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CONSOLIDATION OR FRAGMENTATION? EUROPEAN COMPETITION LAW IN THE EU AIR TRANSPORT SECTOR: A POLICY ANALYSIS

INTRODUCTION

Since the entry into force of the Treaty of Rome in 1958, the air transport sector has undergone significant changes, at both the technical and regulatory levels, in order to adapt to the growth and needs of international trade in an ever-globalizing world.[1] The sector has always been specific in terms of its regulatory regime as it involves the application of territorially-limited legal regimes to the global industry.[2] This is the crucial factor which sets the point of departure of this analysis.

From the European Law standpoint, competition can be perceived in its intra-European dimension as well as at the global level. The key issue can be boiled down to the dilemma of whether to promote fragmentation or consolidation of airlines. In a nutshell, a high number of smaller operators boosts competition on the internal market and thus increases consumer choice on short-haul routes.[3] At the same time, due to their relatively small size these carriers are less effective in competition with non-EU airlines (often highly subsidized). On the other hand, consolidation causes the decline of the overall competitiveness of the sector within the EU, but larger carriers gain a competitive edge in the long haul (transcontinental) routes.[4]

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[1] B. Havel, *Beyond Open Skies: A New Regime for International Aviation*, Kluwer Law International, Alphen aan den Rijn: 2009, pp. 23-96; L. Ortiz Blanco, B. van Houtte, *EC Competition Law in Air Transport Sector*, Oxford University Press, Oxford: 1997, p. 1; M. Stainland, *A Europe of the Air? The Airline Industry and European Integration*, Rowman & Littlefield Publishers, Lanham, Boulder, New York, Plymouth, Toronto: 2008, pp. 3 et seq.

[2] *See* A. Cheng-Jui Lu, *International Airline Alliances: EC Competition Law / US Antitrust Law and International Air Transport*, Kluwer Law International, The Hague, London, New York: 2003, pp. 35-53.

[3] Stainland, *supra* note 1, pp. 108-123.

[4] *Ibidem*.

In the post-Lisbon EU, competition is neither a stand-alone goal nor a value in itself, but a means to an end.[5] The axiological hierarchy of the European economic model (with the embedded concept of a social market economy) has given rise to the development of a unique model of competition law, where the twin objectives of market integration and attainment of economic efficiency enjoy equal standing with the goal of achieving consumer welfare.[6] Therefore, the application of competition rules must depart from purely economic efficiency-oriented considerations and require a fundamental value judgment with respect to contradictory but equally important policy objectives.

1. MARKET TRENDS – LEGAL AND OPERATIONAL FACTORS

The air transport sector is by nature oligopolistic. Regardless of the regulatory approach, its operational characteristics form the main contributing factors.[7] Most legacy carriers (FNSC – Full Service Network Carriers) have their networks organized according to the *hub-and-spoke* model. This distribution paradigm is arranged like a wheel, with a main hub airport at its centre and its various flights arranged like spokes. The consolidation of a carrier's operations at a large hub airport has several operational and cost advantages.[8] The airline requires fewer technical facilities (for aircraft maintenance, crew domicile, etc.), which reduces expenses.[9] In other words the large volume of centralized operations leads to economies of scale.[10] Hub operations also offer scheduling advantages, where fixed connecting bank times at the hub allows for simplified fleet and crew scheduling, at the same time creating the possibility to override "bottlenecks" caused by various delays and cancellations by switching passengers and aircraft between flights.[11] And because all air operations are arranged in so-called "waves", short-haul flights serve as a feeder service for long-haul routes, widening an airport's catchment area and improving the load factor and performance of the latter flights.[12]

[5] The notion of "undistorted competition" has been moved from the main body of the Treaties to Protocol no. 27 ([2010] OJ C83/308), which may be perceived as downgrading. *See*, *inter alia*, A. Riley, *The EU Reform Treaty and the* Competition *Protocol: Undermining EC Competition Law*, 28(12) European Competition Law Review 703 (2007).

[6] J. L. Buendia Sierra, *Writing Straight with Crooked Lines: Competition Policy*, [in:] A. Biondi & P. Eckhout (eds.), *EU Law after Lisbon*, Oxford University Press: Oxford 2012, pp. 355 et seq. *See generally* case C-126/97 *Eco Swiss China Time Ltd. v. Benetton International NV* [1999] ECR I-3055, para. 36; C-453/99, *Courage* [2001] ECR I-06297, para. 20. See also the decision Microsoft [2007] OJ L32/23, paras. 693-708.

[7] J.G. Wensveen, A.T. Wells, *Air Transportation: A Management Perspective,* (6th ed.), Ashgate, Aldershot: 2007, pp. 175-200.

[8] G. Burghouwt, *Airline Network Development in Europe and its Implications for Airport Planning*, Ashgate, Aldershot: 2007; G. Dobson, P.L. Lederer, *Airline Scheduling and Routing in a Hub-and-Spoke System*, 23(3) Transportation Science 281 (1993).

[9] Wensveen & Wells, *supra* note 7, p. 178.

[10] *Ibidem*.

[11] *See also* J. Veldhuis, *The Competitive Position of Airline Networks*, (3)4 Journal of Air Transport Management 181 (1997).

[12] Burghouwt, *supra* note 8; Dobson & Lederer, *supra* note 8. It must be noted that the hub-and-

Furthermore one may point to the very high base cost of the industry in question, which in turn makes the barriers to entry very high.[13] As a consequence, there is relatively small number of market players.[14] In such an environment, network carriers are (to a various extent) interdependent. Taking these factors into account, J.G. Wensveen and A.T. Wells concluded that airline industry closely approximates an oligopolistic market structure.[15]

All these factors foster cooperation and promote consolidation, but there is another important "external" factor – the effective control and ownership clauses. These broad-ranging provisions in bilateral air service agreements (as well as in internal law) set out the requirement that a certain percentage of the equity and voting rights remain in the hands of citizens of a particular country, and that a certain percentage of executive management be composed of citizens from that State.[16] In the European Union, this threshold is set at the level of 51% of European control and ownership (without distinguishing between Member States).[17] One may say that the clauses in question effectively prevent cross-border mergers. But at the same time, these restrictions have a paradoxical effect. On one hand they indeed limit mergers on a global scale, but on the other hand they foster them in the regional markets (e.g. intra-EU), at the same time pushing airlines towards different forms of cooperation on the transcontinental routes.[18]

Finally one has to mention that recent market developments reveal attempts to circumvent these EU-imposed restrictions. The rapidly expanding Gulf States carriers are investing heavily in various European airlines (Community carriers), and by the acquisitions of shares between these partially-owned operators could try to encroach on the ownership and control restraints.[19] So far no proceeding concerning this practice has been instigated.[20]

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spoke model is to a certain extent diverse in itself (*e.g.* K. Button, *Wings Across Europe: Towards an Efficient European Air Transport System*, Ashgate, Aldershot: 2004, pp. 31-34).

[13] P.P. Belobaba & A. Odoni, *Introduction and Overview*, [in:] P.P. Belobaba, A. Odoni & C. Barnhart (eds.), *The Global Airline Industry*, Wiley & Sons, Chippenham: 2010, p. 6.

[14] Wensveen & Wells, *supra* note 7, p. 175.

[15] *Ibidem*.

[16] Havel, *supra* note 1, pp. 133 et seq.; Cheng-Jui Lu, *supra* note 2, pp. 16-22. *See generally* I. Lelieur, *Law and Policy of Substantial Ownership and Effective Control*, Ashgate, Aldershot: 2003.

[17] As a result of the Open Skies Judgment (which confirmed the Community's external competences in this field), the nationality clause in bilateral agreements between EU Member States and the US was subsequently replaced by the EU Agreement and the concept of "Community Air Carrier". For the most recent legal notion: Regulation (EC) No 1008/2008 of the European Parliament and of the Council of 24 September 2008 on common rules for the operation of air services in the Community (Recast), [2008] OJ L293/3.

[18] V. Corduant & J.L. van de Wouwer, *One Sky for Europe? World-wide Challenges*, Bruylant-Homes International, Brussels: 2001, p. 88; Havel, *supra* note 1, pp. 133 et seq.; Cheng-Jui Lu, *supra* note 2, p. 54.

[19] Etihad of the United Arab Emirates acquired approx. a 29% stake in Air Berlin. This was followed by the acquisition of minority shares in, *inter alia*, Aer Lingus and Jat Airways (later renamed Air Serbia) and a 33.3% stake in the Swiss carrier Darwin Airline. Darwin will be rebranded as Etihad Regional from March 2014. *See generally* F. Alamdari, *Can Gulf Carriers Sustain Their Current Growth Rate?*, [in:] J. O'Connel & G. Williams (eds.), *Air Transport in the 21st Century: Key Strategic Developments*, Ashgate, Farnham: 2011, pp. 15-18.

[20] Although the European Commission expresses concern regarding the possible control of Air Serbia by the new strategic investor – Etihad (Serbia is not in the EU but it belongs to the European Common Aviation Area).

2. POLICY PRIORITIES – COMPETITION LAW PERSPECTIVE

In order to manage this natural tendency towards concentration, the regulatory authority – namely the European Commission (EC) – has to answer the question that was formulated in the introduction: In terms of objectives, what is more beneficial for the EU – concentration or fragmentation? There are three main competition law areas where one of these adopted paradigms must be practically applied: substantive competition law, merger control, and State aid. Before proceeding with the analysis of these policy areas it is crucial to briefly outline the concept of "relevant market".[21] Every competition case involves extensive forensic work encompassing the identification and assessment of the "relevant market" and analysis of the impact (actual or potential) of practices or proposed actions by one or more actors, i.e. in our analysis, airlines. Therefore an adequate definition of the relevant market greatly contributes to the effectiveness of regulatory actions.[22]

For the purpose of EU competition law, the relevant market in the air transport sector can be divided into two subcategories – product market and geographic market.[23] The former is based on the concept of substitutability – whether one product can be replaced by another.[24] It is based on a demand-side approach with a dichotomist distinction between time-sensitive passengers and non-time-sensitive passengers, which roughly means a division between business and leisure travellers. The latter market refers to every combination of city pairs – each of them forms a separate O&D market (O&D is an acronym for point-of-origin and point-of-destination).[25] This approach has been criticized for not adequately portraying the network effect of hub-and-spoke carriers. The Commission acknowledged the existence of this effect, but remained unconvinced about changing its current approach.[26] Therefore all market assessments, upon which the decisions presented below were based, were carried out in accordance with the above-described methodology.

2.1. Antitrust law – airline alliances involving European carriers

The primary challenge for antitrust law in the air transport sector is linked with the phenomenon of airline alliances. Despite the loosening of ownership and control

[21] "Relevant market" for the purpose of competition law need not be consistent with its counterpart in the field of economics. This is due to the difference in situational contexts and functions that both of these classifications serve.

[22] J. Kociubiński, *Relevant Market in Commercial Aviation in European Union*, 1(1) Wroclaw Review of Law, Administration and Economics 12 (2011), p. 20. "Effectiveness" is here broadly defined as the capability of producing a desired result – policy goals.

[23] Commission Notice on the definition of the relevant market for the purposes of Community competition law [1997] OJ C372/5.

[24] This can further be divided into supply-side substitution and demand-side substitution. L. Peeperkorn & V. Verouden, *The Economics of Competition*, [in:] J. Faull, A Nikpay (eds.), *The EC Law of Competition*, Oxford University Press, Oxford: 2007, p. 39.

[25] Commission Notice, *supra* note 23.

[26] *United Airlines/US Airways* [2001] OJ C270/131; *Air France/KLM* [2004] OJ C60/5.

requirements (which by all means still remain an important factor), airlines trying to expand outside the EU are still facing legal barriers, as bilateral air traffic agreements restrict services on international long-haul routes, and cabotage rules stop foreign airlines from operating on domestic routes abroad.[27] In order to tap the foreign market (e.g. EU or US), the "external" airlines have to bypass these restrictions – and if merger or direct investment is not an option, they resort to the "second best" solution – alliances.[28] The evidence reveals a measurable inclination on the part of passengers for large carriers with extensive international networks, which offer better connectivity to more destinations.[29] Furthermore, cooperation within alliances leads in many cases to a reduction of the number of stops required and an increase in frequencies available to reach a destination, with the added value of convenience.[30]

Nevertheless, while alliances between international airlines may bring consumer benefits, such alliances are inherently anti-competitive. They clearly fall within the definition of "concerted practices" and "decisions by associations of undertakings" set forth in Art. 101 of the Treaty of the Functioning of the European Union (TFEU).[31] This is especially true in light of the fact that the provision applies to all collusion between undertakings, in whatever form.[32] It is sufficient to establish that the parties involved had mutually agreed to adopt a particular form of conduct.[33] Such behaviour is generally considered illegal (Article 101(1) TFEU) as long as it has an appreciable, distortive effect on competition and trade. However, the prohibition is not absolute.[34] Under Art.

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[27] B. Allan, M. Furse & B. Sufrin (eds.), *Butterworths Competition Law 3*, LexisNexis, London: 2008; V. Rose & D. Bailey, *Bellamy & Child European Union Law of Competition*, Oxford University Press, Oxford: 2013, pp. 390-391; Stainland, *supra* note 1, p. 245.

[28] Havel, *supra* note 1, pp. 162 et seq.; Cheng-Jui Lu, *supra* note 2, p. 56; Corduant & van de Wouwer, *supra* note 23, pp. 88 et seq.; M. Weber & J. Dinwoodie, *Fifth Freedoms and Airline Alliances: The Role of Fifth Freedom Traffic in an Understanding of Airline Alliances*, 6(1) Journal of Air Transport Management 51 (2000), p. 52.

[29] T.H. Oum & A. Taylor, *Emerging Patterns in Intercontinental Air Linkages and Implications for International Route Allocation Policy*, 34(4) Transportation Journal 5 (1995), p. 6; S.W. Wang, *Do global airline alliances influence the passenger's purchase decision?*, 37 Journal of Air Transport Management 53 (2014).

[30] G. Doy, *The Quality of Service Index and Passengers Attitudes to Airline Service Levels*, Working Paper No. 6, Plymouth Polytechnic, Department of Shipping and Transport, Plymouth, UK: 1985; Weber & Dinwoodie, *supra* note 28, p. 53.

[31] The current numbering of Treaty articles will be used throughout this text.

[32] *E.g. Polypropylene* [1986] OJ L230/1, paras. 86-87; C-49/92 P *Commission of the European Communities v. Anic Partecipazioni SpA* [1999] I-04125, para. 108.

[33] C-74/04 P *Commission of the European Communities v. Volkswagen AG* [2006] ECR I-06585, Opinion of AG Tizzano, para. 48.

[34] *E.g.* C-8/08 *T-Mobile Netherlands BV, KPN Mobile NV, Orange Nederland NV and Vodafone Libertel NV v. Raad van bestuur van de Nederlandse Mededingingsautoriteit* [2009] ECR I-04529, para. 24. A practice not capable of appreciably restricting competition will fall outside the ambit of Article 101(1) TFEU according to the so-called *de minimis* principle. *See generally* 5/69 *Franz Völk v. S.P.R.L. Ets J. Vervaecke* [1969] ECR 00295, paras. 5-7; T-6/89 *Enichem Anic SpA v. Commission of the European Communities* [1991] ECR II-01623, para. 216; T-53/03 *BPB plc v. Commission of the European Communities* [2008] ECR II-01333, para. 90.

101(3) TFEU, the Commission can rule inapplicable a finding under Art. 101(1) (and 102 TFEU, which contains prohibition of abuse of dominant position) of an infringement based on an agreement or category of agreements between undertakings, any decision or category of decisions by associations of undertakings, any concerted practice or category of concerted practices.[35] In order find the general prohibition inapplicable, the agreement or category of agreements between undertakings must contribute to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefits.[36] At the same time these practices must not impose restrictions that are not indispensable to the attainment of the objective benefits and must not lead to elimination of competition.[37] In a nutshell, the application of Art. 101(3) TFEU boils down to an assessment whether the beneficial effects to consumers of an alliance outweigh the negative effects on competition.[38]

Ever since liberalization of the European air transport sector kicked-in in the mid-1990s, the European Commission has taken a generally favourable view of cross-border alliances.[39] The argument ran that these forms of cooperation would facilitate the healthy restructuring of the airline industry in Europe and lead to an improvement in the quality of customer service and better cost control.[40] One must take into account that at that time the bulk of European flag carriers were public and contained structural inefficiencies inherited from their pre-deregulation status, when they had operated in a competition-free environment.[41] In other words, European carriers were faced with an urgent need to adjust to the cut-throat global competition, and it was expected that the creation of alliances would foster this adaptation process.

However, initially there was an inadequate substantive and geographical scope to the application of EU competition law to transatlantic alliances. Insofar as cooperation concerned air operations on intra-EU (then Community) routes, the Commission had jurisdiction by virtue of Regulation 3975/87 to apply Article 101 TFEU directly.[42]

[35] Article 9 and 10 Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, [2003] OJ L1/1.

[36] This stems from the direct wording of Article 101(3) TFEU that is directly applicable under Article 1(2) of Regulation 1/2003.

[37] *See generally* 71/74 *Nederlandse Vereniging voor de fruit- en groentenimporthandel, Nederlandse Bond van grossiers in zuidvruchten en ander geimporteerd fruit "Frubo" v. Commission of the European Communities and Vereniging de Fruitunie* [1975] ECR 00563 on the indispensability criterion and 6/72 *Europemballage Corporation and Continental Can Company Inc. v. Commission of the European Communities* [1975] ECR 00495; T-7/93 *Langnese Iglo GmbH v. Commission of the European Communities* [1995] ECR II-01533 on the no elimination of competition criterion.

[38] *See generally* V. Bilotkach, K. Hüschelrath, *Airline alliances and antitrust policy: The role of efficiencies*, 21 Journal of Air Transport Management 76 (2012).

[39] European Commission, *25th Report on Competition Policy*, Brussels 1995, para. 76; Allan et al., *supra* note 26, p. IX-215. The Commission has prohibited very few alliances. For a notable example, *see SAS/Maersk* [2001] OJ L265/15.

[40] European Commission, *supra* note 39.

[41] Stainland, *supra* note 1, p. 110.

[42] Allan et al., *supra* note 27, p. IX-216.

However, where the alliance concerned cooperation on third country routes, the Commission had only the limited powers inferred by Article 105 TFEU, and as per Article 104 TFEU national authorities have the final say.[43] Finally, with the entry into force in 2009 of Regulation 487/2009, the EC has been given right to establish whether an alliance falls within the prohibition of Article 101(1) TFEU, or whether it should be deemed acceptable in accordance with the exemptions set forth in Article 101(3) TFEU.[44] The EC's scrutiny may cover: joint planning and coordination of airline schedules; consultation on tariffs on scheduled air services; joint operations on new, less busy scheduled air services; slot allocation and airport scheduling; common purchases; or the development and operation of computer reservations systems.[45]

The Commission's decisions with respect to alliances have usually been accompanied by remedies aimed at facilitating *de novo* entrants into the routes affected, in particular by the surrender of a certain number of slot allocations (scheduled times for take-offs and landings) at a given airport.[46] New entries may also be fostered by the obligation imposed on existing airlines to enter into interlining agreements with new entrants in order to facilitate their access to the market.[47] For example, in the most recent *BA/AA/Iberia* decision, which concerned an agreement between British Airways, American Airways and Iberia to establish a joint-venture on certain routes between the US and EU, involving coordination of schedules and pricing as well as revenue sharing, the EC accepted the commitments to make slots available at the London (Heathrow) airport.[48] In earlier cases, slot divestitures were required in the decisions *Air France/Alitalia* and *bmi/Lufthansa/SAS.*[49] One must note that in the current *communautaire* system of slot allocation, new entrants usually begin their operations from the less favourable slots, which in turn has a negative impact on their overall competitiveness in the market.[50] In other words, the system is prone to anti-competitive behaviours, and these are the circumstances that have to be addressed in the impact assessment of an alliance.

Furthermore, parties are required to establish interlining agreements between alliance members and their competitors.[51] These are agreements to handle passengers

[43] *Ibidem*.

[44] Council Regulation (EC) No 487/2009 of 25 May 2009 on the application of Article 81(3) of the Treaty to certain categories of agreements and concerted practices in the air transport sector [2009] OJ L148/1.

[45] *Ibidem*. However, the Commission adopted a new block exemption providing a short term exemption for agreements concerning slot allocation and tariffs. Commission Regulation (EC) No. 1459/2006 of 28 September 2006 on the application of Article 81(3) of the Treaty to certain categories of agreements and concerted practices concerning consultations on passenger tariffs on scheduled air services and slot allocation at airports [2006] OJ 272/3.

[46] *E.g. Lufthansa/SAS* [1995] OJ C200/10; *Austrian Airlines/Lufthansa* [2002] L242/25; *British Airways/TAT (II)* [1996] OJ C316/11.

[47] Rose & Bailey, *supra* note 27, p. 973.

[48] *BA/AA/Iberia* (Case COMP/39596) – Commitments decision of 14.07.2010. Not published in the Official Journal.

[49] *Air France/Alitalia* [2004] OJ L362/17; *bmi/Lufthansa/SAS* [2001] OJ C83/6.

[50] J. Balfour, *Some Lessons from the European Experience*, XX AASL 497 (1995).

[51] *E.g. BA/AA/Iberia*; *Austrian Airlines/Lufthansa*; *KLM/Alitalia* [2000] C96/5.

on itineraries that require multiple airlines.[52] Also commitments cover the opening of frequent flyer programmes to competitors.[53] It goes without saying that this kind cooperation is at the very core of alliancing behaviour, especially with *hub-and-spoke* carriers involved.[54] Thus by forcing airlines into such agreements, regulators are increasing the level of interdependences in the sector concerned.[55] In this vein, one may argue that managing the dependencies and interdependencies can be perceived as a key consideration for functioning in the alliance environment.[56] So one may draw a conclusion that the aforementioned remedies (commitments), by increasing operational links between networks, are creating mutual dependencies, which would seem to suggest an inclination towards concentration.

2.2. Merger control

Merger Control has always been perceived as a primary tool for maintaining market structure in terms of concentration *versus* fragmentation.[57] The reality is bit more complicated, as Merger Control Regulation (ECMR) covers, under certain conditions, both alliances and full mergers. As a rule of thumb, for the acquisition of non-controlling shares, the EU's antitrust law, namely Article 101 TFEU, is applicable (subsequently, scrutiny under Article 102 TFEU may kick-in).[58] In order to fall within the ambit of ECMR, the alliance must fulfil the criteria for a full-functioning joint venture and exceed the ECMR turnover threshold (the so-called Community dimension).[59] Additionally, the Commission only has jurisdiction to control mergers which are deemed to constitute a "concentration", and then only to those that have a turnover-related "Community dimension".[60] Concentration could be further divided into "mergers" when two or more undertakings amalgamate into a new entity, when one entity is absorbed by another, or when an "acquisition of control" takes place, all of which, broadly speaking, involve one undertaking having decisive influence on all strategic decisions of the other

[52] Wensveen & Wells, *supra* note 7, p. 265.

[53] E.g. *Lufthansa/SAS*; *British Airways/TAT*; *Austrian Airlines/Lufthansa*; *KLM/Alitalia*.

[54] *See* B. Kleymann & H. Seristö, *Managing Strategic Alliances*, Ashgate, Aldershot: 2004, pp. 17-29.

[55] B. Kleymann & H. Seristö, *Levels of Airline Alliance Membership: Balancing Risks and Benefits*, 7(5) Journal of Air Transport Management 303 (2001).

[56] *Ibidem*; *cf.* J. Pfeiffer, G. Salancik, *The External Control of Organizations*, Harper & Row, New York: 1978.

[57] *See generally* E. Navarro Varona, *Merger Control in the European Union: Law, Economics and Practice*, Oxford University Press, Oxford: 2005, p. 215.

[58] The relevance of Article 102 TFEU is limited, as its provision applies to situations of abuse of a dominant position, not to the conditions leading to its creation (*e.g.* R. O'Donoghue, J. Padilla, *The Law and Economics of Article 102 TFEU*, Hart Publishing, Oxford, Portland, OR: 2013). Although in the *British Midlands/Aer Lingus* case ([1992] OJ L96/34), interlining was refused on the grounds of infringement of Article 102 TFEU.

[59] Council Regulation (EC) No. 139/2004 of 20 January 2004 on the control of concentrations between undertakings [2004] OJ L24/1.

[60] *Ibidem*, Article 1(3).

party.[61] It should be noted that the concept of control is a very broad-ranging issue and poses serious interpretational conundrums, but for the sake of this discussion the above-described rudimentary outline should suffice.[62]

At the level of value judgment, the assessment of "concentration/control" bears similarities, under substantive competition law, with the assessment of "concerted practices" described above. It similarly includes an analysis whether the increased efficiency gained by a merger outweighs the anti-competitive effect of market concentration and gains in terms of market shares.[63] This requires not only a quantitative assessment of a merger's effects on consumers' welfare, which is a difficult task impregnated with controversy, but also a weighing of consumers' interests in different markets (product market and geographic market).[64] Also, due to the national interests involved mergers will unavoidably fuel public debate (many European flag carriers are public, or the State is the majority shareholder).[65]

Additionally, the Commission's power in applying ECMR is not limited to European Carriers. There are some very significant cases involving US-based operators, and there is common understanding between the EU and US that cooperation between competition authorities on transatlantic markets (approx. 60% of global air traffic) is absolutely necessary. There are also international agreements in place to adequately increase the territorial scope of competition law for transatlantic mergers.[66] Therefore all markets in which carriers/parties to concentration operate, including routes between the EU and third countries, are within the scope of the ECMR. It goes without saying however that the EC's assessment of such transcontinental alliances does not cover their impact on the global competitiveness of the sector, but is limited to the effects felt in the Internal Market.[67]

In recent years the Commission has taken a rather permissive approach towards mergers, clearing British Airways/Iberia,[68] United Airlines/Continental[69] and US Airways/American Airlines.[70] In its most recent decision, in October 2013, the EC approved the acquisition of Olympic Air by Aegean Airlines.[71] The last merger had been

[61] The ECMR's scope does not overlap with the Control & Ownership Clauses. The former is applied to intra-EU operations where there are no nationality restrictions, while in latter case the influx of foreign capital would never be sufficient to grant effective control.

[62] *See also* Navarro Varona, *supra* note 57.

[63] Cheng-Jui Lu, *supra* note 2, p. 91 et seq. *Cf.* O.E. Williamson, *Economies as An Antitrust Defense: The Welfare Tradeoffs*, 58(1) American Economic Review 18 (1968).

[64] F. Fichert, *Remedies in Airline Merger Control – The European Experience*, [in:] W.Y. Szeto, S.C. Wong & N.N. Sze (eds.), *Transport Dynamics: Proceedings of the 16th International Conference of Hong Kong Society for Transportation Studies*, Hong Kong, p. 367.

[65] *See also* E. von den Steinen, *National Interest and International Aviation*, Kluwer Law International, Alphen aan den Rijn: 2006, pp. 156 et seq.

[66] Air Transport Agreement, [2007] OJ L134/4.

[67] Cheng-Jui Lu, *supra* note 2, p. 123.

[68] *British Airways/Iberia* [2010] OJ C141/1.

[69] *United Airlines/Continental* [2010] OJ C255/1.

[70] *US Airways/American Airlines* [2013] OJ C279/6.

[71] *Aegean Airlines/Olympic Air (II)* [2013] OJ C70/30.

previously rejected (2011) due to possible monopolization risks as the case concerned two Greek carriers based at the same airport. However, under the changing economic conditions following the Greek crisis, the parties notified the transaction again in early 2013.[72] The Commission's investigation showed that Olympic Air would be forced to exit the market due to financial difficulties if not acquired by Aegean. So Aegean would have become a dominant provider in any case, thus there was no real point to opposing the merger. Previously the most notable example of consolidation in the airline industry was the merger of Air France with Dutch KLM.[73] Despite expressing serious competition-related concerns, the Commission cleared the merger, which gave rise to the biggest airline in the world at that time in terms of total operating revenues and international passenger-kilometers.[74] Other significant recent cases include the takeover of Austrian Airlines by Lufthansa, and the earlier cases *Sabena/Swissair*,[75] *SAS/Spanair*,[76] *United Airlines/US Airways*,[77] *British Airways/TAT (I)*,[78] and *Aer Lingus/British Midlands*.[79]

Approximately two thirds of all decisions approving mergers were accompanied by remedies aimed at mitigating the anti-competitive effects of concentration.[80] Quite like in antitrust cases, slot divestitures are an absolute condition to boost competition on a market involving merging carriers.[81] Remedies cover the obligation to transfer slots to both competitors and new entrants – depending on the case – but there is surprisingly little factual information available regarding the criteria for determining which slots should be surrendered and how many.[82] One may argue that slot divestiture is the only fail-proof legal tool in support of market opening in the case of mergers. However, most of the would-be competitors who expressed interest in these markets and could potentially take over surrendered slots were too small to begin effective competition.[83] The sheer size of the newly-created merged entities (most notably Air France/KLM) serves as a deterrent to potential competitors.[84] And there is a convincing body of data that

[72] *Aegean Airlines/Olympic Air (I)* [2011] OJ C195/11.

[73] *Air France/KLM* [2003] OJ C60/5.

[74] Havel, *supra* note 1, pp. 457 et seq.

[75] *Sabena/Swissair* [1995] OJ C96/5.

[76] *SAS/Spanair* [2002] OJ C93/7

[77] *United Airlines/US Airways*.

[78] *British Airways/TAT (I)* [1992] C272/5.

[79] *British Midlands/Aer Lingus*.

[80] Fichert, *supra* note 64, p. 363. European Commission (2008) Commission notice on remedies acceptable under Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004.

[81] *Air France/KLM*; *Lufthansa/Swiss* [2005] OJ C66/25; *Lufthansa/Eurowings* [2005] OJ C18/22; *Lufthansa/SN Brussels* [2008] OJ C312/15; *Iberia/Vueling/Clickair* [2009] OJ C72/23; *Lufthansa/Austrian Airlines* [2010] OJ C16.

[82] Fichert, *supra* note 564, p. 364.

[83] L. Bonova, D. Koska, A. Specker, *Consolidation of the EU airline industry: How the Commission kept seatbelts fastened in the 2009 airline merger wave*, Competition Policy Newsletter (2009), pp. 53-57.

[84] *Ibidem*; Fichert, *supra* note 64, pp. 365 et seq.

forfeited slots are more likely to be picked up by the existing competitor(s) and used to increase their frequencies rather than by new entrants.[85] This however is in any case beneficial for competition and most likely for consumers as well, probably even more so than if the were slots taken over by *de novo* entrants which, due to their scarcity and size, would be able to offer only rudimentary service in terms of locations and frequencies.[86] This observation is in full accordance with that of the former competition commissioner, Neelie Kroes, who stated that concentration is the way to achieve consumer welfare.[87] However, there is also sufficient incentive for an incumbent to try to regain its monopoly.[88]

Regulatory remedies are considered necessary where regulations are considered a barrier to entry.[89] They may cover a government commitment to change the regulatory regime by, *inter alia*, abolishing capacity restrictions, changing corporate governance rules for the carriers, or opening up routes for carriers from third countries.[90] Generally the Commission's approach goes in line with the industry's natural tendency towards concentration.

2.3. State aid

At the first glance the State aid issue seems to be marginally important to the discussed subject. However, it is particularly relevant in the case of rescue and restructuring aid (R&R aid). Owing to relatively small profit margins, the financial condition of the air transport sector is to a large extent dependent on the global economic situation.[91] Any slowdown in the economy directly translates into a lower passenger yield. Added to this are rising fuel costs, increased operating costs derived from overcapacity on domestic markets, and elevated security costs at commercial airports. These are the root causes of the industry's condition.[92] Although given the sector's susceptibility to so-called "Black Swan Events", 9/11 is perceived as the triggering factor to its worst economic downturn, in fact it only deepened a problem that had already existed. And

[85] *Ibidem*; Balfour, *supra* note 50, p. 497.

[86] It would still be problematic whether such low frequency service would be economically viable for a network carrier. *See* M. Franke, *Competition Between Network Carriers and Low-Cost Carriers: Retreat Battle or Breakthrough to a New Level of Efficiency*, 10(1) Journal of Air Transport Management 15 (2004), p. 17.

[87] Quoted [in:] B. Rumensdorfer, *If Faced with a Forced Landing, Fly as Far into the Crash as Possible: Remarks on the AUA Case*, 1 European State Aid Law Quarterly 49 (2011), p. 51.

[88] F. Fichert, *Predatory Behaviour in Air Transport Markets: A Perpetual Challenge to Competition Policy?*, [in:] C. Esser & M.H. Stierle (eds.), *Current Issues in Competition Theory and Policy*, VWF, Berlin: 2002, pp. 261-275. Due to insufficient resources, a small operator would not be able to resort to "hoarding" by utilizing loss-generating slots just to keep them under the "use-it-or-lose-it" rule (see *supra* note 78), therefore is highly likely that previously surrendered slots would return to the "pool".

[89] Allan et al., *supra* note 27, pp. IX-268.

[90] *Sabena/Swissair*; *Lufthansa/SAS* [1996] OJ L54/28.

[91] B. Vasigh, K. Fleming & T. Tacker, *Introduction to Air Transport Economics: From Theory to Applications*, Ashgate, Farnham: 2013, p. 2.

[92] *Ibidem*, p. 3.

after economic resurgence returned the industry to profitability in 2006-2007, the global financial crisis caused 2008 to be one of the worst years in the history of commercial aviation, after which the market began a slow stabilization around 2010. All these factors drove many air carriers into dire financial situations, requiring a public lifeline.[93]

While the rescue of ailing, inefficient European operators is certainly not laudable and in addition quite contrary to the Treaties' principles, rescue aid aimed at allowing short-term survival, coupled with restructuring aid to restore long-term financial viability, is acceptable under specific, strict circumstances.[94] The European Commission took the view that by aiding in the restructurisation of inefficient carriers, it was in fact transferring the costs of this operation on its competitors. Additionally, the aid must be granted according to the "one-time last-time" principle, which means only one aid grant is allowed every ten years and must not exceed the minimum required to restore a company's financial viability.

Compensatory measures form an integral part of a restructuring plan.[95] Since it is assumed that every aid measure disrupts competition and thus that certain compensation is required in order to restore sound competitive processes,[96] every beneficiary of aid is obliged to scale down its operations by withdrawing from parts of profitable activities, regardless of the structural overcapacity in the sector.[97] There is no predefined threshold of compensation, but it is stipulated that compensatory measures must be in proportion to the distortive effects of the aid, and must not lead to a deterioration in the structure of the market, for example by having the indirect effect of creating a monopoly or a close-knit oligopolistic situation.[98] In the air transport sector, the measures in question predominantly take the form of fleet reduction, capacity reduction (measured in ASK – available seat per kilometre) and slot divestitures, although they are established on a case-to-case basis.[99] Indeed, analysis of the European Commission's case-law shows a significant disparity between levels of compensation. For instance, medium-sized Austrian Airlines was required to reduce capacity by approximately 15%,

[93] *Ibidem*.

[94] Communication from the Commission, *Community guidelines on State aid for rescuing and restructuring firms in difficulty* [2004] OJ L244/2 (R&R Guidelines). There are also sector-specific guidelines from 1994 (Application of Articles 92 and 93 of the EC Treaty and Article 61 of the EEA Agreement to State aids in the aviation sector [1994] OJ C350/5) and although not formally amended, due to market changes that took place in the meantime they are not used anymore.

[95] M. Lienemeyer, *State Aid to Companies in Difficulty: The Rescue and Restructuring Guidelines*, [in:] M. Sanchez Rydelski (ed.), *The EC State Aid Regime: Distortive Effect of State Aid on Competition and Trade*, Cameron May, London: 2006, pp. 208 et seq.

[96] *See* joined cases C-278/92, C-279/92 and C-280/92 *Spain v. Commission (Hytasa)* [1994] ECR I-04103.

[97] Lienemeyer, *supra* note 85, p. 208. Lack of compensation would cause aid to be considered incompatible with the Internal Market. See case T-16/96 *Cityflyer Express Ltd v. Commission* [1998] ECR II-00757, para. 55.

[98] R&R Guidelines, *supra* note 94, para. 39.

[99] *Ibidem*, para 40.

while the small CSA Czech Airlines' fleet has been slashed in half, which resulted in a capacity reduction of approximately 30%.[100]

In a naturally oligopolistic sector like commercial aviation, the major network carrier is naturally predisposed to jump into routes where the beneficiary of aid ceases operation due to compensation constraints.[101] These major carriers not only have resources readily available, but in addition (as has been described) the slot allocation system in the EU positions new entrants in an unfavourable position in comparison to incumbents.[102] Hence there seems to be a distinct possibility that as a result of the application of the compensatory measures in question the attainment of a dominant position or, in the worst case scenario, a *de facto* monopoly may be facilitated.

Furthermore, such a scenario would be detrimental to consumers' welfare. Not only would there be a decreased choice of available carriers, but prices would go up. This would happen naturally – as soon as an airline's Revenue Management System would register a lack of competition it would start testing different prices and tariff structures aimed at maximisation of profits.[103] The case of the Polish Airline LOT is particularly relevant here.[104] By withdrawing from international connections from regions, the carrier is abandoning these markets to Lufthansa, which is the only carrier able to fill the vacuum. It goes without saying that in the case of monopolisation of these routes, the rules upon which compensation is determined will be infringed.[105] It is the Commission which has the final say in this matter, therefore it is particularly hazardous to adopt compensatory measures prior to a decision, as it may happen that reversal of the negative market effects would be impossible. Therefore, since the European Commission has adopted a policy of "deep cuts" in terms of the compensatory element of R&R aid, while the beneficiaries are kept afloat it is the major players who are reaping the real profits. Generally a pro-consolidation approach is not necessarily bad, but the question remains open whether this policy should be pursued (albeit most likely unintentionally) through R&R aid.

CONCLUSIONS

Currently the European champions (Air France/KLM, British Airways/Iberia and the Lufthansa group) are approaching a quasi-monopolistic position in their domestic markets.[106] However, in order to enable them to effectively compete on the global

[100] *See Austrian Airlines* [2010] OJ L59/1. *Cf also CSA Czech Airlines* [2013] OJ L92/16 and *Air Malta* [2012] OJ L301/29.

[101] *Cf. Air Malta* and the consequences of divestiture of slots at London (Heathrow).

[102] Balfour, *supra* note 50, p. 497.

[103] *See generally* Vasigh, Fleming & Tacker, *supra* note 90, pp. 347 et seq.

[104] Cases: SA.35900 (Rescue Aid); SA.36874 (Restructuring Aid).

[105] R&R Guidelines, *supra* note 94, para 40.

[106] M. Benacchio, *Consolidation in the Air Transport Sector and Antitrust Enforcement in Europe*, 8(2) European Journal of Transport and Infrastructure Research (2008), p. 114.

markets it is necessary to put more emphasis on gains in efficiency.[107] Otherwise these "complacent giants" might not only fail to deliver a truly competitive product on the global market, but could as well divide the intra-EU market among themselves and lose any incentive for expansion. This is of course the worst case scenario and is raised here just for the sake of discussion (and in addition it is highly unlikely in the short- to medium-term), but its underlying logic is sound and it emphasizes the need to apply tailor-made remedies to reflect major changes and the new equilibriums within the industry.[108]

The traditional remedies are generally route-specific, while effects of alliances, mergers or State aid grants are felt not only on the relevant market, but also on other markets not necessarily linked with the core business of the carriers involved.[109] Furthermore it may have cross-sector impact (i.e. on airports, ground handling services, and maintenance services). Therefore it seems prudent to partially depart from the behavioural remedies prevailing today and put more emphasis on structural ones. However, this basic shift would still not guarantee that "incentives" (upon which structural remedies are based) would suffice. Yet one may argue that if this bait doesn't work, no remedy would be able to boost competition.[110]

As has been said, the air transport sector has a natural tendency toward concentration. Therefore one must recognize that regardless of which regulatory approach is adopted, natural market trends and their dynamics cannot be ignored. There is a common misconception that competition law is a very technicist branch aimed at safeguarding only the competitive process in itself. In fact, competition is primarily a means to an end. It is true that sound economic analysis will always be at the very foundation of every competition law case, but at the end of the day, the final say will be based on a value judgment balancing economic and non-economic priorities, both of which enjoy equal legal status. So the question is not whether one is for or against concentration, but rather the point of focus should be on how to manage and guide the naturally-occurring market dynamics to "squeeze" out the maximum benefits for customers' welfare (with no loss of economic efficiency if possible). The blanket statement that increased competition will bring about consumer welfare is, while true in principle, in itself not sufficient to safeguard economic efficiency at an appropriate level.

The problem that immediately arises here is the stratification of passengers/customers. It goes without saying that the business traveller will have different expectations concerning quality of service, flexibility, and frills than someone going on holiday.[111] The distinction between time-sensitive and non-time-sensitive passengers is, despite

[107] M. Tretheway, *The competition effects of airline mergers and alliances*, IATA, April 2008, p. 3.

[108] Benacchio, *supra* note 96, p. 114.

[109] *Cf.* Button, *supra* note 12, p. 8; G. Burghouwt, J.R. Hakfoort & J.R. Ritsema van Eck, *The Spatial Configuration of Airline Networks in Europe*, 9(5) Journal of Air Transport Management 309 (2003).

[110] Benacchio, *supra* note 96, p. 114.

[111] P.P. Belobaba, *Overview of Airline Economics, Markets and Demand*, [in:] Belobaba et al., *supra* note 13, pp. 46-72.

its shortcomings, a helpful analytical tool. But while the identification of customers' preferences certainly has its merits (as well as its analytical value for economists and managers), the final decision belongs to the regulator – the European Commission and the legislative bodies, the European Parliament with the Council. These bodies are *ex lege* obliged to strike a balance between these preferences as they all fall under the notion of consumer welfare.[112]

[112] *See* H. Vedder, *Competition Law and Consumer Protection: How Competition Law Can Be Used to Protect Consumers Even Better – Or Not?*, 17(1) European Business Law Review 83 (2006).