in our rules—whether the operation at issue is covered by and consistent with our bilateral agreement with that country. An agreement may accommodate code-sharing, but limit it or otherwise restrict the free operation of the marketplace.

Such is the case with our agreements with Japan, China, and France. Although all three agreements permit some degree of code sharing, none is Open Skies, with all the rights and liberties that together promote a competitive environment for services involving the two countries, absent other factors.<sup>9</sup> Where limits on such rights exist, we are inclined to be much less tolerant of any exclusivity provision in a code-sharing agreement. Conversely, where Open Skies govern the relevant market, we are much more likely to be prepared to leave such provisions

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<sup>7</sup> For example, in *E.C.C. v. Toshiba America Consumer Products, Inc.*, 129 F.3d 240 (2d Cir. 1997), which United cites to us to the effect that "exclusive distributorship arrangements are presumptively legal," *Petition of United* at 11 n.12 *quoting* 129 F.3d at 245, the court declared that the plaintiff's allegations "establish nothing more than a run-of-the-mill exclusive dealership controversy, where a former exclusive distributor is attempting to protect its competitive position vis a vis its supplier." 129 F.3d at 245. The competitive environment in all four code-share cases here is less straightforward.

<sup>8</sup> In *E.C.C. v. Toshiba*, the court observed that "to sustain a section 1 claim, a plaintiff 'must . . . show more than just an adverse effect on competition among different sellers of the same product . . .'" 129 F.3d at 245 (citation omitted). In contrast, we may well encounter circumstances where even a modest reduction in competition is unacceptable.

<sup>9</sup> *See, e.g., American Airlines and the TACA Group Reciprocal Code-Share Services Proceeding*, Order 98-5-26, served May 20, 1998, at 12.

undisturbed (although not conclusively, as in the TACA case), because any anticompetitive effect is far more likely to be offset by other marketplace forces.

We regard the presence or absence of Open Skies as a strong indicator of freely competitive market conditions, although this remains rebuttable. In certain circumstances, for example, the characteristics of the affected markets may have a critical bearing on our decision. The specific exclusivity provision's terms may also be significant, particularly where the absence of Open Skies would tend to support conditions limiting the effectiveness of those terms. Other geographic, economic, public policy, or legal factors may also prove relevant.<sup>10</sup>

### **United/All Nippon**

Given that the U.S.-Japan agreement is not an Open Skies agreement, and given the absence of countervailing circumstances, we will affirm in part our condition on approval of this arrangement, which forbade application of a provision that would have prevented each party from engaging in various cooperative activities with other carriers of the other party's nationality. We will reverse the staff action, however, to the degree that the condition that was imposed covered frequent-flyer or lounge-access programs. In reaching this conclusion, we do recognize that exclusivity in these areas raises issues that may warrant further review. We intend to explore the matter by separate action. Accordingly, we will not prohibit the exclusivity provision's application to these frequent flyer programs at this time. Most of United's other arguments involve alleged unequal treatment, compared to our approvals of the Air France code-shares; we address these points in our discussion of those arrangements below.

United also challenges the relevance of *American-TACA* to the circumstances here. United argues that the presence of other competitors (Japanese, American, and third-country) creates a very different environment from the U.S.-Central America market under examination in that case. United describes the facts accurately, but neglects the most significant fact of all: the Japan market is not subject to Open Skies.

Accordingly, we grant the petition for review of staff action, and grant in part and deny in part the relief requested, as stated above.

### **Northwest/Air China**

The U.S.-China Air Services Agreement of 1980, as amended, imposes a variety of restrictions on air services between the two countries, imposing severe limitations on routes, number of designations, frequencies, and other operational features. It thus falls far short of Open Skies.

As we observed in our Notice, "a condition is necessary to maximize competition in this limited-entry market." The competitive environment here is even more restrictive than that with Japan, and we are accordingly disinclined to accept further competitive restraints like exclusivity provisions. The parties' proposed exclusivity provision would prohibit Air China from code-

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<sup>10</sup> While investment in a foreign partner would not, under most circumstances, justify consideration as a factor in our decision to permit an exclusivity clause, we may consider this factor, among others, where such investment is essential to raising the safety and/or security standards of the foreign partner.

sharing with any other U.S. carrier in the U.S.-China market, whether one that is designated and serves the market with its own aircraft (*e.g.*, United) or one that is not designated and serves the market only by code-sharing. In the context of the markets involved, we find this overly broad and therefore unacceptable. Specifically, exclusivity provisions that prevent Northwest and Air China from entering into cooperative arrangements with U.S. and Chinese air carriers that have not been designated to provide combination service in the U.S.-China market unacceptably constrain competition. We believe it important to ensure the possibility of Air China's code sharing with the various undesignated U.S. carriers that may serve China only by code-share; the same considerations apply to Northwest's ability to code-share with other, undesignated Chinese carriers, an ability we wish to preserve.

Although exclusivity provisions are not generally pro-competitive where relations are not governed by Open Skies, particular circumstances may offset this initial indication. Here, in a market with only two U.S. carriers actually designated and operating aircraft, we could foresee adverse competitive consequences were both to code share with Air China. Such circumstances could actually reduce the latter's incentive to code-share with other U.S. carriers. Permitting this exclusivity provision with regard to United could well have a positive effect.

For these reasons, we will also affirm our condition on approval of this arrangement, but here clarify that the condition does not extend to exclusivity with respect to frequent flyer programs.<sup>11</sup>

### **Code-Sharing Agreements with Air France**

We will also condition our previous approvals of the Delta and Continental code-sharing agreements with Air France, since these parties have had an opportunity to comment on the general and specific issues involved, and have done so. United is correct that conditioning its agreement with ANA would be inconsistent with unconditional approval of these agreements.<sup>12</sup>

With restrictions on fifth-freedom services, capacity limitations, and other limitations on third-country code sharing via third countries to France, our agreement with France cannot be regarded as Open Skies. There are also no countervailing circumstances in this market that would lead us to depart from our disinclination to tolerate exclusivity provisions in a non-Open Skies situation. We thus find that an exclusive arrangement with Air France would constitute an unnecessary and unjustified additional restriction on competitive operations by non-participating U.S. airlines that cannot be justified by any alleged countervailing benefits. We note specifically in this regard that there is no competitive benefit here to preserving a particular provision, unlike the case with China. We will accordingly amend our approval of the Delta/Air France and Continental Air France code-share authorizations to preclude application of the carriers' agreements with respect to exclusive dealings between the parties with respect to code-share operations.

ACCORDINGLY,

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<sup>11</sup> The Notice of Action taken described the condition imposed as "to preclude the carriers from exercising the exclusivity provisions . . . to the extent that they would prevent Northwest and Air China from entering cooperative service arrangements . . ." Section 10 of the carriers' agreement treats the term "Commercial Cooperation Agreement" as including both code-sharing and frequent-flyer programs.

<sup>12</sup> Petition of United for Reconsideration, November 5, 1998, at 5-9.

1. We grant the petition of United Air Lines, Inc. and All Nippon Airways for review of the staff's August 7, 1998 action approving, with conditions, the applications of United and All Nippon for Statements of Authorization to engage in code-share operations;
2. Upon review, to the extent consistent with this order, we (a) affirm the decision of the staff to condition approval of the United/All Nippon code-share operations to preclude application of a provision in the code-share agreement preventing each party from engaging in various cooperative services with other carriers of the other party's nationality, and (b) reverse the staff's action to the extent that the condition imposed would apply to frequent-flyer or lounge access programs under the United/All Nippon agreement;
3. We grant the joint petition of Northwest Airlines, Inc., and Air China International Corp. for reconsideration of the Department's October 16, 1998 approval of the Northwest/Air China code-share operations, and upon reconsideration, to the extent consistent with this order, affirm our decision to impose a condition on the exclusivity provisions of the Northwest/Air China code-share agreement;<sup>13</sup>
4. We amend, to the extent consistent with this order, the May 8, 1998 staff actions authorizing code-share operations by Delta Air Lines and Air France and by Continental Airlines and Air France so as to preclude the carriers from giving any force or effect to the provisions in their code-share agreements that provide for exclusive dealings between the carriers;<sup>14</sup>
5. We grant all motions for leave to file unauthorized documents in the captioned proceedings;
6. To the extent not granted, we deny all other requests for relief in the captioned proceedings; and

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<sup>13</sup> As discussed in the text of this order, we clarify that the condition applies to the code-share operations only and does not extend to the carriers' arrangements regarding frequent flyer programs.

<sup>14</sup> See Exhibit AA I.1 and II.1 of the Delta/Air France arrangement (points exclusive to Air France and points exclusive to Delta) and Item 8 of the Continental/Air France agreement.

7. We will serve this order on United Air Lines, Inc., Northwest Airlines, Inc., Continental Airlines, Inc., Delta Air Lines, Inc., All Nippon Airways Co., Ltd., Air China International Corp., Société Air France; the Ambassadors of Japan, the People's Republic of China, 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)

*An electronic version of this order is available on the World Wide Web at:*  
<http://dms.dot.gov/reports/aviation.asp>