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LATIN AMERICAN COMPETITION FORUM

Session IV: Competition Issues in the Air Transport Sector

Background Note

13-14 Septembre 2011, Bogotá (Colombia)

This Background Note was prepared for the Secretariat by Mr Pablo Mendes De Leon, Leiden University (Netherlands). It is circulated FOR DISCUSSION under Session IV of the Latin American Competition Forum at its forthcoming meeting to be held on 13-14 September 2011 (Colombia).

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Session IV: Competition Issues in the Air Transport Sector

Background Note ^{*}

^{*} This background paper was prepared for the Secretariat by Pablo Mendes de Leon (Leiden University, Netherlands). It is circulated under session IV of the Latin American Competition Forum at its forthcoming meeting to be held on 13-14 September 2011 (Colombia). The views expressed in this paper are the personal responsibility of the author. They should neither be attributed to the Inter-American Development Bank, the OECD nor to its member countries. The author welcomes comments and corrections of factual errors at the following email address: p.m.j.mendesdeleon@law.leidenuniv.nl.

Introduction

1. This background paper for the OECD-IDB Latin American Competition Forum will focus on competition in the air transport sector with special reference to the Latin American air transport industry. This is a fast growing industry and new market conditions are emerging on this continent. Competition regimes can and should play a key role with respect to promoting and monitoring these emerging market conditions.

2. Section 1 of the paper explains that the existence of air transport markets is not a given. Traditional air law and policy regimes have been designed regardless of the existence of markets, let alone free or open markets. Instead they have emerged from trade in air services which are managed and regulated by governments. That said, countries in all parts of the world, including Latin America, are developing aviation markets nationally and internationally in response to increased globalisation and liberalisation.

3. Section 2 analyses the application of competition law regimes to market behaviour in emerging and mature air transport markets. This section defines air transport markets discusses the application of competition law regimes to air transport markets.

4. The final section considers the role of competition and competition authorities in the development of domestic and international air transport markets and in ensuring that the benefits of liberalisation are passed on to consumers.

5. This paper will examine the above developments taking into account the relevant policy, regulatory and economic parameters, and by reference to experiences from other parts of the world, in particular the EU and the United States.

1. Liberalisation of markets in the air transport sector

1.1 *The global framework for the operation of air services*

6. International air services have traditionally been subject to a special regulatory framework. Air services are governed by a specific Annex of the General Agreement on Trade in Services (GATS). However, the annex excludes from the agreement the largest part of air transport services: traffic rights and services directly related to traffic. The GATS Annex applies to three ancillary services: aircraft maintenance and repair, distribution and selling and the operation of Computerised Reservation Systems (CRSs). Thus, the air transport industry is an exception to the overall WTO/GATS framework which applies to all other economic activities. This is explained by the special characteristics of air transport which also impacts on the competitive and market conditions, or lack thereof, under which air services are, or at least were, operated.

7. The Chicago Convention on international civil aviation (1944) – henceforth referred to as: the Convention - provides a general framework for the operation of *international* air services; the operation of domestic services is left to the regulation and policies of the states in which they are operated. At the time of the conclusion of the Convention, states recognised the security and public service interests of this industry. Hence, the protection of safety and security of international air transport underpin the provisions of this general framework. At present, 190 states including all Latin American states, the 27 EU member states, but not the EU as an international entity, and the US are parties to this convention.¹ The Convention makes a distinction between the operation of scheduled international air services and non-scheduled international air services.

¹ Per 23 June 2011; see: http://www2.icao.int/en/leb/List%20of%20Parties/Chicago_EN.pdf.

8. In 1944, states decided to close their airspace until international agreements between states were agreed for the operation of scheduled international services. Consequently, the Convention does not create open markets but nor does it preclude their creation. It does not establish economic regulation or a competition law regime, both of which are left to bilateral air services agreements and national legislations respectively.

9. Non-scheduled international air services operate within a more liberal regime as these can be performed freely subject to the right of the state of destination of the traffic to impose local regulations. Over time, the regimes for the operation of scheduled and non-scheduled international air services have converged increasing both in law and in practice.

10. The operation of air cargo services is at the forefront of liberalisation. Generally speaking these services are subject to fewer restrictions in bilateral air services agreements, which is reflected by the rapid expansion of cargo operations by, among others, LAN Airlines. Improved market access opportunities such as the so-called seventh Freedom rights (see below) are less reluctantly granted to operators of cargo services than passenger services operators.

1.2 Market access regulation under bilateral air services agreements

11. The operation of international air services and the regulation of airport charges are traditionally regulated under bilateral air services agreements concluded between states. Consequently, the air transport industry was, and still is, subject to government managed and regulated trade in services whereby states determine the economic conditions, including market access conditions, to which the operation of air services is subject. It led to protectionism and gave rise to the “Freedoms of the Air” which are actually restrictions on commercial aviation rights, as they can only be exploited if states agree to do so as per the terms and conditions of the international agreements.

Freedoms of the Air

First Freedom

To fly over one country en-route to another

Example.: Aerolinas Argentinas flies over Brazil from Buenos Aires to Chicago (US)

Second Freedom

To make a technical stop in another country

Example.: LAN Chile makes a stop for fuelling purposes in Caracas (Venezuela) on a flight between Santiago de Chile and Miami (US)

Third Freedom

The carriage of traffic (passengers and cargo) from the home country of the airline to another country

Example.: TAM carries traffic from Rio de Janeiro to Minneapolis (US)

Fourth Freedom

The carriage of traffic to the home country from another country

Example.: Avianca carries traffic from London to Bogota

Fifth Freedom

The carriage of traffic between two foreign countries by an airline of a third country, where the carriage is linked to Third and Fourth Freedom traffic rights of the airline.

Example.: Copa Airlines operates a service originating in Panama to Mexico City, and then on to New York, picking up traffic in Mexico City with New York as the final destination.

Sixth Freedom

The carriage of Fifth Freedom traffic between two foreign countries via the home country of the airline

Example.: TACO International carries traffic originating in Cartagena (Columbia) via San Salvador (El Salvador) to Los Angeles (US)

Seventh Freedom

The carriage of traffic between two foreign countries by an airline of a third country, where the carriage is not linked to Third and Fourth Freedom traffic rights of the airline.

Example.: Aeromexico carries traffic between Atlanta (US) and Paris, France on a service, which is unrelated to a point in Mexico

Eighth Freedom

The carriage of passengers and cargo between two points in a foreign country on a route with origin and/or destination in the home country of the airline (cabotage)

Example.: Pluna Uruguay Airlines carries traffic between Sao Paolo and Brasilia (both in Brazil), on a flight Montevideo - Sao Paolo - Brasilia

Ninth Freedom

The carriage of passengers and cargo between two points in a foreign country on a route, which is unrelated to the home country of the airline (stand-alone cabotage)

Example.: LAN Peru carries traffic between Monterey and Guadalajara (both in Mexico) on a service which is unrelated to a point in Peru

12. In the Latin American context, this model is exemplified by the doctrine put forward by Professor Ferreira from Argentina who regarded international air traffic as the “estate” belonging to a state. Pursuant to this doctrine, traffic carried between two states belongs to those states,² rather than to markets.

13. In line with this model, the number of carriers, the conditions airlines had to comply with in order to be eligible for market entry, the capacity they were allowed to mount on the agreed international air services and the frequencies of their operations, were and still are in many cases agreed upon by states. Pricing of international services was agreed upon by states which was, and still may be, coordinated by the International Air Transport Association (IATA). This traditional regime for regulating market entry, market behaviour and pricing is changing under the so-called Open Skies agreements and the subsequent application of competition rules to the air transport sector.

1.3 *Open Skies agreements*

1.3.1 *The introduction of an Open Skies policy in the US*

14. The first steps towards economic deregulation of *domestic* air transport were taken in 1978, when the (US) International Air Transportation Competition Act was adopted. This Act was designed to provide greater opportunities for US air carriers, to promote the availability of a variety of adequate, economic, efficient, and low-price services by air carriers and foreign air carriers. Deregulation was supposed to remove government control over fares, routes and market entry of new airlines in domestic commercial air transport while enhancing competition.

15. In 1990, the US Department of Transport conceded to the wishes of secondary US airports, under the USA BIAS programme, by allowing foreign airlines, outside bilateral agreements to start operations to and from so called ‘underserved’ US airports. This program also formed the impetus for the launching of the US government “Open Skies” policy in 1992.

² Cf. E.A. Ferreira, *The Capacity Problem under the Argentine Doctrine in International Air Law* 34 ff. (1962).

1.3.2 *Elements of Open Skies policies*

16. The term “Open Skies” indicates a shift from the exchange of traffic rights under traditionally restrictive bilateral agreements towards a more progressive whereby competition and market conditions form the core elements. The US uses the term “Open Skies” to designate a liberal approach towards the operation of international air services. The term therefore is more of a policy concept than a legal one.

17. Open Skies agreements contain the following liberalising elements:

- Freedom of each country’s airlines to operate air transport services between any point or points in the countries of the contracting parties, including to intermediate and beyond points, subject to a third state’s approval, and to customs, technical, operational or environmental restrictions.
- Multiple designation of airlines;
- No capacity limitations;
- Freedom to set prices, subject to government intervention designed to prevent monopolies, predatory pricing and artificially low prices due to government subsidies;
- Promotion of liberalisation in the field of charter flights, cargo and Computer Reservation Systems;
- Performance of own support functions at airports located in the territory of the other party.

18. The exercise of the above rights is subject to national and local rules regarding safety, customs, security, and the environment. Also, slot scarcity can place restrictions on the exercise of traffic rights, as to which see further below.

19. The main, if not the most essential benefit that countries whose “flag” carrier is engaged in an alliance with a US carrier receive when concluding an Open Skies agreement with the US, is the potential for an *anti-trust immunity* grant by the US authorities for such an alliance.

20. Open Skies does not mean that all elements falling under economic regulation of international air transport services are liberalised under the agreement. The following restrictions remain, or may be made subject to further negotiation:

- National ownership and control clauses for designated air carriers;
- Seventh freedom operations;
- Cabotage;
- Commercial opportunities in the other country, including the requirement that code sharing must be based on traffic rights for all partners;
- (Wet-) leasing arrangements.

1.3.3 *Alliance building and competition issues in Open Skies markets*

21. Open Skies agreements promote the operation of air services between the two countries in line with market conditions which determine the price and quality of services. In order to benefit fully from Open Skies agreements, the airlines flying under these agreements should cooperate in an alliance formed by, for instance, two carriers, A and B. The alternative would be that a single carrier could only operate routes with sufficient end-to-end traffic for the entire operation. Hence, the allied airlines A and B have an interest in coordinating and linking networks around their hub and spoke systems, so as to create:

- *'End to end' alliances*, that is, the operation of air services starting at a point behind the hub of carrier A of the alliance, via spoke to its hub, through the hub of the partner carrier B, via a spoke of carrier B to a point beyond the hub of carrier B;
- *Synergy of operations*, including joint scheduling, joint distribution and selling etc.;
- *Joint ventures* regarding the operation of routes.

22. The term “alliance” is not defined by policy or law. It covers several types of agreements in varying degrees of depth, breadth and commitment. Simple forms of alliances concern arrangements on code sharing and the reciprocal use of frequent flyer programs and of business lounges at airport terminals. The more sophisticated alliances involve quasi mergers between the airlines concerned. Synergies increase in accordance with the depth, economies of scale and scope and the binding effect of the alliance. Protagonists of alliances contend that they lead to improved passenger service and reduction of costs – through the creation of synergies. Critics claim that alliances are liable to restrict competition through the elimination of smaller airlines and new entrants, and higher prices, especially on routes from and to hub airports of the hub carriers.

23. Co-operation via alliances has raised antitrust concerns. (For instance, if a transatlantic airline alliance were not to receive antitrust immunity, the airlines would either face possible antitrust enforcement action in jurisdictions where the agreement has an effect on the market or they would have to reduce the intensity of their cooperation, or both.

24. Aside the legal implications, the granting of antitrust immunity has an important policy element.³ Whereas the US grants antitrust immunity only if an Open Skies agreement has been concluded, European countries only conclude an Open Skies agreement if antitrust immunity will be granted. So far, this dilemma has been resolved through the EU-US agreement on air transport of 2007 as amended in 2010, providing for co-operation on competition. This cooperation is to:⁴

- Enhance mutual understanding of the application of competition rules;
- Facilitate understanding on competitive developments among the parties;
- Reduce potential conflict on competition questions;
- Promote “compatible regulatory approaches to agreements through a better understanding of the methodologies, analytical techniques including the definition of the relevant market(s) and analysis of competitive affects and remedies that the parties use in their respective competition reviews.”

25. Neither the Open Skies policy, nor the subsequent Open Skies agreements, provides for harmonised competition enforcement. The agreements on operating air services internationally in a market oriented environment function with the applicable competition regimes.

³ See also, *US-UK Alliance case*, US DoT Order 2002-4-4 dated April 4, 2002, on the United Airlines (United)/British Midland (bmi) alliance, at 10: “However, we do not believe that it is in the public interest to permit United/bmi to implement their proposed alliance before we achieve Open Skies with the United Kingdom because that approach would materially reduce the incentives that we have determined are needed to achieve that result. Our grant of approval and antitrust immunity accordingly will become effective only after the United States has achieved an Open Skies agreement with the United Kingdom that meets our aviation policy objectives. By thus conditioning the effectiveness of our approval and antitrust immunity, we are fully complying with our long-established policy that a U.S. airline and a foreign airline may obtain the authority to operate an immunized alliance only when the United States has an Open Skies agreement with the foreign airline's homeland.”

⁴ See Annex 2: Cooperation with respect to Competition Issues in the Air transport Industry, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:134:0004:0041:EN:PDF>

1.4 *Liberalisation of the air transport sector in the EU (1987)*

26. Following the US deregulation process, the – then - European Economic Community (EEC) started its own liberalisation program. Whereas the US government executed deregulation practically overnight, the EEC preferred a step by step approach because traffic between the Member States was regulated by a web of bilateral air services agreements. Economic regulation pertaining to market access laid down in those agreements has been superseded by EU regulation.

27. Since 1 January 1993, EU carriers have freedom of access to any route within the EU, including domestic routes.⁵ EU carriers are carriers of which Member States and/or nationals of Member States own more than 50% of the undertaking and which they effectively control, whether directly or indirectly through one or more intermediate undertakings.⁶ Hence, EU carriers can operate intra-EU routes under perfect or nearly perfect market conditions as laid down in law.

28. Access to EU airports by EU air carriers may be subject to a number of conditions and constraints, including:

- Environmental, i.e. noise-related, limitations;
- Safety considerations (see for instance the volcanic ash conditions of 2010);
- Congestion, in which case slots must be allocated in accordance with applicable EU rules (as to which see further below);
- Special arrangements for airports serving the same city or conurbation pursuant to traffic distribution rules for those airports.

29. Since the completion of the internal market, prices on intra-EU services have fallen dramatically, in particular on the most popular routes, while the choice of available routes has increased . Low cost carriers, such as easyJet and Ryanair, have impacted on this transformation as they carry traffic across Europe without a “natural” home base. The traditional “flag” carriers such as British Airways, Air France, Lufthansa, KLM, Austrian Airlines and Iberia still operate from their principal places of business and other points in their home countries.⁷

30. The EU internal market has created new conditions for competition between carriers and the European Commission performs the role of “watchdog”, overseeing the functioning of the internal market for air transport.

31. Access to EU airports by non-EU air carriers remains subject to the more traditional and restrictive bilateral air services agreements or to the new Open Skies agreements. The most well known Open Skies agreement is the above mentioned 2007 Agreement on air transport, as amended in 2010, between the EU, its 27 Member States and the US, creating a liberal market regime between the two jurisdictions. However, the EU-US market is not as free as the intra-EU market as a number of restrictions prevail. Among others, they pertain to nationality requirements and the Seventh, Eighth and Ninth Freedoms of the Air (as to which see above).

⁵ Domestic routes, or cabotage, were opened up as from 1 April 1997.

⁶ As per Article 4 of EU Regulation 1008/2008.

⁷ See: G. Riley, *The European Airline Market* 16-18 (2003), available at: <http://www.scribd.com/doc/12780640/Case-Study-European-Airlines>

1.5 Latin American regional market developments

1.5.1 The emergence of regional markets within Latin America

32. There are a number of regional agreements in Latin America designed to liberalise and open air transport markets.

33. The member states of the Andean Community (ANCOM) including Bolivia, Colombia, Ecuador and Peru established the Andean Subregional Air Transport Integration System - the Andean Pact.⁸

34. The Andean Pact liberalises air traffic among its member states but leaves the underlying bilateral agreements intact. It does not refer to the application of national competition laws, nor does it create a supranational competition law regime. The Andean Pact is relatively liberal as it allows airlines to enter the Andean market if they have their principal place of business in one of the member states and there are no ownership and control requirements. Moreover, and subject to further arrangements, the Andean Pact provides for the operation of non-scheduled services outside the Andean region.

35. The Andean Pact also established an Andean Commission of Aviation Authorities, which is comparable to the Joint Committees under the EU-US and EU-Brazil agreements on air transport.⁹

36. The Agreement Constituting the Central American Corporation for Air Navigation Services (*Convenio Constitutivo de la Corporación Centroamericana de Servicios de Navegación Aérea*, 1961) was signed by Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua.¹⁰ This agreement focuses on the combined provision of air navigation services; it has no effects on markets or competition.

37. The 1966 Mercosur Subregional Agreement on Air Transport Services - the Mercosur agreement - involves Argentina, Bolivia, Brazil, Chile, Paraguay and Uruguay.¹¹ Like the Andean Pact, it opens new routes alongside the existing services agreed on a bilateral basis between the participating countries. The agreement concerns the developments of new markets and the elimination of unfair competition practices but it does not indicate which procedures and rules should be followed. It also provides for national treatment in respect of the grant of rights to the carriers falling under its terms.

38. In 2004, the member states and associate members of the Association of Caribbean States (ACS) concluded an Air Transport Agreement.¹² Its provisions are similar to those drawn up under bilateral air

⁸ See, the Eleventh Meeting of the Intergovernmental Follow Up and Coordination Committee on Economic Cooperation among Developing Countries (IFCC-XI), Havana, Cuba, 21-23 March 2005, available at: <http://www.g77.org/ifcc11/docs/doc-10-ifcc11.pdf>; see also: Mauricio Siciliano, *The Andean subregional air transport integration system* (1995)

⁹ See: Decision 297 of the Commission of the Cartagena Agreement, *Integration of Air Transport in the Andean Subregion*, available at: <http://www.sice.oas.org/trade/junac/decisiones/Dec297e.asp>. Participating states are Antigua and Barbuda, the Bahamas, Barbados, Costa Rica, Belize, Colombia, Cuba, Costa Rica, El Salvador, Dominica, the Dominican Republic, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, St Kitts Nevis, St. Lucia, St Vincent and the Grenadines, Suriname, Trinidad & Tobago and Venezuela

¹⁰ See, Free Trade Area of the Americas (FTAA), *Sectoral Agreements on Services in the Western Hemisphere* (1998), available at: http://www.ftaa-alca.org/wgroups/wgsv/sagreem/English/sv_p231.asp

¹¹ See, InterAmerican Development bank, *Mercosur Report No 1* (1996), Chapter VI; see also: Jason Bonin, *Regionalism in International Civil Aviation: A Reevaluation of the Economic Regulation of International Air transport in the Context of Economic Integration*, 12 Singapore Yearbook of International Law 113-131 (2008) at: <http://law.nus.edu.sg/sybil/downloads/articles/SYBIL-2008/SYBIL-2008-113.pdf>

¹² See: http://www.acs-aec.org/Documents/Transport/Final_ATA_En.pdf

services agreements. They have the objective of promoting a “Community of Interest” and introducing a moderate market regime among the member states.¹³ The agreement focuses on the internal market without giving it external effects. There is no evidence to date of increased market behaviour in the “ACS” as a result of this agreement.

1.5.2 *Inter-regional liberalisation in Latin America*

39. More than 100 states, including Chile, Peru, Argentina and Brazil have concluded Open Skies agreements with the US.¹⁴ These have created close to open markets between the countries concerned.

40. Open Skies agreements have also been concluded between Latin American states. For instance, Argentina and Uruguay liberalised air traffic as between them, with the exclusion of cabotage traffic (i.e. domestic services operated by airlines of another state).

41. The Latin America Civil Aviation Commission (LACAC) has a model clause designed to prevent unlawful and anti-competitive behaviour by airlines, which it recommends that its member States introduce in liberal air services agreements.¹⁵ Such behaviour may include the provision of excessive capacity and predatory pricing.

42. The EU, its 27 Member States and Brazil agreed on liberalising their air transport markets in 2011. The EU-Brazil agreement could generate up to 460,000 extra passengers per year and consumer benefits of up to €460,000 million in the first year of market opening.¹⁶ On the EU side, market access is enhanced by the designation of a Community air carrier enabling each EU carrier from any point in the EU to operate services to any point in Brazil, but not between points in Brazil (cabotage). On the Brazilian side, market access is enhanced by the designation of air carriers which are majority owned and effectively controlled by Brazil or member states of the Latin American Civil Aviation Commission¹⁷ “which, in particular, have an agreement on certain aspects of air services (Horizontal Agreement) with the European Union, or nationals of such State or States, or both;”.

43. Strikingly, the Latin American Civil Aviation Commission (LACAC) rather than Mercosur is mentioned in the EU-Brazil Agreement. This reference may be a sign on the wall for regional aviation organisations and air transport integration in Latin America. As an organisation which is linked to ICAO,

¹³ See, Article 3B: Community of Interest “The right of each Party to designate an airline or airlines shall include designation in accordance with the Principle of Community of Interest as established by the International Civil Aviation Organization (ICAO). On receipt of such designation and application from the designated airline in the form and manner prescribed for operating authorization the Aeronautical Authorities shall, without undue delay, grant the appropriate authorization provided the designated airline complies with the provisions of paragraph 2 c of the present Article. -. Once the designation is received, the responsibility for compliance with Articles 6 and 7 of the Agreement remains with the Party issuing the air operator’s certificate to the designated airline.”

¹⁴ See: <http://www.state.gov/e/eeb/rls/othr/ata/114805.htm>

¹⁵ See: LACAC Rec. A13-3 - *Draft model clause to avoid unlawful competition Practices*, Presentations and conclusions of the Seminar on the Liberalization of Air Transport (Santo Domingo, Dominican Republic, 1-3 October 2002) ATRP/10 - Report of the tenth meeting of the Air Transport Regulation Panel (Montreal, 13 - 17 May 2002) – the published text of the draft model clause is not yet available in English.

¹⁶ See COM(2011) 253 final of 6 May 2011.

¹⁷ The Latin American Civil Aviation Commission (LACAC) is linked to ICAO and has the following member states: Argentina, Aruba, Belize, Bolivia, Brazil, Chile, Colombia, Costa Rica, Cuba, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, The Dominican Republic, Uruguay and Venezuela.

LACAC is a regional organisation respecting the sovereignty of its member states under the Chicago Convention. It does not foster economic or market integration other than by the issuance of recommendations on market behaviour (see the last point of sub-section 1.1).

44. On paper, market opportunities have been significantly enhanced by the inclusion of the EU and LACAC air carrier clauses. However, practice shows that little use is made of the advantages created by the introduction of such clauses. Based on previous experiences, it is unlikely that Lufthansa will start to operate a Madrid - Sao Paolo service or LAN Peru a Rio de Janeiro – Paris service by virtue of this agreement as the transaction costs for starting these services are too high.

45. As to competition, Brazil and the EU and its Member States agreed on the following:

“The competition laws of each Party, as amended from time to time, shall apply to the operation of the air carriers within the jurisdiction of the respective Party. The parties share the objective of compatibility and convergence of competition law and will cooperate as appropriate and when relevant on application of competition law.”¹⁸

46. This is a somewhat loosely formulated provision. The “operation of services” could have been substituted for the “operation of air carriers”. Services are operated in a market which comes under the jurisdiction of a public body. The operation of air services between Brazil and the EU is an international activity which is not regulated in this clause by reference to, for instance, the “effects doctrine”.¹⁹

47. The Brazil-US agreement of December 2010 is expected to increase traffic between the two countries as it removes price restrictions on the agreed international routes. Designated airlines also enjoy greater commercial freedom through enhanced flexibility with respect to code sharing and charter operations. In the next phases, the designated carriers may exploit additional route rights.²⁰

48. Brazil and Canada have liberalised their air transport arrangements in 2011. The grant of all “Open Skies” liberties, including multiple designation of air carriers, absence of restrictions on capacity and pricing and the first six Freedoms of the Air are geared to create an open market environment.²¹

49. The EU and its Member States on the one side and Paraguay, Peru and Uruguay on the other signed horizontal aviation agreements enabling EU air carriers to fly from any point in the EU to points in the three mentioned countries.²² These agreements stimulate market liberalisation. As noted above, these are likely to be of limited practical use as EU carriers continue to operate air services exclusively from their main hub or at least from points in their home country. For instance, Lufthansa flies from Frankfurt and Munich to New York but not from London or Madrid. It would appear that the entry barriers in airports which are located in other EU Member States are too high to start or justify such operations.

¹⁸ See Article 15 on the Competitive Framework.

¹⁹ According to the “effects doctrine” a competition authority may apply its competition laws to foreign based undertakings if the behaviour of such foreign undertakings affects the market which is regulated and supervised by that authority. The doctrine originated in the US. The US Second Circuit Court of Appeals explained in the Alcoa decision (*US v. Aluminium of Aloc*, 1945): “Any state may impose liabilities, even upon persons not within its allegiance, for conduct outside its borders that has consequence within its borders which the state reprehends.” As to the EU, see: *In Re Wood Pulp Cartel*, *A. Ahlstrom Oy and Others v. EC Commission*, ECJ cases 89/85, 114/85, 116-117/85 and 125-129/85; 4 Common Market Law Review 901 (1998).

²⁰ See: <http://atwonline.com/international-aviation-regulation/news/us-brazil-reach-open-skies-accord-1207>.

²¹ See: <http://www2.anac.gov.br/arquivos/pdf/acordosBilaterais/C/Canada.pdf>.

²² See: ec.europa.eu/transport/air/international_aviation/country_index/country_index_en.htm.

1.6 Other regional developments

50. Partly as a reaction to the completion and the consequent strength of the EU's internal market for air transport and partly as a means for creating synergies between adjacent states and their air carriers in a globalising market, other regions have established regional structures. However, they do not have the legal or institutional foundations of the EU system.

51. In South East Asia, the Association of South East Nations, - henceforth referred to as: ASEAN - was formed in 1967.²³ ASEAN is attempting to move towards a systematic liberalisation of market access. In doing so, it has chosen three paths:

- Arrangements among individual or groups of ASEAN states permitting them to agree to specific forms of liberalisation, for instance between Indonesia, Malaysia, Singapore, also referred to as the Growth Triangle (IMS-GT);
- The implementation of the 2008 *ASEAN Multilateral Agreement on Air Services (MAAS)* liberalising general market access for air services. The main text of the Agreement, its route annex and the six "Implementing Protocols" set forth a complex and detailed system of liberalisation of the Third, Fourth and Fifth Freedom services within the region. Opportunities to serve points in third countries are not addressed.
- The establishment of a regional agreement as part of the goal of the completion of an ASEAN Single Aviation Market by 2015.

52. Within ASEAN, traditional nationality requirements in terms of ownership and control restrictions may be applied. The pricing regime is ambiguous as pricing freedom may be made subject to the national law of one of the ASEAN states which may require prior approval of the tariff. Other economic rights such as those pertaining to capacity and frequencies of operations contain similar ambiguities. In the field of competition, the ASEAN-MAAS agreement identifies a number of anti-competitive practices, including predation. The ASEAN-MAAS agreement does not create an institutional mechanism mandated to supervise the application and enforcement of its provisions, or to mediate in possible anti-competitive practices between "ASEAN" airlines.

53. There are a few supranational structures in Africa. For instance the Common Market for East and South Africa (COMESA), comprising 19 Africa states, has drawn up competition regulations for the air transport market covering services between those states pursuant to the EU model. To date it does not appear to have been applied or enforced. One question is whether there is enough "market activity" in the COMESA region for the application of a competition law regime as regards air transport.

54. The Middle East and Arab region has also endeavoured to gradually liberalise market access. However, the national agendas of these states determine the pace. Liberalisation takes place along national or unilateral lines (for instance, Lebanon) and bilateral lines (for instance, the Gulf States). Regional policies may occur at a later stage.

55. The Arab Civil Aviation Conference adopted a regional accord for the liberalisation of air transport which is also designed to enhance market access. The implementation of its provisions has not yet changed the current structure into an open market environment. This is also due to the slow pace of ratification of the accord as Arab states appear to liberalise air transport markets independently rather than jointly.²⁴

²³ ASEAN consists of 10 member countries: Indonesia, Thailand, Singapore, Philippines, Malaysia, Brunei, Vietnam, Laos, Myanmar and Cambodia.

²⁴ See: Economic and Social Commission for Western Asia (ESCWA) on *Air Transport in the Arab World*, United Nations, New York (2007) at 30-32, available at: <http://www.escwa.un.org/information/publications/edit/upload/grid-07-3-e.pdf>

Table comparing the degree of liberalisation of selected air policy regimes

	‘Traditional’ bilateral agreements	Andean Pact	Mercosur Agreement	ACS	Open Skies agreements	EU internal market
Nationality requirements for airlines (O&C)	Applicable	Principal place of business in a member state	Applicable	O&C plus Principal place of business (cf. EU)	Applicable	Community requirements ²⁵
Designation	Single or dual	Multiple	Multiple	Dual	Multiple	Unlimited ²⁶
Traffic rights²⁷	I-IV	I-V, subject to conditions	I-V, subject to conditions	I-V, subject to conditions	I-VI (passengers) or I-VII (cargo)	I-IX
Pricing²⁸	Subject to conditions	Country of origin approval	Country of origin approval	Country of origin approval	Free	Free
Capacity	Subject to conditions	No restrictions	No restrictions	No restrictions	No restrictions	No restrictions
Frequencies	Subject to conditions	No restrictions	No restrictions	No restrictions	No restrictions	No restrictions
Applicability of competition law regime	Not relevant (<i>ex ante</i> economic regulation)	No reference to competition law regime	No reference to competition law regime	No reference to competition law regime	US regime; application of positive comity	EU regime

Explanation of terms:

Nationality requirements for airlines: for airlines to access an international air transport market they must have a nationality which is expressed in terms of ownership (nationality of the shareholders) and control (nationality of the members of the airline’s executive board), in short: O & C. Most bilateral air service agreements provide that airlines operating the agreed international air services must be “substantially owned and effectively controlled” by the state or nationals of the state designating (as to which see the next term) the airline for the operation of the agreed international air services.

Designation: States party to a bilateral agreement can agree to designate one, two or multiple airlines – complying with the agreed nationality requirements as to which see the previous term – for the operation of the (agreed) international air services.

Traffic rights – are explained in sub-section 1.2., above. Traditional bilateral air services agreement tend to focus on the operation of third and fourth Freedoms of the Air providing basic market access opportunities for the designated airlines.

Pricing: encompasses pricing of the agreed international air services. Fares refer to passenger services whereas rates are related to cargo services. Variations exist as to the freedom of air carriers to set fares. Traditional bilateral air services agreements regulate pricing quite strictly, giving governments, mostly represented by Civil Aviation Authorities, the authority to control pricing of the agreed international air services.

Capacity: the volume of traffic in terms of passenger seats or cargo space that is available for the operation of the agreed international air services.

Frequencies refer to the number of air services per week which a designated airline is allowed to operate under the terms of the bilateral air services agreement.

Applicability of competition law regimes: as governments through traditional bilateral air services agreements regulate and control international air transport markets *ex ante* as exemplified by the above provisions, there is no room for the application of

²⁵ Including that nationality of airlines operating under EU Regulation 1008/2008 are “substantially owned” (more than 50 %) and “effectively controlled” by nationals of the European Union, and have their principal place of business in a Member State of the EU.

²⁶ The term “designation” does not apply to the regime set forth by the EU; access to intra-Community routes is free for Community airlines if the conditions drawn up by EU Regulation 1008/2008 are met.

²⁷ In terms of Freedoms of the Air; see section 1.1.1 of this report.

²⁸ Free pricing is subject to government interventions in cases of predatory or discriminatory pricing, and, in the case of intra-EU traffic, to the European Commission’s supervisory tasks under Regulation 1008/2008.

competition regimes. However, Open Skies agreements liberalise international air transport markets necessitating the introduction of competition regimes.

1.7 Conclusions

56. The operation of international air transport services has not traditionally taken place within a market framework. States governed trade in air services while restricting markets access and managing market behaviour through bilateral air services agreements. This approach has changed internationally with the introduction of the Open Skies policies of the United States in the early 1990s which coincided with the intra-EU liberalisation programme. Both the US and the completion of the EU internal air transport market have dramatically changed market entry and market behaviour.

57. Latin American states have established regional initiatives designed to gradually open up air transport markets, basically as between them. However, the institutional mechanisms required for giving these initiatives an external dimension are missing. These Latin American regional air transport arrangements have yet to be fully implemented. Instead they co-exist alongside bilateral agreements. Both the level of integration and the application of the provisions appear somewhat perfunctory. Furthermore, some states participate in more than one regional union.

58. In 2010 and 2011, Brazil concluded a ground – or air – breaking liberal air transport agreements with the US, the EU and its Member States, and Canada. How these liberalised markets will be aligned with Mercosur, for instance, in which Brazil participates remains to be seen. It exemplifies perhaps that at the policy level, countries operate unilaterally regardless of provisions in regional agreements.

59. There is talk of creating an Open Latin American Sky (OLAS) by combining the Mercosur and Andean arrangements. One of the advantages of such a multilateral regime would be the facilitation of market entry through enlarged cross border financing.²⁹ This idea would have to be underpinned by the establishment of a supranational body supervising the implementation, application and enforcement of the open skies or open market provisions. The question is whether such a step fits with the internal and external developments referred to above.

60. Perhaps more importantly, the operators, that is, the airlines, are finding their own ways into air transport markets. This phenomenon is exemplified by the merger activities of Chile's LAN, which is unique, for its success in increasing its market position through an innovative cross border strategy creating the LAN Group. These actions and the emergence of liberalised markets in certain Latin American countries lead to the question of how to maintain competitive conditions in open market situations.

2. Competition in the air transport sector

2.1 Airline behaviour affecting competition

61. With the exception of the supra-national regime of the EU, competition law regimes are organised on a national basis. The WTO framework which includes rules on subsidies granted by foreign states affecting international trade does not apply to the operation of air transport services. The exceptions have been identified above.

62. Government behaviour, including state aid, the granting of antitrust immunity, airline taxation, and foreign ownership and control limitations may also affect airline competition, but such behaviour is connected with the broader subject of trade policy and economic regulation. This paper argues that state

²⁹ See, Antonio Bosch and José G. Montalvo, *Free and Non-discriminatory Access to Airports: A Proposal for Latin America*, available at: www.econ.upf.edu/~montalvo/wp/ijte_iadb.doc

assistance to airlines, whether direct or indirect may be deemed to distort the market and to be detrimental to airlines and users. Likewise, arguments can be made for the reduction of limitations on foreign ownership of airlines as air transport development should be determined by economic and technical considerations and not by questions of national pride and national ownership.

63. For the present purpose, the following distinction is made with regard to airline behaviour:

- Co-operation, horizontal and cartel agreements, including inter-airline alliances (2.1.1);
- Unilateral conduct involving the abuse of dominance (2.1.2);
- Mergers (2.1.3).

2.1.1 Co-operation agreements

64. Co-operation agreements, designed to achieve fleet rationalization and network efficiencies, are widespread among airlines and are used as an instrument of cost reduction and risk spreading.

65. Cooperation between airlines can include the following practices:

- Consultation on and coordination of tariffs;
- Joint operations, including pooling of services and capacity;
- Interline agreements;
- Route planning;
- Fleet rationalization, including code sharing;
- Blocked space agreements and other mechanisms;
- Coordination of schedules;
- Joined frequent flyer programs;
- Franchising;
- Computerized reservation systems (crss).

66. A number of these coordinated and concerted activities, including joint planning and coordination of airline schedules; tariff consultations; joint operations on new less busy scheduled services; slot allocation and common purchase, as well as the development and operation of Computerised Reservation Systems, were exempted under the EU competition regime. In the US, the Department of Transportation (DoT) has determined that otherwise-prohibited activities of airlines which would reduce competition on air services to and from the US are nonetheless in the public interest and have sufficient transport benefits such that they can be excluded from the application of anti-trust laws. In such cases, DoT may grant Anti Trust Immunity (ATI) as to which see further below.³⁰

67. The above co-operation agreements may take the form of and go as far as the formation of an inter-airline alliance. Alliances are not legally defined. The term is used to identify a more intensive and widespread co-operation agreement between airlines, designed to combine scale and scope.

³⁰ See sub section 2.3.1, below.

68. An airline which engages in an alliance can benefit from the advantages resulting from the number of routes served in combination with other carriers. The ability to implement such economies of *scope* depends on a number of factors. A determining factor will be the competition which the foreign carrier faces in the direct international markets concerned. The scale and scope of airline alliances have increased dramatically the past few years. *Scale* refers to the number of airlines participating in the airline alliance. *Scope* pertains to the freedom granted by the competent authorities to the alliance partners, allowing them to integrate their activities, including co-ordinated marketing, scheduling and pricing and to create synergies across their activities. Scope may be affected by the approval that the airline alliance receives from the competent competition authority.³¹

69. In the course of the 1990s and in the first decade of the 21st century various (transatlantic) alliances have been formed. However, evidence indicates that their composition may change rapidly.

70. Inter-airline alliances have broadened and deepened. The European Commission-US DoT report of November 2010 identifies this process as follows:³²

“This form of cooperation is effectively a close substitute to a merger because it typically involves full coordination of the major airline functions on the affected routes, including scheduling, pricing, revenue management, marketing and sales.”

71. Support for these arrangements by competition authorities may open markets and reduce “economic nationalism”. It may also foster the formation of cross-border or even transnational airlines. The Latin American aviation market as illustrated by the ventures set up by the LAN group fits this picture (see further below).

2.1.2 Abuse of dominance

72. Conduct involving abuses of dominance must also be addressed by competition authorities. Obviously, many airlines, especially flag carriers, inherited dominant positions from former regulatory and policy regimes. Dominance may lead to monopolization by the dominant carrier and predatory behaviour. Predatory behaviour may occur in scheduling, pricing, capacity dumping, and Computerised Reservation Systems (CRSs). The grant of exemptions, as opposed to horizontal or cartel like arrangements, is not possible.

2.1.3 Mergers

2.1.3.1 The emergence of cross border mergers

73. Rationalisation of inter-airline operations became necessary after liberalisation increased competition first at the domestic level and then at the international level. Rationalisation can take different forms, ranging from use of aircraft by the partner airline through code share agreements to alliances (see above) and mergers in various forms including take-overs. Rationalisation produces benefits pertaining to economies of scale and scope for the participating airlines. Benefits related to scale depend on the number of participating carriers in one of the remaining world-wide alliances: Skyteam, oneworld and the Star Alliance.

74. International mergers and take-overs are not easy to realise due to nationality requirements for market entry which relates to substantial ownership and effective control, as established by bilateral air

³¹ See, Volodymyr Bilotkach and Kai Hüscherlath, *Airline Alliances, Antitrust Immunity and Efficiencies* (June 2010).

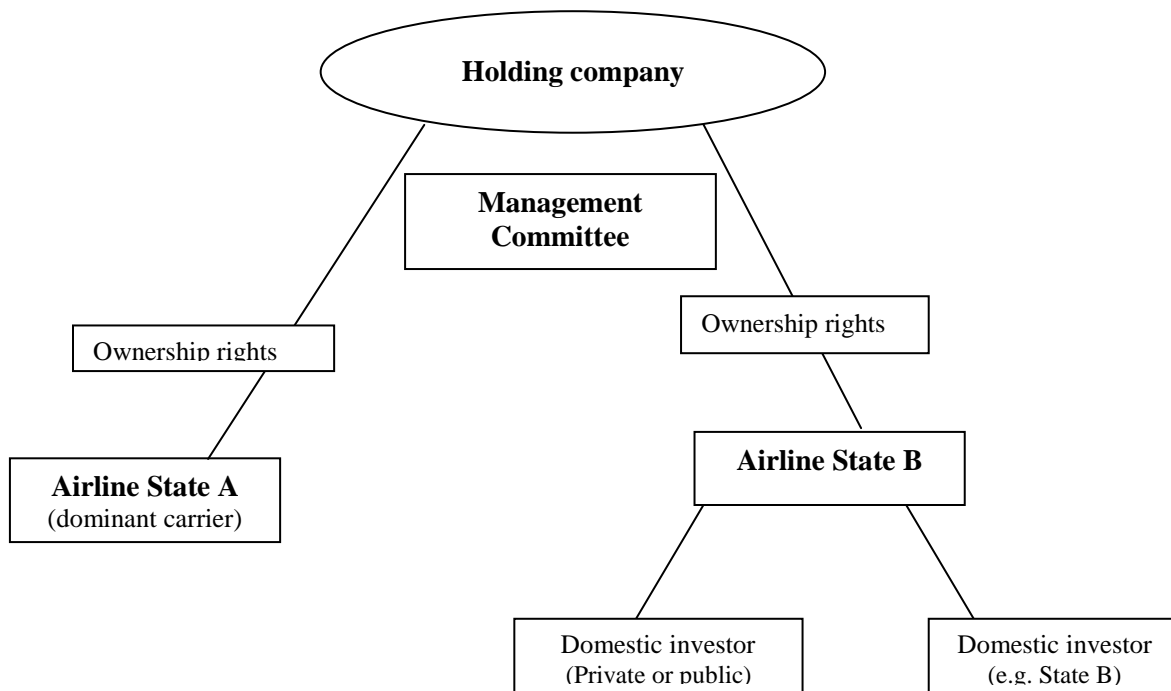
³² *Transatlantic Airline Alliances: Competitive Issues and Regulatory Approaches*, A Report by the European Commission and the United States Department of Transportation, 16 November 2010 (Par. 24).

services agreements and national legislation. This is now changing, as was first evidenced at the intra-EU level. The Air France-KLM merger was the first of a number of other cross border intra-EU mergers, including Lufthansa-Swiss, Lufthansa Austrian Airlines, Lufthansa-Brussels Airlines, and British Airways-Iberia.

2.1.3.2 *The international merger model*

75. Cross border mergers are facilitated by international regulatory developments, including those in the EU, and internationally those relating to the liberalised Open Skies markets. The introduction of the EU air carrier clause into bilateral air services agreements facilitates the designation of carriers which are part of a merged entity.

76. Due to the existence of regulatory constraints in certain markets including EU-Latin American markets, but excluding, of course, the EU-Brazil market (as to which see above), the intra-EU mergers have followed a similar pattern which can be best illustrated by the following model. If there is no equivalence between the two airlines in terms of participation to the merger, one airline may be dominant in relation to the other in which case the merger may have the effect of a take-over. This depends of course on the circumstances of the transaction.



77. In international mergers, the airline's operational activities such as the performance of air services, maintenance of aircraft and the operation of ground handling services may still be carried out on the "Airline A or B" level. This model must secure the preservation of traffic rights of the airlines which account for about 80 % of the revenues of the airline. The holding company supervises the operations through a management committee and holds the shares of the airlines as agreed upon in the transaction. Enhanced synergies can only be created when more or all nationality barriers as referred to above have been lifted.

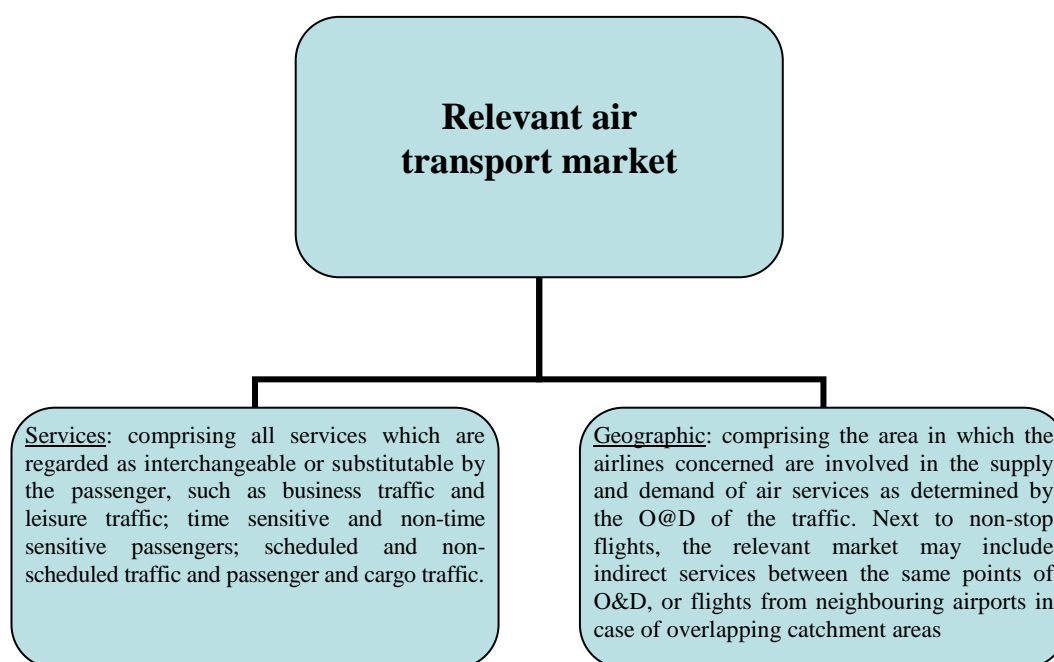
2.2 *Market definition*

2.2.1 *The relevant market*

78. Depending on the regulatory environment, airline behaviour may take place in a *market*. Where it does so, a key element in identifying whether airline behaviour will give rise to competition concerns is the definition of the relevant market

79. The concept of “relevant market” can be divided into two markets:

- The relevant product or, in this case, services market
- The relevant geographic market.



O&D: Origin and Destination of the traffic

80. The European Commission approaches the geographical air transport market by examining whether the alternative, competitive carrier operates services on other O&D city pairs of a similar size and characteristics, and possesses equipment to operate such services.³³ The O&D approach is also adopted by national competition authorities.³⁴ Overlaps between non-stop services, between non-stop and indirect services as well as between indirect services are dealt with depending on the facts of the case.

³³ See, for instance, EC Commission, Case COMP. 37.730 - *Lufthansa/Austrian Airlines*, at para. 53, at: http://europa.eu.int/eur-lex/pri/en/oj/dat/2002/l_242/l_24220020910en00250043.pdf; EC Commission case COMP/38.284 *Air France/Alitalia* (2004), at: http://ec.europa.eu/competition/antitrust/cases/dec_docs/38284/38284_104_1.pdf

³⁴ See for instance the German competition authority (*Bundeskartellamt*), case B 9 – 147/00 - *Lufthansa/Eurowings*, decision of 19.09.2001, at: http://www.bundeskartellamt.de/wDeutsch/download/pdf/Fusion/Fusion01/B9_147_00.pdf, and: Office of Fair Trading (OFT), case CP/1535-01 – *British Midland/United Airlines*, at:

81. The competitive impact of a transaction is determined by reference to the presence or the likelihood of market entry by competing airlines on the O&D city pair in question. A carrier may be regarded as a potential competitor on an O&D pair if that pair is directly linked to one of its hubs or when the amount of traffic is large enough to underpin the operation of a non-stop service. Indirect flights and other modes of transport may or may not form realistic and viable alternatives for non-stop flights.

82. To answer the above question requires an examination of the facts including analysis of the traffic, that is, passenger and/or cargo; time sensitive and non-time sensitive passengers; the distance between the airports and the presence of alternative modes of transport. The distinction between time sensitive and non-time sensitive is, generally, more relevant for short flights than for long haul flights.

83. Substitutability between air transport services and services operated by other carriers may be taken into account in the context of the assessment of the relevant services market. For instance, depending on distance in the relevant geographical markets and other competitive conditions, High Speed Trains may form a viable alternative for air services. In the Olympic Air/Aegean Airlines decision of the European Commission (2011),³⁵ it was held that ferry services between Athens and Greek islands did not constitute a sufficiently close substitute to air services.

2.2.2 Barriers to entry

84. Market entry and market presence is not only dependent on the existence of a sufficient amount of traffic and the availability of equipment to carry that traffic (see above) but also on the presence of entry barriers. These market entry barriers may result from congestion, which can give rise to slot allocation regimes to regulate air traffic at congested airports. Hence, liberalisation of air transport and introduction of market principles in this sector must be accompanied by transparent market access conditions.

85. Barriers to market entry hindering effective airline competition include the following:

- The development of *hub and spoke operations*, enabling hub carriers to channel traffic through hub airports rather than competing on a route-by-route basis. Hub carriers possess dominant positions at those hub airports and the areas around it. This position divides the market into segments reducing and eliminating competition. In the US, hub and spoke systems emerged after deregulation whereas flag carriers in other countries occupy 'historical hubs' in their capitals which they inherited from their favoured position as explained in section 1. Examples are commonplace: Aerolíneas Argentinas in Buenos Aires; Aeroméxico in Mexico City; Japan Airlines in Tokyo and so on.
- The airline market is *less contestable* than expected despite US deregulation. The response to deregulation in some cases was to make routes less contestable, with incumbent hub carriers reducing fares and/or increasing capacity so as to drive new entrants out of the market.³⁶

www.ofc.gov.uk/Business/Legal+Powers/United+Airlines+and+British+Midland+Alliance+Expansion+Agreement.htm.

³⁵ See, Press Release IP/11/68 of 26 January 2011, *Commission blocks proposed merger between Aegean Airlines and Olympic Air*, at: <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/11/68>

³⁶ See, for instance, O. Shy, *The economics of network industries* (2001) and D.W. Caves, L.R. Christensen and M.W. Trethewey, *Economies of density versus economies of scale: Why trunk and local airline services differ*, 15 *Rand Journal of Economics* 471-489 (1984).

- *Consolidation* has also contributed to dominance and barriers to entry. Competition authorities can impose and monitor remedies to deal with the competition resulting from the creation of these alliances.
- *Frequent Flyer Programmes* are an integral part of the marketing strategies of the network airlines. FFPs offer discounts and free services to loyal passengers. They are designed to enhance the loyalty of passengers by binding them to one airline or one alliance. FFP's have not yet been subject to antitrust procedures in the US. The European Commission has dealt with four cases involving co-operation between airlines in FFPs. The European Commission attempts to remedy this practice by dictating that any other airline providing or wishing to provide services on the routes in question and which did not have an FFP should be afforded the opportunity to take part in the FFP.³⁷
- *Slot allocation regimes* are said to favour incumbent carriers and restrict market entry, for instance through 'grandfather' and 'use it or lose it' rules (see below). In short, incumbent carriers stick to the possession of their slots. Competition concerns can arise where hub carriers dominate slot holdings at an airport, assuming no effective competition from other hubs or nearby airports. These hub carriers are able offer more frequent services to a wider range of destinations and to achieve higher margins in downstream markets than would be possible under more rigorous competition. Furthermore, hub carriers may use slots inefficiently to limit competition on downstream services; they may acquire more slots to consolidate their positions and/or refuse to sell slots to strong rivals. A report prepared by the UK's Office of Fair Trading and the Civil Aviation Authority, concluded that the ability of EU competition law provisions to address these concerns is limited.³⁸ Sector specific regulation is required.³⁹ European Commission An OECD-Mexico Federal Competition Commission study on slot allocation in Mexico (see box below) indicated that provisions in the slot allocation schemes favour incumbent carriers. In the same vein as the OFT, the OECD-Mexico study suggests that remedies may have to be found in the applicable slot regulation rather than the competition law regime.
- *Vertical integration between ground handling service provider and airline* may also pose obstacles for market entry and price dominance of the airline. The smaller airlines are, or may be, obliged to purchase the provision of ground handling services from the incumbent, dominant airline providing such services. More discussion follows in sub-section 2.5.2, below.
- Other factors impeding market entry concern restrictions with respect to: access to *Computerised Reservation Systems* (CRSs) operated by an incumbent carrier which is now regulated in the US and the EU⁴⁰; the *IATA interlining system* (see below) through which global, mostly incumbent airlines, discuss pricing of services on interline flights and the

³⁷ See, Commission Decision of 16 January 1996 in *SAS/Lufthansa*; Commission Decision of 13 September 1991 in *Delta/PanAm*; Commission Decision of 11 December 1992 in *British Airways/TAT* and Commission Decision of 5 October 1992 in *Air France/Sabena*.

³⁸ See, UK Office of Fair Trading, *Competition issues associated with the trading of airport slots*, A paper prepared for DG TREN by the UK Office of Fair Trading and the Civil Aviation Authority 10-17 (2005) available at: www.caa.co.uk/docs/589/oft832.pdf.

³⁹ The European Commission is preparing a new slot allocation regulation. It is not yet clear to what extent these concerns will be addressed.

⁴⁰ See the case quoted in footnote 122, below.

practice of which is more or less outlawed in the US and the EU⁴¹; and *agreements between incumbent carriers and travel agents*, where agreements may give rise to actions on the abuse of dominant position by the incumbent carrier.⁴²

Entry barriers and congestion in Mexico air transport sector

The OECD-CFC study concluded that congestion at Mexico City airport resulted into tariffs which are between 40 to 80 percent higher when compared to other routes in the country. The study also found that prices significantly decrease when a low cost carrier enters the market. Reportedly, the high prices on certain routes related to Mexico City airport are due to predatory pricing by incumbent carriers and a slot allocation scheme favouring those incumbent carriers by, among others, awarding ‘grand father’ rights to those carriers and maintaining the “use it or lose it” rule.

The study calls for a more transparent and unbiased slot allocation system. It also highlights the entry barriers, resulting from the methodology for calculating airport charges which do not favour new entrants, and the high exit barriers imposed by previous political administrations.⁴³

2.3 Air transport cases in selected jurisdictions

2.3.1 The US

2.3.1.1 Regulatory and institutional framework

86. The principal antitrust laws in the US are the Sherman Act⁴⁴ and the Clayton Act,⁴⁵ supplemented by sector specific competition rules. The Sherman Act prohibits all agreements, combinations and conspiracies that unreasonably restrain trade. Such prohibited practices include price fixing, allocation of markets and customers, pursuant to which competing airlines divide markets among themselves by allocating passengers, services or geographical areas. Monopolisation and attempts to monopolise markets are also forbidden under the Act. The Clayton Act primarily envisages controlling anti-competitive mergers and acquisitions.

87. The Federal Aviation Act contains competition provisions which are exclusive to the air transport sector. Under this Act, the Department of Transport has the power to allow an “unfair or deceptive practice or unfair method of competition” both domestically and internationally, if it opines that such an assessment would be in the public interest. Hence, illegal competitive acts may be legalised by DoT, under terms and

⁴¹ See sub-section 2.3.2, below.

⁴² For instance, in the early 1990s British Airways introduced a variable additional commission which applied when its travel agents increased their sales of its tickets above a certain level over a specified period. The additional commission was structured to apply to all ticket sales made in the relevant period, not only those above the threshold at which the additional commission was triggered. Upon a complaint from Virgin Atlantic, the ECJ found that the additional commission scheme had the effect of making it even less likely that agents would choose to sell non-British Airways tickets in the knowledge that their income would be lower than if they sought to sell as many British Airways tickets as possible. See, *British Airways plc v. Commission of the European Communities*, Judgement of 17 December 2003 in Case T-219/99.

⁴³ OECD-CFC, *A Competition Policy Assessment of the Domestic Airline Sector in Mexico and Recommendations to Improve Competition* (Agustin Ros 2010), <http://www.oecd.org/dataoecd/31/56/45049588.pdf>

⁴⁴ Dated 2 July 1890; 15 U.S.C. § 1.

⁴⁵ Public Law 63-212, 38 Stat. 730 of 15 October 1914.

conditions laid down by the agency. The DoT also is entitled to draw up and publish regulations under this Act, regulating the display of code sharing agreements in Computerised Reservation Systems (CRSs).

88. The US has consistently applied its antitrust laws to airlines, and even more so since airline deregulation:

*“Although the airline industry has been deregulated, this does not mean that there are no limits to competitive practices. As in the case with all industry, carriers must not engage in practices which would destroy the framework under which fair competition operates.”*⁴⁶

89. Whereas the Department of Justice (DoJ) is the governmental authority responsible for ensuring compliance with antitrust laws on matters involving international aviation, the Department of Transportation (DoT) has the power to grant antitrust immunity for international alliances. Neither the US Federal Trade Commission nor authorities of individual US states are empowered to enforce the competition law regime in the air transport sector.⁴⁷

90. While domestic fares declined by 35 percent between 1978 and the mid 1990s,⁴⁸ concerns have been expressed about potentially anticompetitive practices, including exclusionary behaviour, by large network carriers, especially on their hubs. New entrants experienced difficulty starting operations from a key hub. Perceived causes include the higher frequencies of the dominant hub carrier, dominance of CRS operators, frequent flyer programmes applied by the hub carriers, travel commission bonuses, lack of slots and lack of available terminal space.

91. The competent competition authorities have attempted to address these concerns through enforcement actions. For instance, the DoJ approved the Northwest/Continental/ Delta Marketing alliance with conditions.⁴⁹ Those relate to the prohibition of collusion on fares and the use of shared codes when they offer competing non-stop services, such as services between their respective hubs. Carriers are also required to act independently when setting awards or other frequent flyer programme and when they compete for corporate contracts. The DoJ expected the alliance to result in lower fares for passengers.

92. The DoT, on the other hand, must weigh the potential efficiencies or benefits before it can grant antitrust immunity (ATI). Thus, if DoT approves an alliance and grants ATI, the agency makes detailed findings on the record about the potential public benefits and/or efficiencies. It is important to assess the magnitude of these benefits and efficiencies, as well as the likelihood that they will be achieved, in order to justify an exemption from the antitrust laws. Consistent with its case precedent, the DoT requires applicants to demonstrate that the alliance is likely to produce substantial public benefits that are attributable to the grant of ATI.⁵⁰

⁴⁶ House Report 98-793 reporting out the CAB (Civil Aeronautics Board, predecessor of the DoT) Sunset Act of 1984.

⁴⁷ See, Katten Muchin Rosenman LLP, John Balfour (Editor), *Air Transport in 34 Jurisdictions Worldwide* 193 (2009)

⁴⁸ See, U.S. Department of Transportation, *Competition in the U.S. Domestic Airline Industry: The Need for a Policy to Prevent Unfair Practices* (1997)

⁴⁹ See, *Department of Justice Approves Northwest/Continental/Delta Marketing Alliance*, Statement of 17 January 2003

⁵⁰ *Transatlantic Airline Alliances: Competitive Issues and Regulatory Approaches*, A Report by the European Commission and the United States Department of Transportation, 16 November 2010 (Par. 93-97).

2.3.1.2 *The relationship between antitrust immunity in international alliances and Open Skies agreements*

93. The link between the conduct of a bilateral aviation policy and competition policy can be best illustrated by the instrument of antitrust immunity (ATI) used by the US. The Netherlands, Germany, France and other European countries concluded Open Skies agreements in the 1990s with the US. These Open Skies agreements would not have been attractive without the grant of antitrust immunity to the alliances, for instance, KLM/Northwest (KL/NW) or United Airlines/Lufthansa flying under the Open Skies agreements.

2.3.1.3 *The approval of international airline alliances*

94. The three current mega global alliances are the Star Alliance centred on United Airlines and Lufthansa, Skyteam with Delta and Air France-KLM as leaders, and oneworld set up by American Airlines and British Airways, now British Airways-Iberia.

95. In July 2010, the DoT approved the closer coordination of international services by American Airlines, British Airways, Iberia Airlines, Finnair and Royal Jordanian Airlines.⁵¹ The DoT found that the oneworld alliance agreement was beneficial for passengers and shippers because of the provision of lower fares in specified markets, the introduction of new routes, improved services and better schedules. Significantly, the ATI would enable the oneworld alliance to compete more effectively with Skyteam and Star Alliance.

96. In 2009, the DoT granted final approval for Continental's inclusion in the Star Alliance.⁵² The alliance partners jointly arrange capacity, sales and marketing and share revenues from their joint operations in international markets. The extended alliance is expected to contribute to the increase of the level of passenger service and travel options and the reduction of fares. However, the DoT carved out certain routes from the approval due to concerns that competition on these routes would be too limited. Mention was made of routes between the US and Canada, the US and Beijing and certain transatlantic routes.⁵³

97. In 2008, the US DoT announced a grant of transatlantic antitrust immunity to Skyteam partners Delta Air Lines, Northwest Airlines, Air France, CSA Czech Airlines, Alitalia and KLM.⁵⁴ This alliance was built on the original Skyteam alliance created by Air France and Delta, and the highly integrated Wings alliance formed by KLM and Northwest.

98. The Skyteam partners claimed that their joint venture would:

- Expand non-stop flights, including hub to hub and hub to spoke services;
- Improve online service options by enhancing elapsed travel times, additional flexible routings and a more efficient use of hub networks;

⁵¹ See: <http://aviationblog.dallasnews.com/archives/2010/07/dot-approves-alliance-antitrust.html>.

⁵² See: <http://www.centreforaviation.com/news/2009/07/13/continental-can-join-star-alliance-dot-global-alliances-and-the-demise-of-the-us-airline-industry/page1>.

⁵³ See, DoT Press Release 100-09 of 10 July 2009.

⁵⁴ OST-2007-28644 - *SkyTeam* - Antitrust Immunity, at: <http://www.airlineinfo.com/Sites/DailyAirline/web-content/ostdocket2007/ost0728644.html>

- Eliminate inherent pricing inefficiencies while enabling carriers to offer more attractive fares to passengers;
- Reduce costs through joint marketing and distribution, procurement, development and coordination of accounting and information systems and data.⁵⁵

99. The six airlines are allowed to coordinate their transatlantic fares, services and capacity as if they were a single carrier in these markets, subject to certain conditions. Those conditions pertain to the applicability of antitrust laws to domestic transportation and international transportation that is beyond the scope of the alliance agreement. Secondly, certain transatlantic routes (Paris-Atlanta and Paris-Cincinnati) are carved out for the purposes of coordinating fares there for business travellers. The third condition states that the joint venture should be implemented within 18 months. The DoT took into account the conclusion of the EU-US Open Skies Agreement.

100. The Skyteam airlines introduced the concept of “metal neutrality” establishing in-depth cooperation amounting to quasi merger. It no longer matters which airline carries the passenger as the airlines involved have entered into long term joint ventures for sharing both revenues and costs.

101. Metal neutrality has become a *condition sine qua non* for antitrust immunity alongside the existence of an Open Skies agreement. These far-reaching joint ventures enable the efficiencies produced by the alliance to be realised. Each carrier’s incentive to behave opportunistically by enhancing its own short term financial benefit at the expense of the efficiencies delivered by the alliance as a whole is removed. Consequently, the alliance amounts to a quasi merger.

2.3.1.4 US Mergers

102. Mergers are also covered by the Clayton Act (see above). The Federal Trade Commission and the Department of Justice review the competitive conditions on the relevant markets. Under the Act, the airlines must notify the DoJ and the Federal Trade Commission of their plans to merge and submit to a full merger analysis. Though federal law provides the DoJ with considerable discretion in carrying out its merger analysis, since 1968 the DoJ (jointly with the FTC) has issued a series of “Horizontal Merger Guidelines” which set out the criteria that the agencies will use to determine whether a planned merger complies with US antitrust law. These Guidelines have undergone numerous revisions (the most recent of which took place in 2010, as to which see below) to reflect changes in economic/policy orientations.

103. The Merger Guidelines are based on the following basic approach towards mergers:

- The definition of the relevant market and analysis of the level of concentration⁵⁶ ;
- The analysis of potential anti-competitive effects of the proposed merger;
- The analysis of entry and its effect on the competitive concerns;
- The analysis of efficiencies generated by the proposed merger;
- The analysis of possibility that one of the firms would exit the market but for the transaction.

⁵⁵ See, DoT-OST-2007-28644 (Final Order); Order 2008-5-32 of 22 May 2008.

⁵⁶ The assessment of market concentration largely relies on the Herfindahl-Hirschman Index (“HHI”). The HHI is calculated by summing the squares of the individual market shares of all the participants. It reflects both the distribution of the market shares of the top four firms and the composition of the market outside the four firms. It also gives proportionately greater weight to the market shares of the larger firms, in accord with their relative importance in competitive interactions.

104. The 2010 revision of the Merger Guidelines called for “vigorous antitrust enforcement in tough economic times”. They have been criticized for moving away from relying on objective economic criteria to a more impressionistic, “case specific” analysis. However, despite some early concerns, the new Guidelines did not prevent the DoJ from clearing the Continental/United merger.⁵⁷

105. The basic philosophy of US merger review is that mergers generating benefits for consumers will not be opposed. Nevertheless there is still a bias against mergers as supposed to internal growth.⁵⁸ That said, the DoJ has been sensitive to the efficiencies that airline mergers can create and the positive network externalities they (typically) yield. Nonetheless, in instances where the networks of the two merger airlines are not “end on end” (i.e. complementary route networks) but rather “overlapping route networks,” the DoJ has been less lenient.

106. For example, the DoJ has twice blocked the United Airlines/US Airways merger plans because of too much network overlap.⁵⁹ On the other hand, it cleared the merger between United Airlines and Continental Airlines as the two airlines have largely complementary network, whereas they had entered into arrangements with a “new entrant” (South west Airlines) on overlapping routes where competition was reduced or excluded. As part of the clearance process, the two airlines agreed to transfer takeoff and landing rights (slots) and other assets at Newark Liberty Airport to Southwest Airlines Co.⁶⁰

2.3.2 *The EU*

2.3.2.1 *Regulatory framework*

107. Since the abolition of certain block exemptions for the benefit of the air transport sector,⁶¹ that is, exemptions for IATA traffic consultations⁶² and consultations on airport slot allocation, the air transport sector is fully subject to the general EU rules on competition. IATA has worked out a new interlining system replacing the passenger tariff conferences. The new system is based on Flex fares, which are the average published fares plus interline provision,⁶³ and e-tariffs made via internet. As to the exemption on slot allocation, the European Commission found that consultations on slot allocation are not anti-competitive and hence do not need an exemption. Before the entry into force of EU Regulation 1/2003, firms, including airlines, were entitled to apply for individual exemptions. However, since 1 May 2004 this is no longer possible and firms must conduct a self-assessment of their own practices to determine their compliance with EU competition law.⁶⁴

⁵⁷ See: <http://lawprofessors.typepad.com/aviation/2010/08/doj-antitrust-division-clears-continentalunited-merger.html>

⁵⁸ See, Prof. Piet Jan Slot, *Synopsis US Antitrust Law*, Reader Leiden University, 2010

⁵⁹ See: <http://www.justice.gov/opa/pr/2001/July/361at.htm>

⁶⁰ See: <http://www.justice.gov/opa/pr/2010/August/10-at-974.html>

⁶¹ Block exemptions are exemptions from the application of competition rules of specified activities for the benefit of sector, or group of undertakings.

⁶² This block exemption entitled airlines to consult on pricing in the context of the establishment of interlining.

⁶³ Interline refers to the use of one ticket for two or more services operated by different airlines, facilitating international air line connections. For instance a passengers books an interline ticket when s/he buys a ticket London-Jakarta via Bangkok whereby the London-Bangkok service is operated by British Airways and the connecting service Bangkok-Jakarta is operated by Thai Airways.

⁶⁴ See Article 2 of Regulation 1/2003, dictating that the undertaking or association claiming exemptions from the competition regime shall bear the burden of proof.

108. EU Council Regulation 487/2009 on the application of Article 101(3) of the TFEU⁶⁵ to certain categories of agreements and concerted practices in the air transport sector is the only air transport specific regulation still in place. It empowers the European Commission to exempt specified practices from the scope of Article 101 TFEU on the prohibition of concerted practices with special reference to:

- Joint planning and coordination of airline schedules;
- Consultations on tariffs for the carriage of passengers and baggage and of freight on scheduled air services;
- Joint operations on new, less busy scheduled air services;
- Slot allocation at airports and airport scheduling;
- Joint purchase, development and operation of computer reservation systems relating to timetabling, reservations and ticketing by air transport undertakings.

109. As of 2011, the European Commission has not adopted any specific exemption. There are no indications that it intends to do so in the future. Hence, the operation of air services is fully subject to the general competition law regime of the EU.

110. Practices which have been considered to be anti-competitive by the European Commission in its enforcement practice are the following:

- Revenue sharing;
- Capacity or frequency sharing;
- Market sharing;
- Concerted practices on pricing including the exchange of sensitive information, except possibly in the context of alliances and joint ventures for new and/or the so-called “thin routes”, i.e. routes with relatively low traffic volumes.

111. Pursuant to the practice of the European Commission, technical arrangements on maintenance of aircraft, aircraft and engine leasing or pooling, as well as operational arrangements including but not limited to interlining, successive carriage agreements and clearing house arrangements are permitted. Depending on the circumstances of the case, such as the effects on pricing, code sharing and blocked space agreements may or may not be allowed. The same is true for joint ventures which may be justified for the operation of new or thin routes.

2.3.2.2 *The external competence of the European Commission in air transport cases*

112. The question of the European Commission’s external competence on airline competition has now been resolved on the EU regulatory level by the establishment of the above EU Regulation 1/2003 as amended by EU Regulation 411/2004 extending the EU competition rules to air transport between the EU and third countries. As a result, the European Commission has enforcement powers concerning air services between points in the EU and points outside the EU. To that effect, the European Commission may have to

⁶⁵ The Treaty on the Functioning of the EU (TFEU) entered into force on 1 December 2009 and changed the numbering of the Treaty provisions: the previous articles 81 on horizontal, or cartel like anti-competitive agreements between undertakings and 82 on the abuse of dominant positions were renumbered 101 and 102.

rely on the “effect doctrine” pursuant to which it may decide on practices or agreements outside the EU with an effect on the EU air transport market. European Commission

113. Similarly, the Brazilian competition law applies to anti-competitive acts producing effects in the Brazilian territory.⁶⁶

2.3.2.3 *The emergence and approval of international airline alliances*

114. Since 1995, the European Commission has reviewed airline alliances which have been set up by the major EU airlines (e.g. Lufthansa, Air France, British Airways and KLM). The European Commission has analysed these alliances and defined relevant markets using various tests, such as the substitutability of routes and modes of transport, and the time sensitivity of the passengers. Also, it has assessed if these airlines enjoyed dominance on the markets so defined in the above cases.

115. In general, airline alliances have been approved as the European Commission wishes to strengthen the European airline sector in a global context by supporting intra-EU consolidation. However, approval has been granted subject to conditions. Those conditions, or remedies, generally pertain to the surrender of slots, the freezing or reducing of capacity on the relevant markets and the allowance of access to interlining and to the Frequent Flyer Programmes (FFP) to competitors.⁶⁷ The European Commission’s examination of the Skyteam alliance⁶⁸ and the Star Alliance are on-going.⁶⁹ The US authorities have already taken a position in these cases⁷⁰.

116. In 2010, the European Commission announced that it had made legally binding commitments offered by British Airways (BA), American Airlines (AA) and Iberia (IB), three members of the oneworld airline alliance. These commitments were offered in response to the Commission’s concerns that the planned joint venture between BA, AA and IB may have been in breach of EU competition rules and harmed consumers on transatlantic routes. Under the commitments, the parties offered to make landing and take-off slots available at London Heathrow airport to facilitate the entry or expansion of competitors on routes between London and New York, Boston, Dallas and Miami. After market testing the proposed commitments, the Commission concluded that they were suitable to remedy the competition concerns and closed its investigation.⁷¹

⁶⁶ See Art. 2 of Law No. 8.884/94

⁶⁷ See: MEMO/06/243, 19 June 2006, at:
http://ec.europa.eu/competition/antitrust/cases/dec_docs/37984/37984_406_10.pdf

⁶⁸ See: Press release: Antitrust: Commission opens formal proceedings against certain members of Star and oneworld airline alliances, at:
<http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/09/168&format=HTML&aged=0&language>

⁶⁹ See, for instance, CASE COMP/F-1/39.596 - BA/AA/IB, at:
http://ec.europa.eu/competition/antitrust/cases/dec_docs/39596/39596_3244_14.pdf; partnership between Lufthansa and Austrian Airlines; see:
<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/02/1008&format=HTML&aged=0&language=EN&guiLanguage=en>

⁷⁰ See the previous section.

⁷¹ See European Commission’s Press Release of 14 July 2010.

2.3.2.4 *The fuel surcharge cases (2006 – 2011 and beyond)*

117. One of the most well known and most commented on case of enforcement of competition rules in the aviation sector is the EU and US investigations into the air cargo fuel surcharges. The European Commission and the US DoJ have closely cooperated in this matter.⁷²

118. EU and non-EU airlines, that is, Air Canada, Air France-KLM, British Airways, Cathay Pacific, Cargolux, Japan Airlines, LAN Chile, Lufthansa and Swiss, Martinair, SAS, Swiss, Singapore Airlines and Qantas were investigated for a worldwide cartel on the pricing of air cargo services. The European Commission started its investigations mid-February 2006, carrying out dawn raids at the head offices of the concerned airlines.

119. The Commission claimed that the carriers maintained contacts on the introduction and mechanism of the fuel charge, and that they informed each other when specified levels of the kerosene price had been reached in order to be sure that other carriers, depending on the evolution of the kerosene price, would increase or decrease their surcharge. As the carriers exchanged information on the subject, the surcharges were mostly established on the same level. However the Commission did not argue that the surcharges were commonly agreed upon. The Commission also put forward that the carriers kept in touch with respect to the security charges and that they agreed to refrain from paying commissions on the surcharges to the freight forwarders.

120. Under the EU leniency program, Lufthansa was the first airline to disclose its participation in the alleged cartel to the European Commission and as a consequence it received immunity from fines. Ten out of the eleven airlines were given a reduction of the fine for cooperation under the Commission's Leniency Programme.⁷³ Moreover, all carriers received a reduction of 15% "on account of the general regulatory environment in the sector which can be seen as encouraging price coordination."⁷⁴

121. The European Commission took its decision on 9 November 2010. It imposed fines on 11 airlines to a total amount of nearly €800 million for operating a worldwide cartel in the air cargo market. The arrangements were said to infringe Article 101 TFEU.⁷⁵

122. All airlines apart from Qantas airlines appealed the decision. The appealing airlines claimed that:⁷⁶

- the level of the fines was disproportionate to the relatively low profitability of the airline sector;

⁷² As to the DoJ case against, for instance, Air France, see: www.justice.gov/opa/documents/airfrance-case.pdf.

⁷³ Current version: see Commission's Notice on *Immunity from fines and reduction of fines in cartel cases*, Official Journal of the European Union C 298/17-23 (2006)

⁷⁴ See sub-section 1.2. The bilateral framework and the former role of IATA with respect to coordinating of tariffs and rates helped to create not only inter-government but also inter-airline discussions.

⁷⁵ Case COMP/39258 – *Airfreight* decision of 9 November 2010; IP/10/1487

⁷⁶ Case T-9/11 - *Air Canada v Commission*, Case T-28/11 - *Koninklijke Luchtvaart Maatschappij v Commission*, Case T-36/11 - *Japan Airlines v Commission*, Case T-38/11 - *Cathay Pacific Airways v Commission*, Case T-39/11 - *Cargolux Airlines v Commission*, Case T-40/11 - *Lan Airlines and Lan Cargo v Commission*, Case T-43/11 - *Singapore Airlines and Singapore Airlines Cargo PTE v Commission*, Case T-46/11 - *Deutsche Lufthansa and Others v Commission*, Case T-48/11 - *British Airways v Commission*, Case T-56/11 - *SAS Cargo Group and Others v Commission*, Case T-62/11 - *Air France - KLM v Commission*, Case T-63/11 - *Air France v Commission*, Case T-67/11 *Martinair Holland v Commission*. Appeals brought in January 2011 (*OJ 2011 C72/25, 30 and 32, OJ 2011 C80/25, 26, 27, 31 and 32, OJ 2011 C89/21 and 23 and OJ 2011 C95/8-10*).

- the European Commission’s decision infringed the principle of equal treatment in applying different standards of proof;
- the decision failed to correctly define the relevant market, and that it violated the principles of non-interference or comity between states;
- the European Commission exceeded its jurisdiction with respect to activities regulated and managed outside the EU jurisdiction⁷⁷;
- The decision infringed the principle of proportionality as it only reduced the fines by 15 % on account of the prevailing principles of cooperation in the established regulatory framework.

123. They also used other, procedural arguments.⁷⁸

124. Some airlines are seeking a partial reduction whereas others try to annul the decision. Next to the competition cases certain airlines are facing civil liability claims in national courts put forward by freight forwarders, shippers and other operators who are claiming damages as a result of the airlines’ actions. Those proceedings may include class actions before national courts.

125. Moreover, airline managers who have been involved with these cases may face, are facing and have faced imprisonment, especially in the US and the UK where there are criminal regimes for cartel offences. Also, the DoJ is currently conducting a criminal price fixing investigation of airlines involved in these cases. The investigation has resulted in 17 guilty pleas and over 1.6 US\$ billion in fines to date, the largest fine ever imposed in a single criminal antitrust investigation. Following the announcement of criminal investigations, purchasers of air cargo services filed antitrust class actions seeking treble damages from the airlines for price fixing.⁷⁹

2.3.2.5 Abuse of dominance

126. There is relatively little case law on this subject. In 1997, for example, KLM was accused of predatory pricing by easyJet. It claimed that KLM undercut its tariffs with the purpose of excluding it from the London-Amsterdam market.⁸⁰ The case was settled but there is no record of the settlement arrangements.

127. In the British Midland/Aer Lingus case, the European Commission found that Aer Lingus enjoyed considerable commercial strength in its home country whereas it accounts for a very high share of passengers and frequencies as compared to British Midland. Because of the scarce available of slots at London Heathrow, British Midland could not increase the frequency of its Dublin service rapidly without lowering the frequency of some of its other services. Therefore the European Commission concluded that Aer Lingus abused its dominant position in the relevant market and obliged it to interline with British Midland.⁸¹

⁷⁷ See the above comments on reliance on the “ effects doctrine”.

⁷⁸ That is, concerning the admissibility of the evidence; breach of the rights of defence and breach of the right of fair trial.

⁷⁹ See, Katten Muchin Rosenman LLP, *Air Transport in 40 Jurisdictions Worldwide* 247 (2011).

⁸⁰ See: <http://www.europolitics.info/competition-officials-probe-klm-s-pricing-practices-artr165217-20.html>.

⁸¹ Commission Decision 92/213 of 26 February 1992.

2.3.2.6 Examination of mergers by the European Commission

128. Under the Merger Regulation, which is designed to control concentrations (including those involving non-EU airlines but having a “Community dimension”)⁸² the European Commission has reviewed a number of airline mergers.

129. Since the adoption of the Merger Regulation, the European Commission has reviewed some 30 airline mergers. The first mergers were domestic mergers, including Air France/UTA and KLM/Transavia.⁸³ Air France/Sabena⁸⁴ and Swissair/Sabena⁸⁵ were the first international mergers. Meanwhile, these first international mergers have been dissolved. Other cross border mergers involved transactions in which the taken over airline only operated intra-EU flights. Consequently, its change in ownership following the takeover did not matter as bilateral air agreements with restrictive nationality requirements did not apply⁸⁶.

130. As said, the merger regulations also apply to mergers with a “Community dimension” between non-EU airlines. Thus, the European Commission has reviewed the United/USAir,⁸⁷ Delta/PanAm,⁸⁸ Singapore/Virgin,⁸⁹ and Swissair/South Africa⁹⁰ joint ventures under the EU regime. Significant cross border merger activity started to take place in the 21st century with the merger between Air France and KLM. It will be briefly analysed in the next section as a case study.

2.3.2.7 Remedies in competition cases

131. Remedies used by the European Commission in competition cases include the following:

- Slot divestiture at congested airports at one of the two or the two O&D airports;
- Freezing of capacity by the airlines which are subject to competition review;
- Price constraints so as to avoid predatory pricing;

⁸² See EU Regulation 139/2004. This regulation applies where there is an acquisition of control and the transaction meets specified thresholds in terms of turnover of the firms involved. Anticipated mergers must be notified to the European Commission which can either prevent them from being implemented or approve them with or without attaching conditions to the approval, that is, if the merger creates or strengthens a dominant position substantially impeding competition in the EU. Most cases are handled relatively rapidly, that is, within the statutory deadlines. The approval in terms of assessment of dominance on the relevant market is similar to that adopted in alliances cases. However, mergers are cleared rather than self assessed as they are under airline alliances cases.

⁸³ These cases have not been published.

⁸⁴ Case M. 157, at: http://ec.europa.eu/competition/mergers/cases/decisions/m157_fr.pdf.

⁸⁵ Non-opposition to a notified concentration under Art. 6(1)(b) of the Merger Control Regulation, OJ C200 of 4 August 1995 at 10.

⁸⁶ See for example the takeover of BA of the French domestic carrier TAT.

⁸⁷ Case M. 2041 at: http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=2_M_2041

⁸⁸ Case M. 130, at: http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=2_M_130

⁸⁹ Case M. 1855, at: http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=2_M_1855

⁹⁰ Case M. 1626, at: http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=2_M_1626

- Introduction of requirements on mandatory engagement into blocked space agreements and interlining with new entrant airlines;
- Access to Frequent Flyer Programmes and CRS by new entrant airlines or competitor airlines;
- Relaxation of limitations with respect to the performance of fifth and sixth freedom rights on services from within the EU to points outside the EU and *vice versa*.

132. Slot disposal by airlines engaged in an alliance, a merger or a takeover and slot allocation to new entrants are the most important remedies the European Commission uses in the competition law related cases. Whether or not slot related measures are appropriate and effective must be assessed on a case-by-case basis. As practice shows that slot divestiture has not always yielded the desired pro-competitive results, the European Commission seems to be willing to adopt a more interventionist role with respect to the implementation of such remedies.

The Air France-KLM merger as a case study⁹¹

In order to remedy potential anti-competitive effects of the transaction, the European Commission has developed a number of tools which are air transport specific. Those measures are designed to promote market entry by competing airlines in the relevant market, that is, the identified Origin and Destination (O&D) city pairs.

Air France and KLM set up a holding company, called Air France-KLM S.A. (*société anonyme*), absorbing KLM and Air France shares. The holding company's shares consisted of 81 percent of the former Air France shares, including the French state's shares and 19 percent of the former KLM shares. The holding company Air France-KLM is listed at the stock exchanges of Paris, Amsterdam and New York. Its principal place of business is located in Paris. This holding company Air France-KLM will hold two operating companies, namely, the national companies Air France and KLM.

The European Commission approved the merger, subject to a number of conditions. The Commission found that the airlines' networks were basically complementary. However, competition would be affected on fourteen routes on which the merging parties currently competed. Nine of those routes were intra-European,⁹² whereas five were inter-continental routes.⁹³ The European Commission discussed suitable remedies with the parties to overcome competition concerns on the overlapping routes and the two airlines committed to give up 94 slots per day, allowing up to 31 new return flights per day on the routes in question. Parties were required to give up slots for an unlimited period, which was a novelty as the surrender of the slots was in the past limited to a six-year period.

Other conditions for approval were the following:

- If the slots are misused or not used by a new entrant, they must be brought into the slot pool instead of being returned to Air France or KLM;
- The airlines agreed to freeze frequencies at the appearance of a new entrant on one of the problematic routes.
- A new entrant using slots thus obtained for the Amsterdam-Paris routes was allowed to use them for other routes once the High Speed train between the two cities became operational (as it now is).
- The airlines committed to enter into intermodal arrangements with surface transport operators (for instance, the High Speed train between Paris and Amsterdam permitting interlining between air and rail).

⁹¹ Case M. 3280, Press Release at: <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/04/194>

⁹² Namely, routes between Amsterdam and: - Paris; - Lyon; - Marseille; - Toulouse; - Bordeaux; - Rome; - Milan; - Venice; and - Bologna.

⁹³ Namely: Amsterdam-New York; Paris-Detroit; Amsterdam-Atlanta; Paris-Lagos and Amsterdam-Lagos.

- The Dutch and French governmental authorities were required to support the grant of fifth freedom traffic rights to other Community air carriers flying via Amsterdam or Paris to a destination outside the Community.
- The Dutch and French governmental authorities were not allowed to regulate pricing on long haul routes.

2.3.3 *Latin American merger activities: the LAN Group*

133. The Latin American market is special because of the activities in this respect of the LAN Group. This undertaking was created by merging with or taking over airlines in a number of Latin American states. Because of its structure, where one undertaking has taken over airlines in other countries in the broader region without the institutional and regulatory backing of a single jurisdiction, the LAN Group is more advanced than similar ventures in other parts of the world.

134. The acquisition of TAM (Brazil) by LAN (Chile) has raised competition concerns with respect fares and consumer choice generally. LAN guaranteed lower fares and more competition on relevant routes shared with TAM to get approval for the merger. Whereas the Brazilian Civil Aviation Authority approved the merger in March 2011, the Brazilian competition agency (CADE) has not yet done so; a decision is expected soon. The LAN-TAM merger is also structured in accordance with the above scheme but is not supported by the strong regulatory and institutional environment as shaped by the EU. This merger could be used as a benchmark for future Latin America airline merger developments.

135. Peru-based TACA is planning a merger with Avianca from Columbia. This merger is supposed to increase competition across South America with LAN, or LAN-TAM which may be called LATAM. The two big Latin American alliances already compete fiercely in Ecuador where LAN's daughter company offers services in the domestic market which was previously dominated by Avianca and its subsidiary.⁹⁴

2.4 *State aid*

2.4.1 *State aid in the air transport sector*

136. Due to the perceived public service character of air transport, state intervention has always played a relatively important role in the air transport sector. This applies to both airlines and airports which are, or at least were, often government owned and controlled undertakings. This makes airlines and airports, including Latin American airlines and airports, eligible for state aid or subsidies, although government ownership does not necessarily imply automatic subsidisation. Indeed, states can invest in undertakings following the market investor principle as to which see below.⁹⁵

137. The more market oriented approach towards the sector is changing the attitude towards state aid. State aid may affect the level playing field between air carriers and is supposed to negatively affect competition by tampering with market signals and distorting prices.

138. Under specified conditions, state aid may be prohibited by for instance the WTO under the Subsidies and Countervailing Mechanisms (SCM) Agreement. The agreement allows contracting states to

⁹⁴ See: www.flightglobal.com/articles/2011/02/22/353449/latin-rivals-battle-for-power-in-peru.html

⁹⁵ State aid can include but are not limited to state grants; interest rate relief; tax relief and tax credits; state guarantees or holdings; state provision of goods or services on preferential terms; direct subsidies; tax exemptions; preferential interest rates; guarantees of loans on especially favourable terms; acquisition of land or buildings either gratuitously or on favourable terms; provision of goods and services on preferential terms; see: www.yorkshire-forward.com/sites/default/files/documents/ERDF%20state%20aid%20guide%20for%20practitioners.pdf

challenge a subsidies granted by another contracting state before the WTO Dispute Settlement Body.⁹⁶ An example of this concerns the Boeing-Airbus dispute on measures including the provision of financing for design and development to Airbus companies and illegal export subsidies. However, as the operation of air services does not fall under the scope of the WTO or the GATS, these WTO/SCM rules do not apply to them.

139. Whereas stated aid is supposed to negatively affect market entry and market behaviour, it may, under specified circumstances, also prohibit or slow down market exit. Reference is made to the so-called Chapter 11 mechanism in the US.⁹⁷ Chapter 11 provides a delay of payment of debts for the debt undertaking; ‘Chapter 11’ provides (much) more protection to the creditors than similar proceedings in other jurisdictions. It has benefitted some airlines, including American Airlines and United Airlines. However, it is disputed whether Chapter 11 measures can be earmarked as public aid or state subsidies. The fate of airlines in the EU, including Alitalia, Olympic and Austrian Airlines, have also been influenced by powerful political pressure which slowed down or even prevented market exit.

140. Outside the WTO, the EU is the only jurisdiction which has a defined set of rules and principles on state aid. As state aid is seen as a tool of industrial policy, Latin American States, and the US do not regulate it. EU provisions and measures will be examined in the next section.

2.4.2 *EU law on state aid*

141. The EU Treaty prohibits Member States from directly or indirectly subsidising firms if this distorts or threatens to distort competition and affects EU trade. Certain forms of state aid may be exempted from the prohibition, such as “aid to facilitate the development of certain economic activities” where “it does not adversely affect trading conditions to an extent contrary to the common interest.”⁹⁸ The proposed aid must be notified to the European Commission (*ex ante*). Aid which is granted without prior notification is unlawful *per se*.

142. The European Commission has published Guidelines on state aid in the air transport sector.⁹⁹ Those guidelines focus on financing of airports and start up aid to airlines departing from regional airports. Reference is made to the section on airports below.

2.4.3 *Application of state aid rules*

143. The rules on state aid have been enforced in the EU, albeit with some difficulty due to the political pressure from national governments regarding subsidies granted by governments to airlines. Because aviation contributes to the economy of a country and raises the international profile of a country, the task of the European Commission has not always an easy one.

144. Generally, the European Commission has three ways of addressing a state aid case:

- a) It can prohibit it;
- b) It can approve it subject to conditions imposed to the beneficiary of the aid;

⁹⁶ As to which see: <http://trade.ec.europa.eu/doclib/press/index.cfm?id=709>

⁹⁷ Chapter 11 refers to the relevant chapter of the US Bankruptcy Code

⁹⁸ See Article 112(3) TFEU

⁹⁹ See: http://www.eipa.nl/UserFiles/File/state_aid/State_Aid_in_the_Transport_Sector.pdf

- c) It can allow it if the *market investor* principle and the *proportionality* principle are observed. These are the two criteria which the European Commission uses to assess whether a state aid is anti-competitive or not. The *market investor* principle allows aids made under terms and conditions that would be similar to those carried out by a private investor operating under normal market economic conditions. Under the *proportionality* principle means the aid must be proportional to its purpose, for instance, the restructuring of the undertaking.

145. The European Commission has monitored state aid granted to airlines since 1989, starting the Belgium carrier Sabena (which does not exist anymore). In most cases, involving major airlines and flag carriers such as Air France,¹⁰⁰ Sabena,¹⁰¹ TAP Portugal,¹⁰² Aer Lingus,¹⁰³ Austrian Airlines¹⁰⁴ and Alitalia,¹⁰⁵ the aid was approved, sometimes under conditions as will be discussed below. In the Greek carrier (Olympic Airways) case the subsidies granted by the Greek state were not approved.¹⁰⁶ The Greek carrier and the Commission are engaged in proceedings before the Court of Justice of the EU (CJEU) on the legality of the European Commission's decisions.

146. As to cases of conditional approvals (see b above), the European Commission has imposed the following conditions:

- The establishment of a restructuring plan for the undertaking;
- The imposition of the “one time last time” condition, implying that an EU Member State may use public funding of a certain undertaking once every 10 years;
- The establishment of a normal shareholding relationship between the government and the air carrier;
- No entitlement to preferential treatment with respect to market access in the form of traffic rights;
- The imposition of capacity restrictions;
- The prohibition of airline acquisitions;
- Restrictions on price leadership and

¹⁰⁰ As contested by a number of EU air carriers, as to which see: *BA, SAS, KLM, Air UK, Euralair, TAT and British Midland, supported by the Scandinavian and UK governments v. the Commission, supported by the French government*; Cases T-371/94 and T-394/94, decided on 25 June 1998. See <http://curia.eu.int/jurisp/cgi-bin/>

¹⁰¹ See: Case N636/2001, at: http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_N636_2001

¹⁰² Case N132_2002, at: http://ec.europa.eu/eu_law/state_aids/transport-2002/n132-02.pdf

¹⁰³ See: case SA_29064, at: http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_29064

¹⁰⁴ Case NN72_2008, at: http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_NN72_2008

¹⁰⁵ See: Case N318, at: http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_N318_2002

¹⁰⁶ See, for instance, case SA_24639, at: http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_24639

- Divestment of parts of the undertaking.

147. Since 1989, many air transport-related state aids have been examined by the European Commission. The table below lists selected airline cases.

Table: Selected state aid cases in the EU

Recipient	Case No	Date	Decision	Comments
Air France	T-371/94 (ECJ)	25.6.98	Approved	Provided aid “does not adversely affect trading conditions to an extent contrary to the common interests” and does not discriminate against other competitors
Sabena Belgium	C(2001) 3137	17.10.01	Approved	All conditions of EU law satisfied; loans made under market rates, to be paid back
TAP Portugal	C(2002) 1328	9.4.02	Approved: rescue aid	State guarantees for the acquisition of A340; application of market investor principle
Alitalia Italy	C2/2005		Approved subject to conditions (rescue aid)	Recapitalisation through a public undertaking; application of private investor principle; no state aid if conditions are met
Ryanair Ireland	C37/07	17.1.08	More information needed	State aid to and by Alghero airport (Sardinia, Italy) for Ryanair and others; possibly unfair and discriminatory ground handling charges and support for market arrangement
Olympic Airways (OA), Greece	C(2006) 2706		Not Approved	Advantageous sub-lease payments; overvaluation of Olympic Airlines’ assets at the time of OA; delay of tax and security debt payments by OA to the Greek state
Alitalia	C26/08	22.7.08	Aid to be recovered but privatisation approved	Loan by state to Alitalia; question whether the state acted as a prudent shareholder; aid incompatible with the common market
Austrian Airlines (AUA)	C6/09	28.8.09	Approved as rescue aid, subject to conditions	Price of AUA’s shares when privatised must accord with market price; question of application of market investor principle
Ryanair/Bratislava airport (Slovak Republic)¹⁰⁷	C (2010) 183	27.1.10	Approved	Application of market investor principle re agreement on discount of airport charges

2.4.4 State aid provision in the EU-Brazil air transport agreement

148. The 2011 EU-Brazil agreement on air transport contains a few provisions on state aid. This is noteworthy because the Brazilian legislation does not have any provisions on state aids. In the past, it appears that state aid has been granted to Varig. It seems that there are no current recipients of state aid.¹⁰⁸

¹⁰⁷

See: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:027:0024:0038:EN:PDF>

149. The EU-Brazil agreement has three provisions on state aid. State aid is defined as both “government subsidies and support”. Government subsidies and support are defined as “capital injections, cross subsidisation, grants, guarantees, relief or tax exemption, protection against bankruptcy, or insurance, by any government entities.”¹⁰⁹ The parties to the agreement recognise that such government subsidies and support negatively affect the fair and equal opportunity of the designated air carriers to compete on the agreed services. If one party finds that these practices affect the level playing field, it may send its “observations” to the other party.¹¹⁰

150. In order to remedy the situation, a party may bring the question to the attention of the Joint Committee which is established by the agreement. The Joint Committee which consists of representatives of the two parties is mandated to draw up the procedures for actions which the affected party has to put in place to remedy the irreparable harm caused to its carriers. Any such action must be appropriate, proportionate and restricted as to its scope and duration to what is strictly necessary.¹¹¹ The right to take action does not affect the right of the parties to settle the dispute under the provisions for Dispute Settlement.¹¹²

2.4.5 *EU subsidies in relation to third country carriers*

151. The European Commission disposes investigative powers and can impose corrective measures in case it suspects the existence of subsidy to a non-EU air carrier which results in unfair pricing practices by a non-EU air carrier on services to or from the EU. This matter is regulated by EU Regulation 868/2004 which defines the relevant subsidies and unfair pricing practices.

152. This regulation has not yet been enforced. It is not clear how it relates to the provisions of bilateral air services agreements under which pricing arrangements may have been made and subsidies or state aid are not prohibited. Also, it is unclear how the European Commission can exercise its enforcement powers under the above regulation, taking into account the bilateral regime.

Case study: subsidies for low cost carriers in secondary airports in the EU The Charleroi - Ryanair case

A special case in the EU concerns state aid – or better said – public funding of low cost carriers at secondary airports in the EU. The Walloon region in Belgium had provided financial assistance to the low cost carrier Ryanair operating from and to the airport of Charleroi south of Brussels.

Ryanair had entered into agreements with the Walloon Region and BSCA (a public sector company controlled by the Walloon Region) in 2000 for a substantial reduction in landing charges, compensation for any profit loss arising out of subsequent changes to airport charges, contributions to cover the costs of Ryanair establishing its base at Charleroi Airport, and reduced fees for ground handling services. In return, Ryanair agreed to maintain two to four aircraft at Charleroi and maintain three rotations a day per aircraft for fifteen years. Following a number of complaints, the Commission launched an investigation into these arrangements and found that they amounted to illegal State aid under the EU Treaty.

The European Commission held that the Belgium Walloon Region had acted as a public authority vis-à-vis

¹⁰⁸ See, Booz & Co, *The Economic Benefits of Opening Aviation Markets between the EU and Brazil* (2009) at 4.4.5.5 - Report made for the European Commission (*unpublished*).

¹⁰⁹ See Article 15(4).

¹¹⁰ See Article 15(5).

¹¹¹ See Article 15(6).

¹¹² See Article 22.

Ryanair. That finding foreclosed the application of the so-called “private investor principle”, referred to above, whereby the Commission, through a complex economic analysis, would have had to determine whether or not the arrangement was State aid by comparing it with the likely behaviour of a private market actor under similar circumstances. However, the Commission held that the State acting in its capacity of a public authority can never be compared to a private actor in the market. The Commission thus ordered Belgium to recapture the aid granted to Ryanair.

Ryanair challenged the Commission’s decision before the European Court of Justice. The court argued that the Commission should have applied the private investor principle when it made its decision and annulled the Commission. The same carrier has been involved with alleged state aid questions at, among others, the airports of Bratislava (Slovakia)¹¹³ and Pau (France)¹¹⁴ and Amsterdam (the Netherlands).

2.5 *Air transport infrastructure*

2.5.1 *Airports as essential facilities*

153. The operator of an “essential facility” is expected to provide access to the market infrastructure on a fair and non-discriminatory basis. The critical point in the discussion of essential facilities is *access*. Unequal access opportunities for operators can yield competitive advantages or disadvantages.

154. In the words of the OECD:¹¹⁵

“Essential infrastructure means that supplying a service is substantially more difficult without access to this infrastructure and that a monopolist owner of this infrastructure would find it profitable to impose at least a small but significant non-transitory price increase above the competitive level for access to this infrastructure.”

155. Airports are the essential facilities in the air transport sector. Access to airports can be affected by a number of factors, including but not limited to safety, environment, especially noise hindrance, congestion and economic regulation in the form of high airport charges. Hence it is crucial that such limitations are regulated in a non-biased and non-discriminatory fashion.

156. Public air law at all levels, that is, the Chicago Convention, bilateral air services agreements, national law and policy and domestic, including local regulations, is designed to provide uniform treatment of airlines.¹¹⁶ However, as the case study of Mexico City Airport identified in the OECD-Mexico CFC study shows that public regulations may yield competitive disadvantages for new entrants. The study concludes that the level of airport charges and the criteria for slot allocation reduce competition at Mexico City airport¹¹⁷.

¹¹³ Commission Decision of 27 January 2010 on State aid C 12/08 (ex NN 74/07) — Slovakia — Agreement between Bratislava Airport and Ryanair (*no state aid*)

¹¹⁴ Case NN12/2007, at: http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_C53_2007

¹¹⁵ See, OECD, Latin American Competition Forum, *Competition Principles in Essential Facilities* (Background Paper DAF/COMP/LACF(2010)10) at 4.

¹¹⁶ See also Prof. P.P.C. Haanappel, formulating this view as follows: “In international air transport, as far as the use of airports is concerned, such a competition law doctrine is hardly necessary because of the obligations of ICAO member states with respect to the use of airports “on uniform conditions”, as laid down in Article 15 of the Chicago Convention ...”; P.P.C. Haanappel, *The Law and Policy of Air and Outer Space* 130 (2003).

¹¹⁷ See section 2.2, end.

2.5.2 Access to airport services

2.5.2.1 Airport services as essential services

157. The operator of an essential facility must carry the burden of proof that it provided equal access to all users of the facility¹¹⁸. This doctrine also applies to the service providers engaged with the performance of air transport activities. The European Commission made decisions on access to ports in which it directly or indirectly¹¹⁹ referred to the essential facility doctrine.

158. As said, the air transport sector is regulated by a myriad of provisions designed to assure non-discriminatory access. Also, due to the special status of air transport related activities, including the operation of air services by airlines under bilateral air services agreements (see above), the services operated by airports and providers of Air Navigation Services (ANS) those activities have for a relatively long time in many parts of the world been “immunised” from the application of competition law regimes. This state of affairs is changing, as will be illustrated below by examples from the EU and the US.

159. In the EU, a number of decisions refer indirectly to the essential facility doctrine. In a French case, the (French) Competition Council found that operator of a heliport should accede to reasonable requests for access to these essential structures by competitors on down line service markets whereas the financial terms of such access should not discriminate against them. Also, the fees for access should be cost related, proportionate, and transparent and based on objective criteria as mandated by public law.¹²⁰

160. The European Commission has addressed access to essential services and facilities in a number of cases. In the case involving Frankfurt airport, the Commission held that the airport’s refusal to allow self handling of ground handling services or to admit third party handling abused its dominant position in the relevant market for the provision of ground handling services as Frankfurt airport was the only supplier of those services and did not grant access to other parties.¹²¹ In the case of *London European v. Sabena*,¹²²

¹¹⁸ See, European Court of Justice, *C-7/97 Oscar Bronner GmbH&Co KG v. Mediaprints Zeitungs- und Zeitschriftenverlag GmbH&Co KG et al.* (1998) in which the court had to decide whether refusal of access deprives a competitor of a means of distribution judged *essential* for the sale of its medium, that is, newspaper. The court did not rely on the “essential facilities” doctrine as such in its decision; see: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61997CJ0007:EN:HTML>

¹¹⁹ See: *Holyhead II* (OJ L55/52 (1994));¹¹⁹; *Elsinore* (Commission Press Release IP/96/205 of 6 March 1996 and *Roscoff* (Commission Press Release IP 95/492 of 15 May 1995).

¹²⁰ See, *Héli-Inter Assistance v. SA Jet Systems*; Competition Council, decision of 3 December 1996; B.O.C.C.R.F of 8 January 1998 at 3; for Italian cases, see: See, for the most recent cases: Case 1641C, *Rifornimenti Aeroportuali*, decision of 24 September 2008; Case A377, *Sea-Tariffe Aeroportuali*, decision of 26 November 2008 (violation found of Art. 82 (now 102) on the abuse of a dominant position of the EU Treaty); Case A376, *Aeroportdi di Roma, Tariffe Aeroportuali*, decision of 23 October 2008(violation found of Art. 82 (now 102) on the abuse of a dominant position of the EU Treaty); Case 1641B, *Rifornimenti Aeroportuali*, decision of 26 April 2007 (violation found of Art. 82 (now 102) on the abuse of a dominant position of the EU Treaty); Case 1641, *Rifornimenti Aeroportuali*, decision of 14 September 2006; Case A377B, *Sea-Tariffe Aeroportuali*, decision of 21 July 2010; Case A376B, *Aeroportdi di Roma, Tariffe Aeroportuali*, decision of 21 July 2010.

¹²¹ Commission decision 98/387 of 14 January 1998, *FAG-Flughafen Frankfurt Main AG*, available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:1998:173:0032:0044:EN:PDF>. The Commission has made decisions on similar questions involving possible abuses of dominant positions by airports in matters concerning the provision of ground handling services and refusal to offer competitive services at other German airports. The airports of Berlin/Tegel, Cologne/Bonn and Dusseldorf, Stuttgart and Hamburg have received temporary exemptions from the obligation to limit or prohibit self handling or third party handling. Those exemptions have expired on 31 December 2000.

Sabena (former Belgian carrier) refused access to its Computerised Reservation System (CRS) to its competitor London European. The concerned CRS was managed and controlled by Sabena. The Commission found that Sabena abused its dominant position by refusing to provide essential services to a competitor. The same line of arguments was followed in the well known case *British Midland v. Aer Lingus* in which Aer Lingus refused to interline with British Midland (BM) on the – for BM – relevant London-Dublin route. Aer Lingus is the dominant carrier on that route, and in that geographical market. The interline facility has to be regarded as an essential facility enabling BM to transfer passengers from Dublin via London to other destinations (beyond London). The Commission argued that the refusal to supply that facility constituted an abuse of the dominant position held by Aer Lingus.¹²³

161. In Latin America, including Argentina, Chile and Peru, competition authorities and courts have relied on the essential facilities doctrine in their reasoning of the decisions.¹²⁴ As they do not pertain to air transport, airports or related services they are not discussed here.

2.5.2.2 Other airport related services

162. Apart from the provision of airport services strictly speaking, that is, the provision of terminal and runways facilities and related services such as fire rescue, airlines are assisted by yet other service providers. They include but are not limited to providers of ground handling services¹²⁵, providers of air navigation services¹²⁶, security services and fuelling. The box below summarises activities and competition aspects of a principal service provider in this chain, namely providers of ground handling services.

Competition concerns in the ground handling market

Ground handling services consist of a range of activities varying from parking, loading and unloading of the aircraft, boarding and de-boarding, catering, cleaning of the aircraft, marshalling of the aircraft to the provision of passenger stairs and bridges and sometimes fuelling. These services may be provided by the airport, but also by the principal carrier at the airport or by third parties. Airlines which are not principal airlines may be entitled to what is called “self handling”. Bilateral air services agreements¹²⁷ address this right for the designated airline(s) of the other state in an international context. Most self handling carriers supply ground handling services to other carriers. EU Directive 97/67 attempts to regulate the ground handling market. It requires the following:

- Freedom of third party handling at airports with a traffic volume of 2 million passengers or 50.000 T of cargo per year, with allowances for limitations as to the number of suppliers for specified categories of services.
- Freedom of self handling applies to every airport in the EU, irrespective of the volume of traffic.
- Exemptions from the above requirements may be provided for a limited period of time. Exemptions must be approved by the European Commission.¹²⁸

As many airports in the EU do not surpass the above thresholds for air traffic volumes, competition concerns

¹²² Commission decision 88/589 of 24 November 1988, available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31988D0589:EN:HTML>

¹²³ See Commission decision 92/213 of 10 April 1992, *British Midland v. Aer Lingus*, available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31992D0213:EN:HTML>

¹²⁴ See, OECD, Latin American Competition Forum, *Competition Principles in Essential Facilities* (Background Paper DAF/COMP/LACF(2010)10) at 9-10.

¹²⁵ See also sub-section 2.2.

¹²⁶ As to which see the next sub-section.

¹²⁷ See section 1, above.

¹²⁸ Exemptions have been accorded for airports in Germany (see footnote 116), France (Paris Charles de Gaulle) and Portugal (Funchal). All exemptions expired on 31 December 2000.

stay in place. Smaller airlines may have no other choice but to purchase ground handling services from their dominant competitor. Moreover, even for the larger airports, the EU Directive does not guarantee free and unimpeded access to any independent supplier as it only requires that the number of third party providers should not be less than two, of which one may be controlled by the incumbent or hub carrier.

Another competition concern pertains to the taxation system. If suppliers of ground handling services are vertically integrated with airlines, tax rules may favour such own account modes of operation as compared with outsourcing by independent third parties. If for instance an independent ground handling provider is subject to output value added tax (VAT) while the air carrier can deduct the corresponding input VAT, the hub carrier with an integrated catering services or ground handling department has a clear cost advantage in comparison with the smaller carrier who has to buy these services in the market.¹²⁹

2.5.2.3 Anti-competitive behaviour by the airport operator

163. As airports are normally not competing for traffic, horizontal anticompetitive agreements between airport operators are not likely to arise. This may be different for airports serving the same city or conurbation. However, in such cases the competent authorities may, and are entitled to distribute traffic among the various airports.¹³⁰ For instance, domestic or charter traffic may be channelled to one of those airports, whereas intercontinental traffic flies from and to another airport serving the same city or conurbation. Examples can be found in London (Heathrow, Gatwick, Luton and Stansted),¹³¹ Paris (Charles de Gaulle and Orly) and Milan (Malpensa, Linate and Bergamo). Thus, consequent public regulations on the division of traffic, competition between airports for instance cargo or charter traffic may be limited or depending on the circumstances even excluded.

164. However, if there is no strict division of type of air services operating to airports serving the same city or conurbation or in case airports are adjacent (without serving the same city and being subject to traffic distribution rules) they may have overlapping catchment areas in which case such airports may be considered as substitutes.¹³² Whether passengers deem airports as alternative options depends on a number of factors which include but are not limited to:¹³³

¹²⁹ See, Report from the Nordic competition authorities, *Competitive Airlines, Towards a more vigorous competition policy in relation to the air travel market* No. 1/2002 at 118, available at: <http://www.kilpailuvirasto.fi/tiedostot/competitive-airlines.pdf>

¹³⁰ Pursuant to the terms of Article 19(2) of EU Regulation 1008/2008

¹³¹ See *CC, British Airways Plc and City Flyer Express Limited*, Cm 4346 (20.07.1999), at: http://www.competition-commission.org.uk/rep_pub/reports/1999/430ba.htm#full in which the British Office for Fair Trading (OFT) found that charter flights to Stansted/Luton offer some albeit marginal competition in relation to leisure passengers.

¹³² See, EC Commission, Case COMP/37.812 - *British Midland/Lufthansa/SAS*, at: (http://europa.eu.int/eurlex/pri/en/oj/dat/2001/c_083/c_08320010314en00060010.pdf). See also press release IP/01/831. EC Commission, Case M.20142, *United Airlines/US Airways* para. 20, at: http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=2_M_2041. EC Commission, Case M.5440, *Lufthansa/Austrian Airlines*, para. 54 at: http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=2_M_5440. OFT, case *BMI/United Airlines*, at: www.of.gov.uk/Business/Legal+Powers/United+Airlines+and+British+Midland+Alliance+Expansion+Agreement.htm – and: OFT, case *BA/British Regional*, at: <http://www.of.gov.uk/business/mergers+fta/advice/clearances+and+referrals/ba.htm>).

¹³³ See, European Competition Authorities (ECA), Report of the ECA Air Traffic Working Group, *Mergers and alliances in civil aviation*, an overview of the current enforcement practices of the ECA concerning

- The number of potential passengers living in the overlapping catchment areas concerned;
- The frequency of the services;
- The duration of the journey,
- The prices of tickets and
- The type of passengers travelling (in particular whether they are time-sensitive or non time-sensitive passengers).

165. Obviously, airport substitution increases competition between services on a particular route (only) if the choice between different airports also implies a wider choice between different individual airlines. The European Commission and the UK's Office of Fair Trading (OFT) have applied competition law provisions to acts of airports. Slot shortages may form entry barriers hindering competition.¹³⁴ Spanish authors following the Latin American air transport sector, report on the negative effects which slot allocation regimes may have on new entrants and pricing of air services.¹³⁵

166. Anticompetitive behaviour by airport operators can relate to a number of services, including IT system for bookings, jet fuel distribution system, ground-handling services, catering services. An abuse of a dominant position could also arise in cases where the operator of an airport seeks to alter slots to the benefit of its main customer-airline. Hence, the operator would infringe the provision on the abuse of a dominant position.

167. While the process of slot allocation, as a special regime of Community law, is subject to the general framework regarding competition law, it seems questionable whether provisions on the abuse of a dominant position can be made to apply to the conduct of (hub) airport operators holding a dominant position. The relevant market is the market for air transport services whereas there is not (yet) a market for slots which are not (yet) tradable. The question whether the incumbent airlines abuse their dominant positions at such airports by hampering transfer of slots, or refusing such transfers between airlines must be assessed on a case by case basis by the competent competition authorities.¹³⁶

market definition, competition assessment and remedies 3.3.2 (2010) at: http://www.kkv.se/upload/Filer/ENG/About/eca_report_civil-aviation.pdf

¹³⁴ See, for instance: the EC Commission considered slot shortages as an entry barrier with respect to Lufthansa's hub in Frankfurt in *Lufthansa/SAS/United Airlines*, Case M.36201, at: http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=1_36201, see also the merger case *Air France/KLM* Case M. 1855, at: http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=2_M_1855. The most significant barrier to entry is access to slots at airports in the South East of England, in particular London Heathrow, as to which see the UK Competition Commission (CC), case *Air Canada/Canadian Airlines* Cm 4838, http://www.competitioncommission.org.uk/rep_pub/reports/2000/443air.htm#ful.

The German *Bundeskartellamt* considered slot shortages in its analysis of structural factors at a number of German airports in *Lufthansa/Eurowings*; See *Bundeskartellamt*, case B 9 – 147/00 - *Lufthansa/Eurowings*, decision of 19.09.2001 (http://www.bundeskartellamt.de/wDeutsch/download/pdf/Fusion/Fusion01/B9_147_00.pdf)

¹³⁵ See, Antoni Bosch, and Jose Montalvo, University Pompeu Fabra in Barcelona, *Free and Non-Discriminatory Access to Airports: A Proposal for Latin America*, available at: www.iadb.org/document.cfm?id=352782; see also: Agustin Ross, *A Competition Policy Assessment of the Domestic Airline Sector in Mexico and Recommendations to Improve Competition* (2010) – an OECD Publication

¹³⁶ See, NERA, *Study to Assess the Effects of Different Slot Allocation Schemes* 250-251 (2004) available at: http://ec.europa.eu/transport/air/studies/doc/airports/2004_01_slot_allocation_schemes.pdf

168. Equally, a parallel can be drawn between airports favouring certain airlines (mostly the main customer-airline) when allocating slots, on the one hand, and the imposition of charges, on the other hand. Pricing of airport services may take the special form of airport charges. Such charges are again predetermined by public law to cope with the public service character of airports and to avoid an abuse of dominant position. In the EU, airports, and their dealings with low cost carriers, have given rise to concerns expressed by competition authorities as pricing regimes were felt to be anti-competitive, or were regarded as state aid.¹³⁷

169. In the 1990s, the European Commission examined access to airports located in Finland, Brussels and Lisbon. The concerned airport operators had infringed the provisions on the abuse of a dominant position by the imposition of differentiated airport charges, the application of a system of stepped discounts, which increased with a high volume of traffic, and of discounts respectively, benefiting the local, incumbent airlines. The concerned airport operators were requested to stop their actions.¹³⁸

170. In the US, landing fees at Boston were held to discriminate against general aviation as the effect of the new fee structure was to significantly increase the landing fee of smaller aircraft while decreasing that of larger ones. Airport charges were used as a policy tool, but created anticompetitive practices.¹³⁹

171. In a case involving Aerolinas Argentina,¹⁴⁰ a US court found that fees imposed on US carriers at Buenos Aires airport were three times higher than those set for Argentinean domestic carriers. According to the US court this practice constituted unreasonable discrimination. The claims of US airlines were not assessed under the applicable US antitrust laws but under provisions in the bilateral air services agreement concluded between the US and Argentina, prohibiting discrimination with respect to airport charges.

172. This does not mean that no remedies are available for airlines serving US airports under US antitrust laws. In a case involving New York Airlines, the competent court held that although the concerned airport was publicly owned and the commission responsible for the determination of the airport charges was a public body, these facts did not prevent the court from applying antitrust laws to the actions of that commission with respect to the setting of charges.¹⁴¹ In sum, the court refused to give airports *carte blanche* to engage into anti-competitive behaviour.¹⁴²

2.5.3 Air Navigation Service Providers (ANSPs)

173. ANSPs will be mentioned for the sake of completion. They also enjoy a monopolistic position. However, they are in most cases immune from the application of competition rules. For example, the single European sky regulations dictate that:¹⁴³

¹³⁷ See the Charleroi-Ryanair case discussed in section 2.4, above

¹³⁸ See Commission Decision 1999/198 of 10 February 1999 regarding *airport charges at Finnish airports*, OJ L 69/24-30 (1999); Commission Decision 95/364/EC of 28 June 1995 regarding *landing fees at Brussels airport*. OJ L 216/8-14 (1995); Commission Decision 1999/199/EC of 10 February 1999 on *landing charges in use at Portuguese airports* OJ L 69/31-39 (1999).

¹³⁹ See, *New England Legal Foundation v. Massachusetts Port Authority*, 883 F.2d 157, 169 (1st Cir. 1989).

¹⁴⁰ *Aerolinas Argentians S.A. v. U.S. Department of Transportation*, 415 F.3d 1,3 (D.C. Cir. 2005)

¹⁴¹ See, *N.Y. Airlines, Inc. v. Dukes County*, 623 F. Supp. 1435, 1440-1441 (D. Mass.1985).

¹⁴² See, Roy Goldberg, *Airline Challenges to Airport Abuses of Economic Power*, 72 *Journal of Air law and Commerce* 351 ff. (2007).

¹⁴³ Preamble No 5 of EC Regulation 550/2004 on the *Provision of air navigation services in the single European sky*.

“The provision of air traffic services ... is connected with the exercise of the powers of a public authority, which are not of an economic nature justifying the application of the Treaty rules of competition.”

174. Hence airlines cannot hold air navigation services providers (ANSPs) liable for abuse of a dominant position under EU law. The same is true for claims of airlines in relation to ANSPs in other parts of the world. ANSP's are deemed to carry out public rather than economic activities. It cannot be excluded that this approach will change in the future, to begin with the EU.

175. US air transport infrastructure, including airports and Air Navigation Service Providers, is still largely owned and controlled by US government or public bodies. Realistically, there is no government support for the introduction of a market oriented environment for infrastructure related services because of public interests arguments such as labour, safety and security.

2.6 Conclusions

176. This Chapter has discussed how competition has applied to an increasingly liberalised air transport sector. Chapters 1 and 2 above attempt to analyse the evolutionary process in this respect. It has not been easy, and still is not easy for competition authorities to find their way in this sometimes highly regulated sector. Market access to international routes is in many parts of the world dictated by government intervention rather than by market forces.

177. This dilemma is exemplified by the fuel surcharges cases discussed above, where the European Commission granted all carriers a reduction of 15 % “on account of the general regulatory environment in the sector which can be seen as encouraging price coordination.” Indeed, the above bilateral framework and the former role of IATA with respect to coordinating of tariffs and rates helped to create not only inter-government but also inter-airline discussions.

178. Jurisdictions in all parts of the world are starting to apply competition regimes to the operation of domestic services. Concerns pertain to high fares charged by incumbent carriers. Incumbent carriers inherited privileged positions under the regulatory and policy framework referred to above.

179. Few jurisdictions apply their competition regimes to the operation of international services. The same is true for Latin American countries, for the reasons set out above.

180. Proceeding from the consolidation in the airline industry as exemplified by the increased relevance of large and more intensive airline alliances, competition authorities increasingly assess the scope of the network of the alliance agreements when determining its competitive effects. In other words, the regional approach is gradually replaced by a global approach. This development is signalled by the introduction of the “metal neutrality” test pursuant to which it does not matter which alliance carrier operates the service as they have established a joint venture for pooling revenues and costs of their services.

181. Exceptions to the exclusion of international air services from competition regimes can be found in the EU and the US. In the EU, the competition law regime applies to air transport activities as if they were conducted as regular economic activities by regular undertakings as the exemptions for the benefit of air transport have disappeared there. The competition authorities in these jurisdictions attempt to introduce market conditions into the operation of external services while airlines must streamline their operations by setting up cross border alliances and mergers.

182. The US and EU – Brazil air transport markets have been identified as being increasingly subject to competition by relaxation of regulatory conditions governing the operation of the relevant international

air services. Competition authorities have to take the regulatory environment of air transport activities into account, which is not an easy task.

183. As indicated above, there is an increasing cooperation between competition authorities. The recent air transport agreement between the EU and Brazil also calls for coordination of actions undertaken by the competent competition authorities. This objective must overcome fears of sharing jurisdictional powers and the concerns of companies that confidential information is disclosed to other authorities or to the public. In order to contribute to the globalisation of air transport markets providing for an increasingly seamless travel system, competition laws and policies of various states need to achieve greater convergence by developing common principles regarding airline behaviour that affects competition.

184. Both in the EU and in the US, airport-airline relations are increasingly subject to competition law regimes. Competition authorities and courts have asserted jurisdiction with respect to anti-competitive conduct of airports possessing a significant economic power to establish charges and influence other means of access.

185. The essential facility doctrine is designed to prohibit monopolistic behaviour by the supplier of an essential service or facility and to promote competition in the relevant geographical products and services markets. Access to essential services and facilities in the air transport sector is also secured by public regulations and the enforcement of competition law provisions, principally those pertaining to the abuse of a dominant position.

186. As airports are backed and/or controlled by public bodies, state aid and public funding generally may affect their dealings with users so as to contribute to the promotion of the area in which they are located. In the EU low cost carriers are exploiting the position of less attractive or isolated airports to their advantage by engaging into lucrative deals with their operators and public bodies who back them. Such deals have given rise to investigations of alleged state aids. Public authorities are drawing up rules and guidelines designed to regulate this relationship to avoid anticompetitive behaviour by airport operators.

3. The role of competition authorities in the air transport sector

187. Competition authorities have the important but challenging task of promoting competition policy and addressing some of the obstacles to competition in the air transport sector. Air transport is in many cases, by its very nature, a cross border activity.

188. Traditionally, the air transport sector has been governed by a constellation of air service agreements and varying degrees of regulation and public interference. These regulate and restrict market access or pricing, or both, preventing the full play of market forces. Consequently, competition authorities have had either no, or only a limited role in the supervision of the sector.

189. This pattern has changed as a result of airline deregulation in the US and liberalisation in the EU, which provided an example for other countries to follow in deregulating their own domestic regimes. As domestic markets have been opened up, competition agencies have pursued active competition enforcement and advocacy programmes. Through the enforcement of competition rules to domestic operations, competition authorities ensure that the benefits of liberalisation are not cancelled out by anti-competitive mergers, agreements or practices. Competition authorities also promote regulatory frameworks that enhance competition.

190. However, by comparison, the application of competition principles to the international aviation market is still in its infancy. Government-mandated international air services agreements were designed to protect national carriers, labour interests, security, trade and tourism, among other policy interests. Therefore, the introduction and application of competition policy must be balanced against competing

policy priorities. Forward-looking carriers such as the LAN group are aware of these barriers to opening up international markets and try to navigate around them through innovative ventures which require the approval of both competition authorities and civil aviation departments. This highlights the need for concerted action between regulators and competition authorities, both of whom may be promoting different interests.

191. Competition agencies must more become involved in the regulatory and rule-making process to promote consideration of competition concerns in the air transport sector. Competition authorities have demonstrated that they can play an important role in deregulation and liberalisation. The EU and US domestic experiences are credited with the being driver of the deregulation in the sector worldwide. In Brazil the Competition Authorities' sustained advocacy efforts during the 1990s to the Air Force, Ministries, sector regulator and the public resulted in the deregulation of Brazil's restrictive domestic regime and made the Competition Authorities responsible for developing a liberalisation plan for the sector.

192. Market or sector studies can help to support agencies' advocacy efforts by imparting information about how the market works and the benefits that could result from improved competition. A number of competition agencies have conducted sector studies or produced joint studies with regulators or other competition agencies to highlight competition challenges and suggest measures to enhance competition in the air transport sector. For example, reports on slot allocation procedures by competition authorities in the UK, competition authorities across the EU member states, the European Commission and Mexico's competition authority, have prompted consideration of new regulatory regimes in the EU and Mexico respectively. A report by the Nordic Task Force on Airline Competition, comprised of the competition authorities of the Nordic competition authorities, examined the degree of competition in Nordic aviation and suggested measures to improve it. Brazil's Competition Authorities also made use of a number of studies carried out with non-governmental advisers to underpin deregulation proposals designed to promote competition in Brazil's air transport market.

193. Competition authorities can undertake a screening role to scrutinize existing legal barriers to competition and advocating for the removal of anti-competitive rules in the air transport sector. The EU carried out an in-depth review of the Block Exemption for IATA's passenger tariff conference system in light of current market conditions. The European Commission concluded that the block exemption for tariff conferences on routes within the EU could no longer be justified on the grounds that benefits to consumers outweighed the risks inherent in restricting price. The exemption was therefore removed.

194. At the international level the Open Skies agreements have the potential to provide momentum for liberalisation of the whole sector. The common "Open Skies" recipe has brought about pressures for wider reforms. Competition authorities should make sure that the principles of competition are embedded in these agreements to create a more competitive environment in the heavily regulated international air transport markets. This includes the institutional design of agreements to eliminate tariff restrictions on third countries and the replacement of nationality clauses, as well as the progressive reduction of ownership and control barriers, allowing consolidation even with third country airlines on a reciprocal basis. Where Open Skies agreements do not yet exist, competition authorities could consider using existing regional arrangements such as Mercosur and the Andean pacts as vehicles for promoting competition at the regional level.

195. Actively promoting the application of competition law and policy to the air transport sector must be accompanied by the day-to-day enforcement of competition rules in this sector. Recent enforcement practice demonstrates that the sector is not immune from cartel investigations and sanctions. Airline mergers and alliances are evaluated to determine whether they enhance efficiency and pass on economic benefits to passengers. Competition must be maintained on all markets through imposing remedies on

problematic routes, for example, to make new entry possible. Agencies should be vigilant to avoid the misuse of market power by airport operators, for example in granting access to essential infrastructures and services.

196. Where competition agencies do not have exclusive jurisdiction for the enforcement of competition rules, the agency should seek to comment on cases during the proceedings of the responsible agency. For example, the US Department of Justice files comments in Department of Transport's proceedings to consider whether to approve a proposed international airline alliance and to decide whether to grant antitrust immunity for all or part of such an alliance.

197. International co-operation between competition authorities on cases as well as co-ordination of competition policy can help promote compatible regulatory results and minimise differences in approach. Airline alliances require approval from different competent authorities around the world, which necessitates effective co-operation mechanisms between different national or regional authorities. Collaboration between competition authorities can also identify areas for closer policy co-ordination. For example, the 2010 joint report by the European Commission and the US Department of Transport on *Transatlantic Airline Alliances: Competitive Issues and Regulatory Approaches*, aimed to foster a common understanding of the transatlantic airline industry between the two competent authorities and build compatible regulatory approaches to competition issues in the airline sector.

198. The global trend of airline deregulation and liberalisation has created a very different industry from what it was some 40 years ago. Liberalisation has led to a dramatic increase in air travel; low-cost airlines are shaking up the industry and bringing prices down; airlines have reconfigured their routes and equipment making possible improvements in capacity; airline alliances have enabled airlines to enhance their networks well-beyond their own resources without a buyout or merger.

199. The modern air transport industry is thus one that increasingly operates within a liberal market context. While government controls over fares, market entry, and capacity continue in many smaller countries, they are gradually being removed or relaxed. International controls under the bilateral ASA structure are increasingly moving towards broad Open Skies formulations, allowing free provision of services between the countries involved, although progress on open market, whereby nationality of ownership of airlines is unrestricted, is coming more slowly. The supply and operation of air transport infrastructure is also becoming more market driven with on-going privatizations of airports and air traffic control systems.

200. Competition policy has an important contribution to make to air transport liberalisation. It must underpin existing deregulatory measures to ensure that the benefits of deregulation flow to consumers and that air transport markets operate efficiently. And competition authorities can promote the reforms needed for further competition in the air transport market.

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DAF/COMP/LACF(2011)9

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