Aviation sector

1. Commission closes investigation into Lufthansa/SAS/United Airlines and KLM/NorthWest alliances

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I. Introduction

On 28 October 2002 the European Commission decided to close its investigations under Article 85 (ex 89) of the Treaty into two transatlantic aviation alliances, that is the alliance between Lufthansa, SAS and United Airlines (STAR Alliance) on the one hand and the alliance between KLM and NorthWest (Wings) on the other hand (1). In the first case, the Commission’s decision was based on certain remedies, addressing the Commission’s concerns about reduced competition on a number of routes between Frankfurt airport and certain US destinations. In the case of KLM/NorthWest no remedies were held necessary.

The cases are of importance in particular for two reasons. First, they are the first cases in which the Commission took a formal position under the EC competition rules on a transatlantic aviation alliance agreement (2). In the two cases the Commission further developed its approach to transatlantic air alliances under the EC competition rules, notably in terms of market definition and the identification of affected markets. Second, the two cases are of interest from a procedural point of view. In the absence of a competition enforcement regulation for air transport between the Community and third countries (3), both proceedings were initiated on the basis of Article 85 of the Treaty. Competition cases formally initiated on the basis of this provision are rare (4), and raise a number of particularities. Both aspects will be explained in further detail in this Article.

II. The Commission’s assessment

Background

For a good understanding of the Commission’s competition analysis of the two cases it is necessary to briefly recall the background of the two cases. Neither of the two alliances was notified to the Commission but the latter decided in 1996, on its own initiative, to start proceedings under Article 85 of the Treaty in order to examine the compatibility of the alliance agreements under EC competition law. The focus of these proceedings was on passenger air transport services between the Community and the United States.

The Commission’s investigation initially focussed in particular on the alliance between Lufthansa, SAS and United Airlines (‘the LH/SAS/UA alliance’), which raised the most imminent competition issues. This resulted in 1998 in a so-called ‘draft-proposal’ within the meaning of Article 85 of the Treaty, a sort of statement of objections, in which the Commission identified a large number of point of origin-point of destination pairs (O&D routes) where the LH/SAS/UA alliance was found to restrict competition and where appropriate measures to avoid the elimination of competition were held necessary.

In view of the arguments put forward by the parties the Commission launched an intensive market investigation, which led to a somewhat revised approach to the competition assessment of international aviation alliances, notably as regards market

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(1) See the notice published in the OJ C 264, 30.10.2002, p. 5. This (unpublished) decision was taken after the Commission invited interested third parties to comment on the intention to take a favourable position on the two alliances and close the respective proceedings.

(2) Anti-trust decisions which the Commission adopted with regard to aviation alliances cases so far all related to intra-Community transport.

(3) Regulation (EEC) No 3975/87, laying down the procedure for the application of the EC competition rules in the air transport sector, is limited to air transport between Community airports.

(4) For all other economic sectors, with a few minor exceptions, procedural implementing regulations have been adopted and therefore there is no need to apply Article 85 of the Treaty.
definition and the assessment of potential competition. In particular, the Commission concluded that on long haul routes a certain degree of substitutability between indirect services (e.g. a flight from Frankfurt, via Amsterdam to Washington) and non-stop services could be accepted, depending on a number of factors, such as overall additional flight duration, airline preference, price, schedule and the availability of indirect flights. Moreover, the Commission applied a more economic approach when identifying affected markets, by considering alliance partner A only as potential competitor of alliance partner B (already operating services on the route concerned) where carrier A had a real commercial possibility of entry. This was in particular held to be the case if the route concerned was directly linked to one of the potential competitors’ hubs or sufficiently thick enough in terms of passengers transported to allow marker entry on a point-by-point basis.

This revised approach allowed the Commission to take a more positive view on the LH/SAS/UA alliance and its initial concerns from a competition point of view could be reduced to five hub-to-hub O&D routes. The Commission’s revised approach had also consequences for its examination of the transatlantic alliance between KLM and North-West (KLM/NW), where its initial competition concerns were reduced to two hub-to-hub O&D routes, where both parties were actual competitors prior to the alliance.

The competition concerns

By entering into their alliance agreements, both the alliance partners in LH/SAS/UA and KLM/NW had respectively, while retaining their corporate identities, integrated their services and de facto acted as single entities. In particular, the alliance partners in both cases are engaged e.g. in code sharing, joint pricing, co-ordination of capacity, co-ordination of marketing and sales activities and they share revenues and cost. In short, they co-ordinate all key parameters on which airlines normally compete. By entering into the alliance agreements the parties therefore ended all competition between themselves and this raises in particular competition concerns under Article 81 of the Treaty on those city-pairs where the parties hold high combined market shares and were they were prior to the alliance either actual (the overlap markets) or potential competitors (the non-overlap markets).

In the LH/SAS/UA case the Commission identified five such routes: the O&D routes Frankfurt-Chicago, Frankfurt-Washington, Frankfurt-Los Angeles, Frankfurt-San Francisco and Copenhagen-Chicago. On these markets, all hub-to-hub routes, the parties were, prior to the alliance, either actual competitors (Frankfurt-Chicago, Frankfurt-Washington) or could be considered to be potential competitors with a real commercial possibility to enter (Frankfurt-LA, Frankfurt-San Francisco, Copenhagen-Chicago), holding combined market shares varying from 56 to 95%.

As concerns KLM/NW, the Commission came to the conclusion that the alliance restricted competition within the meaning of Article 81(1) of the Treaty on two routes, that is Amsterdam-Detroit and Amsterdam-Minneapolis/St Paul. Both routes are hub-to-hub routes on which the parties were actual competitors prior to the alliance under a so-called blocked-space agreement and on which they hold combined market shares of about 80%.

Market entry barriers and need for remedies

In the LH/SAS/UA case the Commission concluded that there was, without appropriate remedies, a risk of elimination of competition on four of the affected routes (the routes from Frankfurt to the US), given the existence of substantial market entry barriers. These entry barriers were both of a structural nature (slot shortage at Frankfurt airport) and of a regulatory nature (a possibility of price control by the German Government with regard to the fares of indirect services).

In order to meet the identified competition concerns the parties offered to surrender slots at Frankfurt airport to allow (either direct or indirect) new air services on the four routes concerned. The parties offered to surrender sufficient slots to allow two additional daily competing air services on the Frankfurt-Washington route and one additional daily competing air service on each of the other three routes. In addition, new entrants using the slots, if they operate a non-stop service, will be admitted to the parties’ frequent flyer programme and offered interlining facilities. Moreover, the parties will not participate in that part of the IATA tariff conference concerning services on the routes in question.

In addition to the commitments proposed by the parties, the German Government formally declared that they would not apply any price control on indirect services on the routes concerned. This ensures that indirect services may provide real competitive constraints on the direct services provided by the parties.

The Commission considered that, on the basis of this package of commitments and the declaration
by the German Government, the arguments of the parties that the alliance fulfils the cumulative conditions of Article 81(3) of the Treaty could be accepted (1) and that there were therefore no longer reasons to adopt an infringement decision under Article 85 of the Treaty. As a result the Article 85 proceeding was closed.

As concerns the KLM/NW case, the Commission did not identify significant market entry barriers, in terms of slot constraints at Amsterdam Schiphol or the two US airports concerned, nor substantial regulatory barriers such as government price control on indirect services. Therefore, it concluded that existing or new (indirect) competition could sufficiently constrain the competitive behaviour of the parties and that the Article 85 proceeding could be closed, without the need of imposing remedies.

III. Proceedings under Article 85 of the Treaty

Background

Regulation (EEC) No 3975/87, laying down the essential rules for applying the EU competition rules in the transport sector, is limited to air transport between Community airports. The recently adopted Regulation (EC) No 1/2003, which will replace the procedural provisions of Regulation (EEC) No 3975/87 as from 1 May 2004, does not change this (2). There is thus no procedural implementing regulation laying down the rules to be applied in case of possible infringements of Articles 81 and 82 of the Treaty on routes between the Community and third countries. This means that the Commission will have to continue to rely on the provision of Article 85 of the Treaty when applying the EU competition rules to international air transport.

Article 85 of the Treaty empowers the Commission, if it finds that there has been an infringement of the EC competition rules, to propose appropriate measures to bring it to an end and, if this is not done, record such infringement in a reasoned decision and authorize Member States to take the measures, the conditions and details of which it shall determine, needed to remedy the situation.

The Commission’s experience in dealing with the LH/SAS/UA and KL/NW cases under Article 85 of the Treaty has shown that, although eventually in the cases at stake a satisfactory solution for the identified competition issues was found, the lack of appropriate enforcement powers is unsatisfactory from the point of view of enforcement as well as time-consuming and cumbersome. In particular, the Commission lacks the appropriate tools, which are necessary for the fact-finding process. Although the Commission applies as much as possible mutatis mutandis the procedures of Regulation (EEC) No 3975/87 (3), in practice it has to rely on the willingness of the parties to provide the Commission with the necessary facts. Furthermore, Article 85 of the Treaty does not empower the Commission to adopt a decision requiring the undertakings concerned to bring an infringement to an end and impose the remedies that are necessary to address the competition concerns. Such measures will have to be taken by the competent authorities in the Member States concerned. Although the Commission, in particular in the LH/SAS/UA, closely co-operated with the competent authorities of the Member States concerned, it is clear that this practice does not ensure fully an effective and coherent application of EC competition law.

Proposals for competition enforcement rules for air transport between the Community and third countries

In the past the Commission has submitted several proposals, most recently in 1997, to the Council for extending the scope of Regulation No (EEC) No 3975/87 to transport between the Community and third countries. So far, the Council has not decided upon these proposals.

The recent Court ruling in the ‘open skies’ cases (4) is expected to accelerate the pace of change in the aviation sector. Following the Court’s judgment the Commission has requested the Council to grant the Commission the appropriate mandate for

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(1) Even though the Commission under Article 85 EC is not authorised to grant an exemption, the principles of Article 81 EC can be applied in its entirety to assess whether there is an infringement and to determine the appropriate measures to bring such an infringement to an end.

(2) Article 32 under c of Regulation (EC) No 1/2003 (OJ L 1, 4.1.2003, p. 1) excludes from its scope air transport between Community airports and third countries.

(3) For example, in the LH/SAS/UA case the Commission after sending the parties a draft-proposal, gave them the opportunity to react to this document in writing and it organised a hearing in which the parties and interested third parties were given the opportunity to express their views orally.

(4) Cases C-466/98, C-467/98, C-468/98, C-469/98, C-471/98, C-472/98, C-475/98 and C-476/98 against the United Kingdom, Denmark, Sweden, Finland, Belgium, Luxembourg, Austria, Germany.
negotiations with the United States in order to establish a coherent policy for international air transport. (1) Clearly, an effective enforcement of Community competition laws is an essential part of such a co-ordinated air transport policy. The current competition regime does not provide sufficient level playing field either to the industry or to Member States since internal EU air traffic and international traffic to and from the Community are subject to different enforcement regimes, even though companies and alliances treat them as a single business. Accordingly, the need for an effective enforcement of the EC competition rules to international air transport has become yet more important in the light of the Court’s judgment. In this light the Commission is currently preparing new proposals to establish competition enforcement rules for air transport between the Community and third countries. These proposals are expected to be submitted to the Council in the first half of 2003.

IV. Conclusion

In the LH/SAS/UA and KLM/NW cases the Commission has further developed its competition assessment approach to transatlantic aviation cases, allowing a more positive overall approach, while at the same time ensuring that competition is not eliminated in certain markets. The experience with the proceedings in both cases have however also demonstrated that there is a clear need for effective competition enforcement rules for air transport between the Community and third countries. In light also of the recent Court’s judgment in the open skies cases, the Commission is expected to submit proposals to that end in the near future (2).

(1) Declaration of the European Commission on the implications of the judgements of the Court of Justice in the ‘open skies’ cases of 14 November 2002 (COM(2202) 649).

(2) Declaration of the European Commission on the implications of the judgements of the Court of Justice in the ‘open skies’ cases of 19 November 2002 (COM(2202) 649 (final), para 26 and 53).