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Agenda Item 2: Examination of Key Issues and Related Regulatory Framework

Agenda Item 2.4: Fair competition

EU COMPETITION RULES

(Presented by Ireland on behalf of the European Union (EU) and its Member States¹)

1. BACKGROUND

1.1 Over the last twenty years, liberalisation of the EU air transport services contributed to the significant growth of air transport in the EU. It stimulated the appearance of new carriers, new carrier models (i.e. the low cost model) and many new destinations. As the result of the single aviation market, EU carriers obtained commercial freedom to operate on any EU route as well as to freely choose the number of frequencies and level of fares on those routes.

1.2 Liberalisation also triggered consolidation in the EU airline industry, which had been previously organised along the lines of national borders. It led to a reduction in the number of EU "legacy airlines" through mergers of some and bankruptcies of others. This trend is likely to continue in the near future. Unlike in the United States (US), where the airline industry is represented by a limited number of giant legacy airlines with regional subsidiaries and few major low-cost carriers, the EU airline industry is still largely fragmented, counting a dozen larger legacy carriers, numerous independent regional carriers and many low-cost or semi-low cost carriers.

1.3 The EU air carriers merge or form close forms of co-operation for a number of reasons, such as to seek new potential for revenue, increase scale to bring down unit costs or gain access to new markets. Merged entities with financial difficulties later often go through major restructuring.

1.4 Furthermore, the appearance and strengthening of low-cost carriers in the EU intensified intra-EU competition between carriers. Legacy carriers find it increasingly challenging to compete with low-cost carriers being unable to match the latter's unit cost. This has recently led to legacy airlines implementing major cost-cutting initiatives and setting up their own low-cost subsidiaries on short-haul routes. Long-haul services – still relatively free from competition from low-cost carriers – are also increasingly competitive in certain markets. As a response, consolidation has continued, and EU carriers

¹ Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the United Kingdom.

join alliances, form revenue and profit sharing joint ventures or other cooperative arrangements with partners in other regions to achieve merger-like synergies. The creation of joint ventures – still largely limited to a few larger carriers – can however lead to reduced competition on important EU-US and EU-Asian gateways and risks marginalising smaller or unaligned carriers - outside those joint ventures – on some of these routes.

2. EU COMPETITION RULES

2.1 In this dynamic environment, it, therefore, becomes extremely important to ensure that the level playing field is maintained for all carriers in the EU. Against this background, the task of the European Commission to enforce EU competition rules in a consistent and non-discriminatory manner becomes essential.

2.2 **Anti-trust.** The core legal basis for the European Commission action on anti-trust grounds is Article 101 and Article 102 of the Treaty on the Functioning of the European Union (TFEU). In addition, Article 106 TFEU ensures that competition rules are equally applied in the specific cases of companies owned by Member States or companies to which Member States granted special or exclusive rights. In essence, standard EU competition rules currently apply equally to aviation, as they do to other sectors of the economy.²

2.3 **Article 101 TFEU.** Article 101(1) TFEU prohibits all agreements between undertakings and concerted practices which may affect trade between Member States and which prevent, restrict or distort competition within the internal market. Since 1 May 2004, undertakings have to self-assess compliance of their co-operation with EU competition rules. If the European Commission opens an investigation, it is the burden of the European Commission to demonstrate that cooperation may have as their object and/or as their effect the restriction of competition. For example, in the oneworld investigation, the European Commission concluded that the joint venture between the parties was likely to restrict competition both by object and effect. To that end, the parties proposed commitments - largely consisting of airport slots - to lower entry barriers and, therefore, to mitigate the competition concerns expressed by the European Commission.

2.4 Co-operation is likely to lead to serious competition concerns if (a) co-operating parties have high joint market shares, (b) remaining competitors are weak and unable to constrain the exercise of market power of the co-operating parties, and (c) there are high market barriers (such as airport slots). Other possible competition concerns from airline co-operation may stem from the ability and incentive of co-operating parties to foreclose competing airlines from the access to connecting traffic, thus endangering the sustainability of competitors' services.

2.5 However, an agreement which may restrict competition under Article 101(1) TFEU may nonetheless be allowed if, on balance, it creates sufficient benefits to consumers meeting the criteria of Article 101(3) TFEU. These criteria, which are cumulative,³ are as follows: (a) the agreement must contribute to improving the production or distribution of goods or promote technical or economic progress, (b) consumers must receive a fair share of the resulting benefits, (c) the restrictions imposed by

² Until 29 June 2007 the IATA passenger tariff conferences concerning air routes between the EU and non-EU countries were exempted from the application of Article 101 TFEU.

³ These criteria and other conditions to be met for the efficiencies to be accepted in the Commission analysis under Article 101(3) TFEU are explained in detail in the General Guidelines (formerly “Guidelines on the application of Article 101(3) of the TFEU”). [http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52004XC0427\(07\):EN:NOT](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52004XC0427(07):EN:NOT)

the agreement must be indispensable to the attainment of these objectives, and (d) the agreement must not afford the parties the possibility of eliminating competition in respect of a substantial part of the products or services in question. In aviation, these benefits, for example, may include time saving benefits from re-scheduling of existing frequencies and addition of new frequencies on a route, as well as benefits from mutual recognition of loyalty programmes.

2.6 The burden to demonstrate efficiencies under Article 101(3) TFEU lies entirely on the co-operating parties. Thus, the Commission may not take efficiencies into account in its competitive assessment if, for example, the parties do not quantify these efficiencies or do not submit evidence which would demonstrate that the cumulative criteria set out in Article 101(3) TFEU are met.

2.7 The Commission typically conducts its analysis of anti-competitive effects (harm) and pro-competitive effects (efficiencies) within the same market (i.e., routes affected by the co-operation). Still, the Commission can also consider the efficiencies generated on other routes, provided certain conditions are satisfied: (i) the routes on which these "out-of-market" efficiencies are produced should be related to the routes of concern, and (ii) the customers affected by the cooperation on the routes of concern should be "substantially the same" as the customers reaping benefits on other routes.⁴

2.8 **Article 102 TFEU.** Article 102 TFEU prohibits the abuse of a dominant position within the internal market or a substantial part of it. Abuses are commonly divided into exclusionary abuses, which exclude competitors from the market, and exploitative abuses, where the dominant company exploits its market power by, for example, discriminating – absent objective economic reasons - between different groups of customers charging them unfair prices. Such conduct has, for example, been seen at the level of some airports that seemed to have applied different airport charges to national carriers and carriers from other Member States. Article 102 TFEU does not contain an equivalent exception for anticompetitive agreements as set out in Article 101(3) TFEU, whereby a firm's conduct may be deemed legal because of benefits for consumers. However, a dominant company may be able to show that its conduct, which may prima facie appear abusive, is – in light of the circumstances of the case – objectively justified and proportionate.

2.9 **Mergers.** The main legal basis for merger assessment in the EU is Merger Regulation 139/2004 ("EUMR"). In accordance with EUMR, the merger has to be notified to the European Commission if it attains certain turnover thresholds in the EU and globally.⁵ In such case, the European Commission must examine the merger. If the thresholds are not attained, national competition authorities of the Member States may review the merger. In some cases, Member States may however refer the merger to the European Commission in which case the Commission must review it.

2.10 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 are likely to have high joint market shares and if the existing competitors would be unable to challenge the merging parties' exercise of market power. For example, the presence of market barriers is likely to restrain competitors from disciplining the parties.

2.11 After its assessment, the Commission may clear the merger unconditionally or on the basis of sufficient remedies, or – if no such remedies are proposed by the parties – prohibit the merger. A

⁴ See paragraph 43 of the General Guidelines.

⁵ For example, the merger has to 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.

notified merger can be examined in two phases. If after the phase 1 examination, it is concluded that the merger raises serious competition doubts, it will be further investigated in phase 2. Over the last ten years, about two thirds of all mergers between the airlines, which were notified to the European Commission, were cleared in phase 1. Until now two airline mergers were prohibited following the phase 2 examination: the 2007 Ryanair-Aer Lingus and the 2011 Olympic-Aegean transactions.

2.12 **State Aid. General remarks.** With its State Aid rules, the EU intends to create and foster the internal market by ensuring a level playing field for all market participants. The principle behind EU state aid control lies in the fact that unjustified advantages for certain companies can distort competition on the internal market, as not so competitive companies benefitting from state aid succeed over competitive companies without such aid. State aid control aims to establish a level playing field for all market players and to protect EU Member States from subsidy races.

2.13 The legal basis for EU State Aid control is reflected in the TFEU: Article 107(1) TFEU provides a general definition of state aid, which is composed of the four cumulative elements defined below:

- a) the measure must be granted by a Member State or through State resources;
- b) there must be a selective advantage (it must favour certain undertakings, the production of certain goods or the provision of certain services);
- c) there must be a (potential for) distortion of competition, i.e., the measure provided by the State reinforces (or would be capable of reinforcing) the competitive situation of the beneficiary undertaking compared to that of its competitors; and
- d) there must be an effect on trade between Member States.

2.14 In case a measure fulfils all four cumulative criteria, then it constitutes state aid, which is in principle prohibited by Article 107(1) TFEU. However, Articles 107(2) and (3) TFEU lay down a number of conditions under which a state aid shall or may be considered compatible with the internal market (the exemptions) and could thus be authorised by the Commission (which has the exclusive competence to declare state aid compatible with the internal market). On the basis of these Articles the Commission has issued detailed instruments and guidance documents in order to clarify the criteria it applies when assessing the compatibility of state aid. This is also the case for the aviation sector.

2.15 **State Aid for the Aviation Sector.** For the aviation sector, the Commission has so far published two sets of guidelines:

- a) application of Articles 92 and 93 of the EC Treaty and Article 61 of the EEA Agreement to State aids in the aviation sector⁶ (1994 Guidelines); and
- b) community guidelines on financing of airports and start-up aid to airlines departing from regional airports⁷ (2005 Guidelines)

2.16 It has to be highlighted that the Commission has decided to initiate a revision of both the 1994 and the 2005 Guidelines, which is still on-going.

⁶ Official Journal C 350 of 10. 12. 1994, p. 5

⁷ Official Journal C 312 of 9.12.2005, p. 1

2.17 The 1994 Guidelines were published at the beginning of the liberalisation of the aviation sector. Today, several of the rules laid out in the 1994 Guidelines are not applied any longer, as the legal basis has changed. Moreover, the Commission has also published the 2005 Guidelines to add to the 1994 Guidelines. For cases of airlines in difficulty, the Commission now applies its horizontal Community guidelines on State aid for rescuing and restructuring firms in difficulty⁸. However, the rules on operating aid (i.e. aid to cover operating losses) of the 1994 Guidelines are still valid. Operating aid is not compatible with the EU state aid rules except in two cases:

- a) aid in form of a public service compensation; and
- b) aid of a social character which benefits e.g. children, elder persons or inhabitants of remote areas.

2.18 Following the liberalisation of the 1990s, the aviation sector has changed significantly. Therefore the Commission published a further set of Guidelines in 2005. These 2005 Guidelines add to, but do not replace, the 1994 Guidelines. In particular, the 2005 guidelines provide guidance concerning state aid for the financing of airport infrastructure and start-up aid for new routes linking smaller EU airports with other EU airports.

2.19 As regards airport infrastructure, the 2005 Guidelines set out criteria under which such aid can be authorised by the Commission. The criteria define that the airport infrastructure must meet a clearly defined objective of general interest; it must be necessary and proportional to this objective; it must have satisfactory medium term prospects of use; all its potential users must have equal and non-discriminatory access to it and the development of trade is not affected to an extent contrary to the Community interest.

2.20 Start-up aid for new routes aims to support smaller airports in the EU, i.e. airports with less than 5 million passengers to achieve a critical mass of passengers and thus the breakeven point. With start-up aid, these smaller airports can attract air carriers to set up new routes to link these smaller airports with any other EU airport. However, several criteria have to be complied with, in order that such aid can be authorised by the Commission.

2.21 As mentioned above, the Commission is currently revising the existing sets of Aviation Guidelines. The Commission's starting point for the revision is the 2005 Guidelines and the recent judgments of the European Courts⁹, ruling that the operation of an airport and the construction of airport infrastructure is an economic activity, except for activities falling within public policy remit, e. g. police, customs, air traffic control.

2.22 With its new regime, the Commission wants to establish more equitable conditions of competition in the aviation sector while, at the same time, allowing regional authorities to meet accessibility and transport needs. In the mid- to long-term, there should be a more efficient (i. e. demand oriented) allocation of airport capacity to airlines, less need for public funding of airports, more private investments into airports and (to an appropriate extent) the closure of inefficient airports.

2.23 **State Aid Procedures.** State aid measures (individual measures and aid schemes) have to be notified to the Commission for approval and must not be put into effect before the Commission has

⁸ Official Journal C 244 of 01.10.2004, p. 2

⁹ Judgement of 12 December 2000 in *Aéroports de Paris* case, confirmed by Leipzig-Halle airport judgement of 24 March 2011.

taken a decision authorising them (“standstill obligation”). All aid implemented before approval of the Commission is considered unlawful aid and may have to be recovered from the recipient with interests.

2.24 Following the assessment of a complete notification, the Commission formally decides on the state aid measures. There are either no doubts from the Commission, i.e. the measures contain no aid or the aid is compatible with the state aid rules (and authorised), or the Commission expresses its doubts and opens a formal investigation procedure to carry out a detailed assessment of the aid measures. This detailed assessment is also closed by a formal decision of the Commission, whereby the Commission either declares the measures to be no aid or compatible aid or incompatible aid. In the latter case the Commission will order the Member State involved to recover the state aid plus interest from the beneficiary company.

3. INTRA-JURISDICTIONAL COOPERATION

3.1 Given the international dimension of the airline sector, mergers and agreements between airlines often produce an effect on competition simultaneously in several jurisdictions. This is the case even despite the lack of cross-jurisdictional airline mergers inhibited by existing regulation (for example, between EU and US airlines).

3.2 It is thus often the case that the same merger or cooperation is investigated, for example, by the European Commission and by its counterpart in the US, often in parallel. It is important that in such cases – in order to avoid excessive regulatory price – the proposed remedies agreed by involved competition authorities are compatible vis-à-vis each other.

3.3 Recently, in the oneworld alliance case, the European Commission and the US Department of Transportation (DOT) achieved tangible results by working jointly on a set of remedies proposed by the parties: in essence, slots released by the parties to comply with the decision of the European Commission could be counted against the parties' obligation to release slots under the DOT's final order. Such results would be unthinkable without close co-operation of the two authorities. To that end, the ability of both authorities to share documents and information on the basis of waivers granted by the parties, but subject to strict confidentiality duties, was instrumental.

4. INVOLVEMENT OF ICAO

4.1 In this environment, ICAO's role as an active and powerful advocator of competition rules can only grow. ICAO should not only, where necessary, provide guidance to its Member States, but also stimulate debate on the subject. It should also explain the advantages of closer co-operation of different competition authorities, advocating in favour of waivers or permission to allow for a free exchange of views, documents and information between these authorities. As it was demonstrated in the oneworld case, such co-operation could only be to the benefit of carriers. Under these circumstances, competition authorities will continue enhancing their mutual understanding and discussion of competition issues.