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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Issues Addressed:

1. Introduction to Competition Law
2. Anticompetitive Conduct with a Positive Intent Requirement
3. Anticompetitive Intention not Necessary (but not necessarily non-existent)
4. Civil or Criminal Liability?
5. The Potential Relevance of the Essential Facilities Doctrine
6. Extraterritorial Antitrust Regulation in an International Industry
Introduction to Competition Law
The Antitrust Analysis

Antitrust
- Market
  - Geographic
- Product

Substantive Test

Mitigating Factors *
*Depending on the Analysis Adopted by Each Jurisdiction
## Antitrust Laws in the United States I – Sources of Law & Substantive Tests

<table>
<thead>
<tr>
<th>Act</th>
<th>Substantive Tests</th>
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</table>
| **Sherman Act**              | - Section 1: Every contract, combination in the form of trust or otherwise, or conspiracy, in *restraint of trade or commerce*  
- Section 2: monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce |
| **Clayton Act**              | - Section 7: acquire the whole or any part of the assets of a company...where the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly. |
| **Federal Trade Commission Act** | - Section 5: prohibition of unfair methods of competition                                                                                     |
| **Federal Aviation Act**     | - Section 41712: prohibits unfair and deceptive practices and unfair methods of competition                                                       |
Issues:
1. Disagreement on Need for Enforcement Action
2. Restrictions on continuous monitoring of competition and anticompetitive practices
## Antitrust Law in the European Union I

### – Sources of Law & Substantive Tests

<table>
<thead>
<tr>
<th>Treaty on the Functioning of the European Union</th>
<th>Article 101: agreements that have as object or effect the prevention, restriction or distortion of competition within the internal market, subject to the exception of agreements that “contribute to improving the production or distribution of goods or to promoting technical or economic progress” and subject to: (i) passing on a fair share to consumers; (ii) restrictions must be indispensable to attainment of benefits; (iii) not afford possibility of eliminating competition in substantial part of the market</th>
</tr>
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<tbody>
<tr>
<td>Merger Regulation</td>
<td>Article 102: prohibits abuse of dominance</td>
</tr>
<tr>
<td>Residual National Law</td>
<td>Merger Regulation: consolidations that significantly impede effective competition in the common market or in a substantial part of it</td>
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Antitrust Law in the European Union II – Regulatory Enforcement and Supervision

Potential overlap between applicability of European and National competition law
Basic Principles of Aviation Antitrust

At the crux of traditional competition law is the avoidance of market dominance that will result in price abuse, high market concentrations or both.

In aviation, this is concern is important because of inherent structural features of the industry that precipitate these events:

- High barriers to market entry
- The consolidation of the industry into large hub carriers with large inaccessible networks
- Limitations on the accessibility of airports
- The strong incentives of air carriers to engage in anticompetitive conduct
The Different origins and assumptions of EU / US Antitrust Law

Different Objectives & Assumptions:

- Market Contestability & Barriers to Market Entry
- The need and viability of efficiencies
- The motivation of incumbent company to abuse position and exclude competition
- Different political objectives
These Different Assumptions at Play

- The G/E Honeywell Merger – Protecting Competition or Competitors?
Anticompetitive Conduct with a Positive Intent Requirement
Collusion and Cartels

- Express agreement to set prices or impose common charges at pre-agreed levels
- Win-win assumption (no spill-overs to competitors)
- But also possibility of short-term success followed by a live and let die approach, where one member breaches the cartel by lowering prices to win over new customers from its previous cartel partners
Tacit Collusion

• Monitoring fares and frequency choices of competitor

• No express agreement in effect, but:

• Price following and

• Occasional informal mood testing through price-setting variations and monitoring of whether competitors will follow
Predation

- Acts to force competitors out of own market
- Three aims:
  - Cost increases of competitor
  - Revenue diminution of competitor
  - Setting reputation to deter new entry
- Examples:
  - Sham litigation
  - Abuse of regulatory processes
  - Capacity flooding
  - Aggressive (often, but not necessarily, below-cost pricing)
Computer Reservations Systems

- Ownership of CRSs by incumbent carriers
- Incentives to travel agents to book flights of particular carrier
- Design parameters of CRSs can be used in a way that hinders prominent display of competitors’ flights
- Successful actions in the United States and the European Union for anti-competitive abuse
Anticompetitive Intention not Necessary (but not necessarily non-existent)
Mergers & Acquisitions

• Result in the elimination of one competitor, thereby removing a source of competitive constraint

• Increase market power, which becomes problematic in an industry with substantial barriers to entry of newcomers

• Loss of competitive constraints and difficulty of new entry can result in higher prices, reduced output and lower quality of service
Equity Partnerships

• One airline buys substantial equity in another carrier

• Often, foreign ownership requirements will not allow formal purchase of controlling share

• However, coordination of capacity/frequency and other areas of service capable of reducing, or even eliminating, a competitive source are possible
Airline Alliances

• Level of cooperation can vary and range from mere code-sharing to metal neutral joint ventures

• In cases of more advanced coordination, the competitive pressures previously exercised by the allied carriers to one another can be reduced substantially or even disappear

• Certain code-sharing practices can also give rise to the exclusion of unaligned carriers through the ticket reservation process or through the impairment of their ability to compete effectively with the allied carriers in terms of frequency of service and possibly price
Airline Brands and Product Differentiation

• In a fungible commodity industry, such as commercial aviation, the differentiation of a carrier’s product from that of its competitors is essential for the attraction and retention of passengers.

• Examples include carrier reputation, Frequent Flyer Program benefits – passengers consistently flying one airline will refuse to fly all other airlines serving the market concerned thereby discontinuing the market presence of such carriers.

• The airline brand can also be associated with a particular type of operating model and airfares – in this sense, aggressive advertising focusing on price can also result in exclusionary, anticompetitive effects.
Civil or Criminal Liability?
Civil or Criminal Liability?

Generally civil, but some shift towards criminalization of cartels:
1. United States - yes
2. United Kingdom - yes
3. New Zealand Proposed Reform Criminalizing Cartels Cancelled in December of 2015

Criminal Liability:

Strong Disincentives to enter a cartel but also strong disincentives to whistle blow
1. According to the OECD, many jurisdictions that have criminal sanctions for cartels also have leniency programs, but the strong disincentive to report persist
2. Contract European to US Approach – LH blew the whistle and was exempted from a fine in the notorious air cargo cartel case (explained below)
3. Given the inherent incentives participants may have to breach the cartel, such as to temporarily increase their market share through lower prices, a civil liability regime would incentivise cartel disintegration
The Potential Relevance of the Essential Facilities Doctrine
Airline Networks

- **Airline networks accord carriers substantial revenue augmentation opportunities**, since they are able to maximize the number of passengers carried on each flight by transporting many passengers for/from onward travel.

- **As a corollary**, a carrier that cannot access the network of a competitor in a particular city pair will only be able, at most, to carry just the passengers wishing to travel between the two cities of the pair concerned.
Airport Slots

• Airport slots are the right to take-off or land at a particular airport at a given time

• Different times of the day and different days of the week have substantially distinct commercial values for an air carrier (the most valuable times being in the morning and afternoon, when the most high-yield business traffic is transported)

• Many airports are slot controlled, and acquiring a slot at commercially valuable times, and sometimes acquiring a slot in the first place, can be difficult or impossible

• Airline slots give rise to two antitrust concerns:
  • The ability of a carrier to access a particular airport and service it;
  • The ability of the carrier to earn viable revenues by being able to serve the high-yield traffic in the most commercially valuable times of the day
The Essential Facilities Doctrine

• **Incumbent owns the infrastructure** necessary for the provision of a particular service

• Access to this infrastructure is necessary for the provision of a similar service by a competitor, but:

  • **It is practically or financially impossible** for a new entrant to build similar facilities

• In the context of the airline industry, such facilities take the form of computer reservations systems, route networks...and possibly airport slots
Extraterritorial Antitrust Regulation in an International Industry
Extra-territorial Application of Antitrust Laws

• Extra-territorial application = application of antitrust laws to foreign entities not bearing the nationality of applying State

• Usually, a link is required and takes the form of the provision of services in the market of the State applying its laws extra-territorially

• Such cross-border provision can suffice *per se*, or value of the services provided may be required to exceed a certain value (see e.g. approval of the merger of two carriers by the competition authorities of another State)
Coordination of Antitrust Regulation

• Provisions in Open Skies Agreements requiring Contracting States to cooperate in the regulation of competition in their common market

• However, often, antitrust coordination is not very advanced and disparities persist

• Certain global, but yet underdeveloped, initiatives: e.g. OECD