

Unclassified

DAF/COMP/WD(2014)31

Organisation de Coopération et de Développement Économiques
Organisation for Economic Co-operation and Development

26-May-2014

English - Or. English

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

DAF/COMP/WD(2014)31
Unclassified

AIRLINE COMPETITION

-- Note by Ukraine --

18-19 June 2014

This document reproduces a written contribution from Ukraine submitted for Item IX of the 121st meeting of OECD Competition Committee on 18-19 June 2014.

*More documents related to this discussion can be found at:
www.oecd.org/daf/competition/airlinecompetition.htm*

JT03357977

Complete document available on OLIS in its original format

This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

English - Or. English

1. Structural and Operational Analysis of the Aviation Industry

1. The Committee sees the aviation industry not only in terms of interaction between consumers and airlines (passenger and cargo) but also as an interrelationship between airlines, agents, airports and regulators.

2. In particular, the Committee studied the connection between airport charges and air navigation service charges in Ukraine's airspace; today, research is conducted to study related services provided at Ukrainian airports such as aircraft maintenance and passenger services, catering, etc.

3. According to the information airlines, air carriers are facing a number of economic hindrances for operating domestic flights, including small passenger numbers and consumers' low purchasing power.

4. As a result, price has become the main competition factor on the air transportation market.

5. However, the international passenger airline industry is regulated by interstate air transport agreements signed on the government level between Ukraine and other countries.

6. Such agreements normally limit the number of airlines on a specific route, the number of passengers, as well as force airlines to align their passenger tariffs and settle other commercial matters concerning airline flights.

7. These international agreements are a major barrier preventing low cost international airlines from entering the Ukrainian market.

8. Still, the agreements between Ukraine and other countries signed over the last several years do not explicitly restrict competition. The Antimonopoly Committee of Ukraine has consistently promoted to the Government the idea of the air transportation market liberalization.

9. According to Ukrainian legislation and interstate air transport agreements, airline ticket rates shall not be controlled by government authorities.

10. Thus, economic entities calculate prices for these services based on the prime cost, as well as obligatory charges and fees regulated by the government, in particular airport and air navigation service charges.

11. Prices are primarily based on the prime cost of transport on a certain route, which in turn depends on various economic factors like the cost of aviation fuel (which accounts for up to 50 percent of the air fare), Ukraine's airport and air navigation service charges, depreciation cost, aircraft cost or lease payments, aircraft maintenance costs and so on.

12. When calculating prices, airlines take into account some additional factors such as the market situation on a particular air travel route, the structure of passenger traffic, the flight season, booking time, ticket purchase deadline, type of trip, type of flight (regular or charter), number of competitors and their rates. As a result, a rate plan is developed for every route, and it may consist of several dozen types of prices. It means that there is a wide range of airline ticket prices which are based on detailed analysis of a particular air transportation market, adjusted on the fly and entered into international booking system.

13. For frequent airline travellers, this system is clear and straightforward.

14. The Committee considered the case with regard to infringement of the legislation for protection of economic competition by Company X which changed its name to Y. The company provided automated airline booking services in Ukraine.

15. The main customers of automated booking systems in Ukraine are air transport sales agents operating in Ukraine.

16. In this context, flight booking is part of the technological process of selling air transport services. Flight booking is done by means of automated flight booking systems.

17. Automated flight booking in Ukraine can be done with the help of:

1. Global distribution systems;
2. Distribution inventory systems;
3. Airline internal booking systems;
4. Specialized internet portals.

18. During the examination, it was found that the air transportation market participants both in Ukraine and in other countries distinguish booking through Global Distribution Systems and the above systems as a whole, on the one hand, from booking through other, in particular local, automated flight booking systems, on the other hand, which in turn makes it possible to say that automated flight booking through Global Distribution Systems is a separate service.

19. By results of the analysis of the market of automated reservation was established that the Company "A" in the period of 2003-2006 was a dominant position in this market with a market share exceeding 35 percent (over 80 percent). During the analysis of activity of the Company "A" revealed that in a separate contracts between the Company and its consumers (agencies ticket) the Company has established provisions, which fully or partially limited the rights of consumers to use the same services of competitors.

20. That is, by concluding such contracts, the Company which has a dominant position on the market, connected Users (Agency on sale of air transportation) obligation to provide for their needs in the services of an automated airline reservation through Global Distribution Systems only through the "A". The establishment of obligations to receive services exclusively from a particular subject and binding them to a specific system privileges restricts services consumers the possibility of free choice of other companies that can provide such services. Such actions of the Company "A", which was to impose restrictions on the use of the similar services of competitors at the time of the conclusion of contracts, can lead to restriction of competition, and is a violation of the legislation on protection of economic competition, as stipulated in paragraph 2 of article 50 and the first paragraph of article 13 of the law of Ukraine "On protection of economic competition", in the form of abuse of monopolistic (dominant) position on the national market of automated airline reservation through Global Distribution Systems.

21. For breaches committed on the Company "And" fined the Company "A" has found a violation and paid a fine. Today, complaints of violations of the legislation on protection of economic competition relative to automated airline reservation before the Committee had been received.

22. Slots: the benefits of liberalization of the airline sector are unlikely to be fully realized if airport capacity continuous to be constrained. Limited availability of slots can constitute a significant barrier to entry. Can primary slot allocation and secondary slot trading impact, and in particular reinforce, the position of airlines?
23. Slot allocation may affect airline competitiveness, especially if the airport is affiliated with a certain airline.
24. Following the results of the examination of the Committee of the appeal of a private company "A" concerning the actions of OJSC "B" which failed to provide "A" with arrival and departure slots in the international airport of Dnipropetrovsk (airport slots), the Committee inspected a case of infringement committed by "B." The international airport of Dnipropetrovsk was part of "B."
25. During examination of this case, the Committee provided "B" recommendations to be mandatorily considered to provide "A" with arrival and departure slots in the international airport of Dnipropetrovsk on non-discriminatory terms in accordance with the Guidelines for Allocation of Arrival and Departure Slots in International Airports in Ukraine.
26. Recommendations of the Committee were followed, specifically, "B" provided "A" with slots as per its requests.
27. So far, the Committee is not aware of non-admission, elimination or restriction of the interests of other airlines in terms of access to specialized services of the airport.
28. According to the Act on the State Aviation Administration of Ukraine, the State Aviation Administration is a government body responsible for implementation of the government's civil aviation policy. More specifically, the State Aviation Administration ensures that all aviation market participants comply with Ukraine's aviation legislation and interstate agreements signed by Ukraine.
29. According to the Airline Act about Ukraine's operation of international airline routes, approved by the Order no. 247 of the State Aviation Safety Administration of Ukraine of December 24, 2004, registered with the Ministry of Justice of Ukraine on December 29, 2004, no. 1665/ 10264, international routes shall be allocated to Ukrainian airlines by the State Aviation Administration of Ukraine in accordance with this Act and provisions of a relevant intergovernmental agreement on air travel services (air transport) or other agreements between the aviation authorities.
30. According to the Resolution of the Cabinet of Ministers of Ukraine of 25.12.2996 no.1548 "On Establishing the Powers of the Executive Authorities and of City Councils for the Regulation of Prices (Tariffs)," The Ministry of Transport and Communications of Ukraine in coordination with the Ministry of Economy of Ukraine determines air navigation services charges, as well as airports' aircraft and passenger charges and fees in Ukrainian airports.
31. Thus, air navigation service charges and Ukrainian airports' aircraft and passenger charges and fees are regulated tariffs.
32. According to Ukrainian legislation, the government is the only regulator of air travel, and no industry associations, other organizations or economic entities shall have such powers.
33. The Committee believes that any regulation or lack thereof affects competition on the market. Today, airlines only need to obtain necessary licenses and certification to provide air transport services and face no other administrative hindrances preventing them from operating any flights on any domestic routes.

34. According to the State Aviation Administration of Ukraine, there are currently 82 licensed passenger and cargo airlines most of which operate in the business segment by providing customized charter flights.

35. At the same time, according to the Law of Ukraine "On Natural Monopolies," national commissions for regulation of natural monopolies, formed and operating in accordance with this Law, are responsible for the government regulation of natural monopolies, particularly in transport.

36. According to this law, the individual markets for transport services operate as natural monopolies, which requires effective regulation of certain natural monopolies and adjacent markets by the government in order to promote the effective operation of the markets based on balancing the interests of society, subjects of natural monopolies and consumers of goods produced (sold) by subjects of natural monopolies.

37. However, the current system of state regulation in the field of transport does not ensure effective competition between economic entities, as the Ministry of Infrastructure of Ukraine, being a central body of the executive branch in areas including aviation, road and rail transport, acts as both operator and regulator on the transport market.

38. Naturally, there is a need to establish an independent non-departmental regulator of subjects of natural monopolies in the transport sector, including the airline industry.

39. Ukraine declares that it pursues the policy of reducing the regulatory pressure and liberalization of the air transportation market. For that end, Ukraine intends to sign an "open skies" agreement on the Common Aviation Area with the European Union and actively revises bilateral agreements with partner countries on the domestic market.

2. Competition in the Aviation Industry

2.1 Market definition

40. For consumers, flights on specific routes cannot be replaced by flights on different routes (e.g., if you need to fly from Kyiv to Lviv, you will not consider the flight from Kyiv to Kharkiv as a valid replacement), but may be replaced by services provided by different modes of transport.

41. Therefore, the Committee examines the situation of each individual airline on all domestic airline routes, since every route is a separate market for passenger air transport services.

42. Because by a number of consumer characteristics, including cost, travel time, comfort, etc., air transportation differs from other modes of transport (train, car), for determining the boundaries of the market for air travel within Ukraine it is important to make a differentiation based on customer groups.

43. There are two main groups of transport customers:

1. Those, who needs to get to the destination as soon as possible;
2. Those, for whom time is not important, and they will agree to spend more time on the road if they pay less.

44. Consumers, for whom time is not a priority, can be divided into several categories - those for whom comfort is critical and those for whom the cost of the ticket is critical. Thus, on the one hand, there are air travellers who pay less attention to comfort and are more concerned about the cost, and, on the other hand, there are air travellers who value comfort over the ticket price.

45. Those consumers, who do not place importance on travel time, may consider road, rail and air transport interchangeable (except for the market segment where the cost of travel is critical).

46. For example, the Committee's market survey of the passenger airline route Kyiv-Donetsk has shown that the market of price-conscious travellers (travel time and comfort are not important) is strongly dominated by rail transport.

47. On the other hand, comfort-conscious travellers (transportation comfort factor) consider first-class rail cars and air transport to be interchangeable.

48. The main characteristic of this group of consumers is that they are willing to pay a premium for extra comfort.

49. As already mentioned, despite the fact that the least travel time is provided by air traffic for a particular route, customers in this group consider this fact irrelevant for their priority ranking.

50. It should be noted that the cost of the first class car railway ticket is less than or equal to the economy class airline ticket.

51. Also it should be noted that on average aircraft are not as filled up with passengers as first class railway cars (e.g., in the Kyiv-Donetsk train the cars were filled approximately to 65 percent).

52. Obviously, given the passenger flexibility in this transport segment, as well as the availability of alternatives and strong competition between modes of transport, are unlikely to dominate the market.

53. In view of the above, it can be concluded that the market of cost-conscious travellers (travel time and comfort are secondary) is obviously dominated by rail transport.

54. For comfort-conscious travellers (comfort is more important than travel time), rail transport in first class cars and air transport are more costly and interchangeable.

55. For time-conscious travellers, although an airline ticket (e.g. from Kyiv to Donetsk) costs more than a trip by car or train (except first class cars), there are no other options, since the flight from Kyiv to Donetsk takes about 1.1 hours, a car trip takes about 12 hours, a train trip is 8 hours (express) or 12 hours (ordinary), or as long as 13 hours 45 minutes if you go from Kyiv to Mariupol.

56. It is important to remember that in case with air travel it is necessary to take into account the time needed to get to the airport and leave it on arrival, airport check-in time, baggage claim, waiting, etc. Thus, an average flight between Kyiv and Donetsk should take about 4 hours.

57. Thus, the difference between trips by rail and air is approximately 4 hours. To determine how important this difference will be for time-conscious travellers, expert opinions are needed, including a relevant sociological survey.

2.2 *Concerted Actions*

58. The Antimonopoly Committee of Ukraine decided to allow amendments to concerted actions in the form of an Additional Agreement between a closed joint stock company "A," a limited liability company "B" and open joint stock company "C" to the Agreement on Strategic Alliance, more specifically, joining the Strategic Alliance.

59. Participants of the concerted actions had to comply with the following:

- not to impose such ticket prices and baggage fees on scheduled domestic air routes, where participants of concerted action exclusively operate, that would be impossible in the strong market competition environment;
- ensure the availability of low rates declared by members of the concerted action beyond the price range, in particular by increasing their quota in the rate plan for every route.

60. Strategic Alliance "X," which includes "C" and "A," reported that to implement the Committee's decision, "the companies of the Alliance ... have begun to provide passengers with the opportunity to purchase one-way tickets for domestic flights within Ukraine with a total cost of up to 500 UAH including all fees and charges. These tickets account for approximately 20% of the total number of tickets sold for domestic flights."

61. The Strategic Alliance sends monthly statements to the Committee, which include the total number of tickets sold for each of the domestic air routes operated by the airline.

62. The research of passenger air transportation markets of the Committee demonstrated that airline tickets offered by "C" on the routes Kyiv - Dnipropetrovsk - Kyiv, Kyiv - Ivano-Frankivsk - Kyiv, Kyiv - Lviv - Kyiv, Kyiv - Odessa - Kyiv, Kyiv - Kharkiv - Kyiv and Kyiv - Chernivtsi have signs of being economically unjustified and impossible to impose in a strong market competition environment.

63. In this regard, the Committee has inspected the case of "C's" infringement of the legislation on protection of economic competition.

64. During the consideration of this case, the Committee analyzed the economic feasibility of airline ticket prices offered by other domestic air carries (including closed joint stock company "A").

65. In order to stop actions that have signs of infringement of the legislation on protection of economic competition, on the basis of Article 46 of the Law of Ukraine "On Protection of Economic Competition," in September 2011 the Committee provided recommendations to be mandatorily considered no. 16-rk on "C" and "A," which are part of the Strategic Alliance "X," requesting to review ticket prices on scheduled domestic air routes and bring them to a level that would be natural in a strong market competition environment.

66. The Strategic Alliance informed the recommendations were followed and provided relevant supporting documents proving that the airlines reduced ticket prices in economy class and business class.

67. In particular, the Strategic Alliance informed that "the companies of the Alliance ... began providing passengers with the opportunity to purchase social tickets for one-way domestic flights at a total cost of 500 UAH including all charges and fees. Such tickets account for approximately 20% of the total number of UAG tickets sold for domestic flights..."

68. In addition, to follow the recommendations of the Committee of 21.09.2011 no. 16-rk, the Strategic Alliance informed that the following measures were taken to reduce the cost of tickets for a number of air routes in Ukraine:

- Reduction of the highest economy class air fare by 6%-14% (on average by 10.1%) depending on the route and season;
- Introduction of a pass card ("business rate") for frequent flyers in Ukraine allowing to buy an economy class ticket for any domestic flight - at any time, even on a same-day flight - at a maximum cost of 1,080 UAH (or 95 US dollars including charges and fees);
- Introduction of a minimum ticket price with all fees included on the routes Kyiv - Odessa - Kyiv and Kyiv - Dnipropetrovsk - Kyiv of only 494 UAH."

69. After comparison of the maximum air fares in winter 2010 and summer 2011 with air fares of winter 2011 (after providing the recommendations of Committee) it was found that ticket prices offered by "C" fell by an amount equal to 20-30 US dollars, or approximately by 8-13%.

70. Thus, analysis of the data provided by the Strategic Alliance indicates that Recommendations of the Committee were followed and therefore the Committee has closed the case.

2.3 With regard to the questions of "Merger" pool

71. In accordance with Article 22 of the Law of Ukraine "On Protection of Economic Competition" the concentrations are understood namely as a merger or consolidation of one economic agent with another.

72. In accordance with Part One of Article 25 of the Law of Ukraine "On Protection of Economic Competition", the Antimonopoly Committee of Ukraine or the Administrative Board of the Antimonopoly Committee of Ukraine grant authorization for a concentration where it does not result in monopolization or a significant restriction of competition in a market as a whole or a significant part thereof.

73. Monopolization is the achievement by an economic agent of a monopolistic (dominant) position in a product market, the maintenance and strengthening of such position.

74. In accordance with Article 12.2 of the Law of Ukraine "On Protection of Economic Competition" a position of an economic agent is understood as monopolistic (dominant) where one's share in a product market exceeds 35 percent, unless one proves that one faces significant competition.

75. Thus, the Antimonopoly Committee of Ukraine grants authorizations for mergers to traditional air carriers, as well as to low-cost carriers so long as such concentrations do not result in monopolization or a significant restriction of competition in product markets of Ukraine.

76. Airline companies' consolidation is a worldwide development trend in international aviation, equally beneficial for both passengers and air carriers. High quality of products and a wide range of offered services of airline companies – alliance members significantly improve their competitiveness in international markets.

77. Aviation alliance is a partner association of airline companies that allows reaching a higher level of international collaboration in commercial air transport. Airlines within the alliance preserve their legal independence but unify such elements as booking system, bonus program for passengers, introduction of joint flights and coordination of their schedules.

78. Taking into consideration that entering into agreement for the creation of aviation alliance of Ukrainian air carriers did not stipulate the creation of a new association, a concentration, a consolidation of capitals of the parties thereto, the establishment of control of one economic agent over another, the Antimonopoly Committee of Ukraine considered entering into such agreement as coordinated actions of economic agents.

79. The Antimonopoly Committee of Ukraine conducted advanced analysis of agreements for aviation alliance creation or the entrance of new airline companies to the alliance within consideration of coordinated actions cases, as in respect of certain internal routes within Ukraine the participants of coordinated actions had not a single competitor. Following the results of investigation, the Committee found that claimed coordinated actions promoted the production improvement, purchase or sales of goods, technical and engineering and economic development as well as maximization of efficiency and productivity. Moreover, taking into consideration the absence of administrative barriers to entrance into the markets of internal air carriage of passengers and baggage, claimed coordinated actions did not result in significant competition restriction in the markets of passengers and baggage air carriage and other product markets of Ukraine.

80. As for revision of “concentration” notion and inclusion of a broader range of preventive control agreements to it: the legislation on the protection of economic competition provides for various methods of control acquisition, including the one by means of minority shareholding.

81. First and foremost, it can be attributed to the fact that international air transportation to and from Ukraine is only possible under the conditions established by interstate air transport agreements in effect. I.e. a foreign air carrier may be granted the right for an airway operation so long as Ukrainian air carriers are granted the same rights in the state of a foreign air carrier’s registration or acquire other rights on a reciprocal basis.

82. In accordance with Part One of Article 31 of the Law of Ukraine “On Protection of Economic Competition”, following the results of consideration of coordinated actions and concentration cases, the decision of the Antimonopoly Committee of Ukraine, namely, in respect of granting authorization for coordinated actions, prohibition of coordinated actions, granting authorization for concentration and prohibition of concentration is pending.

83. The decision of the Antimonopoly Committee of Ukraine on granting authorization for coordinated actions, concentration may be conditioned by the performance by the participants of coordinated actions, concentration of certain obligations and by their compliance with certain requirements eliminating or cushioning the adverse effect of coordinated actions, concentration upon competition. Such conditions and obligations may relate, in particular, with management, use or disposal of property, as well as the obligation of an economic agent to alienate property.

84. For instance, in consideration of coordinated actions case, in order to cushion the adverse effect produced by coordinated actions upon competition, the airline companies were namely obliged to:

- Not set such prices or establish other conditions of purchase or sales of products, namely the rates for passengers and baggage transportation services in respect of regular internal aviation routes, where solely the participants of coordinated actions conduct ones’ activities, that would otherwise have been impossible to set subject to existence of significant competition in the market, as well as:

- Not to apply the same approaches in setting the prices of passenger transportation services in respect of routes where significant competition exists, and routes where competition is insignificant or totally non-existent, namely by means of setting of substantiated rates for the said services;
- Withhold from any actions (inaction) that are aimed or might result in non-admission, elimination or restriction of competition with regard to access of airline companies not being participants of coordinated actions, to the services of the airport of the city of (.....), namely by means of availability of obtaining convenient (in-demand) time intervals for the performance of flights;
- Ensure availability of the lowest under the price line prices declared, namely, by means of increase in their quota in the rates schedule with regard to each route.

85. Where a merger does not result in monopolization or a significant restriction of competition in products markets of Ukraine, the Antimonopoly Committee of Ukraine grants authorizations for such actions and does not conduct the *ex post* analysis of such agreements. At the same time, upon one's one initiative or applications of individuals, the bodies of the Antimonopoly Committee of Ukraine can revise the decisions they adopted in cases with regard to violations of the legislation on the protection of economic competition and in respect of applications, cases with regard to coordinated actions, concentrations in the events specified in Part One of Article 58 of the Law of Ukraine "On Protection of Economic Competition".

86. Where such agreements might produce a certain adverse impact upon competition, the AMCU imposes obligations upon economic agents and conducts the *ex post* analysis of such agreements. In particular, with the purpose of conducting control over the compliance with the legislation on the protection of economic competition, prevention, detection and suppression of violations of this legislation, the airline companies – the participants of coordinated actions were obliged to monthly provide the Antimonopoly Committee of Ukraine with the information on the cost and quantity (in percent out of the total volume) of sold tickets which the lowest under the price line, with regard to each separate internal flight performed by the participants of coordinated actions along with the information on the total quantity of tickets sold for these flights.

87. In particular, following the results of consideration of the coordinated actions case, the Antimonopoly Committee of Ukraine found that joining opportunities of airline companies would allow to expand the network of flights and the network of sales, improve the efficiency of aerial vehicles use, as well as minimize expenses of airline companies (decrease the cost of purchases, including the cost of aviation fuel constituting the major part of costs of airline companies), which would consequently decrease the net cost of the air transportation services, which, in its turn, could result in the decrease in rates for the said services.

88. I.e. claimed coordinated actions shall promote the improvement of production, purchase or sales of products, technical and engineering and economic development and maximization of efficiency and productivity.

2.4 With regard to the questions of “Financial Distress and Competition” pool

89. Thus, in consideration of the coordinated actions case, the Antimonopoly Committee of Ukraine also took into consideration that none of Ukrainian airline companies was capable of competing on the equality with prominent international airline companies under the conditions of a great liberalization of the market. The practice of Central European countries that deregulated ones’ internal markets of air conveyance upon ones’ entrance into the EU, bears record to the fact that small national companies do not stand up to competition with potent European airline companies and typically go bankrupt, surrender the servicing of international flights (primarily, long-haul flights), and get taken over by competitors.

90. Only the consolidation of Ukrainian airline companies through development of the routes network, growth of air transportation, improvement of financial and economic standing of air carriers shall allow competing with foreign airline companies operating flights to Ukraine.

91. I.e. Ukrainian airline companies had no alternative other than joining in their national alliance necessary for survival and efficient competition in international markets under the conditions of globalization of the air transport industry and increasing activity of global alliances in Ukrainian air transportation markets.