WORLDWIDE AIR TRANSPORT CONFERENCE: CHALLENGES AND OPPORTUNITIES OF LIBERALIZATION

Montreal, 24 to 29 March 2003

Agenda Item 2: Examination of key regulatory issues in liberalization
2.3: Fair competition and safeguards

SAFEGUARDS TO ENSURE FAIR COMPETITION

(Presented by the Secretariat)

SUMMARY

This paper examines the issue of how to ensure fair competition in international air transport in a liberalizing economic environment, addresses some policy options and proposes a regulatory arrangement to deal with anti-competitive practices.

Action by the Conference is in paragraph 7.1.

REFERENCES

Doc 9587, *Policy and Guidance Material on the Economic Regulation of International Air Transport*

1. INTRODUCTION

1.1 Liberalization of international air transport entails a shift in regulatory approach from detailed regulation to greater reliance on market forces. While a less regulated economic environment provides more commercial freedom and flexibility for airlines, it also increases the potential for anti-competitive practices. Consequently, how to prevent and control abuse in a liberalizing environment has been a key issue for both government regulators and the industry. The sustainability of air carriers and assurance of service has also become an issue of increasing concern, particularly for developing countries. There is a need to address these issues in order to ensure that liberalization in air transport results in fair competition for all participants, and that all States can participate in international air transport in an effective and sustained manner.

1.2 While safeguards for liberalization, in a broad sense, also encompass regulatory measures dealing with aviation safety and security, which remain paramount in any liberalization arrangement, this paper focuses on the examination of safeguard measures dealing with the economic aspects of air transport. It addresses issues related to measures against anti-competitive practices and application of competition laws to international air transport. The issues concerning sustainability and participation are covered in WP/12.

2. PREVIOUS ICAO WORK

2.1 At the 1994 World-wide Air Transport Conference (ATConf/4), there was widespread support for the concept that liberalization must be accompanied by institutional arrangements to ensure fair competition and effective and sustained participation for all air carriers. The Conference, in connection with the examination of a proposed regulatory arrangement for full market access, considered a safeguard mechanism for healthy and sustained competition in the form of a code of conduct and a dispute resolution mechanism, and recommended further development and refinement of the two concepts.

2.2 In response to the ATConf/4 Recommendation, the Air Transport Regulation Panel at its Ninth meeting (ATRP/9) in 1997 developed a safeguard mechanism for fair competition which contains a list of airline practices which regulatory authorities may use as signals of possible unfair competitive behaviour meriting closer examination. Recognizing the difficulty for a globally agreed comprehensive list that would cover all situations, the Panel noted that the descriptions could only be a guide or a starting point for States that wanted to identify unfair practices. The Panel also developed a related dispute settlement mechanism, which provides an alternate or an intermediate step between the traditional consultation and arbitration processes for dispute resolution. The Council subsequently approved, *inter alia*, these mechanisms recommended by the Panel (Recommendations ATRP/9-1 and ATRP/9-2) as guidance for use by States (see Doc 9587).

2.3 In the area of competition laws, ICAO developed, in 1989, a number of specific guidelines for States and a model clause for potential inclusion in bilateral air transport agreements on the avoidance or resolution of conflicts between States over the application of national competition laws to international air transport (see Doc 9587). The guidance is mainly procedural in nature and deals with potential and actual competition law conflict situations arising in air transport relations. It emphasizes consultation, cooperation and coordination in the application of competition laws to international air transport. However, it does not address the nature of competition laws or how they should be applied to international air transport. The 1994 Air Transport Conference also examined the issue and endorsed the use of this guidance to deal with disputes that may arise when applying such laws.

3. RECENT DEVELOPMENTS

3.1 Since ATConf/4, States have continued to apply the general principle of "fair and equal opportunity" to operate or compete in their air services agreements with respect to capacity, pricing and other airline commercial activities. Some liberal or "open skies" agreements have included new fair competition provisions or commitments. A number of regional air transport liberalization arrangements have also made use of the guidance on safeguards developed by ICAO in addressing potential unfair competitive practices (e.g. The Intra-regional Liberalization Programme adopted by member States of the Arab Civil Aviation Commission).

3.2 With increasing globalization and widespread adoption of the market economy over the past decade, there has been a marked rise in the adoption of competition laws by States, spreading gradually from developed economies to other parts of the world. Some 90 countries now have competition laws of some sort, although the number which actually apply such laws to the airline industry remains limited. Nevertheless, the use of competition laws to deal with air transport has occurred not only with more frequency but also has encompassed an increasing number of issues, ranging from antitrust immunity, mergers and alliances, abuse of dominant position, capacity dumping and predatory pricing, sales and marketing, to airport charges and fees, State aid and loan guarantees.

3.3 While national and regional approaches to competition laws continued to differ, a number of bilateral antitrust enforcement cooperation agreements have been entered into by States, particularly between developed countries. These agreements have proved useful for dealing with matters such as cartels and merger/alliances. At the same time, there has been recognition that enforcement cooperation alone would not resolve some significant areas of procedural and substantive differences among antitrust regimes, and that these differences would need to be addressed. An emerging trend has been the concurrent review of airline commercial transactions by a number of competition authorities in different countries owing to an ever-widening geographical scope of competition cases.

3.4 One notable recent development is that, unlike most competition laws which are for general application with no or limited air transport provisions, States belonging to the Common Market of Eastern and Southern Africa (COMESA) and the Southern African Development Community (SADC) have developed a comprehensive set of competition rules specifically for the air transport sector for common application to the two sub-regions. Such rules form part of their regional liberalization programmes.

4. DISCUSSION

4.1 In considering how to ensure fair competition in international air transport, States are faced with two basic issues: a) what constitutes fair or unfair competition; and b) what would be the appropriate means to meet their policy objectives regarding competition. A related issue is how to deal with disputes that may arise from regulatory actions on competition matters.

4.2 With regard to a), how to define or distinguish between normal and anti-competitive practices has been one of the most challenging tasks facing regulators. While efforts have continued at national and international levels to devise competition guidelines, reliance has increasingly been placed on analyses and development of standards through a case-by-case approach. However, where competition laws do not exist, or where they are not applied to air transport, an indicative list of possible anti-competitive practices may assist States in identifying unacceptable behaviours in the marketplace and in considering appropriate regulatory action. In this regard, the safeguard mechanism developed by ATRP/9 provides a good basis for such a list.

4.3 As far as b) is concerned, it should be recognized that situation varies from State to State, as does the scope and degree of their liberalization in air transport. Therefore different States may need to use different approaches in addressing competition issues based on their own situation and specific aviation relationships with partner States. Generally, the extent of liberalization which both or all States in an air services agreement are comfortable with influences the type of safeguard mechanism chosen by States in their relationships. For example, there could be three basic situations in the bilateral context:

a) where two States have agreed to an open competitive system and both have competition laws, they are more likely to rely on such laws as the primary safeguard mechanism to ensure fair competition, although there would still be a need for some type of dispute resolution mechanism, or competition law enforcement cooperation;

b) where two States have agreed to move toward a less controlled regime but either one or both parties do not have competition laws, they may need to have a mutually-agreed set of descriptions of what would constitute unfair and/or fair competitive practices as a safeguard measure, as well as an efficient and effective dispute settlement mechanism that could help settle disputes involving competition complaints; and

c) where two States have no competition laws, and have chosen to take a gradual and step-by-step approach in liberalizing their air transport, they may continue to use the traditional concepts of fair and equal opportunity to compete, coupled with detailed regulation on airline commercial activities to ensure fair competition until they graduate to the next stage of liberalization.

4.4 As liberalization progresses and takes hold in more States, the traditional concepts to ensure fair competition tend to gradually give way to the application of competition laws, particularly in the cases where States have agreed to an open competition system. In liberalized economies, market forces provide the necessary link between service providers and customers; whereas independent regulatory and competition authorities acquire the critical role of keeping a check on the operation of market forces in order to underwrite the long-term workability of the system. With an increasing number of countries adopting competition laws, there is currently far greater potential for application of general competition law to air transport. Experience indicates that application of general competition law to mergers, restrictive practices and abuse of dominant position involving air transport can be a fairly effective safeguard mechanism.

4.5 However, due to the different stages of liberalization between or among States, there continues to be a need during the transition for some type of aviation-specific safeguards to ensure fair competition, because: a) not all States in an aviation relationship have competition laws; b) such laws may not have specific aviation coverage (as in most cases); c) the regime employed in national competition law may differ from State to State; and d) most international air services are governed by bilateral agreements which have international treaty status. Such rules are also necessary in order to facilitate a gradual, progressive and orderly change towards market access, particularly in those cases where one or both States concerned have no competition laws, or where such generic laws are applicable, to help elaborate on them.

4.6 Application of national competition laws may also give rise to problems due to the differing, sometimes even conflicting, regimes employed by different countries, which could cause particular difficulties for airlines operating international air services (for example, regulations dealing with mergers or alliances, denied boarding). While repeated efforts have been made at the international level with a view to harmonizing competition regimes, global consensus has proven to be difficult to obtain, due to the different legal systems involved and the disparity in their scope and content. It is therefore important for States, when dealing with competition issues involving foreign air carriers, to give due consideration to the concerns of other States involved and avoid taking unilateral action.

4.7 The extra-territorial application of national competition laws could also undermine certain cooperative arrangements regarded by many as essential for the efficiency, regularity and viability of international air transport, certain forms of which benefit both users and air carriers alike. Where antitrust or competition laws apply to such arrangements, appropriate immunity and exemption has been made available

to permit inter-carrier cooperation, including interlining, to continue where they benefit users and air carriers. The continuation of such immunity and exemption is in the interest of a global air transport system, and promotes the objective of effective and sustained participation by all States.

4.8 With respect to the disputes that may arise from applying the various safeguard measures, States may rely on the consultation process available under relevant air services agreements, as well as the dispute settlement mechanism recommended in WP/15 under Agenda Item 2.6. For disputes arising from the application of national competition laws, States may use the guidelines and the model clause developed by ICAO which are contained in Doc 9587.

5. CONCLUSIONS

5.1 From the discussion above, the following conclusions may be drawn.

a) Liberalization must be accompanied by appropriate safeguard measures to ensure fair competition, and effective and sustained participation of all air carriers, regardless of their size and competitive strength. Such measures should be an integral part of the liberalization process and a living tool corresponding to the needs and stages of liberalization. Such measures may include progressive introduction of liberalization, general competition laws, and/or aviation-specific safeguards.

b) While general competition laws may be an effective tool in many cases, given the differences in competition regimes, the differing stages of liberalization among States and the distinct regulatory framework for international air transport, there is in most cases a need for aviation-specific safeguards to prevent and eliminate unfair competition in international air transport. This may be done by means of an agreed set of anti-competitive practices which can be used, and if necessary modified or added to, by States as indications to trigger necessary regulatory action.

c) In cases where national competition laws are applied to international air transport, care should be taken to avoid unilateral action. In dealing with competition issues involving foreign air carriers, States should give due consideration to the concerns of other States involved. In this context, cooperation between or among States, especially between or among competition authorities, and between such authorities and aviation authorities has proved useful in facilitating liberalization and avoiding conflicts.

d) Harmonization of different competition regimes continues to be a major challenge. In cases where disputes arise from the use of aviation-specific safeguards or the application of competition laws, States should seek to resolve their disputes through the consultation and dispute settlement mechanisms available under relevant air services agreements, and in the case of the latter, by making use of the existing ICAO guidance on competition laws contained in Doc 9587.

e) The extraterritorial application of national competition laws undermines cooperative arrangements regarded by many as essential for the efficiency, regularity and viability of international air transport, certain forms of which benefit both users and air carriers alike. Consequently where antitrust or competition laws apply to such arrangements,

appropriate immunity and exemption should be made available to permit inter-carrier cooperation, including interlining, to continue where they benefit users and air carriers.

6. RECOMMENDED REGULATORY ARRANGEMENT

6.1 In a situation where States find it necessary in their air transport relationships to have aviation-specific measures to ensure fair competition between airlines, they may consider to include, in addition to the general competition principles (i.e."fair and equal opportunity to compete") and commitments, the draft model clause below in their air services agreements, as an additional means to identify, prevent and eliminate anti-competitive abuses. This model clause is developed on the basis of the safeguard mechanism recommended by ATRP/9 (Recommendation ATRP/9-1). The indicative unfair competitive practices listed in the clause may be modified or expanded by States if necessary. This clause has also been included in the ICAO Template Air Services Agreement (see WP/17).

Safeguards against anti-competitive practices

1. The Parties agree that the following airline practices may be regarded as possible unfair competitive practices which may merit closer examination:

a) charging fares and rates on routes at levels which are, in the aggregate, insufficient to cover the costs of providing the services to which they relate;

b) the addition of excessive capacity or frequency of service;

c) the practices in question are sustained rather than temporary;

d) the practices in question have a serious negative economic effect on, or cause significant damage to, another airline;

e) the practices in question reflect an apparent intent or have the probable effect, of crippling, excluding or driving another airline from the market; and

f) behaviour indicating an abuse of dominant position on the route.

2. If the aeronautical authorities of one Party consider that an operation or operations intended or conducted by the designated airline of the other Party may constitute unfair competitive behaviour in accordance with the indicators listed in paragraph 1, they may request consultation in accordance with Article [_ on Consultation] with a view to resolving the problem. Any such request shall be accompanied by notice of the reasons for the request, and the consultation shall begin within 15 days of the request.

3. If the Parties fail to reach a resolution of the problem through consultations, either Party may invoke the dispute resolution mechanism under Article [_] to resolve the dispute.

7. ACTION BY THE CONFERENCE

7.1 The Conference is invited to:

a) review and adopt the conclusions in paragraph 5.1; and

b) review and endorse the proposed regulatory arrangement in paragraph 6.1.

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