

EC competition law and airline alliances

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Abstract

The EC Commission has examined a number of airline alliances under EC competition law. Its general approach is to identify the relevant market(s), to assess the likely effect on competition in those markets and then to propose remedies/conditions. Remedies generally include those: concerning operations on the route(s); allowing competitors access to certain facilities; involving undertakings by governments; and involving wider conditions. The Commission's approach and policy has developed with experience, as can be seen from its decisions. It is still too early to tell whether the Commission has been successful, but it has to achieve a delicate balance between, on the one hand, permitting some consolidation in the excessively fragmented European market, and on the other ensuring that competition is sufficiently protected.

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1. Introduction

This article will examine the application by the EC Commission of the competition rules in the EC Treaty in the area of airline alliances, and in particular, how the Commission's policy has significantly evolved over the past several years.

It is a subject of great topical importance, given the explosion in cooperative arrangements between airlines, and the emergence of at least three major global airline alliances (Star, led by United and Lufthansa, oneworld, led by American and British Airways, and SkyTeam, led by Delta and Air France).

Alliances are prevalent among airlines for various reasons, but perhaps one of the most important is the negative reason that, generally, cross-border mergers and acquisitions between airlines are not possible. This is because most bilateral air services agreements between pairs of states (from which airlines derive the right to operate international air services) provide that a state may refuse to allow an airline from the other state to operate if it is not substantially owned and effectively controlled by that other state or its nationals. Hence, a merger between two airlines from different states, or the acquisition by an airline from one state of an airline from another, would entitle most of the other states to

which such airline(s) operated to withdraw operating permission. It is generally considered that it was concerned about such consequences which led to the abandonment of the recently discussed possible merger between British Airways and KLM. Given this situation, alliances, not involving the acquisition of substantial ownership or effective control, are the next best available option.

2. The competition rules

The principal provision of the EC Treaty which is relevant to airline alliances is Article 81, which prohibits and makes void agreements preventing, restricting or distorting competition affecting trade within the EC, subject to the possibility of exemption (for a limited period) where, essentially, sufficient consumer benefit can be shown. Article 82, the other principal competition rule, prohibits abuse of dominant position, and hence is mostly applicable to unilateral behaviour, and not alliances, although it can apply to positions of "collective dominance".

In addition, Regulation 4069/89 (as amended) provides for Commission control of large concentrations (i.e., mergers and take-overs) which create or strengthen a dominant position and impede effective competition.

Depending on the way in which they are structured, airline alliances may be investigated by the Commission

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either under Article 81 or, if they are considered to be more concentrated in nature, the merger Regulation. For example, the Commission investigated the KLM/Alitalia alliance under the merger Regulation, even though no equity participation was involved.

The competition rules are enforced by DG Competition of the EC Commission. Enforcement of the competition rules is facilitated by way of implementing regulations, which, among other things, empower the Commission to conduct investigations, impose fines and grant exemptions. Although most other sectors are covered by a general implementation, air transport is governed by special sectoral implementing regulations (Council Regulations 3975/87 and 3976/87), although, following a recent amendment in the system, it will be treated as other sectors from May 2004.

Currently, however, the special air transport implementing regulations only apply to air transport within the EC, and there are no implementing regulations with regard to air transport between the EC and other states, which makes enforcement difficult, though not impossible. The Commission has on several occasions proposed so extending the scope of the implementing regulations, but without success, and issued a further such proposal in February 2003 in the wake of the judgments of the European Court of Justice on 5 November 2002 in the so-called “open skies” cases, concerning the legality of air services agreements between eight member states and the US.

3. The commission’s general approach

Over the period since 1996, the Commission has investigated and cleared (in most cases subject to conditions) a number of alliances between airlines. Its approach, which closely follows that in the case of airline concentrations (of which it has examined a greater number), can therefore be described with some accuracy, although it is important to note that the Commission’s approach is constantly evolving.

The starting point is to define the relevant market or markets. As in other sectors, the market is essentially defined with regard to demand substitutability—in other words, the relevant market comprises all those transport services which a passenger would consider reasonably substitutable with one another. Obviously, this includes direct flights between the same two airports, but it also can include, to some extent, direct flights from airports with overlapping catchment areas, indirect flights (depending on how attractive the timing is), and on short-haul sectors, other modes of transport. As a general rule, the longer the route in question, the more likely the Commission is to accept that competition exists from indirect flights. A further, relatively recent, refinement in the Commission’s approach is to consider

that the market, even on a particular route, should be divided between time-sensitive and non-time-sensitive (but generally price-sensitive) passengers: clearly, indirect competition is likely to be much more relevant in the latter case.

The next step is to analyse what effect the proposed alliance would have on competition in the relevant market or markets. Although the test under Article 81 does not expressly involve an assessment of dominance (as opposed to the test under the merger regulation, which does), nevertheless, the Commission generally takes a similar approach in practice. Clearly, the parties’ market shares on the relevant routes are of prime importance from this respect. But also important is the structural situation—i.e., whether there are legal or practical barriers to entry by potential competitors. The shortage of slots at a particular airport is an important practical constraint, and provisions of relevant bilateral air services agreements may create a legal barrier to the entry of new competition. The existence of strong networks and hubs at a particular airport may also provide a barrier, because it is difficult in practice for an airline to compete on a new route to an airport where an incumbent airline has a large number of connecting flights to offer to transfer passengers (which may constitute the majority of traffic on some flights).

The Commission then makes its assessment of the likely effects on competition, and may refuse to allow the proposed alliance to proceed. The Commission has not yet done this in the case of an airline alliance (although it has in a few cases under the merger regulation). More normally, the Commission will permit the transaction to proceed subject to certain conditions or remedies, as they are often known.

4. Remedies

The types of remedies which the Commission has found acceptable in the case of airline alliances can best be seen from [Table 1](#), in which they are briefly summarised. They may broadly be broken down into four categories:

- Remedies concerning operations on the relevant route or routes, such as the freezing or reduction of capacity, and constraints on fares, in respect of services operated by the parties.
- Remedies which involve the parties agreeing to allow would-be competitors access to certain facilities they need in order to mount effective competing services. The most important of such facilities are airport slots—at any rate at airports which are congested, although clearly it is not an available remedy at airports where there is no difficulty for an airline to obtain slots at satisfactory times. Other remedies of

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