

Commuter Code Sharing

*Kelly Ison (BWI)
Chairman, Regional Jet Task Force*

“Code sharing provides both benefits and drawbacks to the passengers, the mainline carrier, and the commuter carrier.”

Commuter code sharing – particularly RJ code sharing – has been a popular topic in the press and other forums lately. Since US Airways management has approached ALPA for relief in the commuter code sharing restrictions of the pilot Contract, it may be useful to examine the basics of code sharing between major and commuter carriers.

This article explores various ownership arrangements and contract relationships between code sharing partners. It also details US Airways’ relationship with its various commuter carriers. A short history and timeline of the practice of code sharing follows.

Code sharing – one airline carrying the code of another – can occur in most any type of market, whether it is domestic, or international, and between most types of airlines. International alliances and domestic code sharing between mainline carriers are separate areas with issues of their own.

Major airlines have shared their code with commuter airlines for many years to serve routes the major did not. The practice came into widespread use in the 1980s as airlines came to rely on their commuter carriers to feed their developing hubs and focus cities from smaller cities. These are cities that, in theory, would not support a mainline aircraft, or at least the flight frequency required to compete effectively in that market. The feed from these cities, however, helped the carriers create effective hubs in a newly deregulated environment.

Code sharing provides both benefits and drawbacks to the passengers, the mainline carrier, and the commuter carrier. For the passenger, some of the benefits are:

- **Joint fares**

Developed during the early 1970s, partner airlines developed joint fares to provide savings to the passenger traveling on more than one carrier. The interlining carriers would each absorb a portion of the reduced price, and would hope to increase overall revenue by attracting more passengers. As an early example, American Airlines applied for joint fare approval in 1970 with Air Wisconsin on the Appleton to Chicago segment of a trip to New York or Washington. The ticket was discounted \$7.00, with American absorbing \$5.00 of the discount and Air Wisconsin \$2.00.

- **More seamless travel**

Passengers can buy a single ticket, check in one time, etc. Prior to code sharing, travel required a different ticket and check in for each carrier.

Benefits for the commuter airline include:

- **Recognition**

Adopting the major’s name, as in US Airways Express, American Eagle, Northwest Airlink, etc., enhances a smaller carrier’s image. That makes it possible to attract new passengers, obtain more financing at better terms, and hire more experienced employees, in addition to a host of other tangible and non-tangible benefits.

- **Management expertise**

Many commuter airline entrepreneurs had little experience in route planning and development, or cost and revenue accounting, relying instead on a combination of luck and opportunism to build their airline.

Major airlines' experience in these areas helped improve the carrier's financial and operational performance. The major also helps its partners with technical assistance in many other areas.

- **Advantageous CRS listing**

Prior to 1984, it had become apparent that airlines owning Computer Reservation Systems were giving priority to their own flights. In November of that year, to address competitive inequities, the Civil Aeronautics Board, or CAB, mandated how airlines may use their Computer Reservations System. The ruling stated that a CRS must list flights in the order of: (1) nonstop flights and one stop or direct flights in chronological order (regardless of airline); (2) code share connecting flights, interline connecting flights; then (3) independent flights that may connect. Travel agents sell 80 percent of tickets from the first screen of available flights. So having flights listed on the first CRS screen can create an important marketing advantage. (Travel agents book 80 percent of mainline passengers at US Airways, excluding MetroJet and Shuttle.)

- **More predictable revenue**

The feeder does not have to take as much risk in developing markets. The code share agreement includes many markets that are already developed. When the feeder does develop new markets, it is much easier with the benefit of the major's name, frequent traveler program, and connecting flights.

A few of the benefits to the major carrier are:

- **Access to additional aircraft**

The major does not have to buy or lease aircraft for additional lift. The major can gain additional ASMs without the long-term commitment associated with new aircraft and expanding into new markets. Many times, this access to new traffic comes with little or no investment. The major airline relies on the credit and balance sheet of the commuter carrier. The major bears only short term risk if the market is not successful.

- **Access to smaller aircraft**

Smaller aircraft sometimes allow the major to better match the size and frequency of the aircraft to the size of the market. In

many cases, the small airplanes allow the major to retain a market presence in a city that would otherwise be unprofitable because of a lack of passengers and the city's distance from the hub.

Disadvantages for the mainline carrier and the passenger are relatively minor. Drawbacks for the commuter airline can be more significant, but the benefits usually far outweigh the cost. Disadvantages include:

- **Loss of control**

The mainline partner largely dictates when and where the carrier will fly. The larger partner also dictates service levels, sets prices, and controls revenue.

- **Lost identity**

Code share agreements usually require the feeder carrier to adopt some form of the partner's paint scheme. Many even require the feeder to change its name to a form of the mainline's. (This drawback is largely sentimental and quickly offset by the sharp increases in traffic.)

- **Fortunes tied to the mainline**

Problems of the mainline are amplified at regional carriers. The regional carrier's revenue comes mostly from its connecting traffic at the hub. A drop in revenue at the mainline, due to fare wars or other reasons, can affect a greater percentage of the feeder's revenue than the larger carrier.

- **Short term contracts with long term leases/financing**

For a feeder carrier to buy aircraft, it generally finances them for at least 15 years. Leasing popular equipment also requires long-term commitments. Code share contracts are frequently of much shorter duration. If the mainline carrier cancels or fails to renew the contract, the feeder could face continuing lease or finance commitments while losing a large portion of their revenue.

- **Cost increases**

Code share agreements sometimes contain mandated improvements in image and service levels. This can mean additional increases in equipment, stations, and personnel.

“Smaller aircraft sometimes allow the major to better match the size and frequency of the aircraft to the size of the market.”

Ownership

There are three basic relationships between a mainline carrier and its regional partners: complete ownership, partial ownership, or no ownership.

Complete ownership is the most expensive and perhaps the cleanest relationship of all; the airline is merely a subsidiary of the parent carrier. There are fewer contractual provisions to work out, no conflicts of interest, and revenue allocation is largely an accounting exercise. The parent company must, however, manage the subsidiary and bear the cost and risk of owning the company and its assets. It must also allocate capital and credit to the subsidiary's operation. The parent company receives the benefit of any subsidiary profits, and must also bear any losses.

Partial ownership costs less than buying the entire company, and, depending on the particular arrangement, it probably gives the parent company less control than complete ownership. Partial ownership can create conflicts of interest where the mainline carrier must balance the benefits of its code sharing relationship with its responsibilities as a stockholder.

A no ownership stake relies solely on a contractual arrangement with the affiliate. The mainline carrier typically does not have a voice in corporate decisions beyond its code share agreement. The affiliate carrier is free to choose its code share partners, and to discontinue the relationship in favor of code share arrangement with another airline if it sees fit.

There is, presumably, some amount of profit an affiliate carrier makes from its code share arrangement. The mainline carrier does not benefit from that profit in a no ownership relationship. The mainline carrier, however, does not have to spend money for new aircraft and equipment, and it does not have to hire staff to support service into new cities where the affiliate carrier already has operations.

Contract carriers

If the mainline carrier does not own the affiliate carrier, the relationship must be outlined in a contractual agreement. The contract usually specifies certain performance responsibilities the contract carrier must meet. There are two basic ways affiliate carriers enter into contractual code sharing relationships: ASM purchase or revenue sharing.

ASM purchase agreements occur when mainline carriers contract with affiliates to fly a

certain number of seats at certain times. Of course, contracts can contain any details the parties agree to, but generally ASM purchase agreements allow the affiliate carrier to compute its cost of providing certain flights, then add some amount to that cost to arrive at the price the mainline carrier pays for the ASMs. The mainline carrier sells the tickets, schedules the aircraft, controls the revenue, and sometimes provides ground service or other services.

Mainline gets the benefit of additional ASMs without the investment in additional assets and marketing to develop a new route. The contract carrier receives a steady, predictable revenue stream. The mainline carrier takes the risk of an unprofitable route and gets the benefit of a profitable route.

In a revenue sharing agreement, the mainline and the contract carrier agree on a percentage for dividing the flight's revenue. The contract carrier must absorb some of the losses if the route is not profitable and probably retains a greater portion of any profit. Either way, both carriers realize the overall benefits of code sharing.

American and Continental own most of their regional operations. Delta owns part of Comair and recently acquired all of ASA. United does not own any of its affiliate carriers. US Airways uses the complete ownership approach with Allegheny, Piedmont, and PSA, and has no ownership stake in its remaining affiliate carriers.

US Airways Express

Allegheny, Piedmont, and PSA serve US Airways' core region of the East Coast. Allegheny serves the Northeast; Piedmont serves the mid Atlantic region; and PSA operates primarily from PIT.

In addition, US Airways' affiliates, or contract carriers, add service in the East, Midwest, and California. Air Midwest serves Kansas City and the South; CCAir focuses on CLT; Chautauqua serves the Ohio Valley and will operate additional RJs with the US code. CommutAir and Florida Gulf operate in the upper Northeast and CommutAir is adding some service at IAD. Liberty Express feeds PIT; Trans States feeds California long haul flying; and Mesa flies RJs in CLT, PHL, and DCA.

A brief history of commuter code sharing

Allegheny Airlines was the first company to put its code on commuter airlines. In that

“US Airways uses the complete ownership approach with Allegheny, Piedmont, and PSA, and has no ownership stake in its remaining affiliate carriers.”

regulated environment, the Civil Aeronautics Board had to approve all code share agreements. Allegheny was able to gain CAB approval through Suspension-Substitution agreements, which allowed larger carriers to suspend or substitute service on low traffic routes. Under these Suspension-Substitution arrangements with the CAB, the mainline carrier remained responsible for the “quality and quantity” of the service on the substituted route. In many instances, the mainline carrier retained the financial responsibility for the substitute carrier. Under the Suspension-Substitution agreement, Allegheny gained the necessary approval to substitute service to smaller cities with smaller aircraft than the airline operated, by contracting with smaller carriers.

On October 13, 1967, the CAB allowed Henson Aviation of Hagerstown, Maryland to take over Allegheny’s 67-mile route from Hagerstown to the Baltimore-Washington Friendship airport. The CAB required Allegheny to guarantee that Henson would at least cover its total expenses for the first two years of the substitute operation. Henson began operation on November 15, 1967, with Beech Queen Airliners flying five round trips on weekdays and two round trips on weekends. Previously, Allegheny had operated a single daily round trip with an F-27.

In its first year, Henson carried 11,313 passengers on the route compared to the 5,429 passengers Allegheny carried during the year prior to the agreement. That increase provided proof that, for trips of the length and time offered by commuter airlines, more passengers were willing to pay a reasonable price to have more frequent and more conveniently timed service. More frequent service brought more passengers, even though the aircraft were smaller.

The CAB then approved additional Suspension-Substitution agreements. On July 1, 1968, it allowed Pocono Airlines of Hazelton, PA to replace Allegheny from Hazelton to Newark.

The commuter flights were published in Allegheny’s timetable and Computer Reservations System under the AL code. The airline offered favorable joint fares to all cities available within the Allegheny system. The commuter airlines also had access to Allegheny’s facilities (reservations, ticket counters, boarding lounges, baggage claim, etc.) at connecting airports.

Allegheny was able to abandon money-losing markets, but retain the traffic these cities

produced, all while maintaining its market identity there. Because of the smaller aircraft used, the affected cities received more frequent and, therefore, more convenient service. Traffic increased accordingly, often dramatically. The government was able to reduce subsidy payments associated with guaranteed air service in these low traffic cities. In fact, in 1974, Allegheny became the first local service airline to completely dispense with federal subsidies.

Allegheny was able to convince its pilots to accept these agreements by involving them in the process and giving them additional job security guarantees as the company retired its DC-3 and Convair fleets. Allegheny’s jet fleet and route network had been growing and continued to grow rapidly.

Allegheny’s innovation was not widely copied by other airlines, at least yet. Not until the mid 1980s did strong formal ties become a familiar part of the airline industry. In 1983, Piedmont Airlines became the first large company to buy a commuter airline. It acquired Henson Aviation, thereby severing the relationship with USAir (Allegheny changed its name to USAir in 1979) and breaking USAir’s dominance of BWI. On October 30, 1983, Henson restructured its route system to feed Piedmont’s developing BWI hub and became “The Piedmont Regional Airline.” (According to OAG data, Piedmont went from a 3 percent market share in the second quarter of 1983 to almost 54 percent in the fourth quarter of 1985 at BWI. USAir’s market share fell from 38 percent to 12 percent in the same period.)

Although Air Florida had also contracted Air Miami to fly some of its low traffic routes earlier, code sharing became widely accepted after a 1984 CAB ruling that dictated how Computer Reservation Systems would list connecting flights. With preferential joint fares, this decision made code sharing such an advantage that it became almost impossible for small independent carriers to compete. The CAB ruling also gave tacit government approval to the code sharing practice. That approval promoted even wider acceptance, even though many within the industry, (including ALPA) objected strongly.

Code sharing continued to gain momentum in 1984 when some airlines implemented a “create-a-feed” practice, where a new commuter airline was created specifically to feed traffic to a major airline at a hub. 1984’s first agreement was between Eastern and Metro Airlines to create a feeder network for Eastern’s Atlanta hub. The subsidiary, named Eastern

“Code sharing continued to gain momentum in 1984 when some airlines implemented a “create-a-feed” practice, where a new commuter airline was created specifically to feed traffic to a major airline at a hub.”



“Regional airlines operate about 12,000 flights daily serving 718 airports. Code sharing airlines carry 96 percent of all regional airline passengers.”

Metro Express, bought Jetstream 31s and painted them in Eastern colors. The service was successful from the start, growing from 7,000 passengers in April 1984 to more than 30,000 in March 1985.

May 1, 1984, one month after the birth of Eastern Metro Express, an alarmed Delta entered a code share agreement with Atlantic Southeast Airlines, which was already serving Atlanta. Delta's choice was to find a code share partner or lose feed to Eastern. A month later, Delta also implemented code share agreements with Ransome Airlines in PHL and with Rio Airways in DFW. September of that year, Delta began contracting with Comair throughout the Great Lakes and Ohio Valley regions.

Eastern's success did not go unnoticed. Others were quick to create feeder networks of their own. Other examples include Phoenix Airline Services starting a Republic Express feeder at MEM, Air Midwest organizing an American Eagle at BNA, and WestAir starting a United Express airline in the Pacific Northwest. In December 1984, Mesaba Airlines

became the first Northwest Orient Airlink partner, providing service at MSP.

Today

All major airlines except Southwest have regional feeder networks. The regional industry continues to grow, accounting for more than 8 percent of the U.S. airline industry's total revenue.

Regional airlines operate about 12,000 flights daily serving 718 airports. Code sharing airlines carry 96 percent of all regional airline passengers. There are 53 code-sharing relationships between major carriers and their affiliates. Twelve of those agreements are with carriers the major owns. Four agreements exist with the major owning a portion of the affiliate. Thirty-seven agreements are contract only; they are between carriers with no ownership. Today, one in nine U.S. airline passengers (66.3 million in 1997) flies on regional aircraft.

