



**International Chamber of Commerce**

*The world business organization*

## Policy statement

### **Convergence of competition law and policy in the field of air transport with special reference to the EU-US context**

Commission on Air Transport, 16 July 1997

#### Summary of recommendations

The ICC:

- supports a freer exchange of air services throughout the world, under competitive conditions which are transparent for all users of the air transport system;
- notes the growing number of cross-border, especially transatlantic alliances among airlines;
- notes also the potential for the unilateral application of competition policy, which causes lack of coherence between air transport regimes and uncertainty for users and airlines;
- considers it necessary to seek convergence between air transport competition policies and a coherent and a more transparent regulatory aviation framework, both at the procedural and at the substantive levels, in order to facilitate freer exchange of international air transport services;
- believes these principles of convergence should apply, in the first instance, to the EU/US market, since both entities have well-developed competition rules applying to air transport;
- supports the eventual adoption of these principles by other regions as soon as reasonably practicable.

With regard to procedural questions, the ICC believes there should be:

- a regular exchange of non-confidential information between competent competition authorities concerning the enforcement of their respective air transport competition regimes;
- application of the "positive comity" principle by these same authorities in order to avoid unilateral actions;
- hand-in-hand with the EU/US negotiations, a grant of competence to the European Commission air transport negotiators by the European Council of Ministers to vest Commission negotiators with the power to negotiate on aviation competition issues having an impact on the single European market. The granting of this power should be subject to consultation with the competent national authorities, the industry and consumers' groups, and should be based on the Commission's developing a clear framework of principles and policies.

With regard to substantive questions, the ICC supports:

- the creation of clearly defined and transparent rules regarding transatlantic airline behaviour, whether unilateral or concerted, based on an analysis of the present standards of the two jurisdictions;
- a greater convergence of competition laws and policies as they affect air transport, beginning with an EU/US agreement, which would then be open to participation by countries in other regions;
- the development of an effective dispute settlement system to ensure the speedy resolution of conflicts between parties.

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## 1. Which airline practices affect competition?

The present statement focuses on airline behaviour which affects competition. Government behaviour may also affect airline competition, but such behaviour is connected with the broader subject of trade policy and regulation. Consequently, state aid, the granting of anti-trust immunity, airline taxation, and foreign ownership and control limitations are not examined in this paper. But the ICC notes that it has already expressed its strong disapproval of state aid in its 1995 paper "State Aid to Airlines", which concluded that "state assistance to airlines, whether direct or indirect, should be deemed to distort the market and to be detrimental to airlines and users". Likewise, in 1994, the ICC argued for the reduction of limitations on foreign ownership of airlines, stating that "air transport development should be determined by economic and technical considerations and not by questions of national pride and national ownership". In its 1997 paper, "Taxes on international aviation: a 1997 update", the ICC called for "the elimination of all airline ticket taxes not strictly related to air transport needs". Moreover, a future ICC paper, now under discussion, will include a more comprehensive look at the economic effects of liberalized air transport competition, and will consider many issues not included in the present paper.

For the present purpose, the following distinction is made with regard to airline behaviour:

- i. cooperative agreements;
- ii. unilateral conduct involving the abuse of a dominant position.

Cooperative agreements, designed to achieve fleet rationalization and network efficiencies, are widespread among airlines and are used as an instrument of cost reduction and risk spreading. Cooperation between airlines can include the following practices:

- consultation on and coordination of tariffs;
- joint operations, including pooling of services and capacity;
- interline agreements;
- route planning;
- fleet rationalization, including code sharing;
- blocked space agreements and other mechanisms;
- coordination of schedules;
- joined frequent flyer programs;
- franchising;
- computerized reservation systems.

A number of these coordinated and concerted activities have been exempted under the EU competition regime. In the US, the Department of Transportation (DoT) has determined, in particular cases, that otherwise-prohibited activities of airlines which would reduce competition on air services to and from the US are nonetheless in the public interest and have sufficient transport benefits so that they can be excluded from the application of anti-trust laws. Among these are - under certain conditions - tariff coordination and interlining under the auspices of IATA.

Conduct involving abuse of dominant position is clearly objectionable and must be addressed by competition authorities. Obviously, many airlines, especially flag carriers, inherited dominant positions from the former regulatory and policy regime. Dominance may lead to monopolization by the dominant carrier and predatory behaviour. Predatory behaviour may occur in scheduling, pricing, capacity (dumping), and CRSs.

## **2. EU-US cooperation in enforcement**

The 1991 EU-US agreement regarding the application of their respective competition laws set forth the principle of positive comity, under which each side must notify and give weight to competition policies of the other in instances where their own enterprises are involved. With regard to information and consultation, as of early 1997 some 65 notifications, of which about 45 concerned mergers, had been sent by the European Commission to the US competition authorities, and some 115 notifications, of which 70 concerned mergers, have been sent to Europe by US authorities.

The Microsoft case (1994) was a prominent example of transatlantic cooperation on procedural matters. In this case, the Commission and the US Department of Justice (DoJ) cooperated and jointly held discussions with Microsoft in order to reach a settlement under which Microsoft committed itself to comply with both EU and US competition rules.

## **3. Competition authorities (enforcement)**

### **US jurisdiction**

For air transport, though the governmental authority on the US side in the context of the application of the above EU-US agreement is the DoJ, on matters involving international aviation, the DoT has the power to grant immunity from the application of the anti-trust laws. Under certain conditions, anti-trust immunity has been granted by the DoT in several transatlantic alliances above, namely, KLM and Northwest (1993), United Airlines and Lufthansa (1996), SAS (1996) and Swissair/Sabena/Austrian and Delta (1996).

### **EU jurisdiction**

It is undisputed that the European Commission is responsible for the enforcement of competition rules, including the so-called Merger Regulation of 1989, with respect to agreements and concerted practices liable to affect intra-Community trade. Even though these rules have not often been applied to air transport, several decisions based on them, including those affecting Lufthansa-SAS and British Midland-Aer Lingus, have been taken by the Commission.

National authorities of the EU member states may also rule on the admissibility of concerted practices and agreements among airlines. Up to the present, enforcement at the national level has been quite limited, with the exception of actions taken by the UK and German competition authorities. The UK government, as reported above, laid down its own conditions for its approval of the BA/AA alliance.

### **European Commission: external competence**

The question of the European Commission's external competence on airline competition questions has not yet been resolved. The Commission claims competence under Article 89 of the Treaty of Rome, but this is not universally accepted by national competition authorities.

All of the alliances mentioned above, including those which were established before 1996, will be re-examined by the Commission. The Merger Regulation (1989), designed to control concentrations, including those involving non-EU airlines but having a "Community dimension", can already be applied and has been applied in the Delta/PanAm agreement (1991).

### **The creation of a "Common Aviation Area"**

On 24 June 1996, the EU Council authorized the Commission to open negotiations with the US on behalf of the EU regarding certain aspects of an EU-US aviation agreement. The authorization, however, was less than a grant of full competence for the Commission to reach decisions which could lead to full liberalization of the transatlantic market.

The long-term purpose of the EU is the creation of a "Common Aviation Area", defined as an "area where air carriers could freely provide their services in the EU and US on the basis of commercial principles ensuring for airlines the possibility to compete on a fair and equal basis and equivalent regulatory conditions". It is also stated that "equivalent competitive conditions for carriers from both sides" must be established.

#### **4. The restructuring of the airline industry**

At a time when access to foreign markets is being liberalized for international air transportation, as exemplified by "open skies" agreements, and when the airline industry is in the process of being privatized, airlines need to meet increasing competition at the global level, which, in turn, leads to pressure on tariffs. A privatized airline industry, in order to stay profitable, is compelled to seek cost reductions and to optimize market share.

Especially in the growing leisure market, no-frills and charter competition will intensify for operators of scheduled services as non-scheduled carriers offer low fares as a result of high load factors and low costs. A proliferation of start-up scheduled carriers also puts pressure on costs and fares.

In these circumstances, airlines have entered into cross-border joint ventures and other cooperative agreements in order to rationalize their operations, increase their market coverage, and strengthen their competitive position in the marketplace. But as they do so, they face different competition regulations and policies from individual states. A proposed code-sharing alliance or an equity alliance may be subject to a series of different regulations by national authorities and international competition regimes.

In the EU/US case, for example, the European Commission's competition authority may be at odds with competition authorities in individual EU states, which may, in turn, be in conflict with the competition policies of US authorities. A case in point is the marketing/code sharing alliance between American Airlines and British Airways, in which the European Commission has taken a position on competition policy which differs markedly from that of the United Kingdom and which is likely to be at odds with policies concerning the same alliance by the US authorities. The result is confusion, delay and uncertainty for airlines and users.

#### **5. International inter-airline alliances in the 1990s**

The trend towards more comprehensive airline cooperation was set in 1993 by the alliance between KLM and Northwest Airlines. The alliance was judged by the US and Dutch governments who allowed the airlines in question to exclude competition among them. The US DoT, which must investigate anti-competitive effects of agreements between airlines that affect international air transport, granted anti-trust immunity to the alliance. The European Commission did not take any action at that time.

In 1996, cooperative agreements have been concluded between Lufthansa and United Airlines (UA), SAS and UA, Swissair/Sabena/Austrian Airlines and Delta Airlines, and, at the time of writing, an alliance between BA and AA is pending. Competition authorities on both sides of the Atlantic have assessed or are assessing these later alliances to determine whether they should obtain anti-trust immunity.

#### **6. Comparison of recent decisions on transborder air transport competition**

##### **The EU-US dimension**

In the EU-US context, two separate regimes, namely, EU law and policy on the one hand and US law and policy on the other, govern the behaviour of alliances which have an "EU-US dimension". Airline

behaviour can be characterized as having an EU-US dimension when it affects air transport in all of the following markets: the EU domestic market, the US domestic market and the transatlantic market connecting the two domestic markets.

So far, a limited number of decisions on competition cases with an EU-US dimension have been taken. With the exception of the Delta-PanAm case, all of these decisions were taken by the US authorities.

Consequently, it is difficult to make a comparative analysis of the positions taken by the EU and the US, since there is insufficient case law to support such a comparison. An attempt can be made, however, to outline the criteria which have played a role in decisions with an EU-US dimension, taken by US authorities on the one hand, and decisions with an EU dimension only, taken by EU authorities.

With respect to the first, "international comity" and "foreign policy considerations" play a crucial role. As noted earlier, the US DoT cannot approve a transborder alliance that substantially reduces or eliminates competition unless the alliance achieves important "public benefits".

It is true, nonetheless, that US decisions with an EU-US dimension are related to larger markets than those rendered so far by their European counterparts, with the exception of the Delta-Pan Am case. A more valid comparison may be made between the *policies* of the competition authorities on the both sides of the Atlantic.

#### **Issues in judging competition cases**

EU and US competition authorities have considered some of the following questions in judging the acceptability of transborder alliances:

- the relevant market;
- access to routes, including capacity and slots;
- tariff coordination;
- CRS participation;
- exemptions and periods of exemption.

#### **Similarities and differences with respect to the judgements**

Though the criteria for judging transborder alliances in the EU and the US have been similar, the bases for the decisions vary according to their geographical and jurisdictional context: US-EU, or the EU internal market. The "missing" element has been a common basis for judging alliances in the EU-US context.

That being said, both the European Commission and the US DoT, in judging alliances, conduct a detailed analysis of economic concepts such as the "relevant market", with both jurisdictions tending to carry out a sophisticated analysis of the data in this respect. It should be noted, however, that the decisions rendered by the Commission, in nearly all instances, have concentrated on the particularities of the EU internal market, and do not have to take into account matters impacting on foreign relations. In other words, the scope of the US competition decisions has been wider than that of their EU counterparts.

## **7. Design of a transparent framework**

The ICC believes that the trend to alliances and other forms of cooperation among airlines can be of benefit to the industry and the travelling public in that it can offer seamless services, a range of new

destinations, and greater convenience to the user. At the same time, it is imperative that these cooperative agreements be subject to fair and objective competition rules, in order that the proponents of alliances will benefit from a stable and predictable legal environment, and so that the rights of other airlines and those of users will be adequately protected.

Bearing these points in mind, the ICC believes that there should be a greater convergence in aviation competition policy and regulation among the different authorities, national and international, having jurisdiction over air transport. Such convergence should begin with the transatlantic market, and, as practicable, be extended to other areas.

The term "convergence" applies to questions of authorizing new services, as well as to the enforcement of competition laws. Specifically, airlines should know with reasonable certainty:

- which are the competent authorities;
- what are the rules that apply to different cross-border competitive practices.

If no attempt is made to find a more common approach to competition law and policy, the prospects for uncertainty and frustration, will increase.

The history of transatlantic airline competition demonstrates the point. The DoT's Show Cause Order directed at IATA activities (1978) led to objections from many of the world's airlines and governments over what was seen to be an unwarranted extension of the extraterritorial reach of US anti-trust laws. The Laker case (1985) caused a conflict between the US and UK governments over the US claim to have jurisdiction over what the UK government considered to be a strictly British dispute. Both of these unilateral actions led to conflict at the highest levels of government. In a liberalized environment, with its increased competition and uncertainty, these disputes are likely to intensify.

## **8. Conclusions and recommendations**

The ICC is in favour of a freer exchange of air services throughout the world. Such an environment requires the liberalization of the international regulatory framework, which can stimulate and enable cross-border, inter-carrier cooperation, subject to rules of fair competition.

As air transport markets become increasingly global, the ICC's broader objective is to arrive at a seamless travel system in which national laws and regulations on air transport achieve a greater convergence, so that the essentially national character of the present air transport system is gradually replaced by a system of multinational rules and regulations which will achieve more coherence and predictability for carriers and a wider choice of services at reasonable prices for users.

As an important first step towards these objectives, the ICC believes that competition laws and policies of various states need to achieve greater convergence. We urge that the process begin with an EU/US agreement, and that it be open to participation by governments in other regions as well, with a first emphasis on developing common principles regarding airline behaviour that affects competition.

The discussions between the European Commission and the US on transatlantic competition issues would be an appropriate occasion to reach an agreement on convergence between the two sides concerning air transport competition law and policy.



To achieve such an agreement, the ICC recommends that the European Commission air transport negotiators be given a clear and unambiguous grant of external competence to negotiate this and other competition issues with the US authorities, subject to consultation with competent national authorities, the industry and consumers' groups, and based on a clearly understood framework of principles and policies.

Such an EU/US agreement could usefully include:

- the creation of clearly defined and transparent rules regarding airline competitive behaviour, based on an analysis of the present standards of the two jurisdictions and building on earlier agreements which provided for positive comity;
- a streamlining of the procedures concerning the standards to be applied to competitive behaviour involving cross-border, "inter-area" and "intra-area" alliances;
- the creation of an adequate dispute settlement mechanism in order to ensure a smooth and speedy solution of differences between the parties.

In the longer term, the ICC supports the creation of a "Common Aviation Area" between the EU and the US, which should be open to other governments from regions to join when they believe it is appropriate to do so. Such a "Common" area would incrementally replace hundreds of bilateral agreements, most of which restrict market access and deny choice to consumers.

The ICC commends the principles set forth in this paper to the EU/US negotiators, as well as to national transportation authorities in other regions.

**Document n° 310/468 Rev. 2**

16 July 1997