



AIR TRANSPORT REGULATION PANEL (ATRP)

THIRTEENTH MEETING

Montréal, 1 to 4 September 2015

COMPETITION IN INTERNATIONAL AIR TRANSPORT

(Presented by the Secretariat)

1. INTRODUCTION

1.1 This paper presents information on the research by the Secretariat on the subject of competition in international air transport, in relation to Agenda Items 1 and 2.

1.2 Without purporting to exhaustively cover the area of competition in international air transport, this paper attempts to provide a basic understanding of competition, both at the general level and as applied to international air transport markets, from a theoretical, practical perspective. It also describes the regulation of competition and the differences that exist in approaches taken by different States.

2. BACKGROUND

2.1 Prior to the 1990s, States, individually or collectively, generally either did not apply national competition laws to international air transport, or exempted it from the scope of such laws, sometimes with certain conditions designed to mitigate perceived anticompetitive effects (for example, multilateral traffic conference machinery, tariff coordination and agreements). Consequently, many bilateral air transport agreements contained no clauses dealing specifically with the application of competition laws, although some agreements did include certain competition principles and commitments to avoid unfair practices.

2.2 Since then, with increasing globalization and widespread adoption of the market economy, there has been a marked rise in the adoption of competition laws by States, spreading gradually from developed economies to other parts of the world. As liberalization progresses and takes hold in more States, the traditional concepts to ensure fair competition tend to gradually give way to the application of competition laws, particularly in cases where States have agreed to an open competition regime.

2.3 As illustrated in **Figure 1** below, the liberalization of international air transport, generates additional business opportunities and stimulates economic activities by opening up market access for air carriers. Such expansion, in turn, leads operators to compete for existing or new market shares. Enhanced competition has led many carriers to consider consolidation as a means by which to achieve economies of scale and scope and to respond to consumer demands for more seamless service and global networks. With heightened competition and consolidation comes a potential risk of anticompetitive behaviours.

2.4 Since, in the context of liberalization, States have opted for greater reliance on market or competitive forces, there is a greater need to address potential anticompetitive behaviours by national or regional competition laws and regulations than in the past era of tight government regulation of routes, capacities/frequencies, and fares.

Figure 1 - Relationship Between Air Transport Liberalization, Competition and Safeguards



Source : ICAO

2.5 In recent years, the application of competition laws and regulations to air transport has occurred not only with more frequency but also has encompassed an increasing number of issues, ranging from antitrust immunity, mergers and alliances, abuse of dominant positions, capacity dumping and predatory pricing, sales and marketing, to airport charges and fees, State aid and loan guarantees.

2.6 One of the potential issues associated with the application of national competition laws is the differing, sometimes even conflicting, regimes or practices employed by States. This may create certain complexity for airlines operating international air services when they must comply with different rules or practices in different countries. In addition, the disparity in the stages of development, geographical location, and competitive strength of air carriers may be taken into consideration to ensure proper application and avoidance of disputes in applying them internationally.

3. UNDERSTANDING COMPETITION

3.1 **General definitions of competition** - At a basic level, competition can be understood as *“The action of endeavouring to gain what another endeavours to gain at the same time; the striving of*

two or more for the same object; rivalry". Under a more commercial definition, competition is a "*rivalry in the market, striving for custom between those who have the same commodities to dispose of.*"¹ Competition has also been defined as a situation in which two or more people or groups are trying to get something which not everyone can have.²

3.2 Etymologically, competition may be defined as follows³:

1610s, "***to enter or be put in rivalry with,***" from Middle French *compéter* "be in rivalry with" (14c.), or directly from Late Latin *competere* "strive in common," in classical Latin "to come together, agree, to be qualified," later, "strive together," from *com-* "together" (see *com-*) + *petere* "to strive, seek, fall upon, rush at, attack" (see *petition* (n.)).

3.3 Therefore, competition generally implies two or more operating entities striving to gain advantage within the same market(s). In the context of international air transport, competition may be defined as "*the existent or potential rivalry between two or more operators, carriers or groups striving for advantage in the same market, including using price and quality of products or services to achieve the desired gains.*"

3.4 **Relevant market** – The enforcement of the provisions of competition law would not be possible without referring to the market where competition takes place. To understand a market's form or level of competition, it is first essential to delineate the boundaries of the relevant market or, in other words, identify the products and undertakings which are directly competing in a business. The relevant market is one where the competition takes place. The extent to which firms are able to increase their prices above normal competition levels (i.e. market clearing prices) depends on the possibility for consumers to buy substitute goods and the ability for other firms to supply those products.⁴

3.5 A relevant market has two dimensions: product and geography. In transport sectors, however, the product dimension already includes a geographic aspect since passengers, cargo and mail typically use transport in order to travel from one point to the other. More specifically, in the context of the airline industry, the product on which operators are competing is the carriage, for remuneration or hire, of passengers, cargo or mail. Consequently, the delineation of relevant markets in the airline sector starts with the identification of the point of origin (O) and the point of destination (D), the so-called O&D approach.⁵ Besides, the relevant product market is determined according to demand-side substitution and supply-side substitution.

- Demand-side substitution. This takes place when consumers switch from one product to another in response to a change in the relative prices of the products. If consumers are in a position to switch to available substitute products or to begin sourcing their requirements from suppliers located in other areas, then it is unlikely that price

¹ Oxford English Dictionary.

² <http://www.collinsdictionary.com/dictionary/english/competition>.

³ Online Etymology Dictionary, <http://www.etymonline.com/index.php?term=compete>.

⁴ Bellamy, C. W. and G. D. Child (1993): *Common Market Law of Competition*. London, Sweet and Maxwell; Bishop, Simon and Mike Walker (1999): *The Economics of EC Competition Law*. Sweet and Maxwell

⁵ *Airline Competition - Background Paper by the Secretariat*, OECD 2014.

increases will be profitable (i.e. demand is price elastic in terms of cross-price elasticity of demand).

- Supply-side substitution. Sometimes consumers may be unable to react to a price increase (because of a switching cost and a search cost, etc.). Nevertheless, producers may be able to do so by increasing their supply to satisfy the demand of these consumers, for example. If other producers respond to an increase in the relative price of the products supplied by the single supplier by switching production facilities to producing the monopolized collection of products, the increased level of supply may render any attempted price increase unprofitable.
- Ultimately, in the air transport sector, demand-side substitution is the determining factor. To illustrate this, if the price of travel in city-pair A were to increase, it is unlikely that passengers would consider substituting route A with travel to B.

3.6 However, it is important to note that market definition is not uniform worldwide and is also evolving. According to the Organisation for Economic Co-operation and Development (OECD)⁶, there is no consensus on the definition of relevant markets for airlines. While “several competition authorities have adopted the traditional O&D approach, others have adopted narrower or broader definitions taking industry changes into account.” Differences also occur as to whether markets should be further segmented between business and leisure passengers, and between direct and indirect flights.

3.7 Finally, it should be pointed out that, from a broader perspective, competition in the airline industry involves not only existing air carriers but also potential entrants (or even “credible” threats of entrance in accordance with the contestable market theory). Over 1 300 new airlines have been set up in the past 4 decades, an average of over 30 each year. Other modes of transportation, such as high-speed trains, cars, traditional trains, ships and buses are all potential substitutes for the carriage of passengers and cargo. Their impact becomes significant when the speed advantage of aircraft becomes less important.⁷

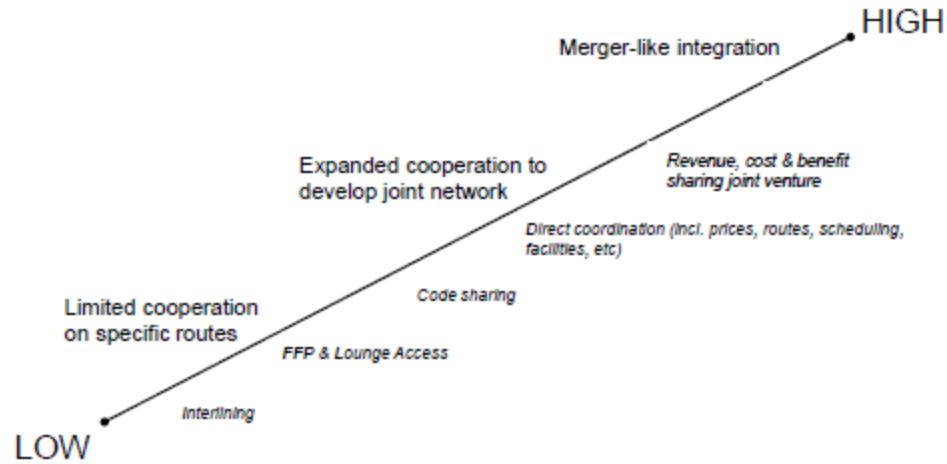
3.8 **The forms of airline cooperation** - As shown in **Figure 3**, cooperation between air carriers covers a broad spectrum of arrangements. These arrangements can be generally characterized as taking the form of tactical or a strategic alliances⁸ or different combinations involving both cooperation and competition between airlines.

⁶ OECD (2014), Annex to the Summary Record of the 121st Meeting of the Competition Committee held on 18-19 June 2014, Executive Summary of the discussion on Airline Competition.

⁷ IATA *Vision 2050*, 2011, p. 25.

⁸ *Transatlantic Airline Alliances: Competitive Issues and Regulatory Approaches*, Report by the European Commission and the United States Department of Transportation, 2010, p. 5.

Figure 3 - Spectrum of Airline Cooperation



Source: *Transatlantic Airline Alliances: Competitive Issues and Regulatory Approaches*, Report by The European Commission and The United States Department of Transportation, 16 Nov. 2010

3.9 **Alliances** – Many airlines seek to improve their market prospects through forming partnerships with other air carriers. These alliances may be domestic, regional, intercontinental or global and can be of any size, for any particular purpose or objective, or for any length of time. While numerous agreements concern cooperation on a limited scale (for example, code sharing on certain routes), the number of wide-ranging strategic alliances has been on the rise in recent years. Most notable was the emergence of several competing mega-alliances, which are essentially alliance groupings of geographically spread large and medium airlines with extensive combined global networks. There are three general variants of alliances:

- Tactical alliances, which typically involve only two carriers and cover a limited number of routes, address specific deficiencies in carriers’ networks. Cooperation takes place through interline, frequent flyer programme, or code sharing arrangements.
- Strategic alliances, which can be defined as voluntary unions of airlines held together by various commercial cooperative arrangements.⁹ An alliance agreement may, of course, contain a variety of elements found in tactical alliances, such as code sharing, blocked space, cooperation in marketing, pricing, inventory control and frequent flyer programmes, coordination in scheduling, sharing of offices and airport facilities, joint ventures and franchising.
- Global alliances allow air carriers to link their route networks and sell tickets on the flights of their partners. As a consequence, alliances allow a carrier to offer travellers access to a large number of destinations around the world with more convenient and

⁹ ICAO *Manual on the Regulation of International Air Transport* (Doc 9626), 4.8-1.

better coordinated schedules, single on-line prices, single point check-in, coordinated service, and reciprocal frequent flyer programs.

3.10 **Coopetition** – Not all competition occurs in an antagonistic environment, as might be suggested by dictionary definitions. In practice, the inter-airline ties may be substantially closer, an arrangement at times called “coopetition.” The term “coopetition”, created by combining the words cooperation and competition, was coined by Ray Noorda, founder of the networking software company Novell. It was popularized by Adam Brandenburger from Harvard Business School and Barry Nalebuff from Yale School of Management. This situation occurs when competing firms cooperate in some aspects of their production and marketing in order to maximize their profits.¹⁰

3.11 Examples of coopetition activities involve arrangements between competing airlines in what are called “code sharing” agreements, which allow partner airlines to market seats on each other’s flights. Several forms of coopetition can be observed:

- Coopetition on different markets: in this case, the airlines cooperate on certain markets and compete on others. The objective is for each carrier to focus its resources on more profitable markets, while still remaining present on other markets.
- Coopetition on different activities: this situation involves, in the same market, cooperation on certain activities (e.g. schedules, lounge, luggage, etc.) and competition on other activities (pricing, distribution, etc.). The objective here is for each carrier to increase its frequencies without reducing its load factor, and while keeping control over the fares it offers.
- Coopetition on different markets and activities: This scenario combines the first two. Within one specific market, the carriers may cooperate on certain activities (e.g. schedules, lounge, luggage, etc.) while competing on others (pricing, distribution, etc.). Simultaneously, they may compete on some markets, while cooperating on others.

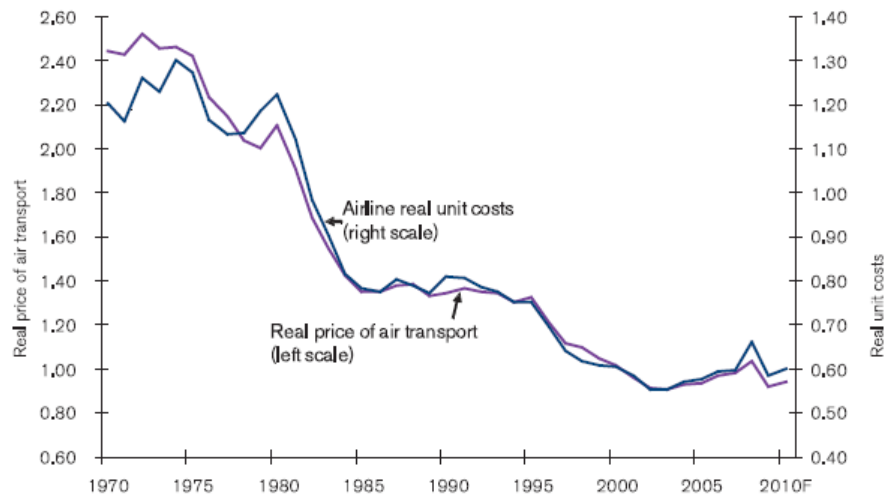
4. COMPETITION IN PRACTICE

4.1 Over the past 40 years the real operating cost of providing air transport services has fallen by more than 60 per cent, as shown in **Figure 4**. This decline in operating costs is driven in part by increasing efficiency of new aircraft, higher utilization of airplanes, and better operational performance of airlines. Increased competition between carriers has also played a role in lowering prices. The inflation-adjusted price for consumers has fallen by a similar extent.¹¹

¹⁰ P. Chiambaretto, Colloque DGAC-CSAC, 2015.

¹¹ IATA *Vision 2050*, 2011, p. 7.

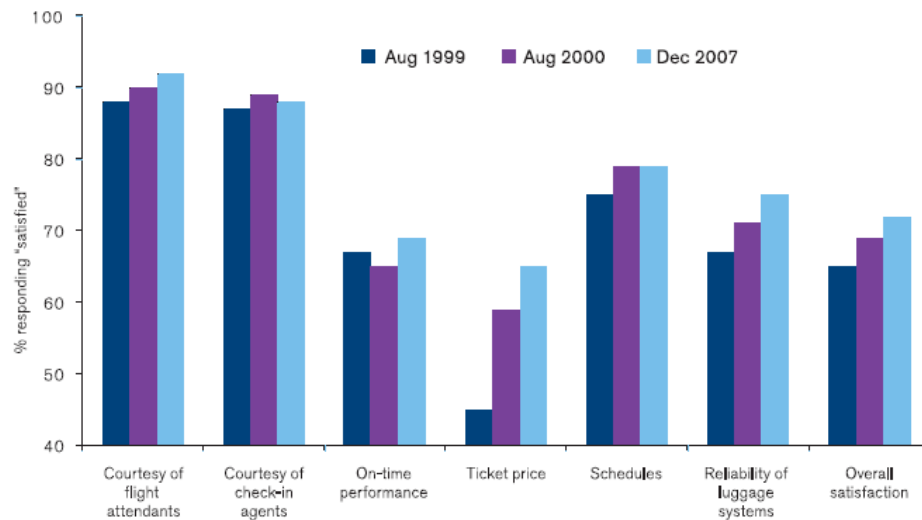
Figure 4 - Real Costs and Real Price of Air Transport



Source: IATA

4.2 Satisfaction of passengers with quality of services and products seems to have improved over time (i.e. direct result from service competition). As shown in **Figure 5**, overall passenger satisfaction increased over the period 1999-2007, and in particular, satisfaction with ticket price increased from around 45 per cent around 65 per cent, while on-time performance was relatively stable, between 65 and 70 per cent.

Figure 5 - Passenger Satisfaction with Different Facets of the Service



Source: IATA

4.3 **The challenges to consolidation** - In many economic sectors, one way for operators to gain market shares, rationalize their operations with a view to achieving economies of scale/scope and

reduce costs (including transaction costs), is to carry out cross-border mergers. However, such cross-border mergers are not always possible in the airline industry. Under bilateral air services agreements, States have traditionally retained the right to withhold, revoke, or impose conditions on the operating permission of a foreign air carrier that is not “substantially owned and effectively controlled” by the designating State or its nationals. This “nationality clause” criterion has been used, since the 1940s, in the overriding majority of air service agreements, and continues to be included in many newly negotiated bilateral accords.

4.4 The rationale for the nationality clause is that it provides a convenient link between the carrier and the designating State by which parties to the agreement can implement a “balance of benefits” policy for the airlines involved, prevent a non-party State through its carrier from gaining, indirectly, an unreciprocated (“free rider”) benefit, and most importantly identify the country that is responsible for safety and security oversight. National defence considerations are also a factor in some cases. The nationality clause made obvious sense in the days when most airlines were State-owned.

4.5 **The need for airline cooperation** - Facing heightened competition on the one hand and the challenges to consolidation on the other, airlines have found various ways by which to expand networks beyond national borders, including alliances, mergers and acquisitions, many of which involved foreign investment or equity exchange.¹² Recent years have seen an extraordinary acceleration of this trend. In Europe, Latin America, and Asia, airlines with foreign or transnational ownership and control, as well as “families” of related carriers in different countries but under a single management, are now a common and growing phenomenon.

4.6 The majority of passengers want to travel “point-to-point” between relatively small cities, and the number of city-pair combinations amounts to thousands. It is difficult for a single airline to offer “from anywhere to anywhere” service using its own aircraft.¹³ Since consumers want network scope and depth, and the economics of providing this may not be possible for a single airline, particularly considering the prohibition of cross-merger mergers, air carriers have been naturally driven to cooperate to varying degrees to join forces. In order to meet the demands of consumers for network scope and depth, airlines have resorted to various degrees of cooperation.

4.7 The impact of global alliances on the airline industry is significant. The marketing power of global alliances, together with their competitive consequences, including their dominance at some hubs, has small and medium-sized airlines concerned about their survival which has prompted these airlines to either develop a particular segment of a market or to compete as low-cost point-to-point airlines. Today, three global airline alliances exist:

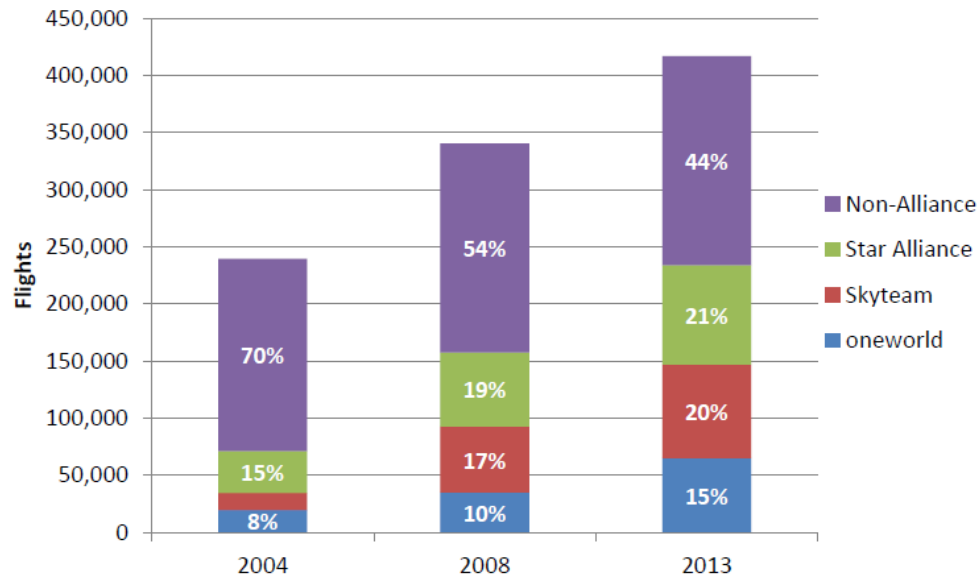
- Star Alliance, founded in 1997 by Air Canada, Lufthansa, Scandinavian Airlines System (SAS), Thai Airways International and United Airlines (as of July 2015, it had twenty-eight member airlines. Website: www.star-alliance.com);
- Oneworld, founded in 1998 by American Airlines, British Airways, Cathay Pacific and Qantas (as of June 2015, it had fifteen member airlines. Website: www.oneworldalliance.com); and
- SkyTeam, founded in 2000 by AeroMexico, Air France, Delta Air Lines and Korean Air (as of July 2015, it had twenty member airlines. Website: www.skyteam.com).

¹² ATConf/6-WP/12.

¹³ IATA Economic Briefing, *The Economic Benefits Generated by Alliances and Joint Ventures*, 2011.

4.8 As a result of the competitive advantages alliances provide, member airlines have collectively been able to increase their market share. **Figure 6** shows the share of flights operated between Europe and Asia by each of the alliances. In 2004, the flights operated by the alliances collectively accounted for 30 per cent of all flights in this market.¹⁴ Between 2004 and 2013, several major carriers in Asia and Europe gained membership into an alliance. As a result, the market share operated by alliances increased to 56 per cent in 2013.

Figure 6 - Evolution of Alliances' Market Share (2004-2013)



Source: Al-Sayeh, M.I.T.

4.9 For passengers, the main benefits of alliances are a more streamlined travel experience and larger choice of destinations, since alliances provide airlines with valuable access to destinations that they would otherwise not serve. They also allow passengers to take advantage of frequent flyer miles on other airlines.

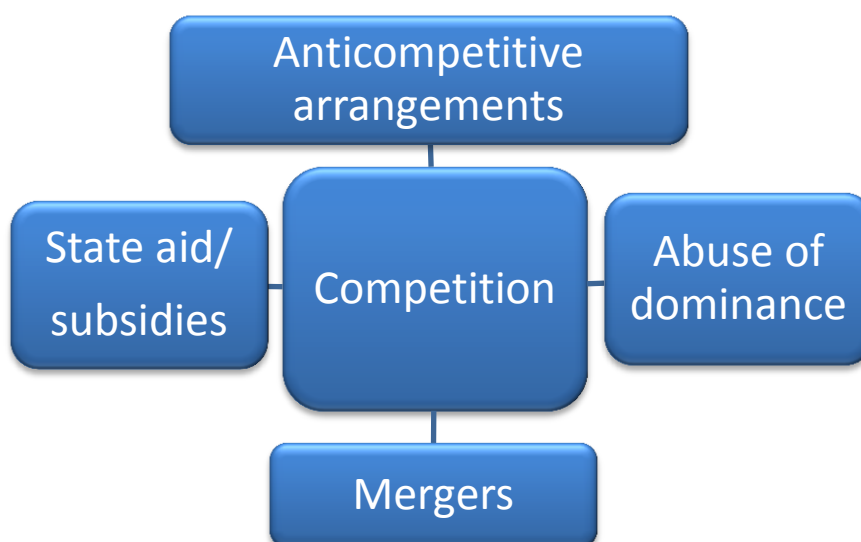
4.10 Although these arrangements possess the potential to improve the utility of passengers and the efficiency of the industry, the effects of alliances are not uniformly positive. Some have attracted considerable attention from regulatory authorities because of their potential impact on market access, competition and consumer interests. Certain proposed major alliances have been examined closely by relevant national and regional regulatory bodies. In some cases, certain regulatory measures were introduced to alleviate the potential anticompetitive aspects of the arrangements. Such measures could include the surrender of a certain number of slots to facilitate other airlines' entry into the market. Regulatory treatment of airline alliances varies amongst States and is mostly on an ad hoc rather than systematic basis, often dictated by general economic and/or political considerations of the States concerned, i.e. a "public interest" test.

¹⁴ *The Rise of the Emerging Middle East Carriers: Outlook and Implications for the Global Airline Industry*, Al-Sayeh, M.I.T. 2014.

5. REGULATING COMPETITION

5.1 The goal of competition policy is to contribute to overall welfare and economic growth by promoting market conditions in which the nature, quality and price of goods and services are determined by competitive market forces.¹⁵ As illustrated in **Figure 7**, competition policies and rules apply to four broad categories of activities: anticompetitive agreements (including cartels); abuse of dominant market position; mergers and acquisitions and government support.

Figure 7 - Main Areas Covered by Competition Rules



Source: ICAO

5.2 Anticompetitive agreements/arrangements

5.2.1 Anticompetitive agreements are understood as arrangements between operators which prevent, restrict or distort competition. They are generally forbidden. One example of general prohibition of such arrangements can be found in Article 101 of the Treaty on the Functioning of the European Union, which prohibits:

“all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market, and in particular those which:

- a) directly or indirectly fix purchase or selling prices or any other trading conditions;
- b) limit or control production, markets, technical development, or investment;

¹⁵ OECD (2011), *OECD Guidelines for Multinational Enterprises*, OECD Publishing, p. 58.

- c) share markets or sources of supply;
- d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantages; and
- e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.”

5.2.2 Agreements entered between economic operators are traditionally approached either under the regime of anticompetitive agreements or the control of mergers and acquisitions. However, in the airline sector, the distinction may be challenging to draw. One reason for this is that, as described previously, airlines have increasingly resorted to horizontal cooperation, ranging from light alliances to deeper cooperation, and even integration, arrangements.

5.2.3 In the United States, the Sherman Act prohibits contracts, combinations, and conspiracies that unreasonably restrain interstate and foreign trade. It also outlaws agreements among competitors to fix prices, rig bids, and allocate customers, which are punishable as criminal felonies. The Antitrust Division of the U.S. Department of Justice is responsible for enforcing the Sherman Act and other traditional antitrust laws.

5.2.4 United States air carriers are required to submit cooperative service agreements that they have with each other, such as arrangements for reciprocal code sharing, joint frequent flyer and lounge access, and joint marketing, to the United States Department of Transportation (DoT) for review before implementation.

5.2.5 Even though alliances are the most common horizontal agreements in the airline industry, there exists a broad spectrum of antitrust enforcement tools and mechanisms across countries, as shown by the following diversity of regimes:

- merger control in countries that have a broad merger definition, such as in Brazil, Canada and India;
- specific exemption, authorization or immunity regimes requiring an application from the airline alliance and a case-by-case examination, such as in the United States;
- block exemption regulations for certain types of airline alliances, such as in Israel;
- self-assessment obligation to determine whether the alliance falls under an exception to cartel law, such as in the European Union; and
- residual cartel enforcement, in most jurisdictions.

All these enforcement mechanisms aim to subject alliances to antitrust scrutiny. They differ, however, as to their procedure, timing, remedies and outcome, and sometimes even as to the authority in charge.¹⁶

5.3 Abuse of dominant market position

5.3.1 Behaviour falling under the denomination of abuse of dominant position can be broadly grouped in two categories:

- exclusionary abuses, which aim at driving competitors out of the market;
- exploitative abuses, where the dominant company exploits its market power by, for instance, discriminating, absent any objective economic reasons, between different groups of consumers charging them unfair prices.

5.3.2 In the international air transport field, the most often invoked of these anticompetitive practices are the formation of monopolies, the maintenance of predatory pricing regimes, and the dumping of capacity.

5.3.3 *Monopoly* - When firms hold large market shares, consumers risk paying higher prices and getting lower quality products than compared to competitive markets. However, the existence of a very high market share does not always mean consumers are paying excessive prices since the threat of new entrants to the market can restrain a high-market-share firm's price increases.

5.3.4 In the United States, Section 2 of the Sherman Act¹⁷ is enforced by the Department of Justice, and forbids the monopolization of any part of interstate commerce. An unlawful monopoly exists when one firm controls the market for a product or service, while it has obtained that market power, not because of superior product or service, but by suppressing competition with anticompetitive conducts.

5.3.5 *Predatory pricing* - Generally, predatory practices are understood as situations where a dominant undertaking deliberately incurs losses or foregoes profits in the short term, so as to foreclose or be likely to foreclose one or more of its actual or potential competitors with a view to strengthening or maintaining its market power, thereby causing consumer harm.¹⁸ Price predation is essentially a strategy to injure competitors by low prices, strategic exclusion, or other means of forcing rivals to bear costs that the predator does not incur itself. Predation through exclusionary pricing and selling strategies is a commonly alleged abuse in the airline industry.

5.3.6 According to the Australian Competition and Consumer Commission (ACCC) -,¹⁹ predatory pricing occurs when a company with substantial market power or share of a market sets its prices at a sufficiently low level with the purpose of:

- eliminating or substantially damaging a competitor;

¹⁶ OECD (2014), Annex to the Summary Record of the 121st Meeting of the Competition Committee held on 18-19 June 2014, Executive Summary of the discussion on Airline Competition.

¹⁷ Sherman Act of July 2, 1890 - 15 U.S.C. § 2.

¹⁸ Information from European Union Institutions and Bodies, Communication from the Commission - Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings.

¹⁹ <https://www.accc.gov.au/business/anti-competitive-behaviour/predatory-pricing>.

- preventing the entry of a competitor into that or any other market;
- deterring or preventing a competitor from engaging in competitive.

5.3.7 In the international air transport context, the following definition of predatory pricing was developed by the Fifth Worldwide Air Transport Conference (ATConf/5) in 2003: “charging fares and rates on routes at levels which are, in aggregate, insufficient to cover the costs of providing the services to which they relate.”²⁰

5.3.8 Although there is no universally accepted clear-cut or so-called “bright-line” rule to assess whether the pricing is predatory, many courts have used an *Areeda-Turner rule*, i.e. a firm’s pricing is predatory if its price is less than its *short-run marginal cost*, i.e. an increment to cost that results from producing one more unit of output in a brief time period such that some factors of production cannot be varied without cost, or its *average variable cost*, i.e. a variable cost divided by output, as a more practical proxy. In the airline industry, however, a short-run marginal cost of adding some extra passengers is close to zero at any given time once capacity is provided. Therefore, some have suggested the use of a *long-run marginal cost*, i.e. an increment to cost in a sufficiently lengthy period of time such that all factors of production can be varied without cost, as a yardstick for judging predatory pricing. Since the longer the planning horizon the more likely it is that a fixed cost will become a variable cost, a marginal cost or an average variable cost becomes greater in the long-run.

5.3.9 In addition to these simple cost-based rules, several more complex rules have also been developed. For example, some argue that a firm’s pricing is predatory if its output is expanded in response to entry and its price is less than its average variable cost, while others suggest that a price cut made in response to entry is not predatory if a firm keeps its price for a considerable period of time after a new entrant has been driven off. There is also a two-tier approach that focusses first on market structures to examine whether predatory pricing is a workable strategy, followed by a number of cost-based tests.

5.3.10 Most of these rules which try to define illegal action can, however, be difficult to implement in a straightforward way because of the data limitations and the existence of related factors (such as capacity changes, yield management for seat allocation, sales and marketing activities). Given these difficulties, States (and groups of States) tend to rely on *a rule-of-reason approach*, which involves taking each case on its merits with a thorough examination of the factual circumstances such as market structures and dominant airlines’ conduct in a relevant market, as a starting point for assessing alleged cases (see ICAO *Manual on the Regulation of International Air Transport* (Doc 9626), Chapter 2.3).²¹

5.3.11 *Capacity dumping* - “The airline strategy of adding additional flights to a route in an attempt to drive a competitor out of business or off the route,” capacity dumping, which can also involve using larger aircraft than normal, leads to lower load factors and decreased profitability for a route.²² Under such a strategy, the airline would be better off discontinuing the flight, but it does not do so as it is better able to sustain temporary losses than its competitors with smaller cash reserves. Once they exit the market, the capacity dumper possesses a monopoly and is able to raise fares above the competitive market equilibrium price.

²⁰ Report of the Fifth Worldwide Air Transport Conference (ATConf/5), held on 24-28 March 200 (Doc 9819), concl. 2.3.3.2.

²¹ ICAO *Manual on the Regulation of International Air Transport* (Doc 9626), 4.3-11.

²² <http://www.travel-industry-dictionary.com/capacity-dumping.html>.

5.3.12 Capacity dumping is rather difficult to prove, as many airline routes are interconnected and may initially be unprofitable at first due to the expense of marketing and promoting a new route, procuring additional aircraft, working the frequency into an existing airline timetable, and gaining market share from existing air transport providers along the given segment.

5.4 Mergers

5.4.1 International mergers, between carriers from different States, are relatively rare, except in cases where specific arrangements enable each airline to preserve nationality requirements.²³ A considerable body of rules has developed in the areas of airline mergers. There are strong incentives, from regulators' perspective, to encourage convergence and consistency in the area of cross-border mergers. Besides imposing substantial costs on the merging firms involved, divergent outcomes undermines the public's confidence in the work [of authorities] and risk politicizing antitrust - both of which can have adverse effects on sound and predictable antitrust enforcement".²⁴

5.4.2 In the United States, Section 7 of the Clayton Act²⁵ prohibits business combinations where "... in any line of commerce or in any activity affecting commerce in any sector of the country, the effect of such acquisition may be substantially to lessen competition, or tend to create a monopoly." The Department of Justice and the Federal Trade Commission have developed Horizontal Merger Guidelines. According to these guidelines, mergers should not be permitted to enhance market power, which is likely to happen if the merger encourages one or more firms to raise price, reduce output, diminish innovation, or otherwise harm customers as a result of diminished competitive constraints or incentives.

5.4.3 In Europe, the basic standard for the evaluation of a merger is found in the Merger Regulation 139/2004, which provides: "A concentration which would significantly impede effective competition, in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position, shall be declared incompatible with the common market."

5.4.4 Accordingly, a merger must be notified to the European Commission if it attains certain turnover thresholds in the European Union and globally. The merger must be notified if the combined worldwide turnover of airlines concerned exceeds EUR 5bn and EU-wide turnover of each of at least two airlines concerned exceeds EUR 250m.

5.4.5 In its assessment, the Commission examines whether the merger would significantly impede effective competition, in particular as a result of the creation or strengthening of a dominant position of the merging entity. This is likely to be the case if the merging parties have high joint market shares as a result of the consolidation and if the existing competitors would be unable to challenge the merging parties' exercise of market power.²⁶

5.5 Government support

5.5.1 The basis for State aid control in the European Union is reflected in Article 107 of TFEU: "save as otherwise provided in the treaties, ***any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring***

²³ Examples include the AirFrance KLM or LAN-Tam cases.

²⁴ J. V. Dick and M. S. Sinick, *Different U.S. and EU Competition Regimes Create Uncertainty for Airline Consolidations*, The Air & Space Lawyer, 2013.

²⁵ 15 U.S.C. § 18 - Clayton Antitrust Act of 1914 (Pub.L. 63-212, 38 Stat. 730, enacted October 15, 1914, codified at 15 U.S.C. §§ 12-27, 29 U.S.C. §§ 52-53.

²⁶ ATConf/6-IP/4, presented by Ireland on behalf of the European Union and its Member States.

certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.”

5.5.2 The United States does not have a regulatory regime governing State and local aids and subsidies. However, courts have found certain State assistance to violate the Commerce Clause of the United States Constitution. Measures designed to benefit in-state economic interests by burdening out-of-state competition are deemed to constitute economic protectionism.

5.5.3 The World Trade Organization (WTO) Agreement on Subsidies and Countervailing Measures²⁷ disciplines the use of subsidies, and it regulates the actions countries can take to counter the effects of subsidies. For the purpose of this Agreement, a subsidy shall be deemed to exist if:

a-1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as "government"), i.e. where:

- (i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);
- (ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits);
- (iii) a government provides goods or services other than general infrastructure, or purchases goods;
- (iv) a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments;
or

a-2) there is any form of income or price support in the sense of Article XVI of GATT 1994; and

b) a benefit is thereby conferred.

6. CONCLUSION

6.1 As previously mentioned, a preliminary definition of competition in international air transport could be the *“the existent or potential rivalry between two or more operators, carriers or groups striving for advantage in the same market, including using price and quality of products or services to achieve the desired gains”* Such tentative definition is to be regarded as work-in-progress, considering the variety and complexity of topics involved.

²⁷ “The Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations was signed by ministers in Marrakesh on 15 April 1994. References to the related agreements, including the Agreement on Subsidies and Countervailing Measures, can be found at: https://www.wto.org/english/docs_e/legal_e/ursum_e.htm#kAgreement.

6.2 Nonetheless, beyond the definition of competition, there are significant differences across States in approaches to competition in international air transport. For example, and as mentioned above, market definition in the air transport is evolving and there is no consensus on the relevant markets, nor on whether enforcers should provide guidance on market definition criteria. While some authorities retain the traditional origin-destination (O&D) approach, defining markets by city-pairs or airport-pairs, other have adopted different definitions. Additional segmentation is sometimes made between leisure and business passengers, and between direct and indirect flights. Relevant markets have been broadened to include other means of transportation, such as high-speed rail.²⁸

6.3 Even in markets having similar characteristics of maturity, such as the European Union and the United States, there are differences in regulatory approaches to competition regimes. These differences appear in the area of alliances, with respect to several areas: the competition regime applicable to aviation; the mandates of competition authorities; the tests for competition review; and procedure.

6.4 However, these differences should not be overstated. As shown by the EU-U.S. cooperation endeavour on transatlantic alliances, efforts to foster compatibility can be successful. Several mechanisms can assist in forging a common understanding of the competitive structure of the airline industry. First, continuous cooperation on remedies in order to avoid conflicts or duplications. Second, the exchange of confidential information or documents. Dialogue and exchange of information with stakeholders is also an important element. As mentioned, “given the dynamic nature of the industry, cooperation between the authorities has to be a continuous process. It is essential for both authorities to understand exactly how the industry evolves and how its regulators should respond.”²⁹

— END —

²⁸ OECD (2014), Annex to the Summary Record of the 121st Meeting of the Competition Committee held on 18-19 June 2014, Executive Summary of the discussion on Airline Competition.

²⁹ See *Transatlantic Airline Alliances: Competitive Issues and Regulatory Approaches*, Report by the European Commission and the United States Department of Transportation, 2010.