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TURKISH AVIATION ACADEMY

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Competition Law and the Airline Industry

Module 21

Istanbul Technical University

Air Transportation Management, M.Sc. Program

Air Law, Regulation and Compliance Management

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Outline

- Antitrust law
 - Types of business conduct
- Antitrust issues in the airline industry
 - Mergers and acquisitions
 - Cartels and conspiracies
 - Unlawful monopolization
 - Deceptive practices

Antitrust Law

What is antitrust law?

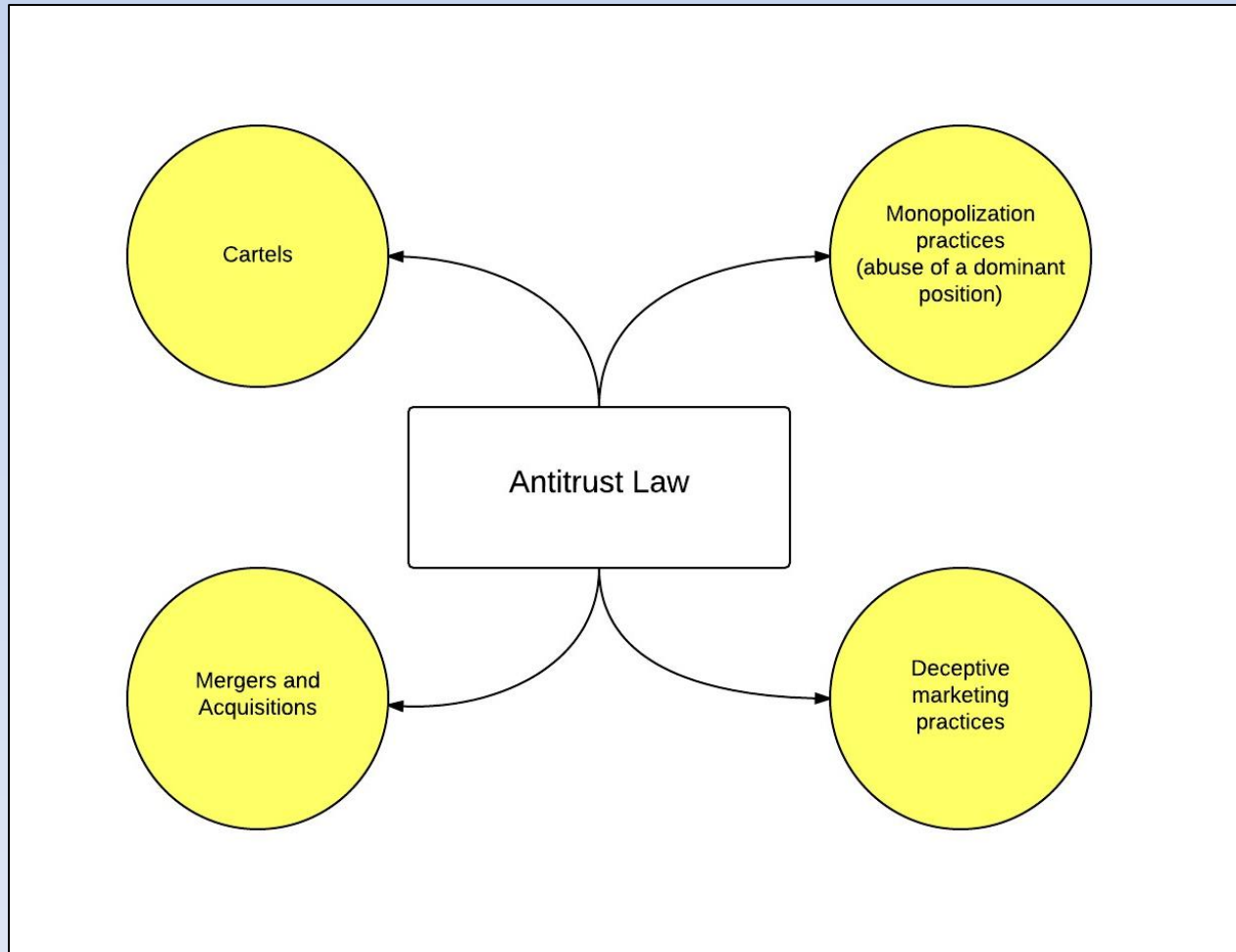
- Antitrust law encompasses laws which regulate the conduct of businesses with the aim to promote fair competition in the marketplace to the benefit of consumers.



Objectives of antitrust law and policy

- There is a broad consensus that the main goal of antitrust policy is to **encourage market efficiency and protect competition in the market** rather than protecting individual competitors.
 - Economists and lawyers agree that promoting market efficiencies is the fundamental goal of antitrust policy and law.
- A competition authority's main task is to promote competitive markets in order to achieve an efficient market outcome where consumers will benefit from competitive prices and a greater variety of product choices.

Business conduct that may violate antitrust laws



U.S. antitrust laws

- Sherman Antitrust Act of 1890
- Clayton Act of 1914
- Robinson-Patman Act of 1936
- Federal Trade Commission Act of 1938
- Civil Aeronautics Act of 1938 (Federal Aviation Act of 1958)

Section 1 of the Sherman Act

- Prohibits contracts, combinations, and conspiracies in restraint of trade.
 - Airlines seek antitrust immunity to create alliances.
- The purpose of the antitrust laws is to protect competition, not protect individual competitors. Thus, it is not enough to show that the restraint caused the plaintiff economic injury.
 - To determine whether the agreement has an adverse effect on competition, courts examine such factors as reduced output, increased prices and decreased quality.

Section 2 of the Sherman Act

- Prohibits monopolization and attempts to monopolize
 - Focuses on market power – the ability to reduce service and/or raise price to maximize wealth, at the price of consumer welfare.
- Market power is the ability of a firm to raise prices to supracompetitive levels and maintain them profitably.

EU antitrust laws

- The Treaty on the Functioning of the European Union (TFEU)
- Article 101 of TFEU
 - prohibits agreements between two or more independent market operators which restrict competition (vertical and horizontal agreements)
 - Price-fixing
 - Limitation or control of production
 - Shared markets or sources of supply
- Article 102 of TFEU
 - prohibits firms that hold a dominant position on a given market to abuse that position

Antitrust Issues in the Airline Industry

Airline competition matters

- Airline markets grow fast
 - 4 billion trips in 1980; 19 billion trips in 2012 (ICAO)
 - passenger traffic grew by 5.2% in 2013 over 2012
 - cargo traffic represents over 35% of value of global cargo
- Growth in passenger and cargo markets is driven by lower fares and growing income
 - liberalization and deregulation increased competition in airline markets (LCCs, ULCCs, cost synergies)
 - passengers and shippers benefited from lower prices

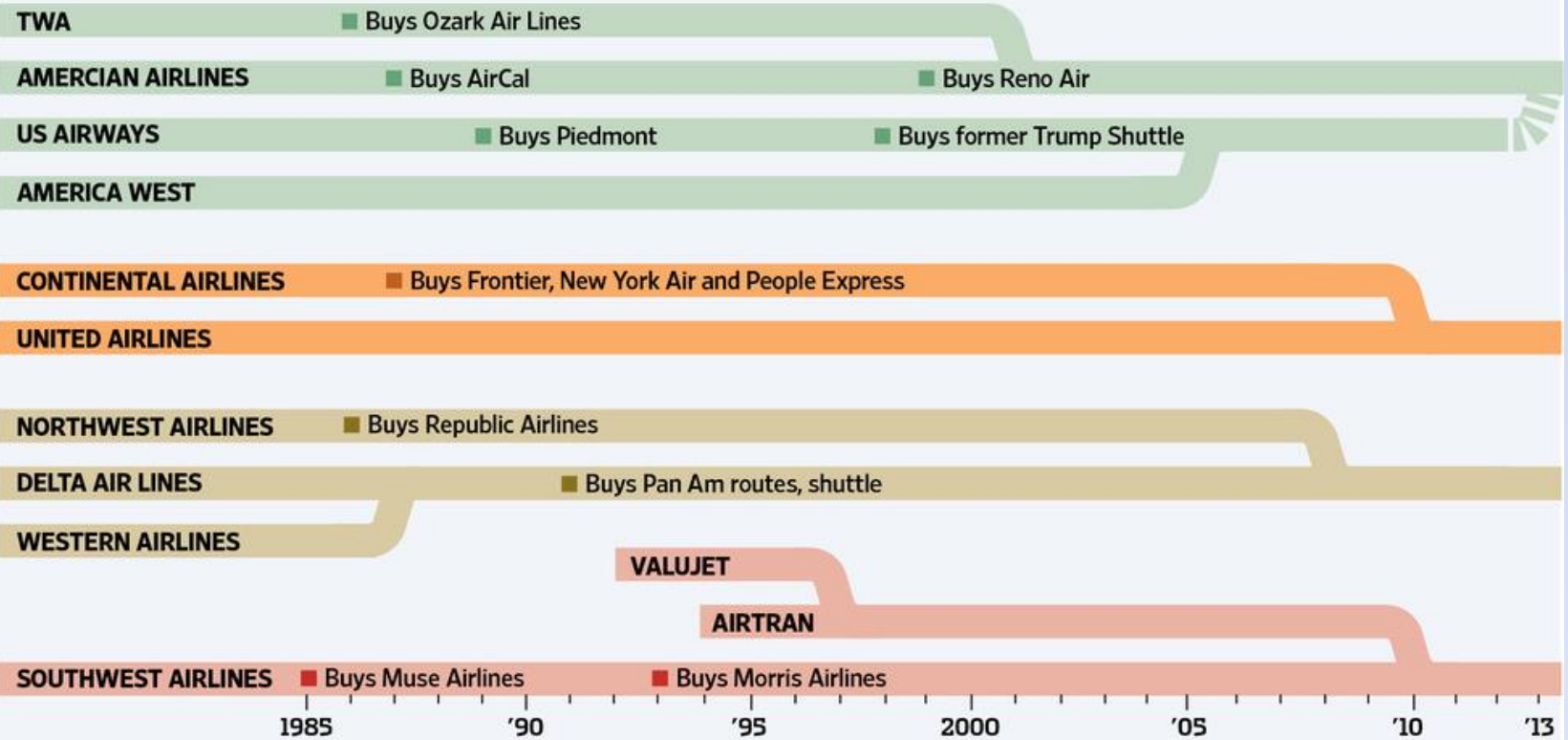
Antitrust concerns

- However, some market trends are worrisome for antitrust regulators
 - Airline agreements to conspire on price lead to inflated costs for passengers and shippers
 - Cooperation agreements between airlines may result in anticompetitive effects
 - Mergers and acquisitions lead to high levels of market concentration
 - **Some incumbent carriers have the ability to abuse their dominant position**
 - (e.g. hub airlines may use predatory strategies to preclude entry)
 - **Deceptive marketing practices may tilt a competitive level playing field**

Mergers and Acquisitions

The “New Holy Grail”

Flight Paths | Some major U.S. airline mergers since the industry was deregulated in 1978



Sources: the companies; Airlines for America

The Wall Street Journal

Cartels and Conspiracies

Cartels and conspiracies

- Cartels are the most egregious form of anticompetitive behaviour. It is unlawful in many countries around the world for competitors to agree to fix prices or divide territory.
 - In the U.S., such conduct can result in criminal prosecution by the Justice Department, or a civil suit in which treble damages are potentially recoverable.
 - In the European Union, companies may face a fine of as much as 10% of annual turnover.

Air cargo antitrust case

- A number of airlines found themselves in the cross-hairs of government antitrust lawyers in a number of countries for fuel and security surcharges
 - Some airlines paid fines totaling tens of millions of dollars



Unlawful Monopolization

Abusive practices by a dominant carrier

- A *dominant* airline is an airline that can behave relatively independently of rivals.
- Dominant carriers can abuse their strong market position by :
 - Engaging in predatory pricing
 - Limiting access to essential facilities
 - Introducing fighting brands
 - Using sham litigation
 - Abusing regulatory processes
 - Etc.

Predatory pricing

- Before deregulation carriers could not compete on price
 - fares were determined based on a cost-plus formula
 - regulation protected profit margins of existing carriers and provided price stability
- After deregulation FSNC carriers restructured networks into hub-and-spoke systems and protected fortress hubs
 - airlines acquired a potent competitive tool – the ability to undercut competitors' price

Predatory pricing

- In 1986, the U.S. Supreme Court announced that the “consensus among commentators” was that “predatory pricing schemes are rarely tried, and even more rarely successful.” It therefore created a test that make it virtually impossible for plaintiffs to prevail.
- “The Court has made a mistake. The theoretical and empirical literature now suggests that predation is possible, can be rational from the predator’s perspective, and might be quite harmful socially. . . .”
- Chris Sagers

Access to essential facilities

- Some jurisdictions require firms to provide access for competitors to facilities that are considered **essential**.
- Four elements of the essential facilities doctrine:
 1. controlled by a monopolist
 2. cannot be replicated
 3. denied use to competitors
 4. where it is feasible to provide access
- E.g. railways, airports, airline CRSs, ports, electricity wires, gas pipelines, etc.

Access to CRSs

Owners:

Air France
Iberia
Lufthansa
SAS

Users:

AF/IB/LF/SAS
Other carriers
Travel agents
OTAs
Tour operators



The European Commission adopted rules obliging CRSs to provide non-discriminatory access under the doctrine of essential facilities (Commission Regulation No. 3652/93)

Fighting brands

- Fighting/fighter brand – a lower priced alternative offered by a company to undercut a competitor
- Not always successful
 - “Ted” by United
 - “Song” from Delta
- Profits are not always the main objective; brands are designed to eliminate competition
 - Saturn by GM
 - Jetstar by Qantas



Fighting brands

Go Fly vs. EasyJet

- BA's ex-CEO Bob Ayling "borrowed" the idea from EasyJet CEO Stelios Hajiloannou
 - "when the Queen knighted Stelios she hit him a bit hard with the sword"
- In 2001, Go became a separate entity as it was cannibalizing the core brand
- In 2003, GO taken over by EasyJet



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Sham litigation



- Noerr-Pennington doctrine
 - petitioning activities are immune from antitrust liability unless it's a sham
- Sham litigation test
 - No reasonable litigant could realistically expect success on the merits
 - Litigation was an “attempt to interfere directly with the business relationships of a competitor” through the use of the process, as opposed to the hoped-for outcome

Abuse of regulatory processes

- Regulatory capture
 - regulatory agencies come to be dominated by the very industries they were charged with regulating
- 2008 FAA + Southwest scandal
 - led to \$7.5m in fine



Deceptive Marketing Practices

Misleading advertising

- **Canada:** “false or misleading representations and deceptive marketing practices in promoting the supply or use of a product or any business interest”
- **US:** “any advertising or promotion that misrepresents the nature, characteristics, qualities or geographic origin of goods, services or commercial activities”
- **Europe:** misleading advertising is any advertising which, in any way, including in its presentation, is capable of:



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NEW
DAILY
FLIGHT

Booking Period: 8 - 11 April 2010
Travel Period: 13 May 2010 - 13 February 2011

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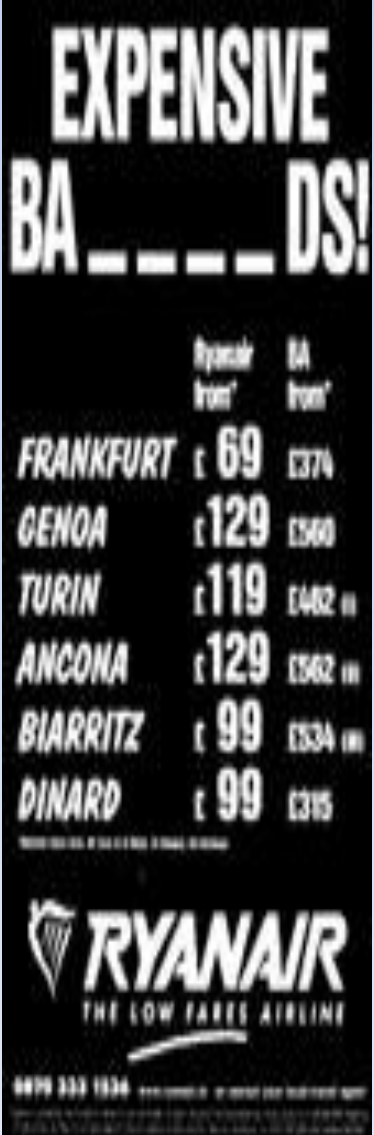
Over 70,000 hotels & tours to choose from! Log onto www.airasiago.com now!

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1. deceiving the persons to whom it is addressed;
2. distorting their economic behavior; or
1. as a consequence, harming the interests of competitors

Comparative advertising


- **US:** legal since 1970s
 - Federal Trade Commission's policy statement
- **Europe:** law requires that ads
 - are not misleading;
 - compare "like with like" - goods and services meeting same needs or intended for the same purpose;
 - objectively compare important features of the products or services concerned;
 - do not discredit other companies trademarks;
 - do not create confusion among traders.



**EXPENSIVE
BA _____ DS!**

	Ryanair from*	BA from*
FRANKFURT	£ 69	£374
GENOA	£ 129	£560
TURIN	£ 119	£402 in
ANCONA	£ 129	£562 in
BIARRITZ	£ 99	£534 in
DINARD	£ 99	£315

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0870 333 1334

All-in fares



\$492.25

Total same-day return Air Canada flight fare between Toronto's Pearson International Airport and New York's LaGuardia Airport. This includes a **\$364 base fare** and **\$128.25** in the following taxes, charges and fees:

\$25

Canadian Airport Improvement Fee

\$33.70

U.S. Transportation Tax

\$5.17

U.S. Agriculture Fee

\$22.81

Canadian sales taxes

\$4.65

U.S. Passenger Facility Charge

\$7.24

U.S. Immigration User Fee

\$12.10

Air Travellers Security Charge

\$2.58

September 11 Security Charge

\$15

Airline surcharges

Sources: Air Canada, Transport Canada, U.S. Transport Security Agency

All-in fares



- *Consumer Protection Regulation* of the GACA (2005) requires total price advertising



- *Regulation No 1008/2008* requires full fare advertising which includes unavoidable charges (taxes, surcharges and fees)
 - ‘Opt in’ for supplementary services



- *Enhancing Airline Protection Regulation* (2010) requires airlines to display the entire airfare
 - ‘Opt in’ for supplementary services



- All air service items have to be included in the airfare (except optional components)



- Canada CTA regulations (2012) require airlines to advertise full fares including all mandatory components



- There is a push to adopt all-in fare advertising as a uniform industry standard through ICAO.