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CHAPTER 4

ANTI-TRUST ISSUES WITH RESPECT TO FREQUENT FLYER PROGRAMS AND CODE-SHARING AGREEMENTS THAT PERSIST IN THE AVIATION INDUSTRY: THE INDIAN CONTEXT

I. INTRODUCTION

One of the sectors which has been most effected by anti-competitive practices is the civil aviation industry. Civil aviation plays an integral role in the development of an economy. It helps in realizing the socio-economic objective of providing connectivity to foster travel and trade. There are certain factors intrinsic to the airline industry that are anti-competitive such as 'Frequent Flyer Programs' (hereafter referred to as 'FFP') and 'Code Sharing Agreements' that are operated by various airlines and which tend to restrain competition in the market.

Such rewarding tends to induce future loyalty amongst its customers and not only strengthens the airlines market position, but also tends to fetter competition in the market by making it difficult for new entrants to enter the market and expand. These loyalty agreements give the airline a dominant position in the market as they raise the switching costs between various airlines as the traveller is keen to continue travelling on that airline only as switching the airline would lead to the customer not accruing points in the FFP of the airline of which he is a member. Hence, this chapter does a careful review of these agreements and alliances in order to ensure that competition in the airline industry may be preserved and enhanced.

Perfect competition is an ideal market of atomistic firms who are price-takers. It is increasingly recognized more than ever before that competition in markets promotes efficiency, encourages innovation, improves quality, boosts choices reduces costs, and facilitates governance. The resulting effect is availability of goods and services in abundance of acceptable quality at an affordable price. Imperfect competition prevails in an industry whenever individual sellers have some measure of control over the price of their output, although, it does not imply that a firm has absolute control over the price of its product.[89]

Competition law has grown enormously in recent years, especially since the 1990s. The growth has been both in terms of geographical regions that have adopted competition law, as well as in the range of economic activities now subject to competition law. India's competition law, the Competition Act, 2002, was passed by the Parliament in December, 2002 and received the assent of the President of India on January 13, 2003 thereby becoming the law of the land from that date. On May 20, 2009, provisions related to anti-competitive agreements and abuse of dominance came into effect.

The air passenger transport industry has been one of the major drivers behind rapid globalization of the world businesses and the consequent shortening of the distances on the planet. Starting off in the US in 1978, the deregulation of the air passenger transport industry brought sea changes in the industry. European countries emulated the steps within the next ten years. With deregulation setting in, there was freedom to choose routes to operate on, set the prices as demanded/told by the market with no government intervention on the prices.

There are certain practices intrinsic to the airline industry that are anti-competitive such as 'Frequent Flyer Programs' and 'Code Sharing Agreements' that are operated by various airlines and which tend to restrain competition in the market. These cost-cutting efforts led to rationalization of route structures. The efforts to gain efficiency led to formation of "hub and spoke" networks wherein the "traffic feed" was brought in to a central place (the hub) from other areas in the vicinity of the hub (the spokes). This hub and spoke network is prevalent today all over the world. Globally, New York, London, Amsterdam, Dubai, Singapore, and Tokyo are the best examples of the hub wherein passengers fly in from all corners of the region and again take off for their respective destinations.

Over a period of time these hubs have developed into "fortress hubs," that is, a particular carrier or family of carriers dominates the hubs. For example, Dubai is the hub of Emirates while London is the hub of British Airways among others. In India, many airlines operate hubs such as Mumbai and Delhi. For example, Air India uses both Delhi and Mumbai as hubs.

FFP are basically loyalty-inducing programs offered by airlines which reward customers with free travel on the basis of accumulated miles on each travel by the airline. Through these FFP's, airlines tend to enhance the value of subsequent flights on its airline by increasing opportunity for free travel,

89. Samuelson Nordhaus, *Economics*, 18th Edition, Tata Mcgraw-Hill Edition at pp. 166–167.

rewards due to reduced costs, and more streamlined transfers.[91] The following are the benefits that result from such an alliance:

- An extended network providing seamless connectivity through code share agreements.
- Reducing costs by sharing sales offices, check-in desks at the airport, ground handling personnel, and maintenance facilities, and so on.
- Lower prices due to lower operational costs.
- Access to each other's FFP programmes thereby offering more partners to earn and redeem miles on.
- Access to more airline First and Business Class lounges.
- More flights to choose from.
- Merging of reservation systems.

For example, if Air India and Lufthansa have an alliance, then if a passenger approaches Air India for a ticket from Mumbai to Geneva, then through its alliance with Lufthansa, the passenger can fly to Frankfurt on Air India and then proceed on his/her onward journey to Frankfurt on Lufthansa. This also results in the passenger earning miles on both the sectors by being a member of the Air India FFP, obtaining his boarding passes of both the sectors in Mumbai itself, using the Air India lounge at Mumbai and then the Lufthansa lounge at Frankfurt, checking his bags for the entire leg of his outbound journey from Mumbai itself, among a host of other advantages.

However, these alliances may also result in a bane for the passengers as:

- They may result in creating a monopoly thereby leading to increase in prices and deficiency of services.
- The ability of an airline to join a global alliance is often restricted by regulations and laws of the country of origin of that airline, which may delay its joining the alliance.
- It is not necessary that the landing rights are owned by the airlines itself, instead these rights may be owned by the government of the country in which their head office is situated. Hence, if an airline merges with a foreign airline, it loses its national identity and thus existing agreements may be declared void by the country that objects to the merger.

91. "Proposed Domestic Airline Alliances Raise Serious Issues," GAO/T-RCED-98-215, June 4, 1998.

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C. *Code-Share Agreements*

The liberalization of the aviation industry in India has precipitated the boom for domestic and international air carriers.

In order to identify the proper defendant claim arising from a code-shared flight, the Guadalajara Convention, which was adopted in 1961, applies to which India is a party. It ensures that a carrier performing carriage without having entered into a contract with the passenger will be liable according to the Warsaw Convention, as modified by the Guadalajara Convention. This convention has formally introduced the distinction between a contracting and an actual carrier. As per this convention, both carriers will be jointly liable and the plaintiff is released from the difficulty in proving which carrier caused the damage which could be due to lost baggage, delay in the flight taking off, diversion of the flight due to unavoidable circumstances, passengers been offloaded due to overbooking, and so on especially in congested airports. Code-sharing involves one airline advertising and selling the services of another airline as its own and the transportation of passengers and cargo on an airline other than the one identified in the travel documents. The carrier performing the flight is usually referred to as the operating carrier while the other airline is typically identified as the marketing or contracting carrier. Code-share agreements enable airlines to increase their traffic and revenues thereby profits, network size, service frequency, offering more destinations through its FFPs and coordination of operations.

Example:

Jet Airways already has a code-share agreement with Garuda Airlines, among others in order to give its passengers wider destinations in Indonesia, South-East Asia and Far East to choose from.

III. ANTI-TRUST ISSUES AFFECTING AVIATION ALLIANCES

A. *Anti-Competitive Agreements*

Section 3(3) of the Competition Act, 2002 (hereafter referred to as 'the Competition Act') talks about prohibition of anti-competitive horizontal agreements. It states that horizontal agreement is any agreement,[92] entered into between enterprises[93] or associations of enterprises or persons or association

92. Section 2(b) defines agreement and says that it includes any arrangement, understanding or action in concert whether or not such an agreement, understanding or action is formal or in writing or whether or not such an agreement, understanding or action is intended to be enforceable by legal proceedings.
93. Section 2(h) defines 'enterprise' as a person or a department of the government, who or which is, or has been, engaged in any activity, relating to the production, storage, supply,

of persons or between any person and enterprise or practice carried on or any decision taken by, any association of enterprises or association of persons, including cartels, engaged in identical or similar trade[94] of goods or provisions of services which:

- Directly or indirectly determines purchases or sale prices.
- Limits or controls production, supply, markets, technical development, investment or provision of services.
- Shares the market or source of production or provision of services by way of allocation of geographical area of market, or type of goods or services, or number of customers in the market or any other similar way.
- Directly or indirectly results in bid rigging or collusive bidding

shall be presumed to have an appreciable adverse effect on competition which is prohibited by law.

Cartel busting requires certain specialized skills that differ from the skills required for investigation and prosecution of other infringements of competition law. An increasing number of competition authorities operate leniency programmes as a key tool to detect cartel infringements. The law now empowers the Competition Commission of India (hereafter referred to as 'CCI') to extend the benefit of lesser penalty to more than one party and that the disclosure can be made at any time before the submission of investigation report by the Director General (hereafter referred to as 'DG') with the CCI.[95]

This section is almost identical to Article 81 of the EC Treaty. The purpose of Article 81 of the EC Treaty is to preclude restrictive agreements between independent market operators, whether horizontal (between parties operating at the same level of the economy, often actual or potential competitors) or vertical (between parties operating at different levels, for example, an agreement

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distribution, acquisition or control of articles or goods, or the provision of services, of any kind, or in investment, or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate, either directly or through one or more of its units or divisions or subsidiaries, whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or at different places, but does not include any activity of the government relatable to the sovereign functions of the government including all activities carried on by the departments of the Central Government dealing with atomic energy, currency, defence, and space.

94. Section 2(x) defines trade as any trade, business, industry, profession or occupation relating to the production, supply, distribution, storage or control of goods and includes the provision of any services.
95. Abdullah Hussain, G. R. Bhatia and Ravishekhar Nair, "Competition Law in India: A Legal Quagmire," *The Indian Journal of International Economic Law*, vol. 1: 2008.

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97. Cases T-374, 375, 384
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Nair, "Competition Law in India: A Legal
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between a manufacturer and its distributor).[96] Article 81 sets out the prohibition and prohibits collusion between undertakings which have as its objects or effect the prevention, restriction, or distortion of competition within the common market and which may affect trade between Member states.

In *European Night Services* v. *Commission*,[97] the CFI held that agreements containing obvious restrictions of competition will automatically be held to restrict competition within the meaning of Article 81(1). In that case, the CFI took the view that provisions fixing prices or sharing markets in horizontal agreements would be obvious restrictions of competition. Thus, hard-core cartel activities, where competitors agree or otherwise conspire to fix prices, share markets, impose quotas or otherwise limit output, have as their object, the restriction of competition. The assessment of whether or not an agreement has as its object the restriction of competition is based upon a number of factors which include, in particular, the context of the agreement and the objective aims pursued by it.

In another case, Christie's and Sotheby's, the well-known houses, were found to be involved in a collusive agreement fixing trading terms. The purpose of the cartel agreement was to reduce the fierce competition between the two leading auction houses that had developed during the 1980s and the early 1990s. The most important aspect of the agreement consisted in an increase in the commission paid by sellers at auctions (the so-called vendor's commission). But the collusive agreement also concerned other trading conditions such as advance paid to sellers, guarantees given for auction results and payment conditions. The Commission fined Sotheby's 20.4 million euros, that is, 6 per cent of its worldwide turnover. The amount included a 40 per cent reduction for its cooperation in the investigation. Christie's, on the other hand, escaped a fine because it was the first to provide crucial evidence, which enabled the Commission to prove the existence of the cartel.[98]

In many cases it is the detection of cartels, rather than the legal intricacies of Article 81, which presents the main difficulty.

Exception:

Horizontal agreements of the above entered into by way of joint ventures are not presumed to have an appreciable adverse effect on competition and are excluded from the provisions of Section 3(3) of the Competition Act if they increase efficiency in production, supply, distribution, storage, acquisition or

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96. G. R. Bhatia, *Combating Cartel in Markets Issues and Challenges*, January, Competition Law Reports, 2008.
97. Cases T-374, 375, 384 and 388/94 [1998] ECR II-3141, [1998] 5 CMLR 718.
98. EC Press Release DN:IP/02/1585 Dated: 30/10/2002 "Commission Rules against Collusive Behaviour of Christie's and Sotheby's."

control of goods or provisions of services. Article 81(3) of the EC Treaty sets out four criteria, all of which must be satisfied if the agreement is to benefit from it.[99] The following are the criteria which need to be satisfied:

- The agreement must lead to an improvement in the production of goods and services, lead to an improvement in the distribution of goods or services, promote technical progress and/or promote economic progress.
- The parties must establish that the agreement allows consumers a fair share of the benefit. The benefit referred to here is the same objective benefit, which must be established to satisfy the first criterion. Further, the more intense the competition, the more willing the Commission is to conclude that the resulting benefits will accrue to the consumer. So long as the first and fourth criteria are satisfied, it is likely that this condition will also be satisfied.
- An agreement which satisfies the first two criteria must only contain restrictions which are indispensable to the achievement of the benefits shown to result from the agreement.
- The last requirement is that the agreement as a whole must not lead to the substantial elimination of competition. Rivalry between undertakings on the market should be preserved since rivalry is the essential driver of economic efficiency, including dynamic efficiency.

B. *Abuse of Dominance*

Section 4 of the Competition Act describes what is meant by abuse of dominant position. Dominance relates to a position of economic strength enjoyed by an enterprise,[100] which enables it to prevent effective competition in the relevant market by giving the undertaking, the power to behave to an appreciable extent

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99. See Case T-528/93, *Metropole Television SA* v. *Commission* [1996] ECR II-649, [1996] 5 CMLR 386 at para 86. In case T-65/98, *Van den Bergh Foods* [2004] 4 CMLR at para 144 states that the CFI held that once it has been concluded that the Commission had been correct to find out that the first criterion of Article 81(3) had not been met, it was unnecessary to consider whether or not the other criteria had been satisfied.

100. Section 2(h) defines 'enterprise' as a person or a department of the government, who or which is, or has been, engaged in any activity, relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or the provision of services, of any kind, or in investment, or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate, either directly or through one or more of its units or divisions or subsidiaries, whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or at different places, but does not include any activity of the government relatable to the sovereign functions of the government including all activities carried on by the departments of the Central Government dealing with atomic energy, currency, defence, and space.

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independently of its competitors, customers and ultimately of its consumers.[101] In the case of *United States* v. *E.I. du Pont de Nemours & Co.*[102] it has been observed that in order to be considered dominant, a firm must be in a position of such economic strength that it can behave, to an appreciable extent, independently of its competitors.

- Abuse of dominant position by enterprises is a per se violation of the law and therefore, per se anti-competitive. The elements that constitute a dominant position are: (i) a position of strength, (ii) that position being enjoyed in a relevant market in India (both product and geographical market), (iii) and such a position that gives the enterprise the power to 'operate independently of competitive forces in the relevant market' meaning, thereby, that it can at will, disregard market forces and conditions and impose its own trading conditions, which will include the prices at which it is prepared to supply the goods or services. Therefore, to assess dominance, it is important to consider the constraints that an enterprise faces to act independently.[103]

Now the question in the last factor mentioned above is what is meant by relevant market. The relevant market is defined with reference to the competitive constraints that exist between products and regions. It is based on the "relevant product market" and "relevant geographic market." Relevant product market is defined in terms of substitutability of products.[104] It means a market comprising of all those products or services which are regarded as interchangeable or substitutable by the consumer by reason of characteristics of the products or services, their prices and the intended use.[105] The definition of a 'market' in the airline industry is usually based on pairs of flight destinations that constitute a route (Delhi-Mumbai route, for example, is one such pair).[106] It is possible for enterprises to gain dominant position through entering into agreements with other enterprises who are competitors in the relevant market.

Relevant geographic market is defined in the Competition Act in terms of the area in which the conditions of competition for supply of goods or provision of services or demand of goods or services are distinctly homogenous and can be distinguished from the conditions prevailing in the neighbouring market.[107]

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101. Abir Roy and Kartik Ganapathy, "*Abuse* of Dominance: Intel's Insides?," *Competition Law Reports*, July–September, 2009 at p. A–288.
102. 351 U.S. 377.
103. Section 4 Explanation (a) of the Competition Act, 2002.
104. G. R, Bhatia, "Assessment of Dominance: Issues and Challenges under the Indian Competition Act, 2002," *Competition Law Reports*, April–June, 2009.
105. *Supra* note 103, Section 1(t).
106. Sunil Barthwal, "Airline Mergers and Competition," *The Financial Express*, March 30, 2007.
107. *Supra* note 103, Section 1(s).

It is some "geographic area" in which a firm can increase its price without large number of customers turning to alternative supply sources outside the area.

A high profile example of an enterprise found abusing its dominant position is the *Microsoft* case.[108] Microsoft was fined 497 million pounds for infringing the EC Treaty rules on abuse of a dominant market position (Article 82) by leveraging its near monopoly in the market for PC operating systems onto the markets for work-group server operating systems and for media players. This conduct hindered innovation in the markets concerned to the detriment of consumers. To put an end to this abusive behaviour, the Commission ordered Microsoft to disclose interoperability information, which would allow non-Microsoft work-group servers to achieve full interoperability with Windows PCs and servers and to offer a version of its Windows operating system without Windows Media Player. The Court's ruling confirmed that the Commission was right to prohibit Microsoft's anti-competitive conduct that harmed competition to the detriment of consumers.

Dominant position is linked to a host of factors: size and resources of the enterprise, market share of the enterprise, size and importance of competitors, commercial advantage of enterprise over competitors, vertical integration, dependence of consumers, dominant position as a result of a statue, entry barriers, countervailing buying power, market structure and size of the market, social obligations and costs, and contribution to economic development.[109]

TABLE 4.1 MARKET SHARE IN DOMINANCE DETERMINATION

Market share (per cent)	Observation
85–90	Usually conclusive of dominance
75	Indicative of dominance
More than 50	Strong evidence of dominance, where held for three years, except in exceptional circumstances
40 or more	Evidence of dominance considered with other factors
25–40	Single dominance unlikely, unless there is a fragmented market and significant other factors
20	Possibility of dominance left open, Considered with other factors
10	Too small

As complied by Peter R. Willis, *Introduction to EU Competition Law* (MPG Books, Bodmin: Cornell, 2005).

108. Judgement of the Court of First Instance (Grand Chamber) in *Microsoft Corp.* v. *European Commission*, CaseT-201/04 (2007), affirming the Commission's Decision of 24.03.2004 relating to a proceeding under Article 82 of the EC Treaty.

109. Peter Augustine, *Treatment of Dominance under Competition Act, 2002*, *Competition Law Reports*, January–March, 2009 at p. A-5.

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110. Case T-219/99, *British Ai* C-94/04), 2004.

111. Case 85/76.

112. *Ibid.*

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In *British Airways plc.* v. *Commission*,[110] the lowest market share where the EC Commission has established dominance is 39.7 per cent. An enterprise with deep pockets has higher say in power and can, therefore, afford to abuse the market power. Control over financial resource facilitates financial leveraging.

In Hoffmann-La Roche & Co. Ag, Basle v. *Commission of the European Communities in Brussels*[111] the European Commission held that Roche, with a dominant position within the common market, on the markets for certain vitamins, abused that position by concluding with twenty-two purchasers of these vitamins, agreements which contained an obligation upon them, or the grant of fidelity rebates offering an incentive, to buy all or most of their requirements of vitamins exclusively, or in preference from Roche. On the principles on which a dominant position is to be determined, the Court stated that a number of factors would show the existence of a dominant position, a highly important factor among them being the existence of a very large market share.

The court, further stated that an undertaking which has a very large market share and holds it for some time, by means of volume of production and the scale of supply, is by virtue of that share in a position of strength. This makes it an unavoidable trading partner which is the special feature of a dominant position.

The Court also listed other relevant factors in determining the existence of a dominant position:

- The relationship between market shares of the undertaking concerned and of its competitors especially those of the next largest.
- The technological lead of an undertaking over its competitors.
- The existence of a highly developed sales network.
- Absence of potential competition.

Abusive conduct could be either exclusionary or exploitative. Exclusionary conduct involves preventing entry or expansion of new enterprises in the relevant market or driving competitors out of the market. Exploitative conduct, on the other hand, consists of price discrimination, excessive pricing or lower payment to customers.[112] Proving excessive pricing is difficult as it can be proved only if a reasonable or competitive price can be defined.

This provision of abuse of dominance is almost identical to Article 82 of the EC Treaty, which prohibits undertakings from committing an abuse of

110. Case T-219/99, *British Airways plc* v. *Commission*, 4 CMLR 19 (subject to appeal in Case C-94/04), 2004.
111. Case 85/76.
112. *Ibid.*

dominant position held within a substantial part of the common market, where that abuse has an effect on trade between Member States. It prohibits dominant undertakings from engaging in certain conduct. The provision does not set out a procedure for declaring an undertaking to be dominant and so is subject to Article 82. It can be seen from the text of Article 82 that five essential elements must be established before prohibition applies which are as follows:

- One or more undertakings
- A dominant position
- The dominant position must be held within the common market or a substantial part of it
- An abuse
- An effect on inter-state trade

In the case of *NV Nederlandesche Banden Industries Michelin* v. *Commission of the European Communities*,[113] there was an appeal against the decision of the EC, which had imposed a fine on Michelin NV for abuse of its dominant position. The business of Michelin NV was production of new tyres for vans and lorries. Michelin was alleged to have abused its dominant position, in the market in new replacement tyres for lorries, buses, and similar vehicles. The abuse was tying tyre dealers in the Netherlands to itself through the granting of selective discounts on an individual basis conditional upon sales 'targets' and discount percentages, which were not clearly confirmed in writing, and by applying to them dissimilar conditions in respect of equivalent transactions and granting an extra annual bonus in 1977 on purchases of tyres for lorries, buses, and the like and on purchase of car tyres, which was conditional upon attainment of a 'target' in respect of car tyre purchasers.

The Court agreed with the finding of the Commission that the Netherlands was the geographic market. In the opinion of the Court, the requisite criteria in examining the existence of a dominant position were Michelin's share of the relevant product market, its position in relation to its competitors, customers and consumers. The Court also agreed with the Commission's ascertaining, for the purpose of establishing Michelin's dominant position, Michelin's market share, with reference to replacement tyres for lorries, buses, and similar vehicles, excluding the consideration of car and van tyres, at 57 per cent to 65 per cent, as compared to that of its main competitors at 4 to 8 per cent. This market share was a valid indication of Michelin's predominant strength in relation to its competitors.

It is not an offence to hold a dominant position (Article 82 does not prohibit the holding of a dominant position per se but only an abuse of that dominant

113. Judgement of the Court of November 9, 1983 Case 322/81.

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from a competition perspective when e
not have market power may have serio
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IV. CONCEPT OF ANTI-TRUS SECTOR

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A. *Alliances Rejected*

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114. "Aviation Competition: International
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115. *Ibid.*

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; Case 322/81.

position), but some behaviour which may be competitive, or at least neutral, from a competition perspective when engaged in by an undertaking which does not have market power may have serious effects on competition and be prohibited when engaged in by a dominant undertaking.

IV. CONCEPT OF ANTI-TRUST IMMUNITY IN THE AVIATION SECTOR

In the United States, Department of Transportation (hereafter referred to as 'DOT') has the authority not only for approving airline alliances, but also for granting those alliances immunity from the anti-trust laws. In determining whether to grant approval and anti-trust immunity for an airline alliance, DOT must find that the alliance is not adverse to the public interest. DOT cannot approve an agreement that substantially reduces or eliminates competition unless the agreement is necessary to meet a serious transportation need or to achieve important public benefits that cannot be met or that cannot be achieved by reasonably available alternatives that are materially less anti-competitive.[114] In general, DOT has found code-sharing agreements to be pro-competitive and therefore consistent with the public interest because they create new services, improve existing services, lower costs, and increase efficiency for the benefit of the travelling and shipping public.

A. Alliances Rejected

(i) The American Airlines/British Airways Proposal

The proposed alliance of American Airlines and British Airways – the two largest carriers in the US–UK markets raised significant competition issues. The two airlines accounted for nearly 58 per cent of the available seats on scheduled US and British airlines between the United States and London. In addition, they provided over 70 per cent and in some cases, all of the available seats on scheduled US and British airlines between Heathrow and several key US airports, including Chicago, Boston, and Miami among other routes.[115] As a result of this level of market concentration, the DOT's approval of the alliance would further reduce competition unless, as a condition of the approval, other US airlines were able to obtain adequate access to Heathrow.

The proposed AA/BA alliance was subject to review by the EC, UK Department of Trade and Industry and the DOT who had the decision-making authority over the proposed alliance. The UK Office of Fair Trading and the US Department of Justice's Anti-trust Division (hereafter referred to as 'DOJ') had

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114. "Aviation Competition: International Aviation Alliances and the Influence of Airline Marketing Practices," GAO/T-RCED-98-131, March 19, 1998.

115. *Ibid.*

advisory roles and provided analysis and comments to their respective decision makers. The process for reviewing the proposed alliance was complicated by the fact that it was new and untested and some European laws had not been previously applied to airline alliances.[116]

The then US–UK accord commonly known as "Bermuda II" was signed in 1977, after the British renounced the prior agreement and this agreement restricted the number of US airlines that could serve Heathrow to American Airlines and United Airlines. Hence, competition was restricted in these two markets thereby resulting in fewer service options for the US and British consumers. In addition, they also resulted in higher airfares. The UK Department of Trade and Industry conducted its own review for the proposed AA/BA alliance.[117]

The UK Office of Fair Trading issued a draft report in December 1996 that called for AA/BA to, among other things, make available to other airlines up to 168 slots per week at Heathrow for use only on the US–UK transatlantic services and allowed third-party access to their joint FFP in those cases in which that party did not have access to an equivalent programme. The report took into account the views of third parties on conditions that should be placed on the alliance to remedy competition concerns.[118]

The UK agencies, reviewing the proposed AA/BA alliance were in contact with the EC and had a duty to cooperate with them. If the United Kingdom's decision on the proposed AA/BA alliance differed from the EC's, the differences would have to be reconciled. This could require a judgment by the European Court of Justice in Luxembourg, which ultimately judges the sound application of the EU's treaties by the institutions of the Union or Member States. DOT explained that they would not approve of the AA/BA unless the United States has reached an open skies agreement with the United Kingdom.[119]

According to US law, DOT was to give the Attorney General and Secretary of State an opportunity to submit written comments about the application. The DOJ's role is advisory and is performed pursuant to the Sherman Act and Clayton Act, which set forth anti-trust prohibitions against restraint of trade. To determine if a proposed alliance is likely to create or enhance market power and allow firms to maintain prices above competitive levels for a significant period of time, the DOJ applies its Horizontal Merger Guidelines, which describe the analytic framework and specific standards to be used in analysing mergers and alliances.[120]

116. *Ibid.*
117. *Ibid.*
118. *Ibid.*
119. *Ibid.*
120. *Ibid.*

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121. *Ibid.*
122. *Ibid.*

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DOT had the discretion in deciding the factors it would analyse and in past applications for international code-sharing alliances, it had considered issues raised in petitions by interested parties. DOT then analysed the United–Lufthansa alliance. In response to United's application for anti-trust immunity in its code-sharing with Lufthansa, TWA contended that Lufthansa's control over travel agents, both through dominance of computer reservation system and through commissions and override payments, was a serious impediment to new airlines' entry into the US–Germany marketplace.

The proposed AA/BA alliance had network benefits and could increase competition in markets between the United States and the European continent, the Middle East, and Africa because of the number of alliances competing in these markets would increase from three to four. However, it raises serious competition issues in the US–UK markets. Competition issues arose because, under the alliance rather than competing with each other, the two largest airlines in the US–UK markets would in essence be operating as if they were one airline.[121]

Restrictions on access to slots and gates at Heathrow Airport were the most significant barriers to competition in the US–UK markets, but sales and marketing practices that included FFPs and corporate incentive programs, among others, may also reduce competition. They could do so by reinforcing market dominance at hubs and impeding successful entry by new carriers and existing carriers into new markets, which could lead to higher fares. However, measuring the impact of these practices on fares was difficult, and limiting them would involve a trade-off between their anti-competitive effect and the consumer benefits that some of them bring. It was felt that if an airline was already dominant in a given market, these programs would serve to reinforce this dominance.[122]

As a result of the challenges in addressing the barriers to entry at Heathrow, significant intergovernmental agreement would be needed well beyond the scope of prior "open skies" agreements. If the US government was successful in obtaining an open skies agreement with the United Kingdom, and that agreement provided for sufficient access to Heathrow, significant new entry in the US–UK markets would likely provide substantial benefits for consumers in both countries in terms of lower fares and better services.

Although the British and US governments couldn't work out an agreement, the efforts were superseded by talks between European Union and US negotiators. In 2007, the two sides agreed to open up the skies so that any US airline could fly to any city within the EU, including those in the United Kingdom, and any carrier from a EU country could fly to any city in the United States. The "open skies" policy took effect in late March 2008. In August, American, British

121. *Ibid.*
122. *Ibid.*

Airways, Iberia, Finnair, and Royal Jordanian Airlines, the five key Oneworld members that fly across the Atlantic, asked the DOT to bless their alliance with anti-trust immunity. This would let them jointly set fares, market their services, coordinate their schedules and frequent-flier programs, and take other actions that US anti-trust laws now prohibit.[123]

The American–British Airways alliance was rejected by the DOT since it felt that the two carriers simply controlled too much traffic between the United States and the United Kingdom, the largest segment of transatlantic traffic and that there uncertainty about the viability of new entry of a competitive airline service between the United States and the United Kingdom.[124]

(ii) KLM/Alitalia Proposal

The EC under the provisions of the EC Merger Regulation cleared the alliance between KLM and Alitalia. The Commission considered that the alliance was globally pro-competitive, particularly in view of the largely complementary nature of the parties' activities. Nevertheless, the Commission found that the operation would have led to monopoly positions on two markets: Amsterdam-Milan and Amsterdam-Rome.[125] The parties had therefore to accept undertakings with a view to attract potential new entrants in these markets and to exercise a competitive pressure on the parties. The remedies included inter alia the release of a significant number of slots at the congested airports in question and the reduction of the parties' frequencies up to 40 per cent of the frequencies actually operated when a new entrant starts operating the problematic routes.[126]

The European Commission stated in paragraph 33 of the decision in COMP/M.5181 *Delta Airlines/Northwest Airlines* that depending on their respective market shares, a merger between the two alliance partners can still significantly affect competition.

> "*33. Depending on the market position of the merging parties on the routes concerned, it cannot be excluded that a merger between two alliance partners could significantly affect the competitive situation on some routes, in particular on hub-to-hub routes. The Commission therefore analyzes below on a route by route basis the specific effects of the creation of a permanent structural link between the two merging parties in order to assess the extent to which competition may be affected post merger.*"

123. *Ibid.*
124. *Ibid.*
125. "Airline Competition: Issues Raised by Consolidation Proposals," GAO-01-370T, February 1, 2001
126. *Ibid.*

B. Alliances Granted Anti-Trust

(i) Lufthana/SAS/United and KL

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127. Negenman Monique, Directorate Ger
Competition Policy Newsletter.
128. *Ibid.*
129. *Ibid.*
130. *Ibid.*

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B. Alliances Granted Anti-Trust Immunity

(i) Lufthana/SAS/United and KLM/Northwest Proposals

On October 28, 2002, the EU Commission decided to close its investigations under Article 85 of the Treaty into two transatlantic aviation alliances, that is, the alliance between Lufthansa, SAS and United Airlines (Star Alliance) on one hand and the alliance between KLM and NorthWest (Wings) on the other hand. The cases were important in particular for two reasons. They were the first cases in which the Commission took a formal position under the EC competition rules on a transatlantic aviation alliance agreement.[127] In these two cases, the Commission further developed its approach to transatlantic air alliances under EC competition rules, notably in terms of market definition and the identification of affected markets.[128]

The Commission's investigations initially focused in particular on the alliance between Lufthansa, SAS and United Airlines, which raised the most prominent competition issues. This resulted in 1998 in a so-called 'draft proposal' within the meaning of Article 85 of the EC Treaty, a sort of objections. In this, the Commission identified a large number of point of origin-point of destinations (O&D routes) where this alliance was found to restrict competition and where appropriate measures to avoid the elimination of competition were held necessary. There was a competition assessment of international aviation alliances, notably with regard to market definition as an assessment of potential competition.[129]

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.[130]

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 out of the route concerned where carrier A had a real commercial possibility of entry. 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 had consequences on its examination of the transatlantic

127. Negenman Monique, Directorate General Competition, unit D-2, Number 1, Spring 2003, Competition Policy Newsletter.
128. *Ibid.*
129. *Ibid.*
130. *Ibid.*

alliance between KLM and NorthWest (KLM/NW), where its initial competition concerns were reduced to two hub-to-hub O&D routes, where both parties were competitors prior to the alliance.[131]

By entering into their alliance agreements, 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 identities. In particular, the alliance partners in both cases were engaged in code-sharing, joint pricing, coordination of capacity as well as coordination of marketing and sales activities, and sharing revenue and costs. By entering into the alliance agreements, the parties therefore ended all competition between themselves and this in particular raised competition concerns under Article 81 of the EC Treaty on those city pairs where the parties hold high combined market shares and where they were prior to the alliance either actual (overlap) or potential competitors (the non-overlap markets).[132]

While in the LH/SAS/UA alliance, the commission identified five routes on which the parties prior to the alliance could be considered to be actual or potential competitors and where they held a combined market share varying from 56 to 95 per cent. With regard to the KLM/NW alliance, the Commission came to the conclusion that the alliance restricted competition within the meaning of Article 81(1) of the Treaty on two routes as both the routes were 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 held a combined market share of about 80 per cent.[133]

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 United States), 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.[134]

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 three other routes. In addition, new entrants using the slots, if they were operating a non-stop service, would be admitted to the parties' FFP and offered interlining facilities. Moreover, the

131. *Ibid.*
132. *Ibid.*
133. *Ibid.*
134. *Ibid.*

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(iii) Delta and Northwest A

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135. Philip G. Gayle, "An Empirical
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edu/~gaylep/dlconw-october-
136. Phillippe-Emmanuel Partsch
Airlines Merger: Potentially A
a Significant Impediment to
[2009] E.C.L.R. at p. 491.
137. Decision of August 6, 2008 d
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parties would not participate in that part of the International Air Transport Association (hereafter referred to as '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 parties. Hence, the Commission felt that the argument of the alliance fulfilled the cumulative conditions of Article 81(3) of the EC Treaty.

(ii) Delta, Continental and Northwest Alliance Proposal

The DOT's analysis revealed that the three airlines offered overlapping services in 3,214 markets accounting for approximately 58 million annual passengers. Given the broad nature of discussions that were required to implement the alliance, the DOT was concerned that such communications among the carriers may result in collusion, either tacit or explicit, on fares and service levels.[135]

(iii) Delta and Northwest Airlines Proposal

The EC approved the merger between Delta Airlines and Northwest Airlines under Regulation 139/2004 ("EC Regulation") by its decision of August 6, 2008.[136] An important factor while deciding the case was the extensive cooperation that was already in place between Delta Airlines and Northwestern Airlines within the framework of the SkyTeam alliance, which also included amongst others Air France/KLM and Alitalia.[137] The cooperation within alliances of this kind ranged from plain code-sharing on a single route to worldwide network and fare-coordination.

The EC concluded that airlines within the SkyTeam alliance are not effective competitors. Para 32 and 103 of the decision in COMP/M.5181 *Delta Airlines/Northwest Airlines* convey the said decision.

> "32. *The only change brought about by the merger as regards competition between Delta and Northwest is that the absence of effective competition*

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135. Philip G. Gayle, "An Empirical Analysis of the Competitive Effects of the Delta/Continental/Northwest/Codeshare Alliance," October 2007, available at http://www-personal.k-state.edu/~gaylep/dlconw-october-2007.pdf (last accessed on January 9, 2019).

136. Phillippe-Emmanuel Partsch and Vincent Wellens, "The Delta Airlines and Northwest Airlines Merger: Potentially Anti-competitive Co-operation as a Counterfactual to Assess a Significant Impediment to Effective Competition under the EC Merger Regulation?," [2009] E.C.L.R. at p. 491.

137. Decision of August 6, 2008 declaring a concentration to be compatible with the common market according to Regulation 139/2004 (COMP/M.5181-*Delta Airlines/Northwest Airlines*).

between the will no longer result from cooperation agreements but from their integration into a single economic unit. The merger will create a permanent structural link between Delta and Northwest that replaces the extensive cooperation on transatlantic routes that currently takes place within the framework of SkyTeam."

and:

"103. In light of the relevant counterfactual for the assessment of the present case, the parties and other Sky Team 6 members cannot be considered as effective competitors on transatlantic routes. Accordingly, the present transaction does not eliminate actual or potential competition. The only effect this merger has is it changes the nature of the parties' relationship form cooperation and coordination of their activities to a structural integration."

As mentioned earlier, airline alliances generally provide for a fairly substantial degree of cooperation, including widened networks, code-sharing and cost reductions (via shared back office functions and operational staff, as well as joint purchasing). They can accordingly result in benefits for passengers: lower prices due to reduced costs, a wider choice of flights, destinations and rewards due to reduced costs and more streamlined transfers.[138]

The primary potential benefits of the proposed alliances for consumers, according to airline officials, are additional destinations and frequencies that occur when alliance partners join route networks by code-sharing. The primary source of potential harm to consumers from the proposed alliances is the possibility that they will reduce competition on hundreds of domestic routes if the alliance partners do not compete with each other or compete less vigorously than they did when they were unaffiliated.

The airlines believe that these increases will in turn attract new passengers, allowing them to offer more frequent flights and if demand is substantial, then more destinations. This type of service is generally preferred by airline passengers because it allows the convenience of single ticketing and check-in. Airlines have interline agreements, which offer many of the same services, for some time. Interline agreements provide for the mutual acceptance by the participating airlines of passenger tickets, baggage checks and cargo waybills as well as establish uniform procedure in these areas.[139]

As mentioned above, the EC under the provisions of the EC Merger Regulation cleared the KLM and Alitalia alliance considering that it was

138. Adamantopoulos Konstantinos, Croce Riccardo, and Taillandier Guollaume, "Airports, Airlines, Alliances and Mergers: Increasingly on the Radar of Antitrust Regulators," *The European Antitrust Review*, 2010 at p. 66.

139. *Ibid.*

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140. *Ibid.*

141. OJ 1992, L 96.

142. See in particular C-66/86 Ahmed Sae
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globally pro-competitive. However, the parties had to make certain remedies on the Amsterdam-Milan and Amsterdam-Rome sectors as the EC felt that this would have led to monopoly positions on the two markets. Hence, the remedies included accepting undertakings with a view to attract potential new entrants on these markets and to exercise a competitive pressure on the parties by releasing a significant number of slots on these sectors at the respective airports and reduction of their frequencies on these sectors.[140]

Although slots and gates may make competitive entry more difficult for other airlines, both the airlines' sales and marketing practices may make competitive entry more difficult for other airlines. This includes practices, such as FFPs and travel agent commission, which encourage the travellers to choose one airline over another on the basis of factors other than obtaining the best fare.

Control of abuse of dominant positions is also of high importance in the air transport sector. On the one hand, several Member States conduct their air transport policy in a manner befitting their 'flag carriers' by placing them in the strongest possible position in their home market. On the other hand, these dominant airlines often by means of control of essential facilities and by their overwhelming market share in their local market, hinder competition.

In *British Midland* v. *Aer Lingus*[141] dominance was found as each airline's share was in excess of 50 per cent and there existed both regulatory and practical (lack of slots at congested airport) barriers to entry. When FFPs, override commissions, and excessive capacity or frequency, are practiced by a dominant airline without persuasive business justification and if they have a significant adverse effect on the development or maintenance of competition, they are liable to constitute an abuse in the sense of Article 86.

According to the so-called "point of origin-point of destination" (O&D) city-pair approach,[142] every combination of a point of origin and a point of destination is considered to be a separate market from the customer's viewpoint. This includes the direct and indirect flights between the two airports concerned, alternative transport modes (rail, road, and sea), and flights between other airports whose respective catchment areas significantly overlap with those of the airports concerned (airport substitution). The key test used is whether the scheduled flight on a given route can be distinguished from the possible alternatives by virtue of specific characteristics as a result of which is not interchangeable with those alternatives and is affected only to an insignificant degree by competition from them[143]

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140. *Ibid.*
141. OJ 1992, L 96.
142. See in particular C-66/86 Ahmed Saeed Flugreisen [1989] ECR 803 and the Court of First Instance in C-2/93 Air France/Commission (TAT) (1994), ECR 323.
143. C-66/86 Ahmed Saeed Flugreisen [1989] ECR 803.

For instance, on the market, London-Frankfurt, passengers have the choice between direct flights offered by British Airways and Lufthansa from Heathrow to Frankfurt airport, a direct flight offered by Ryan Air between London-Stansted and Frankfurt-Han, and indirect flights offered for instance by Air France/KLM via Amsterdam and Paris. They may also travel by train or coach. Depending on the type of passenger, the overall traveling time, the quality of service, and the frequency of services offered, some of these services may be considered substitutes while others may not.

Based on market investigations, the Commission distinguished "time sensitive" and "non time sensitive" passengers.[144] Time sensitivity includes several parameters, as the overall travelling time, number of available frequencies and schedule frequency. Time-sensitive passengers are primarily concerned with a maximum of travel flexibility and the main criteria on the basis of which they select a carrier are the number of offered daily flights, the possibility to change reservation at short notice, the convenience of departure/arrival times, the minimization of total elapsed travel time or the location of the airports the flights depart from and arrive at.

The EC considered that on short-haul city pairs indirect flights did not provide a significant competitive constraint on direct services. In exceptional circumstances, due to inadequacy of the direct flights to meet the specific requirements of time-sensitive passengers, indirect flights could exert a certain competitive constraint over direct flights. In the case of long-haul flights, direct and indirect services are considered to be imperfect substitutes.[145] Direct flights were far more attractive to customers, enabling carriers to charge a premium.

Nevertheless, depending on certain characteristics such as the number of frequencies, departure and arrival time and overall travelling time, indirect flights could exert a competitive constraint on direct ones although on short-haul city pairs, indirect flights do not provide a significant competitive constraint on direct services.[146]

Generally a distinction is made between (1) city pairs on which prior to the transaction partner airlines operate direct flights ("direct-direct overlap"), (2) those where one operates direct and the other one indirect flights, and (3) those with an indirect-indirect overlap. City pairs with a direct-direct overlap and which in addition connect the hubs of the respective partners are likely to raise the most serious competition concerns, given that indirect flights can

144. For example, Commission decision July 5, 2002 Austrian Airlines/Lufthansa, OJ L 242 10.09.2002 (Article 81 decision), Lufthansa/Swiss (2005), M.3770; Air France/KLM (2004), M.3280.

145. *Ibid.*

146. *Ibid.*

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only be imperfect substitutes and that there are particularly high entry barriers at hub airports.

V. CONCLUSION

Today most major players in the industry are part of such an alliance with Star, SkyTeam and Oneworld being the main alliances in the industry.

Strategic alliances fall short of outright mergers and in particular, preserve the participant's identity and autonomy. They constitute a framework within which the participating airlines are committed to developing extensive cooperation in technical, commercial and operational areas. Typically, the alliance will endeavour to attain economies of scale by joint equipment purchasing and maintaining, insurance, personnel training, and so on. Often the alliance is supported by small shareholdings by each of the parties in the others. Difficulties would arise where the cooperation eliminates competition on a route or where the partners control access to essential facilities.

Further suggestions include the following:

- Having an "open skies" agreements which are less restrictive in regard to the number and identity of airlines and routes or capacities that can be flown rather than bilateral air agreements which restrict the number of airlines as seen in the proposed BA/AA alliance.
- Clearly, an effective enforcement of the Competition Act, 2002 is an essential part of such a coordinated air transport policy. Accordingly, the need for effective enforcement of the competition rules to international transport has become yet more important. This includes, adding the concept of anti-trust immunity to the Competition Act by defining it so that it may easily be applied to the various provisions of the Competition Act in a more transparent manner.
- The CCI should also enter into MOUs with competition authorities in other countries such as the Federal Trade Commission, EU Competition Commission among others to ensure better coordination and more effective investigation as seen in the proposed AA/BA alliance as have mentioned earlier where there was coordination among the DOT, DOJ, EU Commission, and the UK Office of Fair Trade and hence effective investigation.

Such alliances could be treated as either a merger or as an anti-competitive agreement, or as both, depending upon the facts of the case. The anti-competitive effect is generally examined on the basis of the impact on 'city pairs'. The possible adverse effect of the cooperation on the markets, especially on important 'city pairs' such as Delhi, Mumbai, and Frankfurt as discussed above and the consequences for consumers have to be analysed. According to the Competition Act, if such an alliance has the characteristics of a 'combination', it would require a pre-merger notification to the Commission and the alliance could be effected only after the CCI grants clearance to it.[147] If it would not fall in the definition of a 'combination', no pre-notification would be needed but the alliance could be examined by the Commission either *suo motu* or on the basis of 'information' provided by any party.

147. "Is Jet-Kingfisher Deal Anti-Competitive?," *The Economic Times*, October 17, 2008.

AVIATION SE

I. INTRODUCTION

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148. ICAO Resolution A 26–
149. Speech by Professor Bi
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150. *Ibid.*
151. Speech by Andreas L
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Law, January 1987, Pea
152. *Ibid.*
153. *Supra* note 149.