

Unclassified

DAF/COMP/WD(2014)37

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

03-Jun-2014

English - Or. English

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

DAF/COMP/WD(2014)37
Unclassified

AIRLINE COMPETITION

-- Note by Chinese Taipei --

18-19 June 2014

This document reproduces a written contribution from Chinese Taipei 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
<http://www.oecd.org/daf/competition/airlinecompetition.htm>.*

JT03358580

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. This paper will outline the state of and regulation measures for the air transport market in Chinese Taipei. It also discusses competition issues of the industry and cases investigated by the Fair Trade Commission (FTC). To prepare this paper, the FTC consulted with the Civil Aeronautics Administration (CAA), the central competent authority, and the Institute of Transportation, both of the Ministry of Transportation and Communications (MOTC).

1. The state and regulation of the air transport market in Chinese Taipei

2. The air transport market in Chinese Taipei is divided into two main categories: international and domestic. As of April 30, 2014, there have been eight airlines¹ registered under Chinese Taipei, of which two² are running international air route service, four³ are running international and domestic air route service, and two⁴ are running helicopter carrier service or domestic offshore and outlying islands air route service. In light of the rapid rise of the international low-cost carrier industry, the MOTC of Chinese Taipei, in an effort to promote the evolvement of the low-cost carrier industry, amended laws in 2013 that lowered the threshold for entry applications. So far two airlines have been granted permission to be low-cost carriers, which are under progress. In 2013, the international and inter-Taiwan-Strait passenger traffic reached 38.27 million person-times, of which 58.28 percent was accounted as airlines registered in Chinese Taipei. In 2013, the volume of international and inter-Taiwan-Strait air freight reached 1.64 million metric tons, of which 41.61 percent was accounted as airlines registered in Chinese Taipei. In terms of individual airlines, China Airlines led the pack with a 32.99 percent market share, compared to Eva Air with 22.48 percent. It is worth pointing out that China Airlines joined the Sky Team airline alliance in September 2011 and Eva Air joined the Star Alliance in June 2013.

3. Having adopted an “open sky” policy since 1987, Chinese Taipei has basically deregulation on air fares and flights, giving businesses the flexibility to adjust their prices (fares) and quantities (flights) according to business needs and market demands. However, route acquisitions, given restrictions on quotas and available time slots at airports, remain under heavy regulation. The regulation measures adopted by the civil aeronautics competent authority in Chinese Taipei include:

1. Restrictions on applications by a civil air transport enterprise for permission to establish its business. Article 48 of the Civil Aviation Act (CAA) stipulates that a civil air transport enterprise shall obtain permission from the competent authority to establish its business and during the preparatory period its operational plan should pass inspection. Only after receiving a license from the CAA may the enterprise begin to operate.
2. Restrictions on applications for flights. Article 50 of the CAA stipulates that a civil air transport enterprise should have secured international air traffic rights with relevant slots and be in possession of an air route certificate before it can engage in international scheduled air transport service on assigned air routes. Likewise, a civil air transport enterprise should have acquired aircraft takeoff and landing allotments for domestic airports or slots and be in possession of an air route certificate, prior to commencing domestic scheduled air transport service on designated air routes.

¹ China Airlines, Eva Air, TransAsia Airways, Far Eastern Air Transport, Mandarin Airlines, UNI AIR, Daily Air Corp., and Sunrise Airlines were registered under Chinese Taipei.

² China Airlines and Eva Air were registered under Chinese Taipei.

³ TransAsia Airways, Far Eastern Air Transport, Mandarin Airlines, and UNI AIR were registered under Chinese Taipei.

⁴ Daily Air Corp. and Sunrise Airlines were registered under Chinese Taipei.

3. Restrictions on ticket prices. Article 55 of the CAA stipulates that a civil air transport enterprise engaging in domestic scheduled air passenger or cargo services shall apply for permission as to the ceiling and floor of its fares. A civil air transport enterprise shall notify the competent authority regarding its fares for passengers and cargo services on scheduled international air routes. The fares are the ceilings. In addition, the MOTC has issued *Regulations Governing Tariffs for Passengers and Cargo Air Transportation* to regulate the fares on scheduled flights for passengers or cargo.
4. Restrictions on alliances. Article 58-1 of the CAA stipulates that civil air transport enterprises shall receive approval from the MOTC before undertaking alliance operations. An alliance shall be subjected to approval from the FTC if the alliance meets the scope of concerted actions under Article 7 of the Fair Trade Act (FTA). The Reviewing Rules for Approving the Alliance shall be promulgated by the MOTC together with the FTC.

2. Market competition in the airline industry: market definition, cartel agreements, mergers, abusing market dominance, financial difficulties, and competition

2.1 Market definition

4. Article 5 of the FTA stipulates that the term “relevant market” means a geographic area or a coverage wherein enterprises compete in respect to particular goods or services. “A geographic area or a coverage” shall include the combination of all goods or services that can reasonably substitute for each other in price, quality, and other functions to satisfy specific needs. Based on Point 4 of the “*Principles for the Fair Trade Commission to Handle the Merger and Alliance of Domestic Civil Aviation Enterprises*” and internationally generally accepted definitions for air transport markets, Chinese Taipei adopts the city-pair as the smallest unit of a market while also taking into account the following factors: 1) the substitutability of routes whose origin and destination combinations are in close proximity; 2) the substitutability among transport vehicles in the air, high-speed rail, rail, highways, and waterways; and 3) other factors relevant to the definition of aviation markets. The assessment of substitutability among the above-mentioned transport vehicles among different routes shall take into account the following factors: 1) travel distance and length of time; 2) passenger characteristics and time cost of travel; and 3) the ability of service providers to collectively or individually make small but significant and non-transitory increase in price without impacting their profitability.

2.2 Cartel agreements, mergers and abusing market dominance

5. Chinese Taipei in principle prohibits cartel agreements, to which it grants permission only on an exceptional basis. As for mergers, it only regulates merger cases of enterprises exceeding a certain scale threshold. The enterprises concerned must submit applications to the FTC in advance of forming the mergers. The FTC has issued the “*Principles for the Fair Trade Commission to Handle the Merger and Alliance of Domestic Civil Aviation Enterprises*” so it may effectively review applications for alliances and mergers from enterprises engaging in air transport so as to maintain market order and consumer rights and to ensure fair competition. Point 4 of the “*Regulations on the Examination of Applications for Alliances of Enterprises Engaging in Civil Aviation*” stipulates that “code sharing, the transferring of ticket coupons without endorsements, co-promotions, and other alliance operations that are sufficiently capable of impacting the production, commercial transactions, or the supply and demand of the market” shall be deemed as concerted actions under Article 7 of the FTA, and as such, shall be allowed only with prior approval from the FTC. As for the abuse of market dominance, the FTC has yet to handle a penalty case against any enterprise in civil aviation for abusing its market dominance in Chinese Taipei.

2.3 *Financial difficulties and competition*

6. On an exceptional basis, Article 14(6) of the FTA allows “joint acts limiting the quantity of production and sales, equipment, or prices for the purpose of meeting the demand orderly, while in economic downturn, the market price of products is lower than the average production costs so that the enterprises in a particular industry have difficulty in maintaining their business or encountering a situation of overproduction”. Accordingly, enterprises engaging in civil aviation may apply to the FTC for permission to conduct joint acts on an exceptional basis.

3. Case example 1: TransAsia Airways and UNI AIR signed a revenue pool agreement for the Kaohsiung-Kinmen and Kaohsiung-Magong routes in violation of the FTA (2008)

7. According to the Civil Aviation Act, for those airline companies intend to form a alliance operation, they “shall file request to the MOTC through CAA for approval.” Also, they have to apply for approval from the FTC as it involves concerted action. The two companies, TransAsia Airways and Uni AIR, signed the revenue pool agreement for the routes Kaohsiung-Kinmen and Kaohsiung-Magong without applying for approval either from the CAA or from the FTC. .

8. The Kaohsiung-Kinmen and Kaohsiung-Magong routes are for remote islands with no on-land substitutes available. Ferry services and the services offered by the air routes in this case differ markedly in transport volume, pricing, and travel time. Take the Kaohsiung-Magong route as an example, the vessel Tai Hwa offers one or two daily trips, the fare is a mere NT\$860, and the trip takes about four to six hours one way. These factors make the sea route markedly different from the air route. Therefore, the case adopted the city-pair, i.e. Kaohsiung-Kinmen and Kaohsiung-Magong air transport routes, as the market.

9. The FTC investigation revealed that the Kaohsiung-Kinmen and Kaohsiung-Magong air routes were served only by TransAsia Airways and UNI AIR, making the two companies horizontal competitors. The two companies signed the “revenue pool agreement” on November 4, 2003, which specified the number of seats they would supply to the said routes in a week and how they would split the revenue. They operated the routes jointly and shared the profit by entering into such an agreement. They engaged in concerted action given: 1) that the parties engaging in the alliance held a 100 percent market share, 2) that the said agreement, specifying percentages of airplane seats supplied by the parties and their shares of the proceeds, would lower the willingness of the parties to offer more favorable price or non-price conditions to attract customers, and 3) that there were no competitors, the action of the said parties was sufficient to affect the market function of commodity transactions or the supply of and demand for services.

10. The FTC concluded that the “revenue pool agreement” that TransAsia Airways and UNI AIR signed to specify the percentage of airplane seats and how they would settle the proceeds constituted a concerted action that mutually restricted business activities sufficiently capable of affecting the market function of the supply of and demand for air transportation on the Kaohsiung-Kinmen and Kaohsiung-Magong air routes. Such an act was in violation of Article 14(1) of the FTA. The FTC ordered the two companies to immediately cease the unlawful act and imposed an administrative fine of NT\$1,000,000 respectively.

4. Case example 2: The approval of the application from Far Eastern Air Transport, Mandarin Airlines, TransAsia Airways, and UNI AIR for a concerted action to transfer ticket coupons without endorsements for the Taipei-Kaohsiung air route (2007)

11. The four participants in the concerted action in this case held a 100 percent market share in the air transport market for the Taipei-Kaohsiung air route. The parties applied for permission to implement the Taipei-Kaohsiung air route “transfers of ticket coupons without endorsements,” which would enable

consumers to use a valid airplane ticket for the said route to board any flight offered by any of the participants without first being endorsed by the company issuing the ticket. In other words, the validity of such unified Taipei-Kaohsiung air tickets in fact had the effect of increasing the liquidity of airplane tickets, thereby making it more convenient for passengers to fly, and increasing seat occupancy rates for the airlines. The action was beneficial to the operational efficiency of the airlines, and so this case satisfied the requirement of Subparagraph 1 of Article 14(1) of the FTA.

12. Article 14 of the FTA clearly stipulates that a concerted action can be approved as an exception only when it is “beneficial to the economy as a whole and in the public interest”. The FTC considered that the proposed concerted action was beneficial to the economy as a whole and in the public interest because 1) consumers benefit from a shortened wait for flights, 2) airlines benefit from improved efficiency as a result of increased seat occupancy rates, 3) lowered costs of flying enhance the efficiency of resource utilization, and 4) the central competent authority, the MOTC, offered a favorable opinion. The FTC also considered that the concerted action did not restrict competition or result in disadvantages from unfair competition because 1) it did not cause significant market entry barrier, 2) it had a limited effect on price rigidity, 3) it did not lower the incentives for the airlines to provide innovative services, 4) it did not impact the upstream and downstream markets, and 5) it did not apparently and negatively diminish the rights of consumers. After considering these factors, the FTC, pursuant to Article 15 of the FTA, attached conditions to address concerns that the proposed concerted action may subsequently cause restricted or unfair competition and to ensure that the proposed concerted action would bring about results that are “beneficial to the economy as a whole and in the public interest”. Based on the proviso in Article 14(1) of the FTA, the FTC granted permission for the proposed concerted action for a period of two years.

13. The conditions attached to the approval were as follows: 1) To address concerns about the effect on price rigidity, two conditions were attached: “the applicants may not without reasonable justification prevent others from withdrawing from or renegotiating the terms in the ‘Agreement for air ticket transfers without endorsement’ about the settlement of the proceeds,” and “in addition to issuing and selling airplane tickets that can be transferred without endorsement for the Taipei-Kaohsiung air route, the applicants shall issue and sell non-transferable airplane tickets that are subject to market competition mechanisms and price competition.” 2) To address concerns about market entry barrier, the FTC attached this condition: “the applicants may not without reasonable justification prevent other enterprises from joining this concerted action under reasonable conditions.” 3) To address concerns about the applicants engaging in other concerted actions as a result of this concerted action, the FTC attached this condition: “Each applicant shall make its own independent decisions about the prices and other terms of transaction for its transport service on the Taipei-Kaohsiung air route. Under the approval of this concerted action, the applicants may not enter into agreements by contract, accord, or otherwise to jointly set the prices and other transaction conditions for the air transportation on the Taipei-Kaohsiung route.” 4) To ensure that this concerted action brings about positive benefits, the FTC attached this condition: “During the permission period of this concerted action, if the applicants reduce their flights for the Taipei-Kaohsiung air route, the reduction may not exceed 20 percent of the approved flights at the time of the approval of this concerted action.” 5) To monitor whether or not the conditions attached to this concerted action have been adhered to and whether or not the economic condition at large has changed, the FTC attached these undertakings: “Every six months, the applicants shall submit their transaction data about the concerted action on the Taipei-Kaohsiung air route to the FTC for reference; the data shall include the pre-agreed amounts of settlement, the net amounts of actual settlement between two parties, passenger seats offered, number of passengers on board, seat occupancy rates, published fares, average sale unit price, amount of total sales, and the ratio of sales between transferable and non-transferable tickets.”

14. Taiwan High Speed Rail (THSR) was inaugurated in 2007. In that year, the Taipei-Kaohsiung air route, which was served by four airlines registered under Chinese Taipei, logged 1.335 million passenger-times. Three fourths of that market fell in 2008, forcing three airlines to withdraw from the market. The

market further declined to just more than 25,000 passenger-times in 2009. After five years of hard struggle against the high-speed rail, the Taipei-Kaohsiung air route was shut down in September 2012.

5. Case example 3: Domestic civil aviation businesses collectively reduced flights in violation of the FTA (2000)

15. Due to apparent declines in seat occupancy rates and in an attempt to lower operational costs and relieve financial stress, four airlines registered under Chinese Taipei, by agreement, started in May 2000 to unanimously and jointly reduce the supply of domestic flight services. The act was in violation of Article 14 of the FTA and was punished in a ruling of the 473rd meeting of FTC Commissioners on November 30, 2000. However, the FTC's decision was repealed by the appeal council in the Executive Yuan for the following reasons. The seat occupancy rates of airlines have continually declined since 1996, resulting in excess capacity and mounting losses for the airlines. Out of consideration for operating costs and the relief of aviation management, the CAA had encouraged the airlines to take the initiative to reduce their flights and, on unofficial occasions, had also required the airlines to take the initiative to reduce flights. In light of the fact that the four airlines reduced their flights at the request of the CAA and that it had agreed to the reduced flight schedules, did the unanimous action of these airlines constitute an intent to engage in a concerted action? In addition, was the degree of reduction sufficient to affect market supply and demand mechanisms? These questions remain to be investigated, and the original decision by the FTC was repealed.

16. It should be pointed out that the position of the CAA on this case during the FTA investigation was inconsistent with that during the appeal process. During the investigation of the case, the CAA indicated that 1) the flight adjustments that the airlines made in May 2000 were spontaneous acts that they had undertaken according to their fleet capacity and market demand, and 2) the CAA had not invited the airlines to conduct discussions or engaged in moral persuasion. However, during the appeal process of the case, the CAA changed its stance to indicate that, out of consideration for operating costs and for the relief of aviation management, it had, as a matter of its long-held policy, encouraged the airlines to take the initiative to reduce their flights and, on unofficial occasions, it had also required the airlines to take the initiative to reduce flights. The FTC subsequently decided that the act in question that the four airlines had undertaken, based on the evidence available at the time, could not be ruled as being in violation of the FTA.

6. Conclusions

17. After opening the air transport market to competition from the low-cost carriers under the "open sky" policy, the competition among airlines in Chinese Taipei will intensify, giving rise to strong competitive pressure. Therefore, strategic alliances or cooperation among airlines will only intensify. Will strategic alliances or cooperation among airlines bring about anti-competition results, or will they be considered as acts involving mergers or concerted actions under the FTA? Therefore, the FTC will review or conduct research on the current development of strategic alliances in the civil aviation industry, operational models, and their negative impacts on market competition. It will also review civil aviation laws and policies in Chinese Taipei, market structure, the state of competition, and changes in other economic and social factors to make timely amendments to the "*Principles for the Fair Trade Commission to Handle the Merger and Alliance of Domestic Civil Aviation Enterprises*". In addition, the FTC will continue to monitor competition issues in the marketplace, including business mergers, alliances, agreements on ticket prices or ticket matters, concerted reductions in flights, joint plans, or even the allocation of takeoff and landing times and the arrangement of flight schedules.