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AIRLINE COMPETITION

-- Note by Italy --

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

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1. Introduction

1. In the last fifteen years Italy, similarly to other European countries, has experienced significant changes in the air transport industry. While until the end of the 1990s the flagship State owned carrier, Alitalia, faced virtually no competition on domestic routes and limited competition on international routes, the European liberalization packages introduced in the national system progressively opened the skies to competition¹.

2. The main effect of the liberalization was the end of the monopoly position of Alitalia in many routes as entry of other carriers, and especially of Low Cost Carriers (LCCs), eroded traditional carriers market shares. The contribution provides some data on this evolution.

3. Alitalia faced difficulties in adapting its business model to the new scenario. From the end of the 1990s the Italian Government, holding 51% of its shares, supported the company through recapitalization and loans. At the end of 2007 an attempt to sell 49,9% of the stake to Air France- KLM group failed. The company was finally privatized in 2008, when a consortium of Italian investors bought its profitable activities together with those of the second Italian carrier Air One².

4. The Italian Competition Authority (ICA) conducted a competition analysis of air transport in several cases and information on some of them is summarized below. However, this contribution will mainly focus on the merger between Alitalia and AirOne that took place at the end of 2008.

5. The merger is noticeable because not only it raises many of the issues that competition authorities are currently facing with respect to mergers in the airlines sector (including the definition of relevant markets with respect to intermodal competition), but also it took place in a unique legislative framework in which the ICA had the possibility to re-assess the merger after three years and to conduct, in fact, an ex-post evaluation on the effects of the merger on the different routes involved.

2. Recent trends in the Italian airline industry

6. Since 2004³ total passengers transiting through the Italian airports have grown by 35.8%, amounting to 143.5 million in 2013. This upward trend in the demand, which has been less pronounced in the last years due to the economic crisis, has mainly concerned the international passengers segment rather than the domestic one (+51.7% compared to 17.1%).

7. The Italian airline sector experienced the significant growth of the LCCs since 2004, partly at the expense of the traditional airline business, in both the domestic and international passengers segments (see Table 1 below).

¹ See the Italian contribution to the 1999 Roundtable on Airline Mergers and alliances for a description of the regulatory evolution of the sector in the 1990s.

² Bergamini, Gitto, Mancuso, *Restructuring the Alitalia business model*, in *Journal of air Transport Management* 16 (2010) 16 -19.

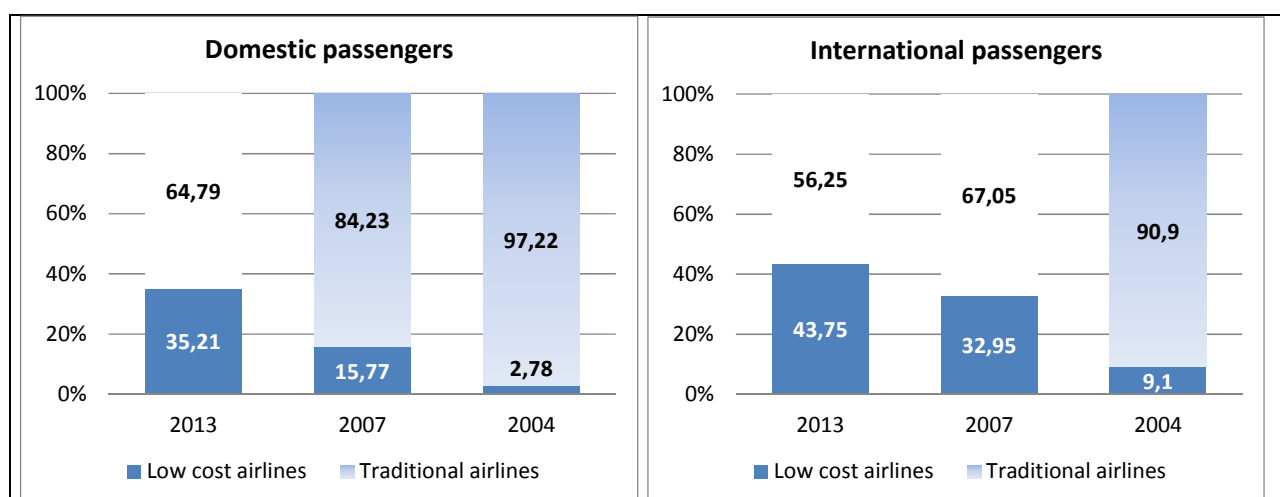
³ This is the first year for which data on passengers of LCCs are available from the statistics of Enac, the national civil aviation agency.

Table 1 - Evolution of airline passengers (arrivals + departures) in Italy during 2013-2004

TOTAL PASSENGERS	2013	2004	Var % 2013-2004	Difference 2013-2004
Low cost airlines	57,942,340	6,553,099	784	51,389,241
Traditional airlines	85,567,994	99,105,708	-14	-13,537,714

Source: Enac, annual report 2013.

8. In terms of market shares, the low-cost business has reached about 40.8% of total passengers in 2013 compared to a share of 25.7% in 2007 and 6.2% in 2004. This figure is higher in the international passengers segment compared to the domestic one (see Chart 1 below).

Chart 1 - Market shares in the domestic and international passengers segments

Source: Enac, annual report 2013.

9. The Italian flag carrier, Alitalia, and the Irish Ryanair are the top players in the passengers business. In 2013, the Irish low-cost company has almost matched the number of passengers transited with Alitalia (see Table 2 below) while it has become the primary operator in the international segment.

Table 2 - Top ten players in the Italian airline business in 2013

Total Passengers (arr. + dep) in 2013		Number	% of Total	
1	Alitalia	Italy	23,993,486	16.7
2	Ryanair	Ireland	23,041,752	16.1
3	Easyjet	UK	12,426,485	8.7
4	Deutsche Lufthansa	Germany	4,961,595	3.5
5	Gruppo Meridiana Fly	Italy	3,831,484	2.7
Domestic Passengers (arr. + dep) in 2013				
1	Alitalia	Italy	13,707,450	24.2
2	Ryanair	Ireland	6,838,399	12.1
3	Easyjet	UK	3,018,802	5.3
4	Gruppo Meridiana Fly	Italy	2,988,403	5.3
5	Blue Panorama Airlines	Italy	723,589	1.3
International Passengers (arr. + dep) in 2013				
1	Ryanair	Ireland	16,203,353	18.7
2	Alitalia	Italy	10,286,036	11.8
3	Easyjet	UK	9,407,683	10.8
4	Deutsche	Lufthansa	4,960,945	5.7
5	Air France	France	3,159,591	3.6

Source: Enac, annual report 2013.

10. As for the airports, the Rome-based Fiumicino airport is the leading infrastructure in Italy as it accounts for a quarter of total passengers transited in Italy in 2013, covering nearly 70% of international passengers and 30% of domestic passengers.

3. Competition issues

i) The Italian Competition Authority's interventions in the air transport sector⁴

11. In the course of the last decade the Italian Competition Authority dealt with several cases in the air transport market. A relevant issue that emerged – both in assessing mergers and alliances and in a general survey on the situation of the sector after the liberalization – was that the availability of airport slots is crucial in ensuring competitive entry. Slot release was therefore the remedy chosen in various cases assessed by the Authority, in line with international and European case law.

⁴ A summary of older cases investigated by the Authority can be found in the Italian contribution to the 1999 Roundtable on Airline Mergers and Alliances.

In 2002, the Italian Competition Authority fined the main Italian carriers, which had colluded to simultaneously apply an identical fare surcharge ('fuel surcharge') on all domestic routes. The Authority considered that, thanks to the fuel surcharge, the airlines had achieved the purpose of keeping their respective fare structures and market positions unchanged, while neutralising the potential competitive impact of a sudden increase in fuel prices⁵.

In 2003 Alitalia and Volare (the 4th operator in the domestic market) submitted a code-sharing agreement for the Authority's approval. The Authority observed that the agreement, which involved 22 routes characterised by limited competition due to economic, reputational and administrative barriers, reduced price competition. Therefore, it authorised the agreement on 5 routes only⁶.

In 2005 the Authority published a survey on airline fares. It argued that the potential benefits stemming from liberalisation and from the advent of low cost carriers were still hindered in many routes by administrative barriers, notably slot availability. Moreover, it observed that traditional carriers were trying to limit price competition by disguising the real price through additional fees to be added to the advertised fare⁷.

In 2006 the Authority approved the merger between Alitalia and Volare, subject to the release of slots on several routes⁸.

ii) The Alitalia-Air One merger: short story of an exceptional case

12. In 2008, the Italian government, by means of Law Decree No. 134/2008, adopted ad hoc urgency measures exempting from merger control scrutiny those "*mergers [that] fulfill major public interests*". The exemption only applied to mergers concerning the restructuring of large firms in distress operating essential public services, in order to guarantee stability of the provision of these services. The exemption was due to last for a period no longer than three years, after which, according to the law, "*any ensuing monopoly position must end*". The law did not concern specifically the airline industry, but only applied to mergers of large firms in financial distress realized until 30 June 2009.

13. In practice, the only operation that fell within the criteria set in the law was the merger of Alitalia and Air One, the first and second Italian airlines in terms of passengers, which took place in December 2008 and involved a vehicle company owned by a group of Italian investors, Compagnia Aerea Italiana ("CAI"), which was established for that purpose. The transaction consisted in CAI's acquisition of: (i) certain assets of the Alitalia Group (which at that time was under special administration); and (ii) sole control over the companies of the Air One Group. The new company, Alitalia- CAI, began operations in January 2009.

14. The ultimate aim of the merger was to prevent Alitalia's default by creating a new Italian airline combining Alitalia's and Air One's main operating assets. Nonetheless, the transaction led to an overlap between the parties' activities on a number of domestic and international routes, resulting in very large aggregated market shares on several routes. The ICA, given the provisions laid down by Law Decree No. 134/2008, was in fact barred both from prohibiting the transaction and from imposing structural remedies

⁵ Italian Competition Authority's case I446 Compagnie aeree-fuel charge, decision n. 11038 published in Bulletin n. 31/2002.

⁶ Italian Competition Authority's case I532 Alitalia/Volare, decision n. 12185 published in Bulletin n. 28/2003.

⁷ Italian Competition Authority's survey IC34 Dinamiche tariffarie del trasporto aereo passeggeri, published in Bulletin n. 17/2005.

⁸ Italian Competition Authority's case C7667 Alitalia/Volare, decision n. 15666 published in Bulletin n. 26/2006.

such as the divestiture of airport slots⁹. Only behavioural remedies could be imposed in order to “prevent the risk of prices or other contractual conditions being imposed that would be unduly burdensome for consumers”. Accordingly, on December 3, 2008, the ICA adopted a decision ordering a number of price control and consumer protection remedies for a period of three years¹⁰.

15. On November 30, 2011, the Authority opened an investigation in order to reassess Alitalia’s position on the air transport market following the 2008 merger with Air One. The Law in fact had only “suspended” the Authority’s authorization powers for this concentration and provided for a reassessment of the effects of the merger after three years. It should be noted that this reassessment – undertaken on the basis of Law Decree 134/2008 - had some different features with respect to the analysis ordinarily carried out under the rules of merger review in Italy. As the three-year suspension period elapsed, the ICA opened an investigation to ascertain whether the 2008 transaction created or strengthened a dominant position on certain routes and whether any such dominant position persisted to date. The Authority had to assess whether on the routes where the merger had created market power this market power persisted after three years and in case give a deadline to the party for its removal.

3.1 Definition of relevant markets

16. The Authority adopted a relevant market definition consistent with the European Commission’s consolidated approach to market definition in air transport of passengers, the point-of-origin/point of-destination pair approach (“O&D”). As for airport substitutability it deemed that, despite their proximity, the three Milan airports (Linate, Malpensa, and Orio al Serio) could not be considered substitutable either at the time of the transaction (2008) or the revision (2011) and should have been therefore identified as distinct markets at least in relation to domestic flights. This is particularly relevant for time sensitive passengers, especially those returning within the day, for which only flights from Linate are a viable alternative.

17. The ICA then identified seven international routes and 22 domestic routes where the transaction had determined an overlap between the parties’ activities.

3.2 Competition assessment

18. Turning to the competitive effects of the merger, the ICA held that, as regards international routes, in light of CAI’s limited market share and of the competitive pressure from other carriers, the transaction did not distort competition.

19. As regards the domestic routes, the ICA relied on EU and national precedents, which consider the control of at least 60% of the daily flights operated on a given route to be a threshold of concern that may trigger the application of structural remedies.

20. The analysis focused on the identification of the routes where the merger had created a dominant position. Key points of the analysis involved assessing

- a) the substitutability of the two Milan airports (Linate and Malpensa), and

⁹ The Decree did not exclude the application of the rules on agreements and abuse of dominance.

¹⁰ The ICA set out measures concerning tariffs, information requirements concerning delays or cancellations, compensation for delays. These measures complemented the commitments proposed by CAI concerning the coverage of the frequent flyer program and the re-allocation of 50 slots from Fiumicino-Linate to other routes where Alitalia-CAI’s market share was lower than 60%.

b) intermodal competition between high speed trains and airline transport.

21. The ICA identified 18 domestic routes where Alitalia-CAI after the merger came to operate at least 60% of daily flights (on most routes, Alitalia-CAI controlled 100% of the daily flights). The ICA added that, of these 18 routes, those having Milan Linate airport as their origin or destination raised particular concerns due to the high entry barriers resulting from regulatory constraints on the availability of slots at that airport, and in light of Alitalia-CAI's 70% overall share of total available slots.

22. In particular the analysis of the 18 domestic routes affected by the merger led to the identification of three different groups:

1. Routes to/from Rome and Naples.

23. In the first group of routes, having Rome and Naples as point of origin/destination (with the exception of the Milan-Rome route), the Authority ascertained that the merger had not created or strengthened a dominant position. These markets were, according to the Authority's analysis, highly contestable in view of the availability of slots and some LCCs had indeed entered these routes since 2008. Alitalia-CAI's unit revenue per passenger had decreased of 20% between 2008 and 2011;

2. Routes between Milano and the South.

24. In the second set of routes, though the concentration reinforced the merged entity's position (in particular in view of regulatory restrictions on the availability of slots in Linate airport), the Authority did not deem that this resulted in the creation of a dominant position. The analysis carried out with respect to passenger traffic, in fact, showed that for these routes there was substitutability between the Milan's airports of Linate and Malpensa, in view of the fact that only a limited share of passengers (10%) were travelling on the same date while the majority stayed overnight¹¹. The analysis indicated that Alitalia-CAI on these routes faced effective competition from other carriers including low cost carriers such as Easyjet, Meridiana and Windjet, as well as potential competition due to availability of slots in Malpensa.

25. Finally, the Authority ascertained that the 2008 merger had created a monopoly on the Milan's Linate – Rome's Fiumicino route that persisted in 2012. The analysis carried out by the Authority showed that for the route in question, notably the most profitable one, Alitalia-CAI faced no competitive pressures from other airlines because of specific regulations and administrative rules making it impossible for other companies to obtain slots for the Linate airport. The Authority considered in its analysis that the introduction of high-speed rail transport service between Rome and Milan, in 2009, represented an important development, connecting the two cities in less than three hours. However, the Authority considered that Alitalia-CAI's dominant position would not be undermined by shifting a meaningful portion of the demand from air to rail or by reducing ticket prices to the benefit of the passengers as intermodal substitutability in the early morning and late evening slots (i.e., the slots preferred by time-sensitive passengers) would still be limited¹².

3.3 Remedies

26. On April 11, 2012, the ICA closed its investigation. The ICA concluded that the Alitalia-CAI monopoly persisted on the Linate-Fiumicino route. As a consequence, the ICA ordered Alitalia-CAI to

¹¹ This is a relevant element since Linate is located very close (7 km) to the city centre while Malpensa is 50 km from the city center.

¹² The Authority estimated that time sensitive passengers on this route accounted for 20-25% of the total (35% in value).

adopt, within 90 days from the notification of the decision, all the necessary measures aimed at removing the monopoly. Due to the legal framework in which the merger was reassessed, the Authority could not directly impose remedies on the party but only indicate a term by which market power had to be removed. The authority, however, made it very clear in its decision what course of action should be followed in order to achieve this objective. According to the ICA, “*the removal of Alitalia-CAI’s Linate-Fiumicino market power seems to require the introduction of a competitive restriction that could only be imposed by the presence of another airline that could compete with Alitalia-CAI on the time sensitive slots*”, and, “*to offer a credible alternative to the incumbent, a competing airline would need to have access to a number of time slots sufficient to ensure a minimum efficient offer and flight frequencies that could guarantee an adequate supply for the time-sensitive slots*”.

27. The Authority therefore indicated that Alitalia should release eight of its slots on the Linate-Fiumicino route to allow a competitor’s entry on the route.

28. Following the Authority’s decision Alitalia-CAI released the slots to Easyjet. The Authority’s decision was upheld by the Council of State.

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