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AIRLINE COMPETITION

-- Note by BIAC --

18-19 June 2014

This document reproduces a written contribution from BIAC 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.

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1. The Business and Industry Advisory Committee ("BIAC") to the OECD appreciates the opportunity to submit these comments to the OECD Competition Committee for its roundtable on airline competition.

1. Introduction

2. BIAC appreciates the OECD's continued focus on issues specific to airline competition and supports the OECD in its efforts to promote clear and uniform competition law, policy and enforcement in the industry.

3. The airline sector has evolved drastically over the past quarter-century. The reduction of government controls within the industry, more generally referred to as "liberalization," has led to an increase in competition and a greater reliance on competitive forces in promoting procompetitive behaviors. In turn, agencies are increasingly tasked with addressing the competitive implications of routes and fares previously subject to tight regulation.

4. At the same time, government intervention still persists in many aspects of the industry. This intervention can often have a profound effect on competition in airline services. Some forms of intervention, for example air traffic control which has the effect of regulating route density, are undoubtedly necessary and justified. Others, however, may not be essential and require more careful scrutiny, as discussed below. This means that competition enforcement regimes play an important role not only in terms of potential enforcement actions, but also in terms of competition advocacy within existing governmental structures to eliminate unnecessary barriers to competition or inefficiencies that may impact competitors and ultimately limit consumer welfare.

5. Likewise, agency enforcement efforts must be conducted in a manner consistent with encouraging procompetitive behaviors. Airline industry participants need clear and consistent guidance from enforcers as to which types of behaviors are permissible, and which behaviors are viewed as anticompetitive. It is increasingly important competition enforcement agencies coordinate closely with their counterpart aviation regulatory bodies. In some jurisdictions, these two agencies have conflicting objectives, and as a result, differ significantly in the manner in which they analyze and impact markets. A uniform and coherent framework, both within and between state governments, provides predictability and certainty to businesses that will both sustain and encourage procompetitive industry growth.

2. Structural Impacts on Airline Competition

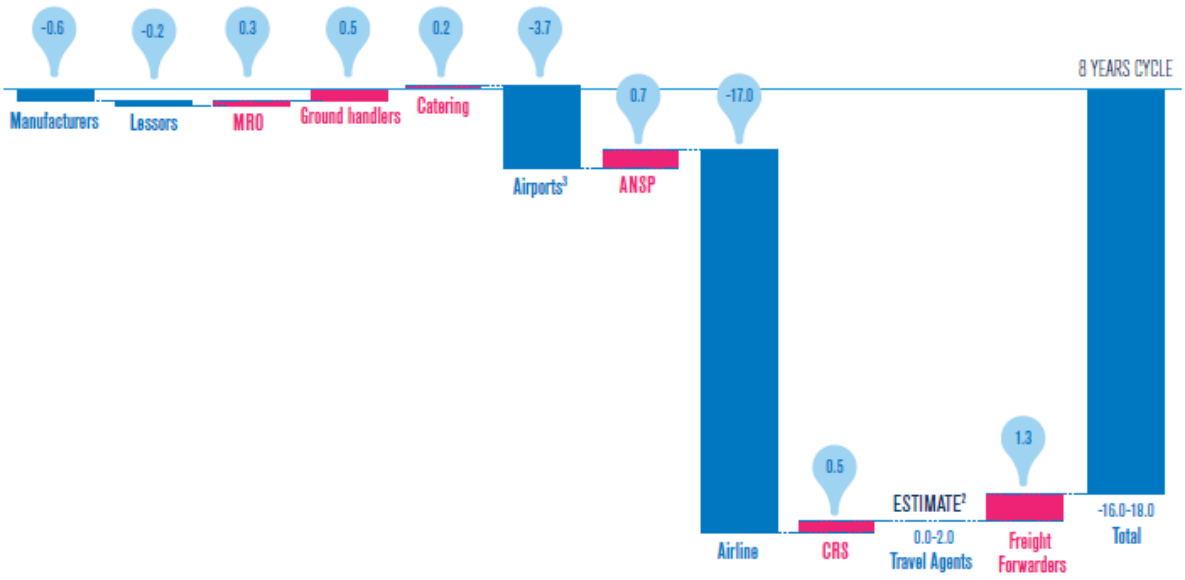
6. The air transport industry value chain is inclusive of airlines, as well as a large number of other actors that directly and indirectly affect airline competition. These include, among others: airports; travel agents; airframe manufacturers and lessors; maintenance, repair and overhaul ("MRO") providers; freight forwarders and consumers. The extent to which these other actors should be viewed as part of the "airline sector" itself is a complex issue that we need not address directly. Instead, the fact that airline profits are interwoven with these other sectors necessitates that airline competition, however defined, must be viewed in the context of the air transport industry as a whole.

7. Notably, while airlines are often at the focus on competition questions, profits across the entire air transport industry are hard fought, and the carriers, in particular, bear the brunt of lackluster profits more than any other segment. In fact, over the period 2004 to 2011, investors in airline carriers earned on

average $17 billion less each year than they would have earned investing their capital elsewhere in assets of similar risk[1]:

CHART 14: ECONOMIC PROFITS IN THE AIR TRANSPORT VALUE CHAIN (EXCLUDING FUEL AND LABOR)

Average economic profit[1], (ROIC-WACC) × invested capital, USD billion, 2004-2011



[1] Based on invested capital excluding goodwill, extrapolated to total industry
[2] Sample too small to give meaningful estimate
[3] Economic profit for airport sector extrapolated based on weighted average of sample excluding AENA. AENA subsequently added back to sector estimate

Source: McKinsey & Company for IATA

[1] *Profitability and the Air Transport Value Chain* (Int'l Air Transport Ass'n Economics Briefing No. 10, June 2013), *available at* www.iata.org/whatwedo/Documents/economics/profitability-and-the-air-transport-value%20chain.pdf.

8. Moreover, airline profit margins remain razor-thin[2]:

Source: IATA

9. Driving these results, in large part, is significant exposure to swings both in costs and demand. Supply-side factors, like aircraft leasing, route expansion, slot acquisition, and code-sharing or alliance strategies, are often long-term decisions that require significant commitment of capital—especially for traditional carriers. Demand-side factors, like travel demand, weather, and currency fluctuations, have significant short-term effects. While some of these factors can be hedged to some extent, they place a greater burden on the efficient operation of an airline than in many other industries.

10. One example of such an effect is the price of oil and, derivatively, fuel. Fuel currently accounts for about 30 percent of the average airline cost structure, making it the industry's largest single cost item.[3] Near-term fuel prices are expected to increase further due, in part, to continued geo-political instability in Ukraine.[4] In recent years, airlines have responded to high fuel costs by operating more fuel efficient aircraft and by achieving large productivity and efficiency gains in non-fuel cost items.[5] Efficiency initiatives have indeed led to improved profitability independent of fuel cost, but the price of fuel will continue to play a pivotal role in the long-term success of the industry—one over which airlines have very little control. As BIAC has previously advised in its comments to this Committee's June 2013 Roundtable on Competition in Road Fuel, it is important "for competition authorities to ensure that important sectors of the economy are functioning competitively" and "essential that the actions undertaken by competition

2 Brian Pearce, *The Outlook for Commercial Air Transport* 20, IATA.ORG (Mar. 2014), *available at* www.iata.org/whatwedo/Documents/economics/IATA-outlook-for-the-airline-industry-December-2013.pdf.

3 *See* Press Release, Int'l Air Transport Ass'n, Industry on Track for Second Year of Improving Profits—Rising Fuel Costs Largely Offset by Increased Demand (Mar. 12, 2014), *available at* www.iata.org/pressroom/pr/Pages/2014-03-12-01.aspx.

4 *Id.*

5 *Airline Fuel and Labour Cost Share* (Int'l Air Transport Ass'n Econ. Briefing, Feb. 2010), *available at* https://www.iata.org/whatwedo/Documents/economics/Airline_Labour_Cost_Share_Feb2010.pdf.

authorities be based upon—and constrained by—fundamental competition law principles underpinned by sound economics."[6]

11. Another factor of significant impact is the cost of MRO. Next to fuel, maintenance constitutes the largest portion of the total cost of aircraft ownership over 20 years,[7] and MRO typically represents between 12 and 15 percent of total airline operating costs.[8] Despite efforts to control MRO costs by low-cost-carrier ("LCC") and mainline carriers alike, maintenance costs per available seat mile have continued to rise significantly.[9] These costs are generally driven by several factors, including aging fleets, accumulation of deferred maintenance, rebuilding of rotable inventories (through repair of unserviceable parts) that were depleted during the recession, inflationary pressure, and other recent changes in industry market dynamics.[10] Like fuel, MRO costs are largely outside the control of airlines,[11] and continued cost increases have the potential to undermine airline profitability and overall industry stability.

12. Also, profits in the airline sector are driven by both passenger transport and air freight. A great deal of the freight moved by the airline sector is transported in the hold of passenger aircraft, rather than in freighter aircraft.[12] As a result, it is infeasible to separate the economics of passenger transport and air freight completely. While demands in both segments tend to track overall economic activity, this is not always the case and in particular may be different for different airlines. Thus, a decline in either segment can impact profits.

13. The airline sector is further characterized by players with inherently divergent cost structures. Airlines are impacted by localities and airports served, historical access to routes/slots, and the cost (and profitability) of the routes flown. For example, LCCs are not typically obligated to fly higher-cost routes

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6 BIAC, *in* OECD COMPETITION IN ROAD FUEL 338-339 (2013), *available at* www.oecd.org/daf/competition/CompetitionInRoadFuel.pdf.

7 *MRO Survey 2012: Market Dynamics Create New Points of Leverage,* OLIVER WYMAN, 4 (2012), *available at* www.oliverwyman.com/content/dam/oliver-wyman/global/en/files/archive/2012/373424_NYC-AGE98201-001_P1_-_Press_Proof.pdf [hereinafter MRO 2012].

8 *Special Report—Overhauling Maintenance, Repair and Overhaul*, IATA.ORG (Dec. 2009), *available at* www.iata.org/publications/airlines-international/december-2009/Pages/08.aspx.

9 MRO 2012, *supra* note 7.

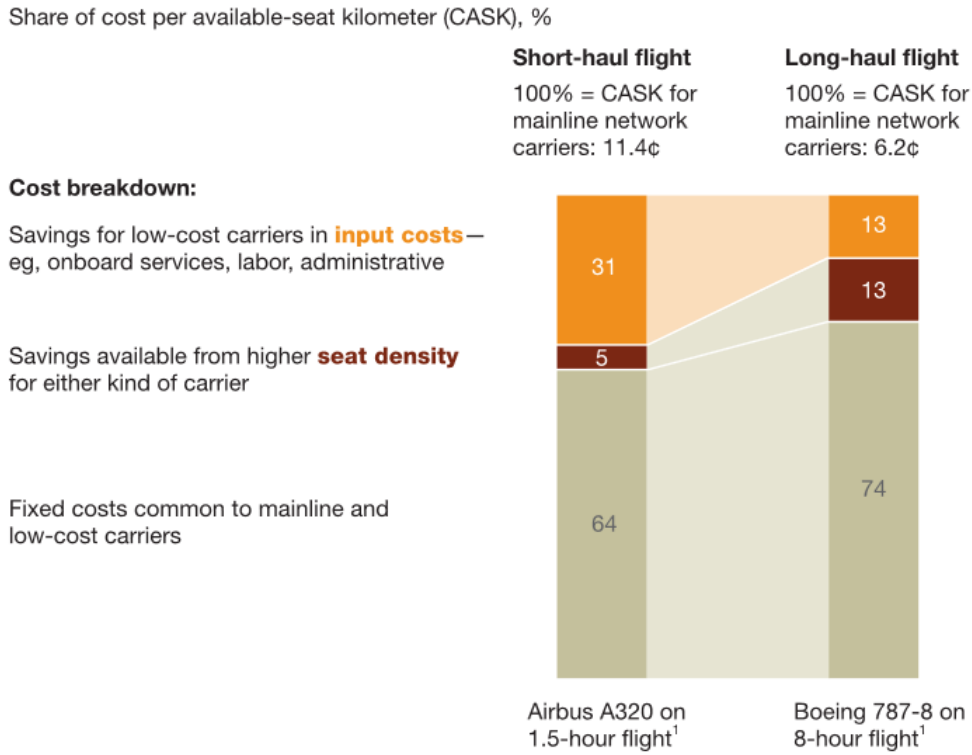
10 Some industry sources have observed that OEMs, and in particular those in the field of engines and components, have increasingly utilized potentially restrictive contracting behaviors in capturing a larger portion of the growing MRO market. *See* MRO 2012, *supra* note 7 ("Not surprisingly, engine and component OEMs are continuing to expand and consolidate their control of the aftermarkets. Since last year, MROs have noticed more OEMs limiting access to technical publications, initiating license agreements, and making service authorizations harder to come by."); *see also* Chris Spafford & Darryl Rose*, MRO Survey 2013: Thrive Rather than Survive*, OLIVER WYMAN, 2 (2013), *available at* www.oliverwyman.com/content/dam/oliver-wyman/global/en/files/archive/2013/MRO_ Survey_2013.pdf ("By restricting access to intellectual property and introducing alternative material restrictions into aircraft leasing agreements, OEMs have come to dominate the engine and component aftermarket for new platforms."). We note, however, that BIAC takes no position with respect to this issue.

11 Chris Spafford & Darryl Rose*, MRO Survey 2014: Signs of New Life*, OLIVER WYMAN, 2 (2014), *available at* www.oliverwyman.com/content/dam/oliver-wyman/global/en/2014/apr/MRO%20Survey%202014-digital.pdf (noting that, due to current market conditions, most airlines are able to provide a decreasingly small percentage of MRO services in house).

12 David Starkie & George Yarrow, *Market Definition in the Airports Sector*, *available at* www.caa.co.uk/docs/5/ergdocs/MarketDefAirports.pdf.

that their network counterparts sometimes must serve. These obligations can stem from many factors, including state-imposed requirements (especially for flag carriers), slot restrictions, airport capacity restrictions, etc. Instead, LCCs can strategically "cherry-pick" and fly more profitable routes. Unsurprisingly, for some more profitable/lower cost routes, there is a significant disparity in those fares charged by network and LCC airlines. This can benefit consumers in the short-run, but can create dis-equalities that distort the competitive landscape.

14. Similarly, the route structure of an airline can play a huge role in how that airline is impacted by input costs. Over the past 25 years, LCCs have expanded into more short-haul than long-haul routes. According to consulting firm McKinsey & Company, a comparison of the cost structures associated with short- and long-haul routes suggests that input costs, such as labor rates and administrative expenses—a sizable share of the LCC cost advantage on short-haul routes—are a much smaller share of the average cost per available-seat kilometer on long-haul ones[13]:



15. In other words, the cost advantages enjoyed by LCCs over network carriers are phased out as flight time increases, leaving LCCs with declining margins on longer hauls and, as a result, less headroom within which to reduce prices. Moreover, taxes, fees, and surcharges account for up to 80 percent of ticket prices in some long-haul markets—further incentivizing LCCs to focus on shorter, higher-margin routes.[14]

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13 Urs Binggeli, Alex Dichter & Mathieu Weber, *The Economics Underlying Airline Competition*, MCKINSEY Q. (Dec. 2013), *available at* www.mckinsey.com/insights/travel_transportation/theeconomics_underlying_airline_competition.

14 *Id.*

3. Government Influences and Restrictions on Airline Competition

16. Prior to liberalization, state governments generally controlled both the routes flown and prices charged by airlines. While route schedules and pricing for the airline sector have been largely deregulated over the past twenty years, many key inputs necessary for effective competition remain subject to government oversight and other non-market mechanisms.

3.1 Government Charges, Taxes and Fees

17. Government charges, taxes and fees represent an increasingly large percentage of the overall cost of air travel.[15] In 2011 alone, airlines and passengers are estimated to have paid at least $92.2 billion, or 14.4% of the cost of transport, for the use of airport and air navigation infrastructure globally.[16] As economic growth continues to stagnate in many parts of the world, increased taxes, together with rising charges and fees, remain a threat to airline competition.

18. Unwarranted or excessive taxation on international air transport has a negative impact on demand as well as economic and social development, and hampers efficient competition in the airline industry. Due to Internet booking, no frills competition and centralized corporate purchasing power, air travel is increasingly sensitive to price. When a new or increased tax on aviation is introduced, it will generally be transferred to the price of the ticket, and demand will be negatively impacted.[17] Further, given that just a few incremental passengers can make the difference, increased aviation taxes and fees may result in tipping routes from profitability to unprofitability and reduce the number of competitors willing to provide service to and from a destination.

19. The impact of government charges on airline health is evident in Europe, where taxes have cost billions in the UK. The Air Passenger Duty ("APD")—levied on all passengers departing from a UK airport—is currently the highest aviation ticket tax in the world.[18] The APD distorts competition, particularly for carriers operating out of UK airports or with a UK hub. The savings made by operating through some non-UK hubs and avoiding APD on the long-haul sector provides a perverse incentive to avoid the UK entirely. According to some estimates, the APD has cost the UK economy an estimated $459 million per year in lost GDP and around 7,000 lost jobs.[19] In 2013, the Northern Ireland Assembly recognized the economic and competitive impact of the tax when it set its own rate to zero for all flights from Northern Ireland in order to prevent Continental Airlines from abandoning flights from Belfast to the U.S.[20] While some reforms have been announced, the APD continues to distort competition and undermine the long-term success of airlines internationally.

20. As the OECD has previously noted, "[t]here has been an increase in the number and scope of taxes especially on air travel . . . [and] governments need to monitor the impacts on competitiveness."[21]

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15 Susan Stellin, *Taxes and Fees Grow for Air Travelers*, N.Y. TIMES, Mar. 1, 2010, *available at* www.nytimes.com/2010/03/02/business/02fees.html?_r=0.

16 *Fact Sheet: Aviation Charges, Fuel Fees and Taxes*, IATA.ORG (Dec. 2013), *available at* www.iata.org/pressroom/facts_figures/fact_sheets/pages/infrastructure.aspx.

17 *Tourism Tax*, IATA.ORG, *available at* www.iata.org/policy/Documents/tourism-tax.pdf.

18 *Taxation*, IATA.ORG, *available at* www.iata.org/policy/Pages/taxation.aspx.

19 *Id.*

20 *Id.*

21 OECD, *Taxation and Tourism*, *in* OECD TOURISM TRENDS AND POLICIES 2014, *available at* http://dx.doi.org/10.1787/tour-2014-6-en.

Moreover, economists have long urged tax policy makers to raise revenues in a non-distorting, equitable and sustainable manner.[22] In this regard, BIAC urges OECD membership to carefully weigh the impact of new air transport charges, taxes and fees against the potential impact on competition, in line with those principles articulated by both the OECD[23] and International Civil Aviation Organization ("ICAO").[24] To this end, competition authorities should exercise their advocacy authority to discourage additional taxation on airlines and aviation services.

3.2 Airport Capacity

21. From 2008 to 2012, global demand for passenger transport grew at [compound annual growth] rate of 4.3 percent. Growth in passenger transport is expected to continue, with demand estimated to expand by an average of 5.4% through 2017.[25] In some geographies, airports have anticipated this demand and have ample capacity to address increasing air travel. Given recent industry growth, however, demand now exceeds existing capacity at many airports throughout the world.

22. In Europe, airports are facing a significant "capacity crunch," with five major airports already operating at full capacity: Düsseldorf, Frankfurt, London Gatwick, London Heathrow, and Milan Linate (Eurocontrol).[26] Recent European Commission estimates suggest that, by 2030, 19 key European airports will reach capacity saturation.[27] Brazilian air transport is facing a similar crisis, particularly for domestic service. Airports in São Paulo and Rio de Janeiro are already operating at near-maximum capacity, with six more airports approaching saturation in the next two years.[28]

23. State and local governments typically own and manage the airports in their region. These governments control the key inputs necessary for capacity expansion: gates and runways. As a result, airlines are limited in the actions they can independently take to increase capacity in response to increased demand: (1) utilizing larger aircraft (which also may be limited by availability of airport gates to handle

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22 Robin Burgess & Nicolas Stern, *Taxation and Development*, 31 J. ECON. LITERATURE 762 (1993).

23 *See generally*, OECD, MODEL TAX CONVENTION ON INCOME AND ON CAPITAL (2010), *available at* www.keepeek.com/Digital-Asset-Management/oecd/taxation/model-tax-convention-on-income-and-on-capital-2010_9789264175181-en#page1.

24 *See generally*, INT'L CIVIL AVIATION ORG., ICAO'S POLICIES ON TAXATION IN THE FIELD OF INTERNATIONAL AIR TRANSPORT (2d ed. Jan. 1994), *available at* www.icao.int/publications/Documents/8632_2ed_en.pdf.

25 Press Release, Int'l Air Transport Ass'n, Airlines Expect 31% Rise in Passenger Demand by 2017 (Dec. 10, 2013), *available at* www.iata.org/pressroom/pr/pages/2013-12-10-01.aspx. *See generally*, INT'L AIR TRANSPORT ASS'N, IATA AIRLINE INDUSTRY FORECAST 2013-2017 (2013).

26 Press Release, European Comm'n, Europe's Airports 2030: Challenges Ahead (Dec. 11, 2011), *available at* http://europa.eu/rapid/press-release_MEMO-11-857_en.htm?locale=en.

27 *Id*; *see also* Shereen El Gazzar, *Gulf Airlines Have Double Advantage, Says Swiss Airline Chief*, THE NATIONAL, June 2, 2014, *available at* www.thenational.ae/business/industry-insights/aviation/gulf-airlines-have-double-advantage-says-swiss-airline-chief (noting that the expected shortfall in European airport capacity could lead to a 12 percent gap between demand and infrastructure capacity by 2035).

28 Paulo Winterstein, *Brazil Airport Capacity Limits Competition Between Airlines*, WALL ST. J., May 27, 2013, *available at* http://online.wsj.com/article/BT-CO-20130527-703888.html; *but see Acsa Assists Brazil to Open Airport Terminal*, CAPA CENTRE FOR AVIATION (May 21, 2014), *available at* http://centreforaviation.com/members/direct-news/acsa-assists-brazil-to-open-airport-terminal-169469 (noting that the successful May 2014 completion of "Terminal 3" at São Paulo's Guarulhos International Airport is expected to significantly increase capacity in the region).

larger aircraft); and (2) expanding the number of flights per day at the gates they control (which necessitates expansion at less desirable, off-peak hours).

24. Other alternatives are in the control of governmental entities. These may include decreasing the intervals between takeoffs and landings (which has obvious safety implications and may necessitate an update to the global air traffic control system) and expanding the number of gates, terminals and runways available to airlines and passengers.

25. To date, however, government investment in airport infrastructure worldwide has been insufficient to respond to the growing need for capacity expansion. Due to capacity constraints, some airports already are closed to new competition.[29] Further, without expanded capacity at major airports worldwide, air transport demand will continue to exceed supply and ultimately lead to increased prices.

26. Where the supply/demand imbalance exists, prices naturally increase. BIAC is concerned that in some instances competition enforcement authorities have used this situation—specifically where capacity constraints have resulted in an insufficient supply of gates or slots—as a basis for investigating or asserting an abuse of dominance. BIAC is of the view that such situations do not reflect a market distortion that requires competition enforcement intervention as a first choice, but instead requires government action to alleviate the supply constraint.

3.3 State Aid/Subsidization

27. In a liberalized market, the distortive effect of "state aid"—the public funding of airlines, airports and other aspects of the air transport industry—has been broadly recognized. The increased impact of state aid is "underscored by the inclusion in a growing number of liberalized air services agreements of non-exhaustive enumerations of conditions likely to adversely affect a fair and competitive environment, such as capital injections, cross subsidization, grants, guarantees, government ownership, tax relief or tax exemption and protection against bankruptcy or insurance by a government entity."[30] To the extent that such assistance is within the scope of national competition laws, its impact on competition must be considered.

28. In the EU, state aid is generally prohibited under the Articles 107 and 108 of the Treaty on the Functioning of the European Union.[31] Certain exceptions allow authorized aid if it is justified by common interest objectives, as long as that aid does not distort competition in a way as to be against the public interest.[32] The European Commission ("EC") has actively policed state aid under the Treaty. In 2012, for example, the EC ordered Hungarian national airline Malév to repay about 100 billion forints of state aid,

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29 *Id*. (noting that, according to Brazilian antitrust regulator CADE, "without major investments . . . competition between airlines at the country's eight largest airports will be near impossible").

30 *Fair Competition in International Air Transport* ¶ 4.2 (Int'l Civil Aviation Org., Working Paper No. ATConf/6-WP/4, 2013), *available at* www.icao.int/Meetings/atconf6/Documents/WorkingPapers/ATConf6-wp004_en.pdf.

31 Consolidated Version of the Treaty on the Functioning of the European Union arts. 107-108, May 9, 2008, 2008 O.J. (C 115) 91-92 ("Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.") [hereinafter TFEU].

32 TFEU art. 108 ("On application by a Member State, the Council may, acting unanimously, decide that aid which that State is granting or intends to grant shall be considered to be compatible with the internal market, in derogation from the provisions of Article 107 or from the regulations provided for in Article 109, if such a decision is justified by exceptional circumstances.")

including loans and debt deferrals, that it had received from 2007 to 2010.[33] Further, EU Competition Commissioner Joaquin Almunia announced in February that the EC would rule on the legality of state aid granted to 28 more airports and LCC airlines later this year.[34]

29. BIAC generally supports the European Commission and the efforts of others in promoting fair competition, efficiency in public financing and attracting private financing. However, such efforts must also be tailored to promote infrastructure growth and long-term industry stability. To that end, BIAC believes that competition agencies and their regulatory counterparts worldwide must closely cooperate to set forth clear guidance under which state aid is permissible. More specifically, guidelines must ensure that, when public entities provide state aid, they act without distorting competition. Moreover, to the extent that the market alone cannot adequately provide for the public interest, aid must only be granted subject to transparent and non-discriminatory rules put forth in strict legal requirements.

3.4 Passenger Rights Legislation

30. Over the past decade, so-called "passenger rights" laws have proliferated globally. There are now approximately 60 jurisdictions that have a passenger rights law of some kind.[35] These take the form, typically, of extra-contractual service entitlements that are created by statute and enforced as law notwithstanding the content of the contractual relationship between the passenger and the airline. Passenger rights laws regulate certain events that sometimes occur in the course of carriage by air such as delay, denied boarding and flight cancellation. A prominent example is EC Regulation No. 261/2004,[36] which provides for entitlements that range from care and assistance (*i.e.*, refreshments and hotel accommodation) and rerouting to standardized compensation, payable without proof of any loss, in the sum of EUR 250 to EUR 600. In a landmark case in 2009, the Court of Justice of the European Union ruled that a delay in arrival of three hours or more entitles a passenger to standardized compensation, calculated with reference to the length of flight (*i.e.*, between EUR 250 and EUR 600).[37] Similar laws, for example, are in place in Brazil, India, Israel, the Philippines, Turkey, Saudi Arabia and Venezuela.

31. Passenger rights laws have significant implications for industry. Most laws, depending on their content, impose direct financial costs on airlines and may influence operational and commercial behavior

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33 Press Release, European Comm'n, State aid: Commission orders Hungary to recover incompatible state aid from national air carrier Malév (Jan. 9, 2012), *available at* http://europa.eu/rapid/press-release_IP-12-7_en.htm .

34 Foo Yun Chee & Barbara Lewis, *EU to Rule on State Aid for 28 Airports, Airlines by September*, REUTERS, Feb. 20, 2014, *available at* www.reuters.com/article/2014/02/20/us-eu-airports-stateaid-idUSBREA1J11920140220.

35 Tony Tyler, State of the Air Transport Industry, Address Before the IATA Annual General Meeting and World Air Transport Summit (June 2, 2014), *available at* www.iata.org/pressroom/speeches/Pages/2014-06-02-1.aspx.

36 Commission Regulation (EC) No 261/2004 of the European Parliament and of the Council of 11 February 2004 Establishing Common Rules on Compensation and Assistance to Passengers in the Event of Denied Boarding and of Cancellation or Long Delay of Flights, and Repealing Regulation (EEC) No 295/91, 2004 O.J. (L 46) 1.

37 Joined Cases C-402/07 and C-432/07, Sturgeon and Others v. Condor Flugdienst GmbH and Böck and Lepuschitz v. Air France SA, 2009 E.C.R. I-10923.

as a result. It is estimated, for instance, that liability posed by the proliferation of such laws could nearly triple in the next five years, from over USD 4 billion per year in 2012 to USD 12 billion in 2017.[38]

32. In many cases, airlines will be liable for a given event regardless of whether the event is attributable to the airline or not. Liability, under these types of laws, is usually channeled to the airline notwithstanding root cause of event (which, for example, could be weather, traffic congestion, unexpected airport closure, a mechanical problem or a widespread systemic disruption). Airlines quickly become the insurers of first (and last) resort, with a limited ability to recover these costs from the other actors (*e.g.*, airports, ground handlers and air traffic control) that may have caused or contributed to the event in question. Without any other way of covering this relatively new species of liability, airlines—as a basic economic proposition—are forced to "price in" some element of these entitlements to their fares.

33. Airlines also face the additional costs of complying with multiple different passenger rights laws around the world, which frequently overlap for the same event without sufficient reconciling provisions. Conflicting passenger rights rules can damage the competitiveness of certain markets and render particular routes unprofitable. For tourist destinations, this could have the distortionary effect of making competing destination more attractive for airlines to operate and for cost conscious tourists to visit.

34. Universal standards, by their nature, limit commercial flexibility and the types of products, and particularly services, that airlines can offer. This means, simply stated, less choice and an artificial restraint on market forces and competition. The present trend towards passenger rights laws is, in many respects, a return to the comprehensive service regulation that was axiomatic of the regulatory environment twenty years ago.

35. Airlines and passengers have a shared goal of getting to destinations reliably, comfortably and on-time. Due to the competitive nature of the market and thin profit margins, airlines are highly incentivized to operate schedules as planned, and to provide proper care and assistance to their passengers when interruptions occur. However, this is often not reflected in existing passenger rights laws that disproportionately burden airlines. The policy objective of such regulations should be clear and their effectiveness measured, along the lines of various "smart regulation" or "better regulation" initiatives undertaken by governments and international organizations, including the OECD. Such an approach can help to avoid unintended consequences for passengers and the competitive marketplace at large.

4. Specific Issues Impacting Airline Competition

4.1 Market Definition and the International Competition Standards

36. As BIAC has outlined in previous submissions, market definition has long functioned as a core economic framework for evaluating whether particular business conduct has, or is likely to have, anticompetitive effects. Defining a relevant market enables agencies to measure market shares and market concentration, distinguish competitive alternatives available to consumers, evaluate the relative significance of these alternatives, and collect a wide range of valuable evidence of supply- and demand-side constraints. While competition regulators have recognized certain limitations of traditional market definition analysis, recent developments in the international enforcement landscape illustrate that market definition continues to play a significant role in the outcome of cases involving airline competition.

37. In the *Delta/Northwest*, *United/Continental*, and *Southwest/Air Tran* mergers, the United States Department of Justice ("DOJ") indicated that it would likely include LCCs in the market for scheduled

[38] IATA Working Paper Presented to the Air Transport Regulation Panel 12th meeting, (Working Paper No. ATRP/12-WP/13) (April 30, 2014).

passenger flights, and would treat city-pair routes with nonstop service in a separate market from routes involving a connection.[39] In the *American Airlines/US Airways* merger, however, the DOJ's complaint largely limited the alleged relevant market players to the "network" airlines—*i.e.*, ones that have extensive national networks comprising "hub-and-spoke" service, as opposed to non-network carriers, like Southwest Airlines and JetBlue, which offer point-to-point service.[40] DOJ also did not consider the market for nonstop routes between "city pairs" and the market for routes with connections on such city pairs as separate, but instead looked at how the "network" airlines allegedly compete across the two markets.[41] Recently in the EU, the EC defined the market based on the "point of origin/point of destination" city pair approach in each of the *Delta/Northwest*,[42] *United/Continental*,[43] and *American Airlines/US Airways* mergers.[44]

38. These shifting sands make it difficult for airlines and other interested parties to delineate the confines within which behavior can be evaluated as competitive or anticompetitive. For example, differing approaches create uncertainty as to the way in which mergers, collaborations, and other conduct are analyzed in the U.S., EU and elsewhere, making it difficult to evaluate proposed transactions or initiatives within the airline sector. As in any other industry, such divergent views may also lead to inconsistent and, ultimately, less effective remedies. Despite some steps taken toward a more common analytic approach in analyzing airline competition,[45] BIAC believes increased international cooperation between competition

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39 *See,* U.S. Dept. of Justice, Antitrust Div., "Statement of the Department of Justice's Antitrust Division on Its Decision to Close Its Investigation of the Merger of Delta Air Lines Inc. and Northwest Airlines Corporation" (Oct. 29, 2008), *available at* www.justice.gov/opa/pr/2008/October/08-at-963.html ("[Delta and Northwest] currently compete with a number of other legacy and low cost airlines in the provision of scheduled air passenger service on the vast majority of nonstop and connecting routes where they compete with each other."); U.S. Dept. of Justice, Antitrust Div., "United Airlines and Continental Airlines Transfer Assets to Southwest Airlines in Response to Department of Justice's Antitrust Concerns" (August 27, 2010), *available at* www.justice.gov/opa/pr/2010/August/10-at-974.html ("overlap on a limited number of routes where United and Continental offer competing nonstop service"); U.S. Dept. of Justice, Antitrust Div., "Statement of the Department of Justice Antitrust Division on Its Decision to Close Its Investigation of Southwest's Acquisition of Airtran" (Apr. 26, 2011), *available at* www.justice.gov/opa/pr/2011/April/11-at-523.html ("the presence of low cost carriers like Southwest and AirTran has been shown to lower fares on routes previously served only by incumbent legacy carriers") (the two airlines had "overlaps on certain nonstop routes," although it found that such overlaps ultimately did not pose a concern).

40 Amended Complaint, United States v. US Airways Group, Docket No. 1:13-cv-01236-CKK (D.D.C. Sept. 5, 2013), ¶ 32, *available at* www.justice.gov/atr/cases/f300400/300479.pdf.

41 Competitive Impact Statement, United States v. US Airways Group, Docket No. 1:13-cv-01236-CKK (D.D.C. Nov. 12, 2013), *available at* www.justice.gov/atr/cases/f301600/301618.pdf.

42 Case No COMP/M.5181—Delta Air Lines/Northwest Airlines, Comm'n Decision, ¶ 11 (Aug. 6, 2008), *available at* http://ec.europa.eu/competition/mergers/cases/decisions/m5181_20080806_20310_en.pdf.

43 Case No COMP/M.5889—United Airlines/Continental Airlines, Comm'n Decision, ¶ 12 (July 27, 2010), *available at* http://ec.europa.eu/competition/mergers/cases/decisions/M5889_20100727_20310_787579_EN.pdf.

44 Case No COMP/M.6607—US Airways/American Airlines, Comm'n Decision, ¶ 12 (Aug. 5, 2013), *available at* http://ec.europa.eu/competition/mergers/cases/decisions/m6607_20130805_20212_3270644_EN.pdf.

45 EUROPEAN COMM'N & U.S. DEP'T OF TRANSP., TRANSATLANTIC AIRLINE ALLIANCES: COMPETITIVE ISSUES AND REGULATORY APPROACHES (Nov. 16, 2010), *available at* http://ec.europa.eu/competition/sectors/transport/reports/joint_alliance_report.pdf.

agencies, in line with international best practices[46], is necessary to develop and adopt common standards for market definition in order to promote more consistency and predictability.[47]

4.2 Slotting

39. As noted, infrastructure development has failed to keep up with growth at an increasing number of airports worldwide. These airports are unable to supply the runway, terminal and other infrastructure capacity that the industry needs to maintain healthy competition. Without careful management, gridlock could result.

40. To avoid this situation, the industry has developed a set of global guidelines—known as the Worldwide Slot Guidelines[48] ("WSG")—for the management and allocation of airport slots to ensure the most efficient use is made of congested airport infrastructure. A slot represents the approval that an airline needs to access the full range of airport infrastructure necessary for an aircraft to arrive at or depart from an airport on a specific date and time. The principal users of the WSG are airlines and airport coordinators. Although slot allocation evolved as a system administered by airlines, government involvement has increased in the form of appointed airport coordinators as congestion worsened and market access became increasingly more difficult. These "slot coordinators" are under a duty to act in a transparent, neutral and non-discriminatory manner.

41. The WSG are an important tool to provide the certainty airlines need for long-term investment and consumers need for effective travel planning.[49] Aircraft leasing costs are extraordinarily high and carriers need to know that they will be able to utilize these valuable assets in a manner they see fit in order to sustain long-term growth. Furthermore, the system's transparency ensures a well-functioning network, guaranteeing airlines appropriate take-off and landing slots on a global basis.[50]

42. Today, there are 159 fully slot-coordinated airports around the world.[51] It is critical that these established guidelines continue to be implemented effectively at such airports and that both competition and transportation regulators do not undermine the benefits by developing local rules that can have huge unintended and negative consequences for airlines, their customers and the environment. Instead, the decision to implement slot management at a given airport should only be determined by the responsible regulatory authority following a thorough demand and capacity analysis and consultation with airlines and other stakeholders.

43. Finally, slot allocation must not be viewed as a solution to the fundamental problem of a lack of airport capacity. In all instances, they are only an interim solution to manage congested infrastructure until the longer term solution of expanding airport capacity is implemented.[52]

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46 INT'L COMPETITION NETWORK, RECOMMENDED PRACTICES FOR MERGER ANALYSIS 3, *available at* www.internationalcompetitionnetwork.org/uploads/library/doc316.pdf.

47 *Id*.

48 INT'L AIR TRANSPORT ASS'N, WORLDWIDE SLOT GUIDELINES (5th Ed., Aug. 2013), *available at* www.iata.org/policy/slots/Documents/wsg-5.pdf.

49 *Managing Scarce Airport Capacity: Airport Slots & Worldwide Slot Guidelines*, IATA.ORG (2013), *available at* www.iata.org/policy/slots/Documents/position-paper-slots.pdf.

50 *Id.*

51 *Supra* note 49.

52 *Id.*

4.3 Liberalization in Africa

44. According to the World Bank, while Africa is home to 12 percent of the world's population, it accounts for less than 1 percent of the global air transport market.[53] At least one reason for this disparity is the fact that a large percentage of African countries continue to restrict their air services markets to protect the share held by state-owned carriers.[54] As a result, many African airlines are isolated and unable to develop networks in support of the continent's economies. Some governments, in part to prevent competition on heavy intra-Africa routes, deny market access to African airlines based in other states while simultaneously granting limited access to non-African airlines.[55] As a result, non-African airlines account for around 80% of the intercontinental market share to and from Africa.[56]

45. The 1999 Yamoussoukro Decision—ultimately adopted by 44 signatory countries in Africa—was intended to improve competition in the African airline sector through a series of liberalization initiatives. More specifically, the Yamoussoukro Decision mandated the following: (1) full liberalization of intra-African air transport services in terms of access, capacity and frequency; (2) free exercise of so-called first, second, third, fourth and fifth freedom right—which allow non-national carriers to land in an African state and take on traffic coming from, or destined for, a third state; and (3) liberalization and fair competition in tariffs.[57] In practice, however, the Yamoussoukro Decision has been ratified in only a select group of countries within Africa, leaving in place a series of sometimes perverse incentives that threaten economic growth throughout the continent.[58]

46. Liberalization elsewhere in the world has led to increased competition, more frequent flights and lower fares. Full adoption and implementation of the Yamoussoukro Decision would no-doubt lead to similar benefits in Africa. In this regard, BIAC urges OECD membership to promote the signing and implementation of the decision, including any recommended competition regulations, implementing provisions and dispute resolution mechanisms, as quickly as possible. Moreover, BIAC urges authorities elsewhere to provide support, where possible, in assisting their African counterparts in working toward liberalization.

5. Conclusion

47. Liberalization of the airline sector has given way to increased competition, lower prices, wider supply and more comprehensive product offerings. The industry, however, remains subject to continued government influence in the form of taxes and fees, limitations on infrastructure, and access to essential inputs. As a result, regulators at the national and international level must work closely with the national aviation regulators and the airline sector in order to develop cohesive strategies that both promote open competition and support the expansion necessary to meet growing demand. Competition law is crucial to effective and efficient airline service in the interests of consumers, but competition law *enforcement* is but one small element that should not be over-used in achieving these goals. The efforts of competition agencies worldwide to advocate for the changes needed to support a competitive air transport sector, as well as monitor potential abuses across the wider industry, will have the benefit of improving the sector and promoting worldwide economic health.

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53 WORLD BANK, OPEN SKIES FOR AFRICA (2010), *available at* http://go.worldbank.org/UCOV9Z3ZJ0.

54 *Id.*

55 *Special Report: Unlocking Africa's Potential*, IATA.ORG, *available at* www.iata.org/publications/airlines-international/june-2013/Pages/unlocking-africas-potential.aspx.

56 *Id.*

57 *Id.*

58 *Supra* note 55 (noting that "some countries, such as Ethiopia, have ratified Yamoussoukro . . . [b]ut this is the exception and not the rule").