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LATIN AMERICAN COMPETITION FORUM

Session IV: Competition Issues in the Air Transport Sector

Contribution from Argentina

13-14 Septembre 2011, Bogotá (Colombia)

The attached document from Argentina is circulated FOR DISCUSSION under Session IV of the Latin American Competition Forum at its forthcoming meeting to be held on 13-14 September 2011 (Colombia).

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LATIN AMERICAN COMPETITION FORUM

13-14 September 2011, Bogota (Colombia)

Session IV: Competition Issues in the Air Transport Sector

-- CONTRIBUTION FROM ARGENTINA* --

1. Argentine airline industry: structural characteristics, evolution and regulation

1. Although Argentina has an extensive land area with large urban and tourism zones distributed throughout the country, its airline system is designed in a hub-and-spoke format, dominated by the pampas region centred mainly on the federal capital and Greater Buenos Aires. The latter is country's largest conurbation and contains the "Jorge Newbery" Airport (*Aeroparque*),¹ as well as the "Ministro Pistarini" International Airport of Ezeiza, which handles most domestic and international passenger and cargo traffic, with a high level of installed-capacity utilisation.² Although other Argentine cities have a main airport for domestic flights, and in some cases international ones also, albeit with low installed-capacity utilisation, these airports are a long way from Ezeiza and are therefore not substitutes for it. The fact that Argentina is also far from the main international tourism and business departure points means that the new concept of relative distance in air transport (measured in terms of time, cost, connectivity and accessibility) becomes more important and has a major effect on the traveller's perception when choosing the best means of transport.³ It also influences airline strategies, and hence also processes of social and economic integration within the country, regionally and worldwide.

* This document is submitted by Danila Goisen (National Commission for the Defence of Competition).

¹ Although *Aeroparque* emerged as the airport for domestic flights, Resolution 265/2010 internationalised it by authorising it also to operate flights from Brazil, Paraguay and Chile.

² In July this year, a third terminal (Terminal C) was inaugurated at the Ezeiza international airport, which for the time being is operating international flight departures, and departures and arrivals of domestic flights by the State-owned airline *Aerolíneas Argentinas*. The restructuring is expected to be completed in 2013, by which time the airport will be in a position to serve 30 million passengers per year and undertake 90,000 operations.

³ Passengers wishing to fly to a particular destination generally form part of a captive market, because they do not have many possibilities for substituting the service demanded with another one to a different

1.1 Formation and evolution of the national commercial airline system

2. Argentina's airline market dates back to 1925 when private firms started to operate a number of domestic and international flights. In 1945, the Aeronautical Secretariat (*Secretaría de Aeronáutica*) was created, and the first national airline policy was formulated, providing that domestic routes had to be operated preferably by the State or else by domestic firms under mixed ownership.^{4/5} This system proved a failure; and in 1950, a State-owned enterprise *Aerolíneas Argentinas Empresa del Estado* ("AR *Empresa del Estado*") was created, with exclusive rights to operate domestic and international flights. Subsequently, as a result of demand growth, incentives were given for the creation and operation of private airlines;⁶ but in 1962, regulations were issued for the reorganisation of commercial airline services,⁷ and AR was granted exclusive rights to operate international flights and a guaranteed 50% of the domestic flight market. In 1971, Law 19.030 was passed, which is still currently in force, and a new commercial airline policy was put in place.⁸

3. In 1989, AR was privatized⁹ and sold to a consortium comprising Iberia and *Cielos del Sur*, creating *Aerolíneas Argentinas S.A.* (ARSA); and the national airline market was radically restructured. In 1992, a new deregulated legal framework was put in place¹⁰ to encourage new operators to enter the market and stimulate competition, with freedom to set prices and tariffs within a price band system defined by the State.¹¹ In addition to AR¹² and Austral (both firms belonging to *Cielos del Sur S.A.*), the following

destination. Thus, each route constitutes a single market, with several competitors, different elasticities of demand (depending on the reasons and needs underlying the service), and different degrees of substitutability with other modes of transport.

⁴ Decree No. 9.358/45.

⁵ The national State joined with private sector partners to create the following airlines: Aeroposta Argentina, Aviación del Litoral Fluvial Argentino (ALFA), the western and northern zones of Aerolíneas (ZONDA), Flota Aérea Mercante Argentina (FAMA) and Líneas Aéreas del Estado (LADE).

⁶ The following private airlines were created: Transcontinental, ALA, Austral, LAC (Líneas Aéreas de Cuyo), Transatlántica Argentina, Aerochaco, Nor-Sur, Aerolíneas INI, TABA (Transportes Aéreos Buenos Aires).

⁷ Decree No. 10.632/61. This was followed by the general guidelines imposed in the "Ferreira doctrine", the Argentine doctrine on international air transport law, also known as the "Intermediate doctrine" or "Third position" developed as from 1946 with the noble aim of establishing "mastery of the air under the rule of law", which served as a posture for defending the traffic of individual countries, in the face of requirements imposed by the larger aeronautical powers.

⁸ Article 42 of Law 19.030 states that: "Prices will be set taking account of the interests of the nation, users, and operators, applying the concept of economic return to each route and route segment." This regulation also provides that price regulation should protect consumer interests.

⁹ Law No. 23.696 of 1989, and Decrees Nos. 1591/89 and 1024/90.

¹⁰ Decrees Nos. 1492/92 and 2186/92.

¹¹ The regulation of passenger air fares (according to the SSTA for domestic flights in economy class) was originally created by Resolution ST 275/87 and amended by Resolutions 1/89 and 146/89. This framework established the principle of regulation through a price-band system based on a benchmark tariff. The upper and lower limits of the authorised fares were set as percentages of the benchmark for each route. Subsequently, Decree 1654/2002 provided that the benchmark would operate as the lower limit of the band, and maximum fares could be up to 90% above the benchmark. In addition, Resolution 35/2002 (issued by the former Ministry of Production) added a system of pricing for residents, which forced firms to sell a certain proportion of the capacity of each aircraft at the minimum fare. The benchmark tariff and the width of the bands were varied over the years. Recently, the Transport Ministry (*Secretaría de Transporte*) has issued Resolution 112/2011 authorising the operators of regular domestic airline services

airlines also began to operate domestic flights: *Líneas Aéreas Privadas Argentinas S.A* (LAPA S.A), *Dinar Líneas Aéreas S.A.* (DINAR) and Southern Winds (SW), along with other smaller firms.¹³ In 1997, the national airport system regulatory body (ORSNA) was created,¹⁴ and, alongside this in 1998, *Aeropuertos Argentina 2000* (AA2000) was granted the concession for the management, operation and functioning of airports in the national airports system (SNA).¹⁵ The obligations in the concession included ensuring “equality, free access and non-discrimination in the use of airport services and facilities.”¹⁶

4. At the start of the twenty-first century, owing to the deepening national crisis in Argentina, a rise in fuel prices and excess supply of airline services, among other factors,¹⁷ LAPA and DINAR were declared bankrupt, AR filed for insolvency, and a state of emergency was declared in the commercial airline sector. To guarantee the continuity of services provided by these airlines, the national government created¹⁸ *Líneas Aéreas Federales Sociedad Anónima* (LAFSA); and the Marsans group of Spain took over AR and AUSTRAL.¹⁹ Lastly, in 2008, AR was renationalised, and in 2010 it signed an agreement to join the Sky Team alliance. At the present time, AR is operating 33 domestic routes and serving 19 international destinations. LAN Argentina²⁰ is the other major alternative for domestic flights, along with

for passengers to apply new fares in economy class, fluctuating within bands set by the benchmark fare and the maximum fare for each of the origin-destination pair specified in the aforementioned resolution. Under these regulations, airlines are required to notify fare changes seven days before they take effect. Without prejudice to the above, the fares reported and included within the band have to be approved by the Application Authority.

¹² Resolution 459/94 granted AR the concession to operate regular international cargo and mail services between Argentina and the United States for a 15-year period; and Resolution 484/94 extended the firm's concession to operate its current routes of economic interest for 15 years.

¹³ Including: Laer, Cata, Kaiken, Tan, Sapse, Alta, Andesmar, El Pingüino, Servicios Aereos Sudamericanos, American Falcon, Aerosur, Aeroposta, Staff, Air Plus and Aerovip.

¹⁴ Decree 375/97. In addition, principles and objectives were defined for ORSNA, including: ensuring quality, free access and non-discrimination in the use of airport services and facilities, and ensuring that the rates charged for airport services are fair, reasonable and competitive.

¹⁵ Decree No. 163/98.

¹⁶ Specifically, ORSNA Resolution 79/201 provides that AA 2000, in its role as SNA airports operator and in fulfilling its functions of coordination and control of ramp operations and activities, assigns aircraft ramp parking positions using objective criteria for allocating airport resources and respecting the norms, recommendations and specific manuals issued by the competent authorities.

¹⁷ In August 1999, LAPA was involved in one of the most serious accidents in Argentine aviation history, when flight 3142 crashed at the Jorge Newbery Aeroparque, and the firm went into a deep crisis.

¹⁸ Decree No. 1238/03.

¹⁹ Nonetheless, as a result of the legal disputes in which the SW company became involved, compounded by the state of emergency prevailing in the country, in September 2003 the national government repealed the “business cooperation agreement” and called for the “urgent privatisation of LAFSA”.

²⁰ Decree No. 1283/2003, which stated: “*The national government shall guide the activity of private entities and direct their efforts to avoid situations in which the concentration of airline services, dominant position or inadequate competition, could give rise to situations that are harmful for users*”, provided facilities for LAN CHILE (a foreign firm) to take over the Argentine enterprise, AERO 2000, which, by absorbing part of LAFSA staff - a solution similar to that of SW - can operate any routes that LAN might request.

Sol Lineas Aéreas and Andes Lineas Aereas S.A, while Lineas Aéreas del Estado (LADE) - another smaller state-owned enterprise - continues its development work, particularly in the Patagonian region.²¹

2. Competition vs. regulation: the scope of Law 25.156 (LDC)

5. Argentina has had antitrust legislation since Law 11.210 passed in 1923, which was updated in 1980 by Law 22.262, which lasted until 1999, and by Law 25.156, which remains in force today. The rules of regulation and the defence of competition generally overlap in regulated markets that are themselves subject to competition regimes. Nonetheless, Article 59 of the LDC states that: *any provision on competition related to the purpose of this law, granted to other organisations or State entities, is hereby repealed.*” In other words, the CNDC is the only body authorised to resolve competition issues; and this enhances its authority, because, while it can consult regulatory bodies to resolve specific cases, the antitrust body has the final decision.²²

3. Cases analysed in Argentina: mergers and anti-competitive conduct

3.1 *Fexis S.A. and Líneas Aéreas Privadas Argentinas S.A. (LAPA S.A) (June/July 2001)*

6. The operation in question entailed the purchase of 99% of the shares of FEXIS SA and the enterprises under its control - LAPA and *Lapa Estudiantil SA* (LAPAES) - by the controlling shareholders of AA2000 - the exclusive concession-holder of the 32 most important airports in Argentina, and provider of airport services - and Empresa de Cargas Aereas del Atlantico Sud S.A.(*Ecdadassa*) - the concession-holder on customs warehouses located at the international airports of Aeroparque, Ezeiza, Córdoba, Mendoza and Mar del Plata.

7. The takeover notified involved vertical integration in the airline and airport and customs warehouse service markets, so the evaluation of the effects of the operation was based on the existence of incentives for the vertically integrated airport operator to transfer its market power to the airline market, and the likelihood that it would engage in anti-competitive conducts based on the position thus obtained.

8. In keeping with international analytical standards, the CNDC considered airline services between a point of origin and a point of destination as a relevant market in itself, in other words “by route”; and it separated air transport from other means of transport, basically because of the differences in travel time, prices and quality. It also decided that the relevant geographic market for each of the airport services was the airport, because in Argentina, most cities (or regions) have just one airport, so airlines have no alternatives for providing services on a given route; and because of the technical characteristics of its infrastructure which mean that for a given level of demand, it is desirable for airport services to be provided by a single airport.

²¹ Although the National Commercial Air Transport Directorate (DNATA) issues permits for an airline to operate a given route, several permits are required to start operating air transport services in general. These are issued by that Directorate and by the National Airworthiness Directorate (*Dirección Nacional de Aeronavegabilidad – DNA*).

²² Article 16 of the LDC states that: “*When a merger involves firms or persons whose economic activity is regulated by the national government through a regulatory body, the National Tribunal for the Defence of Competition (Tribunal Nacional de Defensa de Competencia), prior to issuing its ruling, shall request a report from that State body providing a justified opinion on the proposed merger, in terms of its impact on competition in the respective market or on compliance with the respective regulatory framework...*” Although taken into account in the analysis, this opinion is not binding on the CNDC. For example, in the AA2000/ LAPA case described above, the CNDC ruled against the opinion given by the regulatory body.

9. Accordingly, the following relevant markets were defined: airline cargo and passenger services (separately); aircraft landing and parking services; telescopic walkway services; aircraft ground assistance services; space rental at airport terminals and customs warehousing services at international airports.

10. As AA2000 was the exclusive airports concession-holder and *Edcadassa* held an exclusive concession on customs warehouse services,²³ and given the lack of substitutability between airports in Argentina, making those infrastructures essential for carrying out airline activities, there was concern that the buying group - vertically integrated - could discourage new firms from entering the market, since they could expect to be subject to exclusionary conduct, particularly in view of the purchasing firm's (LAPA SA) large share of the national airline market (about 40% in 2001 and 2002), and also of most of the routes it was operating.

11. Although the airports managed under concession were subject to economic and technical regulation by ORSNA for the purpose of ensuring equality, free access and non-discrimination in the use of airport infrastructures, the CNDC decided that this was insufficient to combat the anti-competitive practices that might be exercised by the vertically integrated airport operator. The reason for its opinion was that the regulation did not mitigate the risk of the operator discriminating against competing airlines, owing to the lack of objective criteria for allocating spaces within airports, the discretion available to the operator in allocating them, and the fact that anti-competitive practices could take forms that would be difficult for the regulator to monitor. As a result, the dominant position that LAPA SA could potentially obtain could not be challenged by other firms; and the notified operation would restrict competition in the cargo and passenger airline market and could be harmful to the general economic interest.

12. The CNDC, in a majority ruling, therefore advised the Minister for the Defence of Competition and Consumer Protection to refuse authorisation for the merger.²⁴

3.2 *Marsans S.A., Aerolíneas Argentinas S.A., Austral Lineas Aereas-Cielos del Sur S.A., OPTAR Operador de Servicios Turísticos S.A. (October, 2001)*

13. This operation consisted of the purchase by the Spanish firm *Air Comet S.A.* - controller in Argentina of the wholesale tourism operator *Marsans S.A.* - of a controlling interest in *Interinvest S.A.*, and indirectly of *ARSA.*, *Austral Lineas Aereas-Cielos del Sur S.A.*, *OPTAR Operador de Servicios Turísticos S.A.*, *Jet Pack S.A.*, *Aerohandling S.A.* and *Air Patagonia S.A.*

14. The operation had the following effects from the competition standpoint: (a) upstream vertical integration of MARSANS, given that the airline service, together with "ground services" (hotel accommodation, car rental and excursions) are the basic inputs of package tourism, so the vertical integration already existing between AR-AUSTRAL and OPTAR would be intensified; and (b) a horizontal economic relation between MARSANS and OPTAR in the production and wholesale marketing of tourism packages in Argentina.

²³ *Edcadassa* had exclusive rights, granted by the Argentine Air Force, to provide stevedore, storage, warehousing and related services for air cargo entering international airports.

²⁴ The minority ruling argued that merely denying authorisation for the merger would generate uncertainty and loss of value for the firm; so it recommended not authorising it and also ordering the controlling shareholders of AA2000 SA to sell their shares in Fexis SA to private individuals or legal entities with no links to AA2000 SA, within 10 months. Ultimately, Aeroandina S.A bought those shares - a firm in which one of the shareholders (with a 45% stake) was the president of Aerosur S.A, a Bolivian commercial airline operating both Bolivian domestic and international flights.

15. The relevant markets were defined as the domestic wholesale package tourism market, and the passenger airline market, divided into routes serving the main tourist destinations.

16. The CNDC advised authorisation of the operation as notified, on the following grounds: (i) the domestic wholesale tourism market displayed a low degree of concentration, and the notifying entities' joint share was small; (ii) no harmful effects would be foreseen on competition in the upstream passenger airline market as a result of the backwards vertical integration of *Marsans*; and (iii) the improbability of Aerolíneas/Austral discriminating against independent tourism operators.

3.3 *LAN Pax Group S.A., LAN Airlines S.A and Inversora Cordillera S.A. (August 2006)*

17. The operation notified consisted of the takeover by *Lan Pax Group S.A.* - a Chilean investment company controlled by *Lan Airlines S.A.* - of the Argentine holding company *Inversora Cordillera S.A.*, thereby gaining indirect control of *Lan Argentina S.A.*, the operator of domestic and international airline routes in Argentina.

18. It was ruled that the operation only involved a change in the stakes held by each of the shareholders in *Inversora Cordillera S.A.* and that there were no horizontal or vertical relations between the firms in question. According to CNDC jurisprudence, airline services constituted a market *per se*, and were not substitutable by other means of transport, so the relevant market operated by the parties was defined as each origin/destination pair.

19. In the takeover contract, the notifying entities also stated that the operation would also make it possible for *Lan Argentina S.A.* to receive the capital contributions needed for it to fulfil its official functions more efficiently. In this regard, the Transport Ministry (Resolution 341/2005) argued, among other things that: "...the technical studies undertaken reveal excessive market concentration, such that domestic commercial air transportation is currently operating with less supply and higher prices than are socially optimal." (...) "so, reducing monopoly effects by increasing competition would lead to an increase in supply in the short term, and consequently lower prices." Based on its analysis, the CNDC decided that the operation would not have harmful affects on competition or the general economic interest; and it also noted that, if the predictions of the buyer and sellers were fulfilled, *Lan Argentina S.A.* would receive capital injections enabling it to bring greater competition to the domestic airline market, so it advised the Minister of Domestic Trade to authorise it.

4. New brands, strategies and analytical rules of the game: major challenges

20. As noted above, competition in the airline sector depends on many variables, including changes in technology and the services supplied, and changes in demand conditions; economic variables that change market prospects, along with its risk and volatility; the availability of essential operating infrastructure; and market entry conditions. Moreover, it also depends significantly on the airlines' strategies and behaviour in response to new scenarios and the public policies implemented, as well as competition legislation and policy on company mergers and takeovers, strategic alliances or code-sharing agreements, bilateral agreements on airline services²⁵ and antitrust immunity.²⁶ Although such strategies might be a legitimate tool for reallocating resources more efficiently and improving the quality and variety of services, in some cases they can imply an increase in and greater probability of the exercise of market

²⁵ The Chicago Convention of 1944, which forms the core of the international civil aviation regime, establishes that access to international markets for air travel is granted exclusively by governments through bilateral agreements.

²⁶ There are no anti-trust immunity agreements in the Argentine airline industry.

power, resulting in exclusionary and/or exploitative conduct that harms the general economic interest and violates the LDC.²⁷

21. Examples of the above include:

- a) The emergence of low-cost airlines that changed the rules of the game of the commercial airline market in several parts of the world and forced large companies to make major changes;
- b) The possibility of buying air tickets over the Internet, which, although it has reduced airline operating and customer search costs by allowing instantaneous comparison of alternatives and thus increasing efficiency, this greater transparency has also made it easier for competitors to coordinate and monitor prices;
- c) Loyalty programs for frequent passengers which, although benefiting them, raise potential problems from the competition and economic efficiency standpoints, because they generate captivity by increasing the opportunity cost to users of switching airlines. They could also represent an entry barrier or an exclusionary practice, by creating advantages for larger airlines or alliances operating in several markets;
- d) The formation of alliances and code-sharing agreements between airlines that give rise to new forms of competition and increase sector consolidation.²⁸ Although these have the potential to be highly favourable to competition and achieve significant efficiency gains, they can also foster a higher degree of co-operation between airlines on marketing and operations (destinations, timetabling, frequencies, and days of operation), as well as joint decisions on prices, capacity, customer care and after sales services, while concealing anti-competitive agreements to exclude competitors and exploit users, thus harming the general economic interest, previously well safeguarded by the LDC;
- e) The low degree of substitutability between airports, compounded by airport infrastructure constraints, which could pose a significant market entry barrier and/or actual exclusion. This makes efficient, transparent and equitable distribution and allocation of airport capacity a fundamental logistical asset that is essential to the activity - including take-off and landing slots in certain preferred scheduling segments, and the imposition of limits on the accumulation of slots by each airline and scheduling segment.^{29/30}

²⁷ Possible conducts include the following, among others: predatory practices, exercise of control and discrimination in access to essential operating infrastructure, and the hoarding of spaces and slots in airports, concerted practices on prices and other operating conditions, division of the market, etc.

²⁸ There are currently three major airlines alliances - Oneworld, Star Alliance and Skyteam - compared to five in 2002.

²⁹ As noted above, in most cases, the various national and regional airports are not substitutes for one another, so each airport becomes a captive market for the airlines wishing to operate a given route. Moreover, not all of the flights on a given route are considered adequate substitutes for each other, since certain departure or arrival times are generally not convenient and/or are preferred by users. All of these issues are taken into account by the airlines when deciding which routes to operate, and have direct repercussions on competition policy.

³⁰ Argentina has no system for allocating slots, as there is the European Union; it merely has a procedure regulated by Resolution 764/2010 issued by the National Civil Aviation Administration (ANAC) which establishes the procedure for requesting berths, operations base and scheduling feasibility for operating regular, occasional and special flights. At Ezeiza airport, slots are programmed every five minutes throughout the 24 hours of the day, with a limit of 12 slots per timetable segment, without distinction between regular commercial firms and provided on the basis of each airline's request.

22. To conclude, there are several issues for competition legislation and policy. Possibly the most crucial for our countries, where the range of alternatives is smaller, are strategic alliances and code-sharing agreements. To what extent are these a new form of collaboration between airlines resulting in a better service and the “only” way to survive and succeed in the market? And to what extent do they constitute an agreement between competitors with the aim and/or effect of restricting competition and damaging the general economic interest?

23. Moreover, given that the aforementioned alliances and agreements (and also most mergers) involve the laws and competition authorities of different jurisdictions, it is essential to implement cooperation agreements between different countries and competition authorities.

24. The CNDC is currently analysing the following putative mergers: British-Iberia (Conc.840), Lan-Tam (DP 66) and Gol-Varig (DP40), so we are facing new challenges and the need to settle the conflicts raised quickly, in conjunction with the other bodies. It is also important to implement and operate a strict regulation that creates an economically efficient mechanism for allocating airport spaces, and thus avoid introducing artificial limits on supply.