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**AIRLINE COMPETITION**

-- Note by Korea --

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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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## **AIRLINE INDUSTRY AND COMPETITION POLICY: SANCTIONS ON ABUSE OF MARKET DOMINANT POSITION**

### **1. Introduction**

1. Traditionally, air transport market has been monopolistic due to high economic barriers such as massive capital investment and advanced technological knowhow, causing it hard for a new player to enter the market. Other factors such as the government's direct intervention in the market through various regulations to secure safety and low supply elasticity have also been obstacles to new players' market entry.

2. However, new low cost carriers' aggressive market entry, emergence of alternative transportation including high speed railways and spread of air transport liberalization are giving way to structural transformation of the air transportation market. In Korea, competition among domestic and some international carriers is getting fiercer, with aggressive entry of low cost carriers (LCCs) since 2004.

3. In response to such a change, the Korea Fair Trade Commission (KFTC) is having its eye on airlines' potential anticompetitive practice, putting its effort to help aviation industry become a competition-friendly market.

4. Now we will have a look at an airliner's abuse of market dominant position on ticket sales, one of the competition issues in the airline sector, and will have an overview of the current status of Korea's regulation reform that has impact on competition among airlines.

### **2. Structural Features of Aviation Industry**

#### ***2.1 Boundaries of the airline sector***

5. Air transport service is a business which transports passengers or goods using airlines (Item 26 Article 2 of Aviation Law). The service is comprised of four elements: airlines, route network, human service and information service. It is also classified by the regions and regularity of the operations.

#### ***2.2 Ticket Selling Structure***

6. Airline tickets are sold either directly or indirectly. Direct sales are made in a way that an airliner sells directly to customers through branches home and abroad or in the airport, the internet or call centers. Indirect sales are made through indirect sales network including travel agencies rather than by the airliner itself. Depending on the characteristics of the selling agency or the agent of the sales, indirect sales are classified as travel agency sales, exclusive distributor travel agency sales and foreign airliner sales.<sup>1</sup>

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<sup>1</sup> Travel agency sales are made in a way of having a designated travel agency to sell the tickets and the agency gets paid a certain rate of commission according to the amount of sales. Exclusive distributor travel agency sales are made through an agency which represents agencies in the (non-)plying region. Foreign

7. More than 80 percent of the airline tickets are indirectly sold through travel agencies including wholesale travel agencies, package travel agencies or commercial travel agencies. And travel agencies play a big role in selling tickets for overseas tourism. Considering these factors, an airliner's success depends on whether it can conclude sales contract with travel agencies and have their tickets distributed well through the agencies. In this regard, when an airliner restrains sales of LCCs' tickets, using means of trade suspension or price support suspension, the agency has no other way but accepting it, which leads to a concern that there could be interruption of competing LCCs' normal business activities.

### **3. Law Enforcement on the Airliner's Market Dominant Position**

#### **3.1 Summary**

##### *3.1.1 Restraint on travel agencies' sales of LCCs tickets*

8. Korean Air and Asiana Airlines restrained travel agencies from selling LCCs tickets from 2006 to 2008 by putting pressure on the agencies suggesting trades with LCCs would lead to limited price support, limited number of seats of popular or peak-season routes or other disadvantages.

9. Securing seats of popular or peak-season routes is a decisive factor of gathering tourists. Airliners' such practice led to difficulties in LCCs' selling seats of domestic (mainly from Seoul to Jeju) and major international airlines' tourism routes (to destinations such as Japan, Southeast Asia, Hawaii) through travel agencies.

##### *3.1.2 Conditional rebate to travel agencies and limits on discount sales of airline tickets*

10. Korean Air provided conditional rebate (or so-called "volume incentive") to some major domestic travel agencies from 1998 to 2009 under the condition that an agency reaches certain target sales of Korean Air's tickets (compared to the agencies' total airline tickets sales).

11. Incentive criteria varying year by year, the airliner in 2008 provided 1.5 to 2 percent of total sales of tickets when Korean Air's sales share by the agency reached over 80 percent.

#### **3.2 Illegality determination**

##### *3.2.1 Market definition and determination on market dominant enterpriser*

12. The KFTC in this case defined the relevant product market to include markets of domestic airlines and international air passenger transportation departing and arriving in Korea.

13. Air passenger transportation's usefulness is different from other transportations including vessels, trains and automobiles. And considering that core benefits of a transportation service is time value such as speed and timeliness, the Commission determined that usefulness air passenger transportation service provides clearly distinguishes itself from other transportations.

14. Also, buyers and sellers of other passenger transportations are mostly not substitutable for the ones of air passenger transportation service. Thus even if the air freight charge increases up to a meaningful level (5 to 10 percent) for a substantial period of time, it is very unlikely to be substituted by other transportations.

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airliner sales are made in a way of selling the tickets for the cruising section to foreign airliners and making accounting adjustment with the airliner later on.

15. The Commission has defined relevant geographical markets to be domestic market with the determination that even if the air freight charge increases up to a meaningful level for a substantial period of time, it is economically and geologically unfeasible for representative customers using air transportation services in Korea to use airliners departing regions other than Korea instead.

16. The Commission's decision that the two airliners are in the market dominant position considering the following; (1) As of 2009, Korean Air and Asiana Airlines' domestic airliner market share stands at 55.4 percent and 33.4 percent respectively, with international airliner market share 52.4 percent and 23.8 percent each. (2) The entry barrier is considerably high as it takes huge amount of capital to start the business and there are many forms of regulations to enter the aviation industry by nature. (3) Gap between the two major airline companies and others are dramatically huge.

### *3.2.2 Determination on exclusive dealing*

17. Korean Air and Asiana Airlines have alarmed agencies selling tickets of competitor airliners that they could undergo limited numbers of seats during peak period, and withdrawal of price support. Such behavior is determined to be limiting agencies' options over airliners and forcing trades or behavior that are unfairly contrary to the agencies' interest, in light of the following facts: (1) alternative trading partners are hard to find, (2) the fixation of subordinate trade relationship has been prolonged, (3) the airliners provide the travel agencies with production elements essential for running their businesses.

18. Meanwhile, internal document revealed that conditional rebate for travel agencies provided by Korean Air was aiming at maintaining and strengthening its market dominance. The KFTC determined this case to substitute exclusive dealing as the rebate criteria was composed in a way that maximizing Korean Air's ticket sales and not increasing competitor airliners' sales would be the most reasonable choice for the travel agencies.

### *3.2.3 Anticompetitive effect on the related market*

19. The KFTC determined that anticompetitive effects had taken place, considering the following fact: Price reduction had been limited. Variety of airline services had decreased. Such behavior seems to have had substantial impact on business suspension of two low cost carriers since 2008.

20. On conditional rebate, considering that Korean Air, due to its competitive advantage, has been providing products of routes which cannot be provided by other competitors, the KFTC determined that such an exclusive rebate has a highly exclusive effect, enabling Korean Air, leveraging the seats it can secure without competition, to limit the competition in other areas competition exists.

21. Also, conditional rebate has a significant containment effect seeing from the fact that as of 2009, sales of travel agencies which concluded volume incentive contract with Korean Air takes up 73 percent of Korean Air's total profit from international passenger transportation and that most of domestic travel agencies have concluded volume incentive contract with Korean Air.

### **3.3 Measures taken by the KFTC**

22. KFTC imposed corrective measures on Korean Air and Asiana Airlines with fines of 10.39 billion won and 640 million won respectively.

### **3.4 Significance and Effect of the Case**

23. This measure is significant as it corrected the old practice of anticompetitive behavior of enterprisers dominating air passenger transportation market, Korean Air and Asiana Airlines, in the market where monopolistic market structure has been chronic.

24. Exclusive behavior against LCCs runs against the government's policy direction of aviation market advancement, which aims to facilitate competition through relaxed entry regulation. It also raises burdens on airline users by limiting ticket discounts provided by travel agencies. Thus we believe such a measure has substantially improved competition condition for LCCs.

## **4. Achievements of regulation reform in the aviation sector**

25. Aviation Law stipulates license of air transportation business, registration and navigation of airlines. With licensing and approval of aircraft operation and regulations on business activities comprising most of this Law, the content of the regulation is closely related to the possibility of new competitor's market entry. Regulations on price or entry of the aviation industry have been gradually relaxed since 1990.

26. In 2010, the KFTC submitted to the Presidential Council on National Competitiveness its plan to improve regulation on entry to monopolistic areas including aviation area and the specific contents are the following.

27. The KFTC has expanded participants for aircraft slot adjustment. Slot allocation is a critical factor determining effective operation of aviation businesses. Slots are allocated in accordance with slot adjustment criteria developed by slot schedule committee, considering each airport's capacity and through deliberation process for highly controversial slots' adjustment. In the past, only Korean Air and Asiana Airlines were allowed to participate in the schedule committee, which led to slot adjustment unfavorable to LCCs. And strategic slot policy<sup>2</sup> was operated only in Incheon Airport. As a result, frequently used Gimpo and Jeju airports had been excluded from the policy, which made it hard to get slots for new airlines. To solve such problems, the KFTC determined that guidelines to be revised so that new carriers to participate in the schedule committee on their demand and strategic slot policy to include Gimpo and Jeju airports.

28. Also, the Commission relaxed registration criteria for small-size air transportation businesses. In the past, applicants were obliged to buy insurance by the time of registration, when they aim to register small-size air transportation businesses, even when it takes substantial time from registration until operation. So the Commission reduced new enterprisers' burden by having some insurances to allow them to postpone the holding of the insurance until the operation verification procedure.

29. The improved regulation is expected to activate competition among airline companies by reducing new enterprisers' initial investment costs while improving competition condition for new low cost carriers.

## **5. Conclusion**

30. In Korea competition condition has much improved due to the relaxed regulation in the aviation sector and sanctions against anticompetitive behavior. The ratio of passengers for international low cost

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<sup>2</sup> A policy which retrieves slots with a lower performance rate (less than 80 percent) and reallocates to new airliner company

carriers rose to 9.6 percent in the late 2013, from almost none in the late 2008, for domestic LCCs, the ratio increased to 48.2 percent in the late 2013 from 9.7 percent in the late 2008.

31. The KFTC is committed to put an eye on any regulation which is likely to limit competition in the aviation sector and respond sternly to a airliner's behavior which has a anticompetitive potential, so that consumers can be provided with wider range of opportunity to use inexpensive and various air transportation services.