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**LATIN AMERICAN COMPETITION FORUM**

**Session IV: Competition Issues in the Air Transport Sector**

**Contribution from Colombia**

**13-14 Septembre 2011, Bogotá (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 COLOMBIA --

#### 1. Industry characteristics

1. In terms of the airlines that service both domestic and international routes, the structure of Colombia's aviation industry is oligopolistic, and as regards its infrastructure it is monopolistic, which affects the country's airports and air navigation systems.<sup>1</sup>

2. Air transport is a public service<sup>2</sup> that can be categorized according to certain criteria. One of these is whether service is "regular" or not, i.e., whether it is provided on a regular ongoing basis. Another criterion defining regular commercial air services is that they feature "published rates, itineraries, conditions of service and established schedules."<sup>3</sup> Air transport services can also be broken down into the air freight and passenger categories.

3. Under Article 1855 of the Commerce Code, "Commercial air services can be domestic or international. Domestic services are those provided exclusively between points within the national territory, while international services are those not meeting this criterion." It has been ascertained that there are 10 domestic routes<sup>4</sup> classified as trunk routes, which transport the greatest number of passengers, while the country's remaining routes are classified as secondary.

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<sup>1</sup> *Estudio Económico del Transporte Aéreo en Colombia* [Economic Study of Air Transport in Colombia], 1970-2006.

<sup>2</sup> Article 1776 of the Commerce Code.

<sup>3</sup> Article 1854 of the Commerce Code.

<sup>4</sup> The trunk routes are: (1) Bogotá-Medellín-Bogotá; (2) Bogotá-Cali-Bogotá; (3) Bogotá-Cartagena-Bogotá; (4) Bogotá-Barranquilla-Bogotá; (5) Bogotá-Bucaramanga-Bogotá; (6) Bogotá-Pereira-Bogotá; (7) Bogotá-Santa Marta-Bogotá; (8) Bogotá-Cúcuta-Bogotá; (9) Bogotá-Montería-Bogotá; and (10) Cali-Medellín-Cali.

4. Since the 1990s, Colombia's airports have been operated both by the State and by other operators under a concessionary model, while navigation services such as radar, telecommunications equipment, satellite technology, etc., are owned by the State alone, which charges fees set by the country's Special Civil Aeronautics Administrative Unit (UAEAC).

5. 1991 marked the inauguration of an “*open skies*” policy, liberalising the passenger air transport sector in a way similar to what was done in other sectors of the economy. In this connection, Colombia is a participant in the creation of the aviation policy of the Andean Community of Nations—a policy set forth in Decision 297 of 1991 and Decision 320 of 1992 and formalized in the Agreement of Cartagena, and subsequently modified by Decisions 360 and 361 of 1994. The policy was influenced by the “*open skies*” agreement signed by Colombia and Venezuela in May 1991, which provided for freedom of operation between those points open to international traffic. Said decisions introduced the notion of “series of flights” where two or more non-regular flights are scheduled together, and the concept of “all-included” packages, which may also include tourist flights.

6. 1992 marked the introduction of a free regime with controls. Up to that point, rates increased steadily, in line with the UPAC [constant purchasing power unit]. Resolution 15542 of 21 November 1991 (regarding domestic air transport) and Resolution 0476 of 31 January 1992 (covering international transport) allowed airlines to introduce lower rates, provided that they met the criteria of fairness (rates must be in proportion to the service provided) and sufficiency (rates must be sufficient to cover operating costs, overhead and some profit).

7. As regards the domestic trunk routes, fares for the Medellín and Cali routes were fairly constant up to 1994; the average rates for Barranquilla and Cartagena entered a clear downtrend after 1994. As of 2001, domestic passenger service was concentrated in three airlines serving close to 90% of the demand. Avianca/SAM led in passenger service, with around 50%, while Aces had a 25% share and Aerorepública 15%.<sup>5</sup>

8. As of 2008, the three main domestic passenger airlines were Avianca, with 39.63% of the market, SAM with 19.78% and Aerorepública with 17.72%. The figures for 2009 were Avianca 35.34%, SAM 18.88% and Aerorepública 17.88%, and if Copa is included (with 7%), these leading four companies represented 61% of the market. One important element in this context is the change in the share of other companies, such as Easy-Fly, whose share rose from 1.91% to 2.75% as a result of marketing strategy, access to online ticket purchasing and low intermediation rates. In the international passenger traffic market, Avianca had 37.9% of the market, followed by Aerorepública at 8.2% and American Airlines with 8.1%.<sup>6</sup> “*Of note are the rise in share over 2008 for Spirit Airlines (+150.6%) and Lan Perú (+83.2%), and the decline for Aerogal (-43.8%), VRG Líneas Aéreas (-33.13%) and Air Comet (-30,98%).*”<sup>7</sup>

9. Figures for 2010 show Avianca with 34.6% of the international passenger market, followed by Aerorepública with 9.75% and American with 6.96%, and Spirit Airlines in fourth place with 4.6%. The remaining 44.07% of this market is distributed among 22 airlines. Between 2009 and 2010, sales of international tickets grew 11.56%, with notable growth in such airlines as Aerogal (+320.3%), Aires (+222.59%), Lacsá (+36.92%) and Spirit Airline (+34.9%). Meanwhile, major airlines such as American

<sup>5</sup> Pena, Ximena (2001), “¿Qué tan poderosas son las aerolíneas colombianas? Estimación de poder de mercado en las rutas Nacionales,” in *Archivos de Economía DNP*.

<sup>6</sup> Information from [www.mintransporte.gov.co](http://www.mintransporte.gov.co), *Diagnóstico del Transporte 2010*, pp. 85-87.

<sup>7</sup> *Ibid.*, p. 88.

and Air France lost market share (-1.64% and -1.63% respectively).<sup>8</sup> As regards domestic passenger traffic, six companies were in the market in 2010. Avianca had the largest share, at 54.38%, followed by Aires with 18.87%, Aerorepública with 15.18%, Satena with 6.26%, Easy Fly with 3.38% and Aerolínea Antioquia with 1.92%. Overall growth was 30.31%. The greatest growth in domestic sales was enjoyed by Aires (81.02%) and Easy Fly (30.39%).

*1.1 Have aviation services been liberalised in your country?*

10. Colombia's domestic air transport sector has undergone gradual liberalisation since the early 1990s, when the previous protectionist scheme began to be dismantled. The new national Constitution of 1991 provides guarantees of economic freedom and free trade, but preserves the State's authority to intervene in the provision of public services, including air transport. The State performs this function in the aviation sector through the Special Civil Aeronautics Administrative Unit (UAEAC). In 1991, Law 9 implicitly rescinded the provision of the Commerce Code according to which foreign capital could not constitute over 40% of a Colombian firm's capital.

11. As regards the rates charged by the airlines, a free regime with controls was in place under the UAEAC rules from 1992 to 2007. This consisted of a price band with defined minima and maxima. In 2007, the UAEAC indicated that firms could set their rates freely, provided that they not exceed the maximum rates approved by the UAEAC for other airlines. If airlines wish to propose levels that differ from existing rates, they must justify this under technical parameters of equity and sufficiency. Under the current policy and maximum rates, the end price paid by passengers for domestic flights has five components: the airline's published rate, the fuel surcharge, the administrative surcharge, VAT and airport tax. For international flights, in addition to the foregoing, there is an exit tax (for residents) or tourism tax (for foreigners). The fuel surcharge mechanism was adopted in 2003 in order to reduce the impact of increasing fuel prices on the cost structure of airline operations. The charge was made mandatory for passenger service, and optional in the case of air freight. The surcharge is adjusted automatically by the UAEAC on a monthly basis as a function of changing international fuel prices. The adjustment is different for domestic and international flights.<sup>9</sup>

12. Currently, regulation by the State through the Aeronautic Regulations (RAC) of the UAEAC generally covers technical issues and elements internal to the airlines. The defence initiatives behind the deregulation of the air transport sector initially reflected the government's policy of economic openness. In recent years, deregulation has been a function of the government's campaign to promote tourism to Colombia, which calls for low air prices.

*1.2 Does competition law apply to the air transport sector? What exemptions are there? What is the relationship between regulation and competition in the aviation sector of your country?*

13. The current competitiveness law, Law 1340 of 2009, applies to air transportation services in Colombia without any exemptions. However, the air transport sector is one of the two exceptions which that law stipulates to the authority of the Superintendency of Industry and Commerce (SIC) as the single

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<sup>8</sup> See Civil Aeronautics Statistical Tables, December 2010, available at: [http://portal.aerocivil.gov.co/portal/page/portal/Aerocivil\\_Portal\\_Internet/estadisticas/transporte\\_aereo/Estadisticas%20Operacionales/Boletines%20publicados%20anteriormente/Boletines%20Mensuales%20Origen-Destino](http://portal.aerocivil.gov.co/portal/page/portal/Aerocivil_Portal_Internet/estadisticas/transporte_aereo/Estadisticas%20Operacionales/Boletines%20publicados%20anteriormente/Boletines%20Mensuales%20Origen-Destino).

<sup>9</sup> Under UAEAC Resolution 2941 of 2008, the fuel surcharge for international flights is set in dollars for four distance brackets: short (up to 1,000 km), medium (1,001-2,600 km), intermediate (2,601-4,900) and long (over 4,901 km).

entity with authority to regulate competition.<sup>10</sup> Before Law 1340 of 2009, the UAEAC was the government entity with authority over agreements between air transport companies that could constitute economic integration. However, the current competitiveness law, in referring to this issue, indicates that the UAEAC preserves its authority only for the authorization of commercial operations by air transport firms involving “*code sharing, joint operations, chartering, interchange of aircraft and block space arrangements*”. In relation to other restrictive commercial practices and economic concentration, the SIC retains its authority.

## 2. Market definition

14. The relevant markets in the aviation sector are defined on the basis of the services or activities where the firms in the market overlap. Thus, for the purposes of studies on the economic integration of companies or for investigation of restrictive practices, it has been established that each regular air route or group of routes providing passenger service constitutes its own product market and geographical market, (the so-called origin-destination approach). The routes are defined to include alternative connections between origin and destination that are considered valid substitutes. Hence, each combination of point of origin and destination is regarded as a distinct product market and geographical market from the point of view of demand.

15. In the case of the AVIANCA-Aces merger, three domestic air transport activities were considered: air freight, mail and passenger service. Passenger service was divided into domestic and international.

16. As to the possibility of considering other transportation services substitutes for airline services, it should be noted that the investigation of the SATENA airline for abuse of its dominant position<sup>11</sup> established that land transport cannot be considered a substitute for air transport domestically, for the following reasons: (i) the time required to travel each route by land is substantially greater; (ii) on most of the routes analysed, there is no direct passenger service; and (iii) the risk involved in land transport is greater than that involved in the air.

17. As regards the types of cases that are investigated (for cartels, mergers, etc.), these same major markets are studied, since they are the markets of the air transport sector that have been evaluated, researched and investigated in Colombia.

18. The markets can be distinguished from the point of view of demand. For each route, substitutability between airports and between **direct and indirect** flights will depend on what the potential passenger is seeking in terms of price, schedule, frequency of flights and access to airport.

19. The geographical scope of the markets involved in Colombian aviation is national, and must be analysed in terms of the product market and geographical markets in which the firms in question overlap. In the case of the joint venture of Delta, Alitalia and KFL, which is currently under study, the relevant markets are the passenger and freight markets on the overlapping routes (Bogotá-London and Bogotá-Rome).

20. The air freight market is analysed in the same way as the passenger market.

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<sup>10</sup> The second exception to the jurisdiction of the Superintendency is the financial sector.

<sup>11</sup> SIC Resolution 04285 of 2002.

### 3. Alliances and mergers

21. The table below provides a summary of the cases that have been analysed by the Superintendency of Industry and Commerce where anticompetitive commercial practices or mergers are involved.

**Table 1. Aeronautic sector cases – Anticompetitive commercial practices**

Opened /closed	Parties	Anticompetitive practice	Relevant market	Decision
1999-2001	Association of International Airlines in Colombia (ALAIICO), Satena, Avianca, SAM, Aces, and other airlines operating in Colombia.	Alleged pricing agreement consisting of imposing a charge for the reimbursement of air tickets.	Sale of domestic air tickets and sale of international air tickets.	Investigation closed. Guarantees provided.
2000-2002	Satena.	Abuse of dominant position consisting of application of discriminatory discounts for different groups of passengers without economic justification.	Each air route on which the relevant firms overlap is a distinct relevant market.	Sanction.
2000-2002	Association of International Airlines in Colombia (ALAIICO).	Alleged pricing agreement consisting of setting the exchange rate used for payments for international air tickets.	Sale of international air tickets in Colombia.	Investigation closed. Exception for shared facilities.
2000-2001	American Airlines, Continental Airlines and British Airways.	Alleged pricing agreement in the form of a “consciously parallel practice” in reducing the commission paid to travel agents.	Sale of air tickets issued by travel agents.	Investigation closed. Proof of the behaviour not obtained.

**Table 2. Aeronautic sector cases – Alliances and mergers**

Year	Parties	Type	Definition of relevant market	Decision
2001	Avianca-Sam and Aces	Alliance	Each route on which the relevant firms overlap is a distinct relevant market.	Objection to the integration. The SIC later declared itself without authority over the case.
2010	Avianca y Sam	Merger		Superintendency of Ports upheld. The operation was found to be exempt from the duty to give notice.
2010	Aerogal, Avianca and Taca Group	Acquisition of control	Each air route on which the parties overlap is a distinct relevant market.	Civil Aeronautics Unit upheld.
2010	Lan and Aires	Acquisition of control	Each air route on which the parties overlap is a distinct relevant market.	Lan and Aires notification acknowledged.

#### 4. Airport services

22. Airport services include all those provided to an aircraft from the time it lands to the time it takes off again. In general in Colombia, these services are provided as a separate product, as in the case of fuel supply. According to figures from the Ministry of Transportation, few suppliers are in this market.<sup>12</sup> The principal services provided include:

- **Passenger handling:** This includes services to passengers from the time they arrive at the airport until they enter the aircraft where the flight crew is available. Services include billing, determination of excess baggage and charges, VIP lounge services and boarding of transit passengers.
- **Handling of baggage and freight:** Handling of passengers' baggage, as well as freight carried in the aircraft, transport of freight from terminal to and from aircraft, and loading and unloading at the aircraft.
- **Catering:** Provision of food and drink for passengers and crew in flight.
- **Ramp handling:** Assistance provided to the aircraft, including:
  - **Coordination:** Supervision, registration and coordination of all servicing to the aircraft, both on the runway and through direct contact with crew.
  - **Manifest and weight distribution:** Specification of what the aircraft is carrying; its weight, including ballast and aircraft parts, and how this total weight is distributed through the aircraft. All of this is fundamental for correct determination of the aircraft's centre of gravity, and is vital in guaranteeing the flight's safety.
  - **Operational messages:** Creation and sending of information with flight data (time of arrival, freight, number of passengers, etc.) to the destination and to the airline's base of operations.
  - **Stairs:** Safety in boarding and deplaning always requires stairs, even when the passengers enter and leave the aircraft via a ramp.
  - **Air and air conditioning:** Connection of auxiliary machinery that, among other things, provides air conditioning to the aircraft when its engines are off, while passengers are boarding.
  - **Transport of passengers:** If the aircraft is parked far from the terminal, passengers are transported to and from it in buses.
  - **Transport of crew:** Crews do not enter the aircraft in the same way as the passengers, but are taken in small vans.
  - **Pushback:** Aircraft do not have reverse gears. Thus, they pull back from the gate thanks to machines that push them back into the correct position for taxiing to the runway.
  - **Fuelling:** At each of the airports where this service is provided, it involves supplying special aviation fuel.

##### 4.1 Airports (public and private airport operators)

23. Law 105 of 1993 allows concessions for the administration and operation of airports in Colombia, as illustrated by the airports of Cartagena, Barranquilla, Cali and Bogotá, all of which operate under concession agreements.

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<sup>12</sup> Ministry of Transportation. Agent of the fuel distribution chain.

24. The air transport sector currently requires an advanced level of specialized infrastructure to be competitive. Colombia's airport infrastructure has certain constraints, creating barriers that prevent a competitor entering the market from increasing its offerings. The airlines currently in the market use to capacity the infrastructure needed for most domestic flights.<sup>13</sup>

25. The hub and spokes system in Colombia creates barriers to entry to the market, given the current system of assigning airport resources and the limited quantity of resources. The two elements that generate barriers to entry are hanger space and take-off and landing spots, as a result of long-term leases in the former case, and the assignment of spots in the latter case, which is generally handled as an administrative process.

#### **4.2 *Air navigation***

26. The provision of air navigation services (radar, communication equipment, satellite technology, networks of antennas and transmitters) currently remains a responsibility of the State, specifically the Civil Aeronautics Unit, which charges fees for these services.

27. As regards the cases where airport services have been analysed, this entity is currently conducting a study to determine whether an agreement was made between an airport concessionaire and the wholesale aviation fuel distributor at the airport in order to disproportionately increase the ramp access fee paid by the airlines to land on the airport's runways.

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<sup>13</sup> From Resolution 19354 of 2001.