Japan Civil Aeronautics Board Hearing
Concerning IATA's Antitrust Immunity
13 November 2008

In advance of the hearing, the JCAB posed specific questions to IATA for comment. IATA's responses to those questions are set forth below.

1) How does IATA evaluate the Anti-Trust Immunity ("ATI") that Japan currently grants to IATA and is there a case that can be made that it should be continued?

Response:

Upon the founding of IATA in 1945, its Member airlines were assigned the task by governments of establishing passenger fares and cargo rates for international air transportation. However, neither IATA nor its Member airlines was ever accorded "global" ATI by these same governments. Indeed, no international body exists or is empowered, either then or now, with the authority to grant ATI across jurisdictions. In fact, during its history only four governments have expressly granted IATA special status under their competition laws, namely the US, the EU, Australia, and, of course, Japan.

In recent years, the US, the EU and Australia have each carefully scrutinized IATA's ATI under their respective competition laws and considered whether the time had come to eliminate entirely or dramatically scale back the special status that IATA and its members had previously enjoyed. In each instance, these governments concluded that increased liberalization of air transport in their markets combined with the prevalent policy trend away from industry or sector-specific grants of ATI in favor of greater reliance on generally applied competition rules to govern marketplace behavior warranted a change to the *status quo*. At the same time, in recognition of this evolving regulatory environment, the IATA Board of Governors concluded that IATA's Members would be best served by adopting an approach which ensured that IATA's activities could continue without the need to secure new grants of ATI from governments or sustaining previous grants of ATI. To do otherwise would not only be extremely difficult -- if not impossible -- from a practical standpoint due to the explosion of new competition laws around the world, but making changes deemed necessary to transition to a "non-immunised" environment would also alleviate the significant drain on limited resources required to retain, or at least attempt to retain, IATA's dwindling ATI.

The core activities of IATA take place through the various IATA Traffic Conferences (both Passenger and Cargo), which provide participating airlines a forum to hammer out the complex industry standards which underpin the global interline system. Such standards, which are adopted in the form of Resolutions or Recommended Practices, are critical to enable the traveling public to enjoy such conveniences as through check-in on multi-sector journeys and to be able to through check baggage so they don't have to pick up their bags at an intermediate point in their

journey then clear customs and check-in again. Although these essential standard-setting functions and industry cooperation through IATA are collective agreements among actual or potential competitors, they are critical to enable passengers to enjoy the seamless travel experience they make possible and facilitate the efficient shipment of cargo around the world.

From an antitrust standpoint, these Resolutions and Recommended Practices can all be placed on a spectrum based on the relative competitive sensitivity of the underlying activity governed by such agreements. Indeed, as the US Department of Transportation ("US DOT") remarked in its July 2006 Show Cause Order issued to consider IATA's ATI for Tariff Coordination, the IATA Traffic Conferences which are devoted largely to standard-setting functions (*i.e*., Passenger and Cargo Agency and Passenger and Cargo Services Conferences) – and the agreements which have been developed by them to support multilateral interlining, have not proven to be controversial (*e.g.,* a competitively benign Passenger Services Conference Resolution 740 "Form of Interline Baggage Tag", establishing an industry standard for checked baggage identification). IATA's ATI for these types of activities has been entirely eliminated in the EU and only remnants remain of ATI in Australia and the US. As a consequence of these changes, there has been no disruption to the standard-setting functions of the respective Traffic Conferences and the global interline system has not been adversely impacted.

However, on the other end of the antitrust spectrum, the US DOT, consistent with the approach that had earlier been taken by the European Commission's Directorate General for Competition ("DG Comp") and the Australian Consumer and Competition Commission ("ACCC") under their competition laws, considered the traditional form of IATA Tariff Coordination under US antitrust law. The Final Order by the US DOT confirmed the preliminary finding of the Show Cause Order that the traditional form of Tariff Coordination (*i.e.,* a largely meetings-based mechanism allowing face-to-face negotiations on fares and rates) was anticompetitive and did not provide important public benefits or meet a serious transportation need (the statutory standard under Section 412 of the Federal Aviation Act which needed to be satisfied in order to warrant continued ATI). As such, traditional IATA Tariff Coordination activity could not continue absent a sustained grant of ATI. Although the US DOT could have, based on the reasoning contained in the Final Order, withdrawn the decades-old ATI for IATA Tariff Coordination world-wide, it instead elected to "disapprove" ATI for only two routes: (i) US-EU; and (ii) US-Australia. This approach by the US DOT reflected the convergence in approach taken by their counterparts in the EU and Australia after their lengthy proceedings which had earlier considered these issues.

In order adjust to the changing legal environment, and to address the antitrust concerns raised by the US DOT, DG Comp, and the ACCC, IATA's Passenger Tariff Coordination Member airlines, with the assistance of IATA technical staff, have developed twin mechanisms to replace the traditional form of Tariff Coordination: (i) e-Tariffs, which provides an electronic communication mechanism to replace face-to-face meetings, eliminating concerns regarding the manner in which IATA Tariff meetings are organized which could impact competition among airlines (the so-called "spill over effect"); and (ii) FlexFares, which is a market-based formula for developing IATA interline fares that eliminates the concerns which had been raised that IATA interline fares impacts the fares that airlines charge for their on-line services (the so-called "coat-hanger effect"). This new method of developing IATA interline fares through e-Tariffs and FlexFares was initially launched in January 2007 for routes within the European Common Aviation Area and has since been implemented in various other routes around the world (*e.g*., Europe-Japan).

A decision by MLIT to retain ATI in Japan for IATA activities would, of course, continue to provide legal certainty for the international airline industry that the activities and agreements of the various IATA Traffic Conferences would not place Member airlines in jeopardy of being adjudged to have contravened Japanese competition laws. However, as outlined in detail above, IATA is confident that the necessary steps have already been taken to ensure that the considerable consumer benefits made possible by the IATA Traffic Conference system can continue to be maintained absent ATI. Of course, if there is any particular component of the IATA Traffic Conference system that in the view of the MLIT authorities would require ATI to continue IATA interlining in the Japanese market (*e.g.,* FlexFares), IATA would take such conclusions into account moving forward.

2) How does IATA evaluate FlexFares already implemented in the market and the resulting market impact?

Response:

As mentioned above, FlexFares has been successfully implemented on various routes around the world to replace traditional Passenger Tariff Coordination and that trend is expected to continue in the coming months. In addition to the regulatory imperatives that have required the establishment of FlexFares in order to retain multilateral IATA fares on some routes, there are other benefits which FlexFares and e-Tariffs have made possible. Moving away from a meetings-based mechanism for establishing IATA fares has generated considerable cost savings for participating airlines as well as IATA. FlexFares and e-Tariffs does not require the significant expense of organizing and staffing Tariff Conference meetings all over the world and allows airline delegates (as well as IATA staff needed to support such meetings) to participate without spending weeks away from their home offices. For these reasons, from a practical as well as policy standpoint, IATA would prefer that FlexFares/e-Tariffs becomes the standard mechanism for establishing IATA interline fares in the future without the burden of maintaining two separate systems simultaneously.

As for the fare levels which have been generated from the FlexFares mechanism versus traditional Passenger Tariff Coordination, there is no distinct conclusions that can be drawn thus far. Comprehensive transaction data is limited and, as a result, analytical treatment of the impact of FlexFares cannot yet fully be assessed. However, preliminary assessments suggest that, depending on prevailing market conditions for a particular route, FlexFares could result in moderately higher or lower interline fares vis-à-vis the fares which were derived from traditional tariff coordination.

3) Does IATA see a need for the implementation of FlexFares in the intra-Asia market?

Response:

As noted above, the development and implementation of FlexFares (and e-Tariffs) was driven in large measure to address the concerns raised by competition authorities and the resulting loss of ATI for certain impacted routes. However, even in jurisdictions where governments have not precluded IATA from continuing traditional, meetings-based Passenger Tariff Coordination, it would be IATA's preference, and the preference voiced by many airlines which participate in Passenger Tariff Coordination, to migrate to a FlexFares/e-Tariffs system on a global basis. Of course, Resolutions of the Passenger Tariff Coordinating Conferences, like all IATA Traffic

Conference Resolutions, requires the unanimous assent of participating Members. Absent unanimous support for moving to FlexFares by Member airlines of a particular Tariff Conference, IATA cannot implement FlexFares for those routes. However, to limit potential legal exposure resulting from future scrutiny of government authorities and/or to preclude challenges by private plaintiffs, IATA may at some point elect to withdraw from traditional Passenger Tariff Coordination activities on routes in which participating Members have failed to adopt FlexFares.

4) Where FlexFares do not exist in Cargo market, what would be the impact?

Response:

The development of FlexFares was made possible due to the ready availability of on-line passenger fares drawn from GDSs and other fare filing facilities. This enables the FlexFares formula to derive a market-based fare. However, there is no corresponding mechanism for developing a market-based cargo rate for interline shipments by city pair. As a result, it has been impossible to translate the FlexFares model into a similar "FlexRates" mechanism for developing IATA interline cargo rates. There is currently no method to replace traditional IATA Cargo Tariff Coordination under consideration, as a proposed IATA Settlement Rate mechanism was rejected earlier this year.

Although, IATA Cargo Tariff Coordination activities have not generated scrutiny by regulators to the same extent as IATA Passenger Tariff Coordination, the US DOT, DG Comp, and the ACCC, have each determined that such activities could be construed as anticompetitive under their respective legal standards. As a result, in recent years IATA Cargo Tariff Coordination for the setting of cargo rates has ceased for routes within the EU as well as for routes encompassing the US-EU and Australia-Rest of the World. Input provided by Members of IATA Cargo Tariff Coordination suggests that the elimination of this activity would not necessarily result in harm to shippers or airlines as IATA cargo interlining represents and increasingly small proportion of cargo shipments. The phasing out of IATA Cargo Tariff Coordination is currently under consideration for certain routes. However, it is contemplated that the various standard-setting functions of the Cargo Tariff Composite Conference and the Resolutions established by it can be retained without ATI.

5) With certain countries like Japan maintaining ATI, how have the airlines been managing in terms of compliance? Have there been problems for airlines trying to deal with this situation?

Response:

As discussed in detail above, the regulatory environment in which IATA activities operate has become more complex in recent years as more countries have adopted comprehensive competition law regimes for the first time and the fact that ATI is not available to IATA on a global basis. Although compliance obligations have become more of a challenge, appropriate steps are taken to ensure that all applicable antitrust laws are adhered to and compliance with internal competition law guidelines is maintained.

At this juncture, Japan currently stands alone as the only jurisdiction that confers blanket ATI for all IATA Traffic Conference agreements and activities. Of course, while many countries have adopted competition law regimes in recent years, they differ to some degree or other, including on the fundamental questions of jurisdiction as well as other procedural and doctrinal differences on

what constitutes an infringement, the severity of punishment for violations (*i.e*., criminal versus civil penalties), *etc*. However, IATA is of the view that very few types of activities which its Members participate in could arguably raise significant competitive concerns, most notably tariff coordination. Even with regard to this activity, as outlined above, IATA is of the view that this should properly be considered legitimate joint venture activity among participating airlines under most national competition law regimes. As such, IATA is of the opinion that such activities can continue to be engaged in provided appropriate procedural safeguards to manage legal risk are in place.

It should be noted that it is customary at the start of all IATA meetings which could potentially stray into competitive topics delegates are reminded of the ground rules which govern their participation. For example, at the recently convened Passenger Services Conference, the meeting began by the Chairman providing the following admonishment:

"This meeting is being conducted in compliance with the Provisions for the Conduct of the IATA Traffic Conferences. Pursuant thereto, this meeting will not discuss or take action to develop fares or charges, nor will it discuss or take action on remuneration levels of any intermediaries engaged in the sale of passenger air transportation. This meeting also has no authority to discuss or reach agreement on the allocation of markets, the division or sharing of traffic or revenues, or the number of flights or capacity to be offered in any market. Delegates are cautioned that any discussion regarding such matters, or concerning any other competitively sensitive topics outside the scope of the agenda, either on the floor or off, is strictly prohibited."

Of course, as the recent antitrust enforcement activity in various jurisdictions arising from possible collusion on the setting of cargo fuel and other surcharges amply demonstrates, it is critical that IATA remains vigilant in demonstrating its commitment to maintaining strict adherence with all applicable antitrust compliance obligations.

6) How does IATA understand the Intra-Asia market and should Japan lift ATI in terms of Intra-Asia relationship (with other countries in Asia)?

Response:

Since the first Traffic Conference meetings in 1947, in addition to passenger and cargo rate coordination, IATA and its Members have been devoted to establishing the technical standards, passenger/baggage handling procedures and communications protocols necessary to facilitate multilateral interlining. The approach has been to develop a truly global air transportation system, while taking due account of different legal and regulatory systems that may apply. It bears noting, of course, that all national legal requirements take precedent over any IATA Traffic Conference Resolutions and Recommended Practices. However, although IATA makes every effort to keep abreast of legal and regulatory changes which could impact aviation, it is up to our Member airlines to ensure compliance with their own legal obligations which may be applicable on a national or regional basis. Although, the intra-Asia market, particulary Chinese routes, are an increasingly important component of the international air transport network, IATA does not have an opinion as to the particular features of the intra-Asia market for purposes of the inter-relationship among Asian countries. However, given that IATA does not enjoy express ATI in any Asian country with the exception of Japan, IATA does not seek special status from other Asian countries under their competition law regimes. Instead, IATA would prefer to adhere to its global

approach which is geared to operating in a "non-immunized" environment for purposes of competition law compliance.

7) Please share what IATA knows about in current Anti-Trust law and its administration in key Asian Countries. Is Asia Market still dependent to conventional IATA Fare.

Response:

As in other parts of the world, Asia has seen a dramatic increase in recent years in both the enactment of new competition laws as well as the vigorous enforcement of such laws. Some recent examples include the passage of the Singapore Competition Act in 2004 as well as coming into effect of the long-awaited Anti-Monopoly law in China earlier this year. India, which along with China, is an increasingly important part of the global economy, will soon have a new competition law regime to replace one that was considered to be inadequate by some. Korea is notable as a vigorous enforcer of its competition laws, in particular its focus on combating cartel-like behavior impacting its economy. Although these laws and others in Asia differ in many respects, they represent the clear trend toward the convergence across geographic regions by competition law enforcers. As such, they have joined other more-established competition law counterparts such as the US, the EU, Australia, as well as Japan, as members of the International Competition Network. It is likely that the years ahead will bring a greater degree of cooperation among Asian governments and other prominent competition law enforcers in developing best practices and a more coordinated approach on enforcement priorities, including matters impacting air transport.

With specific regard to the prevalence in Asian countries of the use by customers of IATA fares, it is apparent that, as with most parts of the world, airlines are becoming less and less dependent on IATA fares in marketing and selling their products. Where possible under existing regulatory standards, airlines are increasingly publishing their own carrier fares which are developed independent of the IATA Tariff Conferences and are set based on each individual airline's commercial judgment in light of prevailing market conditions.

8) How does IATA feel about business-to-business contracts such as airline alliances? Does IATA feel that immunity is needed for this airline alliances, or is there a better practice to manage without formal immunity?

Response:

Airline alliances, in particular Star Alliance, One World and Sky Team, have become a fixture of the international air transport landscape in recent years. However, the treatment of alliances by competition authorities has not been uniform for a variety or reasons, including the differing legal standards which respective governments have applied to them. As a result, there is not a uniform approach given to the intersection between airline alliances and the antitrust laws. However, there has been considerable review of these arrangements by the US DOT and DG Comp, for example. The consensus that seems to be developing is that these alliance, which are in essence formal joint venture arrangements, can appropriately coordinate marketplace activity to some degree without any special grant of ATI (e.g., linking up respective frequent flyer programs). However, outright coordination on more sensitive areas, including capacity, pricing, *etc*., could be construed as anticompetitive and, therefore, cannot occur absent ATI. In the US for example, a recent Supreme Court case suggests that "legitimate joint venture activity" including coordination

by joint venture participants on the pricing of the joint venture product would not be subject the *per se* rule against price-fixing. In short, the treatment of airline alliances by competition law enforcers is still evolving, but the trend is clearly to allow them to be formed consistent with applicable standards on allowable levels of market concentration, merger and joint venture rules, *etc.*

9) How does IATA feel about Open Sky in Japan in term of its progress?

Response:

IATA's view is that all governments should disband the archaic economic regulation of the airline industry which has inhibited rational commercial decision-making and deny access to necessary capital that other industries are able to avail themselves of. In short, IATA advocates further liberalization and the removal of highly restrictive of bilateral air services agreements which have been seen to be highly detrimental in efforts to rationalize the industry and enable it to better function in accordance with standard business approaches.

10) Would there be any bearing on ATI against network airlines merger, alliances?

Response:

As discussed in response to Item 8 above, the treatment of alliances and mergers can effectively dealt with by analyzing such transactions consistent with mainstream merger and joint venture review analysis. As such, there would not appear to be the need to secure ATI if the activities at issue are similarly engaged in by other industries without ATI. Again, this continues to be an evolving area of the law and long term impact on airline alliances is yet to be seen.

11) How does the high price of fuel, and the resulting capacity reductions and network contractions impact the competitive environment of airline business or the ATI?

Response:

In recent years, the international airline industry has faced an extremely difficult environment in which to operate profitably. Jet fuel is, of course, a very large cost component for airlines with a disproportionate impact on operating margins vis-à-vis other industries. As a result of jet fuel and other increased costs, industry consolidation in the form of mergers may be a necessary option for some struggling airlines to contemplate. However, irrespective of the challenging market conditions facing the airlines, antitrust compliance must not be compromised. It would seem that the issues surrounding ATI, at least taken in isolation, would not be directly impacted by high fuel prices or other challenges such as capacity reductions that are implemented by individual airlines to reduce costs.

12) LCC movement and market development in terms of anti-trust?

Response:

The explosion in the formation of LCCs (or more accurately, point-to-point) in recent years has generally followed the implementation of more liberalized air transport regimes (*e.g.,* EU). It is

likely that the trend will continue, with more LCC entrants placing ever increasing competitive pressures on legacy network carriers, due to their higher relative costs base. However, there would not appear to be any direct link with antitrust compliance obligations or enforcement as LCCs are required to adhere to the same rules as other market participants, absent a grant ATI.