Has EU Competition Law Failed the Aviation Market?

Solovov, Kirill

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Abstract

Aviation sector has always been a distinct and unique market that has impact across other industries and modes of transport. Airline industry has seen a number of changes over the last decades with the European Union implementing numerous regulatory instruments to achieve its liberalisation goals in air transport market including efficiency and competitive quality of services.

In many ways, an increase in the competition levels may be expected from this liberalisation approach. The liberalisation of the regulatory restrictions represents an important cost driver for the market participants. At the same time however, liberalisation might also be used principally by the government in order to benefit the interests of their public at large.

This thesis examines the role of the European Commission in both its assessment and implementation of its competition policy in the liberalisation process of the EU's airline market. The focus will be on mergers as well as other transactions such as the formation of alliances and joint ventures. Furthermore, the Commission's role in the regulation of state aid provided by national governments around the EU. The thesis also defines market definition as a tool to identify the boundaries of competition between airlines with the adequate market definition being at the centre of the process of application of the EU competition policy.

The analysis shows that while a comprehensive regulatory framework has been achieved during the liberalisation process within the EU dimension, the European Commission is still generally reluctant to accept what will be seen to be a wide network-based approach in determining the impact on competition of the transaction in question which leads to the inadequate approach and ineffective remedies applied by the Commission as part of the enforcement of the Competition policy. Meanwhile, the market environment has been the subject of rapidly changing conditions, with the overall architecture of the airline sector being affected in terms of the operational availability and financial sustainability.

These changing market conditions include rather unusual factors such as Brexit or the unprecedented COVID-19. pandemic for example. This has changed the direction of the competition law in the European Union especially in relation to the implication of the State Aid rules which has had a disturbing effect on the aviation market and competition.

This thesis further highlights and criticise the ineffective nature of the current remedies applied by the Commission.

The thesis concludes by suggesting that the Commission's present approach is inadequate and ineffective, both in respect of the way it addresses liberalisation, but also in the way in which it seeks to advance the competition goals leading to the disturbing practices in the EU's aviation market.

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"[T]he rules of natural justice-or of fairness-are not cut and dried. They vary infinitely."'

Lord Denning

Regina v. Secretary of State for the Home Dep't, ex parte Santillo, [1981] 1 QB. 778, 795 (C.A.) (Lord Denning).

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Kirill Solovov
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CHAPTER 1.
INTRODUCTION

1. *Purpose of thesis*

The objective of the thesis is to analyse the European Union (EU's) competition rules[1] within the aviation sector. Specifically, the thesis will examine the overall effectiveness of these rules within the context of airline market liberalisation.

This introductory chapter discusses what is meant by liberalisation here, and why this has been such a complex topic. The chapter will then examine the research hypothesis put forwards and will detail the contributions made by this thesis. A structure for the rest of the work will also be set out.

2.1. Setting the scene

This section will now examine why adequate competition levels are considered important, particularly in the aviation sector and, secondly, why scrutiny has been raised.

2.2. Research Questions

The European airline sector is the focus of this study. This is an industrial sector which has gone through massive changes over the past twenty years or so, from deregulation, liberalisation, an opening up of competition, emergence of low-cost carriers and then protracted market consolidation as airlines have fought to survive. All of this has been followed by a number of economic crises, and more recently, a general interruption to all travel as a result of public-health mandated 'lockdowns' of entire countries during the Covid-19 pandemic.

In general, an analysis of the trend of EU law here tends towards liberalisation. However, as will be seen, liberalisation and ensuring free competition may be either two sides of the same coin, or, potentially, in conflict with one another. As such, the following, key objective, or research topic around which this thesis is built can be phrased as a question as follows:

"**Have the EU competition rules been successfully applied to underpin the liberalisation of the EU aviation market? And if not, what are the major barriers and how can they be overcome**?"

1 In this thesis, by EU competition rules it is meant the rules in Articles 101 and 102 TFEU, the merger control rules and the state aid rules.

To answer this question following research questions must be answered:

1) What is the framework of EU competition law relating to the aviation market in the EU's internal market?
2) What are the rationales of these rules as far as they impact the aviation market?
3) Is "market liberalisation" a goal of the EU in respect of the aviation sector and market?
4) How do the EU's rules achieve market liberalisation?
5) In summary, has there been a failure to achieve an adequate degree of liberalisation and how can this be shown?

2.3.Background of research: Trends influencing the aviation industry

Despite recent challenges to airlines around the world posed by Covid-19, in general terms, the air transport industry continues to be a profitable and growing one. As such, the industry as a whole is evolving to manage the increasing demand for passenger travel and cargo transportation around the world as well as in the EU.[2]In the face of airport expansion and growing competition among the airlines, airlines are consolidating their position in the industry by pushing their services and products into existing markets to gain a sizable market presence not least considering that the industry is categorised by low margins. Airlines build on this success by broadening into new market regions or developing and marketing new products in their existing regional presence. A strong consolidation strategy is the foundation to diversifying into other market segments. On the other hand, the 'full' service flag carrier business model has come under increasing pressure since the year 2000.

A number of factors help to explain this. Firstly, these types of carriers typically experience more competition at the level of routes. As a result, their share and number of 'monopolised' airport-pairs which these carriers historically might have benefitted from is decreasing. At the same time, increased competition from low-cost carriers has been seen. Perhaps unsurprisingly, financial results of these EU 'flag' carriers have been poor as noted by the reflections set out in the IATA's Vision 2050.[3] It is worth briefly considering some of the reasons why. Firstly, as noted, there has been a consolidation of the EU's airline market itself, resulting in a general decline in share as well as a stagnation or decline in the growth of established national flag-carriers such as Lufthansa of Germany, or Air France for example. This trend in the industry dates from around the turn of the millennium, and in particular

2 Oksana Gerwe, 'The Covid-19 Pandemic and the Accommodation Sharing Sector: Effects and Prospects for Recovery' (2021) 167 Technological Forecasting and Social Change 1, 2.
3 IATA's Vision 2050 available online at; https://www.iata.org/contentassets/bccae1c5a24e43759607a5fd8f44770b/vision-2050.pdf> accessed 14 March 2022.

with notable with the bankruptcies of both Sabena and Swiss Air. Secondly, these 'flag' carriers have been attempting to rationalise their networks since this period of time at the start of the new century in response to increasing competition from both inside the EU market (in particular in response to the rise of low-cost carriers) and outside the EU market including Turkey and the Gulf area. This has been amidst adverse economic conditions such as rising fuel prices and economic downturns. In fact, some airlines have departed from their historic bases, with Alitalia for example having largely dispensed with Milan Malpensa and Iberia having left Barcelona airport, whilst SAS has reduced the scope of its operations from Copenhagen drastically in recent year. Thirdly, the fact that there has been a general stabilisation in terms of the number of frequencies and routes served by the flag carriers may also indicate an overall saturation of the continental market of the EU hubs. In short, the growth potential of the EU's aviation sector market when considered from a 'hub and spoke' perspective may already have been tapped.

Furthermore, unfair competition and level playing field debates have intensified. This has been notable in respect of the development of aviation markets throughout the world. Good examples include the long-haul hub and spoke system operated in the Gulf States by carriers such as Emirates for example, [4] and at the same time, the EU is seeking to ensure its open market agenda is encouraged to operate with adjacent and neighbouring states in mind. These non-EU states based in neighbouring regions to the EU, in the Mediterranean, or in East or South Eastern Europe for example, are then encouraged to ensure alignment of their own aviation rules with those of the EU so as to ensure seamless access to the EU's market.[5] The Commission here plays a leading role as it must prepare that alignment and carry out the negotiations.

Many of these surrounding states have proved willing to align in this manner with the EU's rules in order to ensure that their designated air carriers receive access to the attractive EU internal market in return. Additionally, these states and their carriers may then also be able to count on financial and technical assistance from the EU. However, in other parts of the world, states continue to wish to decide their own pace of liberalisation, for political, policy, or commercial reasons. Another factor to consider here is that airlines tend to replace aging fleets with more modern and fuel-efficient aircraft as and when they can. This means that . there is an expected retirement of existing fleets over the next 20 years which will in turn, create significant demand for modern planes with greater efficiency to

4 Jaap G. de Wit, 'Unlevel Playing Field? Ah yes, you mean Protectionism' (2014) 41 Journal of Air Transport Management 22, 24.

5 Sandra Lavenex, 'The Power of Functionalist Extension: How EU Rules Travel' (2014) 21 Journal of European Public Policy 885, 885.

penetrate the market.[6] Replacement of older fleets with optimised aircraft will naturally boost profitability and efficiency for those airlines able to do so. This is particularly so as aircraft are optimised for size depending on route, with single-aisle segment aircraft for example being more efficient on shorter routes. As such, given the geography of the EU and its territorial scope, it might be expected that single-aisle aircraft in the 100 - to 150-seat segment will be critical to the growth of hub-and-spoke networks within the EU, as well as the establishing of competitive but profitable point-to-point short-to-medium haul routes. This is something which is beginning to be put into effect, as it is estimated that some eighty-six percent of the current fleet in this segment, a massive proportion, will be ready to retire by 2036.[7]

Having said that, some airlines started to face intense competition from high-speed rail and low-cost rivals which has led to a scaling back of the domestic networks together with the reduction of the headcount through redundancies[8].

3. Objectives

The objectives of this thesis are to provide enough evidence that the concept of the Single Aviation Market has not been fully implemented in practical terms, and to identify relevant instruments and mechanisms to mitigate and overcome the existing conflicts as well to develop a flexible and robust assessment model to assure accurate examination of the market conditions and forecast of the relevant outcomes as part of the transactions' evaluation. The notion of 'Market' here is defined by the narrow approach and in certain circumstances by the national interests rather than perhaps the market's own interests or desires, and those of the players on such a market, and as a result such definition might contradict the fundamental principles of the fair competition.

4. Methodology

The research approach that has been adopted is in line with the research question. The research problem in this thesis has originated from the evaluation of the cases, expert opinions and from information that is gathered from published sources. These form the base of the problem statement and research question in this particular thesis. The study that has been conducted is primarily doctrinal in nature, to

6 Rico Merkert, David A. Hensher, 'The Impact of Strategic Management and Fleet Planning on Airline Efficiency – A Random Effects Tobit Model based on DEA Efficiency Scores' (2011) 45 Transportation Research Part A: Policy and Practice 686, 688.

7 Samarth Jain, William A. Crossley, 'Predicting Fleet-Level Carbon Emission Reductions from Future Single-Aisle Hybrid Electric Aircraft' (2020) AIAA/IEEE Electric Aircraft Technologies Symposium (EATS) available online at; < https://ieeexplore.ieee.org/abstract/document/9235168> accessed 14 March 2022.

8Myles McCormick and Josh Spero in London and David Keohane. Air France to cut jobs amid 'fierce' competition. Financial Times. 13/05/2019 available online at: <https://www.ft.com/content/599f7718-7571-11e9-be7d-6d846537acab> accessed 14 May 2019

analyse both the rules in themselves and how they have been applied individual cases, to assess whether the rules themselves and their application has been successful or not vis-à-vis the stated liberalisation objective and demonstrate the alternative scenarios with different variables.

This study has adopted a mixed methods approach using complementary research methods in order to identify discrepancies, generate new criteria and validate findings.

This thesis reflects the law as it stood in May 2022. This thesis employs, in all of its substantive chapters, a doctrinal legal research methodology, which comprises of the analysis of the relevant case law, decisional practice, legislation, policy documents and literature in Europe and, partly, the United States of America. These are based in turn on the analysis of the aviation regulations and competition rules of the EU. These findings will determine whether categories of anticompetitive conduct, relating specifically to aviation sector present in Europe. Analysis is to be supported by the economic context. Without a sound understanding of the underlying legal and economic reasons behind competition - policy decisions in the field of the aviation, a reasoned and comprehensive analysis would not be possible. The study therefore also takes industrial economic principles into consideration, supported by empirical evidence where available.

The thesis also adopts a comparative method, as a means of assessing the suitability of the Competition's approaches and tests applied, market participants power before and after the transactions under the scrutiny, measuring and explaining similarities and differences between the approaches and cases under review as well as a tool in assisting to refine an individual approach by applying the comparative technique providing with a critical perspective on the current legal regime by contrasting it with the hypothetical scenarios. A comparative method adds a critical tool for analysis on the EU competition policies. In addition to that, the comparative method allows for identification of conflicts and similarities in legal concepts. An extensive on-line search was conducted using textual analysis to arrive at a comprehensive list of all airlines and deals that have been assessed by the EU Commission. Qualitative and quantitative data were analysed together.

5. Scope and Limitation

It is generally understood that competition begins to be effective once there are at least three carriers present on a market. This is because the presence of three carriers at least prohibits the formation of either monopoly or duopolies (although just three market participants might also be considered a triopoly). Of course, it is not sufficient to say that a duopoly is always necessarily anti-competitive. It

is rather that the existence of duopolies is more likely to create a risk of harm to competition than is the case if more network participants are present.[9]

From a general perspective, since competition can only be effective with more than two carriers competing in a market, in some developing countries, effective competition may simply not be possible on some of the routes due to the absence of a carrier on many of the routes. This will be so if the absence of competition leaves a route with a monopoly or duopoly serving it. Hence, the impact of liberalisation in such a situation may differ depending on whether or not such liberalisation actually allows new entrants to break into a market. Based on the problem statement and research question, this thesis will predominantly focus on identifying the accurate variables and assessment criteria required to implement the fundamental principal of preserving competition with the EU Aviation Market.

6. *Brexit*

The trade agreement agreed between the UK and the EU of 24 December 2020 came into force on 31 December 2020It runs to 1,449 pages, of which 26 deal with aviation.

Aviation was something of a side-line in Brexit and was never really influential in the debates around the UK's exit from the EU, and nor was it about improving the European aviation system in general. There were, however, serious concerns that the existing conditions of liberalisation would be seriously eroded. Fortunately, these have mostly been avoided under the terms of the agreement even if the outcome is less than optimal.[10]

In summary, compared to the *status-quo ante* typified by the UK's membership of the EU and its single market, the new agreement represents an unprecedented reversal of liberalisation in aviation. There do remain wrinkles to be ironed out on the subject of airline ownership and control, causing some airlines to go through unnecessary contortions at present, and there is at least some risk of divergence over time in areas such as aviation safety and consumer protection.

Despite these problems however, it is also fair to say that compared with older style bilateral agreements historically agreed between states– the TCA still represents a fairly liberal agreement. The

9 B Graham, 'Liberalization, Regional Economic Development and the Geography of Demand for Air Transport in the European Union' (1998) 6 Journal of Transport Geography 87, 87.
10 CAPA Centre for Aviation, 'Brexit and Aviation: All's Well that Ends. Well, almost…' (2021) available online at: <https://centreforaviation.com/analysis/reports/brexit-and-aviation-alls-well-that-ends-well-almost-548205> accessed 14 March 2022.

agreement largely preserves the regulatory status quo as much as possible without actually keeping the UK in Europe's single aviation market.

7. Covid-19

There has been a dramatic drop in demand for passenger air transport and freight due to the COVID-19 pandemic and subsequent public-health containment measures. This in turn has threatened the viability of many organisations in both the air transport sector as well as the rest of the wider aviation industry placing many jobs at risk.

8. Structure

Firstly, this thesis will analyse M&A activity, predominantly, within the European Union and will be supported by the case law. Although the EU's Merger Regulation (previously Council Regulation (EEC) No 4064/89[11], now falling instead under Regulation 139/2004)[12] has been applied numerous times since its introduction in this area, there are of course landmark cases. There have for example been few decisions as monumental as that in the Commission's decision regarding the Boeing Company's (Boeing) takeover of McDonnell Douglas Corporation (MDC). This case is helpful for the purpose of this thesis as highlighting the various elements and concerns attributed to the approach taken by the Commission in regard to the transactions under the question including the scope of the operational activities as well as public policy issue. While not directly involving air transportation, much of the Commission's analysis in the case would have equal applicability for air carriers.

The background to the case was as follows. In December 1996, Boeing and MDC concluded a purchase agreement under which MDC would become a subsidiary of Boeing. This transaction meets the basic definition of a 'concentration' in EU law as set out within the terms of the Merger Regulation.[13] The Commission was quickly able to establish that the Boeing-MDC agreement fell within its purview under the merger regulation, allowing them to begin analysis of the likely effects of the agreement.

While it was determined that Boeing indeed occupied a dominant position in the commercial jet aircraft market, already used its competitive advantage to engage in predatory pricing to drive other industry competitors from the market and that the merger strengthened Boeing's dominant market position *vis-*

11 Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings OJ L 395.

12 Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings OJ L 24.

13 Commission Decision 97/816/EC, (5) - (6), 1997 OJ. (L 336) 16, 17.

a-vis the rest of the industry players, because the proposed merger effectively impeded true competition across Member States, the Commission decided against blocking the merger.

Instead, the transaction was approved subject to Boeing agreeing to certain concessions which appear to be illusory.[14] It has been indicative that the decision to propose concessions as an alternative to blocking the merger directly contradicts the Regulation and economic integration. The *Boeing* decision clearly compromises the merger law of the European Union, presumably for the political reasons.[15]

Another factor to be considered is the different types of the cooperation which might fall within Articles 101 and 102 TFEU. Airlines have sought to achieve this within the scope of EU law by engaging in alliances, with the main goals being to ensure fleet rationalisation, or to continue with their expansion plans and to take advantage of economies of scale for example.

In summary, whilst it is the case that multiple connecting options by airline alliances clearly benefit many consumers, there is also credible evidence to suggest that some major alliances may have anticompetitive effects in certain markets. Given the real potential for the use of such alliances to create a virtual amalgamation of airlines into a few mega-airlines, it is reasonable to suggest that the consolidation in the form alliances have to be cautiously scrutinised by the Commission. This thesis will also examine the assessment criteria applied by the Commission to define the relevant market.

In addition to considerations over mergers and alliances, the provision of State Aid is also an area which will be examined here. An analysis of key policy issues arising from the provision of state aids to European airlines and airports will be conducted using several case studies. The thesis will analyse approaches taken by the Commission to determine whether the circumstances are appropriate for the State Aid, and what factors the Commission examines including a carrier's debt to equity ratio, their cash flow, operating costs, labour productivity, fleet condition, and commercial strategy along with the "general economic environment of the airline industry in order to decide whether a coherent restructuring program to restore profitability must be offered. It will also assess the Commission's view on the indirect subsidisation such as loan financing and loan guarantees with the factors including the level of the interest rate and what collateral is required, as well as the financial position of the company at the time the loan is made and specific conditions under which the carrier operates.

14 Jeffrey A. Miller. The Boeing/McDonnell Douglas Merger: the European Commission's Costly Failure to Properly Enforce the Merger Regulation. Maryland Journal of International Law. Volume 22 | Issue 2 available online at: <https://core.ac.uk/download/pdf/56358984.pdf > accessed 12 June 2023.

15 Ibid.

The thesis will then conclude by showing that the fact that some European airlines are still state-owned or are largely subsidised for political reasons, and that these compromises undermine the ability of liberalisation measures premised on free market principles to work effectively. The thesis will also present some solutions needed to rectify this situation, with some practical examples i.e., the denationalisation of British Airways by the British Government for example.[16] This thesis will also critically evaluate the procedures used in practice by the Commission to assess different types of state aid and, in each case, some of the limitations of the approaches taken are identified, including their treatment of market definition with the major concerns due to the market reshapes and its impact on the competition to be discussed Finally, this thesis will conclude that the Commission has failed to prevent anti-competitive practices and it shall reconsider its enforcement priorities in applying the legislative measures.

16 Colin Marshall, 'Opening the Skies: The Prospects for European Airline Deregulation' (1989) Journal of European Business (Sept.-Oct) 43, 44.

CHAPTER 2.
LIBERALISATION AND COMPETITION

1.1. Introduction

This chapter of this thesis will examine the concept of liberalisation, at least as far as it attends the aviation sector in the EU, and the relationship between the ideas of 'competition' on one hand, and between 'liberalisation' on the other. As might well be expected, the two concepts do go hand in hand, increased liberalisation is likely to lead to increased competition. Liberalisation however is something which is designed to ensure an increase in competition, at least as is so far as possible, and will usually do so. The aviation sector however is something of a different beast to most others, as a result of factors such as its size, and the many high-barriers to entry and capital and technical requirements which are faced by new entrants into this sector. In order to determine the specific link between liberalisation and competition in the aviation sector within the EU, and to analyse the EU's attempts at engaging in liberalisation, this chapter will explore this area in greater depth.

1.2. Definition of liberalisation

Liberalisation may broadly be defined as Aggarwal does, as being "the removal or loosening of restrictions on something, typically an economic or political system".[17] The general distinction between liberalisation and deregulation is as follows. Firstly, liberalisation may mean the reduction of constraints imposed upon the existing actors in the marketplace. Secondly, deregulation meanwhile may refer to the abolition of all restrictions dominating the air traffic marketplace, thus providing free access to international air transport.[18] Although both are liberal aviation policies, liberalisation addresses existing companies and attempts to lift gradually the restrictions imposed upon them. Deregulation goes a step further and aims for unrestrained entry into both national and international markets, and free competition under free enterprise conditions.[19] There is therefore a subtle difference between the terms, and Europe has chosen the liberalisation approach. The United States is characterised meanwhile by intentional deregulation since the introduction of the Airline Deregulation Act of 1978,[20] which yielded only mixed results.[21]

17 Preeti Aggarwal, *SSC English* (1st edn Radian Learning 2020) 34.

18 Reports of Conferences, 12 AIR L. 303, 306 (1987) (Fourth Lloyd's of London Press International Aviation Law Seminar, Algarve, Portugal, Oct. 11-16, 1987) cited in Stacy K. Weinberg, 'Liberalization of Air Transport: Time for the EEC to Unfasten its Seatbelt' (1991) 12 University of Pennsylvania Journal of International Law 433, 435.

19 HA Wassenbergh, 'New Aspects of National Aviation Policies and the Future of International Air Transport Regulation' (1988) 13 AIR L. 18, 20.

20 Airline Deregulation Act of 1978 Pub L. 95-504 92 §1705.

21 Alfred E. Kahn, 'Surprises of Airline Deregulation' (1988) 78 The American Economic Review 316, 316; George E. Samuels, 'Airline Deregulation: Its Effects and the Competitive Environment' (1990) 2 International Journal of Transport Economics 131, 134.

In the aviation market, European aviation policy has always been, and remains the product of the conflicting and competing legal, economic and political interests.[22] The key stakeholders include major publicly owned airlines, the European Union itself, and a number of air transport associations such as EASA as well as the EU's Member-States and their governments. The complexity of the regulatory regime is characterised by several factors, including the state-owned originality of the major airlines, attempts by the governments to protect national interests and high fixed cost structure and rather low variable costs.[23]

Overall, the immediate legal initiative towards present changes in Europe came from the Treaty for the establishment of the European Economic Community[24] (EEC Treaty; later EC Treaty, now TFEU). The principal provisions of the Treaty on the Functioning of the European Union (TFEU) that are relevant to air transport are Articles 90 et seq. (Title VI Transport) that concern the adaptation by the Member States of a common transport policy, and Articles 101 et seq. (Title VII Common Rules on Competition, Taxation and Approximation of Laws, Chapter 1 Rules on Competition, Section 1 Rules Applying to Undertakings) that among other practices, prohibit undertakings from making anticompetition agreements and abusing a dominant position. Conditions of fair and open competition are essential to achieve the appropriate balance between the interests of consumers and airlines, while safeguarding the overall public interest. For that reason, the Open Aviation Area concept shall be mentioned which is intended to cover not only the general liberalisation of freedoms of the air between bilateral parties, but also to stimulate and create a general commitment to regulatory convergence and to harmonisation of air transport standards including in the area of competition regulation. Objectives of the OAA include to remove barriers to entry, as well as to limit or even to eliminate state aids that can promote excess capacity and weaken the overall industry being one of the major issues as regards the creation or maintenance of level playing fields across the EU's aviation market.[25]

1.3. Free market and market access

A keystone element of liberalisation, market access provisions have been a primary focus of the Council and Commission for many years. Historically, market access was predicated on bilateral agreements between individual states (i.e., nations would independently negotiate terms of market

22 Paul S. Dempsey, 'Competition in the Air: European Union Regulation of Commercial Aviation' (2001) 66 Journal of Air and Commerce 979, 1153.

23 Andreas Wittmer, Tobias Bieger, 'Fundamentals and Structure of Aviation Systems' in Andreas Wittmer and others (eds), *Aviation Systems: Management of the Integrated Aviation Value Chain* (1st edn Springer 2011) 27.

24 EEC Treaty of 25 Mar.1957 (BGBl. 1957 II 766, corrected 1678, and 1958 II, 64), came into force on 1 Jan. 1958, publication on 27 Dec. 1957 (BGbl. 1958 II).

25 Erwin Von Den Steinen, *National Interest and International Aviation* (1st edn Kluwer Law International 2006) 143.

access for each other's air carriers).[26] However, this type of bilateral agreements go against one of the key central planks of the EU: establishing uniform laws and regulations among Member States to advance commerce, including transportation. Thus, the Council and Commission have worked to establish a body of regulations governing intra-Union market access[27] and have increasingly sought to replace the bilateral agreements that exist between Member States and non-members with EU-negotiated multilateral agreements.[28] The EC/ EU's internal efforts at improving market access have been primarily directed at four areas: standardising licensing of air carriers, eliminating capacity limits on routes, making full cabotage available, and regularising slot allocation.[29]

1.4. Fair competition

Absent a global understanding of 'core principles' which might help define it under the WTO/GATS regime, or indeed, any other international regime, the scope of liberalisation of international air transport has yet to be determined. Nevertheless, the introduction of 'fair competition' principles plays a principal role. These principles are based on the Resolutions reached by the 38th General Assembly of ICAO of 2013. The principles contain the following ideas on liberalisation. These include a discussion of 'fair competition' principles in the context of competition law regimes, the avoidance of conflict between competition law regimes and bilateral air agreements, the scope and nature of the ICAO's engagement with the gathering and analysis of competition laws and enforcement actions worldwide. Additionally, the ICAO considered the nature of cooperation between competition authorities on a bilateral, regional or multilateral level and the way in which this might help to improve competition outcomes Hence, ICAO appears to support liberalisation by drawing up core principles affecting 'fair competition'.[30] It adopts a more reserved stance with respect to the question of State aid.

Although it does not apply to the operation of air transport services, the WTO regime offers an interesting model in terms of procedures, provisions and measures for liberalisation. The air transport sector takes a special place in trade law as trade in air services are governed by bilateral or plurilateral (e.g., EU-US) agreements in which questions of 'fair competition' and especially State aid have not, not yet or only partially found a place.

26 Daniel C. Hedlund, 'Toward Open Skies: Liberalizing Trade In International Airline Services' (1994) 3 Minn J Global Trade 259, 267-69.

27 Council Regulation 2408/92, pmbl., 1992 O.J. (L 240) 8, 9.

28 Chris Thornton, Chris Lyle, Freedom's Paths, (2000) Airline Bus. Mar. 74, 74.

29 Paul Stephen Dempsey, *European Aviation Law* (1st edn Kluwer Law International 2004) 63.

30 Ibid.

1.5. Liberalisation and its purpose

One of the primary purposes of liberalisation according to some of the theories is to make air transport services competitive. This acknowledges the role which liberalisation has in increasing competition, as noted earlier. From a more conceptual level, the perceived benefit of this liberalisation is that it might improve airline efficiency and quality of service, thus benefitting consumers and constituents within the marketplace All of this however, is of course built upon the fundamental assumption which is that liberalisation must result in an increase in the competition levels depending on market regulation, whether that be free entry, free capacity, free pricing, or all three.[31]

The European Union adopted comprehensive liberalisation of its air transport market and formed a single market in which remarkable achievements were recorded. The success of European deregulation is another notable benchmark. The economic liberalisation of air travel was part of a series of deregulation moves based on the growing realisation that a politically controlled economy largely served no continuing public interest and was at odds with attempts to liberalise in the area. That said, it remains true that the practice and effects of liberalisation in Europe are different in scope and magnitude compared with other jurisdictions, for example, in the US.[32]

Historically, much of the institutional framework of regulation in this sector developed in response to developments in air transport technology, as well as a result of the wider economic and political picture seen during the early and mid-20th century. In some places, states pursued regulation policies designed to actually curtail domestic air transport competition. The aim was to promote public interest by enabling people to enjoy a safe and adequate transport service provided by financially sound and reliable carriers, and this was a product of the technological and general concern of the times, many of which are no longer present concerns. In the nascent EU, the overriding regulatory policy concern established by European governments was aimed at protecting mostly publicly owned flag-carrier airlines from competition. By tightly controlling market entry on both domestic and international routes, the countries were able to provide their carriers with a virtual monopoly.[33]

According to the ICAO air transport regulation insinuates the process of giving authoritative direction to bring about and maintain a desired degree of order for an expected result. This involves the

31 Joseph Berechman, Jaap de Wiit, 'An Analysis of the Effects of European Aviation Deregulation on an Airline's Network Structure and Choice of a Primary West European Hub Airport' (1996) 30 Journal of Transport Economics and Policy 251, 255.

32 K Button, 'Deregulation and Liberalisation of European Air Transport Markets' (2001) 14 Innovation: The European Journal of Social Science Research 255, 275.

33 G Williams, *The Airline Industry and the Impact of Deregulation* (1st edn Ashgate 1994) 66.

regulatory structure and a legal framework in the form of licences, regulations and agreements. Also, all air transport regulations contain some content of the particular subjects being regulated such as market access, pricing and capacity. Overall, the process and structure of international air transport regulation has three distinct venues – national, bilateral and multilateral. There is empirical evidence that liberalisation of international transport has imparted considerable incentives for passengers and the economy. Morrell has claimed that there was a significant increase in traffic demand on most of the routes in Europe after liberalisation.[34] Button has found that the EU single aviation market had greatly increased competition on many routes resulting in more new routes being operated, leading to a 34% decline in average air fare.

Some organisations such as the World Trade Organization (WTO) and the IATA have sought to progress further liberalisation of the sector on the assumption that further benefits would accrue from this. Nevertheless, it is notable that the IATA identified a number of areas where difficulty might arise, such as in respect of national sovereignty, the overstretching of critical infrastructure, labour concerns, the needs of developing states and so on.[35] On the other hand, the aviation markets of developing countries can be a source of survival for some countries' airlines with extensive competition. In most developed countries aviation markets are at saturation level while in many developing countries the market is in a growth phase; therefore, foreign investment can be a source of survival for some airlines.[36]

In addition to that, restrictions on airline ownership and control has been found to withhold certain benefits from passengers and the economy, with limited access to new and cheaper sources of capital and managerial talent.[37] InterVISTAS-EU (2009) claimed that liberalising airline ownership and control could provide airlines with access to new and cheap capital sources through mergers and consolidation. As per the Commission Notice (2017) , there is an obvious need to bring more clarity for investors and air carriers alike on the application of the current regulation with respect to the provision on ownership and control[38] with the objective of safeguarding the interests of the EU air transport industry which implies, in particular, that companies from third countries must not be allowed

34 P Morell, 'Air Transport Liberalisation in Europe: The Progress So Far' (1998) 3 Journal of Air Transportation World-Wide 42, 42.

35 IATA, 'The Economic Impact of Air Service Liberalization: Executive Summary' available online at; < https://www.iata.org/en/iata-repository/publications/economic-reports/the-economic-impacts-of-air-service-liberalization---intervistas/> accessed 14 March 2022.

36 Bijan Vasigh and other, *Introduction to Air Transport Economics: From Theory to Applications* (1st edn Ashgate 2008) 59.

37 Roberto Piermartini, Linda Rousova, 'Liberalization of Air Transport Services and Passenger Traffic' (2008) WTO Economic Research and Statistics Division Staff Working Paper ERSD-2008-06.

38 COMMISSION NOTICE of 8.6.2017. Interpretative guidelines on Regulation (EC)1008/2008 - Rules on Ownership and Control of EU air carriers.

to take full advantage, on a unilateral basis, of the EU liberalised internal air transport market and ensuring a balance between financial benefits and national interests bearing in mind the nature of the aviation section as of strategic importance.

Also, a special point on the current and future international air transport agenda concerns the question of 'fair competition' as a result of the entry of Gulf carriers into markets which were so far dominated by EU and US carriers. Chinese, Indian and South East Asian carriers are also affected by the articulated presence of these Gulf carriers in their respective markets. While the US and the EU, especially the EU States, try to resolve this perceived imbalance in bilateral relationships, the EU Commission, ICAO and other States are working together to promoting standards for 'fair competition' internationally. Various mechanisms are being proposed in order to address this question. They include but are not limited to: addressing state aid, which is perceived to be a driver behind the operations of the Gulf carriers, in a bilateral, interregional or global context; including 'fair competition' clauses as formulated by the EU Commission, EU States or ICAO in bilateral air services agreements, or, more generally, international agreements on air transport; or, from requesting more transparency on the financial accounts of the carriers in question before granting traffic rights[39].

From the market perspective, intra-regional routes continue to dominate the air travel market, growing 5 percent CAGR through 2036. Intra-regional routes are also markets that generate the highest yield. This trend will support point-to-point service on short-to-medium haul routes, creating opportunities for more profitable service models on new and previously thin routes.

2.1 The regulatory framework

Prior to the process which led to the establishment within the EU of the single market in 1993, the air transport market across the whole of Europe was a largely fragmented collection of national markets. Domestic air services within each country were governed by national rules which varied enormously in the degree to which competition was permitted or promoted, as is the case in much of the rest of the world. As an example, international air transport in Europe, something which is now largely seamlessly carried out in the EU, was governed prior to the establishment of the single air market, by bilateral air services agreements being signed between each pair of countries. Although some of these agreements were relatively liberal, all contained traditional ownership and control restrictions and many restricted

39 Guillame Burghouwt and others, 'EU Air Transport Liberalisation Process, Impacts and Future Considerations' (2015) OECD available online at; < https://www.oecd-ilibrary.org/transport/eu-air-transport-liberalisation-process-impacts-and-future-considerations_5jrw13t57flq-en> accessed 14 March 2022.

market access and capacity, frequently allowing only one airline from each country to operate services, often on a limited number of specified routes. International fares were generally agreed between airlines under the oversight of IATA and both international and domestic fares were usually subject to government regulation.

2.2. The First Steps towards Liberalisation

With the development of two international agreements in 1987 which permitted partial capacity and tariff liberalisation, the European Civil Aviation Conference (ECAC) took the first steps in Europe towards liberalising the air transport market. However, it was only within the EU that the real progress towards full liberalisation has been made, as this was made possible or more likely by the EU's institutional framework and its general impetus towards economic integration, as well as by the powers and competencies held by the Commission and Council which have allowed a framework of law to be created in this area. A process of progressive liberalisation swept away the pre-existing institutional barriers to entry and competition and created a genuinely single market within the EU. This has since been extended to cover Iceland, Norway and Liechtenstein through the creation of the European Economic Area, while Switzerland is also now associated with the market through a bilateral agreement. In advance of their full accession to the EU, negotiations are under way with eleven more ECAC States on the early creation of a yet wider European Common Aviation Area based on EU rules.

The Third Package of liberalisation measures which took effect on 1 January 1993 represented the culmination of a gradual process of dismantling the bilateral restrictions which had begun with the First Package in December 1987. Most significantly, the Third Package gave practical effect for the first time in the air transport sector to the right of establishment provisions of the Treaty of Rome by introducing common licensing criteria for air carriers across the whole of the EU. It replaced national ownership and control restrictions with the concept of a "Community air carrier", under which EU airlines must be majority owned and effectively controlled by EU Member States and/or nationals of EU Member States. Any airline meeting these (and specified financial and safety) requirements must be licensed by the EU Member State in which it has its registered office and principal place of business. Once an airline has been granted an Operating Licence by any EU Member State it is afforded the rights laid down in the Market Access Regulation, which allows airlines to exercise traffic rights on virtually any route within the EU. The Air Fares Regulation also establishes the right in principle for airlines to set their own fares freely.

Having said that, in order to accommodate EU Member States who felt that their national markets would need time to adjust to the notion of a completely open environment, the regulation did not seek to abolish national markets in a single step. It essentially provided for a transitional period during which a number of provisions circumscribed the general right of access in certain respects, mostly relating to domestic services. The most significant restriction which continued to apply after 1 January 1993 was that relating to cabotage services - domestic services operated in one EU Member State by a carrier licensed in another Member State. EU Member States were not obliged until 1 April 1997 to open their domestic markets to free competition from all EU-licensed carriers, although airlines were entitled to operate consecutive cabotage services as extensions to services to or from their own state provided that no more than 50% of the capacity was made available on the cabotage sector. Provision was also made for Member States to impose public service obligations on routes to regional airports in their territory which were considered vital for economic development so as to ensure that air services would be provided.

2.3. The Application of Competition Law to the Sector

The removal of restrictions on market entry, capacity, frequency and pricing resulted in greater emphasis being placed on the use of normal competition law to safeguard against anti-competitive behaviour and abuse of market power. In fact, rules had already been adopted in 1987 that gave the European Commission the power to apply the competition rules of the EU Treaty to air transport services within the EU and to adopt certain group exemptions. Currently, Article 101 prohibits agreements between entities which prevent, restrict or distort competition unless those agreements can be shown to promote technical or economic progress and that consumers enjoy a fair share of the resultant benefits. Article 102 prohibits the abuse of a dominant position. The Commission also has exclusive competency to assess the competition issues raised by a transaction that falls within the scope of the EU Merger Regulation. The Commission does not yet have equivalent investigation and enforcement powers for air transport between the EU and third countries.

Specific block exemptions concerning certain categories of agreement in the air transport sector were adopted and, while some have since been removed, those relating to consultations on passenger tariffs on intra-EU scheduled air services and slot allocation at EU airports remain in force. The effect of these block exemptions has been that operators have not needed to apply to the Commission for an individual exemption each time they are involved in these practices.

Early in the liberalisation process the Commission also adopted a strict policy to apply the EU Treaty's provisions on state aid to the airline industry and, in particular, attached a clear "one-time, last time" condition to any state aid that it approved. The Commission has left little doubt in its communications that a second injection by Governments not in accordance with the "market economy investor principle" will only be considered in the most exceptional of circumstances and in light of unforeseeable events external to the company.

At the end of the 20th century while liberalisation did make some aspects of the European air transport industry more competitive, alliances seemed to take the place of mergers. Thus, whilst the anticipated consolidation thus occurred, but in a manner that might be even more potent than pure monopoly.[40] These alliance structures presented their own somewhat oblique uncompetitive challenges.

The competition rules were promulgated in the wake of the *Nouvelles Frontieres* case[41] to forestall the Member States from seizing authority over air transportation regulation, while the merger regulation was created in the late 1980s as part of a surge in Community regulatory powers in anticipation of the coming formation of the EU. Unlike the antitrust regulations of the United States, these various regulations and treaty provisions are intended not so much to prevent the formation, or force the dissolution, of monopolies, but rather to prevent an undertaking, or group of undertakings, from achieving a market position that makes competition impossible or injures the consumer.[42] Both categories of competitive measures have played key roles in the shaping of the EU air transport industry. Before proceeding with the analysis of the competition rules, however, there is a broader issue, which includes both of them and is especially noteworthy in the realm of international air transportation.

While airline deregulation in the European Union has been a major step towards a fully liberalised aviation market. In consequence, Europeans benefit from many discount fares and a network of additional routes within the E.U., a single aviation market has not yet been accomplished because deregulation alone is not a sufficient prerequisite for intense competition. According to Scharpenseel [43], the regulatory bias rooted in public ownership is something structural problem, which can only be solved by selling the national carriers to private owners. In truth however, even this might not be

40 Peter Forsyth and others, 'Airport Alliances and Mergers – Structural Change in the Airport Industry?' (2011) 17 Journal of Air Transport Management 49, 51.

41 Paul S. Dempsey, 'Competition in the Air: European Union Regulation of Commercial Aviation' (2001) 66 Journal of Air and Commerce 979, 1153.

42 G. Porter Elliott, 'Antitrust at 35, 000 Feet: The Extraterritorial application of United States and European Community Competition Law in the Air Transport Sector' (1985) 31 George Washington. Journal of International Law & Economics 185, 185.

43 Moritz Ferdinand Scharpenseel, 'Consequences of E.U. Airline Deregulation in the Context of the Global Aviation Market,' (2002) 22 Nw. J. Int'l L. & Bus. 91, 91.

sufficient to prevent inherent structural bias towards those carriers regarded as a prestige national flag carrier, irrespective of its ownership structure.

2.4. Impact of liberalisation

There is a strong opinion that liberalisation in the EU has not led to dramatic changes, like those in the U.S., following deregulation of air transport.[44] Nevertheless, there were notable changes following liberalisation. The first such change is that there was above average total growth in air transport in the E.U., made arguably all the more notable as that part of the liberalisation process took place during a general, EU wide economic recession. Second, the number of routes operated in the E.U. increased sharply. Whilst there had been some 490 intra-EU routes available in 1992, this grew to 520 in 1996, primarily because of the introduction of new non-stop connections of former charter operators that took up scheduled services.'[45] With respect to the creation of new airlines meanwhile, market dynamics have been most visible. Over three years after the implementation of the third aviation package of 1993, eighty licenses have been granted and eighty companies were created, while sixty have disappeared indicating a dynamic and highly competitive arena As far as airfares are concerned, the impact of liberalisation is still difficult to assess, but it has been found[46] that on routes where two or more airlines were operating, airfares have generally been much lower, than on routes without competition.

3.1.Competition and liberalisation. Introduction

Competition is crucial to any liberalisation process, where regulatory authorities should retreat while economic agents take over (in the airline industry as well for airports). Only free and open markets, in fact, force companies to compete on their merits. If competition, by its nature, implies rivalry and foreclosure, the issue is to keep the competitive strategies within the space of compliance to competition law. In this contest, the role for Competition authorities (enforcing competition rules) should not be to influence the market outcomes (in terms of number of players, price and quantities), but – as a referee – to preserve the contestability and competitiveness of the air transport markets in the light of the current regulation by identifying and effectively adjusting the market impairments attributed to the market behaviour of individual players.

44 Consequences of E.U. Airline Deregulation 22:91 (2001).

45 Romina Polley, 'Defense Strategies of National Carriers' (2000) 23 Fordham Journal of International Law 170, 172.

46 British Midland, Clearing the flight path for competition, June 1996, quoted in Barry Seal, Memorandum of the European Parliament regarding COM (96) 514 final, January 21, 1998, at 11.

While maintaining the economic stability of the airline sector might be a priority in a short term, in the mid- to long-term, consumer and social welfare require preserving competitive and contestable markets to mitigate the risks of cartelisation with air carriers fixing prices or allocate routes or customers, as well as State aid to specific national airlines to the detriment of other eligible companies.[47] By this way the sub-set of competition-distorting strategies put in practice by operators (leading to exploitation of market power in terms of output restriction and price increase) would be reduced, while the sub-set of efficiency-promoting strategies (including those aiming at excluding less efficient competitors) would be maximised, with the likely final result of increasing consumer welfare.

3.2. Literature Review

The liberalisation of restrictions of air services has been an important aspect of international aviation since the 1990s. In the last two decades governments worldwide have become more attentive to the potential gains from increased air transport activity. This change in governments' attitude has stemmed from a number of factors, particularly the overall trend of abandoning protectionist policies and the increasing number of successful examples in air transport liberalisation such as the US airline deregulation and the EU single aviation market.

Overall, majority of the existing literature on the subject of the liberalisation of the aviation market and its close relation with the competition is limited and too descriptive. There is also a gap between different approaches taken by the European Commission and academics. Several empirical studies have demonstrated that opening up international aviation markets gives a positive stimulus to the overall growth of the aviation industry and to the economy of the countries concerned. Liberalisation has generally been accompanied by enhanced market entry as is its objective, and by a respective increase in competition. In turn, this has generally resulted in lower fares for consumers, in a greater volume of people travelling as a result of this wider availability of choice and price attractiveness, and in generally improved levels of service for the consumer.[48]

Fu and Oum[49] conclude that liberalisation has led to substantial economic and traffic growth. Again, these positive outcomes are mainly regarded as being due to increased levels of

47 Georgiana Pop. Up in the Air: Airlines and Competition Policy in Times of COVID-19. July 28, 2020. Available online at: <https://www.competitionpolicyinternational.com/up-in-the-air-airlines-and-competition-policy-in-times-of-covid-19/ > accessed June 07, 2023

48 Dresner and Tretheway,1992; Schipper, 2002; Adler and Hashai, 2005; UK CAA, 2006.

49 Xiaowen Fu and Tae Hoon Oum (2014), Air Transport Liberalization and its Effects on Airline Competition and Traffic Growth – An Overview, in James Peoples (ed.) *The Economics of International Airline Transport (Advances in Airline Economics, Volume 4)* Emerald Group Publishing Limited, pp.11 - 44

competition resulting from liberalisation, but also as a result of increased efficiency gains in the airline industry. This has positive knock-on consequences for the wider economy too. The mechanism for this is that liberalisation allows airlines to optimise their networks in as efficient a manner as they are able to achieve. This may in turn result in some airports being less favoured, and there are potential concerns on the financial uncertainty this might create as a result for such operators, but this cost comes at a general positive advantage for airlines. Furthermore, it might also be said that this can be mitigated by airlines and airports entering into a sort of vertical arrangement and this may well offer a wide range of benefits to the parties involved. Even here however, the competition spectre raises its head, as competitors would be likely to consider that such vertical agreements would be likely to lead to barriers on entry at such airports, and this shows some of the difficulties which regulators have here in balancing the need to ensure competition with the financial and economic advantages which can be accrued through liberalisation.

It has also been argued that the impact of liberalisation in international aviation is influenced by various factors including the degree of liberalisation already undertaken, economic conditions and geographic position.[50] In an empirical study on liberalisation conducted by Dresner and Tretheway (1992), it was found that airline liberalisation in North America resulted in a reduction of fares by up to 35% on competitive routes. Similarly, InterVISTA-ga2 (2006) argues that the traffic impact of traffic access liberalisation across 12 countries range from an increase in international traffic of 9% to 47%, with a median impact of 33% growth. The study by InterVISTA establishes that a combined liberalisation of traffic access and ownership and control restrictions stimulated a 21 to 79% increase in traffic, with a median impact across all 12 countries of 53% growth. The estimated fare reductions range from 17% to 50% over the 12 countries and averaged 38%. Another strand of literature has explored the employment and wider economic impact of air transport liberalisation.[51] One of the concerns arising from liberalisation of international aviation is its impact on the profitability of home carriers. Liberalisation has the potential to weaken the market position and profitability of the national carriers through increased competition. However, liberalisation also has the potential to improve the position of the home carriers by opening up new markets and providing the opportunity to grow their operations and access to a wider pool of investment and expertise. Kincaid and Thetheway[52] point out that whether

50 InterVISTA-ga2, 2006

51 Caves, 1983; Bailey, 1985; Oum and Yu, 1995; Maillebiau and Hansen, 1995, Forsyth, 1997; UK CAA, 2004; Myburgh, 2006; Schlumberger, 2010; Dobruszkes and Mondou, 2013; InterVISTA, 2014

52 Bylan Kinciad, Michael Tretheway, *Economic Impact of Aviation Liberlization* (1st edn Taylor Francis 2013).

the home carriers prosper or suffer under liberalisation will depend in greater part on the quality of the management of the carrier and how the carrier chooses to respond to the liberalisation.

Likewise, Gillen[53],assessed the effects of changes in a bilateral air transport agreement on the distribution of benefits and costs to various stakeholders (e.g. bilateral partner nations' carriers, consumers and foreign carriers and consumers) concluding that while removing entry restrictions increases industry profit and consumer welfare, some carriers gain and others lose. A further strand of the literature has concentrated on the impact of liberalisation on airports. It has been argued that catchment area plays an important role in airport business and airport competition[54], whereas price and frequency determine to which extent passengers choose a specific airport.[55]

Using the case of the deregulated European aviation market, Berechman and De Wit acknowledge that in the world of competing airlines and full liberalisation, an airline will intensify the use of a hub-and-spoke network with a specific airport as its main hub as to maximise profits and deters entry by potential rivals.[56] In a study on the impact of changes to the international aviation bilaterals on airport revenues, employment and tourism effects for the State of Hamburg, Germany, Gillen and Hinsch[57] (established that the changes in passenger and operations resulting from the policy reform would lead to increases in overall airport revenues, local output, investment and employment. Christidis investigates the status of the EU's aviation relations with four important partners: USA, Russia, Morocco and Turkey.[58] Using the Herfindahl–Hirschman Index as a measure of concentration at airport level, the author argues that airline alliances, ownership limitations, political, geographic, demographic and economic factors influence the airline network dynamics and the spatial distribution of aviation.

This thesis aims to investigate the connection between air transport liberalisation and the effective competition environment within the EU in order to examine the level of liberalisation between the EU Member States and its impact on competition.

53 DW Gillen, 'Airline Cost Structure and Policy Implications: A Multi-Product Approach for Canadian Airlines' (1990) 24 Journal of Transport Economics and Policy 9, 34.

54 Hess and Polak, 2005.

55 Pels, 2009 and Tierney and Kuby, 2008

56 Joseph Berechman, Jaap de Wiit, 'An Analysis of the Effects of European Aviation Deregulation on an Airline's Network Structure and Choice of a Primary West European Hub Airport' (1996) 30 Journal of Transport Economics and Policy 251, 255.

57 DW Gillen, H Hinch, 'Measuring the Economic Impact of Liberalization of International Aviation on Hamburg Airport' (2001) 7 Journal of Air Transport Management 25, 25.

58 Panayotis Christidis, 'Four Shades of Open Skies: European Union and Four Main External Partners' (2016) 50 Journal of Transport Geography 105, 107.

3.3.Practical correlation between liberalisation and competition

It has been concluded that there is a significant statistical relationship between air policy reform and traffic/capacity growth, leading to greater output and competition levels.[59] Similarly, Button[60] found from a UK CAA analysis that the reforms of the 1990s produced greater competition both on EU domestic routes and on international routes within the European Union. Specifically, 30 per cent of EU routes were served by two operators and 6 per cent by three operators or more. Further analysis showed that since 1992 the number of international city-pair routes within the EU with multiple carriers rose from 500 to 566, many having three or more competitors. On the denser routes, the number of cities served by multiple carriers with three or more competitors doubled. Similarly, the number of domestic city-pair routes served by multiple carriers rose even more, with 20 per cent now served by three or more airlines. Consequently, fares fell on routes where there were at least three operators.[61]

In 1998 the UK CAA published a report on the first five years of the single aviation market.[62] This was followed by a further communication by the European Commission in 1999[63]. The UK CAA report found that the liberalisation of European aviation had resulted in a substantial increase in competition, although this could be undermined by the growth in airline alliances and by airport congestion. While the single market had not led to a reduction in the number of European airlines, one reason for this was the inability of major airlines to exploit long-haul traffic rights out of other Member States due to the absence of EU-wide aviation agreements with third countries. The share of national carriers of international routes was 80 per cent, down from 90 per cent in 1992. It found that the effects of deregulation in aviation were analogous to those in other markets. It had brought steady growth to smaller and medium-sized airlines and a consequent fall in the market share of the national carriers. On routes where significant new entry had occurred air fares usually fell. This, however, had not been true on routes where national carriers retained their monopolies. Overall, national carriers' dominance of scheduled flights had fallen from 80 per cent in 1992 to 70 per cent in 1997 but in some domestic markets this share had fallen from 75 per cent to 60 per cent.

59 D Warnock-Smith, Peter Morrell, 'Air Transport Liberalisation and Traffic Growth in Tourism Dependent Economies: A Case-History of Some US-Carirbbean Markets' (2008) 14 Journal of Air Transport Management 82, 91.

60 K Button, 'Deregulation and Liberalisation of European Air Transport Markets' (2001) 14 Innovation: The European Journal of Social Science Research 255, 275.

61 K Button, 'Deregulation and Liberalisation of European Air Transport Markets' (2001) 14 Innovation: The European Journal of Social Science Research 255, 275.

62 Louise Butcher, 'Aviation: European liberalisation, 1986-2002.The Single European Aviation Market,: the first five years' available online at: <SN/BT/182. https://researchbriefings.files.parliament.uk/documents/SN00182/SN00182.pdf> accessed 21 April 2023.

63 COM(1999) 182 final, 20 May 1999

In addition to that, InterVISTAS-ga2 (2006) summarised the impact on competition as, between 1992 (the year before the EU air market was fully liberalised) and 2000, the number of intra-EU routes served by more than two carriers increased by 256 per cent while the number of domestic (within member country) routes with more than one carrier increased by 88 per cent.

Overall, it is agreed that the liberalisation of air transport markets in the EU has promoted greater competition to the benefit of passengers and shippers. The total number of airlines based in the EU that offer scheduled services has changed little between 1992 and 2000, increasing from 124 to 131 over that time. However, there has been extensive entry and exit with only just over half of the airlines present at the start of 1993 still operating scheduled routes under their own code at the end of the period. Of the 144 start-up airlines, less than half (64) were still flying by early 2000.

The Commission's 1999 communication[64] stated that, whilst the increasingly competitive aviation environment had brought benefits to consumers, some of the responses by the airlines to this environment could undermine these benefits, such as: the proliferation of tariffs, over-booking, the availability of seats at the most publicised promotion, fare, the growth in FFP's (frequent flyer programmes) code-sharing and airline alliances, can all make it harder for consumers to compare competing offers. As competition increases, market transparency needs to be assured, if consumer confidence is to be maintained. A competitive and efficient air transport market depends as much on well-informed consumers, in a position to make rational choices, as efficient providers.

The Commission has also indicated that it was investigating the regulatory and commercial barriers restraining the complete development of competition in the aviation single market. Some concerns were identified[65] within the regulatory environment with several of the airlines being concerned about the attitude of national authorities in some Member States towards emerging competition in particular in the areas of slot allocation, negotiation of bilateral agreements covering access to non - EU markets, award of Public Service Obligation (PSO) contracts and other special situations requiring ad hoc decisions.

Nevertheless, the tendency of lowering of barriers to entry appears to have encouraged innovation and entrepreneurship. In particular, liberalisation has allowed the establishment of many new airlines

64 Ibid.

65 Ibid.

which operate totally within the liberalised area. This has spurred the growth in competition, especially on domestic routes. It shall be also noted that different markets respond to liberalisation differently. While some markets might be dominated by leisure travellers and believed to be foreign nationals, other markets are substantially dominated by business travellers and mostly national passengers.

3.4. Obstacles to liberalisation due to the non-effective application of competition law

Despite the ensuing liberalisation, there are still a number of factors preventing the air transport market in Europe from achieving its full potential. First and foremost, intensified competition in the E.U. is in conflict with the dominance of partly state-owned national carriers in almost every member state. Due to the state ownership of the national carrier, member states, particularly during the early phase of liberalisation, were not willing to implement the liberalisation measures and employed tactics such as delaying granting licenses to other non-state-owned airlines. Furthermore, the national airline has tax advantages, privileged access to landing slots at airports and sometimes partakes in the airport's allocation of slots to competitors. Therefore, airlines do not compete at equal levels in the deregulated European market; and unless this distortion of competition can be overcome, airlines will maintain their territorial share of the European market pursuant to former national markets.

Another obstacle to liberalisation is the continued practice of state grants of aid to airlines in the E.U. Under TFEU, aid which is granted by a member state and distorts competition is incompatible with the theory of the internal market insofar as it affects trade between member states. In its state aid decisions, the Commission has tried to impose conditions on granting state aid to ensure that state aid is used for restructuring instead of being used for gaining a competitive advantage. Compliance with the Commission's conditions, however, is difficult to supervise, and from a competition law perspective, it would be best if no state aid were granted at all.

One of the most significant obstacles to successful liberalisation is airport congestion resulting in slot allocation problems, because the absence of attractive slots is the main barrier to entry for competitors on high-density routes. Since national carriers own all the attractive slots and have superior access to airport facilities, they have a competitive advantage under the current structure. Council Regulation No. 95/93 preserves these ‘grandfather’ rights if the carrier concerned uses at least 80% of the slots during a season and permits slot exchanges between carriers on different routes at coordinated airports. Thus, it is only slots which have been withdrawn, or those which are newly created which are able to be put into a pool, of which 50 percent are allocated to new entrants.

Given the relative ease with which established slots can be retained by airlines, it is not perhaps surprising that this seems to favour established market players over new entrants and may harm competition as a result. For example, empirical studies suggested that most slots at airports are still held by the former national carriers, even years after liberalisation, and that there will almost never be enough attractive slots in number and time in the pool to accommodate new entrants.[66] One proposal suggests free trading of slots is a favourable approach but the experience from the U.S., which has of course deregulated to allow this, has actually shown that slots are more valuable for an incumbent airline than for a new entrant and therefore barriers of entry have increased following slot trades rather than diminished in a manner which is somewhat paradoxical at least at first glance. Another proposal suggests that airlines holding more than a certain percentage of slots at a fully coordinated airport could be obliged to surrender a proportion of those slots to the scheduling committee.' This option could generate a sufficient number of attractive slots to be available to new entrant airlines. It would however, also create a serious risk of harming the financial stability of these established flag carriers in a manner which is yet further harmful to competition, and which might also impair their ability to compete globally.

In summary, regulatory bias rooted in public ownership, and the infrastructure of airport congestion are one of the most important structural obstacles for the liberalised single aviation market. It has been also suggested that despite today's trend toward global markets, free trade, the internet, and the economic integration of entire continents, one of the most globalised, technology-intensive industries remains encumbered by the "bilateral air service agreements" (ASAs) that stifle competition and prevent airlines, communities, passengers, and shippers from benefiting to the fullest. According to InterVISTAS-ga2 study,[67] these ASAs often frustrate market growth, force users to pay a price premium, and create a series of vested interests.

One key objective which is sought to be advanced by EU in the next phase of liberalisation is likely to be the application of EU competition law on international airline alliances in order to ensure that these alliances do not operate as something of a back-door or loophole which restricts competition in the sector. At the same time, cooperation between the respective antitrust authorities in the EU and the U.S. must be strengthened in an attempt to avoid conflicting decisions and to establish multilateral guidelines to assure uniform treatment of airline alliances.

66 S Berry, Panle Jia, 'Tracing the Woes: An Empirical Analysis of the Airline Industry' (2010) 2 American Economic Journal 1, 1.

67 IATA, 'The Economic Impact of Air Service Liberalization: Executive Summary' available online at;:< https://www.iata.org/en/iata-repository/publications/economic-reports/the-economic-impacts-of-air-service-liberalization---intervistas/> accessed 14 March 2022.

4.1.National interests and liberalisation

The general tendency for the last decades has been that in the European countries where a policy of state support prevails, operating profits are clearly less critical to an airline's survival. Historically, most EU states originally owned or subsidised their airlines, and therefore, resisted liberalisation[68]. As a result, inefficiency ran rampant, and the consumer rather than the airline beard the burden in the form of high fares and poor service. This situation has been improved since 1990s although statistically majority of the airlines which have faced bankruptcy have been either state owned or subsidised. This is a fundamental dilemma because in addition to the governments of state-owned or subsidised airlines having little incentive to accept increased industry liberalisation, "[management and labour unions of state-owned airlines may also be less than enthusiastic about giving up the shelter of the state for the uncertainties of a more competitive marketplace."[69] If liberalisation efforts are to gain momentum, support from each of these significant players - government, management, and labour - is essential. Many European airlines are "operated for purposes of enhancing prestige, national security, tourism, or earning foreign exchange, rather than for reasons which inspire capitalist efficiency."[70] For a variety of reasons, European governments regard air routes as valuable assets, and although the movement toward privatisation is growing in Europe, the political realities of governmental sovereignty cannot be lightly brushed aside".[71]

The EU has exclusive competence over competition law in so far as it is necessary for the establishment of an internal market. The internal market provisions include the free movement of goods (Article 34 TFEU), services (Article 56 TFEU) and freedom of establishment (Article 49 TFEU). Article 63 TFEU also prohibits, subject to limited exceptions "all restrictions on the movement of capital" between Member States and between Member States and third countries. On the one hand, The Directorate-General for Competition at the Commission has not been willing to endorse attempts by Member States to protect or create national champions which are not to the consumers' advantage or which form an obstacle to competition.[72] Rather, this adheres to the view that EU rules allow firms to search for the best scale and size to compete globally, but ensures that they face sufficient competition to secure performance in international markets as a sort of compromise. It has, as a result at times, controversially, precluded mergers which would have created a national champion even if this would

68 Paul S. Dempsey, 'Competition in the Air: European Union Regulation of Commercial Aviation' (2001) 66 Journal of Air and Commerce 979, 1153.

69 D. Kasper, *Deregulation and globalization: Liberalizing International Trade in Air Services* (1st edn Ballinger Publishing Co 1988) 26.

70 PS Dempsey, 'Turbulence in the Open Skies' (1987) 15 Transportation Law Journal 305, 362-63.

71 P Haanappel, 'The External Aviation Relations of the European Economic Community and of EEC Member States into the Twenty-First Century' (1989) 14 AIR L. 69, 70.

72 Alison Jones, John Davies, 'Merger Control and The Public Interest: balancing EU and National Law in the Protectionist Debate' (2014) 10 European Competition Journal 453, 453.

have been beneficial to a given Member-State and its economy.[73] Recent indicative example Siemens/Alstom [74] case with EC rejecting the Siemens' proposed acquisition of Alstom with the proposed merger would significantly impede effective competition in the markets under the review.

Nevertheless, most of the EU Member States, in contrast, have in place laws, whether set out in merger, regulatory, foreign investment, or other, rules, which permit Governments, or national competition authorities (NCAs), to take account of a broader range of "non-competition" - public interest or public policy - factors in determining whether a merger, acquisition or investment should be authorised, prohibited or otherwise controlled. The range of applicable rules and relevant public interest factors vary significantly from Member State to Member State but, collectively, potentially allow for a vast spectrum of issues to impact on the assessment of whether a proposed investment or merger transaction should be able to proceed.[75] This includes a possibility by the Government to intervene in, and to review, relevant mergers which raise public interest considerations and where necessary to override any competition law assessment conducted.

For instance, Townley advocates a vision of competition law that can be used to promote the general well-being of European Union citizens.[76] According to Townley, in order for competition law to achieve its goal of the citizen's well-being, it is necessary to include goals beyond efficiency so to enable the decision-maker 'to ensure that the optimal balance between conflicting goals is achieved in the specific case in question'.[77] Furthermore, allowing consideration of these non-competition policies leads to administrative efficiency, since 'decision-makers [can] go about their business in a joined up way, considering a variety of goals within Article [101 TFEU] (and other Treaty articles)'.[78]

Townley further argues that so called 'policy-linking clauses' (i.e., Articles 1 1, 147(2), 167(4), 168(1), 169(2), 175, and 208(1) TFEU) are intended to ensure consistency between Union policies and demand that their objectives be considered whenever other EU policies and activities are implemented.[79] As a

73 IP/04/501, 'The Commission puts industry centre stage and reinforces competitiveness in an enlarged European Union', Case M.469, *MSG Media Service GmbH* (1994) and Case M.1672, *Volvo/Scania* (2001).

74 Case M.8677 SIEMENS/ALSTOM.

75 Alison Jones, John Davies, 'Merger Control and The Public Interest: balancing EU and National Law in the Protectionist Debate' (2014) 10 European Competition Journal 453, 453.

76 Okeoghene Odudu, 'The Wider Concerns of Competition Law.' *Oxford Journal of Legal Studies*, vol. 30, no. 3, 2010, pp. 599–613. available online at <http://www.jstor.org/stable/40959746> Accessed 12 July 2023.

77 Okeoghene Odudu, 'The Wider Concerns of Competition Law.' Oxford Journal of Legal Studies, vol. 30, no. 3, 2010, pp. 599–613. available online at <http://www.jstor.org/stable/40959746> Accessed 12 July 2023.

78 C Townley, 'Article 81 EC and Public Policy' (Hart Publishing, Oxford 2009)

79 Ibid.

result, by considering a plurality of public policy goals, the policy- linking clauses guarantee that action under Article 101 TFEU does more than only promote efficiency.[80]

Brook also suggests that the competition authorities have used their discretion to decide not to enforce Article 101 TFEU against other types of agreements even when they do not meet the conditions for an exception under Article 101(1) and (3) TFEU.[81]

Assessment of alliances or mergers/acquisitions in the aviation has been conducted from more than the perspective of economic efficiency that competition law generally adopts. National authorities attempt to achieve this same balance between economic efficiency gains and national interests. A one-size-fits-all approach for application of competition law to aviation is not likely an achievable goal.[82] Indicative examples include *Aegean/Olympic II*[83], where Olympic has become a subsidiary of Aegean, Greece's largest airline, after the European Commission concluded the merger was the only way of preventing the carrier's collapse.

The attainment of a bona fide internal market in all economic sectors, including aviation, required not only the removal of trade barriers, but also a "fusion of the members into a single economic area **...** extended to include freedom of movement of workers, the right of establishment, the free movement of services and capital, and a common transport policy."[84]

The decentralised enforcement system is another significant obstacle to the liberalisation and healthy competition environment. National interests have played a role in the application of Article 101 TFEU when it was enforced by NCAs following the entry into force of Regulation 1/2003. The consideration of national interests can be traced back to two types of legal sources. First, certain national procedural or substantive measures specifically demand taking national interests into account in the application of Article 101 TFEU. Second, the wording of Article 101 TFEU and the case law of EU Courts tolerate a certain degree of divergence in the way the NCAs apply Article 101 and, accordingly, allow NCAs to align their enforcement with their national view on competition policy. As a result, Member States

80 Okeoghene Odudu, 'The Wider Concerns of Competition Law.' Oxford Journal of Legal Studies, vol. 30, no. 3, 2010, pp. 599–613. available online at <http://www.jstor.org/stable/40959746> Accessed 12 July 2023.

81 Or Brook, "Non-Competition Interests in EU Antitrust Law: An Empirical Study of Article 101 TFEU", Global Competition Law and Economics Policy, Cambridge University Press. 2022.

82 Mike Tretheway, Robert Andriulaitis, 'What do we Mean by a Level Playing Field in International Aviation?' (2015) International Transport Forum Discussion Paper 2015-06, OECD, available online at: < https://www.internationaltransportforum.org/jtrc/DiscussionPapers/DP201506.pdf> accessed 15 March 2022.

83 Case No COMP/M.6796 – *Aegean/Olympic II*.

84 Creation of Internal Market, 1 Common Mkt. Rep. (CCH) 202.07 (1978) (CCH Explanation); 'They've Designed the Future, and It Might Just Work', *The Economist*, Feb. 13, 1988, at 45-48.

can shield an agreement form the prohibition of Article 101 TFEU by adopting substantive laws that explicitly limit EU competition law in favour of the protection of a national interest while the national procedural rules can limit the application of EU competition law in favour of promoting national interests. The so-called *de-minimis* rules in national laws are a good example of how Member States can protect, among others, SMEs from the general application of EU and national competition laws. The EU's own de minimis rule excludes from the scope of prohibition of Article 101(1) TFEU agreements between undertakings with low market share, or agreements having a small impact which are unlikely to have an appreciable effect on competition.[85]

NCAs have a wide margin of discretion to decide if an agreement affects trade between Member States,[86] the above national de minimis rules may apply in practice to cases that could have been investigated as Article 101 TFEU infringements. To this extent, the national procedural rules directly affect the application of both EU and national competition laws. In other cases, national rules can also influence the application of Article 101 TFEU.

Several indicative examples are the national *de minimis rules* of the Netherlands, France, Hungary and Germany which are focused on the protection of SMEs in a manner deviating from the Commission's approach. For instance, in Hungary a 'warning' mechanism was introduced which replaced the fine imposed on SMEs for a first-time infringement of the national cartel prohibition[87] while the French de minimis rule sets a separate threshold for the so-called "micro-practices".[88]

In *EasyJet (2015),*[89] the GC stipulated that the Commission is entitled to reject a complaint that was previously rejected by an NCA on priority setting grounds, even though the NCA had not examined the case's merits.[90] That would apply even if the complaint was rejected by the NCA in the course of an investigation under a separate provision of national law. This clearly indicates that application of a sector regulation by one enforcer can lead to prevention of a complaint's examination by another.[91]

85 David Bailey, Richard Whish, *Intellectual Property* Law (8th edn OUP 2015) 148–152

86 M Botta and others, 'The Assessment of the Effect on Trade by the National Competition Authorities of the "New" Member States: Another Legal Partition of the Internal Market?; (2015) 52 Internal market Law Review 1247, 1249-1271.

87 Section 78 (8) of the Hungarian competition act.

88 Article L-464-9 of the Commercial Code.

89 T-355/13 EasyJet (2015).

90 Ibid.

91 Or Brook, "Non-Competition Interests in EU Antitrust Law: An Empirical Study of Article 101 TFEU", Global Competition Law and Economics Policy, Cambridge University Press. 2022.

4.2. Social welfare and national interests

Despite varying levels of optimism for deregulation, nearly all economists agree that deregulation improves consumer welfare.[92] According to some scholars, competition policy needs to be clearly market oriented in the application of its leading principles to a concept of workable competition in order to perform as a public intervention that does not affect, as a *per se*, efficient market outcomes and promote incentive to maximise social welfare.[93] On the other hand, economists have also shown that in a society composed of individuals with different preferences, the public interest does not exist *per se*. As a result, in technical terms, if the preferences of all individuals are to count equally, a coherent "social welfare function" does not exist.[94]

Over the last decade, many studies predicted enormous economic growth impacts resulting from reduced regulations and Open Skies. One of the most commonly cited reports in this area is the Brattle Group's 2002 assessment of "The Economic Impact of an U.S.-EU Open Aviation Area". This report was in fact commissioned by the EC's Directorate-General Energy and Transport,[95] which asked Brattle to "analyse the effects of complete U.S.-EU aviation liberalisation". In particular, the group was asked to analyse specifically the economic effects on airline costs and output and the resulting effect on both consumer welfare and aviation employment. In the report, Brattle estimated that the potential cost savings to the airline industry from a greater productive efficiency are about €2.9 billion annually, or 4.2% of total costs. A majority of those savings would come from intra-EU operations. Furthermore, Brattle estimated that fare decreases associated with these cost savings would result in up to €370 million in added consumer welfare due to the increase in passenger traffic.

Numerous studies have shown that, with the appropriate legislative safeguards, removing regulations generates a social benefit that far outweighs its cost. Passengers should certainly be considered in the discussion of national interests. But policymakers must not forget about the employees of the airlines, airports and service providers that depend upon a healthy (rather than simply large) industry[96]. There is also an opinion, that the regulation of post-war international aviation markets suggests that existing approaches to international institutions cannot adequately account for important elements of

92 S Borenstein, 'The Evolution of US Airline Competition' (1992) 6 Journal of Economic Perspectives 45, 73.

93 Marco Benacchio. 'Consolidation in the air transport sector and antitrust enforcement in Europe' (2008) 8 EJTIR 91-116.

94 Pierre Lemieux. 'The Tyranny of the National Interest' (2018) EconLib Blog, available online at; <https://www.econlib.org/Columns/y2018/Lemieuxnationalinterest.html#_ftn2>a accessed 15 March 2022.

95 Brattle Group Report, cited in K Button, 'The Impact of US-EU 'Open Skies' Agreement on Airline Market Structures and Airline Networks' (2009) 15 Journal of Air Transport Management 59, 61.

96 Alex Cosmas and others, 'MIT International Center for Air Transportation – White Paper. Framing the Discussion on Regulatory Liberalization: A Stakeholder Analysis of Open Skies, Ownership and Control' (2011) Global Airline Industry Program, Massachusetts Institute of Technology, available online at; < https://web.mit.edu/airlines/news/news_new_documents_files/Cosmas_ICAT2008_RegulatoryLiberalization.pdf> accessed 15 March 2022.

international institution building. There is an argument that national politicians use international institutions to increase the wealth available for domestic redistribution. with national politicians creating and maintaining international institutions to maximise domestic political support.[97]

Ideally, the European carriers in international aviation shall be obtain the status of the European rather than national operators. This would allow to have the spread of new forms of services that could be offered to the customers as well as an access to diversified operating models across a wide range of individual markets that are currently closed to specialist national carriers.[98]

5. Conclusion

The liberalisation process has been the key driver for the phenomenal growth of the aviation market for the last decades. Nevertheless, within Europe, a genuinely single market in air transport services still calls for common rules and harmonised standards of implementation. Establishing a properly resourced and legally robust regime, for ensuring high standards across Europe is an important element of the well functioned economic model.

It is essential to ensure the deliverance of an efficient, high-quality regime in the European Common Aviation Area. Also, in supporting liberalisation beyond Europe, there is a necessity to demonstrate that it will not lead to lower safety standards or loss of effective safety oversight and must ensure clear lines of responsibility leading back to specifically accountable regulatory authorities. In addition to that, liberalisation is found to stimulate traffic growth significantly for both passengers and freight services. This has a multiplier effect on other market variables, for instance passenger increases lead to more frequencies and increases in traffic density. This reduces cost per passenger which could lower air fares on the route. Also, liberalisation impacts on other contemporary developments in the aviation market such as hubbing and airline alliances.

There are some areas where EU market participants still face difficulties in terms of the equal access including slot allocation, negotiation of bilateral agreements covering access to non - EU markets. Another key factor which prevents closer consolidation are the government-imposed ownership and

97 John E. Richards 'Toward a Positive Theory of International Institutions: Regulating International Aviation Markets' (1999) 53 *International Organization* (Winter) 1-37.

98 Erwin Von Den Steinen, *National Interest and International Aviation* (1st edn Kluwer Law International 2006) 143.

control restrictions that still form the backbone of most bilateral relations with countries outside the liberalised European area.

Overall, this chapter has shown that the airline market in the EU has been the subject of gradual liberalisation. The overall objective of liberalisation however has been hampered within the EU in a manner which was not seen in other places such as in the United States, as a result of the ongoing patchwork of national interests and desires which play a rather unique role in this respect in EU law when it comes to the enforcement of competition law. As such, liberalisation has not yet been entirely completed, and, as a direct consequence of this, competition law and policy within the EU plays a vital role not only in the operation of the private sector market, but also in ensuring that companies from different EU Member States enjoy proper market access on the internal market, and to allow them a level playing field in this respect. As such, the rest of this thesis will now examine how the competition law and rules of the EU have been applied in the aviation sector, and, whether or not these rules have achieved their ostensible objectives when doing so.

CHAPTER 3.
MARKET DEFINITION

I. Introduction

1.1. Theoretical Argument

Under Commission Notice (97/C372/03),[99] the definition of a given market is a tool used to identify and define the boundaries of competition between firms.[100] The main purpose of market definition is to systematically identify competitive constraints that firms face, while defining a market in terms of both product and geographic dimensions; this supports identification of competitors capable of constraining the behaviour of other firms and preventing them from behaving independently of competitive pressure. In a concentrated industry such as commercial aviation, a properly defined market is essential for the adequate identification of the competition concerns arising from carrier mergers, agreements and joint ventures, or unilateral conduct by allegedly dominant carriers.

Market definition is crucial when analysing competitive dynamics and effects in the following scenarios:

i. When determining whether an agreement between aviation market players has the appreciable effect of restricting competition (Article 101(1) TFEU);
ii. When determining whether an agreement between aviation market actors has an appreciable effect on trade between Member States (Article 101(1) TFEU);
iii. When determining whether an agreement between aviation market actors would substantially eliminate competition (Article 101(3)(b) TFEU);
iv. When determining whether an aviation undertaking has a dominant position (Article 102 TFEU);
v. When determining whether an aviation-related merger would have a negative effect on competition (EU Merger Regulation);
vi. When determining whether a block exemption is applicable.

An increasingly economic approach to competition policy has put market definition at the centre of the process of application of the EU competition rules. Market definition and market shares are used as a proxy for the measurement of the market power enjoyed by aviation firms. In general, the European Commission focuses on overlapping routes of the airlines concerned, analysing both

99 97/C 372/03, Commission Notice on the definition of relevant market for the purposes of Community competition law; Section 6. Short Form CO for the notification of a concentration pursuant to Regulation (EC) No 139/2004.

100 European Commission, 'Evaluation of the Commission Notice on the Definition of Relevant Market for the Purposes of Community Competition Law' (2021) available online at; < https://ec.europa.eu/competition-policy/public-consultations/2020-market-definition-notice_en> accessed 22 June 2022.

the current market situation and potential negative effects on competition. The European Commission, from a demand-side driven market definition perspective, justifies analysing effects of cooperation primarily under the 'point of origin/point of destination' (O&D) city pairs approach, with network competition issues being insufficient to require changes to the established market definition approach followed by the Commission.[101]

This chapters challenges the Commission's approach relying on the following hypotheses:

1. It is wrong to give priority to the demand-side evaluation as it leads to inaccurate analysis;
2. Supply-side considerations are underestimated;
3. The competitive significance of competition at network level is underestimated.

While the Commission extends its classic route analysis in some cases to also examine whether other means of transport (such as by car, train, ship, or connecting flights for example) might provide an alternative for consumers, the approach is still limited and does not reflect the reality of the impact that transactions may have on the market and consumers in general. Finally, the value to consumers of the non-price characteristics of airline networks shall be also taken into consideration in order to appraise transaction in question to the full extent.[102]

*1.2. **Network Competition & Operational Approach***

Cooperation and synergy allow improvements in the operational and financial stance of a market player. The city pair approach does not adequately address the wider implications of this. Although, for instance, a merger may not affect specific routes to the extent that it infringes on a specific competition sector, in a wider vision and longer term it creates certain anti-competitive effects, which may disadvantage other players and new entrants within the same global network, even if on a different route.

Let's say airline A and airline B merge, having their fleets, finances, and human recourses combined. On an overlapping route(s), both may have less than 5% presence. While this may not create a (significant) disadvantage on one or a couple of specific routes, within the combined network, it may be possible to reallocate resources to other existing (or new) routes and improve presence, without needing additional approval from the Commission. The reallocation will be purely a commercial

101 Michael Gremminger, 'The Commission's approach towards global airline alliances — some evolving assessment principles,' (200) Competition Policy Newsletter. Number 1 — Spring 2003.

102 Mark Israel and others, ', Airline Network Effects and Consumer Welfare' (2013) 12 Review of Network Economies 287, 287.

decision depending on financial resources available to secure slots, procure airport services, and pay relevant charges. Those affected are only those present in the specific market. However, the current market decision, based on the narrow city pair approach, does not test the transactions to this extent.

1.3. Key factors hitherto omitted in the analysis

The relevant market is a significant criterion reviewed in this chapter. Historically, it has developed and changed from the geographical (catchment area) as well as operational (supply) stand points. Today, additional determinants are taken into account. Instead of narrowing the relevant market on the demand side and broadening it with supply-side substitutes, the Commission is more concerned and pays more attention to the competition environment itself.

In practical terms, in order to fully assess the impact of an airlines merger, and more generally of agreements or conduct in the airline sector, the following variables shall be used:

- *Financial related variables shall be used to represent the direct production process of an airline, together with network related variables reflecting the volume and variety of airline services and*
- *Fleet related variables with the total number of aircraft and types as well as more flexibility associated with the crew members' substitution on different sectors and positing (due to the time restrictions associated with the duty hours allowed under the regulations) shall be used to indicate the operational capacity of the airlines, which unavoidably lead to the increase of the market share, and*
- *Operational complexity with the number of destinations against number of aircraft is taken into consideration, which is linked with the second point above.*

1.4. Problem

How concentration affects the competition on a wider, network scale needs to be considered. There is no doubt that competitors may be affected on a specific city pair route, but the question of more interest is whether there is an overall negative effect on competition caused in the market. A broader approach is to assess how the market will be affected on the specific route and also any overall disadvantages to other players and potential new entrants, which the change may introduce.

Let's say airline A reduces the fares below the market price on a route A-C to build its presence and that the presence of airline B is significantly affected on that specific route (market). However, on a global scale, the route may have less than 1% of the overall network of airline B, with a proportionate impact on revenue generation. There may also be other impacts, such as the change causing airline B

to go elsewhere, either to a new or existing market. Such changes may have longer term impacts on revenue generation. A further unknown is whether any anticipated impact or detriment forecasted for instance by using the ex-ante counterfactual approach will actually occur.

This thesis argues that the tests applied by the Commission are model based on the hypothetical 'assumptions,' or a simplified version of reality, which have not been verified to project factual outcomes.[103]

1.5. ***Chapter Navigation***

This chapter discusses market definition in the aviation sector. It argues that the current approach applied by the Commission is inappropriately structured and equipped for the purpose of safeguarding the competitive environment and an alternative framework is proposed.

The rest of this chapter is structured as follows. Firstly, the assessment and different regulatory approaches relevant to the market definition are examined and it is argued that the Commission approach is relatively ineffective through illustrations of decision discrepancies within the European Commission. Secondly, major concerns related to market reshaping and the impact on competition are discussed. Finally, recommendations to improve the situation are presented, including factors that need considering when defining the market.

II. Market Definition

2.1. Market Definition

A key element in identifying whether a merger or alliance will give rise to competition concerns is the definition of the relevant market. Market definition shall, for the purposes of this thesis, identify the closest short-term competition constraint on a given service which shall be followed by other essential determinants. It is therefore an essential element of any investigation of network and market effects, or of assessing competition issues, to first be able to identify the nature of an extent of any relevant "market". Market definition is to be considered below therefore.

A classic approach is suggested by Bishop and Walker[104] which include substitutes, degree of competition between these substitutes, barriers to entry, and expansion, together with the potential responses of competitors as essential determinants. Overall, these authors argue that market definition

103 Afke Schouten, 'Model Assumptions — Explained' Towards Data Science, (2020) available online at; <https://towardsdatascience.com/model-assumptions-explained-2c7bb7607f1c> accessed 3 November 2020.

104 Simon Bishop, Mike Walker, *The Economics of EC Competition Law: Concepts, Application and Measurement* (1st edn Sweet & Maxwell 2010) 108.

is not sufficient in the current aviation environment and has a lack of practicality, failing to reflect industrial reality.

At the most fundamental level, to define a relevant market means to delineate an area of conflict between competing undertakings, in a material, geographic, and temporal sense. This area reflects, up to a point, the competitive pressures to which those undertakings are subjected and which are capable of limiting their behaviour in the supply or demand of the products or services in question.

Market definition 'is not an end in itself, but an initial step in identifying the competitive constraints on a supplier of a given product.'[105] Further, markets tend to change over time, which leads to change of the appropriate market definition.[106]

Ferro claims it is important to determine the borders of the relevant market to assess (i) whether an undertaking holds a dominant position awarding it a special responsibility and limiting its freedom of behaviour; (ii) whether an agreement between undertakings is capable of having a significant impact on the market and is, thus, subject to legal restrictions; (iii) whether a merger between undertakings is likely to substantially lessen competition and should be prohibited.[107]

2.2.Market Definition in the Aviation Industry

Complex market definition questions can arise in aviation markets, particularly when competition authorities apply the Origin & Destination (O&D)[108] approach. One approach is to identify and consider every flight route of a relevant undertaking as a separate market. In a second step, the overlapping routes of undertakings should be identified and examined for potential anti-competitive effects. A further complication is that the aviation industry is very dynamic; airlines can reorganise their business activities in a short time, meaning that competition authorities also have to take into account that they may 'create' new O&D pairs (and, therefore, new separate markets) by changing their flight schedules. Nevertheless, this 'flexibility' can be practically restricted by other factors, such as slot availability for example which is likely to result in a .

105 David Bailey and others, *Bellamy & Child: ,European Union Law of Competition* (8th edn . OUP.2018) para 2.1

106 European Commission, 'Market definition in a globalised world,' (2015) Competition Policy Brief No 2/2015.

107 Miguel S. Ferro Market Definition in EU Competition Law. New Horizons in Competition Law and Economics Series (1st edn Edward Elgar 2019) v.

108 Origin and Destination (O&D) - refers to the start and end points of each passenger's journey. The number of O&Ds also indicates the size and complexity of a carrier's route network, making them useful for analysis in fare management and yield management. available online at: <https://www.atpco.net/glossary/o> accessed August 2021.

As suggested by Ferro market definition is shaped differently depending on whether framed by economic theory, administrative theory or legal (judicial) theory, while in most cases, none of these frameworks quite matches legal practice.[109]

2.3.Point of Origin/Point of Destination (O&D) Paired Approach

The way passengers engage in airline transport is to generally purchase a ticket on a scheduled air transport service operating between a point of origin, and point of destination. That is the basic product sold by most airlines. . In other sectors, market definition has both a product or service dimension and a geographic dimension. However, as an air transport service has an inherent geographic dimension, it is less useful to draw the line between the service dimension and the geographic dimension of air transport services, when defining the relevant market.

To establish the relevant market in air transport cases, the Commission applies the so-called origin and destination, or, O&D paired approach. According to this approach, every O&D combination, such as London to Frankfurt, or Munich to Rome for example, should be considered a separate market from the customer viewpoint. To establish whether there is competition in an O&D market, the Commission looks at the different transport possibilities in that market. This includes not only the direct flights between the two airports concerned, but also alternatives to the direct flights. These alternatives may be direct flights between the airports whose respective catchment areas significantly overlap with the catchment areas of the airports concerned at each end (airport substitution), indirect flights between the airports concerned, or other means of transport, such as road, train, or sea (inter-modal substitution). Whether one of those alternatives is substitutable to the direct route depends on multiple factors, such as the overall travel time, frequency of services, and the price of the different alternatives and can only be decided on a route-by-route basis.

The Commission also investigates whether passengers travelling on unrestricted tickets (who can travel on any flight offered by a carrier on a given city pair) are in a different market to passengers with restricted tickets (who are restricted to travelling on the flights specified on their ticket). In the past, these two groups of passengers have been labelled ‘time-sensitive’ and ‘non-time-sensitive.’ In practice, airlines distinguish between these two groups more by their preference for schedule flexibility rather than short journey times. Time-sensitive passengers are prepared to pay more to ensure they will always be able to travel on the most convenient flight. Whereas in cases concerning *intra-European* routes, this distinction has led to the definition of separate markets, in *transatlantic* cases it has never

109Miguel S. Ferro Market Definition in EU Competition Law. New Horizons in Competition Law and Economics Series (1st edn Edward Elgar 2019) v.

been necessary to argue on the basis of this distinction, since alliance partners usually had similar shares of both the unrestricted and the overall markets.[110]

2.4.Overlap Markets

For *intra-European* alliance cases, in principle only direct overlap markets may raise competition concerns. However, for *long-haul traffic,* the situation is different because both direct and certain indirect routes may belong to the same relevant market. Hence, it is imperative to distinguish the latter services into three further market overlap subcategories: direct-direct overlap routes, direct-indirect overlap routes, and indirect-indirect overlap routes. For these categories, approximate assessment thresholds have been established, specifying possible competition concern. Recently, the Commission has only raised serious competition concerns on O&D markets with regard to the airline alliances where the combined market shares of the parties were higher than 50%, and in the case of direct-indirect overlaps, where in addition to the 50% threshold the increment was higher than 3%. Since the usually available competing direct or other indirect services via competing hubs should sufficiently constrain the alliance market behaviour, indirect-indirect overlaps normally would not raise any serious concerns.[111]

Other examples include cases when the Commission has considered indirect flights as a competitive alternative to non-stop services, if they are marketed as connecting flights on the city pair on CPRSs/GDSs, are operated on a daily basis, and cause only a limited extension of the trip (150 minutes waiting time).[112] However, there is no clarity on connecting flights. With respect to time-sensitive and non-time-sensitive passengers, while the latter can accept longer connection times, the distinction on the basis of passenger's types has become less clear, as an increasing number of time-sensitive passengers appear to have become more price sensitive.[113]

In general terms, competition law is concerned with effects on the consumers of goods and services as well as other market participants, and the first step in any market definition is to identify a group of products or services that consumers consider as a substitute for each other. There is therefore a question as to how far, if at all, indirect flights should be included in the relevant market for the assessment. For instance, in merger transactions, the vast majority of transactions do not pose competition

110 Michael Gremminger, 'The Commission's Approach Towards Global Airline Aliiances – Some Evolving Assessment Principles (2003) Competition Policy Newsletter [1] (Spring) , available online at; <https://ec.europa.eu/competition/publications/cpn/2003_1_75.pdf> accessed August 2021.

111 Ibid.

112 ; Case COMP/M.2041 - United/US Airways, at paragraphs 13-19 as regards specifically transatlantic city-pairs. Also, Case No COMP/M.3280 - AIR FRANCE / KLM para 21 andCase COMP/M.5403 – *LUFTHANSA/BMI* para. 16.

113 *IAG/Aer Lingus I*, supra para. 73.

problems and are cleared by the competition authorities after review. Only mergers that significantly impede effective competition in the EU in a substantial way, in particular by creating or strengthening a dominant position shall be prohibited.[114]

2.5.Network Effects on Competition

Overall, network effects include increased share of traffic within the existing or expanded network of airline services.

Research shows that studies which that ignore the quality effects associated with expanded airline networks are apt to come to incorrect conclusions and as such ought not be influential in the development of policy decisions. As an example, , appropriately incorporating quality effects into quality-adjusted fares reverses the conclusion that hub airports yield lower consumer welfare due to generally higher fares than other airports. [115] From the perspective of consumer welfare in the aviation industry, to evaluate potential airline mergers, alliances or other transactions, it is therefore important that one ought not to focus solely on the effect of the concentration of fares for example, but that one ought also to take into account the other effects, such as on welfare, of the larger networks too. Some have further opined in this spirit [116] that the quality changes flowing from the larger networks engendered by the merger predict reduced quality-adjusted fares and increased consumer welfare.

Brueckner and Spiller[117] point out that network effects are problematic for competition authorities because the traditional approach of focusing on individual routes fails to capture the wider effects of mergers and might be misleading. Additional criteria should be considered during the assessment of a proposed transaction: the overall network of the applicants and operational capacities prior to and after the merger. This view has also been accepted by the US Government Accountability Office.[118] However, there is an apparent lack in the literature discussing the current lack of reviews of these criteria.

An issue that needs to be discussed is whether the overall airline network and operational capacities should be the fundamental criteria of a regulatory framework. Critical evaluation of the EC Policy is also required.

114 Merger Regulation 139/2004 Article 2 (2).

115 Mark Israel,and others, . 'Airline Network Effects and Consumer Welfare' (2013) Review of Network Economics, available online at: <[https://www.law.berkeley.edu/files/Airline_Network_Effects_and_Consumer_Welfare.pdf> accessed August 2021.

116 Ibid.

117 Jan Brueckner and Pablo Spiller, 'Economies of Traffic Density in the Deregulated Airline Industry' (1994) Journal of Law and Economics, 379–415.

118 GAO-13-403T, Airline Mergers: Issues Raised by the Proposed Merger of American Airlines and US Airways (19 June 2013).

2.6. Evolution of the Commission's Market Definition

Initially the Commission was of the opinion that for time-sensitive passengers, indirect flights were generally not substitutable for non-stop flights on long-haul routes, since — other things being equal — indirect flights are considered as less attractive. Intensive market investigations in the alliances cases *Lufthansa/United Airlines/SAS*[119], *KLM/ Northwest Airlines*[120] as well as in the merger case *United Airlines/US Airways*[121], however, have indicated that indirect flights — depending on a number of factors, such as airline preference, price, schedule, availability of direct flights — have to be seen as (at least as potential) suitable alternatives to non-stop services on long-haul routes. The situation and market conditions, however, may be totally different when indirect flights involve 'back tracking.' In *British Airways/American Airlines*[122] and *Bmi/United*[123] it was concluded that on many UK-US routes, only a small number of passengers choose to fly indirectly and that these flights were, therefore, disadvantaged competitively and, as such, unlikely to constrain the market behaviour of the alliance on the problematic direct overlap routes.

In *United Airlines/US Airways*[124], it was concluded that indirect routings may constitute a competitive alternative to non-stop-services if they are marketed as connecting flights for the city pair concerned on the CRS, are operated on a daily basis, and cause only a limited extension of the trip duration.[125] In transatlantic airline cases[126], where the routes concerned showed a corresponding pattern, the Commission followed a similar approach and concluded that indirect flights, under certain conditions, appear to exert a sufficient competitive constraint on non-stop long-haul services. Conversely, the Commission needs to assure that the competitive conditions on markets, where one party offers a direct service and the other a competitive indirect service, will not be substantially affected by the alliance.

Regarding *intra-European* routes, the Commission maintained in its *Lufthansa/AuA* decision its established practice that indirect flights do not place sufficient competitive constraints on short-haul direct flights.[127] The situation may, however, be different — depending on the market conditions —

119 36201 PO / Lufthansa + SAS + United

120 36111 PO/KLM+Northwest

121 Case No COMP/M.2041 – United Airlines / US Airways

122 Christine Tomboy. 'The proposed British Airways-American Airlines Alliance' (2002) available online at:< https://ec.europa.eu/competition/publications/cpn/2002_2_38.pdf > accessed August 2021.

123 2001/C 367/12

124 Case No COMP/M.2041 – United Airlines / US Airways

125 Case COMP/M.2041 — United Airlines / US Airways of 12.1.2001.

126 For instance, Case No M.7541 - IAG / AER LINGUS

127 Commission decision of 5 July 2002 in the case COMP/37.730 — *AuA/LH*, OJ. L 242, 10.9.2002.

on certain medium-haul routes; the Commission concluded in the *Spanair/SAS* case that indirect flights are less disadvantaged than direct flights relative to short-haul services.[128]

As for the State Aid, while market definition should identify harmed competitors, it should also draw boundaries around the possible direct and indirect effects of the aid. Therefore, it is suggested to use two types of market definition: a basic definition to identify damaged competitors, and a more comprehensive definition to draw a boundary around the aid. Application of the framework developed by Fingleton, Ruane and Ryan[129] suggests that any revisions to that framework should incorporate either implicitly or explicitly these two inter-related roles for market definition to be more accurate. Market definition should be assessed not only by reference to the objective characteristics of the products and services at issue, but also the competitive conditions and the structure of supply and demand on the market.[130]

Overall, a key element in identifying whether a merger or alliance will give rise to competition concerns is the definition of the relevant market. Classic approach, suggested by Bishop and Walker,[131] according to which substitutes, degree of competition between these substitutes, barriers to entry an expansion together with the potential responses of competitors are the essential determinants for the market definition is not sufficient in the current aviation environment and has a lack of practicality with inability to reflect the industrial facts. The Commission has looked again at the definition of the relevant market in recent years, and carried out a consultation in 2020 aimed at assessing whether or not the present market definition was adequate or not.[132] The Commission acknowledged that the definition appeared generally fit for purpose, but that it also failed to keep track with recent developments, and particularly, the idea of 'harm' which has been more readily acknowledged by the CJEU in the case law in this area. It might then be the case that the definition is likely to focus more on the question of harm, and on the impact on the market itself in future.

128 Case COMP/M. 2672 — *SAS/Spanair* of 5.3.2002.

129 John Fingleton and others, , 'A Study of market Definition in Practice in State Aid Cases in the EU,' (1998) available online at; < https://ec.europa.eu/docsroom/documents/2651/attachments/1/translations/en/renditions/native > accessed 15 March 2022.

130 Case 322/81 *Michelin v Commission* [1983] ECR 3461, EU:C:1983:313, para 37; Case T-699/14 *Topps Europe v Commission* EU:T:2017:2, para 81.

131 Simon Bishop**,** Mike Walker, *The Economics of EC Competition Law: Concepts, Application and Measurement* (1st edn Sweet & Maxwell 2010)

132 European Commission, 'Evaluation of the Commission Notice on the Definition of Relevant Market for the Purposes of Community Competition Law' (2020) available online at; https://ec.europa.eu/competition-policy/public-consultations/2020-market-definition-notice_en accessed 21 June 2022.

III. Substitutability and relevant constraints as assessment criterion

3.1.Substitutability Barriers to Competition

Substitutability from the perspective of airlines depends on the kind of service they wish to provide. A network carrier which provides significant connecting and feeder services has greater and different airport needs to a low-cost carrier providing mainly point-to-point services.[133] For instance, in the case of *IAG/Aer Lingus*, the Commission noted in particular the importance of London Heathrow for network carriers.[134]

3.2.Demand-side Criteria

The O&D approach makes a distinction between substitutability on the demand side and on the supply side.

The Commission's competitive assessments place significant weight on the analysis of both demand and supply-related impediments. [135]

All criteria relevant to the direct and indirect substitution on a given route for which passengers consider all possible alternatives of travel from a city of origin to a city of destination play a role. Consequently, every O&D combination (city pair) is considered a separate market (*IAG / Aer Lingus*[136] case).

In the *KLM/Air UK*[137] case, the Commission decided to distinguish between business and leisure passengers, while the market definition itself was left open. Following this decision, in March 2002, in the *SAS/SPANAIR* case[138], the Commission differentiated between direct and indirect flights, without explicit reference as to whether the indirect flights were substitutable for the direct, city pair flights.

Demand-based barriers are often used for definition of the relevant market. As it was highlighted in the *Olympic/Aegean*[139] case, demand-based barriers to entry are commonly associated with the strength of the incumbent carriers' brands in a given market, and the difficulty for potential entrants to acquire

133 John Milligan, European Union Competition Law in the Airline Industry (Wolters Kluwer 2017).

134 *IAG/Aer Lingus* supra, para. 58.

135 Case COMP/M.5335 *Lufthansa/ SN Air Holding* (2009); Case COMP/M.5830 – *Olympic/ Aegean Airlines* (2010).

136 Case M.7541 – *IAG / Aer Lingus* (2015) 32015M7541.

137 Case IV/M.967 – *KLM/Air UK* (1997).

138 COMP/M/ 2672 – *SAS/SPANAIR* (2002).

139 Case No COMP/M.6796 *Aegean/Olympic II* (2004).

equivalent brand recognition. Such an endeavour entails high marketing and advertising costs, which increase the cost of entry. The Commission has assumed that the financial cost of preserving an already recognised brand is substantially lower than that associated with the establishment of an equally acclaimed brand.[140]

Demand-based barriers to entry also include the demographics of a particular route. If the majority of passengers travelling between a city pair are connecting travellers destined for onward travel beyond the particular city pair in question, then carriers not offering flight connections at either end of the pair are deemed to be at a competitive disadvantage.[141] This disadvantage is treated as a barrier deterring the entry of a potential competitor. This is especially the case in routes between the hubs of two network carriers.

A strong argument is raised by Padilla[142] that by focusing mainly on the demand side, the Commission may fail to take properly into account that competition does not come from readily available demand substitutes. Often a single product serves the entire market. The main competitive constraint then stems from potential competitors not currently in the market. In a similar manner it could be argued that the demand – based barriers shall include demographics that are beyond the routes covered at the time of a transaction in question. Likewise, market shall be defined by looking in the future opportunities that might be most likely available to the parties and might cause detriment to potential competitors that not currently in the market.

3.3.Supply-side Barriers to Competition

This concept is also applicable to the aviation market. Assessment of the demand-based barriers does not take into account the effect on competition beyond the existing routes and competition on those routes. Evans and Schmalensee[143] argue that firms 'are not constrained much by the pricing production decisions of existing firms, because they typically face few if any contemporaneous rivals, and economies of scale and network effects are often effective barriers to the entry of comparable…products.' In the aviation market this may relate to operational advantages, which may

140 Case COMP/M.4439 *Ryanair/Air Lingus* (2007).

141 Case COMP/M.5335 *Lufthansa/ SN Air Holding* (2009); Case COMP/M.3770 *Lufthansa/Swiss* (2005).

142 Dr Atilano Jorge Padilla. The role of supply-side substitution in the definition of the relevant market in merger control. A Report for DG Enterprise' (2001) A/4. European Commission.

143 David S. Evans, Richard Schmalensee, 'Some Economic Aspects of Antitrust Analysis in Dynamically Competitive Industries,' (2001) NBER Working Paper, No. 8268.

lead to supply-side barriers/competitive constraints. These include and relate to entry costs, regulatory factors, the presence of strong parties at airports, and slot availability.[144]

3.4. Catchment Area Criteria

When considering airport substitutability, the Commission examines the catchment area served by airports to determine whether they overlap sufficiently to allow consideration as substitutes in the eyes of passengers. If the number of customers on a certain route living in an overlapping catchment area is sufficiently high, a carrier takes this into account when setting prices.[145]

The length of a leg covered may also be relevant, as catchment areas increase with leg length, and where the length is quite short, passengers may be less inclined to change their preferred airport, particularly if the additional time and cost required to have to the alternative airport ratio of total travel time and cost for the two airports is unattractive. In the case of *Air France/KLM*, the Commission found that for flights within Europe, it could be assumed that the radius of an individual airport's catchment area is small, given the overall short travelling time, while for long-haul flights the catchment area is larger.[146] The Commission has developed, as a first proxy of whether airports are substitutable, the distances from the city to the airport and travelling times, using an indicative benchmark of 100 km or 1 hour driving time. For the case, *Ryanair/Aer Lingus*[147], *in* applying this test, the Commission found that scheduled air transport services between Dublin and either Brussels Zaventem airport or Charleroi Brussels South airport belonged to the same market.[148] Nevertheless, the catchment area is only one of several influencing factors; other factors include the characteristics of passengers travelling on the routes in question, overall travel time, frequency, and times of services, quality of service, and the price of different alternatives.

144 John Milligan, European Union Competition Law in the Airline Industry (1st edn Wolters Kluwer 2017).

145 Case COMP/M.3280 – *Air France/KLM* para. 24.

146 Ibid. Para. 25.

147 Case COMP/M.4439 – *Ryanair/Aer Lingus.*

148 Case COMP/M.4439 – *Ryanair/Aer Lingus* para. 196.

3.5. Time- and Non-time-sensitivity

When taking a demand-based approach to market definition, it may be necessary to make a distinction between different groups of passengers, given that different services may be substitutable for different kinds of customers.[149] It is particularly worth considering a distinction between time-sensitive and non-time-sensitive passengers as well as between point-to-point passengers and connecting passengers. The distinction between different types of customers reflects the established practice of the national competition authorities[150] as well as that of the European Commission.[151]

The distinction between time-sensitive (generally business travellers) and non-time-sensitive travellers (generally leisure travellers) can be of great importance in the competition assessment. Generally, time-sensitive travellers expect faster connections and a higher level of punctuality than non-time-sensitive travellers. The former are not flexible in terms of departure and arrival time, and they expect to be able to change their reservations at short notice. Non-time-sensitive travellers are interested in obtaining the lowest fares, and are willing to accept longer travel time and less flexibility. As data on whether passengers are time-sensitive or not are unavailable, appropriate proxies (data on passengers holding restricted/unrestricted tickets) are used instead.

For instance, in *Iberia/British Airways*[152] it was found that London Heathrow, Gatwick, and London City were substitutable routes from London to either Madrid or Barcelona for time-sensitive passengers. However, it was not clear whether Luton and Stansted were substitutable. Inconsistency continues, and in *Air France/KLM*, Charles de Gaulle, and Orly, two main airports in Paris, were found not to be substitutable for corporate customers requiring connections for transfer traffic, since Orly offered fewer connections.[153]

From a business perspective, however, the year 2020 showed a different reality. According to Heathrow chief executive, John Holland-Kaye, by October 2020 Heathrow had been eclipsed as Europe's busiest airport, with more passengers having passed through Paris Charles de Gaulle in the first nine months of the year. This is allegedly because of a failure in airport testing and, interestingly,

149 EC Notice on the definition of the relevant market, para. 43.

150 UK Competition Commission (CC), case *Air Canada/Canadian Airlines* Cm 4838 (hereinafter: '*Air Canada/Canadian*') www.competition-commission.org.uk/reports/, where the distinction between time-sensitive and price sensitive passengers was described as reasonable.

151 European Commission, case M.1305 – *Eurostar*, para. 14 (hereinafter: '*Eurostar*') www.europa.eu.int/comm/competition/mergers/cases/decisions/m1305_en.pdf; case M.2041 – *United Airlines/US Airways*, para. 18 (hereinafter: '*United Airlines/US Airways*').

152 Case COMP/M.5747 – *Iberia/British Airways* paras 21–23.

153 Case COMP/M.3280 –*Air France/KLM*, para. 29.

Frankfurt and Amsterdam Schiphol have been catching up with the competition.[154] So, in practice, overlapping catchment may be far beyond the 100 km/2 hour radius rule, and in fact, substitutability may be defined by the airports even in neighbouring countries UK and France.

The Commission's current practice of assessing the market by substitute routes is inaccurate. Firstly, product and geographic markets are defined too narrowly and usually inconsistently. Depending on the question under investigation, differences are introduced with the Commission considering the market position of individual operators. For instance, with regards to the airport substitution, in the *British Airways/American Airlines/IB* case,[155] the Commission commented that for transatlantic routes, both supply- and demand-side substitution were insufficient to suggest that Heathrow belonged in the same market as the other four London airports (Gatwick, London City, Luton, and Stansted). In the *Iberia/British Airways* case,[156] on the other hand, for routes between London and both Barcelona and Madrid, for non-time-sensitive passengers, Heathrow, Gatwick, and London City were considered to be substitutable. By way of comparison, the Commission regularly applies 'micromanagement style' with assessing predominantly elements that are directly linked to the transaction in question, while avoiding bigger picture that might lead to a completely different scenario. By the attempts to preserve the level playing field within the existing and directly affected market area, the Commission in most of the cases is ultimately losing sight of the bigger picture.

3.6. Connecting Versus O&D Passengers

According to ECA Report,[157] the existence and the number of connecting passengers has been an important factor in assessing competition on a specific O&D route in several cases, although it has not been the main focus of the analysis. In contrast to the situation with O&D passengers, for connecting passengers a flight between two airports forms only part of their travel and the airport where the connection is made is neither their point of origin nor their point of destination. Connecting passengers also have a wider choice of flight alternatives than O&D passengers.[158] Connecting passengers and O&D passengers may, thus, belong to different markets.

154 Cat Rutter Pooley, 'Heathrow's Parisian eclipse is not a question of Covid testing' available online at: <https://www.ft.com/content/bedea528-be2f-4561-8eee-6346b245a656> accessed 29 October 2020.

155 **Case** COMP/39.596 – British Airways/American Airlines/Iberia (2010).

156 COMP/M.5747 – *Iberia/ British Airways* (2010).

157ECA Working Group, 'Report of the ECA Traffic Working Group: Mergers and Alliances in Civil Aviation – an Overview of the Current Enforcement Practices of the ECA Concerning Market Definition, Competition Assessment and Remedies' available online at; < https://ec.europa.eu/competition/publications/eca/report.pdf> accessed 15 March 2022.

158 European Commission, *Lufthansa/AuA*, para. 65.

In its decisions, the European Commission has differentiated between point-to-point passengers and connecting passengers in relation to the relevant O&D routes.[159] Connecting passengers and O&D passengers were considered to belong to different relevant markets. In *Air Canada/Canadian Airlines*[160] and in *British Airways/City Flyer Express*,[161] the UK Competition Commission (formerly known as the Monopolies and Mergers Commission) also analysed connecting passengers as separate markets. In contrast to this, in *Lufthansa/Eurowings*[162] the Bundeskartellamt considered point-to-point passengers and connecting passengers as belonging to the same relevant market. In any event, the effects of connecting traffic should be taken into account in the overall competition assessment of affected O&D routes.

3.7. Capacity Constraints

Ignoring capacity constraints in any consideration of airport substitutability also leads to incorrect conclusions. In the case of London airports, for example, Heathrow, Gatwick, London City, and Luton are substitutable but are fully utilised (or fully utilised in peak periods in the case of Luton), and where planning and policy constraints prevent expansion of airport capacity at these airports, airport substitutability must be assessed taking into account this factor. For example, the European Commission has ruled that Heathrow, Gatwick, London City, and Luton are substitutable but capacity constraints mean that new entries cannot move there.[163] So while theoretically the Commission evaluates substitutability as possible, it is impossible in practice and disadvantages potential new entrants, thus impacting on the competition environment.

3.8. Other Modes of Transport

Other modes of transport, most commonly high-speed trains, but also car, and ferry, may form part of the relevant O&D markets for air transport services on short-haul routes, where they could be regarded as viable alternatives by customers, in terms of price, frequency, and aggregate travel time. This has been found to be the case with rail services by Eurostar between London and Brussels, which have are substitutable with air services for all passengers, given the comparable aggregate travel times between

159 European Commission, United Airlines/US Airways; Lufthansa/AuA, paras. 64-72.

160 UK Competition Commission (CC), case *Air Canada/Canadian Airlines* Cm 4838 (hereinafter: '*Air Canada/Canadian*') www.competition-commission.org.uk/reports/, where the distinction between time-sensitive and price sensitive passengers was described as reasonable.

161 CC, *British Airways Plc and City Flyer Express Limited*, Cm 4346 (20.07.1999). (hereinafter: '*BA/City Flyer*') http://www.competition-commission.org.uk/rep_pub/reports/1999/430ba.htm#full accessed October 2020.

162 Bundeskartellamt, case B 9 – 147/00 – *Lufthansa/Eurowings*, decision of 19.09.2001 (hereinafter: '*Lufthansa/Eurowings*') www.bundeskartellamt.de/B9-147-00.pdf accessed October 2020.

163 UK CAA, CAP 1135 Appendix D: Evidence and analysis on market definition (10 January 2014).

city centres, frequencies, and prices.[164] The O&D pair in this case was defined as broader than the direct air services and included rail transport.

In cases where the duration of travel is greater but less frequent, rail has been found not to be substitutable. This was the case for rail transport between Zurich and Frankfurt, where the shortest train travel time of almost four hours compared with flight travel of almost three hours was found to be substitutable for non-sensitive (i.e., leisure) passengers. However, the extra hour travelled in each direction and lower number of daily frequencies (less than half), meant that a typical business return day-trip was not be possible; therefore, it was not substitutable for time-sensitive passengers.[165] A similar conclusion was reached in *Air France/KLM* in relation to rail travel between Paris and Amsterdam; in this case, the rail travel journey was one hour longer, with only six daily frequencies compared with 14 operated by the parties.

Ferry services have only exceptionally been found to be substitutable with air services.[166] In the *Olympic/Aegean* case, the Commission found that for passengers (including time-sensitive passengers), ferry services between Athens and Mykonos formed part of the relevant market, with very similar total travel time and frequency of crossings. On the other hand, services to other islands were not substitutable for time-sensitive passengers and it was left open whether other ferry services were substitutable for non-time-sensitive passengers.

3.9. Market-specific Assessment Criterion

Market-specific analysis involves distinctions in the market (s) to identify the affected markets. Examples include subdivision of the wholesale market for airline seats between short/medium-haul and long-haul flights.[167] In its prior decision practice, the Commission has defined a separate wholesale market for airline seats, in which supply is represented by airlines and demand by tour operators that purchase individual seats, block seats or entire flights and integrate them in their package holidays. As a consequence, when considering activities of suppliers (airlines), the Commission has defined a separate market for the wholesale supply of airline seats.[168]When considering activities of

164 Case COMP/A.38.477/D2 *British Airways/SN Brussels Airways* 10 March 2003 para. 19.

165 *Lufthansa/Swiss* supra para 56-58.

166 John Milligan, European Union Competition Law in the Airline Industry (1st edn Wolters Kluwer 2017).

167 Case M.8046 *TUI / Transat France* (2016).

168 M.4600 – TUI / First Choice, recital 57; M.4601 – KarstadtQuelle/ MyTravel, recital 43; M.5867 – Thomas Cook / Öger Tours, recital 16.

customers (tour operators), the Commission has also defined a separate market for the purchase of airline seats.[169]

Practically, however, this approach has limited application, as illustrated by the recent example of the assessment by the Commission of *TUI/Transat France's* transaction.[170] After consideration of all the evidence available, the Commission concluded that the market shares of the merged entity would remain moderate and not higher than 30–40% of markets, such as all package holidays, tours, and stays within the territories of the US and Canada, as well as Costa Rica, Cuba, the Dominican Republic, Guadeloupe, and Martinique. Based on the Commission's assessment, the transaction did not raise serious doubts or concerns under any plausible segmentation.

The transaction kept to its strategy to focus on Transat's profitable expansion in the Americas and on the transatlantic market as a vertically-integrated tour operator, leisure airline, and hotel company. However, the merger made TUI the largest operator in France, with its recent focus predominantly on package holidays. TUI is ranked as seventh for the overseas source market for US inbound tourism, accounting for 1.7 million visitors to the US annually. These data may suggest, therefore, that the merger had anti-competitive consequences and risked hindering new entrants to the market.

The aforementioned Commission's decision clearly illustrates limited practical application of the market-specific analysis, with unpredictable outcomes. In addition to that, the Commission left its definition of relevant product markets open so that market- or sector-specific thresholds may be difficult to apply practically.

3.10. Direct Versus Indirect

Another major question is whether, for time-sensitive passengers, competition should be assessed by reference to direct non-stop services between each of the relevant transatlantic city pairs, or whether indirect flights should be included in the relevant market for such long-haul routes.

3.11. Network Effects on Competition

Airlines benefit from increasing the size of their global network and overall fleet through M&A, and, from a commercial viewpoint, benefit from presenting a large network as an advantage to the public.

169 M.6704 – REWE Touristik GmbH / Ferid NASR / EXIM Holding SA, recital 21.

170 Ibid.

However, large networks are detrimental to competitors, which mean that this criterion is appropriate to market definition for competition law purposes.

By differentiating the market into subcategories based upon its price elasticity or connectivity, the relevant market is narrowed. On the one hand, this leads to an 'artificial' increase in the market share, with weak competition. On the other hand, it limits relevant application of the merger to indirectly affected routes and competitors.

Applying this logic, for two separate markets, mergers between two firms are unlikely to lead to competition concerns. However, the merger may lead to an increase in the overall power of the merged entities, affecting other players in one or both markets through additional capacities gained.

3.12. Critical Loss Analysis Assessment

Another approached proposed by the Commission is critical loss analysis, as exemplified in the case of *Lufthansa/SN Airholding.*[171] Critical loss analysis attempts to collect empirical data to evidence consequences in terms of competition pressure. However, this approach is not appropriate in the industry in which price discrimination is a major feature and where the calculation of avoidable costs can be very complex. Using the dictum of the decision, practical consideration shall be given to the benefits to consumers which could counterbalance the competitive harm. Criticism of the Commission[172] indicating the inappropriateness has included insufficient data being available to analyse the effects, lack of useful empirical techniques for competitive assessment, parties providing their own studies, and unproductive economic analyses.

IV. Other significant barriers to Competition

4.1. Slot Availability as a Barrier to Competition

Lack of available slots (the right to take-off and land at an airport) is the most frequent barrier to entry in airline transport cases, given that slots are required for a competitor to enter, or expand services on a route. Also, the timing of slots is an issue with lack of slots during peak times being a serious entry barrier to potential entrants targeting time-sensitive customers.[173]

Another issue is congestion. In the *British Airways/American Airlines/IB* case[174], the Commission found that the already high shares of the parties were protected by high barriers to entry, in particular

171 Case COMP M/5335 *Lufthansa/SN Airholding* (2009).

172 Simon **Bishop**, Mike **Walker,** *The Economics of EC Competition Law: Concepts, Application and Measurement* (1st edn Sweet & Maxwell 2010) 108.

173 Case COMP/M.3770 – *Lufthansa/Swiss*, supra, para. 3.

174 **Case** COMP/39.596 – British Airways/American Airlines/Iberia (2010).

caused by the lack of slots at London and New York airports. In *KLM/Alitalia,*[175] this was the case with Schiphol and Malpensa on the Amsterdam-Milan route. Although slots were available at secondary airports like Rotterdam or Orio al Serio, these airports were less attractive for new entry.[176] Whether other airports may be viewed as substitutable is relevant for determining the extent to which the activities of parties overlap, where they operate from different airports in or adjacent to the same city, or the competitive constraint exercised by competitors which operate from other airports.[177]

4.2. Entry Costs as Barriers to Competition

Establishing a base at an airport requires a significant upfront investment and involves significant commercial risks. Even if slots are available, slots at major airports are normally extremely costly, which makes entry costs significant. Such costs include ground handling, customer care, and offices at the airport where there have been no operations previously, as well as marketing and advertising costs, customer information, and promotional campaigns, all of which are critical to the individual success of airlines.[178] High airport charges will be a further barrier, particularly for low-cost airlines, where the success of the low-cost business model depends to a large degree on a high load factor (the ability to fill the individual flights with as many passengers as possible).[179] According to Milligan,[180] entry is also less likely on low volume routes where there is a relatively low average load factor on the route.[181]

4.3. Regulatory Barriers

National regulatory restrictions are another significant obstacle preventing market entry, specifically related to long-haul routes between the EU and third countries.

In *Swissair/Sabena,*[182] it was concluded that the mono-designation rule in the bilateral air transport agreement between Switzerland and Belgium prevents effective new entry into the routes between Belgium and Switzerland. Mono-designation ule implies that each Government at the end of the route is allowed to designate only one carrier owned and controlled by its own nationals. In

175 Case COMP/JV.19 – *KLM/Alitalia*.

176 *KLM/Alitalia*, supra. 30.

177 *IAG/Aer Lingus*, supra, para. 47.

178 Case M.3770 – *Lufthansa/Swiss*, para. 44.

179 Aegean/Olympic I and II; Ryanair/Aer Lingus Section 7.8.4.3.

180 John Milligan, *European Union Competition Law in the Airline Industry* (1st edn Wolters Kluwer 2017).

181 *KLM/Alitalia* 1999, para. 30.

182 Case IV/M.616 *Swissair / Sabena* (1995) 395M0616.

Swissair/Sabena,,[183], the only airlines, which were designated to fly on the routes between Switzerland and Belgium, were Swissair and Sabena.

Also in the *Lufthansa/SAS/United Airlines*[184] and *British Airways/American Airlines*[185] transatlantic alliance cases the Commission considered that regulatory barriers limited the scope for competition on the relevant markets by third carriers. This concerned in particular EU carriers which are restricted to operate direct and indirect services on the routes between the above countries and the US and to set their fares freely.[186] Further, an obstacle exists for competition from non-EU or non-US 'fifth freedom' carriers; these use the right granted by a State to another State to land and take-off, in the territory of the first State, with traffic coming from, or destined to a third State. However, this possibility for third countries is not covered by the framework of the EU-US Open Skies Agreement and would be subject to regulatory restrictions in the existing bilateral air service agreements between individual countries.[187]

From a financial perspective, the barriers to entry that evoke concern also include the relatively weaker negotiating positions of new entrants vis-a-vis airport operators over such issues as landing charges and 'the distribution of airport resources.'[188]

V. Current European Commission Approach

5.1. Mergers/ Articles 101 and 102

According to Talbot[189] there is a perception that the European Commission's practice in the area of defining market within the European dimension appears to be informed by a view that there were too many airlines in Europe – leading to a need for a degree of consolidation in industry. In significant alliance cases, in particular, the Commission has taken the approach of accepting the need for cooperation through alliances but seeking remedies when there was a risk of elimination of competition resulting from the agreements at issue.

183 Ibid.

184 Cases COMP 36.201, 36.076, 36.078 – *Lufthansa/SAS/United Airlines.*

185 https://ec.europa.eu/competition/publications/cpn/cpn2002_2.pdf

186 Commission Notices, OJ C 239, 30.7.98

187 SkyTeam alliance, para. 64.

188 Case COMP/M.4439 *Ryanair/Air Lingus* (2007).

189 Conor Talbot, 'Competition law in times of crisis: case studies of the European passenger airline sector and the Irish beef industry' (2016) (PhD dissertation, Cambridge Scholars, available online at; < https://www.cambridgescholars.com/resources/pdfs/978-1-5275-2245-9-sample.pdf> accessed 15 March 2022.

In the *Lufthansa/SAS*[190] alliance in 1996, the two carriers held considerable power over the markets between Germany, Scandinavia, and Northern Europe in general. In recognition of the parties' complementary networks and the potential efficiencies bound up in the deal, the Commission were relatively open to the partnership and set about designing means of obliging the two airlines to assist and encourage new competitors on the overlap routes where competition would be eliminated. Both parties were required to cooperate with any new entrants to allow them to offer feasible and attractive services in competition with their own. In practice, this meant they had to give up slots at congested airports, postpone any plans to expand capacity and put interlining arrangements in place with potential competitors, while also opening up their frequent flyer programmes for new entrants' customers.

In the *bmi/Lufthansa/SAS*[191] case, the Commission assessed that there was a risk that competition would be eliminated for a substantial number of local time-sensitive passengers on the London-Frankfurt route. The cooperation between Lufthansa and bmi resulted in only two carriers remaining in the market for local time-sensitive passengers: the predominant Lufthansa/bmi combination and British Airways. It was only on the basis of market testing that the Commission granted an exemption to the alliance, as it was satisfied that there was interest from third party competitors to enter or expand their services on the relevant routes with the proposed remedies.[192]

In June 1999, the Commission received a notification of a proposed *KLM/Alitalia*[193] concentration pursuant to Article 4 of Council Regulation (EEC) No. 4064/89.[194] The notified transaction was a long-term alliance between KLM and Alitalia, two national flag-carriers with deeply entrenched market positions at their bases, as a result of which the parties would progressively integrate their scheduled passenger networks, sales, revenue management, and cargo businesses. The parties contended the development of hub-and-spoke systems. Deregulation has already led to significant evolutions in the air transport sector, so it was appropriate to consider the transaction referring to a 'global air transport market' where networks compete against each other. While the Commission did not deny that this evolution affects the supply side of the market, it concluded that from the demand side, consumers would continue to ask for a transport service between two points. The Commission, therefore, examined the transaction from the perspective of each O&D city pair operated by either of the parties constituting a relevant market. This meant that the competitive concerns identified by the Commission

190 Case IV 35.545 – *Lufthansa/SAS.*

191 Case COMP 37.812 – British Midland/Lufthansa/SAS.

192 Damien Geradin. *Remedies in Network Industries: EC Competition Law vs. Sector-Specific* Regulation (1st edn: Intersentia 2004) 245.

193 Case COMP/JV.19 – *KLM/Alitalia*.

194 OJ L 395, 30.12.1989, p.1.

were limited to cases of direct overlap in the shape of O&D pairs, where both parties operated with direct flights. Four O&D pairs arose in that instance: Amsterdam-Milan, Amsterdam-Rome, London-Milan, and London-Rome.

The Commission, thus, allowed the arrangements to proceed only after the parties proposed to divest slots at their key home airports, namely Amsterdam, Rome, and Milan. Obviously for business passengers in particular, the frequency of flights is a key market characteristic, and one of the key barriers to entry for competitors onto a market is the availability of slots which allow them to compete here. As such, these slots were opened up for fifth freedom services, whilst, at the same time, the merging companies were required not only to freeze their capacity levels, but also to reduce their frequencies on a number of key routes by a significant margin (up to 40%) showing the seriousness with which the Commission addressed this. The Commission's perspective of the sector, therefore, does not appear to agree with the empty core theory, which frames the market as capable of supporting future profit-seeking entrants.[195]

According to Rahavan,[196] under certain demand and cost conditions, more competition can lead to harmful consequences for industries such as the airline industry, or can cause an empty core problem. The symptoms of an empty core are described by Telser, as extreme price cutting, loss of money by most of the firms in the industry, and yet with buyers wanting the product and being willing to pay higher prices than those currently prevailing.[197]

An example of an assessment under Council Regulation 3975/87 can be found in the Commission's treatment of *British Airways/SN Brussels Airlines.*[198] In this case, parties sought to cooperate on all routes across their respective networks in terms of pricing, scheduling, and capacity. This cooperation was particularly important on the London-Brussels route, through which SN passengers could access the British Airways network from London.

The same was true for regional routes between the UK and Brussels as this was a route which allowed British passengers to then obtain access at Brussels to SN's African routes. Here, the two companies' pre-existing networks were largely complementary to one another rather than overlapping in nature

195Conor Talbot, 'Competition law in times of crisis: case studies of the European passenger airline sector and the Irish beef industry' (2016) (PhD dissertation, Cambridge Scholars, available online at; < https://www.cambridgescholars.com/resources/pdfs/978-1-5275-2245-9-sample.pdf> accessed 15 March 2022.).

196 Sunder Raghavan 'Application of Core Theory to the Airline Industry' (2003) College of Business, Embry Riddle Aeronautical University, available online at; < https://ntrs.nasa.gov/api/citations/20050156079/downloads/20050156079.pdf> accessed 15 March 2022.

197 Lester G. Telser, 'The Usefulness of Core Theory in Economics' (1994) 8 The Journal of Economic Perspectives 151, 154.

198 Case. COMP/A.38.477/D2 – British Airways/SN Brussels Airlines.

and it was therefore relatively simple for the Commission to identify a clear benefit for passengers. However, there was significant overlap on two important commercial routes, namely Brussels-London and Brussels-Manchester. On the London-Brussels route meanwhile, a large degree of competition (not only from firms such as BMI but also as a result of the Eurostar rail link) existed. Thus, the Commission decided that the alliance would not eliminate competition in that market, therefore causing no impediment.

At the same time, the Manchester-London route was served by much less competition, so much so that the joint market share of the cooperating airlines on this route would be a total 100%. As a result, much stronger remedies were regarded as being necessary to encourage new entrants to compete on it. The Commission's investigations identified a shortage of slots in Brussels to be the key impediment here, particularly for business travellers who sought to return to Brussels form London on the same day as their outward flight. The airlines were, therefore, forced to release slots to allow a competitor to provide suitable services.[199] The Commission's approach in this case reflects its policy of viewing the markets in question merely as one-off O&D routes. Clearly then, the remedy imposed had a goal of mitigating the network effects which were obtained by the cooperation of the two airlines[200]

The trend appeared to be towards strengthening remedies in subsequent cases as the Commission's experience increased, for example, by obliging parties to find new entrants up front, requiring the availability of slots to be advertised, and doing more to help new entrants establish a mini-base at the hub airport in question.[201] However, some have argued that even these enhanced remedies have not been effective. Airneth[202] reports from a study of seven airline merger cases: slot remedies were imposed on 36% of city pairs, where new entry took place, but this reduced to 20% after two years, and new entry was substantially lower on long-haul routes than on short-haul routes.

Arguably the most notable of the transatlantic cooperation agreements has been that of Northwest Airlines and KLM, who acquired a stake of nearly 20% in the latter company in 1989. This was a cooperation which took place gradually, over a number of years on the pairs North Atlantic routes.[203] This was an agreement which the US regulators had hoped to quickly approve as part of the US'

199 John Balfour, 'EC Competition Law and Airline Alliances,' (2004) 10 Journal of Air Transport Management 81–85, 84.

200 Conor Talbot, 'Competition law in times of crisis: case studies of the European passenger airline sector and the Irish beef industry' (2016) (PhD dissertation, Cambridge Scholars, available online at; < https://www.cambridgescholars.com/resources/pdfs/978-1-5275-2245-9-sample.pdf> accessed 15 March 2022.

201 OECD Secretariat, 'Airline Competition: Background Paper' (2014) available online at;
<http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP(2014)14&docLanguage=En> accessed 22 July 2020.

202 John Balfour, OECD, 'Airneth, 'Routes with Remedies,' (2014) (European Aviation Club/Airneth Seminar, Brussels, 9 December 2011).

general liberalisation efforts. Thus, the swift approval that this arrangement received from the US authorities was reportedly based on the prospect of KLM having a competitive advantage over other European airlines in terms of accessing US destinations, which would eventually 'corrode resistance' to liberalisation.[204]

Although this policy imperative was not explicitly acknowledged as a factor, the Commission's decision in October 2002 awards significant prominence to the effect of the business model of KLM, which saw passengers largely routed through their Amsterdam hub before being redirected to their ultimate destination. To the Commission, this indicated that taking multiple flights was something which was already acceptable to their customers, thereby prompting a broadening of criteria for defining a substitutable product. As a result, the Commission assessment took into consideration the effect of indirect competition by way of connecting flights as a counterbalance to the parties having market shares as high as 88% and 78% on two important routes. The parties argued that KLM's base at Amsterdam Schiphol airport faced competition from other gateways within its catchment area, in particular from Brussels Zaventem and Frankfurt. In addition to that, the parties argued that there were various indirect, one-stop alternative routes between Amsterdam and Detroit and Amsterdam and Minneapolis/St. Paul. The Commission concluded that there was no effect on competition and declined to seek any of the types of remedies outlined above. Furthermore, the intergovernmental relations between the Netherlands and the US also led the Commission to accept that no structural or regulatory barriers to entry by competitors would subsequently be placed on the market.[205]

On the other hand, the Commission decision on the *Lufthansa/SAS/United Airlines* alliance in October 2002 is illustrative of the complex package of remedies and restrictions that the Commission deemed necessary to render benign the effects of such partnerships with overlap.[206] Here, the key difficulty was that when put together in combination, the participants would have a very strong market share on transatlantic routes both from, and to, Frankfurt, where the German flag-carrier Lufthansa had its base. The Commission's investigations developed into what is now Article 101 (3) analysis, and required evidence that the alliance did not afford parties the opportunity of eliminating competition in a substantial part of the air transport markets. While certain undertakings were agreed by the airlines in some relevant markets, on the Copenhagen-Chicago O&D route, the Commission accepted that there

206 Cases COMP 36.201, 36.076, 36.078 – *Lufthansa/SAS/United Airlines.*

would be effective competition from indirect services.[207] Again, slot competition was regarded as being the key remedy to apply, with some of the network effects which were otherwise enjoyed by participants being ameliorated as a result of slots being freed up for new entrants at Frankfurt. Additionally, the parties also agreed to a 45% frequency reduction on two of the main routes affected although it is suggested here that in the absence of a competitor being able to fill these routes, this would do little to actually help competition and consumers without the slots themselves being freed. It is after all, one thing to free slots, but quite another to ensure that a given route is profitable and encouraging to competition particularly if a given route is being run as a loss-leader for some other commercial reason by an airline.

In contrast with the *KLM-Northwest Airlines* case, potential regulatory barriers were more pronounced in this case. The Commission, therefore, after holding discussions with the US authorities, took the view that undertakings were required to substantially increase the scope for competition in the relevant markets by extending the traffic rights of EU airlines other than those owned or controlled by nationals of the home states of the parties to the alliance. This was deemed necessary to ensure a sufficient degree of potential competition. As part of the package of remedies, the Commission required the authorities of the Member States concerned to authorise any EUcarrier established in the EEA to operate direct and indirect services between any airport in their territory and the US, setting its fares freely. Additionally, the Commission retained the role of assessing whether the national authorities had indeed authorised the operation of sufficient number and type of flights to avoid the alliance eliminating competition in a substantial part of the relevant markets.[208]

Another example to exemplify the Commission's approach dates from 2009 and 2010 when Air France/KLM, Alitalia, and Delta Airlines – members of the SkyTeam airline alliance – signed agreements establishing a transatlantic joint venture.[209] To help mitigate the Commission's concerns the partners made a number of commitments such as to allow competitors to begin operations on their same routes. Eventually, in October 2014, the Commission acknowledged that these final commitments[210] did indeed properly address the competition concerns identified and made them legally binding on the parties under Article 9 of Regulation 1/2003. In contrast to domestic transactions with the NCA being given an enforcement role, an independent monitoring trustee was appointed to

207 Ibid.

208 Conor Talbot, 'Competition law in times of crisis: case studies of the European passenger airline sector and the Irish beef industry' (2016) (PhD dissertation, Cambridge Scholars, available online at; < https://www.cambridgescholars.com/resources/pdfs/978-1-5275-2245-9-sample.pdf> accessed 15 March 2022.

209 Case COMP 39.964 – Air France/KLM/Alitalia/Delta Airlines.

210 European Commission, 'Antitrust' available online at; https://ec.europa.eu/competition/antitrust/cases/dec_docs/39964/39964_1756_3.pdf accessed 15 March 2022.

monitor the parties' compliance with the commitments.[211] The Commission used the same procedure to accept commitments by members of the joint venture within the Oneworld alliance[212] in July 2010 and by members of the joint venture within the Star Alliance in May 2013.[213] In the Lufthansa takeover of SN Brussels Airlines,[214] the Commission applied the demand-based approach under which carriers tend to operate routes where they have a base or a hub at either end. This approached allowed for a more effective definition, although it failed to address the wider problem of the 'synergetic footprint.'

In the *Swissair/Sabena* case,[215] the relevant market was defined by the O&D approach, the airports' catchment areas, and the frequencies on each route. This approach taken by the EU Commission became the starting point of any airline merger analysis. The Commission has also welcomed the potential positive synergies, including fleet planning, strategic network development, financial planning, route management, yield management, and sales.[216] However, how those synergies might affect the overall market has not been taken into the consideration.

In the *Airtours/First Choice* case, the discussion on supply-side substitution was focused on whether a company operating long-haul flights could switch to short-haul flights without incurring significant investments. The conclusion was that because aircrafts used in long- and short-haul flights are not interchangeable and the aircraft costs are relatively high, these two types of flights belonged to two different product markets.

Padilla and O Donoghue[217] argue that while it is technically optimal to use different types of aircraft for flights to different destinations, it is not clear why it is not economically sensible to use, albeit inefficiently, aircraft of a particular type for an alternative use in response to a price increase. This is a quantitative question that requires an economic inquiry into the costs and benefits including more detailed analysis of the costs of leasing aircraft, maintenance costs, of existing capacity, and other related factors. The Commission separated these two markets for purely technological reasons, but it has failed to undertake the relevant economic analysis to draw correct conclusion.

211 Case COMP 39.964 – *AF – KL/DL/AZ.*

212 Case COMP 39.596-*BA/AA/IB.*

213 Case COMP 39.595 – Continental/United Airlines/Lufthansa/Air Canada.

214 Case COMP M/5335 *Lufthansa/SN Airholding* (2009).

215 Case IV/M.616 *Swissair / Sabena* (1995) 395M0616.

216 Jong-Hun Park, 'The effects of airline alliances on markets and economic welfare' (1997) 33 Transportation Research, Part E: Logistics and Transportation Review, (3), 181–195.

217Robert O Donoghue, Jorge Padilla, *Law and Economics of Article 102 TFEU* (3rd edn Hart 2020) 239.

5.2. Criticism of O&D City Pair Approach

For making Commission decisions, the relevant market for scheduled passenger air transport services has been defined on the basis of the O&D city pair approach.[218] This market definition reflects the demand-side perspective, whereby customers consider all possible alternatives of travelling from a city of origin to a city of destination.

The concept that the relevant market is limited to a city pair by a proposed merger is wrong in its essence. Competition nowadays between carriers occurs on a network rather than an individual city pair basis.[219] Harm to competition is not assessed based on the market power of the given route, but rather on the entire network in combination with the operational variables. According to Talbot,[220] even though the O&D approach allows many relevant competition aspects to be taken into account reasonably quickly, this happens at the expense of largely dismissing the commercial realities of the airlines, often treating cooperation agreements and integrated operations as a unified whole rather than a series of isolated routes.[221]

An indicative example of this is the *IAG/Aer Lingus* merger.[222] On 14 July 2015, the EC approved, subject to commitments, a merger whereby International Consolidated Airlines Group, SA (IAG), the holding company of British Airways, Iberia, and Vueling Airlines acquired sole control of Aer Lingus, the publicly listed Irish-based airline. The routes giving rise to concern were those between Irish airports, notably Dublin and Belfast, and London. Within the O&D approach, IAG and Aer Lingus both operated out of Heathrow, and Aer Lingus also operated out of Gatwick.

The Commission found that regarding the Dublin-London city pair, Heathrow was a differentiated airport for travellers seeking network connections, but generally concluded that the parties' operations at Heathrow were constrained by other airlines' operations at Gatwick and London. The combined share of the parties was, however, significant (upwards of 60–70%) and this, coupled with high barriers to entry or expansion by other airlines, specifically regarding the very limited access to slots and terminals at Heathrow and Gatwick, gave the Commission concerns on this route. Similar conclusions were reached in relation to the Belfast-London city pair.

218 M.8361 Qatar Airways/Alisarda/Meridiana (2017).

219 COMP/M.3280 *KLM/Air France* (2004).

220 Conor Talbot, 'Competition law in times of crisis: case studies of the European passenger airline sector and the Irish beef industry' (2016) (PhD dissertation, Cambridge Scholars, available online at; < https://www.cambridgescholars.com/resources/pdfs/978-1-5275-2245-9-sample.pdf> accessed 15 March 2022.

221 COMP 37.444- SAS/Maersk Air and COMP 37.386 – *Sun-Air v SAS and Maersk,* para 27.

222Case No M.7541 *IAG/AER Lingus.*

To address these concerns, the Commission required the release of slots as follows: two daily frequencies between Gatwick and Dublin, one daily frequency between Gatwick and Belfast and two frequencies between Gatwick and either Belfast or Dublin and both. The agreement to release slots could provide for monetary or other consideration as long as terms were clearly disclosed. The parties also agreed to enter into agreements in relation to city pairs released by slot commitments, if requested by another carrier wishing to operate new or increased services on the London-Irish city pair, allowing the airline concerned to offer a return trip comprising a non-stop service provided by IAG one way and the other way by the airline at issue.

As further addressed in Chapter 5 of this thesis such remedies were ineffective in their essence and should include operation commitments including fleet related undertakings. The reason for this was that slot-assignment as a remedy was something which was inevitably likely to fail given the O&D approach, which means that simply assigning an airline a slot at a given hub or airport provides little to that airline's position in the event of an OY&D strategy having been adopted. Another fundamental problem is the market defined by the Commission. Overall, IAG increased its revenue, operating profits, and net profits, while retaining its own brand, flight operations, and headquarters in Ireland, while many Aer Lingus' back-office functions, such as procurement, merged with IAG. Decisions around the purchase of new aircraft and Aer Lingus' business plans also moved to IAG.[223]

Following the acquisition, there has been strong growth in Aer Lingus' transatlantic network. Aer Lingus has added a good number of the transatlantic routes including Los Angeles (from 1 May 2016), Newark (from 1 September 2016), Hartford (from 28 September 2016), Miami (from 1 September 2017), Philadelphia (from 26 March 2018), and Seattle (from 18 May 2018).[224] New long-haul routes are reported by IAG to be performing extremely well. While being part of the same group (IAG), British Airways and Aer Lingus have also continued to operate out of different terminals at both London Heathrow and Dublin. British Airways and Aer Lingus have not consolidated their schedule on overlapping routes either, which in both cases means the barriers to entry or expansion by other airlines have not been decreased. Since September 2015, Aer Lingus has almost doubled its fleet.[225] IAG has been a financial pool while Aer Lingus has been an operational tool.

223 London Air Travel Blog, 'What is the Status of the Integration of Aer Lingus into AEG?' available online at ;<https://londonairtravel.com/2018/02/11/aer-lingus-iag/> accessed 04 November 2020.

224 Aer Lingus, 'Aer Lingus Announces Further Growth to Its Long Haul Fleet' (2017) available online at; <https://mediacentre.aerlingus.com/pressrelease/details/108/10106> accessed 04 November 2020.

225 Ibid.

It is well illustrated by the cases that operational benefits of the successful mergers include increase of the capacities and reduction of costs which is supported by the economies of scale theory. These factors raise the airline position as a global or domestic market player. The increased fleet, an essential outcome of the merger transactions, allows profits to be diverted and adds value from one market segment to another or even to several routes. Hence, affected routes should be considered on a wider scale and all direct and indirect market sectors and catchment areas should be analysed as part of the assessment exercise. For the purpose of this thesis, the 'synergetic footprint' will be used to define the overall exposure (outcome) that the merger transaction might lead to. Synergetic footprint should not be confused with the network and operations competition approach which also suggested by this thesis. Network and operations competition approach is an assessment instrument while synergetic footprint is the likely impact or outcome of the transaction in question. Synergetic footprint might be used in both *ex-ante* and *ex-post* counterfactual analyses.[226]

This thesis disagrees with the Commission's reasoning in the *KLM/Air France* case that the network and operations competition approach is of little relevance to the individual consumer.[227] There is no doubt that examining the extent that efficiencies are passed on to consumers is a valid point made by the Commission.[228] However, a perfectly competitive market maximises the total consumer welfare with a measure of how well a market is performing.[229] The competitive environment must be preserved not only by consumers' ability to have wide range of products with a reasonable price, but also by allowing other market participants to enter into new markets or freely develop within the existing one. An excessive or exclusive focus on consumers ignores the fact that in the medium- to long-term, consumers are best served by a competitive industry in which the number of players is such that they can exert a meaningful competitive pressure on each other.

To sum up, a narrow approach may lead to adverse effects, which could in turn unjustifiably prevent the merger transaction. On the one hand, in the *Airtours/First Choice* case, the Commission limited its analysis of potential entrants too much, by focusing on the entry of small tour operators, which would also need to integrate upstream market to compete effectively, which the Commission argued may be too expensive to achieve. On the other hand, there are other instances of the associated markets, which

226 Counterfactual analysis is discussed in Chapter 5.

227 COMP/M.3280 *KLM/Air France* (2004).

228 C 95/1 Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings (2008/C 95/01).

229 Alison Jones and Brenda Sufrin, *EU Competition Law: Text, Cases & Materials* (6 edn, OUP 2016).

the Commission appears to have ignored, when entry into the market by an airline involved downstream integration by tour operators and travel agencies. An example is Iberia, the Spanish carrier, which owned a charter airline, Viva Tours, a tour operator, Mundicolor, as well its own network of travel agencies throughout Spain.

5.3. Alternative approaches supporting the Network and Operations Competition

The suggested approach based on the synergetic footprint analysis could be supported by academic and practitioners literature.

Similar approach has already been recognised pertaining to a dominant position and tying.[230] According to OECD note[231], from an economic perspective, tying which facilitates the monopolist's ability to engage in profitable price discrimination or which helps the monopolist to meter use of the tying product may be detrimental, and foreclosure of potential competitors in the tied product market is impediment. Further concerns have been raised by US courts that the monopolist may take profits earned in the tying product market over which it has market power, and "invest" them in efforts to dominate the tied product market. Such a practice known as "anticompetitive leveraging" practice. [232]

In its essence, tied product market would be very similar to the routes within the carrier global network that are not directly affected by the transaction in question. For the purpose of this thesis “anticompetitive leveraging” is used to describe anticompetitive effects and instruments that might be available to the airlines as a result of concentration, i.e., market power generated on market A which might be used to obtain or increase market power on market B. Similarity could be found in connection with the global network and operational capacities. Anticompetitive leveraging may be used by the merging airlines in a different submarket (routes) with foreclosure of potential competitors in those markets.

There is also another view and support in academic literature pertaining to an approach very similar to the “Network and Operations”. According to Hovenkamp[233], sometimes courts must consider whether a grouping of products is a relevant market even though each individual product or service in the group might not be as such. This concept of a “cluster” of products and services parallels the Network and

230 Abuse of dominance and monopolisation. OCDE/GD(96)131 available online at:< https://www.oecd.org/competition/abuse/2379408.pdf> accessed 12 January 2021.

231 Ibid.

232 Ibid.

233 Herbert Hovenkamp, “Principles of Antitrust”. West Academic.2017

Operations Competition and would certainly apply to the airlines' cooperation. The most indicative illustration is a network of both airlines with a group of complementary services ("routes") aim to achieve substantial economies of joint provision (economies of scope) or economies of scale when it comes to the fleet which means doing several things together more cheaply than each can be done separately.[234] Because of the unique characteristics of cluster markets, studies of cluster market definition have been limited.[235] Another downside attributed to the cluster concept is that, according to Ayres[236], the use of cluster definitions has preceded the development of a theoretical framework. The same could be said about the suggested approach of this thesis.

One interesting point has been raised here however is that that even though transaction complementarities may be interpreted as economies of scope on the demand side that benefit consumers, this effect is being reinforced by possible economies of scope on the supply side, where it is efficient for a firm to produce the goods or services jointly rather than separately.[237] There is no doubt that the intention of the airlines cooperation is either to combine fleet and networks or to have an overall control over the diverse but still correlated businesses. One of the most indicative examples is IAG with British Airways, Iberia, Aer Lingus, Vueling and Level operate under their separate brand names within the same group.

The relevant unit for the purpose of the airlines' market definition is the 'bundle of goods or services' that is supplied by airlines. The components of the bundle (network in our case) may be substitutes as well as complements[238]. According to the OECD[239], a market definition that is based predominantly on an isolated component of the bundle, while ignoring transaction complementarities, would be incorrect and too narrow. The same would certainly apply to the airlines business.

In general terms, if the price of a component is raised while the prices of the other components remain unchanged, most likely that consumers will not immediately switch to substitute goods, i.e., the demand for the separate components of the bundle is less price elastic than the demand for the bundle.[240] The reason is that consumers normally take into account the effect of the increase in the price of a component on the total price of the bundle. If the price of the component is only a small

234 Alfred D. Chandler, *Scale and Scope: Dynamics of Industrial Capitalism*, (1st edn Harvard Univeristy Press 1990) chapters 5 & 6.

235 Youngsun Kwon, Shin Cho, 'Defining a cluster market' (2015) 39 Telecommunications Policy.

236 Ian Ayres, 'Rationalizing Antitrust Cluster Markets' (1985) 95 Yale Law Journal 109-125.

237 OECD. 'Policy Roundtables: Market Definition' (2012) available online at; < http://www.oecd.org/daf/competition/Marketdefinition2012.pdf> accessed 12 January 2020.

238 Ian Ayres, 'Rationalizing Antitrust Cluster Markets' (1985) 95 Yale Law Journal 109, 111.

239 OECD. 'Policy Roundtables: Market Definition' (2012) available online at; < http://www.oecd.org/daf/competition/Marketdefinition2012.pdf> accessed 12 January 2020.

240 Ibid.

fraction of the total price, a price increase should not lead to any considerable decrease in demand. Owing to the slight reduction in demand, one would expect that there are no alternatives available to consumers, and a separate market would be defined for the component. If further components of the bundle are taken into consideration, demand will become more price elastic. The reason is that other bundles are becoming more attractive. Thus, without transaction complementarities, the price elasticity of demand would decrease while a number of products increase. Hence, a market definition exercise that ignores transaction complementarities might lead to overly narrow markets.[241]

In its essence hub and spoke distribution paradigm shall qualify the airline's network as 'bundle'. There is no need for overlaps, just the ability to have connecting flights already shall be seen as the wider playground for the airlines. In addition to that, by 'creating' a merged airline with the 'refreshed' strategy and enhanced capabilities, it is nothing less but an 'invitation' to the customers to join the airline on a long journey with the bundle of the frequent flyers programmes and other customer related benefits that normally come along with the big names such as Lufthansa[242], BA,[243] Air France[244].

A significant number of the airlines benefit from the cluster market definition based on the demand side as well. According to Ayres[245], consumers may prefer to buy a product group from a single firm even if different firms' products are functionally incompatible in its classic definition. Such interfirm incompatibility reveals the close association between effectively tied transactional complements and explicitly tied goods. To the extent that firms cause this inter-firm incompatibility, they can create transactional complementarity, thereby tying otherwise untied goods. Klemperer[246] has identified several ways that a firm can incentivise or penalise consumers who switch companies. This list includes airlines and their already mentioned 'frequent-flyer' programs that reward the passengers for repeated travel on the same carrier.

Ayres further suggests that transactional complementary is a demand-side analogue to economies of scope, which ties consumers' purchases of product groups (air transportation services in this instance) to individual firms.

241 Ibid.

242 Lufthansa, available online at; <https://www.lufthansa.com/us/en/miles-and-more> accessed 15 March 2022.

243 British Airways, available online at; <https://www.britishairways.com/en-gb/information/partners-and-alliances/oneworld/frequent-flyer-benefits> accessed 15 March 2022.

244 Air France, available online at; https://www.airfrance.com/IR/en/common/voyageurfrequent/flyingblue/discover-flying-blue.htm accessed 15 March 2022.

245 Ian Ayres, 'Rationalizing Antitrust Cluster Markets' (1985) 95 Yale Law Journal 105, 109.

246 P. Klemperer, 'Collusion via Switching Costs: How "Frequent-Flyer" Programs, Trading Stamps and Technology Choices Aid Collusion' (1984) Stanford University Research Paper No 835.

Thus, it can be inferred that the operational and network extension, for instance, ties the passengers by offering 'frequent flyers' bonuses or 'miles' within the entire network, which in practical terms are the impediments to the level playing field.

5.4. Conclusion

In summary, there is a need to reconsider the traditional approaches of the Commission and to take a hard look at the proposed arrangements. Relevant markets have been historically developed and changed from the geographical (catchment area) as well as operational (supply) standpoints. Today, additional determinants need to be considered. Instead of narrowing the relevant market on the demand side and broadening it with supply-side substitutes, the Commission should be more concerned with the competition environment itself. Ideally, market definition should be based upon a supply-based definition of the market, with the assessment focus on a carrier's overall operations and network[247] in combination with the operational benefits that the merged entity acquires. This may yield additional savings for the global network.

Hence, the markets should not be defined narrowly to particular city pairs but should consider competition between the merging carriers' networks. As opposed to the Commission view, as expressed for instance in the *KLM/Air France* case, where the Commission rejected the supply-side standard and opted for a consumer, demand-based definition of the market, this thesis argues that the Commission needs to apply a more flexible approach corresponding to the market power of the of the merging airlines; with this approach the outcome would be different and should include applicable remedies.

There is no doubt that consumers should be protected from unjustifiable fares or other negative outcomes resulting from mergers. However, other stakeholders of the aviation market more broadly should also be given the opportunity to guarantee their existence.

5.5. State Aid

5.5.1 Why is Market Definition Important?

In State aid, the main focus is not on negative market outcomes. State aid control considers the distributive effects of the aid.[248] When defining the relevant market under State aid control, the issues

247 COMP/M.3280 *KLM/Air France* (2004).

248 Magnus Schmauch, *EU Law on State Aid to Airlines: Law, Economics and Policy* (1st edn Lexxion Publisher 2012).

of complementarity and substitutability in supply and demand should be assessed at the market definition stage and not at the market power stage. According to Fingleton, Ruane and Ryan,[249] market power is not a prerequisite for a restriction of competition under State aid control. Therefore, since the focus under State aid control is on the undertakings themselves and their relative position in the market, the relevant market for which the effects of the aid should be analysed includes all the substitute products that compete with the recipient's product, and all the complementary products, which would be affected. For instance, the aid might indirectly affect distribution channels, including agents and travel management companies. In State aid law, the economic appraisal is necessarily influenced by the policy considerations underlying the economic assessment. Thus, ECJ's case law involves reviewing the Commission's interpretation of economic data,[250] which means that the courts must refrain from substituting their own economic assessment for that of the Commission.[251]

The tendency to focus on one side of the evidence would also appear to be consistent with the way in which the Commission has been found by the Court to mishandle economic theories and evidence. The Court explicitly criticised the Commission for not pursuing arguments and for suppressing or misinterpreting evidence.[252] This interpretation is congruent with some of the criticism that has been formulated towards merger control in the EU from direct observations of the procedures. For instance, Kuhn (2002)[253] describes what he refers to as a 'self-confirming' bias in the Commission analysis, namely that the Commission takes a view on cases early on and subsequently focuses on findings which support that view.

5.5.2 The Current Approach

Overall, in defining the markets affected by State aid, in its 1998 decision on the capital increase of Air France,[254] the Commission pointed out that the relevant markets defined by it in a case concerning State aid are more general than those covered by its analysis in the competition cases referred to under Articles 101 and 102 TFEU or Regulation (EEC) No 4064/89.[255]

249 John Fingleton and others, , 'A Study of market Definition in Practice in State Aid Cases in the EU,' (1998) available online at; < https://ec.europa.eu/docsroom/documents/2651/attachments/1/translations/en/renditions/native > accessed 15 March 2022.

250 Case C-290/07 P, *Commission v Scott* [2010] ECR I7763.

251 Case C-525/04 P, *Spain v Lenzing* [2007] ECR I-9947.

252 Damien J. Neven, 'Competition economics and antitrust in Europe' (2006) 21 Economic Policy 48.

253 Kai-Uwe Kuhn, 'Reforming European merger review: targeting problem areas in policy outcomes' (2002) 2 Journal of Industry, Competition and Trade, (4), 311–36.

254 *Air France* Commission Decision 1999/97/EC (1998) OJ 1999 L 63/66.

255 Rosa Greaves, *Judicial review of Commission Decisions on State Aids to Airlines* (1st edn Kluwer Law International, 2000).

The geographical market in State aid control can be defined as either the EEA market in its entirety or a specific regional market particularly subject to competition. The Commission no longer draws a clear distinction between air transport and other means of transport, such as high-speed trains, when assessing Public Service Obligations.[256] Nevertheless, the route-based analysis is fundamental for understanding how the Commission looks at the scheduled air transport business and distortions of competition.[257]

According to the ECJ's case law, 'in order for a market to be held to be sufficiently homogeneous and distinct from others, the service must be able to be distinguished from other services by virtue of specific characteristics as a result of which it is scarcely interchangeable with those alternatives as far as the consumer is concerned and is affected only to an insignificant degree by competition from them. In that regard, the examination cannot be limited to the objective characteristics of the relevant services but must include the competitive conditions and the structure of supply and demand on the market.'[258] In the *Ahmed Saeed case,*[259] the ECJ concluded that to determine the relevant market, 'the test to be employed is whether the scheduled flight on a particular route can be distinguished from the possible alternatives. The application of that test does not necessarily yield identical results in the various cases which may arise; indeed, some airline routes are in a situation where no effective competition is likely to arise. In principle, however, and in particular as far as intra-Union routes are concerned, the economic strength of an airline on a route served by scheduled flights may depend on the competitive position of other carriers operating on the same route or on a route capable of serving as a substitute.'[260] According to the Commission's view, the ECJ's case law is to be interpreted as meaning that 'there is no global market in transport.' Possible alternative transport must be appraised in terms of each international route.[261] It was further extended to 'substitutable routes.'[262] In the view of the Commission, it would appear that any route served by an airline is potentially a separate market,[263] which is a controversial conclusion based on the arguments below. In *EasyJet v Commission*,[264] the General Court also used a route-based definition in cases regarding the abuse of a dominant position.

256 Article 16 Regulation 1008/2008 of the European Parliament and of the Council of 24 September 2008 on common rules for the operation of air services in the Community (recast) OJ L293.

257 Magnus Schmauch, *EU Law on State Aid to Airlines: Law, Economics and Policy* (1st edn Lexxion Publisher 2013).

258 Case C-462/99 *Connect Austria Gesellschaft für Telekommunikation GmbH v. Telecom-Control-Kommission* [2003] ECR I-5219; Case T-229/94 *Deutsche Bahn AG v Commission of the European Communities* [1997] ECR II-1689; Case T-86/95 *Compagnie generale maritime and Others v Commission of the European Communities* [2002] ECR I-1022.

259 Case 66/86, Ahmed Saeed *Flugreisen and Others v. Zentrale zur Bekarnpfung unlauteren Wettbewerbs* [1989] ECLI:EU:C:1989:;140.

260 Ibid.

261 *Eurotunnel* (Case IV/32.490) Commission Decision 94/894/EC [1994].

262 *LH/SAS* (Case IV/35.545) Commission Decision 96/180/EC [1996].

263 *Virgin/British Airways* (Case IV/D-2/34.780) Commission Decision 2000/74/EC [1999].

264 Case T-177/04 *EasyJet Airline Co. Ltd v Commission of the European Communities* [2006] ECR II-1931.

Taking another example, in its decision,[265] it was found by the Commission that Brussels Airline is, for short-, and medium-haul services within the Union operating from or to the Brussels catchment area, of limited substitutability with other available routes and faces only minor competition from them. The Commission has, however, raised a valuable point: the level of interest shown by competitors in the routes under scrutiny is a credible criterion for the assessment process.

In the *Air France* case,[266] the ECJ confirmed the Commission approach to look at the routes in terms of city pairs as the key criteria for assessment, and to consider other issues surrounding the airline markets. A similar conclusion was reached within another investigation addressed to British Airways, American Airlines, and Iberia Lineas Aereas de Espana SA, which led to the conclusions drawn in the Statement of Objections of 29 September 2009.[267] The Commission took the preliminary view that the city pair market definition was also compatible with the characteristics of corporate customers' demand for air transport services. The investigation showed that some corporate customers, such as large multinationals, attached particular importance to the geographic coverage of airline networks.

This and any similar case would be interpreted differently if the Commission considered the adverse effects of potential aid on both overlapping and substitutable routes as well as across the entire network. In its essence, this should be a two-armed test. The first step is to examine the effect on the separate routes. This is a direct effect as referred to above. Secondly, it should evaluate the impact on the global market. This includes evaluation of direct as well as indirect detriments. This would show that capital placed directly or indirectly at the disposal of an undertaking by the State under certain circumstances does not correspond to normal market conditions and should be regarded as State aid. Based on those decisions, geographic coverage should apply not only to the existing networks of the aid recipients, but also networks that might be reasonably considered as the operational or financial alternatives rather than substitutes.[268] For instance, this means routes that might be entered into, that will ultimately affect the existing participants on that particular route or routes within the same catchment area that are not operated at present by the recipient, but for which there is a (reasonable) chance that the recipient might launch operational activities after the aid is received.

265 *British Midland (Zaventem)* Commission Decision 95/364/EC [1995] OJ L 12/8.

266 Case T-358/94 '*Air France v Commission'* [1996].

267 **Case** COMP/39.596 British Airways/American Airlines/Iberia (2010).

268 Volodymyr Bilotkach and Andreas Polk, **'**The assessment of market power of hub airports,' (2013) 29(C) Transport Policy 29–37.

As already mentioned in this chapter, the decision regarding market definition is usually based on an economic analysis applied by the Commission. The problem is that the economic analysis may conclude incorrectly on the effects of a particular transaction, especially from the financial side. For example, there is a good argument that although losing direct competitors effects prices substantially based on the economic analysis, indirect competitors might also constrain organisations in their price-setting behaviour and should, therefore, be considered as part of an investigation.[269] Economic analysis may, therefore, be a misleading tool for the assessment purpose and broader scrutiny may need to be applied to elicit the most accurate outcome of the aid in question.

5.5.3 Criticism of the Current Approach

Fingleton and others[270] argue that there is a need to take the dynamic effects of State Aid into account. If the aid increases production capacity, it can have an impact on the market's structure in the long term. Further, an analysis of the relevant market should comprise not only those elements found in the Commission's Notice, but also the distribution of the aid effects, and the complementary and dynamic nature of the aid.

Nevertheless, the Commission has occasionally applied a more accurate approach and has treated the EU market for scheduled passenger air transport as one single market.[271] This is because many airlines, especially low-cost airlines, make extensive use of their cabotage rights, which allow them to fly all over the EU without operational limitations.[272] An advantage granted to a firm in a small airport may, therefore, benefit it globally, affecting the balance of competition on other routes in which the airline is active.

There are several factors that are important in defining the markets affected by State aid.[273] The first is those products that are strong complements to the aid recipient's product. Ideally, these will be positively affected by the aid, for instance, travel agents, suppliers, or airports. A second factor is the level of competition or the extent of the complementary market. If the complementary markets are relatively narrow, they will lead to mirroring the effects of the aid in the recipient's own market. As exemplified in this chapter, airports within the same catchment area are affected by aid to airlines;

269 Kai Huschelrath and Kathrin Muller, 'Airline networks, mergers, and consumer welfare' (2014) 48 Journal of Transport Economics and Policy (3) 385–407.

270 John Fingleton and others, , 'A Study of market Definition in Practice in State Aid Cases in the EU,' (1998) available online at; < https://ec.europa.eu/docsroom/documents/2651/attachments/1/translations/en/renditions/native > accessed 15 March 2022.

271 Case COMP/M.3280 *Air France/KLM* (2004); COMP/M.5440, *Lufthansa/Austrian Airlines* (2009); COMP/M.5747, *Iberia/British Airways* (2010).

272 Magnus Schmauch, *EU Law on State Aid to Airlines: Law, Economics and Policy* (1st edn Lexxion Publisher 2013).

273 John Fingleton and others, , 'A Study of market Definition in Practice in State Aid Cases in the EU,' (1998) available online at; < https://ec.europa.eu/docsroom/documents/2651/attachments/1/translations/en/renditions/native > accessed 15 March 2022.

airports are also affected by other airlines, which may not be categorised as competitors based on the route-based approach, but may be using a different airport within same catchment area on different routes. This leads to the conclusion that the indirect effect of aid should also be part of the overall assessment exercise. Applying the above-mentioned factors to the aviation sector, the complementary markets are relatively narrow, which are, essentially, other sectors of the existing or potential network and should, therefore, be included in the overall analysis. Supply substitutability of the recipient's market should also be examined to assess the possibility that damage to competition will arise in a market in which the recipient is not currently active, but in which they may have an indirect effect.

In summary, several aspects should be considered within the assessment process, including affected networks in its wide definition, operational benefits that the recipient airline may have access to, and the impact of the aid on complementary markets. Further, the detriment to social welfare should be an additional mandatory assessment criterion applied by the Commission to evaluate the effect that the aid might lead to.

VI. Conclusion

Inaccurate analysis of the market definition by the 'model assumptions' with the supply-side considerations being underestimated, and unjustified priority being given to the demand-side evaluation, is a fundamental problem in the majority of assessments associated with the concentrations and State aid transactions and [assessments] conducted by the Commission. Even though there has been some development, the Commission still narrows down the variables and criteria to identify the affected areas, subjects, and elements.

In summary, the Commission approach does not follow the dynamics of the aviation market. Players are flexible and can easily enter the new markets, substitute fleets, pilots, and enhance their presence. This is seen more than anywhere in the change in approach in the aviation sector away from a capital investment-heavy 'hub and spoke' based strategy towards an O&D based approach, which maximises market efficiency by allowing challenger airlines to focus on particularly lucrative routes or city pairs. As such, airlines can overcome some of the high entry barriers in this market as they do not need to build up/ set up new production centres; they can relatively easily enter the new markets with enhanced resources. For the airlines, the ultimate target of mergers in the majority of the circumstances is not the routes (city pairs) but assets and opportunities they bring. Two airlines today may have one route each, with no overlaps, and with ten aircraft in each fleet. Tomorrow it may merge to be an airline with

20 aircraft with two routes, with an opportunity to either double its presence on one of the existing routes (which will likely affect the existing competition), or to enter a new market on much more favourable terms compared to the possibilities before merging. The failure of the Commission to fully assimilate this understanding of the way which the airline industry has adapted to changing conditions has hampered the effective enforcement of competition law in this area, particularly as it has prevented effective remedies such as slot-assignments from being really effective.

Analysis of the factors contributing to the definition of the relevant market in the airline industry draws attention to the practical implications of such a definition. This recalls the fact that market definition is not a goal in itself, but an intermediate step for structuring an analysis.[274] The aim of market definition is to analyse economic substitutability of products in a structured way, helping reveal infringement of EU law.[275] It is quite obvious that the current approach taken by the Commission is not fit for that purpose.

274 Jakub Kociubinski, 'Relevant Market in Commercial Aviation of the European Union' (2011) 1Wroclaw Review of Law, Administration & Economics (1) 12–21.

275 See also Robert Strivens, Elizabeth Weightman, 'The Air Transport Sector and the EEC Competition Rules in the Light of Ahmed Saeed Case' (1989) 10 European Competition Law Review 557.

CHAPTER 4
SUBSTANTIVE TEST. MERGERS

I. Substantive test

1. Introduction: Structure

The application of competition law to airlines must be viewed as more welcome steps towards the liberalisation of the global aviation market, which will eventually facilitate the emergence of more efficient consolidated airlines. Previous reluctance by Member States to allow foreign participation in their domestic markets justified by national security arguments, in general has been shifted toward more liberal direction with the economic outlook being increasingly uncertain, and the idea of an injection of foreign capital may become more attractive[276]. Consolidation within the internal market has taken place by mergers and acquisitions, which fall to be scrutinised by the European Commission under EU merger control rules. Merger control is, therefore, a key area for the analysis of the application of competition law to the airline sector.

The substantive test governing the competitive assessment is provided by Article 2(2) of the EU Merger Regulation (139/2004/EC) (EUMR), which reads:

"A concentration which would not significantly impede effective competition in the internal market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position, shall be declared compatible with the internal market".[277]

In EU competition law, there is a significant difference in the substantive tests of the EUMR and Article 101 TFEU. Although the EUMR applies the 'substantial impediment of effective competition' test, the Horizontal merger guidelines have established that most of the problematic cases will continue to be based upon a finding of dominance.[278] While all instruments of EU competition law are concerned with market power, the degree of market power normally required for the finding of an infringement under Article 101(1) TFEU is less than the degree of market of market power required for a finding of dominance under Article 102, where a substantial degree of market power is

276 Conor C. Talbot 'The Battle for the Skies: Recent Legal Developments in the EU and US, and their Implications for the Consolidation of the Airline Industry' (2008. National University of Ireland, Galway. Draft Working Paper, January 2008, available online at; < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1655144> accessed 21 March 2022.

277 Article 2(2) Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings (the EC Merger Regulation) OJ L 24.

278 Lars Hendrik Roller, Miguel de la Mano, 'The Impact of the New Substantive Control Test in European Merger Control' (2006) 2 European Competition Journal 9, 10 available online at: < https://competition-policy.ec.europa.eu/system/files/2021-10/new_substantive_test.pdf> accessed 12 June 2023.

required.[279] Mergers sit somewhat in between, as a finding of dominance is often, but not necessarily, required.

Furthermore, coherent competition policy requires that the sectoral regulator and the competition agency strike a consistent balance between competition standards and other policies and public interest as is noted by Kovacic for example.[280] Furthermore, the history of competition policy has featured a continuing search for optimal substantive rules and implementation methods.[281] This search has benefited from continuous, decentralised experimentation with respect to analytical principles, enforcement procedure and investigation techniques, and organisational innovation. Improvements in substantive standards are likely to be achieved by an incremental process of adjusting enforcement boundaries inward and outward, and by assessing the consequences of pressing for more or less intervention.

Another critical element that should be examined is the growing use of the counterfactual approach in EU law.[282] This method has become more popular as the Commission has endeavoured to adopt an effects-based approach under Articles 101 and 102 TFEU[283]. However, the nature of the counterfactual depends on the type of assessment. For instance, in merger control, counterfactuals are established on an ex-ante basis, often taking the status quo (i.e., the market as it is before the transaction) as the reference. On the other hand, in investigations under Articles 101 and 102, the counterfactuals defined are normally established on an ex-post basis,[284] which is retrospective analysis after the action is taken with the assessment whether an intervention has achieved its expected effects.[285]

In this thesis the use of the counterfactual method by the Commission will be scrutinised to the extent relevant to the aviation transactions. To do so, firstly, this chapter will specify the issues with the focus on the academic opinions as well as approaches taken by the Commission in the context of the

279 European Commission Communication on Guideline on the Applicability of Article 101 of the Treaty of the Functioning of the European Union to Horizontal Co-Operation Agreements OJ C 11.

280 WE Kovacic, 'Competition Policy in the European Union and the United States: Convergence or Divergence?' (2008) Bates White Fifth Annual Antitrust Conference, Speech delivered on June 2 2008, available online at; https://www.ftc.gov/sites/default/files/documents/public_statements/competition-policy-european-union-and-united-states-convergence-or-divergence/080602bateswhite.pdf accessed 22 March 2022.

281 Berend R. Paasman, 'Multilateral Rules on Competition Policy: An Overview of the Debate' (1999) International Trade Unit Division of Trade and Development Finance, available online at; <https://repositorio.cepal.org/bitstream/handle/11362/4369/1/S9890697_en.pdf> accessed 21 March 2022.

282 Damien Geradin, Ianis Girgeson, 'The Counterfactual Analysis in EU Merger Control' (2013) Tilburg Law and Economics Centre, Paper Prepared for the Conference "The Pros and Cons of Counterfactuals" Swedish Competition Authority, Stockholm, delivered on 6 December 2013.

283 Counterfactuals are discussed in various Article 101 guidelines and in the Article 102 Guidance Paper. In June 2013 the Commission published a Communication and a Practical Guide on quantifying antitrust damages, which contain a detailed analysis of various counterfactuals.

284 European Commission, 'Ex post assessment of the impact of state aid on competition: Final Report' available online at https://ec.europa.eu/competition/publications/reports/kd0617275enn.pdf accessed 22 March 2022.

285 Damien Gerardin, Iainis Girgenson, 'The Counterfactual Method in EU Competition Law: The Cornerstone of the Effects-Based Approach' (2011) in Jacques Bourgeois, Denis Waelbroeck (eds), *Ten Years of Effects-Based Approach in EU Competition Law: State of Play and Perspectives* (1st edn Bruylant 2012) 211.

assessment and application of substantial test including in the context of the airline restructuring assessment and application of the market economy investor principle and the one time – last time principle. Secondly, it will analyse the relevant counterfactual approach and its application by the Commission. Thirdly, the network competition approach will be suggested as an instrument to rectify the existing gaps within the Commission's assessment practice. It will look into the elements that are not currently integrated into the narrow test that the Commission tends to apply.

This thesis examines how social welfare is affected by the strategic consolidation falling within the scope of the competition law realm as well as considers the scenarios how it can be optimised by a government that can choose to allow entry or not and that can set the restrictive instruments in an airline market. The possibility of entry deterrence by incumbent airlines is also taken into account.

Finally, in addition to the critical analysis illustrated in Chapter 3, in order to highlight that the discrepancies between consumer and social welfare considerations the market definition will be briefly reviewed to demonstrate the most accurate approach to be taken in that regard. It will also propose the necessary measures that might mitigate the detriments caused by the inconsistency and, more importantly, narrowness of the said approaches in order to define an accurate assessment criterion applicable to the State aid in the airline industry. It will discuss various categories of the aid applicable to the airline industry. As well as assess different types of the aids with the focus on the relations between airlines and states, as well as local airports and airlines.

2. The Concept of Network-Based Competition

2.1. Economies and network growth

The analysis in this chapter will rely heavily on the concept of airline network and network-based competition. It is, therefore, important, to discuss and clarify these concepts at the outset. Different indices are used to measure cost performance within the European Airline Industry. By using the number of routes as an indicator of network size, it is possible to estimate indicators of economies of scale and spatial scope. By estimating total and variable cost functions it is possible to calculate an index of the excess capacity of the firms. it has been suggested that that at some point of the analysed period almost all the firms have had economics of density in their existing networks, while several of the firms also had economies of scale and economies of spatial scope. All of the firms had excess capacity of fixed inputs.[286]

286 Manuel Romero-Hernandez & Hugo Salgado, 'Economies of Scale and Spatial Scope in the European Airline Industry' (2006) ERSA conference papers available online at; < https://ideas.repec.org/p/wiw/wiwrsa/ersa06p905.html > accessed 22 March 2022.

Before the Covid-19 outbreak, results[287] supported a hypothesis that fusion, alliance, and merger strategies followed by the principal European airlines are not just explained by marketing strategies, but also by the cost structure of the industry. Results suggested that almost all the firms had economics of density[288] in their existing networks, while several of the firms also had economies of scale and economies of spatial scope. All of the firms had excess capacity of fixed inputs.

The growth of networks can be understood as an attempt to exploit economies of traffic density, under which the marginal cost of carrying an extra passenger on a nonstop-route falls as traffic on the route rises. Economies of density arise because high density allows the airline to use larger, more efficient aircraft and to operate these aircraft more intensively at higher load factors. In addition, higher densities allow more intensive use of fixed ground facilities as well as more effective aircraft utilisation with more flight hours per day.[289] Network growth meanwhile has been connected to three changes in the structure of the industry. First, after an initial decline, industry concentration has increased at the national level over the post deregulation period. Second, concentration has increased at certain key hub airports, which has been dominated by a single carrier. Third, despite the rising national concentration of the industry, competition in the average city-pair market has grown over the period.[290] Third aspect is normally taken by the Commission as a fundamental point for the assessment of the transactions.

However, from the social welfare position, a network effect shall be taken into the consideration with increase of the value and diminishing effect within the overall network, for the existing passengers and customers (in air freight industry) not to be ignored. For instance, in hub-and-spoke networks, the operation of a network requires heavy use of a hub airport, which gives a carrier several natural advantages in competing for traffic originating and terminating at the hub which allows the carrier to increase its share of local traffic at the hub, creating airport dominance.[291] One of the most critical advantages includes raise of the value of the airline's frequent-flyer program to residents of the hub city, creating loyalty to the carrier.[292] Since the carrier's traffic densities on route segments to the hub are higher compare to competitors, its marginal cost of serving hub-bound or hub-originating

287 Ibid.

288 Ibid.

289 Jan K. Brueckner, Pablo T. Spiller, 'Economies of Traffic Density in the Deregulated Airline Industry' (1994) 37 The Journal of Law & Economics 379, 415.

290 Ibid.

291 Ibid.

292 Severin Borenstein, 'Hubs and High Fares: Dominance and Market Power in the U.S. Airline Industry' (1989) 20 RAND J. Econ. 344, 345.

passengers is lower. This cost advantage may allow to the hub airline to eliminate competitors through aggressive fare cutting. Furthermore, evidence shows that the market power resulting from these effects leads to an increase in fares for local passengers.[293]

There is strong evidence[294] that airline mergers lead to a significant increase in concentration at selected airports and on nonstop routes emanating from those airports.

For example, in the *AIG/Air Lingus* deal case the merger substantially increased the concentration of IAG as the Group at Gatwick airport, with the combined Group accounting for firth of total airport capacity.

Following merger, many nonstop routes out of the hub become more concentrated, with the merger usually removing one of the two airlines that served those routes.

2.2.Network based analysis

The issue of control over a related market is not limited to monopoly supply of specific materials but extends to a wide range of services (as well as goods) that are necessary inputs for the purposes of competing on another market. Hence, a concept of "network" shall be introduced.[295] Network Competition Approach and Network Effect can both be critical elements for the assessment of transactions which might have an impact on the aviation market from the competition law standpoint. There have been a number of cases in the transport sector where the operator of a transport hub has in practice been able to control the conditions of competition facing actual or potential competitors on the relevant market.[296] Hence, it can be said that the network also include the markets that might be affected (not necessarily controlled) by the operator having access to them.

In the centre of the network competition approach is the fair-trade concept. It is based predominantly on a social welfare's consideration. The level playing field shall stimulate equality of opportunities and maintain such equality by means of the preventing the reduction of the players as well as ensuring equal access to the market on the equal terms.[297]

293 Severin Borenstein, 'Airline Mergers, Airport Dominance, and Market Power' (1990) 80 Am. Econ. Rev. 400-404; U.S. Department of Transportation, 'A Comparison of Air Fares and Services at St. Louis Before and After Trans World Airlines' (1989) Acquired Ozark Airlines Document DOT-P-37-89-3, U.S. Department of Transportation ; U.S. General Accounting Office, 'Airline Competition: Fare and Service Changes at St. Louis Since the TWA-Ozark Merger' (1988) Document GAO/RCED-88-217BR, U.S. General Accounting Office; and Gregory J. Werden and others, 'The Effects of Mergers on Price and Output: Two Case Studies from the Airline Industry' (1991) 12 Managerial & Decision Econ. 341, 352.

294 Severin Borenstein. 'The Evolution of U.S. Airline Competition' (1992) 6 Journal of Economic Perspectives 45-73.

295 David Bailey and others, *Bellamy & Child: European Union Law of Competition* (8th edn OUP 2018).

296 *Port of Rodby*, OJ 1994 L55/52*; Sealink/BuI Line* [1992] 5 CMLR 255; *Sea Containers/Stena Sealink*, OJ 1994 L15/8; *Brussels Airport*, OJ 1995 L216/8.

297 Matthew Elliott, Andrea Galeotti, 'The Role of Networks in Antitrust Investigations' (2019) 35 Oxford Review of Economic Policy 614, 614.

In a similar way, the only individual state support that might be allowed is the support to prevent the detriment to the public interest in which case the network competition approach shall include the public interest variable rather than be overpowered/overreached by it. In case of the state aid network competition approach shall consider the benefits out of the overall network, together with the operational elements of an individual airline – such as fleet, personnel, etc. Therefore, although it might sound unbalance but in theory, state aid shall be available to the relevantly big (another word) players only with the substantial assets and promising (another word) business model to be proposed. Inability of the small players to compete is an indication of ether: 1) unhealthy market, or 2) inadequate business model and strategy that should not be subsidies by means of the taxpayers. Either issue is the concern that shall be addressed.

The Network and Operation approach will be considered through this Chapter in line with the existing assessment criterion in order to highlight the critical impediments that have been caused by the inaccurate approach taken by the Commission.

II. Mergers

1. Regulatory framework and its development. Overview

On 10 July 2007 the Commission adopted the Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings (the "Merger Regulation"). The Consolidated Jurisdictional Notice replaced the previous four jurisdictional Notices, all adopted by the Commission in 1998 under the previous Merger Regulation: Council Regulation No. 4064/89.[298]

As it was already mentioned, under the Merger Regulation, the substantive test upon which the Commission can block a transaction is if such transaction would significantly impede effective competition. National competition authorities may also review concentrations that do not meet the thresholds under the Merger Regulation but meet the different, generally lower, national thresholds. Aviation mergers are, however, almost always reviewed under the Merger Regulation.

298 European Commission, 'Competition: Jurisdictional Notices' available online at; < https://ec.europa.eu/competition/mergers/legislation/draft_jn.html> accessed 21 March 2022.

Transactions which meet either of the two turnover thresholds set out below have an EU dimension and must be notified to the Commission unless they satisfy the two-thirds exception.[299]

These thresholds are solely turnover based. The nationalities of the parties, whether or not they have assets within the EU, and whether or not the transaction is likely to have any impact on competition in the EEA, are irrelevant to the question of whether or not a notification must be made.

The main threshold is met when both the:

ii. Combined aggregate worldwide turnover of all the undertakings concerned exceeds EUR5 billion.
iii. Aggregate EU wide turnover of each of at least two of the undertakings concerned exceeds EUR250 million.

The alternative threshold is met if:

i. The combined aggregate worldwide turnover of all the undertakings concerned exceeds EUR2.5 billion.
ii. In each of at least three member states, the combined aggregate turnover of all the undertakings concerned exceeds EUR100 million.
iii. In each of at least the three member states included for the purpose of the above criterion, the aggregate turnover of each of at least two of the undertakings concerned exceeds EUR25 million.
iv. The aggregate EU wide turnover of at least two of the undertakings concerned exceeds EUR100 million.

However, even if a concentration satisfies the main and/or alternative thresholds, there is no EU dimension if each of the undertakings concerned achieves more than two-thirds of its aggregate EU wide turnover in one and the same member state. The Merger regulation also applies to mergers with a 'Community dimension' between non-EU airlines. Historically, the European Commission has reviewed the *United/USAir,*[300] *Delta/Pan/Am*[301], and *Singapore Airlines/Virgin*[302] joint ventures under

299 Porter Elliott and others, 'Merger Control in the EU: Overview' available online at; https://uk.practicallaw.thomsonreuters.com/6-578-2386?__lrTS=20200315045336968&transitionType=Default&contextData=(sc.Default)&firstPage=true#co_anchor_a387509 accessed 21 March 2022.

300 Case No Comp/M.2041 *United Airlines/US Airways* [2001] OJ L-2985.

301 Case No IV/M.130 *Delta Air Lines v Pan Am* [1991] OJ L-2985.

302 Case No Comp/M.1855 *Singapore Airlines/Virgin Atlantic* [2000] OJ L-2985.

the EU regime. In, 2004 the EC Merger Regulation (EUMR) adopted the substantial impediment of effective competition test and abandoned the earlier standard that required proof of dominance as a necessary element to intervene in a merger. It is said by Monti, that this reform was necessary because the dominance test failed to catch unilateral effects absent dominance, so there was a 'gap' in the ECMR and this appears to be a cogent explanation of the shift in approach adopted by the EU here.[303]

The substantive test was revised by the Council in EUMR. Consistent with that revision, the Commission issued guidelines, the Horizontal[304] and Vertical[305] Merger Guidelines, describing its analysis, which included assessing concentration levels and elements in the affected markets identifying the competitors in the market/s and their relative share/s of that market; assessing whether the merger creates or enhances the merged firm's ability or incentives to exercise market power, either unilaterally or in coordination with competitors; assessing whether other market forces, such as the entry of new competitors or the countervailing power of customers, eliminate the risk of a substantial lessening of competition; and assessing any pro-competitive effects or efficiencies that may result from the merger. The new regulation introduced the "significantly impedes effective competition" standard as the substantive test to be used in assessing mergers. This ensures that unilateral, as well as coordinated, effects will be taken into account meaning that the Commission now has competence in two distinct types of market situations, which will be examined separately. By also covering the unilateral effects of a merger the new test means that the Commission is now free to block a merger if the post-merger market is going to be significantly worse off – even when tacit collusion is not likely and no dominance is predicted.

The addition of this extra limb to the test has been of great significance to the airline industry because it allows the Commission to take into account the so-called "network effects" of a proposed merger. Unfortunately, the "network effects" have not been regularly considered to the extent that would allow assessing the broad implications of the proposed transactions.

As noted, according to Monti, [306] the decision to amend the ECMR was unnecessary from an economic perspective because the dominance standard was sufficiently flexible to address all anticompetitive

303 Giorgio Monti, 'The New Substantive Test in the EC Merger Regulation – Bridging the Gap Between Economics and Law?' (2008) LSE Law, Society and Economy Working Papers No 10/2008 London School of Economics Law Department, available online at; https://www.lse.ac.uk/law/working-paper-series/2007-08/WPS2008-10-Monti.pdf accessed 21 March 2022.

304 Commission Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings' (2004) OJ C 31.

29 Commission Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings (2008/C 265/07).

306 Giorgio Monti, 'The New Substantive Test in the EC Merger Regulation – Bridging the Gap Between Economics and Law?' (2008) LSE Law, Society and Economy Working Papers No 10/2008 London School of Economics Law Department, available online at; https://www.lse.ac.uk/law/working-paper-series/2007-08/WPS2008-10-Monti.pdf accessed 21 March 2022.

mergers. Economists' concerns about merger control (in both the EU and US) was that authorities focused on a structural assessment premised upon market definition and market concentration and failed to give sufficient attention to other means to test for anticompetitive effects in a more direct manner. Economists' support for the new test is that it would place a focus on these other methods for identifying anticompetitive effects. From a legal perspective, it seems that the major motivation for reform was to divorce merger control from the abuse of dominance doctrine in Article 102, so that the two legal provisions would develop independently, the latter only applicable to manifestations of significant market power.

It is further suggested[307] that this misunderstanding might explain why the Horizontal Merger Guidelines designed to indicate how the new standard applies are insufficiently precise. The Commission appears to regulate the market rather than remove an impediment of competition caused by the merger, with the risk that the new standard is so loose that it allows the Commission to address questions of industrial policy through the ECMR. In general, the Commission cannot prohibit a concentration unless it establishes that the transaction will result in a significant impediment to effective competition.[308]

2. Classifications

Significant Market Power (SMP) Dominance has been at the confluent of different competition law concepts: Article 101 TFEU which prohibits coordinated practices between competitors, Article 102 TFEU which prevents an abuse of a dominant position by several firms collectively and the EU Merger Regulation ("EUMR") which allows the prohibition of mergers resulting in coordinated effects.

From the market structure standpoint, mergers transactions are classified as horizontal or vertical, which depends on various factors, including the economic function, purpose of the business transaction and relationship between the merging companies. Horizontal merger is a business consolidation that occurs between firms who operate in the same market, often as competitors offering the same service and, according to the general trend, are common in industries with fewer firms, as competition tends to be higher and the synergies and potential gains in market share are much greater for merging firms

307 Ibid.

308 Case T-342/99 *Airtours plc v Commission* [2002] E.C.R. II-2585; The General Court has confirmed that a merger may only be prohibited under the EUMR if it has the direct and immediate effect of (as the substantive test then stood) creating or strengthening a dominant position. *Airtours plc v Commission* (T-342/99) [2002] E.C.R. II-2585, at [58]. The General Court also emphasised in Airtours, at [82], that, "if there is no significant change in the level of competition obtaining previously, the merger should be approved because it does not restrict competition".

in such an industry. It is a general assumption that horizontal mergers help a company to either increase market share or diversify its product offering and therefore its addressable market[309].

Concerns that arise in respect of horizontal mergers relate to the elimination of competition between rival firms which, depending on their size, can be significant. Issues that come under consideration in such mergers are whether there is a material reduction in the level of competition, and the implications of that for consumers; the market power the merged business is likely to enjoy following the merger; and the degree to which any increase in concentration in the relevant market may strengthen the ability of the market's remaining participants to coordinate pricing and output decisions.[310]

Horizontal mergers always reduce the number of competitors in the market. If barriers to entry are significant and the combined market share of the merging airlines exceeds a critical threshold, competition will be constrained, leading to welfare losses and harming consumers.

Depending on the pre-merger market structure, several options for anti-competitive effects of an airline merger exist. In case of a duopoly, a merger will inevitably result in a monopolistic market structure. Since most competitive intra-European markets are only served by two airlines, this problem arises with almost all transnational mergers. If prior to the merger more than two airlines serve a city-pair market, the competitive effect depends on the market share of the two merging partners compared to the market share(s) of the remaining competitor(s). However, in some cases the merging airlines claim that without the merger, one of the merging airlines would have ceased its operations ('counterfactual'), thereby arguing that the merger is not the determining factor for market concentration.

In a monopoly market, a strengthening of the incumbent's position might occur also if the other airline is considered to be a potential competitor. Many city-pair markets have a low passenger volume, allowing only one airline to operate. However, those 'thin' markets are often characterized by low barriers to entry (e.g. services between two secondary airports) and therefore do not cause competitive concerns.

309 Gustavo Grullon and others, 'Are US Industries Becoming More Concentrated?' (2017) available online at; <https://pdfs.semanticscholar.org/138f/249c43bfec315227a242b305b9764d57a0af.pdf> accessed 21 March 2022.

In the case of vertical mergers, concerns tend to be about possible changes to the pattern of industry behaviour following the merger, rather than the reduction in the number of rivals in a given market. For example, the merger may increase the likelihood that competitors to the new merged business may no longer have access to inputs they require to compete in the market, or suppliers will no longer be in a position to sell their goods or services to a customer that forms part of a merged entity. Examples may include interactions with upstream suppliers, in particular suppliers of hotel accommodation and of airline seats, and with downstream retailers, i.e., travel agents. Whether such developments are detrimental to effective competition is at the core of any examination of such transactions. Recent examples include already mentioned TUI acquisition of Transat in 2016[311]. In addition, for consumers, the mergers may eventually result in higher prices and reduction in service quality. Though the new company perhaps did not intend to raise fares, one of the rationales for airline mergers is to cut capacity. That reduces the number of seats in the industry and allows airlines to increase fares. Also, consolidation gives more leverage to the airlines which leads to the less choices, fewer routes, and more fees.

3. Jurisdictional test

Although principles of merger evaluations adopted by various regulators appear to be consistent in general, conflicting views have been reached by different government agencies over certain merger application.[312] The EUMR provides for a bright-line jurisdictional test. When this test is satisfied, notification to the EC is compulsory and the merger cannot be completed until an approval decision has been issued by the EC (or a waiver from the obligation to suspend pending approval has been granted, which is rare).

There are essentially two elements to the jurisdictional test: concentration and dimension. Both elements must be met for a merger to require notification to the EC. The first element is that there is a "concentration". The question of what is a "concentration" is relatively settled after some years of application of EUMR. A concentration will exist where there is a transaction leading to a change of "control" of an undertaking. An "undertaking" essentially means a business with a commercial presence on a market. A "concentration" could arise as a result of a merger between two previously independent undertakings as well as the acquisition of control by one (or more) undertaking(s) over another undertaking (which includes, for the purposes of the EUMR, the creation of a full-function

311 Case No. M.8046 *TUI / Transat France* (2016).

joint venture).[313] Control by one undertaking over another will be conferred where the former has the ability to exercise decisive influence over the latter. Although the line between what is and what is not decisive influence can raise complex issues in practice, the concept itself is relatively well-understood. This relative certainty in relation to the EUMR's approach to the definition of a "concentration" was, however, disturbed by the EC in 2014, with its White Paper, "Towards more effective EU merger control", in which it considered that certain acquisitions of minority stakes, which did not result in a change/acquisition of control under the EUMR, could be found to have a negative impact on competition.[314] The White Paper set out a proposal to bring acquisitions of minority shareholdings falling below the level of control within the scope of the EUMR.

The EC proposed a targeted transparency system to capture anti-competitive acquisitions of minority shareholdings. The system would limit the administrative burden on undertakings because the EC would only need to be informed of a limited number of cases, namely those which would create a "competitively significant link". The reactions to this proposal were mixed, eventually resulting in the abandonment thereof. Based on the remaining proposals of the 2014 White Paper, the EC launched a public consultation in 2016. Generally, the Commission is concerned that the interlocking directorships might facilitate co-ordination in competitive behaviour. Thus, undertakings are proposed to eliminate those concerns. The Commission concern was raised in its paper "Minority Shareholdings", OECD, DAF/COMP (2008), by stating that interlocking directorates may facilitate collusion or the unilateral exercise of market power by serving as a means by which market – sensitive information can be passed between competing enterprises. This also might affect the incentives of competing firms to compete vigorously being driven by the motive of profit maximisation. Also, the acquisition of a minority stake may be regarded as anti-competitive if it seems likely to have been made in pursuit of a strategy to deter entry to a market, or to have that effect.

The most prominent example of a minority participating on giving rise to unilateral effects is Irish budget airline Ryanair's stake in rival Irish carrier Aer Lingus. Whilst the European Commission blocked Ryanair's proposed acquisition of control over Aer Lingus as creating a monopoly or near-monopoly on many air connections between Ireland and other European cities[315], it had no power to order Ryanair to dispose of the 29.8 % of Aer Lingus' share capital it had acquired during the first merger procedure, as requested by Aer Lingus. As the General Court confirmed, since that stake did not confer Ryanair decisive influence (i.e., control) over Aer Lingus, its acquisition did not constitute

313 Article 3(1) Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (EC Merger Regulation) OJ L 24.

314 European Commission, 'White Paper: Towards More Effective EU Merger Control' (2014) COM/2014/0449 final.

a (partial) implementation of the prohibited concentration that the Commission could order to unwind under Article 8(4) of the Merger Regulation.

On the other hand, the UK Office of Fair Trading, then investigated whether Ryanair's minority stake in Aer Lingus affected competition to the detriment of UK customers. It referred the case to the Competition Commission, which concluded that that minority shareholding granted Ryanair ''material influence'' in Aer Lingus (within the meaning of the UK Enterprise Act)[316] and was likely to substantially lessen competition on routes between Ireland and the UK. It therefore ordered Ryanair to reduce its shareholding to 5 %.[317] Subsequently, the Competition Commission's order was confirmed on appeal by the Competition Appeals Tribunal and by the Court of Appeal.[318] Although, the decisions as such are relatively rare and, according to some discourses, highly unlikely to be proven by any enforcement agency in any other case, what could be taken from that indicative example, is the conclusion by the Competition Commission that through its participation in the share capital of Aer Lingus, Ryanair was able to weaken Aer Lingus as a competitor by for example blocking special shareholders' resolutions necessary for issuing shares or raising capital for major investments or for entering an alliance or merging with other airlines.[319] In turn, this shows that potential anti-competitive effects arising from non-controlling minority shareholdings are real and not just theoretical.

Practically, and quite commonly in the airline industry, interlocking directorship and minority shareholding is relevant to the ownership and control regulation, by which only Member States or nationals of Member States shall own more than 50 % of the airline and effectively control it, whether directly or indirectly through one or more intermediate undertakings[320]. Meanwhile, the second element of the test meanwhile is to determine whether or not the concentration has an "EU dimension". This does not typically raise difficult-to-resolve conceptual questions, and is instead a matter of fact for the Commission on any given case and is not required to be discussed further.

In the discussion of the jurisdictional and the substantive tests, focus on the relevance to the thesis and, in particular, to their application to the aviation industry.

316 Enterprise Act 2002.

317 Ryanair Holdings plc v The Competition and Markets Authority and Aer Lingus Group [2015] EWCA Civ 83.

318 Ibid.

319 Mark Furse, 'Testing the Limits: Ryanair/Aer Lingus and the Boundaries of Merger Control (2017) 12 European Competition Law Journal 462, 464.

4. Mergers' effects

According to Seretis,[321] dominance as an assessment standard is an inaccurate criterion. The natural meaning of the term "dominance" would suggest that a merger should only be disapproved if it would result in a position of market leadership. After all, only a leading firm can dominate its market. The jurisprudence of the European Court of Justice reflects this view. The Court has pronounced that, "very large [market] shares are in themselves…evidence of the existence of a dominant position".[322]

Although the wording of the new Merger Regulation appears to place market dominance on the same standing as the general "impediments to effective competition" requirement, which would capture unilateral effects not related to dominance, the dominance-centered analysis has survived into the new regime. It could be suggested that the amendment of the Merger Regulation renders the conceptual differentiation of the two tests irrelevant, since, under the new regime, "dominance" and "impediments to effective competition" are equivalent grounds for a finding of incompatibility with the internal market.

However, such a view would accord insufficient regard to the fact that, in principle, the two notions are distinct, and that, consequently, the finding of either in the course of a competitive review is subject to different conditions. This conceptual distinctness was reiterated in Recital 25 to the Regulation, according to which,

The notion of "significant impediment to effective completion" should be interpreted as extending, beyond the concept of dominance, only to the anticompetitive effects of a concentration resulting from the non-coordinated behaviour of undertakings which would not have a dominant position on the market concerned.

The concept of a "significant impediment to effective competition" was envisaged to cover situations beyond the ambit of "dominant position". It would therefore be unwarranted to substantively equate the two, since each was intended to govern a different situation. The assertion that the substantive difference between the two terms should be disregarded merely because the two concepts can

321 M Seretis, 'Airline mergers in the European Union and the United States. A retrospective account and the ways forward' (2014), Institute of Air & Space Law Faculty of Law McGill University, available online at; < https://core.ac.uk/display/41897721?msclkid=95dcdf94a92f11ecb9e3d793568d3848> accessed 21 March 2022.

322 Case T-228/97 *Irish Sugar plc v Commission of the European Communities* [1999] ECR II-2969 at II-3008.

ultimately have the same effect, namely a declaration of incompatibility with the internal market, would be placing the cart before the horse. Besides, the Commission did insist that,

"By keeping the concept of dominance unaltered, the new test will preserve the acquis and, thus, the guidance that can be drawn from past decisional practice and case law. As a result, previous decisions and judgments could still be relied upon as precedents when considering whether a merger is likely or not to create or strengthen a dominant position".[323]

First, a merger can result in the creation of a monopoly. The post-merger concentration will be the sole provider of a service, will control supply and prices, and will be setting both without any regard for the needs of the market. Instead, the service provider will produce and price at such levels as are required for the maximisation of his profits.[324] This scenario would arise in markets originally hosting only two suppliers, who then decide to merge.

Second, a merger can result in or exacerbate an oligopoly, whereby the post- merger market will be dominated and controlled by only a few suppliers. If the market share accruing to the merged entity were high, then the present scenario would be very akin to the preceding one. Conversely, if the market share accruing to each supplier were not substantial, then there could be no finding of individual market dominance. Provided the antitrust market comprises homogenous, substitutable products, no individual agent would be able to unilaterally increase prices and/or reduce output without adversely affecting his profitability. Any such unilateral pursuit would most likely be punishable by consumer recourse to competing suppliers, and hence a diminished market share.[325] However, in a market dominated by only a few producers, there is a strong incentive for, and only a few practical obstacles to, coordination among competitors.[326] A multilateral and coordinated price increase of this sort would ensure that no individual supplier would lose his consumers to a competitor, since his individually higher price would be matched by everyone else. In this situation, known as the "coordinated effects"

323 P. Lowe, "Implications of the recent reforms in the antitrust enforcement in Europe for National Competition Authorities", (2003) Speech delivered at Italian Competition/Consumers day, Rome, December 9, 2003.

324 Robert J Carbaugh, *Contemporary Economics: An Applications Approach,* (7th ed M.E. Sharpe Inc 2014) 179.

325 Directorate for Financial and Enterprise Affairs, Competition Committee, 'Unilateral Disclosure on Information with Anticompetetive Effects – Background Paper' (2012) Working Party No 3 on Co-Operation and Enforcement 3, 8

326 Massimo Motta, Martin Peitz, 'Intervention Triggers and Underlying Theories of Harm: Expert Advice for the Impact Assessment of a New Competition Tool' (2020) B-1049 European Commission Papers, available online at; < https://ec.europa.eu/competition/consultations/2020_new_comp_tool/kd0420575enn.pdf> accessed 21 March 2022.

scenario, although no supplier is individually dominant, collectively, all colluding suppliers are, as they can act independently of the market.[327]

Third, a concentration can result in the merger of two entities selling similar services that, as far as consumers are concerned, are highly interchangeable. If one firm unilaterally increases the price of the service it sells, some consumers will accept that higher price, while others will opt for the similar, albeit cheaper, interchangeable alternative. If two firms offering such interchangeable services merge, and either increases its price in the described fashion, those customers who do not accept the higher price will be lost to the alternate supplier. Yet, since the latter will be part of the same entity post-merger, the customers lost by one firm will be regained by the other.[328] Consequently, the merged entity will be able to unilaterally raise prices without compromising its total share of a given market.

Alternatively, if the merging firms sell differentiated goods, such that the certain attributes of one product cannot be replicated in another, substitutability will be limited. Consequently, producers will still be able to raise their prices, since their consumers will have limited recourse to competing products to satisfy their needs.[329] This situation, also known as the "uncoordinated or unilateral effects"[330] scenario, is distinguishable, as it can occur even if each individual company enjoys a limited share of the market. As such, there can be no creation or strengthening of a dominant position in the normal sense of the term. Further, as unilateral effects can occur in the absence of coordination, there can also be no collective dominance.

5. Coordinated and Uncoordinated Effects

As required by the Merger Regulation, the European Commission has issued Guidelines outlining the factors that will govern its consideration of future mergers and their compatibility with the internal market. However, these Guidelines do not reflect parity between the dominance and the general "impediments to effective competition" tests; rather they manifest the continuing primacy of the former. The Guidelines start with an appraisal of the expected market share of the merged entity and continue with a general competitive assessment of the market. In defining market dominance, the

327 Simon Baxter, Frances Dethmers, "Collective Dominance Under EC Merger Control – After Airtours and the Introduction of Unilateral Effects, Is There Still a Future for Collective Dominance?" (2006) 27 CML Rev 148.

328 Randal C Picker, "An Introduction to Game Theory and the Law" Paper Delivered at the Coase Lecture Series hosted by the Coase-Sandor Institute for Law and Economics, University of Chicago, 6 December 1994. at 2-6; Roscoe B Starek III & Stephen Stockum, "What Makes Mergers Anticompetitive?: "Unilateral Effects" Analysis Under the 1992 Merger Guidelines" (1995) 63 Antitrust LJ 801

329 Ibid.

330 European Commission Guidelines on the Assessment of Horizontal Mergers under the Council Regulation on the Control of Concentrations between Undertakings OJ C 31.

Guidelines merely reiterate the case law preceding the latest version of the Merger Regulation. Thus, they read, "very large market shares - 50% or more - may in themselves be evidence of the existence of a dominant market position".[331]

Market shares below 50% are only deemed relevant if they are obtained in markets with a few strong competitors, substantial barriers to entry or involving products that are close substitutes. For such lower market shares, the key issue is whether the merger "will raise competition concerns", thereby placing the assessment within the realm of the general "impediments to effective competition" test. So far, the Guidelines appear to reflect the equivalent, as opposed to hierarchical, relationship between dominance and impediments to effective competition alluded to by the wording of the new Regulation. However, unilateral effects are subsequently treated as one of "the two main ways in which horizontal mergers may significantly impede effective competition, "in particular by creating or strengthening a dominant position". Specifically, it is asserted that certain unilateral effects "would significantly impede effective competition by creating or strengthening the dominant position of a single firm".[332]

This approach would seem to understate the independent nature of uncoordinated effects, which can, and often do, arise regardless of an entity's market share and, hence, possible dominance. Uncoordinated effects could have been divorced from the concept of dominance. These Guidelines, however, fail to reflect the conceptual distinction between the two tests, and only perpetuate the primacy of dominance into the regime of the new Merger Regulation by presumptively treating unilateral effects as a subspecies of dominance. The "impediments to effective competition" novelty is merely a residual "catch all" safety net. Under the old merger regime, the starting point in the analysis was dominance; if the latter could not be established in the normal meaning of the term, unilateral effects analysis would be used to find dominance. Under the new merger regime, dominance remains the starting point in the analysis; it is assumed that unilateral effects will occur in a dominated market.[333] If such dominance cannot be established, then recourse will be made to the redundant "impediments to effective competition" test, which in essence rectifies the distortions of the dominance term to which the Commission had to resort in order to catch the pure unilateral effects cases under

331 P. Lowe, "Implications of the recent reforms in the antitrust enforcement in Europe for National Competition Authorities", (2003) Speech delivered at Italian Competition/Consumers day, Rome, December 9, 2003.

332 European Commission Guidelines on the Assessment of Horizontal Mergers under the Council Regulation on the Control of Concentrations between Undertakings OJ C 31.

333 Derek Ridyard,The Commission's New Horizontal Merger Guidelines. An Economic Commentary. GCLC Working Paper 02/05 available online at: < https://www.coleurope.eu/sites/default/files/research-paper/gclc_wp_02-05.pdf> accessed 12 June 2023.

the old wording of the substantive test.[334] Yet, despite this, the concept of dominance cannot be applied in all mergers giving rise to anticompetitive effects. The dominance-based test prescribed by the Merger Regulation is unable to capture anticompetitive situations not involving a position of market leadership. The test merely refers to single-firm dominance, not to collective dominance i.e.,a situation where only the leading firm may have a dominant position..[335]

The intrinsic limitations of the dominance test become appreciable in the light of the following three different ways in which competition can be impeded by a merger [336]. The European Court of Justice has drawn a distinction in its jurisprudence between concentrations giving rise to coordinated and uncoordinated anticompetitive effects. In the seminal case of *Gencor*[337] which concerned the merger of the two largest suppliers in the pertinent market, the Court was confronted with evidence suggesting a substantial risk of post-merger collusion. It reasoned that the word "dominance" was not sufficiently precise to permit an accurate delineation of its ambit. Since the plain meaning of the word in issue could not be used to ascertain its exact scope, the Court employed a purposive interpretation in the light of the Regulation's "overall objective and its position in the legal hierarchy of the system created by the Treaty of Rome."[338]

It reasoned that the Regulation was intended "[to establish] a system ensuring that competition in the internal market [would not be] distorted". Consequently, the Court opined that the word "dominance" could be construed broadly enough to cover instances of tacit collusion. It reasoned that companies acting in a coordinated way could achieve a state of collective dominance, even if each were individually unable to dominate the market. By identifying a very broad policy objective, the Court was able to stretch the concept of dominance to instances that would otherwise offend its plain meaning.

334 Giorgio Monti, 'The New Substantive Test in the EC Merger Regulation – Bridging the Gap Between Economics and Law?' (2008) LSE Law, Society and Economy Working Papers No 10/2008 London School of Economics Law Department, available online at; https://www.lse.ac.uk/law/working-paper-series/2007-08/WPS2008-10-Monti.pdf accessed 21 March 2022.

335 Lars Hendrik Roller, Miguel de la Mano, 'The Impact of the New Substantive Control Test in European Merger Control' (2006) 2 European Competition Journal 9, 10 available online at: < https://competition-policy.ec.europa.eu/system/files/2021-10/new_substantive_test.pdf> accessed 12 June 2023.

336 M Seretis, 'Airline mergers in the European Union and the United States. A retrospective account and the ways forward' (2014), Institute of Air & Space Law Faculty of Law McGill University, available online at; < https://core.ac.uk/display/41897721?msclkid=95dcdf94a92f11ecb9e3d793568d3848> accessed 21 March 2022

337 Case T-102/96 *Gencor Ltd v Commission of the European Communities* [1999] ECR II-753.

338 Ibid.

6. The practical application of the Substantive Tests & the competitive assessment by the European Commission

The Commission's inquiry begins with the estimation of the market share expected to accrue in favour of the merging carrier's post-merger over each city-pair currently serviced by the merging parties. This is followed by the assessment of other factors capable of refining the first impression stemming from the isolated consideration of market share.

In that endeavour, the Commission has followed rather mechanically the factors enumerated in the Merger Guidelines.[339] It first considers the levels of actual competition in the pre-merger market through a retrospective analysis, as well as the expected levels of potential competition in the post-merger market through a prospective analysis. The latter inquiry pays regard to the power of consumers to resist possible post-merger price abuses, as well as the barriers to market entry that may discourage future potential competitors from servicing the subject market.[340] The intention of such analysis is to improve the accuracy of the competitive assessment. However, because the Commission has made very conservative assumptions based on the narrow criterion applicable to the market and competitive contribution of each of the above-mentioned factors, it has preserved the anti-merger bias of its dominance-based test.

7. The Existence and Proximity of Competition Between the Merging Entities in the Pre-Merger Market

This element of the assessment concerns the pre-merger levels of competition between the merging airlines. The inquiry focuses on the actual competition between the carriers servicing a city-pairs.[341] It is relevant because it helps estimate the anticompetitive impact of the proposed transaction on that market. It is to be recalled that the test prescribed by the Merger Regulation is concerned with the overall anticompetitive effects of a concentration, including the loss of competitive constraints formerly exercised by the merging carriers vis-a-vis each other. In the context of duopolies, or other restricted oligopolies, the competitive constraints between the merging carriers are quite commonly the most potent competitive forces in the subject market. Thus, when assessing the anticompetitive

339 Giorgio Monti, 'The New Substantive Test in the EC Merger Regulation – Bridging the Gap Between Economics and Law?' (2008) LSE Law, Society and Economy Working Papers No 10/2008 London School of Economics Law Department, available online at; https://www.lse.ac.uk/law/working-paper-series/2007-08/WPS2008-10-Monti.pdf accessed 21 March 2022.

340 *Ryanair Holdings plc v The Competition and Markets Authority and Aer Lingus Group* [2015] EWCA Civ 83.

341 Ibid.

effects of a merger upon a duopoly, the Commission presumes the existence of such competitive constraints between the two carriers. [342]

There are no express opinions with regard to whether full service, high frills carriers can be in actual competition with low-cost, no-frills airlines. In the *Ryanair/Aer Lingus*[343] decision, the Commission refused to treat flight options offered by a hybrid carrier, Aer Lingus, and a low-cost carrier, Ryanair, as not being in competition, reasoning that there are no substantial differences between a carrier offering medium to low frills service and a carrier offering exclusively low frills service. This was because the two carriers already were, in terms of market shares and traffic volumes, the closest competitors. It would appear that the same conclusion would be reached with regard to the competitive relationship between purely full service and purely low-cost carriers. This is supported by the Commission's inclusion of full-service carriers, such as British Airways and Cityjet for example in its competitive analysis when it was considering the barriers to market entry likely to be confronted by potential competitors in the post-merger environment.[344] Such a broad view of substitutability would also be consonant with the Commission's policy objective of protecting the interests of passengers. If the services offered by the two airlines are deemed substitutable, then the two carriers will be considered to be in competition pre-merger, thereby exercising competitive constraints upon each other. Post-merger, such competitive constraints will be lost and, consequently, the overall impact of the concentration will be anti-competitive.

In addition to the duopoly-based presumption and the substitutability considerations, the Commission will also find the existence of actual competition between two carriers if there is evidence of previous price-based interaction between them.[345] This interaction can take the form of ad hoc price adjustments to match a competitor's fares in individual markers, but can also occur on a systematic basis by way of automated price-matching technologies.

This element of assessment is critical to the network competition approach as part of the defining relevant market with its participants in the context of the competition on the routes under the question. If the network is interpreted widely with full service and low-cost services airlines assessed under one test, that will require more comprehensive analysis in terms of the impact that mergers might lead to.

342 Case No Comp/M.6663 *Ryanair/Aer Lingus* (2013) OJ C/231/4.

343 Ibid.

344 Case No Comp.M.4439 *Ryanair/Aer Lingus* (2007) C(2007) 3104.

345 Ryanair / Aer Lingus, supra note 46 at 86; Olympic/Aegean, supra note 74 at 55-56.

On the one hand, it might be concluded that the overall impact is less significant due to significant numbers of the competitors and as a result overall relevant market share. On the other, the conclusion might be reached that the large mergers might create anticompetitive effect on much wider scale than just diminishing competition between two cities based on the O&D approach.

The Commission has acknowledged that the status quo ante may not always constitute the relevant counterfactual. It is sometimes necessary to take into account certain future events that are likely to take place in the absence of the transaction.

Under Para 9 of the EMCR:

"*In most cases the competitive conditions existing at the time of the merger constitute the relevant comparison for evaluating the effects of a merger. However, in some circumstances, the Commission may take into account future changes to the market that can reasonably be predicted. It may, in particular, take account of the likely entry or exit of firms if the merger did not take place when considering what constitutes the relevant comparison*"[346]

In *Lufthansa/Austrian Airlines*,[347] the Commission concluded that in the absence of the transaction, the target would have probably been acquired by Air France-KLM. The Commission therefore compared the effects of the notified transaction with those of a hypothetical acquisition of Austrian Airlines by Air France. If several effects that influence competition occur at the same time, the descriptive analysis will not be conclusive and more sophisticated techniques such as econometrics should be used to compare the counterfactual with actual data[348].

8. Counterfactual approach

The goal of EU merger control is to prevent transactions that would significantly impede effective competition. As pointed out in the Horizontal Merger Guidelines, in order to evaluate the effects of the transaction the Commission conducts a counterfactual analysis by "compar[ing] the competitive

346 Case No. Comp/M.5440 *Lufthansa/Austrian Airlines* (2009) Decision of 28 August 2009.

347 European Commission Guidelines on the Assessment of Horizontal Mergers under the Council Regulation on the Control of Concentrations between Undertakings OJ C 31.

348 Ibid.

conditions that would result from the notified merger with the conditions that would have prevailed without the merger".[349]

The term "counterfactual" refers to the hypothetical scenario in which the merger would not take place. If the Commission finds the counterfactual to be significantly more pro-competitive than the merger scenario ("the factual"), it should oppose the transaction unless the parties offer adequate remedies. According to Lindsay and Berridge,[350] the counterfactual provides a rigorous means of identifying the effects of the merger, and thereby establishing whether there is a causal link between the transaction and any loss of consumer welfare.

The Commission describes the position as in the paragraph 9 of the Notice on Horizontal Mergers:

"In assessing the competitive effects of a merger, the Commission compares the competitive conditions that would result from the notified merger with the conditions that would have prevailed without the merger. In most cases, the competitive conditions existing at the time of the merger constitute the relevant comparison for evaluating the effects of a merger. However, in some circumstances, the Commission may take into account future changes to the market that can reasonably be predicted. It may, in particular, take account if the likely entry or exit of firms if the merger did not take place when considering what constitutes the relevant comparison".[351]

More specifically, issues of causation are most clearly analysed by identifying separately:

(a) The pre-merger state of the market; this is relevant to the Market Definition which has been discussed in Chapter 3.
(b) Whether the pre-merger state of the market would have been likely to change in the absence of the merger and/ if so, in what respects. The way in which the market is predicted to operate in the absence of the merger is the counterfactual;
(c) The likely post-merger state of the market; and
(d) The differences between steps (b) and (c) (i.e., the effects of the merger).

Because EU merger control normally takes place prior to the implementation of the merger, the counterfactual in merger cases is usually the status quo ante, i.e., the situation that exists at the time when the Commission reviews the merger. However, in certain circumstances the Commission has

349 Ibid.

350 Alistair Lindsay, Alison Berridge. *The EU Merger Regulation: Substantive Issues.* (4th edition Sweet & Maxwell 2012) 246.

351 European Commission Guidelines on the Assessment of Horizontal Mergers under the Council Regulation on the Control of Concentrations between Undertakings OJ C 31.

adopted a more dynamic interpretation of the counterfactual. This dynamic approach was initially developed in the context of the "failing firm" defence and was later expanded to certain other scenarios.

According to Geradin and Ianis, there are two types of counterfactuals applied by the Commission - static and dynamic counterfactuals with the dynamic counterfactual being a manifestation of the prospective analysis of mergers.[352] Two main categories of dynamic counterfactuals include:

i) Market exit counterfactual: this comprises scenarios in which in the absence of the transaction the target would go bankrupt (failing firm defence) or would be acquired by another operator. In these scenarios, the Commission seeks to determine whether in the absence of the transaction competition would deteriorate even more than in the event of the transaction.

ii) Market entry counterfactual: in this scenario, the Commission seeks to determine whether in the absence of the transaction competition would improve because one of the parties would enter the relevant market on its own.

Geradin and Ianis further suggest that the Commission's approach to the "market exit" counterfactual is generally satisfactory.[353] Case law here meanwhile, notably in the case of the Commission's decision in *JCI/Fiamm,* demonstrates that the Commission is capable of conducting a sophisticated analysis of the non-merger scenario in which the target exits the market while the Commission's analysis in cases involving potential market entry is too static.[354]

While the counterfactual provides critical means of identifying the effects of the merger in order to establish the likely impact, the importance of the Network Competition Approach is the most relevant regarding issues of causation and analysis of the impact required to compare the counterfactual with actual data.

352 Damien Geradin, Ianis Girgeson, 'The Counterfactual Analysis in EU Merger Control' (2013) Tilburg Law and Economics Centre, Paper Prepared for the Conference "The Pros and Cons of Counterfactuals" Swedish Competition Authority, Stockholm, delivered on 6 December 2013.

353 Ibid.

354 Case No Comp.M/4381 – JCI/Fiamm (2007) C (2007) 1863 (Final).

9. Development of the approach towards discretionary assessment

According to Talbot, innovation in an attempt to keep pace with a rapidly changing market is commendable.[355] On the one hand, in *Air France and KLM* [356] one of the major and earliest mergers, it was indicated how the Commission approached case analysis at that time.[357] The decision in that specific case revolved around ensuring that passengers gained from the deal (by getting an improved service, better choice of destinations, etc) and ensuring that the post-merger market did not see any price increases on the routes where the airlines were already strong.[358] On the other hand, there was still a gap pertaining to a network assessment and considering the post-pandemic uncertainty the previous course of action is no longer the case.

There is an opinion that an alliance can eliminate the negative externalities that are present in a no-alliance case and thus lead to lower fares for the consumer.[359] Air France and KLM had already formed alliances prior to the merger with Air France belonging to the SkyTeam alliance and KLM to the Northwest-KLM alliance. Therefore, most of the positive effects associated with the formation of alliances in the interline market were already exploited. In fact, it was inferred[360] that the merger increased Air France/KLM's profit and thus the producer surplus, but that this was largely offset be a decrease in the consumer surplus, resulting in a lower social welfare. The reason for this was that the merger did not just decrease competition in the hub-to-hub market, but also in the European domestic market, the EU-US market and the market between interior European endpoints and US hubs and the other way around. What is critical for the analysis within the framework of this thesis, is that the net result of this mega-alliance was a decrease of social welfare.

Speaking of the application of the relevant standards, the willingness of the Commission to explore wider factors to gauge the effects of mergers requires a more structured set of guidelines in order to explain the various theories of harm that the Commission is pursuing. The test applied by the Commission before the pandemic was worrying – not only is it not clear what factors are essential to intervene, but the whole decision making appears to be 'regulatory' in nature – shaping the market to maximise competition. Such criticisms suggest that a possible side effect is that the Commission has

355 Conor C. Talbot 'The Battle for the Skies: Recent Legal Developments in the EU and US, and their Implications for the Consolidation of the Airline Industry' (2008. National University of Ireland, Galway. Draft Working Paper, January 2008, available online at; < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1655144> accessed 21 March 2022.

356 Case COMP/M.3280, Air France/KLM, Commission Decision of February 11, 2004.

357 Ibid.

358 IP/04/194, Brussels, 11 February 2004 Commission clears merger between Air France and KLM subject to conditions.

https://ec.europa.eu/commission/presscorner/detail/en/IP_04_194 accessed February 2021.

359 Jan Brueckner, Eric Pels, 'European Airline Mergers, Alliance Consolidation, and Consumer Welfare' (2005) 11 Journal of Air Transport Management 27, 27.

360 Ibid.

greater discretion to use merger control as an industrial policy tool.[361] The Commission's view seems to be that it is able to work a benevolent industrial policy that contributes to the creation of a better European economy.

Another reflection relates to the implications that the substantive test has for Article 102. The conventional position is that merger control applies to lower levels of market power than the dominance test, and this is the rationale for abandoning dominance in merger cases. According to Monti [362]this is erroneous: unilateral effects are a manifestation of significant market power, and if a firm is able to raise prices profitably and act independently of rivals, the fact that it is not 'dominant' when its size is measured in market shares is irrelevant. Monti further suggests that every merger that is found to substantially impede competition would, if assessed ex post, be an assessment of a dominant firm and Article 102 applies bearing in mind that dominance is the ability to behave to a large extent independently of competitors, consumers and customers. This is exactly the conclusion one reaches when one finds that a merged entity would cause anticompetitive unilateral effects. However, by ignoring the need to address dominance in merger cases, this leaves open the space for the Commission to redefine the concept of dominance as a jurisdictional threshold to determine when that provision should apply, or it allows the Commission to establish a safe harbour market share below which dominance is found not to exist. This could allow the Commission to narrow down the scope of Article 102, which is often applied too aggressively. The rationale for a wider net under the ECMR is that merger law is a prudential tool to prevent harmful consequences, and that many mergers fail and are arguably bad for the economy,[363] so a stricter application of merger rules appears justified. Moreover, merger control is concerned with preventing price increases by the merged entity, and possible follow-on increases across the market, while abuse of dominance provisions are focused on exclusionary abuses, which suggests two different notions of market power are needed for the two provisions to work well.

A final point to reflect on here is in respect of the role of market definition. While it is now somewhat *de rigueur* to begin a competition inquiry by defining markets, the experience under the ECMR confirms that market definition is part of an indirect way of proving the presence of market power and other means exist. The structural approach has attraction because authorities have years of experience

361 J Clarke 'The Dawson Report and Merger Regulation' (2003) 8 Deakin Law Review 245, 251-60.

362 Giorgio Monti, 'The New Substantive Test in the EC Merger Regulation – Bridging the Gap Between Economics and Law?' (2008) LSE Law, Society and Economy Working Papers No 10/2008 London School of Economics Law Department, available online at; https://www.lse.ac.uk/law/working-paper-series/2007-08/WPS2008-10-Monti.pdf accessed 21 March 2022

363 H. Schenk, 'Mergers and concentration policy' in P. Bianchi and S. Labory, International Handbook on Industrial Policy (1st edn Edward Elgar 2006) 153.

in using market definitions and market shares as proxies. Proof of market power indirectly is administratively cheaper but prone to error, while direct proof of market power is probably administratively more expensive but potentially more precise. Accordingly choosing the best approach to study the potential effect of mergers depends on several variables: the cost of applying a given method, the risk of error, the risk that the authority abuses its discretion and misuses merger policy.[364] Comparing direct and indirect methods, the dominance test is probably cheaper as parties have experience in operating the various tests, it is less prone to abuse given that the case law has circumscribed the authorities' discretion, but it is likely to be under or over inclusive. Instead, the direct methods are more likely to yield the correct result but more expensive to operate (because of inexperience by the regulators) and more open to misuse. From this perspective, the merits of choosing to use more economics-intensive standards for review can be questioned.

There is also a consistent line of thinking and agreement with the earlier position of the Antitrust Division of the U.S. Department of Justice (DoJ)[365] in according to which majority of the mergers shall be disapproved based on their potential anticompetitive effects. These effects are viewed as arising from the reduction in the number of competitors in numerous nonstop routes (the usual DOJ concept of 'antitrust markets'). In the recommendations against these mergers, the DOJ argued that potential efficiency gains should not be considered. First, these gains could have been achieved through means other than the merger. Second, since such gains would be obtained in antitrust markets other than the one in which the competitive injury is expected, the gain should be ignored. This will ensure the successes of the smaller market participants and enhance the competition environment.

According to Joint Comments[366] of the American Bar Association's section of antitrust law and section of international law (2017), a number of improvements are suggested to be made in the EU's evaluation of procedural and jurisdictional aspects of EU merger control. Following a discussion of the inefficiencies in the current system, these comments address potential improvements that could be made within the current procedure framework, including simplified procedure. These include suggestions that the Commission: (i) provide enhanced guidance on "plausible alternative markets;"

364 Giorgio Monti, 'The New Substantive Test in the EC Merger Regulation – Bridging the Gap Between Economics and Law?' (2008) LSE Law, Society and Economy Working Papers No 10/2008 London School of Economics Law Department, available online at; https://www.lse.ac.uk/law/working-paper-series/2007-08/WPS2008-10-Monti.pdf accessed 21 March 2022

365 Jan Brueckner and Pablo Spiller 'Competition and mergers in airline networks' (1991) 9 International Journal of Industrial Organization, 323-342.

366 Joint Comments of the American Bar Association's Section of Antitrust Law and Section of International Law of the European Commission's Evaluation of Procedural and Jurisdictional Aspects of EU Merger Control (13 January 2017) available online at; < http://ec.europa.eu/competition/consultations/2016_merger_control/american_bar_association_sections_of_international_law_and_antitrust%20_law_contribution_en.pdf> accessed 21 March 2022.

<http://ec.europa.eu/competition/consultations/2016_merger_control/american_bar_association_sections_of_international_law_and_antitrust%20_law_contribution_en.pdf> accessed 22.10.2018.

(ii) introduce an indicative time limit within which the Commission would notify parties of the need to move from the simplified to the standard merger notification procedure; and (iii) further amend the thresholds applicable to the simplified procedure.

In addition to this, there is an obvious need to adopt and apply the unified approaches among international competition authorities in relation to merger deals in aviation sector, especially considering its international dimension and substantial impact on the consumers and global economy.

10. Network Competition Approach and Network Effect in Mergers

Network aspects are of a significant relevance in the competition assessment. This thesis argues that this is the most accurate approach with the variables that shall be regularly taken by the competition authorities. However, the existing case law on network issues is rather limited.

To a small degree, both the national competition authorities and the European Commission have taken network effects into consideration in the context of the competition assessment in some cases. In *BMI/United Airlines* [367] the Office of Fair Trade (OFT)[368] found that, although the 'point of origin/point of destination' (O&D) city pairs approach to market definition was considered sufficient to analyse the case, network effects may exist in the context of competition for corporate deals or for members of Frequent Flyer Programs (FFPs). This was because a corporate customer's or FFP member's choice of an airline or alliance for a particular journey may be influenced by the network of the carrier(s), as well as the service on the particular route. Furthermore, in *Air Canada/Canadian Airlines*[369] it was found that FFPs acted as a barrier to entry for UK operators. In *Alitalia/Volare* the Italian Competition Authority considered among other things network effects: Alitalia and Volare, as the first and the fourth carrier respectively in Italy, combined their networks at national level and pooled their frequent flyer programmes.[370] The agreement was declared to violate Italian competition law as far as domestic routes were concerned.[371]

Network aspects were also considered by the European Commission in the *Lufthansa/AuA* decision[372]. Among other aspects, the hub dominance of Lufthansa at Frankfurt and the difficulties other airlines face in obtaining slots in peak times at this congested airport, the pooling of frequent flyer programmes,

367 Case CP/1535.01 *United Airlines/BMI Expansion Agreeement* decision of the Director General of Fair Trading of 1 November 2002, OFT Public Register.

368 Ibid.

369 UK Competition Commission, *Air Canada/Canadian Airlines* Cm 4838.

370 Italian Competition Authority, *Alitalia/Volare*. Autorità garante della Concorrenza, decision in the case Alitalia/Volare Group, July 2003.

371 Ibid.

372 Case No. COMP/M.5440 *Lufthansa/Austrian Airlines* (2009) Decision of 28 August 2009.

and the tying effects of corporate customer deals were identified as barriers to entry on the Vienna-Frankfurt route.

In the European Commission's merger decision in *Air France/KLM*[373] some competitors argued that the merger effectively reduced the number of world-wide alliances from four (SkyTeam, Star, Wings and OneWorld) to three, as the Wings and SkyTeam alliances merge and that this would have a serious impact on network competition. However, contrary to the approach supported by this thesis, the European Commission found that the network effects of the merger between Air France and KLM did not raise serious concerns. This conclusion was also considered to apply to corporate customers where a market investigation rejected the hypothesis that corporate customers would be negatively affected by the merger as far as network/alliance competition is concerned.

In *Swissair/Sabena*[374] the European Commission took into account "the effect of the combination of the parties' network at a wider European level, out of the total number of passengers transported within W. Europe" and Swissair's participation in the European Quality Alliance (EQA). The European Commission also found that "the co- existence of the three alliances, namely the proposed concentration, the EQA and the Lufthansa/SAS cooperation agreement, will enable the participating parties to establish an extensive integrated European network."[375] In *KLM/Alitalia* meanwhile,[376] the European Commission found, with respect to the effect of the coordination of the parties' networks at a European and worldwide level, that the alliance would not give rise to a dominant player. In *SAS/Spanair*[377] the European Commission found that "the network effects arising from the proposed concentration do not raise serious doubts as to the creation or strengthening of a dominant position"[378] on EEA-markets by the Star Alliance.

Other factors that can be usually considered in the overall competition assessment are the financial strength of the parties and their access to supply and sales markets. Financial resources are critical leverage in many aspects including access to the aircraft market, workforce and ability to observe losses in a short/mid-terms. For example, in case *Alitalia/Volare*[379], the Italian Competition Authority considered the financial strength of Alitalia together with its distribution capacity a relevant factor in the overall competition assessment. In addition, pre-existing membership of an alliance or cooperation

373 Case COMP/M.3280, *Air France/KLM* (2004) Decision of 11 February 2004.

374 Commission Decision of 19 July *1995 Swissair/Sabena* (1995) OJ L 239 paras. 38 - 41.

375 Ibid.

376 Case No COMP/JV.19 (1999) Commission Decision of 11 August 1999 para 45.

377 Case No COMP/M.2672 – *SAS/Spanair* (2002) Commission Decision of 5 March 2002 paras. 33–35

378 Ibid.

379 Italian Competition Authority, *Alitalia/Volare*. Autorità garante della Concorrenza, decision in the case Alitalia/Volare Group, July 2003.

agreements with other airlines can constitute relevant factors in the assessment[380]. The factors noted in this section should not be considered an exhaustive list of relevant issues and their importance will vary in each particular case.

11. Conclusion

While there is some indication of the Commission limited willingness to accept in certain circumstances the wider approach in the assessment in the past, new market environment has been rapidly changing after the start of the covid pandemic with the overall architecture of the airline sector being revaluated in terms of the operational availability (with the majority of the fleet grounded at some point by all airlines) as well as financial survival. It is likely to be the case for the next few years that the main variables in the assessment will be based predominantly of the industrial policy and social welfare factors such as employment and availability of the airlinks to the consumers.

380 For example, OFT, case BMI/United Airlines, where the OFT considered efficiency claims put forward by the parties and found that some of the proposed efficiencies had already been achieved to some extent through the parties membership in the Star Alliance.

CHAPTER 5
SUBSTANTIVE TEST. ARTICLES 101, 102

I. Article 101

1. Article 101 TFEU

For the purposes of this thesis, cooperation agreements are defined as the agreements that allow airlines integrate their networks and services and operate as if they were a single entity without the implied irreversibility of a concentration while also retaining their corporate identities (as in particular strategic alliances). Cooperation agreements of this kind may comprise several or all of the following fields of cooperation: code sharing; revenue and cost sharing; joint pricing; coordination of capacities; route and schedule planning; coordination of marketing, advertising, sales and distribution networks; coordination of travel agents and other commissions; branding/co-branding; integration and development of information systems; information technologies and distribution channels; coordination of frequent flyer programmes; sharing of facilities and services at airports.[381]

Cooperation agreements in Europe, are the result of the liberalisation of EU aviation market, the creation of the common aviation area, the privatisation and/or the commercialisation of airports and airlines, the rise of the low-cost carriers, the emergence and use of secondary airports, close to large airports and of the associated risks entailed by the creation of a competitive environment.[382] Fundamental regulatory framework in relation to cooperation agreements includes Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements 2011/C 11/01.[383]

Guidelines on horizontal cooperation agreements[384] were designed to help companies determine on a case-by-case basis whether their cooperation agreements are compatible with the competition rules by providing a framework for assessment under Articles 101 (1) and (3) of the Treaty on the Functioning of the European Union (TFEU).[385] Cooperation is of a 'horizontal nature' if an agreement or concerted

381 Commission notice concerning the Alliance between KLM Royal Dutch Airlines and Northwest Airlines, Inc. (case COMP/D-2/36.111 — procedure under Article 85 (ex 89) of the EC Treaty); Commission notice concerning the alliance between Lufthansa, SAS and United Airlines (cases COMP/D-2/36.201, 36.076, 36.078 — procedure under Article 85 (ex 89) EC)

382 Guillame Burghouwt and others, 'EU Air Transport Liberalisation Process, Impacts, and Future Considerations' (2015) OECD Discussion Paper No 4/2015, available online at; <https://www.itf-oecd.org/sites/default/files/docs/dp201504.pdf> accessed 21 March 2022.

383 Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements. 2011/C 11/01..

384 Ibid. .

385 Article 101(1)(3) Treaty on the Functioning of the European Union 2007.

practice is entered into between actual or potential competitors.[386] Guidelines also cover horizontal cooperation agreements between non-competitors, for example between two companies that are active in the same product markets but in different geographical markets without being potential competitors.

There are two fundamental elements that shall be taken into consideration. On the one hand, horizontal cooperation can lead to substantial economic benefits where it is a means of sharing risk, making cost savings, increasing investments, pooling know-how, enhancing product quality and variety and launching innovation faster.[387] On the other hand, horizontal cooperation can lead to competition problems where it causes negative effects on a market with respect to prices, output, innovation or the variety and quality of products.

2. Article 101. Assessment approach

Article 101 TFEU has a structure with the two substantive parts of Article 101(1) and 101(3) TFEU.

Restriction by object forms one part of Article 101(1) TFEU and the possibility of beneficial effects are assessed subsequently under Article 101(3) TFEU. Consequently, an object restriction can still benefit from Article 101(3) TFEU and thus avoid the prohibition of Article 101(1) TFEU if the conditions of the legal exception under Article 101(3) TFEU are met. Hence, any restriction could escape the prohibition of Article fulfilled,[388] although this is very rare in practice.[389]

3. Assessment criteria under Article 101(1) TFEU

Article 101(1) TFEU prohibits agreements that have as their object or effect the restriction of competition.[390] For the purposes of these guidelines, 'restriction of competition' includes the prevention and distortion of competition. If an agreement has the object to restrict competition, that is to say that by its very nature it has the potential to restrict competition under Article 101(1) TFEU, then it is not necessary to examine the actual or potential effects of the agreement. If, however, a horizontal cooperation agreement does not restrict competition by object, actual and potential effects must be analysed to determine whether there are appreciable restrictive effects on competition.[391]

386 Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements. 2011/C 11/01..

387 Ibid.

388 Case T-17/93 *Matra Hachette v Commission* [1994] ECR II-595 (*Matra Hachette*) para 85.

389 Ibid.

390 Article 101(1) Treaty on the Functioning of the European Union 2007.

391 Richard Whish, David Bailey, *Competition Law* (10th edn OUP 2021) 137.

For there to be restrictive effects on competition under Article 101(1) TFEU, the agreement must have, or be likely to have, an appreciable adverse impact on at least one of the parameters of competition on the market, such as price, output, product quality and variety, or innovation.[392] Such an assessment of restrictive effects must be made in relation to the actual legal and economic context in which competition would occur in the absence of the agreement. The nature of an agreement relates to factors such as the area and objective of cooperation, the competitive relationship between the parties and the extent to which they combine their activities. These factors determine which kinds of possible competition concerns can arise.

Horizontal cooperation agreements may limit competition in several ways. For example, production agreements may give rise to a direct limitation of competition where the parties reduce output. The main competition concern pertaining to commercialisation agreements is price fixing. Market power is the ability to profitably maintain prices above competitive levels for a period of time or to profitably maintain output in terms of product quantity, quality and variety, or innovation below competitive levels for a period of time. Market power can sometimes result from reduced competition between parties.

The starting point for the analysis of market power is the position of the parties in the markets affected by the cooperation. To carry out this analysis, the relevant market(s) have to be defined, using the Commission's notice on the definition of the relevant market, and the parties' combined market share has to be calculated. If the combined market share is low, horizontal cooperation is unlikely to produce restrictive effects. Given the variety of cooperation agreements and the different effects they may cause in different market situations, it is impossible to indicate a general market share threshold above which sufficient market power for causing restrictive effects can be assumed.[393]

Depending on the market position of the parties and the concentration in the market, other factors should be considered, such as:

1. the stability of market shares over time;
2. entry barriers;
3. the likelihood of market entry; and
4. the countervailing power of buyers/suppliers.

392 Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements. 2011/C 11/01.
393 Ibid.

4. Assessment criteria under Article 101(3) TFEU

Where a restriction of competition under Article 101(1) has been proven, Article 101(3) can be invoked as a defence. Regulation (EC) No 1/2003 puts the burden of proof on the undertaking invoking the benefit of this provision. There are four cumulative conditions that must be met for cooperation agreements to be exempted:

i) the restrictive agreement must lead to economic benefits, such as improvements in the production or distribution of products or the promotion of technical or economic progress, i.e., efficiency gains;
ii) the restrictions must be indispensable to the attainment of the efficiency gains;
iii) consumers must receive a fair share of the resulting efficiency gains attained by indispensable restrictions;
iv) the agreement must offer the parties no possible elimination of competition in relation to a substantial part of the products in question.

Where these four criteria are met, the efficiency gains generated by an agreement can be considered to offset the restrictions of competition generated by it.[394]

Cost efficiencies is arguably one of the most common justifications for the alliances in the airline industry. Even prior to adopting the Article 101 (3) Guidelines, the Commission had addressed the issues of cost savings achieved through economies of scale and scope, and various forms of integration and rationalisation of business activities.[395] Even though on certain occasions such claims were rejected by the Commission[396] Court of Justice has highlighted that consumers will only obtain a fair share of any such benefit, so as to satisfy the second condition under Article 101 (3), where the pressure of competition is sufficient to force the undertakings to pass on some of the cost savings.

Furthermore, particular attention has to be paid when cost savings are equated with improvements in production or distribution under Article 101 (3) where the savings are the result of conduct which has been found genuinely to infringe (restrict) competition. As a result, without sufficient evidence of the agreement giving rise to lower prices, in reality it might be that the benefit of any cost savings occur

394 Ibid.

395 David Bailey and others, *Bellamy & Child: European Union Law of Competition* (8th edn OUP 2018).

396 COMP/39596 British Airways/American Airlines/Iberia, decision of 20 June 2011.

only to the undertakings concerned.[397] The Commission has clearly indicated[398] that it does not take into account cost savings that arise from output reduction, market-sharing or from the mere exercise of market power.

The test of elimination of competition does not depend on whether the parties hold a large share of the relevant market and whether the agreement in question eliminates competition between those parties. The concept of elimination of competition is separate from the existence or acquisition of a dominant position. Hence, it is necessary to take into account and analyse external competition, both actual and potential. Potential competition must be taken into consideration before concluding that an agreement eliminates competition for the purposes of Article 101 (3).[399] In *Air France/Alitalia*[400] the Commission held that Article 101 (3) applied to the parties' strategic alliance, even though it found that it was uncertain that the cost efficiencies resulting from the alliance would be passed on to consumers in the absence of sufficient competition on the various affected routes. The parties offered to release slots at the relevant airports so as to facilitate competition and guarantee that such pass-on would actually occur.

5. *Network Competition effect and Article 101*

There are no doubts that any shift to the individual players unavoidably disadvantages other market participants. Hence, it is vital to embrace all critical features to accurately evaluate market power of such players.

Elements of the assessment test and variables shall include:

1. Operational network of majority/all routes;
2. Financial impact and stimulus (1. Internal – airline; 2 external – consumers, other players/incumbents) as well as market share;
3. Operational enhancement (fleet, personnel, assets, incentive agreements, contracts) -and how it might impact the market in the longer term (switching the routes, increasing the capacities on the specific destinations)

In *Swissair/Sabena*[401] the European Commission took into account "the effect of the combination of the parties' network at a wider European level, out of the total number of passengers transported within

397 David Bailey and others, *Bellamy & Child: European Union Law of Competition* (8th edn OUP 2018).

398 Horizontal Cooperation Guidelines, OJ 2001 C3/2.

399 Article 101(3) Treaty on the Functioning of the European Union 2007.

400 Case No COMP/38.284 Air France/Alitalia (2001).

401 Case IV/M.616 *Swissair / Sabena* (1995) 395M0616.

W. Europe" and Swissair's participation in the European Quality Alliance (EQA). The European Commission also found that "the co- existence of the three alliances, namely the proposed concentration, the EQA and the Lufthansa/SAS cooperation agreement, will enable the participating parties to establish an extensive integrated European network."

Further analysis of the case law indicates general trend of the Commission in applying the substantive test and addressing relevant concerns with the ineffective outcomes that come along with the detriments to the competition environment.

6. *Literature Review on the Benefits of the Cooperation in a Form of Alliances*

The large benefits from alliances arise from access to the behind and beyond markets. Elimination of double marginalisation is a benefit but schedule coordination and reduction in total trip times are the largest sources of benefit. Surprisingly, recent evidence suggests revenue sharing alliances produce higher net benefits than some weaker forms of alliance.[402] This includes benefits to travellers as well as benefits to carriers.

According to some views,[403] alliances are desirable from a socio-economic welfare perspective. Based on Park's theoretical study, the impact can be assessed in line with the differentiation on parallel and complementary alliances where parallel alliances refer to the collaboration between two firms that previously competed on the same routes (hub-to-hub markets) while complementary alliances refer to the case where two firms link up their existing networks with no overlap and build a new complementary network to provide improved services for connecting passengers (interline market). Research suggests different effects on fares and consumer surplus for each type of alliance. Parallel alliances lead to less competition and therefore higher fares while complementary alliances lead to better connectivity for the consumers and probably higher traffic density and therefore lower fares.

On the one hand, empirical studies suggest that that in the interline market for instance the fares will decrease after an alliance, while traffic will increase. It is supported by Brueckner & Whalen (2001) and Brueckner (2001) who indicated a fare decrease of 25%. Other figures are less compelling still show average fares fall with 5 – 7 % in the interline market due to alliance formation and that traffic will go up by 6%.[404] It was also concluded that that code share agreements increase the consumer

402 International Transport Forum, 'Air Service Agreement Liberalisation and Airline Alliances' (2014) available online at; < https://www.itf-oecd.org/air-service-agreement-liberalisation-and-airline-alliances?msclkid=d739c83fa96a11ec9ccd560de3cb6fc0> accessed 21 March 2022.

403 Ibid.

404 Gustavo A. Bamberger and others, 'An Empirical Investigation of the Competetive Effects of Domestic Airline Alliances' (2004) 47 The Journal of Law & Economics 195, 195.

surplus of connecting passengers.[405] On the other hand, it was argued that higher densities and double marginalisation will decrease fares, but that better connectivity will result in a higher 'willingness to pay' by the consumers, leading to an increase in fares.[406] Studies have also indicated several concerns of the potential anticompetitive effects for alliances and increase in fares in the hub-to- hub market.[407] Furthermore, the research of Armantier & Richard concluded that a code share agreement on the hub-to-hub-market would lead to a decrease in consumer surplus for the nonstop passengers which might enable to the firms to raise prices above the competitive equilibrium.[408]

Finally, it was suggested that an alliance that includes both scheduling agreements and pricing agreements decreases fares, while an alliance that only includes scheduling agreements leads to higher fares than in the case of no alliance.[409] Hence, an impact analysis of an alliance should be conducted on a case-by-case basis and can become very complex. In such networks the main question should be whether this competition loss in hub-to-hub markets is compensated by the gains in the interline market.[410] That is, the efficiencies achieved by eliminating double marginalisation have to outweigh the competition loss in the hub-to-hub market as well as the competition loss on the interline routes that both airlines served before the alliance.

Unfortunately, no empirical studies have focused on networks with a level of complexity where an alliance includes airlines whose networks are complementary while also share some destinations in the interline market. What this shows, is the fundamental elements of the network assessment, results in complex benefits received by the airlines on both hub-to hub and interline markets. That indicates the ultimate dimension for the assessment of the transaction in question, which should be also applied to mergers and Article 102 appraisals.

405 Olivier Armantier, Oliver Richard, 'Domestic Airline Alliances and Consumer Welfare' (2008) 39 RAND Journal of Economics 875, 904.

406 Li Zhou and others, 'Assessing the Price of Airline Alliances on Complementary Routes' (2011) 47 Transportation Research Part E: Logistics and Transportation Review 315, 322.

407 JK Brueckner, T Whalen, 'The Price Effects of International Airline Alliances' (2000) 43 Journal of Law and Economics 503, 505; JK Brueckner, 'The Economics of International Codesharing: An Analysis of Airline Alliances' (2001) 19 Interational Journal of Industrial Organization 1475, 1481.

408 Olivier Armantier, Oliver Richard, 'Domestic Airline Alliances and Consumer Welfare' (2008) 39 RAND Journal of Economics 875, 904.

409 Volodomyr Bilotkach, 'Price Competition Between International Airline Alliances' (2005) 39 Journal of Transport, Ecoonmics and Policy 167, 179.

410 JK Brueckner, 'International Airfares in the Age of Alliances: The Effects of Code-Sharing and Antitrust Immunity' (2003) 85 Review of Economics and Statistics 105, 118.

7. *Case studies*

i. Lufthansa–SAS

In May 1995 the Commission was notified of a cooperation agreement between Lufthansa and SAS for which the parties requested an approval that this was not an infringement of Art. 101.[411] The agreement between the parties was intended to create "an integrated air transport system based on a comprehensive set of long-term commercial, marketing and operational relationships and involving integration of their worldwide networks and other operations".[412] The agreement would include setting up a joint venture, which would be jointly and equally owned by the parties. The joint venture would provide all air transportation services between Germany and Scandinavia, as the carriers would no longer operate services on these routes independently. Capacity, frequencies and fares would be set by the autonomous and would thereby have the right to take autonomous management of the joint venture.

However, the parties would remain within its domestic market and other foreign destinations. The parties were not prohibited from operating direct flights routes where economically viable. The Commission concluded that the object and effect of the joint venture would be to coordinate the competitive behaviour of independent undertakings and would infringe Art. 101.

The results of the alliance have been of interest when assessing alliances impact on competition. As the parties were able to keep their positions on the market and provide a steady number of frequencies, competitors were discouraged from entering the market and the alliance parties were the only carriers operating on that market. In this case it was specifically interesting as the carriers' frequencies were frozen through the commitments and the fares could thereby be set high and the carriers had high load factors. Since then, the carriers have only seen competition from a low-cost carrier that provided services between Scandinavia and Germany although from airports situated at such a distance from the airports that the carriers operated from that it was questionable if these services would even be considered as imposing competition.

411 Commission notice concerning the alliance between Lufthansa, SAS and United Airlines (cases COMP/D-2/36.201, 36.076, 36.078 — procedure under Article 85 (ex 89) EC)
412 Ibid.

That case has become an indicative example of the oligopolistic alliance that was created with its effects.

ii. United – Lufthansa – Air Canada (Star Alliance)

This was the first time where the Commission took a different approach and considered the effects of a network.[413] In this decision the Commission took into consideration the efficiencies created outside the relevant market which went beyond the usually assessments which focuses on the relevant market.

When the Commission assessed the possible efficiencies produced through the alliance it considered the effects on not just the relevant market but also on related markets. To assess the effects of an agreement on a market that falls outside the relevant market, and where there is not enough efficiency created on the relevant market to constrain anti-competitive effects, has not been common practice. In this specific decision the Commission took into consideration the efficiencies created outside of the classic definition of relevant market which went beyond the usually assessments which focuses on the relevant market. Normally, there should be positive effects on the relevant market in order for an action to fall under the scope of Art. 101 (3) TFEU. However, since the markets were related and there was a considerable proximity between consumers on both markets the Commission approved this alliance.

The Commission took the preliminary view that it was not necessary to conclude whether one-stop flights were in the same market as non-stop flights, as the competitive assessment would not materially differ if the market encompassed both non-stop and one-stop flights. The Commission's assessment of the anticompetitive effects on the premium passengers' route under the question (Frankfurt-New York) included an evaluation of the constraint that one-stop services would exercise on LH's and CO's combined non-stop services (in addition to the constraint from competitors' non-stop services) in the premium market.

Although the Commission did not accept the alliance at first, this was subsequently approved once commitments were imposed on the alliance. As the Commission stated that there were no grounds for investigation it is was certain that these efficiencies were decisive for the final decision. However, it is interesting case where an agreement which restricts competition by object and where there are not sufficient benefits created for the consumer on the relevant market or the consumers on the related markets, to have been ultimately approved following commitments. It was further suggested that the

413 Case Comp. AT39595 *Continental/United/Lufthansa/Air Canada* (2013) Decision of 23 May 2013.

Commission has taken a lenient approach towards airline alliances, when it assessed impacts on markets that are outside of the relevant market.[414]

iii. American Airlines – British Airways – Iberia

In 2009 the Commission initiated investigations concerning the cooperation agreements between American Airlines, British Airways and Iberia, after having received a complaint from Virgin regarding the alliance. It was stated that the cooperation in this agreements were of a far more extensive nature than other cooperation agreements within the Oneworld alliance as the alliance would jointly manage schedules, capacity, pricing and revenue management on all routes between Europe and North America, which could have an actual or potential effect on competition.[415]

The Commission concluded that the relevant market would be defined in accordance with the O&D city pairs approach. The Commission was of the opinion that the agreement was an infringement of Art. 101 TFEU and would have an appreciable effect on trade between Member States since the very nature of the agreements concerned cooperation regarding fundamental parameters of airline competition.

The restriction was prominent on all the identified O&D city pairs, where the parties had strong market positions, the barriers to entry were significant and there was no real constraint from competitors. The Commission concluded that the agreement would completely eliminate competition on routes where the carriers had competed prior to the alliance. The carriers were also considered to be strong competitors on the premium market of the identified O&D city pairs, on some of the routes they were even the closest competitors with very large market shares and the effect on competition would therefore be extensive. The parties' strong position on the market was further strengthened as there were high barriers to entry and expansion particularity due to the difficulties of gaining access to slots in London and New York, but also with reference to the number of frequencies provided by the carriers as well as their frequent flyer programme, corporate contracts and connecting passengers. Investigations performed by the Commission also showed that fares would increase as a result of less competition for non-stop services.[416]

414 Ida Hermansson, 'Airline Alliances – A Legal Way of Restricting Competition?' (2016) Masters Thesis, Lund University, available online at; http://lup.lub.lu.se/luur/download?func=downloadFile&recordOId=8874985&fileOId=8884651 accessed 21 March 2022.

415 European Commission 'Antitrust: Commission Opens Formal Proceedings against Certain Members of Star and Oneworld Airline Alliances' (2009) MEMO/09/168.

416 Case COMP/39.596 British Airways/American Airlines/Iberia (2010) Decision of 14 July 2010 para. 38 – 41.

In its investigation the Commission specifically assessed interlining agreements, since these agreements gave carriers the possibilities of connecting passenger on flights past the transatlantic routes. The possibility of offering these services on transatlantic routes were deemed important, as it was very difficult to operate on these routes without the possibility of further transfer past the carriers' hub. The alliance would restrict competition on to connecting traffic past the identified O&D city pairs, as they could refuse to enter into interlining agreements that would take passengers past the alliances' hub-to-hub routes.

After having assessed the identified O&D city pairs with reference to aspects such as connecting passengers and frequencies the Commission concluded that the alliance would appreciable negatively affect competition on these routes. One-stop operations were not found to impose enough constraint. These negative effects were prominent both for premium and non-premium passenger on all routes except the on the routes London–Chicago/New York and Madrid– Miami where only premium passengers were affected.[417] On the other hand, the parties claimed that although the agreements might negatively affect competition on the relevant market it would also lead to various efficiencies for the consumers in accordance with Art. 101 (3) TFEU. The parties claimed that the agreement would lead to lower fares as double marginalisation would be eliminated and there would arise cost savings. Further the parties claimed that they would be able to supply a higher quality service.

While the Commission assessed the efficiencies that the parties claimed would be created following the alliance it was not assessed whether the commitments provided led to an enhancement of the claimed efficiencies. Since the Commission closed the investigations following the commitments with reference to Art. 9 in Regulation 1/2003, this meant that there were no grounds to further investigate the alliance and did not mean that it found it to comply with competition provisions. In addition to that, the Commission stated that the alliance between the parties was a restriction by object, where is usually difficult to show efficiencies leading to the application of Art. 101 (3) TFEU. with no grounds for investigation following the commitments. [418] Hence, the efficiencies are almost impossible to be substantiate and justified other than based on hypothetical counterfactual scenarios. In relation to this thesis, it shall be said that O&D approach was also inaccurate.

As it was alleged by Virgin the proposed cooperation would have a detrimental effect on competition, as it would (1) create or strengthen the parties' dominant position, in terms of capacity shares,

417 Ibid para. 53 – 76.

418 Ida Hermansson, 'Airline Alliances – A Legal Way of Restricting Competition?' (2016) Masters Thesis, Lund University, available online at; http://lup.lub.lu.se/luur/download?func=downloadFile&recordOId=8874985&fileOId=8884651 accessed 21 March 2022.

frequency shares and/or passenger shares, on the six transatlantic routes on which BA and AA currently compete and overlap, (2) strengthen BA's and AA's dominant position on the wider London Heathrow market brought about by BA/AA's combined slot holdings at London Heathrow, making BA/AA by far the largest player on London Heathrow-U.S. routes, and (3) create a dominant position on the corporate deals market in London.[419] It was also alleged that this market power will enable BA and AA to raise fares, lessen service levels, and inhibit innovation. Furthermore, it will enable BA and AA to raise rivals' costs for two reasons: (1) BA and AA will have a greater network reach and frequencies which other carriers will need to compensate for, and (2) it will enable BA and AA to negatively influence their contracts with competitors, for example by only providing access to connecting passengers at commercially disadvantageous terms or not at all. In particular, the complaint refers to the likelihood of the parties restricting access to connecting traffic for Virgin Atlantic. The complaint alleges that this raising of rivals' costs would have further detrimental impact on the viability of competitors, in turn enhancing BA's and AA's market power.[420]

However, in response the Commission defined the relevant market for scheduled passenger air transport services on the basis of the "point of origin/point of destination" city pair approach corresponding to the demand-side perspective whereby customers consider all possible alternatives of travelling from a city of origin to a city of destination, which they generally do not consider substitutable to a different city pair. Ignoring a supply-side as part of the assessment is an inaccurate approach. In long period the impact of the alliances on the market and players might be much more significant with the potential increase of the networks of the airliners' members.

iv. United – Lufthansa – Air Canada

The revenue-sharing joint venture agreement between United, Air Canada and Lufthansa covered passenger air transportation on transatlantic routes and involved extensive coordination on pricing, capacity and scheduling where the parties also agreed to share all revenues within the joint venture.[421]

Proceedings were begun by the Commission in 2009. The Commission's approach was to perform an assessment of the efficiencies that the parties claimed justified the alliance in accordance with Art. 101

419 Brussels, 20.6.2011, SG-Greffe(2011) D/10046 C(2011) 4505 final. Case COMP/39.596 – British Airways/American Airlines/Iberia Decision rejecting Virgin Atlantic's complaint of 30 January 2009 available online at: <https://ec.europa.eu/competition/antitrust/cases/dec_docs/39596/39596_4997_5.pdf> accessed August 2021

420 Ibid.

421 Case Comp. AT39595 *Continental/United/Lufthansa/Air Canada* (2013) Decision of 23 May 2013.para. 2 – 3.

(3) TFEU. To do so, an assessment both of consumers travelling on the identified route with customers travelling behind and beyond the route was made.

v. Air France – KLM – Alitalia – Delta

A highly surprising aspect of this case was the fact the other SkyTeam members would be eligible for slots that would have to be released as a consequence of the present agreement. The fact that the Commission to some extent referred to other SkyTeam members as competitors also raises concerns over the decision.[422] In reality it must be deemed highly unlikely that members of an alliance will actually compete against each other. Since the commitment also concerned the release of slots at a congested airport it is even more surprising that the alliance members were considered as competitors. It is not impossible that the carriers operated individual services on the identified routes without any cooperation, either way they would gain a tremendous advantage compared to other competitors if they received slots at a congested airport, which was also a hub of an alliance partner.[423]

The key issue in that case is the effect on the relevant market. While indeed the network should be reviewed in line with the individual routes of each alliance member, the detriment shall be assessed on the criteria of the increased market power of all members rather than allow individual members to benefit from the remedies.

vi. SAS – Maersk Air

In 2001 the European Commission has decided to fine Scandinavian airlines SAS and Maersk Air € 39.375 million and €13.125 million respectively for operating a secret agreement that led to the monopolisation by SAS of the Copenhagen-Stockholm route to the detriment of over one million passengers that use that major route every year, as well as to the sharing out of other routes to and from Denmark.[424]

While the parties argued that the nature of the cooperation agreement made it impossible to assess the relevant market based on specific routes with the agreement to be assessed as a whole, which would also be justified from a commercial point of view,[425] the Commission was not of the same opinion and stated that a demand side perspective was the most important element when defining a relevant market.

422 Volodmyr Bilotkach, Kai Huschelrath, 'Antitrust Immunity for Airline Alliances' (2011) Zentrum fur Europaische Wirtschaftforschung GmbH, Discussion Paper No 10-080.

423 Eric Pels, 'Optimality of the Hub-Spoke System: A Review of the Literature, and Directions for Future Research' (2021) 104 Transport Policy A1-A10.

424 European Commission, Press Release, 'Commission Fines SAS and Maersk Air for Market-Sharing Agreement' (2001) IP/01/1009, Brussels, 18 July 2001

425 Ibid.

Therefore, again the Commission applied the O&D city pair approach, where every pair was considered as a separate market.[426]

A logical argument, which might be raised here, is that the Commission's established market definition in air transport cases rather lends itself to identifying, not a spatial geographic market, but rather a linear point-to-point understanding of connections. Indeed, in this case, the applicant submitted that, save for the three contested markets (Copenhagen-Stockholm, Copenhagen-Venice and Billund-Frankfurt), the Commission has failed to define any other market and merely referred to broad categories by mentioning a large but indeterminate number of routes to and from Copenhagen and Billund. The Commission at that point therefore failed to identify and delineate any more than three markets. Hence, the assessment was based on three markets only and this could be said to be largely insufficient to support the Commission's findings. In other words, t the Commission failed to prove the existence of a market covering the whole of the EEA and beyond.[427] The Commission further erred in its assessment of the geographic impact of the infringement.

While the Competition Commissioner Mario Monti said that "this is a clear case of two airlines sharing markets illegally to the detriment of passengers", there was no actual detriment to the consumers (such as higher prices) proven. Overall effect of the agreement could be interpreted differently from the consumer welfare's point of view, would it be reviewed with wider definition of the relevant market.

SAS described its fine as "politically motivated" and disproportionate designed to warn alliances from doing similar deals across Europe.[428] Finally, with the greater integration between the airlines in the recent years and considering the overall impact of the Covid-19 pandemic, in 2021 and onwards such cooperation would need to be reviewed within much wider scope of its impact with a specific focus on the social welfare elements.

In 2001, the Sun-Air's founder and chief executive Niels Sundberg commented that "SAS has used its monopolistic position to force smaller airlines off various routes across Scandinavia".[429] Looking into the last decade of the market development with an indicative trend towards the oligopoly model and use by the large groups (i.e., IAG, Lufthansa) of the available sources to either aiming to enter certain

426 Commission Decision *SAS/Maersk Air* of 18 July 2001 OJ L265.

427 Case T-241/01 *SAS v Commission of the European Communities* [2005] ECLI:EU:T:2005:296.

428 Flight Global, 'Airlines fined after breaching European competition rules' (2001) available online at: < 24 https://www.flightglobal.com/airlines-fined-after-breaching-european-competition-rules-/38921.article> accessed September 2021.

429 Ibid.

niche markets by setting-up the new market players or extending its presence by increasing their fleets, it might raise some doubts that the companies will recourse to such practice further on.

II. *Article 102*

1. Dominant position

Article 102 TFEU prohibits the abuse of a dominant position within the internal market or a substantial part of it. It is the legal basis for a crucial component of competition policy and its effective enforcement helps markets to work better for the benefit of businesses and consumers.

Abuses are commonly divided into exclusionary abuses, which exclude competitors from the market, and exploitative abuses, where the dominant company exploits its market power by, for example, discriminating – absent objective economic reasons - between different groups of customers charging them unfair prices. Such conduct has, for example, been seen at the level of some airports that seemed to have applied different airport charges to national carriers and carriers from other Member States.

Article 102 TFEU does not contain an equivalent exception for anticompetitive agreements as set out in Article 101(3) TFEU, whereby a firm's conduct may be deemed legal because of benefits for consumers. However, a dominant company may be able to show that its conduct, which may prima facie appear abusive, is – in light of the circumstances of the case – objectively justified and proportionate. In accordance with the case law,[430] it is not in itself illegal for an undertaking to be in a dominant position and such a dominant undertaking is entitled to compete on the merits. However, the undertaking concerned has a special responsibility not to allow its conduct to impair genuine undistorted competition on the internal market. This has particular importance in the context of the wider objective of achieving an integrated internal market.

Finally, the EU Guidance Paper on enforcement priorities in addressing abusive exclusionary conduct by dominant undertakings [431] and speeches by EU officials indicate receptivity to greater express reliance on an effects test and to reduced emphasis on the category-based assessment sometimes evident in cases such as *British Airways*[432]. Even in the context of what is called an effects test,

430 Case C-333/94 P *Tetra Pak v Commission* [1996] ECR I-5951.

431 Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings (2009/C 45/02).

432 WE Kovacic, 'Competition Policy in the European Union and the United States: Convergence or Divergence?' (2008) Bates White Fifth Annual Antitrust Conference, Speech delivered on June 2 2008, available online at; https://www.ftc.gov/sites/default/files/documents/public_statements/competition-policy-european-union-and-united-states-convergence-or-divergence/080602bateswhite.pdf accessed 22 March 2022.

outcomes often will hinge on the quantum and quality of evidence that a court demands before it is willing to find actual anti-competitive effects or to infer likely adverse effects.

2. Price discrimination

Price discrimination is the most prominent type of abuse in the aviation sector. Price discrimination leads to higher profits for suppliers as suppliers set prices to maximise profits. The effect of price discrimination on profits has a knock-on effect on investment allowing the companies to cover investment costs and overheads. As a result, this might encourage entry and innovation. On the other hand, another critical effect of price discrimination is its ability to undermine stability. This might raise issues under Article 101 TFEU as well as have implications for the definition of collective dominance under Article 102 TFEU. Indeed, this has been something which has troubled the court on occasion. In *Airports de Paris v Commission* for example, it was found that the airport management group was 'dominant' in the market of airport management; nevertheless, the issue was whether the charging by that group of fees to provide ground handling and catering services at both Paris Orly and Rosssy-CDG, on a basis which was *de-facto* discriminatory, constituted an abuse of a dominant market position contrary to Article 102 with the relevant market being not simply "airport management", but rather the market for ground handling and catering.[433] It was held that they were dominant on that market too, largely on the basis of the effects which their dominance on another, related market had on the market which they might otherwise not have been found dominant on.[434] This highlights the flexibility and effectiveness of effects-based assessment.

A narrower case on price discrimination is seen in *MEO v Autoridade da Concorrencia,* in which the interpretation of Article 102(c) on whether a party "applies dissimilar conditions to equivalent transactions" was considered.[435] Here the issue was whether or not such a condition had created a competitive disadvantage, with this being the test for whether or not such a measure contravenes Article 102. It was held that the mere fact that different conditions were applied was not conclusive as to this, and that each practice was required to be shown to have an effect in reality in order for Article 102 TFEU to be contravened.[436]

433 Case T-128/98 *Airports de Paris v Commission* [2000] ECR II-3929.

434 Ibid.

435 Case C-525/16 *MEO v Autoridade da Concorrencia* [2018] ECLI:EU:C:2018:270.

436 Reka Horvath and others, 'The Preliminary Ruling in MEO: Closing the Circle of Article 102 TFEU' (2020) 11 Journal of European Competition Law & Practice 35, 46.

It is worth here, to highlight the practical complexity of the consumer welfare effects of price discrimination. On the one hand, price discrimination increases firms' profits. On the other hand, effect on consumer welfare can only be assessed in individual cases bearing in mind its general ambiguity. It is important to remember that the pattern of price discrimination paid by final customers may be very different from that faced by the intermediate supplier.

In fact, it is also possible that the consumers do benefit from price discrimination. In some circumstances upstream monopolists may want to promote downstream competition by favouring new entrants which ultimately increases efficiency. The critical question of whether discrimination that harms particular trading parties but benefits consumer welfare overall is objectively justified under Article 102 and is therefore of considerable practical importance.[437]

3. Commission approach

British Airways/Virgin[438] highlights how the treatment of mere differences in prices as capable of amounting to unlawful discrimination. In this case, British Airways ("BA") paid a bonus commission to travel agents who had increased their sales relative to sales in a past period. The Commission found that this gave rise to unlawful discrimination, since two agents selling the same absolute number of tickets would receive different commissions if one agent had increased its sales by a greater proportion of its past sales relative to the other agent. The basis for this finding is not clear, since a system based on absolute sales levels would have produced much larger distortions in favour of agents with a larger catchment area.[439]

In this case, the dominant firm paid travel agents a bonus commission of 1-2% for increases in their sales relative to past sales by each individual agent. All agents received a standard commission of 7-9% in any event for each ticket sold, and BA's rivals were obviously free to offer whatever commissions they wished to incentivise sales of their tickets. The Commission objected to this scheme on the grounds that agents who sold the same absolute number of tickets could receive different levels of bonus commissions depending on whether had increased their sales relative to sales in a past reference period. The General Court agreed with the Commission's findings, noting that, by remunerating at different levels services that were nevertheless identical and supplied during the same

437 Robert O'Donoghue QC, Jorge Padilla. *The Law and Economics of Article 102 TFEU* (3rd Edition Bloomsbury 2020) 37.

438 Commission Decision of 14 July 1999 *Virgin/British Airways* (1999) OJ L 30.

439 Ibid.

reference period, the bonus commission scheme distorted the level of remuneration that the agents received from BA. The Court added that discriminatory levels of remuneration "naturally" distorted competition between agents.[440]

On appeal, the General Court attached importance to the finding that BA was at the time an "obligatory business partner" for agents in the sense that, for many ex-United Kingdom routes, agents had no choice but to deal with BA.[441]in these circumstances, the Court concluded that differences in commission for the same absolute amount of ticket sales " naturally" affected competition between agents.[442]However, the court made no serious efforts to quantify the extent of the difference in treatment, to see whether it affected competition between agents in the same geographic, to assess whether the difference in commission affected the agents' total costs and profits, and to assess whether a material effect on total costs or profits could have been set-off by revenues from other airlines and other sources.[443]

The conclusion that agents selling the same absolute amount of tickets could receive different commissions could be a valid arguments, however, this ignores a number of basic procompetitive features of the incentive scheme at issue. BA was looking at ways in which it could incentivise agents to sell more tickets and had to devise some useful way of rewarding agents who did so. Measuring agents' performance in the airline industry is not easy, since demand is a function of the agent's combined efforts (e.g. promotional services, customer support, etc.) and external factors affecting aggregate demand (e.g., the economy, and geopolitical considerations). In such circumstances, it seemed reasonable to base the bonus commission on those variables that are most closely connected to the agent's decisions, i.e., individual promotional and marketing efforts. The agent's sales relative to a past period were a reasonable proxy for these efforts.[444]

From the network effect, which was ignored alike other significant factors, the agreement might also have benefitted consumers and ultimately increased the value of services.

440 Commission Decision of 14 July 1999 *Virgin/British Airways* (1999) OJ L 30.

441 Case T-219/99 *British Airways plc/Commission* [2007] ECR II-5917, para. 217.

442 Ibid.

443 Robert O'Donoghue QC, Jorge Padilla. *The Law and Economics of Article 102 TFEU* (3rd Edition Bloomsbury 2020) .

444 Ibid.

However, on appeal the Court of Justice held that the General Court did not err in making such an inference of competitive disadvantage which is rather disappointing as it becomes obvious that effectiveness was inaccurately assessed.[445]

In general, the decisional practice and case law have involved very limited and superficial review of the economic or other reasons why it may be rational and procompetitive for a dominant firm to engage in discrimination.

4. Competitive disadvantages

One of the most critical issues associated with the competitive disadvantage is how disadvantages should become evident. It has been understood that Article 102 required a material competitive disadvantage. Difference in treatment is contrary to Article 102 "only if it gives rise to a significant competitive disadvantage".[446] Since the dominant enterprise will not necessarily know enough regarding non-associated companies' business to be able to judge this, the key question is "whether a reasonable company in the position of the dominant enterprise should have known that a significant competitive disadvantage was likely to arise".[447]

British Airways/Virgin[448] supported the need for some evidence of a non-trivial distortion of competition between the trading parties. As the Advocate General stated, the conduct of the dominant undertaking must be "likely in the particular case to distort competition, i.e., to prejudice the competitive position of some of the dominant undertaking's trading partners in relation to the others,", even though proof of an actual, quantifiable worsening of the competitive position of individual trading partners of the dominant undertaking was not required.[449]

Furthermore, the Court of Justice in *British Airways/Virgin*[450] implicitly rejected an approach that would require direct evidence of head-to-head competition between the favoured and disfavoured parties. It reasoned that a competitive advantage was made out on the basis that travel agents in the United Kingdom compete intensely with each other, and their ability to do so depended on their ability

445 Case C-95/04 P *British Airways plc v Commission* [2007] ECR I-2331, paras. 145-148.

446 J Temple Lang, "Anticompetitive Non-Pricing Abuses Under European and National Antitrust Law" in B Hawk (ed.), *Fordham Corporate Law Institute*, (1st edn Juris Publishing Co 2004) pp. 235 – 340, 248.

447 Ibid.

448 Commission Decision of 14 July 1999 *Virgin/British Airways* (1999) OJ L 30.

449 Opinion of Advocate General Kokott in Case C-95/04 P *British Airways plc v Commission* [2007] ECR I-2331, paras. 124-125.

450 Commission Decision of 14 July 1999 *Virgin/British Airways* (1999) OJ L 30.

to provide flights at a reasonable cost and their individual financial resources. Owing to the fact that the bonus commission scheme was retroactive, it could lead to exponential changes in the revenue of travel agents. On this basis the Court of Justice concluded that one could infer competitive disadvantage or a tendency towards such a disadvantage.[451]

One interesting point to mention prior to moving on from this discussion at this point in this thesis is the role played here by state aid. British Airways is a very good example of the critical difference between market players and leverage they might have during the crisis. When British Airways moved its short-haul flights from Gatwick to Heathrow in 2020 to survive the pandemic downturn, a question pas been posed if the UK's flag carrier would ever return in full force. The UK's second airport, home base of low-cost rival easyJet, had always been a tougher challenge than Heathrow, BA main hub of operations and the link to its once lucrative transatlantic routes. However, in 2021 BA has announced to return to short-haul flying from Gatwick with a new, lower cost airline operating from the airport.[452] This is after a £2 million sterling support grant received by BA in the United Kingdom, financed through the Covid recovery programme in place in that country, BA would base up to 17 A320 aircraft from Gatwick for the summer 2022 season.[453] Not every airline's corporate budget can afford to set-up an airline as a security measure in order to preserve slots, indicating the key importance of bargaining power in this arena, as well as highlighting once again the very real high-barriers to entry and competition on the market which the airline sector rather naturally displays.

5. Efficiencies and Welfare issue

An explicit assumption appears to exist that discrimination is necessarily anticompetitive, without any evidential or economic analysis of whether this is actually the case.[454] It is important that the EU institutions should adopt a concept of "objective justification" which, consistent with economic thinking, recognises the output enhancement that can result from many forms of discrimination.

In circumstances where any incentive scheme would produce distortions at some level, BA's decision analysed in *British Airways/Virgin*[455] to link the bonus commission to each agent's individual efforts

451 Ibid.

452 Financial Times, 'British Airways Hopes its Third Time Lucky for Low-Cost Plan' *The Financial Times* available online at; <'https://www.ft.com/content/eb0d11c7-18ba-4e1b-8c0a-4b420935fe72>accessed 22 March 2022.

453 Ibid.

454 Ibid.

455 Commission Decision of 14 July 1999 *Virgin/British Airways* (1999) OJ L 30.

seemed a reasonable and efficient way of giving incentives to agents.[456] Standard principal/agent theory in economics indicates that BA's scheme was an efficient way of providing incentives and rewards. Yet, the scheme was considered to give rise to abusive discrimination without any serious consideration of its actual or likely competitive effects and whether alternative schemes would have better effect.

6. Conclusion

In conclusion, the network-based approach can be seen to be very important in the proper application of Article 102 TFEU. Its use in a number of cases, and particularly in *British Airways/Virgin*[457], which operates as something of a case-study in this chapter, indicates how the use of such an approach has created a more coherent system of law here, in which an assessment of the actual level of distortion of competition upon the market, and the notion of competitive disadvantage, is highly relevant. This is as it should be and provides legal certainty to an area which had been lacking in this for some time.

456 Robert O'Donoghue QC, Jorge Padilla. *The Law and Economics of Article 102 TFEU* (3rd Edition Bloomsbury 2020)

457 Commission Decision of 14 July 1999 *Virgin/British Airways* (1999) OJ L 30.

CHAPTER 6
SUBSTANTIVE TEST. STATE AID

I. *State Aid*

1. Commission's approach and its deficiency

State aid is defined as an advantage in any form whatsoever conferred on a selective basis to undertakings by national public authorities. Therefore, subsidies granted to individuals or general measures open to all enterprises are not covered by this prohibition and do not constitute State aid (examples include general taxation measures or employment legislation).

A company which receives government support gains an advantage over its competitors. Therefore, the TFEU generally prohibits State aid unless it is justified by reasons of general economic development. To ensure that this prohibition is respected and specific exemptions are applied equally across the European Union, the European Commission is in charge of ensuring that State aid complies with EU rules.

To be State aid, a measure needs to have these features:

- there has been an intervention by the State or through State resources which can take a variety of forms (e.g., grants, interest and tax reliefs, guarantees, government holdings of all or part of a company, or providing goods and services on preferential terms, etc.);
- the intervention gives the recipient an advantage on a selective basis, for example to specific companies or industry sectors, or to companies located in specific regions;
- competition has been or may be distorted**;**
- the intervention is likely to affect trade between Member States**.**

Despite the general prohibition of State aid, in some circumstances government interventions is necessary for a well-functioning and equitable economy. Therefore, the Treaty leaves room for a number of policy objectives for which State aid can be considered compatible**.** The legislation stipulates these exemptions**.** The laws are regularly reviewed to improve their efficiency and to respond to the European Councils' calls for less but better targeted State aid to boost

the European economy. The Commission adopts new legislation is adopted in close cooperation with the Member States.[458]

This Chapter will discuss different political and economic arguments in favour of the government intervention into the sector and justification for expanding the Government's powers to intervene as some potential transactions currently fall outside of the Government's powers for such intervention. This thesis will also suggest a framework for how the competition law enforcement may seek to accommodate the public interest effectively, in order to limit any distortions of competition, legal certainty and harmonisation that might ensue. This chapter will address the existing gaps in the Commission approaches applicable to the evaluation of the State aid, together with the affected market elements in light of the social and political environment.

It will also assess a practical impact of the substantive test's application in light of the COVID – 19 pandemic crisis as well as relations between airlines and states, local airports and airlines. It will also examine the legislative initiatives enacted by the Commission and Member States including Temporary Framework with a broad range of measures.

Finally, it will conclude that the inaccurate application of the rules and assessment criteria lead to the significant detriment to the industry as well as overall economy. Practice of the unsubstantiated policy-motivated support together with the narrow and misleading justification of the aid for the sake of individual pollical agenda or market participants shall be avoided.

The general outcome of the analysis below is clear. Aviation market has been very dynamic, with multiple variables that are attributes to the core of the business including regulatory restrictions, high operational costs and most often international dimension of the activities. One of the biggest and most common mistakes of the Commission is an attempt to assess a transaction of any sort in isolation.

458 European Commission, 'State Aid' available online at; https://ec.europa.eu/competition/state_aid/overview/index_en.html accessed 22 March 2022.

2. Regulatory framework

i. General scope

Core provisions of the Treaty on the Functioning of the European Union (TFEU) related to State aid are Article 107, Article 108 and Article 109 of the TFEU.

Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty. Known as the general block exemption regulation (GBER), it seeks to enable EU governments to give higher amounts of public money to a wider range of companies without having to request prior permission from the European Commission.

As a general rule, except for very small amounts, State aid must be notified to and cleared by the Commission before it is granted. The regulation exempts EU countries from this notification obligation, as long as all the GBER criteria are fulfilled. The exemption is designed to reduce administrative burdens on national and local authorities and to encourage EU governments to channel aid towards economic growth without giving recipients an unfair competitive advantage.
With the specific focus on aviation sector, there are Guidelines on State aid to airports and airlines 2014/C 99/03 that were introduced by the Commission in 2014.

These guidelines cover 3 key areas:

1. Investment Aid. The European Commission is mostly concerned with airports spending State money / resources on unnecessary airport capacity. So if the investment can be deemed necessary, by increasing mobility of EU citizens, easing congestion at major airports or increasing regional development, the EC will take a kinder view. Consequently, the EC have created a maximum aid intensity that they view as permissible based on the size of the airport. The percentages are based on the amount of aid necessary for the project, and there needs to be an *ex ante* business plan the funding needs and gaps.[459]

459 European Commission Communication on Guidelines on State aid to airports and airlines (2014) 2014/C 99/03.

2. Operating Aid. Similar to investment aid, if operating aid can be shown to increase mobility of EU citizens, ease congestion at major airports or enhance regional development it is viewed more favourably by the EC. Also, in a similar way to investment aid, the EC categorises airports of different sizes and their ability to cover their own costs. The amount of aid required needs to be calculated based on an ex-ante business plan demonstrating the exact funding gap and showing that cost overage will be achievable within the transitional period.[460]

3. Start-up Aid to Airlines. This is a relatively weak instrument and is unlikely to be of much value. The guidelines allow for start-up aid that may cover up to 50% of and airlines' airport charges in respect of a route for a maximum period of three years. The eligible costs are the airport charges in respect of the route.[461]

ii. State aid rules and coronavirus

The outbreak of a novel coronavirus infection has a significant economic impact. Member States have already provided support measures for citizens and companies. Some support measures may entail State aid within the meaning of Article 107(1) TFEU.[462]

As part of emergency response, series of the additional regulations have been enacted including:

i. Commission Regulation (EU) 2020/972 of 2 July 2020 amending Regulation (EU) No 1407/2013 as regards its prolongation and amending Regulation (EU) No 651/2014 as regards its prolongation and relevant adjustments.[463]

ii. On the 19 March 2020, the Commission finally adopted its Communication 'Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak'[464] (the 'Temporary Framework'). The Temporary Framework encompasses a broad range of measures although it does not contemplate every form of measure that might be suitable. The direct provision of equipment and guarantees for credit insurance activities as an example are not contemplated by the Temporary Framework. As such, they cannot be adopted on this basis. Similarly, the Temporary Framework does not contemplate state aid to credit or financial institutions or to undertakings (other than SMEs) that

460 Ibid.

461 Ibid.

462 Article 107 Treaty on the Functioning of the European Union 2008.

463 Communication from the Commission of 1 February 2021 C/2021 (OJ C 34 1.2.2021 p6-15).

464 Communication from the Commission of 19 March 2020, C(2020)1863 (OJ C 91 I, 20.3.2020, p. 1).

were in difficulty before 31 December 2019, so member states will need to rely on other legal bases to adopt measures to assist those undertakings. Furthermore, there is also a limitation in the Temporary Framework in terms of the maximum limits placed on direct grants. For undertakings experiencing significant liquidity impacts from the pandemic, the provision of guarantees does not secure access to financing, meaning that support for those undertakings may need to rely on other state aid options.

iii. On 3 April 2020, it adopted a first amendment to enable aid to accelerate research, testing and production of COVID-19 relevant products, to protect jobs and to further support the economy during the current crisis.[465]

iv. On 8 May 2020, it adopted a second amendment to further ease the access to capital and liquidity for undertakings affected by the crisis.[466]

v. On 29 June 2020, it adopted a third amendment to further support micro, small and start-up companies .and incentivise private investments.[467]

vi. On 13 October 2020, it adopted a fourth amendment to prolong the Temporary Framework and to enable aid covering part of the uncovered fixed costs of undertakings affected by the crisis.[468]

The Temporary Framework seeks to ensure an appropriate balance between the positive effects of the aid measures covered in assisting undertakings and any potential negative effects on competition and trade in the Internal Market. A targeted and proportionate application of EU State aid control ensures that national support measures effectively help affected undertakings during the COVID-19 outbreak, whilst limiting undue distortions to the Internal Market, maintaining the integrity of the Internal Market and ensuring a level playing field. This will contribute to the continuity of economic activity during the COVID-19 outbreak and provide the economy with a strong platform to recover from the crisis, keeping in mind the importance of meeting the green and digital transitions, in line with EU law and the Union's objectives.

There are a number of overall objectives pursued by the Communication. . Some of these may be suggested to be to help prolong the measures set out in the Temporary Framework until 31 December 2021 for example, or to adapt the aid ceilings of certain measures in order to address the prolonged

465 Communication from the Commission of 3 April 2020, C(2020)2215 (OJ C 112 I, 4.4.2020, p. 1).

466 Communication from the Commission of 8 May 2020, C(2020)3156 (OJ C 164, 13.5.2020, p. 3).

467 Communication from the Commission of 29 June 2020, C(2020)4509 (OJ C 218, 2.7.2020, p. 3).

468 Communication from the Commission of 13 October 2020, C(2020)7127 (OJ C 340 I, 13.10.2020, p. 1).

economic effects of the ongoing crisis. In addition to this increased flexibility, the Communication helps to clarify and amend the conditions for certain temporary State aid measures that the Commission considers compatible under Article 107(3)(b) of the Treaty on the Functioning of the European Union ('TFEU') in light of the COVID-19 outbreak. This Communication also aims to amend the list of marketable risk countries set out in the Annex to the Communication from the Commission to the Member States on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to short-term export-credit insurance ('STEC').

3. Market failure and state intervention

In State aid, the main focus is not on negative market outcomes such as loss of dynamic efficiency[469] but rather is based on so-called the negative presumption. In general, State aid within the meaning of Article 107 (3) TFEU is in principle incompatible with the internal market and thus prohibited. Circumstances under which state aid can be granted are limited.

While the Commission regularly states in its decisions that the existence of market failure is indispensable in justifying state intervention,[470] the existence of market failure is not necessary for aid to be declared compatible under Article 107(3). Market failure does not mean that the market is completely unable to supply a good or service. State aid aiming to remedy market failure may be compatible with the internal market even if it has a negative impact on some market operators.

The type and amount of aid are also important, as certain aid characteristics may have greater potential to distort certain aspects of competition.[471] For example, a direct grant is typically considered to be more likely to be distortive than other aid instruments such as a repayable advance or a soft loan. The extent of selectivity refers to whether the aid was granted to all of the companies in the industry, or to a subset. In other words, selectivity enables the assessment of the extent to which incentives have been modified and whether some companies are likely to have enjoyed an advantage over others. It is argued[472] that in restructuring aid to an airline, a measure is company-specific and therefore selectivity is obvious. On the other hand, if a measure is industry-specific, the aid may only be available to

469 Vincent Verouden, 'Economic Principles of State Control' (2005) IBC Conference Brussels, delivered on 28 January 2005, available online at; https://ec.europa.eu/dgs/competition/economist/ibc.pdf accessed 22 March 2022.

470 Lexxion Blog, 'Compatible State Aid May Have Negative Effects on Some Market Operators' (2016) available online at; https://www.lexxion.eu/en/stateaidpost/compatible-state-aid-may-have-negative-effects-on-some-market-operators/ accessed March 2021.

471 Case T-162/13 *Magic Mountain Kletterhallen and others v Commission* [2016] ECLI:EU:T:2016:341.

472 https://ec.europa.eu/competition/publications/reports/kd0617275enn.pdf

existing companies (as compared with new entrants), or to companies whose domicile is located in a specific area.

Furthermore, State aid control considers the distributive effects of the aid.[473] To examine if the aid changes incentives to a point where it may affect competition negatively, it is important to identify appropriate comparators against which to assess the current situation. The comparators must describe a hypothetical scenario in which the aid in question was not granted—i.e., the 'counterfactual scenario'.

The main objective in assessing the impact of State aid on competition is to identify the causal link between the aid measure and the observed market outcomes. A commonly applied methodology in this context is a factual– counterfactual comparison or counterfactual analysis. The factual describes the observed scenario in the presence of the aid; the counterfactual describes the hypothetical scenario that would have been observed without the aid.

4. Counterfactual in state aid assessments

The counterfactual in state aid assessments is considered on an ex-ante basis as part of the evaluation of the incentive effects of the aid. In this setting, the counterfactual analysis aims to identify the economic activity that would not have occurred, had the aid not been granted. It means that the hypothetical scenario usually focuses on the company receiving the aid.

The ex-ante counterfactual may be equally relevant for an ex-post assessment of the potential distortive effects of the aid on competition; indeed, the same counterfactual scenarios as in the ex-ante analysis can be used as a starting point. However, it is important to determine whether the counterfactual scenarios identified on an ex-ante basis still represent the most appropriate scenarios for the purposes of the ex-post assessment.

The 2014 guidelines specify the factors that need to be considered in order to identify the appropriate counterfactual. The counterfactual can be identified based on a group of the most comparable firms that have not received aid ('the control group').[474] When identifying the appropriate control group, the following factors need to be considered:

473 Magnus Schmauch, *EU Law on State Aid to Airlines: Law, Economics and Policy* (Lexxion Publisher 01 October 2012).

474 Fabienne Ilkzovitz, *Ex Post Economic Evaluation of Competition Policy: The EU Experience* (1st edn Wolters Kluwer 2020) 300.

i. The potential for organisations receiving aid to be in a different situation from those that do not receive aid. This includes potential selection biases between companies applying and not applying for aid;
ii. The common factors that explain performance of the companies, i.e., general market trend;
iii. The potential for companies to receive aid from multiple sources.[475]

There are different approaches that may be followed to define the appropriate counterfactual in ex post evaluations. These approaches rely on techniques that are similar in mergers and state aid. However, according to the Commission report on Ex post assessment of the impact of state aid on competition (2017)[476] differences may arise where the assessment is undertaken on an ex-post rather than an ex ante basis. The counterfactual in ex ante assessment resembles the counterfactual in merger assessment, i.e., the factual (what happens with the aid) and the counterfactual (what happens if the aid is not granted) are both unknown. In addition, in ex ante assessments the counterfactual describes the performance of the company had it not received the aid (e.g. profitability, sales, investment levels), while in ex post assessments the counterfactual describes the performance of the market would had the aid not been granted. The factual and counterfactual scenarios in ex post assessments are similar to those in antitrust investigations[477]: the factual is known while the counterfactual is unknown.

iv. Measuring the impact requires comparing the counterfactual with actual data. There are several approaches to comparing. The simplest approach is qualitative. It is based on examining the evolution of key variables of interest (such as firms' R&D&I expenditure) in the factual and in the counterfactual. This approach is only appropriate if there are no significant factors other than the aid itself that explain effects on competition.

5. Distortive Effects of State Aid on Social Welfare

One of the broad objectives of EU State aid policy is the prevention of those aids which have an adverse effect on the EU competition as a whole. Evaluating state aid proposals from an economic perspective requires analysis of the effects of state aid at all levels of the internal market. The issue of market definition is central to this assessment as it helps to identify the sources of competitive pressure by

475 European Commission, 'Ex Post Assessment of the Impact of State Aid on Competition: Final Report' (2017) available online at; < https://ec.europa.eu/competition/publications/reports/kd0617275enn.pdf> accessed 22 March 2022.
476 Ibid.
477 Ibid.

determining the economic markets it is active in as well as areas of the EU economy affected by a particular aid scheme. As argued in earlier study, Fingleton and others,[478] the definition framework presented in the Commission Notice on the definition of the relevant market for the purposes of EU competition law (OJ C372 9/12/97), which is developed for application to suspected anti-competitive practices, is not adequate for assessing state aids as it considers different basic economic concepts.

It would not be exaggerating to claim that in the context of air transport the Commission applies the rules not only selectively, but also inconsistently. The difference of the theoretical instruments used, whether and what extent they expand or contract, is a function of the State aid case at issue.

The aim of preventing and remedying market failures has become an accepted justification for State aid and the State Aid Action Plan (SAAP) emphasises "a proper and more transparent evaluation of the distortions to competition and trade associated with aid measures[479]" and sets out to "investigate the reasons why the market by itself does not deliver the desired objectives of common interest and in consequence evaluate the benefits of State aid measures in reaching these objectives"[480].

A general perception is that definitions of what constitutes a subsidy vary, and that direct and indirect, legal and illegal subsidies may be distinguished. Furthermore, it has revealed that a wide range of subsidies is actually used, including grants (research and development, exports, investments, loss coverage), equity infusions, loans and loan guarantees, public service obligations, hidden subsidies (reduced infrastructure fees, cross-subsidisation, monopoly rights), and no or reduced taxes, including international bunker fuels, value added taxes, and tax exemptions of frequent flyer programmes. The identification of these subsidies is difficult due to the lack of documentation, and they often become public only because of cases brought by governments, airlines, or other entities before the World Trade Organisation, the Directorate General Competition of the European Commission, or other dispute resolution bodies.

As the potential consequences of subsidies are considerable, including rapidly growing capacity in the aviation system and economic vulnerabilities, it seems rather questionable that a wide range of subsidies continues to be appropriate measures to support aviation. At the very least, studies of

478 John Fingleton and others 'A Study of market Definition in Practice in State Aid' (1998) European Commission Study, available online at; < https://ec.europa.eu/docsroom/documents/2651/attachments/1/translations/en/renditions/native> accessed 22 March 2022.

479 European Commission, 'Consultation Document' State aid Action Plan. Less and better targeted State aid: a roadmap for State aid reform 2005-2009 COM/2005/0107, available online at;< https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52005DC0107> accessed 22 March 2022.

480 Ibid.

economic benefits brought about by aviation, including in particular those written by international consultancies for national governments[481] need to consider the role and cost of subsidies, as there is a danger that these have over-stated the economic benefits of aviation while simultaneously omitting its cost.

In addition to that, researchers as well as political decision makers might be interested in the effects of subsidies on different overall targets. Some studies focus on selected environmental indicators whereas others might concentrate on distributional effects since there is a positive relation between income per capita and air transport use, subsidies to the air transport industry, initially lead to benefits for groups of the society with relatively higher income[482].

Undoubtedly, aid has an effect on trade between Member States and almost always as a matter of fact distorts or threatens to distort competition because it instantly alters the nature of free market operations. There is a strong argument that aid granted by a Member State most likely strengthens the position of an undertaking compared with other undertakings competing in intra-Union trade and affected by that aid as a result.[483] Case law suggests that there is no necessity to establish that the recipient undertaking is involved in trade itself.[484] In the liberalised sector such as aviation, the aid might have a significant effect on competition[485]. The European Court of Justice ("ECJ") has found that aid granted to an undertaking may help this undertaking to maintain or even increase domestic activity which might lead to the outcome when undertakings in other Member States have less chances of penetrating the market in the Member State concerned[486]. Even in the scenario when a Member State grants aid to an undertaking that is not yet engaged in intra-Union trade, the aid might strengthen the undertaking in question so as to enable it to penetrate the market of another Member State[487].

The prime objective of this section is to undertake an analysis of key policy issues arising from the provision of state aids to European airlines and airports using several case studies. It critically evaluates the procedures used in practice by the Commission to assess different types of state aid and, in each case, some of the limitations of the approaches taken are identified, including their treatment of market definition.

481 Stefan Gossling and others 'Subsidies in Aviation' (2017) 9 Sustainability 1295, available online at; <https://doi.org/10.3390/su9081295> accessed 19 October 2018.

482 George Williams, Romano Pagliari, 'A comparative analysis of the application and use of public service obligations in air transport within the EU' (2004) 11 Transport Policy Issue 1.

483 Case C-66/02 *Italy v Commission* [2005] CECR I – 10901; Case T-369/06, *Holland Malt BV v Commission* [2009].

484 Cases C-393/04 and C-41/05 *Air Liquide Industries Belgium* [2006] ECR I – 5293.

485 Case C-409/00 *Spain v Commission* [2003] ECR I-1487; Case C-206/06, *Essent Netwerk Noord and Others* [2008] ECR I-5497.

486 Case C-148/04 *Unicredito Italiano* [2005] ECR I – 11137.

487 Case C-66/02 *Italy v Commission* [2005] ECR I – 10901; Case T-369/06 *Holland Malt BV v Commission* [2009].

6. State Aid role in aviation industry

As suggested by Horeth,[488] in undertaking a comparative analysis of the State aid, three key public policy concepts need to be evaluated, namely efficiency, transparency and accountability which shall be achieved when public policy is made and maximised. However, developments in all levels of governance, particularly at the domestic level, demonstrate the difficulty in finding a balance between the goals of those concepts. Another opinion[489] suggests that there is no 'objective' formula. The best combination ultimately depends on the 'normative' values that may be relatively important to each scholar or practitioner, that are found in how one views the concept of 'public enterprise' itself. Likewise, if prime importance is given to the concept of 'public' in the term 'public enterprise', which effectively means that the enterprise belongs to the people, then one must attempt to approximate a process wherein there is maximum accountability and transparency in the process, regardless of how efficient it may be, so that the 'public' and various interests within this have their input in the policy-process in order for it to be deemed legitimate.

The question should be also asked why so much direct subsidy to airlines take place compared to other sectors. Enormous competitive challenges mean that many European carriers remain chronically loss making. In addition to that, there is a constant perception that a national carrier is needed to provide connectivity for the benefit of specific region as well as to support state owned hub airports. In addition to that, for the local political reasons, there is a need for a flag carrier[490]. However, there is also a counterargument based on the practical examples of the market behaviour, and its natural filling of the existing gaps. One example is former Spanair and its closure of Barcelona destination, which led to the growth of rival Vueling, along with other airlines with additional flights, destinations, and passengers[491]. Vueling took advantage of this situation by renting a third of Spanair's planes increasing its fleet to 59 operating aircraft and and hiring 500 of its workers.[492]

Another example is Malev's exit from the market with the subsequent replacement of the flights and filling the passengers demands with Ryanair and Wizz[493], while air cargo market share was gained by

488 Marcus Horeth, 'No way out for the beast: the unsolved legitimacy problem for European governance' (1999) 6 Journal of European Public Policy 249-68.

489 Raj Chari, 'State Aids in the airline sector: a comparative analysis of Iberia and Aer Lingus' (2004) 13 Studies in Public Policy: The Policy Institute Trinity College 1, 1.

490 Niamh McCarthy, 'State Aid to Airlines and Airports' (2013) available online at; <https://www.kcl.ac.uk/law/research/centres/european/Niamh-McCarthy-presentation-slidesa.pdf> accessed 19.10.2018.

491 Ibid.

492 Catalan News, 'Catalan airline Vueling reached new heights in 2012 with a 20% passenger increase' (2012) available online at: <https://www.catalannews.com/business/item/catalan-airline-vueling-reached-new-heights-in-2012-with-a-20-passenger-increase> accessed October 2021.

493 CAPA 'After Malev's grounding, Hungary could become large LCC market with Wizz Air and Ryanair moving in' (06 February 2012) available online at: <https://centreforaviation.com/analysis/reports/after-malevs-grounding-hungary-could-become-large-lcc-market-with-wizz-air-and-ryanair-moving-in-67369>accessed 03 August2018.

integrated service providers such as TNT and DHL together with other network carriers operating in Hungary. As a result, Wizz Air and Ryanair, benefited the most from the exit of Malev from the market. Wizz Air was already the second largest carrier in the Hungarian market and was already well-positioned to fill the void left by Malev. Meanwhile, non-participants in that market, such as Ryanair, acted typically quickly and took up a number of slots at Budapest Airport left by Malev, with this relative interloper to the Hungarian market thereby becoming the second largest carrier in Hungary. Low-cost carriers (LCCs) penetration in Hungary prior to Malev's grounding stood at a relatively modest 24%, down from as high as 28% in 2005. Following Malev's collapse, LCC penetration in Hungary rapidly increased to about 40%[494]. This clearly indicates that the healthy competition and natural substitution of the loss-making companies from the market might be the best option to create or even enhance the social welfare.

There is also a concern that the increasing level of agreements between regional airports and low-cost carriers with a substantial number of cases having arisen in the past decade. These agreements are often challenged as they rise concerns not only about competition distortions between airlines but also about fiscal competition risks among Member States or local governments. Such tendency could be expected as regional airports are characterised by significant overcapacities and overlapping inducing a substitutability for airlines.

Additionally, the Guidelines on State Aid[495] granted to airlines open the way to transitory operating aid schemes. This is despite this option apparently being at odds with established and rather long-standing European principles. There is an opinion that the favourable usage terms granted to low-cost carriers generate additional flows on the other side, with commercial revenues from shops or parking. In total, the act of subsidising operating costs might be rational, even for a private investor in a market economy, and might even be a perennial device, to be repeated as and when necessary.[496]

In many cases it is very difficult to identify the amount of the subsidy which has been granted[497]. Moreover, there might be additional costs associated with subsidies, e.g., for lobbying, or the firm's administrative burden of reporting the actual use of a subsidy (e.g., in the case of R & D grants).

494 European Commission 'Overview of air transport and current and potential air connectivity gaps in the CESE region.Paper B' (04 December 2014) PWC, Final report available online at: <https://ec.europa.eu/transport/sites/transport/files/modes/air/studies/doc/internal_market/2014-12-overview-of-air-transport-and-current-and-potential-air-connectivity-gaps-in-the-cese-region-paper-b.pdf> accessed 19.10.2018.

495 Guidelines on State aid to airports and airlines (2014/C 99/03).

496 Estelle Malavolti, Frederic Marty, 'State Aids granted by regional airports: a two-sided market analysis' (2017) 35 Transportation Research Procedia, Elsevier pp.30-40. <http://www.sciencedirect.com/science/article/pii/S2352146517304933> accessed 19 October 2018

497 Stefan Gossling and others 'Subsidies in Aviation' (2017) 9 Sustainability, available online at: <https://doi.org/10.3390/su9081295> accessed 19 October 2018.

Therefore, the net effect in terms of cost reductions or income increases will be lower than the amount granted by the government. Economic theory shows that in general, subsidies will result in lower prices and therefore a higher output.

Consequently, if subsidies are present, they can lead to the expansion of aviation systems to the extent where significant shares of GDP and employment depend on this industry. In the context of on-going debates on the regional development potential of aviation, as well as discussions of its environmental impacts, it would thus seem relevant to discuss the importance of subsidies on purported effects of aviation on economic growth. The specific effect of subsidies does not only depend on its amount but also on its specific design. Moreover, many structural features like consumer behaviour, production technology, input prices, and market structures affect the impact of subsidies. This thesis will assess the key factors that determine the effect of different types of subsidies.

Also, the state of competition in a modern economy has an appreciable effect on economic efficiency[498]. Thus, both the Commission and the Courts seem to have played a role in enhancing the role of economic analysis which helps to separate the impact of aid from contemporary market developments like the financial crisis. The analysis uses information on market trends gained from traffic at comparable airports in the wider region to measure the effect of the aid in isolation. Based on that, enforcement procedures, like the leniency programs, which find some foundation in economic analysis, have been implemented. Having said that, the Commission has been criticised as being flawed or speculative. Several indicative examples illustrate that. For instance, by way of applying economic analysis, the fact that firms may have "dominant" positions across several geographic markets has been emphasised without clear justification[499], as the importance of the rivalry induced by bidding markets may have been exaggerated as well as the competitive pressure from entry (in the absence of barriers) in new markets may have been underestimated[500]. On top of that, impact of non-price issues of importance may have also been neglected[501]. As a result, it has a negative impact on the overall assessment of the market, and market definition.

498 Damien J. Neven 'Competition economics and antitrust in Europe' (2006) 21 Economic Policy, pp. 741-791

499 Case *COMP/M.1672 Volvo/Scania* [2001] OJ L143/74.

500 Case COMP M 1795 *Vodafone/Mannesman* [2000] OJ C 141/19.

501 Damien J. Neven 'Competition economics and antitrust in Europe' (2006) 21 Economic Policy, pp. 741-791

7. Market Economy Investor

In the process of establishing whether or not unlawful public financing was granted to a market participant, thereby distorting competition, it is necessary to analyse if the transfer was made to a particular undertaking and would a market economy investor ("MEI") have provided funds to the projects expecting a remuneration on the capital invested under the same conditions as a public authority intends to do. The overall issue whether the Commission is entitled to impose any conditions at all in normal investment cases has been discussed by Balfour, who has argued that there is a very great difference between conditions which a market investor might require the target – company to adopt and those imposed in connection with funding which constitutes aid.[502] The core purpose and legal justification of conditions shall be the reduction of adverse effects on competition that harm social welfare.

According to Balfour, the determination whether an investment satisfies the market investor principle does not effectively permit the imposition of certain conditions, to the extent they are commitments which a market investor would be likely to require, but not necessary the type of conditions which may be imposed in cases.[503] By applying the private investor test, the Commission decision is based on arbitrariness according to the political circumstances and to the high or low profile of the case at hand. Indicative example is the *Iberia* case and its decision[504] with the authorisation of a second package of aid under the private investor test which has been contested as running counter to the one time-last time principle. Lykotrafiti here suggests that a negative Commission Decision would have caused major socio – political turmoil, potentially tackled through illegal granting of the planned aid against Commission opposition.[505] Compliance with a negative decision could have supposedly led to further exacerbation of the airline's bad finances and ultimately to its bankruptcy.

The more politically charged a case is, the more likely that the market economy investor principle (MEIP) will prevail over the one time – last time principle and then that Commission – made conditions will prevail over the MEIP. As a result, the issue of whether the Commission is empowered to approve aid for the purposes of airline restructuring subject to conditions has been contested.[506] The same

502 John Balfour, 'State Aid to Airlines. A Question of Law or Politics?' (1995) 15 Yearbook of European Union Law 157, 157.

503 Ibid.

504 Commission Decision 96/278/EC Iberia (1996) OJ L 104, 27.4.1996.

505 Antigoni Lykotrafiti, 'The Intersection between the Market Economy Investor Principle and the One Time-Last-Time Principle in the Context of Airline Restructuring Operations' in E Szyszczak (ed), *Research Handbook on European State Aid Law* (1st edn Edward Elgar 2011) 120.

506 John Balfour, 'State Aid to Airlines. A Question of Law or Politics?' (1995) 15 Yearbook of European Union Law 157, 157.

applies to the nature of some of the conditions imposed by the Commission and to their real and quantifiable ability to minimise distortions of competition without unduly restricting the beneficiary airline's business.

Another example is funding of airport infrastructure which usually entails an important capital injection which can only prove to be good investments after a significant amount of time. Moreover, this kind of investment should not be seen on purely economic considerations as more factors come into play. Hence the difficulty to prove that a public authority did not act as a MEI would have, as regards the funding of a particular project. This difficulty was much debated in the *Charleroi*[507] case, when the ECJ annulled a Commission's decision, which declared some advantages granted by the Walloon Region and Brussels South Charleroi Airport incompatible with State aid rules. However, the source of the MEI test remains. In connection with public funding of airport infrastructure: "it is considered free of aid if in similar circumstances a private operator, having regard to the foreseeability of obtaining a return and leaving aside all social, regional policy and sectorial considerations, would have granted the same funding".[508]

Based on the audit conducted by the European Court of Auditors,[509] with the list of airports produced, a report clearly shows that most of these airports have been loss making and would most probably not have attracted a private investor having carried out a thorough due diligence process. The Charleroi case proved that the Commission got it wrong in its application of the Market Economy Investor Principle as regards possible State aid to Ryanair through subsidised discounts offered by the Brussels South Charleroi Airport. Indeed, the Charleroi airport became the base for Ryanair's operation in continental Europe, servicing 6.7 million passengers in 2013 (in 1999, it only received 20,000). Any investment in that project (and this includes building infrastructure) would certainly have proven attractive for any private investor. However, the audited airports mentioned in the Court of Auditors' report do not offer great potential for growth as too many of these airports were in the same catchment area and the building of airport infrastructure was often not needed and/or oversized.

In reality, a serious private market investor highly unlikely put his own money at stake to fund airport infrastructure which does not generate profits and will continue to be loss-making in the future.

507 Case T-196/04, *Ryanair v Commission* [2008] ECRII–3643.

508Margherita Colangelo, Vincenzo Zencovich, *Introduction to European Union Transport Law* (1st edn Tre-Press 2016) 75.

509 European Court of Auditors 'EU-funded airport infrastructures: poor value for money' (2014) Special Report No 21/2014 available online at;< https://www.eca.europa.eu/Lists/ECADocuments/SR14_21/QJAB14021ENC.pdf> accessed 24.10.2018

Therefore, the Private Investor test highlights that there are strong indications of an advantage granted by the funding from public resources. The selectivity in the advantage is obvious. Selectivity entails that only a limited amount of market participants benefits from the funding in question. In other words, the aid is not a horizontal initiative which benefits all the competitors in the market. The airports are often selected individually for the funding.

MEIP is always an effort to find a balance between EU State aid law limiting certain public investments, in order to make internal market function and focusing on limiting distortion of competition while steering resources towards the common goals of all Member States and the European strategic interest in public infrastructure investment. Investments in transport sector is significant and have an economic purpose.[510] The issue here is whether or not the MEIP can be said to be suitable as a way of investigating, or identifying distortive effects upon the market. This thesis argues that this is not the case. The MEIP approach is one which is unrealistic in some ways, in that it requires an *ex-post* view of an investment opportunity, and ignores any multitude of potential reasons why an investor in the market might invest. Nevertheless, as noted above, the approach has some advantages, particularly from a political perspective for the Commission.

8. State Aid and Its Direct Effect on Competitors

The most likely direct effect of the aid on third parties is the negative impact on competitors. In order to identify these competitors' definition of the market in which the recipient operates is required. For this purpose, according to some studies[511], only demand substitutability should be considered. This is in sharp contrast to the treatment where both supply and demand substitutability should be considered. In this case, the question is whether an increase in price above the competitive level or a corresponding reduction in quantity would be profitable. The answer to this question depends, among other things, on how other suppliers would respond to such a price increase, and this is referred to as supply substitutability. In a state aid case, the recipient's output increases, so the supply substitution, if any, will be out of rather than into the market. The set of competitors likely to be affected negatively are those who produce substitutes in demand, i.e., airlines that are or might be providing services within the same network.

510 Communication An Aviation Strategy for Europe, 7.12.2015, COM (2015) 598 final.

511 John Fingleton and others 'A Study of market Definition in Practice in State Aid' (1998) European Commission Study, available online at; < https://ec.europa.eu/docsroom/documents/2651/attachments/1/translations/en/renditions/native> accessed 22 March 2022.

In other words, there is a need to ascertain whether the effects of the aid might occur not only in a market in which the recipient currently supplies a product, but rather, in a market into which it might switch. This should be measured using substitutability of supply into another market. If state aid makes it easier for the recipient to substitute into a new market (routes) in this way, then this new market should also be considered in the analysis as part of the overall network-based assessment of market effects.[512]

The standard justification for European competition rules lies in the welfare gains of having competitive markets for consumers. Point 139 of the Aviation Guidelines stipulates that start-up aid to airlines will be considered to contribute to the achievement of an objective of common interest, if it: a) increases the mobility of Union citizens and the connectivity of the regions by opening new routes; or b) facilitates regional development of remote regions. This approach focuses on the outcomes of market exchanges and does so by considering their effects on aggregate consumer welfare. Although the concept of consumer welfare itself is not clearly defined,[513] it is understood through the lens of economic efficiency calculations. Nevertheless, the economic analysis is not conclusive with cases where the social welfare (both the welfare of producers and consumers) increases while in others consumers' welfare decreases.[514]

There is a strong argument that the consumer welfare approach has been misused by academics and competition authorities. Nazzini argues that the consumer welfare test is easier to apply than social welfare.[515] The focal point of this criticism is that "the mere fact that a test is easy to apply does not make it a good test and even less does it make it the objective of the law".[516] In the airline sector, it is not difficult to justify the aid by focusing on a short-term benefit available to the passengers within the relevant market, which is the most obvious outcome. What, however, is not included into the evaluation as such is the harm to the economy and industry in the long term, for example, practical inability to transform from the loss-making organisation to the profitable airline with the distribution of the relevant benefits to the economy. Indicative example is Sabena case[517] with the wrong approaches taken by the Commission which led to the eventual collapse of the company together with the loss of several thousand jobs and negative impact on the national economy.

512 Ibid.

513 Kati Cseres, 'The Controversies of the Consumer Welfare Standard' (2006) 3 Competition Law Review 121-173.

514 Roger Blair, Christine Durrance, 'Restraints On Quality Competition' (2014) 10 Journal of Competition Law & Economics, 27–46.

515 Renato Nazzini, *The Foundations of European Union Competition Law: The Objective and Principles of Article 102* (1st edn OUP 2011) 45.

516 Ibid.

517 *Sabena* Commission Decision 91/555/EEC (1991) OJ 1991, L300/48.

Another example is *Olympic Airways*[518] case. In its decision of March 2010 with regards to the recovery plan of Olympic Airways, the Commission took the view that the direct sale of the assets under the question to a private investor will be justified by the protection of residents of outlying islands from possible disruptions to air services. While a direct negotiation may indeed secured a market price, as it was sought by the Greek government, distribution of those assets to the private investor was not assessed from the impact on the market applicable to the said investors (Marfin Investment Group Holding SA, for flight and MRO assets and with Swissport Aviareps Hellas for the ground handling assets).[519]

Following that, in 2013 in *Aegean/Olympic II*[520]it was confirmed that Marfin lacked the ability to continue funding Olympic. After the failure of its bond issuance due to a difficult financial situation of Marfin, Olympic did not appear to be among the core subsidiaries that Marfin would most likely continue supporting with its limited funds.

As a result, the carrier has been taken over by Aegean Airlines. Under the €72m (£62m) deal, Olympic has become a subsidiary of Aegean, Greece's largest airline, after the European commission concluded the merger was the only way of preventing the carrier's collapse. A previous bid by Aegean to acquire its domestic rival in 2011 was rejected on the grounds it would hand the firm a near monopoly of the Greek market and defy the rules of fair competition. However, the eurozone crisis changed thinking in Brussels and the EU competition commissioner, Joaquín Almunia, said: "It is clear that, due to the ongoing Greek crisis and Olympic's own very difficult financial situation, Olympic would be forced to leave the market soon. We approved the merger because it has no additional negative effect on competition." It is quite indicative that the public policy has prevailed over the level playing field's considerations.

Unexpectedly, the entire attitude has changed and the goal of the Commission has become to allow Aegean and Olympic Air to lead in the changes in the tourism market in the country and in the region with the new airline to seek improving fares and connections to far-flung islands and other remote areas badly hit by the crisis Combined, Aegean and Olympic Air were expecting to service more than 250 routes of which 205 were supposed to be to and from destinations overseas.[521] The entire approach

518 Case N83/2009 *Olympic Airways Services* [2010] O.J. C25/53.

519C (2009) 1824 'State Aid N 83/2009 – Greece' (10.3.2009).

520 Case No COMP/M.6796 – *Aegean/Olympic II.*

521 Helena Smith, 'Olympic Air to Become Subsidiary of Aegean Airlines in €72M Deal' *The Guardian* 1 November 2013, available online at;https://www.theguardian.com/world/2013/nov/01/olympic-airlines-subsidiary-aegean-airlines-72-million-euro-deal accessed on April 2021.

of the Commission illustrates inconsistency and rapidly changing policy-based considerations. Instead of setting a clear guidance to the market, the Commission has proved to react with the decisions largely dependent on the industry, not the law.

9. Social welfare and market assessment

Social welfare consists of the consumer surplus and the producer surplus. The first is defined as the different between the 'willingness to pay' of all consumers represented by the demand curve and the actual price they pay, while the producer surplus can be assumed to be equal to the airlines' profits. The majority of studies in the literature uses the same mathematical equations for social welfare and it is generally accepted as a unit of measurement to express 'benefits or losses to society'[522].

It may be argued that the very idea of the market itself can be seen as being a "social institution" as it involves the necessary interaction of private and public economic agents. Examples include the interaction of regulators. rules, regulations and laws, (the public element) with the private sector and its operators.[523] Competition policy therefore needs to be clearly market oriented in the application of its leading principles to a concept of workable competition in order to perform as a public intervention that does not affect, as a per se, efficient market outcomes and promote incentive, as per the neoclassical economic theory, to maximise social welfare.[524]

Today competition policy is regarded by some as a part of a broader action plan, one of the pieces of a regulatory system established for the protection of social welfare.[525] This position would clearly justify looking beyond efficiency and protecting wider aims. Some authors suggest that competition law is essential to protecting consumer welfare by achieving the most efficient allocation of resources and ensuring airlines an environment of fair competition.[526] On the other hand, competition law represents certain aspects of the social and economic policies of the system to which they belong and reflect different concerns and national interests of varying nations and economic entities.[527]

Several studies also concluded that the uprising of low-cost carriers (LCCs) has had a positive effect on consumer welfare, due to the lower prices offered by both the LCCs themselves and the full-service

522 OECD/ITF, 'Air Service Agreement Liberalisation and Airline Alliances' (2014) < https://www.itf-oecd.org/sites/default/files/docs/14airserviceagreements.pdf> accessed 21.10.2018.

523 Federico Caffe, *In difesa del welfare state* (1st edn Rosenberg & Sellier 1986).

524 Marco Benacchio, 'Consolidation in the air transport sector and antitrust enforcement in Europe' (2008) 8 EJTIR 91-116.

525 Sandra Marco Colino, *Vertical Agreements and Competition Law: A Comparative Study of the EU and US regimes* (1st edn Bloomsbury 2010).

526 Angela Cheng-Jui Lu, *International Airline Alliances: EC Competition Law/US Antitrust Law and International Air Transport* (Kluwer Law International, 2003).

527 Richard Whish, David Bailey, *Competition Law* (9th edition. OUP Oxford, 2018).

carriers facing LCC competition,[528] This, however, does not necessarily lead to the conclusion that market entry by LCCs has had positive effects on social welfare. The increase in consumer welfare could be offset by cost inefficiencies occurring in markets run by multiple airlines or by a negative impact on social welfare of undesirable flight frequencies. And even if deregulation in the airline industry has had an overall positive effect on social welfare, this does not imply that every route entered by low-cost carriers, for instance, by the way of having certain incentives available by the regional government or airports, has positively contributed to social welfare.[529]

The main objective of the restrictive measures is not to protect individual interests even thought it might have a short-term negative impact on the individual customer's surplus but rather to prevent effective competition being affected in a long term to the detriment of social welfare.[530] Park meanwhile [531] examined the consequences of parallel strategic consolidations on output levels, profits, and social welfare, which is the sum of the surplus of consumers and the profits of firms. This author used a Cournot competition model of strategic interaction between competing firms and assumed that alliance partners equally share the profit from the joint operation. He showed that parallel alliances reduce social welfare, explaining a result by the fact that in parallel alliances the partners integrate non-stop services on the route in a way that only one partner continuous to provide the service which leads to reduction of competition between partners, and an increase in prices and then to welfare losses. Although, complementary alliances where two firms link up their existing networks with no overlap and build a new complementary network to provide improved services for connecting passengers (these may be termed as being interline market) leads in turn to better connectivity for the consumers. As such, this higher traffic density allows lower fares, and therefore a benefit for the consumer. Hence, social welfare can be influenced by the State Aid in various ways. Without adequate remedies, it is optimal for the dominant airline to deter entry, while appropriate measures lead to the inability to continue this practice and a duopoly naturally arises. This results in higher social welfare as duopoly social welfare is higher than monopoly social welfare. Based on Kawasaki's model, the positive effect of some remedies such as flight frequency on consumer utility has been established to confirm it[532].

Applying the above analysis, social welfare and its elements have to be the vital and integral parts of the network assessment. Better connectivity, higher traffic density and lower fares are short term

528 Joep Lustenhouwer, 'Optimising social welfare with low-cost carriers entering airline markets. Joep Lustenhouwer' (April 2013) AENORM vol. 21 (78).

529 Ibid.

530 Renato Nazzini, *The Foundations of European Union Competition Law: The Objective and Principles of Article 102* (1st edn OUP 2011) 45.

531 Jong-Hun Park, 'The Effect of Airline Alliances on Markets and Economic Welfare' (1997) 33 Transportation Research Part E 181–195.

532 Akio Kawasaki, 'Entry Regulation and Strategic Entry Deterrence in the Airline Market', (2008) 75 Journal of Political Economy 57, 57.

results that might be degraded within the longer period. That applies to all transactions within scope of this thesis (mergers, transactions under articles 101 and 102 of TFEU as well as State Aid).

10. Airports – The Key Players: Airlines

The main purpose of almost all European competition policy, at a high level, is to complete the internal market and to guarantee a level playing field for all the economic operators, e.g. to prevent any competition distortion. This in turn is intended to allow the free market to operate without distortion, providing benefit to the public at large. The competition policy has to prevent any impairment to the market process both coming from public or private economic powers with the competition process to remain undistorted.

One of the key questions is regarding whether the EU had to change the regulatory framework governing public financing to airports and has it succeeded in addressing the existing inconsistencies. In addition to that, various legal instruments will be used to illustrate a test that the Commission carries when analysing the legality of any type of aid.

The major competition concern for the air transportation sector is over the airport – airline cooperation. One of the examples include Ryanair – Charleroi case[533]. Most studies on the effect of that type of cooperation deal with airport price regulation and capacity expansion (Zhang and Zhang[534]; Starkie[535]; Oum, et al.[536]). The objective of thesis is to identify the effect from such cooperation on social welfare and competition, including on other airlines and airports within the same or nearby catchment areas.

For more than fifteen years, the European Commission has issued several decisions concerning State aids cases involving regional airports and low-cost carriers. Some of the provisions of the agreements between airports managers and the LCCs involves rebates in airport charges and other advantages, as start-up aids to create new routes or co-funding schemes of marketing campaigns. Such schemes may lead to some discriminations between airlines and as a consequence may be qualified as State Aids according to the European competition law. The rebates and the other advantages granted may impair the level playing field in the competition between airline carriers. They may also lead to competition

533 Case T-196/04 *Ryanair v Commission* [2008] ECRII–3643.

534 Anming Zhang, Yimin Zhang, 'Airport charges and capacity expansion: effects of concessions and privatization,' (2003) 53 Journal of Urban Economics 54, 75.

535 David Starkie, 'Reforming UK airport regulation,' (2001) 35 Journal of Transport Economics and Policy 119, 135.

536 Tae Hoon Oum, and others, 'Alternative forms of economic regulation and their efficiency implications for airports,' (2004) 28 Journal of Transport Economics and Policy 217-246.

distortions between regional airports.[537] In fact, this risk is made all the more troubling because LCCs can easily select between competing infrastructures that they can see as substitutable considering their specific characteristics such as utility functions as seen from the passenger side (i.e., whether the passenger may consider the locations interchangeable for example).

Discretional, and specific or targeted subsidies meanwhile, granted to a given or chosen entity or company are apt to distort competition between private firms and may constitute an obstacle in the completion of the internal market of free and fair competition. This is of course quite different from sectorally targeted aid, but the potential distortion caused by such discretional or specific subsidies are likely to be significant in the airline sector, as regional airports are numerous (possibly excessively so) and are generally located relatively close to one other in the EU territory and as such, the negotiations between them and the LCCs are intrinsically biased. Indeed, LCC may realise some trade-offs between different airports without fearing an excessive impact in terms of demand, especially because of the relative importance of its leisure passengers compared to a flag company operating from or toward a congested hub. At the same time, its switching costs are all the more reasonable given that LCC commonly outsources its airport services and given that the airports themselves often fund start-up investments. Given all these factors, the choice of the LCC here is inevitably dominated by a low level of both sunk costs and switching costs. On the other hand, however, the airport is in position of contractual hostage as it has already invested in specific assets i.e., the infrastructure. Not only, the airport must generate or maintain route to limit its overcapacities but also it has to face political and general interest related pressure to ensure its public service missions as connectivity.

Overall, smaller airports display the greatest proportion of public ownership and most often rely on public support to finance their operations. The prices of these airports tend not to be determined with regard to market considerations and in particular sound ex ante profitability prospects, but essentially having regard to local or regional considerations. Under the current market conditions the profitability prospects of commercially run airports also remain highly dependent on the level of throughput, with airports that have fewer than 1 million passengers per annum typically struggling to cover their operating costs. Consequently, the vast majority of regional airports are subsidised by public authorities on a regular basis[538]. On the one hand, there is an opinion that the increasing revenues generated at the airport is a legitimate airport goal which provides tangible benefits to airports and is

537 Estelle Malavolti, Frederic Marty 'State Aids granted by regional airports: a two-sided market analysis' (2017) 25 Transportation Research Procedia 30, 45.

538 Communication from the Commission on Guidelines on State aid to airports and airlines (2014/C 99/03).

consistent with the aim of airports being self-sustaining. Adding new passengers increases airport revenues from concessions such as parking, food and beverage, ancillaries from car hire and ground transportation fees. On the other hand, any aid to the specific airports shall be carefully assessed prior to any subsides and incentives being provide. Ideally, State aid measures shall aim at preventing suboptimal dynamics of tax competition between regional airports (Marty, 2005) while situated airlines shall be treated similarly by the targeted airport.

In addition to that, the evaluation of the airport's competitive position involves defining the relevant markets the airport is operating on. This is based on the economic analysis with regards to the particular circumstances of the airport. Due to industry particularities, many diverse issues must be taken into account in this process, such as questions of upstream and downstream market interaction, airport congestion, peak-load pricing, or offsetting bargaining power. Many of these questions have been theoretically analysed in the industrial organization literature, but have only rarely been applied in practical competition analysis[539].The following example well illustrates that.

On the one hand, the Commission has reached conclusions (*Kalmar Airport*[540], *Sundsvall Timra Airport*[541] and *Skelleftea Airport*[542] cases) that the lack of connections would negatively affect persons and business in the catchment areas. And all that would harm the social and economic development of these areas. It can be said that it is the isolation of the catchment areas to be the key factor in the counterfactual. From the hypothetical scenario of isolation of the catchment areas, the Commission seemed to infer a deterioration of the welfare of individuals and businesses with the resulting prejudice of the local social and economic development.

In *Sundsvall Timra Airport* and *Skelleftea Airport* cases the Commission found that in these instances the concerned airports were unable to obtain a significant improvement in revenues and, accordingly, to survive without continuous cost compensation because an increase in air traffic was unlikely due to the scarce population in their catchment areas. The efficiency measures implemented by the airports with the view of cutting costs where possible were not enough to cover the operating losses suffered by them in the provision of the services of what are known as being of general economic interest (or SGEI). These cases then highlight the importance for public authorities to demonstrate that, due to

539 Volodymyr Bilotkach, Andreas Polk, 'The assessment of market power of hub airports,' (2013) 29(C) Transport Policy 29-37.

540 Case SA.43964 *Kalmar Oland Airportentrustment of a Service of General Economic Interest,* C (2016) 7781.

541 Ibid.

542 Case SA.38757 *Skelleftea Airport-. entrustment of a Service of General Economic Interest,* C (2016).

structural conditions such as the geographical position or scarcely populated catchment areas, the aided airport has limited prospects to attract a significant passenger traffic. The implementation of efficiency measures may also help to convince the Commission about a market failure affecting the aided airports. Also, in *Kalmar Airport* case, the Swedish authorities contended that the airport was unable to function without sustainable financial support despite the adoption of the so called the "Basic Airport" concept which means that all staff at the airport carries out more than one task in order to boost efficient use of resources. The Commission did not discuss these arguments, neither did it explicitly reject them. Thus, it can be argued that the Commission considered that the market failure condition was satisfied also in Kalmar Airport. In summary, the key factor was the hypothetical isolation of the catchment area of aid recipients that occurs due to the lack of acceptable alternative domestic and international connections. This proof was reached in Kalmar Airport, Sundsvall Timra Airport and Skelleftea Airport where all the concerned airports were located in remote sparsely populated areas.

On the other hand, between 2006 and 2011, Cornwall Airport Newquay in the UK received approximately £46.8 million of aid to convert the airport from part-military use to fully commercial use. Approximately £6.6 million of the aid was used to expand the capacity of the airport from 400,000 passengers in 2007 to 700,000 passengers in 2011. In 2007 and 2009, the Commission concluded that aid to Cornwall Airport Newquay constituted compatible aid, based on the 2005 aviation state aid guidelines. In line with the evidence submitted by the UK government, the Commission concluded that aid to Cornwall Airport Newquay was unlikely to significantly distort competition. According to the UK government, Cornwall Airport Newquay was not in significant competition with the three commercial airports located closest to Cornwall Airport Newquay —Plymouth, Exeter International and Bristol. However, based on the independent assessment,[543] aid to Cornwall Airport Newquay has created significant competitive distortions. The results from the econometric analysis suggest that the aid might have contributed towards the decline in passenger traffic at Plymouth. The results further suggested that aid to Cornwall Airport Newquay had even more pronounced impact on Exeter International. In the long run, the aid led to around 1,000 fewer passengers, on average, per route each month at Exeter International, which represents approximately 9% of passenger traffic per route at Exeter International in the 2004–06 period.

543 European Commission, 'Ex post assessment of the impact of state aid on competition' (November 2017) Oxera, final report available online at < http://ec.europa.eu/competition/publications/reports/kd0617275enn.pdf> accessed 21.10.2018.

In addition to that, aid to Cornwall Airport Newquay led to a change in the airline base, the number of routes, and airline capacity at neighbouring airports. An analysis of capacity on routes at Cornwall Airport Newquay and Plymouth indicates that the route most likely to have been affected is the London Gatwick route. Flybe was present at Exeter International and operated or started operating at Cornwall Airport Newquay around the time of Cornwall Airport Newquay's expansion, which could have led to Flybe reallocating some capacity from Exeter International to Cornwall Airport Newquay. Of the routes potentially affected by the aid, Edinburgh appears most likely to have been affected by reallocation of some capacity from Exeter International to Cornwall Airport Newquay.

It is very indicative for the above analysis that a wider approach is critical for the comprehensive assessment to prevent disturbing outcome at the later stage of the market development. If the Commission took a different, much wider approach with the consideration of substitutability as well as complementary markets with the assessment of the affected airports together with the airlines and accumulated volume of traffic the results would show that aid to Newquay Airport will negatively affect passenger traffic at the neighbouring airports Plymouth and Exeter Airport and may even have contributed towards the closure of Plymouth Airport, which eventually happened in 2011.

11. Subsides to airlines

Effects of wide subsidies to airlines like a VAT or a fuel tax exemption might be analysed by using standard microeconomic theory, although, for an empirical approach, estimating demand functions and airlines' cost functions is crucial. Moreover, there might be some controversies on a suitable market model especially with respect to competition. With all else being equal, as a result of a subsidy, the number of passengers will grow with a higher price elasticity of demand, a higher price elasticity of supply, and a higher degree of competition. Similar, but more complex, microeconomic models can be used to analyse the effects of selective subsidies, which are only granted to some, especially domestic airlines.

In general, subsidies have an effect on the overall amount of traffic as well as the market shares of the competing airlines, again depending on cost functions, demand functions, and market structure. However, airlines try to influence policy makers to prevent subsidies to their competitors, lobby for countervailing measures (e.g., restricting traffic rights for subsidised airlines from foreign countries) or compensating subsidies by their own governments.

The EU restrictions on state aid can be considered as a framework intended to prevent such activities. A theoretical analysis would have to include target functions of policy decision makers—something extremely difficult to quantify. Moreover, strategic decisions of airline managers might be influenced by expected subsidies. If a 'bail out' scenario is expected in case of large losses, they might tend to take more risky strategies, e.g., with respect to their investment decisions, contributing to a general overcapacity. There are some publications suggesting that subsidies appear to lead to the creation of additional capacity in the aviation system, which also may contribute to even more intense competition in markets already characterized by high volatility and economic vulnerability related to low profit margins[544].

Goetz and Vowles [545] indicate that a self-reinforcing cycle of subsidy dependency exists, as declining profit margins due to deregulation created financial problems for airlines, which in turn asked for subsidies to ensure survival. In the period 1977–2006, global airlines reported years with losses as often as years with profits, but losses were significantly higher than profits, demanding "non-market interventions". Subsidies, in combination with bankruptcy laws allowing airlines to continue operations while restructuring with the protection from creditors, have also had the result that high capacities were maintained even in periods of economic downturns[546]. One key justification of Public Service Obligations mentioned earlier and similar programs is the assumption that these flights would not be offered without the subsidy, or at least be operated at a significantly lower level. However, the counterfactual is difficult to define. In case of an elimination of such programmes, at least some of the passengers of these flights might use other modes of transport to get to an airport so the overall decline in air transport will be smaller than the current number of passengers on subsidised routes.

In the context of airline restructuring, the one time – last time principle is a means to achieve optimal allocation of resources and applies as a second step, when a finding of aid has already been reached and a compatibility assessment is required. MEIP is re-applied during the second step of the analysis, following a finding of incompatibility by virtue of the one time – last time limitation. Although in principle such a funding should entail the end of the State aid analysis and the prohibition of new aid, in practice it initiates the beginning of a second MEIP analysis. This occurs through the imposition of conditions on the aid recipient, whose fulfilment excludes the aid character of the planned operation.

544 IATA (International Air Transport Association), 'Vision 2050' Report (2011)

< https://www.iata.org/pressroom/facts_figures/Documents/vision-2050.pdf> accessed 21.10.2018.

545 Andrew Goetz, Timothy Vowles 'The good, the bad, and the ugly: 30 years of US airline deregulation' (2009) 17 Journal of Transport Geography 251, 263.

546 Rigas Doganis, *The Airline Business* (2nd edn Routledge 2006).

Such practice may become illegitimate in its essence if the conditions imposed do not, in fact, reflect, the reality of the private sector, and are used as a pretext to justify State action that would not otherwise be justified.

By way of example, in the *Sabena* case, the Commission came to the conclusion that taking into the consideration the accumulated debts and the costs of the restructuring programme, no private investor would have been prepared to participate in the company's restructuring. Based on that, the operator qualified as State aid within the meaning of Article 107 (1) TFEU. Despite the unsubstantiated character of the proposed plan, the Commission found the aid compatible with the internal market, subject to a set of conditions, set by the Belgian government itself.[547]

The Commission formulated the government's undertaking to abstain from 'granting any further aid or other new measures favouring directly or indirectly Sabena or lowering the commercial risks of its shareholders into a formal condition. In 2001, the Commission also authorised the bridging loan as rescue aid in the context of pre-bankruptcy proceedings[548] to permit the assisted firm to survive for a short period during which it had to assess in detail the prospects for future viability of the economic activities under threat. In line with the one – last time principle applicable under the 1999 Rescue and Restructuring (R&R) Guidelines[549] to restructuring operations, the Commission made clear that as Sabena had already received restructuring aid in 1991, its restructuring plan could not include State aid. As a matter of fact, Sabena never used the loan. Instead, the Commission has authorised the bridging loan from the Belgian government to be used by Sabena's subsidiary, Delta Air Transport as rescue aid, subject to the same conditions defined by the Commission in its Decision of 17 October 2001[550] in relation to Sabena. First of all, it was very unclear how to divide rescue from restructuring operations in operational terms in order to use the loan for restructuring purposes. Given that Sabena had benefited from restructuring aid in the past, the one-last time principle could only have been respected if the total of the bridging load had been exclusively used to enable the basic airline business to continue operating during the time it takes to draw up a restructuring plan. If the whole of even part of the loan had been used for DAT's restructuring. The once – only principle would have been violated.

547 Erika Szyszczak, *Research Handbook on European State Aid Law* (Edward Elgar 2011).

548 IP/01/1432 'Green light to the bridging loan for SABENA in the context of pre-bankruptcy proceedings' (17 October 2001).

549 Community guidelines on State aid for rescuing and restructuring firms in difficulty (1999), OJ C 288.

550 *Sabena* Commission Decision N 636/2001 (17 October 2001) OJ 2004 C 67.

Under the 1999 R&R Guidelines repeated restructuring packages are prohibited by virtue of the one time – last time principle. The combination of restructuring aid with further rescue aid could be authorised only under exceptional circumstances, unforeseeable and external to the company (Point 38(2) of Aviation Guidelines[551] and point 48 of 1999 R&R Guidelines). In the 2004 R&R Guidelines[552], the Commission defined an "unforeseeable circumstances" as "one which could in no way be anticipated by the company's management when the restructuring plan was drawn up and which is not due to negligence or errors of the company's management or decisions of the group to which it belongs (Fn 25 of 2004 R&R Guidelines)".

A finding that in the Sabena case rescue aid was justified, despite prior restructuring aid, due to such kind of circumstances, would require the scrutiny of the restructuring plan implemented in 1991. There is a strong argument that the Commission did not engage in an analysis of Sabena's constantly deteriorating finances in the light of previous restructuring efforts. Similarly, no exceptional, unforeseeable and external circumstances have been applied as a justificatory basis for the bridging loan. Instead, the aid was deemed justified on acute social grounds due to the fact that DAT's bankruptcy would add to the social upheaval caused by Sabena's collapse, leading to the loss of several thousand direct jobs.[553]

After series of the capital injections, the 1996 *Iberia* decision[554] by the Commission is another illustration of the interrelation between the pivotal principles governing restructuring. Even though, Iberia underwent a restructuring process that eventually restored its profitability, the authorisation of a second package[555] of aid under the private investor test has been much contested as being in controversial to the one time – last time principle due to its excessive nature from a rational investor's perspective.

12. Defining the Public Interest. When the Public Interest should be considered

The civil aviation section has a multiplier effect on the economy. One of the key benefits of a liberal aviation policy is that that it [aviation sector] becomes opened to investment which has a positive effect with a healthy increase of the passenger traffic, airports infrastructure as well as supporting businesses

551 Community guidelines on the application of Articles 92 and 93 of the EC Treaty and Article 61 of the EEA Agreement to State aids in the aviation sector (1994) OJ C 350.

552 Community guidelines on State aid for rescuing and restructuring firms in difficulty (2004) OJ C 244.

553 IP/01/1558 'European Commission says DAT can use 125 million Euro bridging loan granted to Sabena' (9 November 2001).

554 *Iberia* Commission Decision 96/278/EC (1996) OJ L 104, 27.4.1996.

555 *Iberia* Commission Decision of 31 January 1996. OJ 1996 L 104/25.

like ground handling and maintenance repair & overhaul. This thesis addresses the question as to whether deregulation of the EU aviation market has been good public policy and whether reregulation of some kind would be desirable. According to certain academic opinions[556] the principal goal of any government intervention into airline markets ought to be the incentives that force airlines to produce efficiently and to satisfy consumers which is in its essence the social welfare issue.

There are some routes where airlines are reluctant to operate to, as the existing demand is not sufficient to cover operational costs without economies of scale. Therefore, the larger public interest shall not be ignored and shall be taken into consideration in line with the EU aviation and competition policies. Another drawback that might affect the development of the aviation market is the limited incentive for foreign airlines investors due to the ownership and effective control restrictions. In *Swissair/Sabena,*[557] the ownership and control issue was a predominant standard applied to the merger for the assessment. The current effective control requirements discourage the foreign investors in air transport. Many results of deregulation seem inconsistent with the sort of competitive equilibrium predicted by those who theorised about airline competition while public, industry, and governmental concern over these inconsistencies has been reflected only imperfectly in academic analysis of post deregulation airline competition.

Without a complete conceptual account of the forces affecting the structure of the aviation markets, it is difficult to know whether the results achieved so far under deregulation can confidently be expected to continue, or to know how to fashion public policy toward the deregulated industry. Until the industry has such an explanation, even if academic analysts seem to be correct in their general conclusion that airline deregulation has been excellent public policy, they will be unable to offer satisfactory reassurances about any phenomena that may cause concern. Furthermore, during the COVID-19 outbreak, the laws to protect struggling firms from takeovers by foreign companies have been discussed among the EU members, including the United Kingdom. Much of it has been triggered and introduced by ministers following a series of political rows over the expansionist ambitions of Chinese business.[558] The European Commission has adopted a White Paper[559] dealing with the seemingly distortive effects caused by foreign subsidies in the Single Market. The White Paper puts forward

556 Michael E. Levine. 1987. Airline Competition in Deregulated Markets: Theory, Firm Strategy, and Public Policy.

557 Commission Decision of 19 July 1995 *Swissair/Sabena* OJ L 239.

558 Financial Times 'UK to Tighten Takeover Rules for Groups Vital to Virus Response' available online at; <'https://www.ft.com/content/6134da26-3d60-41a1-bd51-284db1620101> accessed 22 March 2022; Glenn Owen, Helen Cahill, 'Ministers Set to Usher in New Laws to Protect Vital UK Firms from Foreign Predators after China Tech Row – as Business Secretary Alok Sharma Declares Britain Open for Investment but not Exploitation' *Mail Online* 21 June 2020, available online at; <https://www.dailymail.co.uk/news/article-8443189/Ministers-set-usher-laws-protect-vital-UK-firms-foreign-predators-China-tech-row.html> accessed 22 March 2022.

559 White Paper on levelling the playing field as regards foreign subsidies. Brussels, 17.6.2020 COM (2020) 253 final.

several approaches: Module 1 proposes the introduction of a general market scrutiny instrument to capture all possible market situations in which foreign subsidies are provided to beneficiaries in the EU and may cause distortions in the Single Market; Module 2 is intended to specifically address distortions caused by foreign subsidies facilitating the acquisition of EU companies; Module 3 addresses the harmful effect of foreign subsidies on EU public procurement procedures. Finally, the White Paper sets out the option to review foreign subsidies in the case of applications for EU financial support.

The legislation initiative in the United Kingdom[560] has been also proposed to give business secretary extra powers to impose conditions on deals to protect key UK firms that have been left vulnerable by the Covid-19 economic crash. National Security and Investment Act 2021 which has been seen as a proportionate response to modern developments in international investment was confirmed on 29 April 2021[561] as it received Royal Assent. New Act modernises government's powers to investigate and intervene in potentially hostile foreign direct investment, while advancing the UK's world-leading reputation as an attractive place to invest. According to the UK Government, the National Security and Investment Act protects the public from potential risks and strengthens the UK's status as an attractive place to invest by providing more efficient clearance processes for relevant acquisitions and more certainty and transparency for investors and businesses.

Under the Act the government must be notified if a person's stake or voting rights in a sensitive acquisition surpasses 25%. The government will be able to scrutinise, impose conditions on or, as a last resort, block a deal wherever there is an unacceptable risk to Britain's national security while the investors and businesses will have to notify a dedicated government unit - the Investment Security Unit - through a digital portal about certain types of transactions in designated sensitive sectors, such as artificial intelligence. Oversighting authorities will also be extended to include assets like intellectual property. In addition to mandatory notification for certain sectors, the Secretary of State will also have the power to 'call in' acquisitions in the wider economy which were not notified to government but may raise national security concerns.

Overall, the primary purpose of effective public policy shall be rectification of the imperfections exploited, or created, by airlines and that regulatory intervention, in some instances, might ameliorate such market imperfections. Other matters that are being in the public interest include: the

560 National Security and Investment Act 2021

561 Ibid.

encouragement and development of an air transport system; the regulation of that system in a manner that recognises its inherent advantages and that fosters sound economic conditions; the promotion of adequate, efficient service at reasonable rates without unjust discriminations or unfair or destructive competitive practices; competition to the extent necessary for the sound development of the industry; safety; and the promotion of aeronautics in general.[562]

While it might be a useful legal tool in the regulation of foreign investment in European companies, including companies with non-European participation, in fact, this practice has already existed in the aviation industry within the framework of "effective control and ownership" provisions.[563] Indeed, there are several indicative examples of significant non-European participation in airlines capital. The most noticeable are the participation of Qatar Airways in the International Airlines Group (20.01%)[564], as well as Henan Civil Aviation and Investment. Co., Ltd. (HNCA) at Cargolux (35%).[565] It remains to be seen how the proposed Modules will work in practice, including the qualitative difference between, on the one hand, legitimate capital injection under the general corporate rules and, on the other hand, investment instruments that will be subject to the proposed restrictions.

If limiting access to non-European subsidies is the ultimate goal, it also makes sense to consider imposing additional obligations, i.e., corporate and financial, on the non-EU majority shareholders. This is a necessary measure in order to distribute the efficiency of the company's activities mainly within the EU dimension, as well as to preserve the financial stability of the businesses in case of the financial difficulties. One hypothesis that is clear is that the survival of the companies depends not only on the amount of funds available, but also on the quality of business operations. Overall focus of the policies shall be on development of the market conditions for healthy competition within the European Single Aviation Market.[566] While public policy including creation of national champions might appear to be a relatedly separate issue with its own agenda, government intervention into airline markets shall be always a tool available in order to preserve the internal competition with the ultimate goal to create additional social value ss well as correct any market divisions that are naturally take place in the market's development process.

562 G. E. Hale, Rosemary D. Hale, 'Competition of Control IV: air carriers.' (1961) Vol. 109 University of Pennsylvania Law Review 311, 360.

563 Isabelle Lelieur, *Law and Policy of Substantial Ownership and Effective Control of Airlines: Prospects for Change* (1st edn Routledge 2017) 12.

564 Vitaly S. Guzhva and others, *Aircraft Leasing and Financing: Tools for Success in International Aircraft Acquisition and Management* (1st edn Elsevier 2019) 171.

565 Ibid.

566 Kirill Solovov, State Aid in EU amid Covid-19. December 2020. Competition and Law Journal' (Russia).

The EU is inevitably moving towards the direction of further market integration into one organism and removing barriers between the Member States. Therefore, the idea of allowing the existence of national champions might be relevant not only on the level of a particular Member State, but on the level of the whole European Union as well. The traditional European airlines are gradually losing the market of long-haul flights from Europe to the foreign carriers, mainly from the Gulf region, therefore some degree of tolerance to dominance in the European market and potential anticompetitive effects arising from it, might be unavoidable to save the airlines of the European Union from becoming insolvent in the long run, by relying on the legislation that, according to Bailey and John in *Bellamy & Child* at least,[567] is designed to promote a social policy in the interests of the public more widely.[568]

According to the report prepared for the 2021 UK Presidency of the G7[569] a particular focus of concern has been whether firms engaging in cross-border investments, notably mergers and acquisitions (M&A), are owned by a foreign government (also argued to be the source of their financial advantage in such deals). Concerns have been particularly strong about investments in high technology and other sensitive sectors, with fears about threats to their essential security interests leading many governments to introduce new or tighten existing FDI screening mechanisms. This trend has been reinforced as a result of the COVID-19 crisis.

On the one hand, increased awareness is required to protect those companies that are important to essential security and economically viable, but that temporarily suffer from financial stress and depressed valuations and could become takeover targets, including by foreign government-controlled investors. On the other hand, a very significant expansion of investment-screening mechanisms could however lead to overreach. Recommendations on policy principles such as the OECD Guidelines for Recipient Country Investment Policies relating to National Security and careful monitoring and accountability to the public can be effective means to counter this risk.

To sum up, from the social welfare point of view, the effective public policy is the vital instrument to safeguard the European level playing field within the European dimension and to prevent market deviations that might be caused by the foreign entrances. It is also unavoidable to market might reach a critical point that will need to be corrected by the policy makers to direct further development of the

567 David Bailey, Laura Elizabeth John, *Bellamy & Child: European Union Law of Competition* (8th edn OUP 2018).

568 *South Somerset District Council v Tonstate (Yeovil Leisure)* [2009] EWHC 3308 (Ch), paras 42-49.

569 OECD, 'G7 Report: Fostering Economic Resilience in a World of Open and Integrated Markets: Risks, Vulnerabilities and Areas for Policy Action' (2021) available online at; https://www.oecd.org/newsroom/OECD-G7-Report-Fostering-Economic-Resilience-in-a-World-of-Open-and-Integrated-Markets.pdf accessed 22 March 2022.

market with its original purpose. Due to the pandemic, a substantial part of the European economy has been going through a prolonged structural adjustment. Existing policies have been slow to correct the underlying problems due to the uncertainly that the global society is facing. The trade-off between ensuring connectivity and maintaining competition after the COVID-19 pandemic is a challenge with several political and economic dimensions. The re-orientation of public policy in the aftermath of the pandemic may limit the relative importance of the policy priorities that shaped the evolution of the air transport sector before the crisis. The role of government and public authorities at all levels – especially the type and duration of measures affecting transport operations – will be crucial for the future development of the aviation industry.[570]

13. State Aid and Impact of COVID 19

i. Overview

The TFEU gives member states three legal bases to justify the grant of state aid to companies in need of support because of the pandemic. The first possible option for member states is available under Article 107(2)(b): this is in respect of aid to make good the damage caused by exceptional circumstances.[571] Article 107(2) is an objective concept, meaning that, unlike aid granted under article 107(3), the Commission has no margin of discretion in applying this provision.[572] Instead, it is limited to verifying that the compatibility conditions are met. Thus, its approach to the application of this provision is rather restrictive, strictly examining the causal link between the pandemic and the damage being compensated and the quantification of the damage suffered.

A second option is that in Article 107(3)(b) with aid to remedy a serious disturbance in the economy of a member state.[573] Traditionally, this legal basis has been accepted by the Commission rather reluctantly. However, despite some initial resistance, in the context of the financial crisis in 2008, the Commission ultimately invoked this provision for the adoption of temporary rules to assist ailing financial institutions and a temporary framework for the 'real economy'. This same approach has now

570 M Abate and others, Government support to airlines in the aftermath of the COVID-19 pandemic (2020) 89 Journal of Air Transport Management 101931.

571 Article 107(2)(b) Treaty on the Functioning of the European Union 2007.

572 Kai Struckmann, Kate Kelliher, 'European Union: Practitioners' Perspective on State Aid and Covid 19' (2022) White & Case LLP 2 February 2022, available online at; < https://globalcompetitionreview.com/review/the-european-middle-east-and-african-antitrust-review/2022/article/european-union-practitioners-perspective-state-aid-and-covid-19> accessed 22 March 2022.

573 Article 107(3)(b), Treaty on the Functioning of the European Union 2007.

been followed in the context of the pandemic with the Commission publishing a covid-19 Temporary Framework to facilitate the adoption of article 107(3)(b) (and some article 107(3)(c)-based) measures.

The third option available for member states is that under Article 107(3)(c) that allows aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest.[574] The Temporary Framework provides some specific compatibility rules for certain article 107(3)(c)-based measures, such as aid for research and development. Member states can also rely on the orthodox options under article 107(3)(c), where suitable.

What then, is likely to be the most appropriate legal basis? For this, it can be said that the most appropriate legal basis will depend on a number of factors. These are likely to include the nature of the problem, the nature of the beneficiary, its own financial condition and so on, as well as the nature of the problem that the aid is intended to address, and the form by which the aid is supposed to be granted (direct grants, guarantees, etc). For measures specifically targeted at compensating companies for the costs of cancelled events due to coronavirus restrictions on public gatherings, for example, article 107(2)(b) will often be the most appropriate legal basis as the costs are specific, directly linked to the pandemic, and easy to verify. Measures supporting entire sectors of the economy in the face of the general impacts of the pandemic, by contrast, will fall more naturally within the auspices of article 107(3)(b).

Member states are of course, also free to grant support that does not constitute state aid without Commission approval, as the EU's competency here is restricted to the measures set out in the Treaties. Considering the provisions of the Treaty and its restrictions, it can be suggested that measures that would not be classified as being state aid might include, as an example, the extension of loans or state guarantees at market rates, or measures that are available to all companies in a sector rather than to targeted firms or companies. In particular, this latter type of measure will not qualify as state aid because it bestows no selective advantage on beneficiaries.

In light of the above, both member states and beneficiaries will invariably have some key strategic choices to make when it comes to both designing a measure and selecting the most appropriate legal basis to ensure a swift approval.

574 Article 107(3)(c), Treaty on the Functioning of the European Union 2007.

ii. Making good damage caused by exceptional circumstances

Article 107(2)(b) is designed to allow member states to grant aid 'to make good the damage caused by natural disasters or exceptional circumstances.[575] Traditionally it has been used to remedy damages incurred as a result of floods, earthquakes and fires under the 'natural disaster' limb. The 'exceptional circumstances' limb has been used in the past in instances of rather extreme or unforeseeable circumstances. Perhaps the most obvious example has been the use of such measures in response to the difficulties and losses suffered by airlines following the 9/11 attacks in New York in 2001 when airlines were grounded and passenger confidence severely dented. On 12 March 2020, the Commission adopted the first article 107(2)(b) State aid Decision to address damage caused by the pandemic.[576]

The fifth amendment to the Temporary Framework sought to bring some clarity on the kinds of coronavirus restrictions that might merit article 107(2)(b)-based intervention. For example, the cessation of certain economic activities (eg, the closure of consumer outlets such as bars restaurants or non-essential shops), restrictions or cessations of certain areas (eg, such as withdrawal or restrictions on flights or other forms of transport to or from certain places or destinations), or the capping of attendance for specific sectors or activities at levels where those caps (due to social distancing rules or restrictions on capacity in certain commercial spaces) entail the cessation of all or a sufficiently substantial part of the affected activity ordinarily carried on there (most notably for example, venues in the entertainment sector, trade fairs and sports events).

The Commission has, in its investigations into this, sought to assess two criteria required to show compatibility with article 107(2)(b).[577] The first is for the Member State to show a clear and genuine link between the exceptional circumstance such as COVID-19 for example, and the aid actually granted. Merely supplying aid as a general support aid to encourage investment in an atmosphere otherwise depressed by Covid would for example, fail here. A good example here might be the case of *SA.57539 (Austria) COVID-19 Aid to Austrian Airlines*[578] in which the Commission referenced the

575 Article 107(2)(b), Treaty on the Functioning of the European Union 2007.

576 *SA.56685 (Denmark) Compensation scheme for cancellation of events related to COVID-19*

577 Kai Struckmann, Kate Kelliher, 'European Union: Practitioners' Perspective on State Aid and Covid 19' (2022) White & Case LLP 2 February 2022, available online at; < https://globalcompetitionreview.com/review/the-european-middle-east-and-african-antitrust-review/2022/article/european-union-practitioners-perspective-state-aid-and-covid-19> accessed 22 March 2022.

578 *SA.57539 (Austria) COVID-19 Aid to Austrian Airlines.* Press Release IP/20/1275 available online at: <https://ec.europa.eu/commission/presscorner/detail/en/IP_20_1275> accessed April 2021

cancelled and rescheduled flights in Austria as a result of the travel restrictions imposed by the Austrian state and by other EU Member States and by states around the world as this was a clear and direct causal factor which the aid was granted to ameliorate. The Temporary Framework, again under the fifth amendment, proposes that general social distancing measures or sanitary constraints imposing general requirements would not meet the requirements of article 107(2)(b) for these reasons and aid to address the implications of those restrictions would therefore be more suited to article 107(3)(b)-based interventions.

The second requirement is that the aid must be strictly limited to what is necessary to make good the damage resulting from the pandemic and cannot result in overcompensation. To meet this criterion the Commission will expect to see 'rigorous quantification' of the damages being compensated. In the *COVID-19 Aid to Austrian Airlines* case noted above[579] damages were assessed according to the level of fixed costs incurred during the lockdown period for example, as well as historical and expected revenues so that a genuine figure of net-loss could be estimated. measuThe Commission has a template here for notification under Article 107(2)(b) measures, which provides, amongst other things, that verification of documents by independent experts, competent authorities and other factors are required. The Temporary Framework meanwhile makes clear that general economic effects of the pandemic, such as those resulting from reduced demand, declines in passenger uptake and so on, or a general consumer reluctance to engage in economic activities because of general restrictions (eg, social distancing) should be excluded from the calculation of damages being compensated under article 107(2)(b). Rather, the damages must be specific to restrictions imposed directly on the beneficiary.

In practical terms, any clarification is to be welcomed as a means to enable legal certainty for member states and beneficiaries, but it is at least notable that this approach somewhat conflates the damages caused by "natural disaster or exceptional circumstance" that member states are empowered to compensate undertakings for under article 107(2)(b), with the damages that derive from the restrictions imposed by member states. Undertakings affected by the same exceptional circumstance – the covid-19 pandemic, are therefore limited in terms of the damages for which they may be eligible not by virtue of the extent of the harm they suffer but the extent to which they can demonstrate that such harms derive from government restrictions directly. Notwithstanding this inconsistency, however, the latest amendments at least simplify the process for member states and beneficiaries by making clearer what the Commission is and is not going to find acceptable under article 107(2)(b) in these circumstances.

579 Ibid.

Article 107(2)(b) is a useful tool as it might be relied upon where other forms of aid are simply not available. In addition to this, it is a tool which appears to be relatively flexible. Particular features that are attributed to Article 107 (2)(b) which improve its flexibility and efficacy might be said to include the following.

(i) **No limits on direct grants:** Unlike measures granted under article 107(3)(b), there is no limit on the level of direct grants that can be bestowed under article 107(2)(b). Where the Temporary Framework limits direct grants to €1.8 million per company or €10 million per company for uncovered fixed costs, no such limits apply under article 107(2)(b) provided the aid is limited to the damages incurred and overcompensation is prevented. Therefore, article 107(2)(b) may well be more appropriate for companies who have experienced such serious cash flow impacts that they cannot access finance even with a government guarantee under the Temporary Framework or for whom a direct grant in excess of the Temporary Framework limits is otherwise deemed more appropriate.

(ii) **Aid to undertakings in difficulty:** Any organisation or undertaking which is classified as being an 'undertakings in difficulty' on 31 December 2019 (and thus before the Covid-19 outbreak was recognised in the EU) will also be excluded under these provisions. This is regarded as being an important safety net for the Temporary Framework to help prevent what might otherwise be a highly disruptive interference with the operation of the free market which aid here might result in.

How has this worked in practice? One example here is seen in case *SA.57026 (Romania) COVID-19 aid to Blue Air*[580], in which Romanian airline was identified as having been already qualified as an undertaking in difficulty on 31 December 2019 (prior to the Covid-19 outbreak in Europe). As a result, the undertaking was excluded from support under the Temporary Framework. To defeat these difficulties, Romania then designed a support mechanism based on both Article 107(2)(b) but also the Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty 2014 (Rescue and Restructuring Guidelines) under article 107(3)(c). Thus, there was something of a pick-and-mix approach taken to the aid measures, showing the flexibility offered here. Indeed, the

580 *SA.57026 (Romania) COVID-19 aid to Blue Air* . Press Release IP/20/1508 available online at: <https://ec.europa.eu/commission/presscorner/detail/en/IP_20_1508> accessed on April 2021.

Commission has made clear in its Communication on the Temporary Framework that state aid granted in compliance with article 107(2)(b) is not 'rescue aid, restructuring aid or temporary restructuring aid'. This means that companies that have already received aid under the Rescue and Restructuring Guidelines can still be eligible for article 107(2)(b) state aid support as long as the same costs are not claimed for under two or more schemes so that overcompensation does not occur.

iii. Disadvantages

One of the drawbacks of this approach is that the threshold challenges faced by organisations here means that commitments from Member States to carry out *ex-post facto* investigations are required. Indeed, the exceptional nature of article 107(2)(b)-based measures means that the threshold and qualification requirements are subject to rigorous scrutiny and this can impact on the timing of aid being granted to the organisation in need. Given the urgency with which these applications are made, this is a problem. Considering again the case of *SA.57026 (Romania) loan guarantee for Blue Air*[581] it took a total of 127 days from registration to approval. Similarly, in *SA.57178 (Romania) Air to Timişoara Airport*[582] the award took a total of 84 days dating from pre-notification to approval .This is a much longer period of time than is generally the case under the Temporary Framework.

iv. Granting state aid under article 107(3)(b) and the Temporary Framework

Another treaty provision under which Aid might be granted is that under Article 107(3)(b) which allows for the grant of state aid;

'to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a member state.'[583]

The Commission has made clear that covid-19 can very much be considered a 'serious disturbance'. Therefore, in the wake of the outbreak the Commission quickly adopted a 'Temporary Framework' of additional, temporary state aid measures that it will consider compatible with article 107(3)(b). The rationale behind the Temporary Framework is to provide a clear set of rules to assist

581 *SA.57026 (Romania) COVID-19 aid to Blue Air* Press Release IP/20/1508. available online at: < https://ec.europa.eu/commission/presscorner/detail/en/IP_20_1508> accessed on April 2021.

582 Official Journal 2020/C 326/01.2.10.2020 available online at: < https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.C_.2020.326.01.0001.01.ENG&toc=OJ%3AC%3A2020%3A326%3ATOC > accessed on April 2021

583 Article 107(3)(b) Treaty on the Functioning of the European Union 2007.

member states in designing schemes that can be cleared quickly such that companies suffering liquidity shortfalls get the support they need as quickly as possible.

The Temporary Framework sets out a range of possible state aid measures based on article 107(3)(b) (and article 107(3)(c)). The measures that can be based on article 107(3)(b) are direct grants, repayable advances and tax advantages, Guara, in ntees on investment and working capital loans, Subsidised interest rates for loans, Short-term export credit insurance, Tax or social security contribution deferrals, wage subsidies to avoid lay-offs, Recapitalisation and subordinated debt and Aid for uncovered fixed costs. Temporary Framework-based measures account for the vast majority of covid-19 decisions adopted thus far. In the main, the measures have been sectoral or general schemes but there are also examples of targeted individual cases to specific beneficiaries. Indicative example is *State loan guarantee for Finnair,* which has been advanced in the form of a dedicated state guarantee to Finnair to enable it to access a €600 million loan to cover its working capital needs.[584]

The range and form of measures adopted varies widely. The UK has adopted the largest scheme to date in *SA.56794 (UK) Coronavirus Business Interruption Loan Scheme* with a total budget of £600 billion.[585] There is no shortage of schemes ranging into the billions, however, with Germany, for example, also implementing a mammoth €500 million scheme in *SA.56814 (Germany) COVID-19 measures of the Wirtschaftsstabilisierungsfonds.*[586] On the other end of the scale, member states have also introduced smaller, targeted measures. These include, for example, Latvia's €800,000 direct grant scheme for tour operators that repatriated stranded clients due to the pandemic in *SA.57423 (Latvia) COVID-19 grants for the benefit of tourism operators* for example.[587]

Direct grant and guarantee-based measures have been the most popular forms of state aid adopted under the Temporary Framework. Member states have introduced several large schemes of general application but as member states are free to set the limits on these schemes' operation at a national level, they may not always be suitable for large enterprises with significant financial needs. If individual beneficiaries' needs exceed the limits set by national schemes, member states may prefer to introduce beneficiary-specific measures under the Temporary Framework.

584 SA.56809 COVID-19: State loan guarantee for Finnair. Official Journal 2020/C 269/01. 14.8.2020 available online at: < https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.C_.2020.269.01.0001.01.ENG&toc=OJ%3AC%3A2020%3A269%3ATOC> accessed on April 2021.

585 Press release IP/20/527. State aid: Commission approves UK schemes to support SMEs affected by coronavirus outbreak. available online at: < https://ec.europa.eu/commission/presscorner/detail/en/IP_20_527> accessed on April 2021.

586 Press Release IP/20/1280. 8 July 2020. available online at: < https://ec.europa.eu/commission/presscorner/detail/en/IP_20_1280> accessed on April 2021.

587 Official Journal 2020/C 198/01. 12.6.2020 available online at: < https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.C_.2020.198.01.0001.01.ENG&toc=OJ%3AC%3A2020%3A198%3ATOC> Accessed on April 2021.

While the Temporary Framework does provide guidance for the measures that it contemplates directly, Article 107(3)(b) may still be applicable for member states looking to provide support not contemplated by the Temporary Framework. There have been a relatively small number of measures adopted on the basis of article 107(3)(b) directly since the outbreak began. Nevertheless, the Commission has referenced the Temporary Framework requirements 'by analogy' in assessing the compliance of these measures with article 107(3)(b) when carrying out its assessments.[588]The Temporary Framework's requirements therefore still remain relevant, and it would likely be difficult for member states to clear a measure of this nature without complying with the Temporary Framework's rules.

The Temporary Framework has been seen in action in a number of Member States. For example, one such measure falling under the framework was a German measure[589] which provided vouchers to travellers who booked package tours prior to 8 March 2020 that had to be cancelled due to the covid-19 outbreak. To assist with the design of state aid measures like this, the Commission has also published a Commission Recommendation on vouchers offered to passengers and travellers as an alternative to reimbursement for cancelled package travel and transport services in the context of the covid-19 pandemic.

v. Covid-19 related state aid under article 107(3)(c). Article 107(3)(c) and the Temporary Framework

Article 107(3)(c) provides for state aid 'to facilitate the development of certain economic activities or of certain economic areas'.[590] It is the basis of most orthodox state aid rules, and the Commission has acknowledged that it also has a role to play in states' covid-19 management.

The Temporary Framework very much focuses on the Article 107(3)(b) measures discussed above, but it does also lay out the conditions on which the following measures will be deemed compatible with article 107(3)(c). These are:

i) aid for Covid-19 relevant research and development;

588 *SA.57937 (Italy) COVID-19 State guarantee for the reinsurance of trade credit risks.*

589 Official Journal 2020/C 269/01.14.08.2020. *SA.57741 (Germany) COVID-19 Aid in the form of guarantees on vouchers issued for package tours* available online at: < https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.C_.2020.269.01.0001.01.ENG&toc=OJ%3AC%3A2020%3A269%3ATOC> accessed on 22 March 2022.

590 Article 107(3)(c) Treaty on the Functioning of the European Union 2007.

ii) investment aid for testing and upscaling infrastructure to develop covid-19 relevant products; and iii) investment aid for the production of Covid-19 relevant products.

The Temporary Framework is explicit that member states seeking to meet companies' acute liquidity needs and support undertakings facing financial difficulty can adopt measures based on article 107(3)(c), and in particular on the basis of the Rescue and Restructuring Guidelines. The Temporary Framework does not support the grant of state aid to large enterprises that were in difficulty before 31 December 2019. Therefore, member states seeking to support those undertakings can rely on the normal rules under the Rescue and Restructuring Guidelines. As an example, Portugal has already adopted two measures under the Rescue and Restructuring Guidelines.[591] That said, the effects of the covid crisis certainly do not enhance the prospects that an undertaking that already is in difficulty has of achieving compliance with the stringent criteria of the Rescue and Restructuring Guidelines.

vi. Services of general economic interest

Services of general economic interest (SGEI) can be defined as being certain forms of activities which might only take place as a result of state intervention, and which are encouraged or facilitated as such by the state because of the fact that they are regarded as being of particular importance to the state or its citizens. To qualify here, measures such as this are traditionally assessed against the criteria in the *Altmark* judgment of 2003.[592] Moreover, the Commission has quickly recognised that the exceptional circumstances caused by the pandemic have meant that Member States are likely to wish to put in place temporary public-service replacements or responses, and as such have published an overview on the state aid rules on PSOs for air transport, land transport and the maritime sector to assist member states with making such assessments.[593] The Commission has also decided to extend the SGEI De Minimis Regulation, the regulation setting out the conditions under which support granted for the provision of SGEIs will not be considered state aid by a further three years, until 31 December 2023. The SGEI De Minimis Regulation has also been adjusted to include a temporary basis on which

591 1)
SA.57369 COVID-19 Aid to TAP. Press Release IP/20/1029. 10 June 2020 available online at: https://ec.europa.eu/commission/presscorner/detail/en/IP_20_1029> accessed on April 2021; 2) State aid SA.58101 (C/2020) (ex 2020/N) — Rescue aid to SATA
<available online at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.C_.2020.294.01.0041.01.ENG&toc=OJ%3AC%3A2020%3A294%3ATOC> accessed on April 2021.
SA.58101 Rescue aid to SATA Group. Press Release IP/20/1489.18 August 2020 available online at; < https://ec.europa.eu/commission/presscorner/detail/en/IP_20_1489> accessed on April 2021.
592 Case C-280/00 *Altmark Trans GmbH and Regierungspradidium Magdeburg v Nahverkehrsgesselschaft Altmark GmbH* [2003] ECLI:EU:C:2003:415.
593 European Commission, 'Overview of the State Aid Rules Applicable to the Land Transport Sector during the COVID-19 Outbreak' (2021) available online at;
<https://ec.europa.eu/competition/state_aid/what_is_new/land_transport_overview_rules_during_coronavirus.pdf> accessed 22 March 2022.

companies that entered into financial difficulties as a result of the covid-19 outbreak can still receive support.[594]

Additionally, any support which does fall below the thresholds set by the *De Minimis* Regulation is exempt from Commission approval. This can allow support for smaller firms operating within these thresholds for up to €200,000 over three years in most sectors, subsidised loans of up to €1 million and subsidised guarantees on loans of up to €1.5 million. The Regulation was actually due to expire in December 2020, but was extended not surprisingly given the COVID-19 pandemic outbreak in order to provide 'predictability and legal certainty' during what was an acknowledged time of difficulty .[595]

Another way in which support can be provided to Member States is under the General Block Exemption Regulation (GBER) without even the need to progress to Commission approval at times as long as criteria within the GBER are met. At normal times, the GBER excludes companies in difficulty but the Commission has changed the rules to ensure that companies that entered into difficulty because of the pandemic can still be eligible for GBER support, a signal of the attempt to mitigate the impact of the pandemic as far as possible irrespective of potential competition and level-playing field concerns. The Commission has also acknowledged that, due to the pandemic, it may not be possible for companies that have previously received regional investment aid under the GBER to avoid job losses. Companies that have received such aid will often have committed not to 'relocate' (in other words, they will guarantee not to suffer any job losses in any EEA organisations or establishments performing the same activity as that which received aid).

14. COVID-19 related State Aid in relation to the European aviation sector. Analysis

Covid-19 may prove to be a great disruptor to progress of the EU's State Aid policy. On the other hand, the legality of state aid under EU law shall be preserved. Furthermore, there is a need for a unified approach to State Aid, not just as between EU Member States but also at a global level, if we are ever to have a truly economically health and competitive global aviation industry.[596]

594 Ibid.

595 European Commission, Press Release, 'State Aid: Commission Prolongs and Further Expands Temporary Framework to Support Economy in Context of Coronavirus Outbreak' (2021) 28 January 2021, available online at; https://ec.europa.eu/commission/presscorner/detail/en/ip_21_261 accessed 22 March 2022.

596 https://www.clydeco.com/insight/article/covid-19-will-covid-19-prove-to-be-a-great-disruptor-to-progress-of-the-eu

International aviation has been severely hit, first by the COVID-19 outbreak and second, by diverse national measures adopted across different countries, attempting to contain the pandemic. According to the International Air Transport Association (IATA), airline revenues could fall by $113 billion (19%) if the virus is not contained.[597] At one point, in 2020 and during Europe-wide lockdowns in 2021, the situation deteriorated on a daily (sometimes even hourly) basis, as air traffic was massively disrupted. On a global basis, IATA estimates that emergency aid of up to $200 billion is required.[598]

The European Commission has shown its willingness to help Member States in the design of state aid schemes and/or individual measures to support companies facing economic difficulties due to the COVID-19 outbreak. Overall, after the launch of privatisation in aviation two decades ago, the coronavirus crisis has caused a sharp policy reversal as countries across the continent have stumped up billions of euros in state aid to save their national flag carriers. There is even something of a potential backlash against state support beginning to be heard, as rival carriers fear that the offering of support by States to prestige flag-carriers rather than low-cost carriers for example is helping to create something of an uneven playing field and is artificially distorting competition. While governments defend investment as necessary to save airlines facing unprecedented short-term risks to their survival, critics say public money could allow propped up airlines to avoid tough decisions needed for long-term growth.[599]

It remains possible for Member States to offer support to airlines and airports affected by the COVID-19 in line with the de minimis rules or the General Block Exemption Regulation (GBER). This form of support does not require the Commission to pre-authorise the support. Meanwhile, under the Rescue and Restructuring Guidelines, and acting together with Article 107(3)(c) TFEU, the Member States, are, subject this time to Commission pre-approval, able, to meet acute liquidity needs and support of companies facing economic difficulties or bankruptcy due to the COVID-19 outbreak.

597 IATA Press Release No: 16 'Europe - Urgent Emergency Support Requested for Airlines'. 19 March, 2020. https://www.iata.org/en/pressroom/pr/2020-03-19-02/ accessed on 20 October 2020.

598 Ibid.

599 Philip Georgiadis and others. 'Europe forced to turn back clock to bail out airlines'. *Financial Times*. 10 May 2021 available online at; <https://www.ft.com/content/3ba22be6-20b8-4ee9-8441-7bcbb2488702> accessed on May 2021

Regarding the aviation sector the Executive Vice-President Margrethe Vestager stated that "compensation can be granted to airlines under Article 107(2)(b) TFEU for damages suffered due to the COVID-19 outbreak…if they have received rescue aid in the last ten years."[600]

There have been the diverse reactions from Member States. Whilst some airlines have called for public support (examples include those such as Finnair, Virgin Atlantic and Air France-KLM to name a few), it is actually the case that the Member States are in fact open to utilising all available means to protect their national champions or flag-carriers, including recapitalization or even nationalisation as was seen in the case of Italy nationalising its "flag-carrier" Alitalia in 2020 for example.[601] A French scheme meanwhile sets up a deferral payment mechanism of certain aeronautical taxes to compensate damages suffered by airlines due to the COVID-19 outbreak.[602] The scheme will be accessible to airlines which hold an operating licence in the country, and provides a flexible benefit to such operators by allowing the deferment of taxes with an option to extend payment for these taxes arising from the period between March and December 2020 for up to a period of 24 months afterwards.

Other efforts have been seen in other Member States. In Scandinavia for example, the Swedish and Danish governments have granted the Swedish carrier, SAS a joint $302 million guarantee. In Norway meanwhile, companies have actually been able to benefit from a moratorium on anti-trust matters as an emergency measure to help ensure the ongoing flow of goods and passengers. According to the Norwegian government, airlines SAS and Norwegian can coordinate their schedules to maintain minimum services for citizens during the COVID-19 crisis.

There are several concerns from the competition law viewpoint associated with State aids addressed to rescue airline companies in a post-emergency scenario.

The first issue to concentrate on is the enormous amount of State aids that, in general, airlines (in particular European ones) are claiming or have obtained already from the respective governments: according to some figures[603] the amounts at stake surpass dozens of billion euros. The legality of these

600 European Commission, Press Statement, 'Statement by Executive Vice-President Margrethe Vestager on a draft proposal for a State aid Temporary Framework to support the economy in the context of the COVID-19 outbreak' (2020) 17 March 2020 available online at; https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT_20_479 accessed 22 March 2022.

601 Francesca Landini, 'Nationalised Alitalia Aims to Break Even in 2022' *Reuters* December 18 2020, available online at; https://www.reuters.com/article/us-alitalia-business-plan-idUSKBN28S2IP accessed 22 March 2022.

602 European Commission, Press Statement, 'State Aid: Commission Approves French Scheme Deferring Payment by Airlines of Certain Taxes to Mitigate Economic Impact of Coronavirus Outbreak' (2020) 31 March 2020, available online at; < https://ec.europa.eu/commission/presscorner/detail/nl/ip_20_514> accessed 22 March 2022.

603 E. Bannon, 'Polluting European Airlines Seek €12.8bn (and Counting) in Bailouts' Transport and Environment (2020) 22 April 2020 available online at; www.transportenvironment.org accessed 22 March 2022.

State aids must be assessed under relevant EU law: to this end, the EU has recently adopted amendments to regulation no 1008/2009 in order inter alia to relax the rules on revocation or suspension of operating licenses to Union carriers, and to allow Member States to refuse, limit or impose conditions on the exercise of traffic rights if this action is necessary in order to address the COVID-19 pandemic.

Furthermore, it has already adopted measures that will in general consider these aids as compatible with the single market, similar to what happened after 9-11, or during the 2008-2009 financial crisis. Whether Brexit may play a role in the evaluation of these aids is another question to pose. This being the actual or prospective scenario, it does not seem however appropriate to evaluate the situations affecting airlines on a case-by-case or, at best, under a sectoral approach; rather, an assessment shall be based on its evolution over time and to the overall medium- to long-term market effects of State aids in aviation.[604]

In particular, it goes without saying that, if all other things remain equal, then for years into the foreseeable future, the whole consequences of the aid granted to airlines in the wake of the Covid-19 pandemic shall be likely to have had the effect of creating a heavily subsidised industry working in a competitive marketplace. One may immediately wonder whether this solution, is sensible – or consistent with the general aims and trends of EU competition law – given that it has become largely a standard. In other words, it may be difficult to 'wean' airlines off such aid in the future, and given the importance of the sector (and particularly in respect of prestigious flag carrying airlines) for member-states, there is a potent risk that the state aid seen during the pandemic may have some sort of psychological, norm-generating effect which creates an acceptance of the use of such aid in the industry in future. The above reasoning is made also by other authors, who have correctly pointed out that, compared to the other "emergency relaxation" of State aids enforcement occurred in the past, we may not necessarily expect that the "temporary framework" envisaged by the Commission to manage State aids under COVID-19 is a proper instrument.[605]

604 F Munari, 'Lifting the Veil: COVID-19 and the Need to Re-Consider Airline Regulation' (2020) European Papers, available online at; https://www.europeanpapers.eu/en/europeanforum/lifting-the-veil-covid-19-and-need-to-reconsider-airline-regulation accessed 22 March 2022.

605 F. Costa Cabral, and others 'EU Competition Law and Covid-19' (2020) TILEC Discussion Paper No DP2020-007, available online at; < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3561438> accessed 22 March 2022; A. Rosano, 'Adopting to Change: Covid-19 as a Factor Shaping EU State Aid Law', (2020) European Papers, available online at; < https://www.europeanpapers.eu/en/europeanforum/adapting-to-change-covid-19-shaping-eu-state-aid-law> accessed 22 March 2022.

According to Munari, if a contingent situation is not envisaged, it does not make sense to approach the airline crisis with State aids:[606] subsidised industries in competitive markets not only waste money for the taxpayer, but also tend to create distortions in overall competition patterns which will eventually allow only a few to win, while at the same time producing certain and irreversible waste of public resources for the "losers".[607] Moreover, and above all, in a generally subsidised industry the richer and more powerful member States are in the best position vis-a-vis the other States, for they have "deeper pockets" in the form of ability to continue subsidisation or protection of industries and sectors such as the aviation sector if this is seen as being desirable.: This must be seen as being something of a possibly fatal blow to the principle of fair access to the EU relevant markets, and may bring durable and perhaps irreversible competitive advantages to some national economic compared to others within the EU. , In turn, this also risks raising inequality among firms on the basis of their geographical or political alignment, irrespective of their relative efficiency. In a word, the possible outcome of the above shows a clear risk of destruction of the pillars on which the single market is founded, not only in the EU aviation industry, air transport services are instrumental to the wider economy, and therefore distortions of competitive patterns would extend also to many other sectors, with enhanced prejudice to the non-distorted market for many industries and services in the EU and beyond. In fact, air transportation is not only a matter for competition law; it has substantial implications also for the industrial policy of any State or the EU as such.

Furthermore, the pandemic has also highlighted established philosophical differences between the continental Europeans, where state-aid rules were relaxed to help companies survive the crisis, and those in the Anglo-American world. The British and Americans have stopped short of taking equity stakes despite offering billions in loans and other financial support, leading some to argue their airlines will emerge stronger as they have been forced to make aggressive cuts to navigate the crisis.[608] In short then,, the Commission has, been expediting decisions and the Temporary Framework itself has been evolving as circumstances change; it is notable for example that the Framework has already been amended five times since its introduction. These amendments make abundantly clear that the Temporary Framework is certainly a flexible, dynamic living instrument, to be used by the Commission as a tool allowing the EU to respond to challenges caused as and when they arise. Quite how far any further changes may make to state aid and level playing fields remains to be seen.

606 F Munari, 'Lifting the Veil: COVID-19 and the Need to Re-Consider Airline Regulation' (2020) European Papers, available online at; https://www.europeanpapers.eu/en/europeanforum/lifting-the-veil-covid-19-and-need-to-reconsider-airline-regulation accessed 22 March 2022.

607 N. Zahariadis, 'Winners and Losers in EU Sate Aid Policy, Journal of Industry' (2013) Competition and Trade 143

608 Philip Georgiadis and others. 'Europe forced to turn back clock to bail out airlines. *Financial Times*. 10 May 2021 available online at; <https://www.ft.com/content/3ba22be6-20b8-4ee9-8441-7bcbb2488702> accessed on May 2021

One question which does arise here is whether the use of the provisions of Article 107(2)(b) ought to become more systematic, as this is a mechanism which recognises the truly exceptional nature of the circumstances and allows for a straightforward way of providing state support as such. That said, the mere payment of monetary funds in response to harm suffered, or compensation as it may be termed, might not in many cases, be sufficient to equip companies to meet the longer-term financial challenges posed by the Covid-19 crisis. As a result, Article 107(2)(b) is best seen perhaps as something of a complementary element than a standalone alternative to the general measures under the Temporary Framework.

The necessary re-orientation of public policy in the aftermath of the pandemic may limit the relative importance of previous policy priorities such as those related to climate change, the environment, terrorism and security and so on which had previously played a shaping role in the evolution of the air transport sector before the crisis, especially those related to climate change and the environment. The role of government and public authorities at all levels – especially the type and duration of measures affecting transport operations – will be crucial for the future development of the aviation industry.

Sustainability criteria, used as one condition for government support to airlines, can be compatible with a post-pandemic strategy for the aviation sector. Guiding the support to air transport operators towards technologies and operational models that meet wider policy priorities is an option that can deliver longer-term benefits. In that sense, government support that results in partial or full nationalisation of carriers can be positive, since it may be a lever to introduce social and environmental goals.[609]

15. Post-pandemic trend

As the aviation industry started to emerge from the pandemic, European aviation has been characterised by a wave of consolidation in the region's airline industry. An indicative example is a bid by Wizz Air for rival budget carrier easyJet[610] which has marked a significant milestone in that trend.

609 M Abate and others, 'Government support to airlines in the aftermath of the COVID-19 pandemic' (2020) 89 Journal of Air Transport Management 101931. 1

610 Financial Times, 'EasyJet rejects takeover approach from rival Wizz Air' *The Financial Times* available online at; < https://www.ft.com/content/4c2d5a82-c548-4f5a-aa06-3ad250855e72> accessed 22 March 2022.

In second half of 2021, the European airlines have been jostling for position in what could be a fundamental reshaping of Europe's fragmented airline market that had already experienced a clutch of bankruptcies before the coronavirus crisis. Another example is British Airways which has been negotiating with unions to back a plan to make sweeping changes to its short-haul Gatwick operations to match easyJet's more flexible and seasonal model. In summary, airlines are looking beyond the pandemic to prepare for a new business cycle, with the major carriers moving to position themselves for the post-Covid world.[611]

According to some views,[612] the pandemic may force the European market, which still has a fleet of national flag carriers and low-cost competitors, to become more like the US in consolidating down to four main players with "inbetweener" airlines that are neither flag carrier nor ultra-low cost faced problems as the industry emerges from the crisis. "This is a once in a lifetime opportunity", as it was described by easyJet CEO Johan Lundgren with regard to take-off and landing slots in cities across Europe, including Paris and Amsterdam that have become available as other airlines retreat.[613]

II. *Conclusion*

The main reason for inadequate compliance with the State Aid rule is in the static attitude, which oppose its operation.[614] Wrong application of the rules is unavoidable so long as national governments have not been convinced to give up on the existing practice of losing State resources for the sake of operationally and financially bankrupt national champions. This requires additional efforts from the Commission to deliver and educate in order for illegal subsidies to be completely removed.

State aid benefits are largely offset be a decrease in the consumer surplus, resulting in a lower social welfare. The reason for this is that the aid does not just decrease competition in the relevant market, but also in the European domestic market, the EU-non-EU markets and the markets between interior European endpoints and other non-EU hubs and the other way around. The net result of this is a decrease of social welfare. In addition to this, market definition has not been adequately developed and adopted to the economic reality of the market. "The route between a city – pair" approach has a

611 Financial Times, 'European Airlines Jostle for Position as They Look Beyond Pandemic' *The Financial Times* available online at; <https://www.ft.com/content/58f4394f-af0f-45ef-80c0-8403eb05b882> accessed 22nd March 2022.

612 Ibid.

613 Ibid.

614 Christian Ahlborn, Daniel Piccinin, 'The Great Recession and Other Mishaps: The Commission's Policy of Restructuring Aid in a Time of Crisis' in Erika Szyszczak (ed), *Research Handbook on European State Aid Law* (1st edn Edward Elgar 2011) 153.

limited degree of value to protect the competition environment. While it extends the scrutiny to the competitive conditions and the structure of supply and demand on the market, the essence of the appraisal is artificially narrowed and does not take into the consideration other relevant facts and market elements affected by the aid.

Another evidence of the necessity to reconsider the Commission approach is the economic assessment applied as part of the examination of the distortion of competition. The only way to achieve efficiencies in air transport, translated into reliable, convenient and economical quality services, is through undistorted competition. In each case, the Commission needs to show healthy scepticism around the restructuring plans of individual marker participants.

State Aid support in the last few years, especially during the Covid-19 crisis has underlined the significance of airlines as significant employers and strategic assets that the EU governments were unwilling to let fail during the pandemic.[615] In the foreseeable future the aviation industry might experience a sharp decline in load factors, and a "less efficient" use of aircraft. This will lead to an increase of costs and therefore of prices. If pricing remains a key factor for the demand, it stands to reason that an increase in price will inevitably lead to a subsequent decline in the demand, unless the price increase is counterbalanced with subsidies.

One potential and realistic mechanism which policy and decision-makers here should consider is a reduction in the supply of passengers' air transport services, i.e., less capacity offered overall with less aircraft in the skies which essentially the statutory or EU-driven restrictions to market access. On the other hand, the practice of the unsubstantiated policy-motivated support together with the narrow and misleading justification of the aid for the sake of individual pollical agenda or market participants shall be avoided.

As an overview, the overall present level of state aid granted at this point in time has already exceeded the trillion-euro mark, and this spending is likely to continue and to increase further. The potential distortive effects of state aid at this scale are also significant. This is particularly so in light of the almost universal eligibility for aid, but *de-facto* exclusion of companies with greater resources and higher resilience as the companies requiring aid are those self-selected to be likely to fail, thereby

615 Philip Georgiadis and others. 'Europe forced to turn back clock to bail out airlines'. *Financial Times*. 10 May 2021 available online at; <https://www.ft.com/content/3ba22be6-20b8-4ee9-8441-7bcbb2488702> accessed on May 2021

hindering the natural consequences of free markets, and promoting inefficiency. Of course, given the unprecedented nature of the Covid-19 pandemic, it is arguable that the failure to provide support would constitute a cliff-edge scenario, rather than a longer-term impact of the market, which might still take effect in the fullness of time, and that this is therefore justifiable given the objective of the support under the Temporary Framework which is aimed at 'remedying a serious disturbance to the economy' as a whole rather than aiding individual undertakings. However, the longer this specific regime remains in place, the bigger the distortion to the market may become, and the longer it will take for the market to correct this. This may become more apparent in due course as different member states' find their ability to be able to fund large-scale measures begin to impact the speed with which national economies begin to recover.

CHAPTER 7.
REMEDIES AND THEIR IMPACT ON THE EUROPEAN AVIATION

I. Introduction

As an introduction, this chapter will examine the nature of the remedies available to the European Commission under competition law to ensure that competition on this market is maintained within the internal market. Any breach of Article 101 TFEU or Article 102 TFEU is, by its very nature, likely to result in some disadvantageous result occurring to competitors or, in a manner which otherwise distorts the internal market and its operations. This is, as has been seen throughout this thesis, a very important part of the way in which whether or not such a contravention of competition law has occurred in the first place. As such, it is natural to expect that some form of remedies might be required in order to rectify the position of disadvantaged competitors and to restore the market to its proper operating position as far as is possible. It is therefore the case that historically, many airline concentrations and alliances which have been permitted by the Commission have been subjected to remedies. It has become essential to offer the efficient solutions in order to deal with airline mergers within the European Union dimension specifically with a focus on the different types of remedies which are likely to address the anticompetitive effects of the proposed transactions.

Prior to the COVID-19 outbreak, the condition of the airline market in the European Union could be modelled with some assumptions and factors that the European Commission should take into consideration in assessing mergers transactions. Classic remedies such as those associated with giving

up slots at congested airports have become a regular but ineffective practice which is not helping encourage new competition despite its originally declared intention as further explained in this chapter. The entire situation has radically worsened in 2020 owing to the COVID-19 pandemic. Both aspects have led to the urgent need for a completely new approach by the Commission.

Within the European Union dimension, Council Regulation (EEC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings[616] (also known as "the Merger Regulation") in Articles 6 (2) and 8 (2) explicitly stipulates that the Commission may decide to declare a concentration compatible with the internal market following certain commitments made by the parties that shall be implemented before and after the initiation of proceedings. Hence, the Commission may attach to its decision conditions and obligations focused on ensuring that the entities concerned comply with the commitments they have entered into vis-a-vis the Commission with a view to revising the transaction to make it compatible with the internal market[617].

In 2001 the Commission has published the Commission Notice on remedies[618] which was revised in 2007.[619] The revision followed an extensive study by the Commission with regard to the implementation and effectiveness of remedies under the judgements of the European Courts and the Merger Regulation (2004).[620] In its essence, the Commission Notice provides guidance to companies on modifications to their proposed transactions in order to eliminate competition concerns identified by the Commission.

The main objective of remedies is to effectively encourage new entry to the sector or balance and distribute benefits effectively within the airline sector. It is an instrument to enhance the liberalisation of the single aviation market within the European Union. While effective remedies are crucial to deal with the competition concerns successfully, in practice, most remedies are significantly less effective than intended and there are doubts over how successful such conditions have been at delivering the original goals. Very few advantages have been realised from such opportunities. This failing has been recognised by the Commission; as a result, in 2009, the Commission sought to strengthen measures in their decisions concerning mergers like *Iberia/Vueling/Clickair*[621] and *Lufthansa/Austria*.[622] For

616 Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings OJ L 24, 29.01.2004, p. 1-22.

617 Commission Notice on remedies acceptable under Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004.

618 Commission Notice on remedies acceptable under Council Regulation (EEC) No 4064/89 and under Commission Regulation (EC) No 447/98.

619 Commssion Notice on remedies acceptable under Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004.

620 https://ec.europa.eu/competition/mergers/legislation/merger_remedies.html

621 Case M.5364 *Iberia / Vueling / Clickair* C(2017) 7449 final

622 Case No COMP/M.5440 *Lufthansa/Austrian Airlines* (2009)

example, parties were asked to try finding new players up front by advertising slot availabilities to help new entrants establish a mini-base at the hub airport concerned.

Most indicative past airline merger cases will be critically assessed here, with the aim to separate effective from ineffective solutions offered in the past. Even the strongest remedies appear to fail to have a considerable impact. Of the seven airline merger cases in a study by Airneth in 2011,[623] (merger cases in which slot divestiture was imposed), new entry had occurred in 36% of the city pairs which were subject to remedies; this figure reduced by 20% after two years. In addition to that, new entry was significantly lower on long haul routes than on short haul routes. Furthermore, the only significant new entry after the *Iberia/Vueling/Clickair*[624] merger in 2009 was mainly through the entry of Ryanair on a number of Spanish domestic routes, and it is not certain whether Ryanair's entry was due to the slot remedy, or whether it represented a suitable option for all types of passengers. It is thus uncertain whether, even with the strong new approach, the remedies imposed in matters of airline concentration and alliances cases have had any significant remedial consequence. However, there is an opinion that it is simply not easy to predict any further or enhanced conditions or remedies that may be available, and the alternative approach of outright prohibition will fail to deal with the need for consolidation in the industry [625].

Additionally, social welfare can be influenced by another pillar of the competition law, i.e., State Aid in various ways. Without adequate remedies, dominant airlines are observed to hinder entry. Appropriate measures obstruct this practice and a duopoly naturally arises, which increases social welfare over that with a monopoly. Based on Kawasaki's model,[626] the positive effect of some remedies, such as flight frequency, on consumer utility has been established to confirm this.[627]

II. Criticism of the Current Approach to Remedies

1. The Commission's current approach to remedies

While it might be argued that the main objective of the remedies is to maintain a single aviation market as close as possible to a condition of 'perfect competition' with no barriers to entering and

623 John Balfour, 'Airline Competition' (OECD, DAF/COMP (2014) 22 04-Jun-2014)

624 Case M.5364 *Iberia/Vueling/Clickair* Commission decision of 11 November 2019.

625 John Balfour, 'Airline Competition' (OECD, DAF/COMP (2014) 22 04-Jun-2014).

626 Akio Kawasaki, 'Entry Regulation and Strategic Entry Deterrence in the Airline Market,' (2008) 75 Journal of Political Economy 57, 57.

627 Ibid.

exiting the market and no single market participant has control over prices,[628] there are other views,[629] in accordance to which where there are economies of scope or scale, implementing such an objective may serve to diminish productive efficiency and, over the long run, diminish incentives to innovate and make other investments.

The methodology of the Commission in relation to remedies associated with airline mergers has been moving inconsistently.[630] Significant number of the transactions raised critical concerns instead of contributing to development of practical and efficient solutions within the competition realm of the airline industry.

The Commission needs to look at the mergers proposed with additional scrutiny, and even somewhat control and direct the market players toward proposing adequate undertakings. Harmony is needed between the interests of the airlines and airline sector together with the ultimate consumers; this requires building a predictable approach to the transactions between airlines.

In reality, emphasis has been placed on the exceptionally restricted definition of the relevant market. Rotations between two cities rather than the entire operational network of the airlines have been a precursor for the Commission for years occasionally narrowed down even further to classes of passengers utilising the same route. Slot divestitures have been viewed by the Commission as a definitive response to mitigate the competition impediments. In the essence of this arrangement is the assignment of slots for a particular number of flights with the aim to re-establish the level playing field affected by a consolidation in question.

As per Szymon Murek[631], after many years of applying narrow approach towards the market definition and impediments attributed to the merger transactions on various points-to-point routes focus has moved to the appraisal of network competition. Culminating point was the general disappointment of a methodology used by the Commission in the *Air France/KLM*[632] consolidation, where for all intents and purposes no airline entered the market after the concentration and the introduction of remedies.

628 Scott A. Wolla, Carolyn Backus, 'The Economics of Flying: How Competitive Are the Friendly Skies?' Economics, available online at: < https://files.stlouisfed.org/files/htdocs/publications/page1-econ/2018/11/01/the-economics-of-flying-how-competitive-are-the-friendly-skies_SE.pdf> accessed 12 June 2023.

629 OCDE/GD(96)131 'Abuse of dominance and monopolisation' (1996) http://www.oecd.org/competition/abuse/2379408.pdf accessed on February 2021.

630 Szymon Murek, 'Remedies in airline mergers in the European Union', (2017) available online at; <http://www.icc.qmul.ac.uk/media/icc/gar/gar2017/4.Szymon.pdf> accessed on 08 September 2020.

631 Ibid.

632 Case COMP/M.3280 Air France/KLM [2004], OJ C60/5.

Following several waves of mergers in the airline sector of the European Union, several types of remedies appear to be most commonly proposed by the undertakings and accepted by the Commission:

1) The primary remedies of principal slot divestitures; divestiture of landing slots remains the most commonly offered and recognised in airline consolidations notwithstanding their limitations and recorded instances of circumstances when they do not tackle the issue of monopolised routes. Divestiture of landing slots is moderately simple to execute. The premise behind this arrangement is to make the market more accessible as well as allow other market participants to create substantial competitive weight. Slot divestures could be further subdivided into two types:

   (i) Upfront purchaser arrangements are an additional instrument to slot divestitures, identifying an airline which is prepared to assume control over the divested slots and is ready to work on the given route (offered, for instance, by Ryanair during the last endeavour to buy Aer Lingus; however, in the end this was declined by the European Commission[633]).

   (ii) Grandfathering of slots is another extra arrangement utilised alongside slots divestiture, aiming to reinforce privileges of the competitors assuming control over the divested slots. This is ordinarily proposed and broadly acknowledged by the European Commission. In the European Union, Regulation 95/9343 provides for the 'grandfather rights' concept. Generally, slots are distributed to those carriers which have utilised them in the past for 80% of the time. In the event that a slot has not been utilised to that level, it shall be returned to a pool of unused slots. This is so called the 'use it or lose it' rule.[634] A portion of the slots in the pool are then granted to new competitors at the airport. Carriers can then trade slots to improve the conditions under the original assignment. A new entrant may also be granted ‘grandfather rights’ once they have operated on a route for a period such as six IATA seasons.

   Fundamentally, grandfather rights permit an occupant carrier to keep a slot indefinitely. If a slot is used 80% during one season, the guideline expresses that it tends to be held for the following season. In reality, there are no restrictions to how the slots to be used.[635]

In order to effectively address the competition concerns associated with the dynamic aviation sector, a flexible approach shall be used by the Commission that shall focus predominantly on 4 to 5 remedies i.e., fleet freeze, fleet divesture, frequencies freeze, regulatory commitments and fare combinability.

633 IP/13/167. Press release. 27 February 2013. Mergers: Commission prohibits Ryanair's proposed takeover of Aer Lingus [https://ec.europa.eu/commission/presscorner/detail/en/IP_13_167] accessed July 2021.

634 https://ec.europa.eu/transport/modes/air/airports/slots_en accessed February 2021.

635 https://aviationstrategy.aero/newsletter/Nov-1997/1/Slot_allocation%3A_the_need_to_dump_grandfather accessed on 19 November 2020.

i. Fleet freeze

One of the most effective and practical remedies is fleet freeze. Fleet freeze has not been discussed in the academic practical literature or professional publications in details. Its concept is based predominantly on economy of scope theory and, as a result, justifies cluster market definition, as discussed in Chapter 3. Due to the increase in the operational capacities of the consolidating (concentrating) entities, other firms (airlines) face barriers to attaining the same economies of joint provision.[636] Indicative examples of the associated competitive benefits as an outcome of the merger transactions include the *Air France/KLM* merger, which led to a merged cargo fleet management (including marketing, commercial, and sales teams) in October 2005.[637]

Another example is 'flexibility' achieved by IAG as a result of its purchase of Aer Lingus when in 2019 it [IAG] transferred Aer Lingus orders for four Airbus A350-900s to Spanish flag-carrier Liberia.[638] IAG thus had leverage due to its market share, first of all to negotiate a favourable deal, and secondly to 'juggle' the fleet between its airlines for its own advantage.

Fleet freeze restricts a merging entity from increasing its fleet (i.e., imposes a 'cap' on its fleet) above a certain level/number and may apply either to the entire fleet, specific entity within the same group or to a specific type of aircraft, based on a network analysis and types of aircraft operated on individual routes. That would allow for example to prevent the use of the targeting airlines as a backdoor solution with the limitation on a fleet available which should allow to control market access and its dynamic, as well as to prevent overwhelming certin rotations with operational capacity that on the one hand might be justified by the economy of scale from the merged entity point of view but on the other hand might also create a disturbing effect on the same rotations for other participants in a mid/long term. At the same time the merged entity will still benefit from the synergy effects and extended network that the transaction might lead to.

636 Herbert Hovenkamp, *Principles of Antitrust* (West Academics 2017).

637 Airfrance KLM '2005-06 reference document' (2006) https://www.airfranceklm.com/sites/default/files/publications/reference-document_2005-06_en.pdf accessed 16 November 2020.

638 Tom Boon, 'Aer Lingus To Transfer 4 A350 Orders Over to Iberia' (5 April 2019) https://simpleflying.com/iberia-a350-transfer/ accessed 16 November 2020.

ii. Fleet divestment

Another methodology that has not been examined in detail in the scholastic or practical writing is fleet divestment. This remedy relates to a fleet being stripped to a certain level in the light of a legitimate concern for a third party, to make or reinforce competition in the relevant submarket (route). While there have been some examples with respect to the fleet being restructured (for instance, Lufthansa's proposed acquisition of certain Air Berlin assets[639], through the entity Luftfahrtgesellschaft Walter GmbH ('LGW')[640] , it has been predominantly relevant to the restructure between the entities being part of a deal rather than involving the third parties.

This remedy may be contingent upon interest from the third party on the relevant sub – market (route), which is similar approach applied to the slot allocation, for instance in *Lufthansa/Austrian Airlines*,[641] where the remedy package comprised of a guarantee to offer new participants slots and grandfathering rights. For instance, consider a merger scenario between two carriers, A and B, carrier A has 40 Airbus 320, 7 Airbus 380 and carrier B has 30 Airbus 320, 10 Airbus 380, and 5 Airbus 330. Both have overlapping routes B-Y (operated by Airbus 320 type) and A-Z (operated by Airbus 380 type), which would most likely raise the Commission's concerns. In its conventional approach, the Commission would ask for divestment of a few slots to a third party for three years. To effectively enhance or stimulate the new entry, a fleet divestment as a remedy would involve (in addition to slot allocation) divestment of:

i) X number of aircraft of Airbus 320 type on B-Y route (number of aircraft dependent upon various assessment factors of the individual entrant),or

ii) X number of aircraft of Airbus 380 type on A-Z route, or

iii) X number of aircraft of Airbus 330 type on another route/unrelated to the specific routes to create a market opportunity for new entries.

Scenarios i) and ii) can be substantiated by the slot allotment and maintenance support (which is also based on the economy of scale as the majority of the incumbents have more favourable commercial terms with the maintenance facilities due to the fleet size, or even have their own maintenance facilities). Other elements that shall be considered include various commercial conditions of such divestments, which may include a 'lease holiday' based approach, or performance based 'power-by-

639 Case M.8633 — Lufthansa/Certain Air Berlin assets

640 IP/17/5402.

641 Case COMP/M.5440, Lufthansa/Austrian Airlines, Commission decision of 28 August 2009.

the-hour' contracts allowing more effective fleet management cost-wise by paying only for the hours actually flown (which has become a frequent practice in the aviation industry), and disposition of the aircraft at the nominal price under a warrant after several years of operations by a new entrant under the above mentioned options. Giannino also suggested alternative instruments to the fleet divestiture including divesture of stand-alone business comprising planes, brands, personnel and any other relevant assets.[642]

iii. Frequencies freeze

Frequencies' freeze remedy is focused on prevention of predatory practices to exclude new entrants to markets. In practical terms, undertakings on slots are accompanied by measures requiring the airline partners to refrain from increasing their offer of flights on the affected routes to give new entrants a fair chance to establish themselves as a credible competitor.[643]

Fleet divestment could be also supported by the requirement of a buyer's undertaking, made up-front, which would mean that even after securing the clearance, the parties may only close their transaction if i) they have presented a buyer of the divestment business to the Commission and ii) that buyer has been approved by the Commission. Such commitment for instance was proposed by Ryanair[644] in its third attempt to have Commission pre-approval obtained for the purchase of a stake in Aer Lingus with Ryanair offering in advance two buyers up-front to take over the routes in question. Unfortunately for Ryanair, the Commission did not believe that the anticipated purchasers were credible competitors and by such actions would be able to reinstate or reproduce the competitive pressure exercised by Aer Lingus which would be lost. Whilst this was not successful for Ryanair, the importance of such undertakings is seen in the *UPS/TNT*[645] case, where the absence of an acceptable up-front buyer ultimately led to rejection of the remedies proposal and prohibition of the merger.[646]

642 M Giannino,. 'European Commission Appraisal of Airline Mergers The Rise of a New Generation of Slot Remedies', (2012), Issue 52, Airlines Magazine available online at; < https://aerlinesmagazine.files.wordpress.com/2012/03/52_giannino_eu_slot_remedies.pdf> accessed on February 2021.

643 Lufthansa/Swiss; Air France/KLM.

644 Ryanair/Aer Lingus III Case COMP/M.6663.

645 UPS/TNT Case COMP/M.6570.

646 Ibid.

iv. Fare combinability

Another alternative which might be used is to ask the parties to enter into fare combinability agreements with competitors on the routes of concern. The objective of this remedy is to provide the opportunity for competitors to offer a return trip comprising a non-stop service provided by that competitor in one direction, with a service in the other direction provided by the parties.[647] The aim is to increase the number of frequencies offered by the competitor, hence reducing the parties' frequency advantage.[648] Of course, there are some practical difficulties with such proposals, namely that there might not be any competitor willing to enter into such an agreement. Thus, in practical terms, such remedies have been limited to competitors with no own hub or focus city operations at both ends of the route.[649] Additionally, commitments have provided for fare combinability agreements to be entered into by parties with competitors on the route of concern, irrespective of whether a new service is being operated using slots released.[650] The Commission has also been able to approve the terms of the agreement and checked that they are reasonable.[651]

v. Regulatory commitments

Regulatory commitments are very important and currently underestimated by the Commission. One of the essential concerns is that with slot release remedies, other airlines might not be able to use those slots due to the traffic rights restrictions even if those slots are technically available. In other words, airlines may have only a formal access to the market, not in practical terms. Traffic rights are one of the most essential elements for consideration when substantive tests are applied. That means allowing other airlines operate under the extended traffic rights (for instance, 5th or 7th freedom) on the affected routes.

In its essence, traffic rights are the rights available to certain airlines based on the nationality criteria to any level of freedom for flights, including the rights allowed by one state to another state. These rights include (i) the right to fly across its region without landing; (ii) the right to land in its domain for non-traffic purposes; (iii) the right to drop passengers, load and mail accepted in the zone of the home state of the carrier operating under this right; (iv) the right to accept passengers, freight and mail

647 John Milligan, European Union Competition Law in the Airline Industry (Kluwer Law International 2017).

648 BA/AA/IB; SkyTeam Alliance; Air France/KLM; IAG/Aer Lingus.

649 SkyTeam Alliance, para 119.

650 John Milligan, European Union Competition Law in the Airline Industry (Kluwer Law International 2017).

651 SkyTeam Alliance, para 120.

proposed for the region of the home state of the airline operating under this right; (v) the right to accept passengers, freight and mail bound for the region of any of the third state and the option to unload a similar traffic from a such an area, on air services starting or terminating in the region of the home state of the carrier ; (vi) the right to transport passengers, freight and mail between the regions of two different states via the region of the home state of the carrier; (vii) the right to unload and to accept on board, in its region, passengers, freight and mail coming from or bound for a third state, with the services not starting or ending in the region of the home state of the carrier; and (viii) the cabotage right - the right to unload and upload at one point within the same territory passengers, freight and mail coming from or bound for another point within the same territory.[652]

For example, in *Air France/KLM*[653], the French and Dutch authorities gave declarations to remove fifth and sixth freedom restrictions in order to give traffic rights to other carriers willing to have an intermediate point in Paris and Amsterdam en route to the US and would refrain from regulating prices on long-haul routes. The said measures were considered significant bearing in mind the view taken by Commission of the existence of indirect, or network, competition on long-haul routes as a factor moderating the finding of dominance.[654]

Without traffic rights and so-called designations, 'classic' remedies, such as slot allocation, are a meaningless instrument. This remedy also entails close cooperation with the national civil aviation authorities.

vi. Monitoring trustee

On some occasions a procedural instrument involving designation of a monitoring trustee, who is tasked with monitoring a conduct of the entity after the consolidation and reporting any lack of compliance, to help ensure correct adoption of responsibilities by parties is used. This arrangement has not generally been utilised in airlines consolidations in the European Union, although recently is has been effectively used in a few concentrations, for instance in *Air France/KLM*,[655] *Lufthansa/SN Airholding*[656] and *Lufthansa/Austrian Airlines*.[657].

652 https://www.icao.int/pages/freedomsair.aspx accessed February 2021

653 *Air France/KLM*.

654 *Air France/KLM*, supra paras 97-104, 155; *Lufthansa/Swiss* paras 188-189.

655 Case COMP/M.3280 Air France/KLM [2004], OJ C60/5.

656 Case COMP/M.5335 Lufthansa / SN Airholding [2009], OJ C295/11.

657 Case COMP/M. 5440 Lufthansa/Austrian Airlines [2009], OJ C16/11.

The monitoring trustee assists the organisations with the remedies as well as reports consistently to the competition authority. By proposing a trustee to supervise the parties' commitment, the parties are ensuring their commitment and permitting the Commission to guarantee that the adjustments attributed to the concentration, as proposed by the parties, is completed with the imperative level of assurance.[658]

The monitoring trustee acts under the oversight of the Commission and is to be viewed as the Commission's 'eyes and ears.'[659] In theory, the Commission may request and direct the trustee to guarantee compliance with the responsibilities, and the trustee may propose to the parties any measures required for correction.[660] While the monitoring trustee plays an important role during the process of the remedies' implementation, the theoretical argument of this thesis is based on the ineffective nature of the remedies and their structure rather than its enforcement. Unless the monitoring trustee is granted more responsibilities and substantial independent instruments which would allow the monitoring trustee to assess the effectiveness of the Commission decisions and report publicly pertaining to its discrepancies in order to initiate formal review of the decisions, the role of the monitoring trustee will be undermined by more fundamental problems related to the inaccurate assessment criteria applied by the Commission well before the implementation stage.

vii. Slot allocation

The most frequently required commitment in the case of airline consolidations is the release of slots. This framework can be effective by achieving productive and allocative efficiency.[661] Productive efficiency implies utilisation of available slots to the maximum extent. Allocative efficiency implies that the slots should be utilised in a way which offers the highest conceivable social benefit. In a perfect world, a slot system ought to have the qualities of both productive and allocative efficiency. This may help decrease 'babysitting' characterised by slot immobility as imposed with the 'grandfathering' rights, when carriers may reassign slots to non-contending airlines, for example, partner airlines with slots moved between the partners. Indicative illustration is an example of KLM[662], with the routes from Rotterdam and Amsterdam to London-Heathrow operated with Fokker 50s (holding around 58

658 Commission Notice on remedies acceptable under Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004

659 Ibid.

660 Ibid.

661 https://www.europarl.europa.eu/RegData/etudes/IDAN/2016/585873/IPOL_IDA(2016)585873_EN.pdf accessed February 2021

662 De Wit J., and Burghouwt G., 'Slot allocation and use at hub airports, perspectives for secondary trading', (2008). 8, European Journal of Transport and Infrastructure 2.

passengers). KLM transferred its slots to Northwest, their parent airline to begin transatlantic routes with larger and more efficient airplanes to start up new Transatlantic routes from Heathrow after the initiation and entry into force of the EU-US Open Sky Agreement on March 30th, 2008.[663]

Behavioural remedies are becoming more significant in airlines consolidations as an ancillary tool to slot allocations. The most widely recognised include:

(i) Participation in various customer focused programmes (examples may include the use of so-calledfrequent flyer schemes for example – these are loyalty programmes offered by airlines under which customers enrolled in the programme accrue points, accrued by travelling on that airline and which can then be redeemed for free air travel and other products or services): generally acknowledged device by the European Commission to increase the appeal of having various options between the consumer. For instance, the Commission might require that if a carrier operating services on routes of concern requests to be hosted on the parties' frequent flyer programme, it must be allowed to participate on equal terms as compared to other members of the alliance of which the parties' ae members, so that the requesting carrier's customers may accrue points, and benefit from other services such as airport lounge access or priority bookings;[664]

(ii) Prorate arrangements supporting the alternative methods for transportation. This remedy is utilised predominantly on well-established routes in demand. Indicative example is a commitment related to Paris-Amsterdam route in *Air France/KLM*[665];

(iii) Code-share arrangements associated predominantly with the hub-and-spoke business model. Seats on a plane are shared among the carriers by providing each other with passengers; this is particularly significant where consistent number of passengers is fundamental in order to maintain an effective operation on long haul routes. Indicative example is *Lufthansa / SN Airholding*[666] where code-share agreement and participation in Lufthansa's frequent flyer programme were offered as additional remedies to supplement the main package of remedies.

663 Ibid.

664 SkyTeam Alliance; Case COMP/M.3280 *Air France/KLM* [2004], OJ C60/5. See also John Milligan, "European Union Competition Law in the Airline Industry". Wolters Kluwer. 2017.

665 Case COMP/M.3280 Air France/KLM [2004], OJ C60/5.

666 Case COMP/M.5335 Lufthansa / SN Airholding [2009], OJ C295/11

2. The current approach does not correctly account for the need to preserve competitive constraints;

One of the fundamental issues is to identify remedies that are appropriate to maintain effective competition in each particular case. Remedies that have been applied in a number of cases include obligations regarding the surrender of slots at congested airports, obligations regarding interlining and code sharing agreements, obligations to enter into intermodal agreements, obligations to open up frequent flyer programmes to new entrants, obligations to freeze or reduce frequencies, and obligations related to price reduction mechanisms.

Many questions also still need resolving including the ongoing changes in the aviation sector that also require changes in the competition toolbox to provide interventions to preserve a sufficient and effective degree of competition and an up-to-date competitive evaluation mechanism that shall be undertaken which remains formally consistent with the consolidated jurisprudence of recent case law. In the air transport cases, competition evaluation has shown that an open and equal access to airport slots remains the key factor for ensuring competition in the aviation market. The underlying principle of this view is that the lack of sufficient take – off and landing slots is generally the main barrier for entrance. For this reason, slot surrender remains a favourable remedy of the competition authorities focused on ensuring allegedly effective access to the market for new entrants.

3. The current approach is influenced by an inaccurate and narrow approach to market definition;

Overall, while recognising the importance of operational scale regarding competition constraints, competitive evaluation should be focused more on the credibility of the competitors' threat than on the number of competitors. According to Macario,[667] 'pluralism' is not always a synonym for competition, especially in network industries. Market analysis must also explore the potential of origin/destination markets, not only in terms of the existing barriers to entry, but also in terms of the likely sustainable demand.

Also, it is uncertain whether the role of reputation effects as in the *Ryanair/Air Lingus*[668] case should be emphasised in relation to the assessment of strategic barriers to entry as part of the general

667 Rosario Macario and Eddy Van de Voorde, *Critical Issues in Air Transport Economics and Business*. (Routledge 2011).

668 Case COMP/M.4439 *Ryanair/Air Lingus* (2007).

competitors' threat [669]. On one side it relates to the incumbent's advantages, which are not easily replicated by competitors, but, on the other, it is linked to the concept of 'competition on the merits' which should be protected with appropriate incentives. Additionally, the increasing importance of airports in the operation of the airline business is creating a strong incentive for carriers to integrate with airport services. The European Commission must comprehensively evaluate various factors, including dedicated terminals, acquisition of shares in main hub airports and strategic destination bases, to decide on the trade-offs between efficiency gains and the risk of increasing barriers to entry.

According to an economic analysis based on assessment of the effectiveness of the competition after a merger, slot release is by far the most far-sighted remedy, especially in the scenario of the current regulation on slot allocation.[670] However, by revising the Commission general approach towards the effectiveness, the Court of Justice has exposed several instances[671] in which the Commission has mishandled economic theory and evidence[672] with too much weight being given to efficiency justifications. Overall, different implementations of the slot release remedy can lead to different results in terms of the market outcomes. Starting point is the scope of the remedies. The dilemma is relatively generic - if the remedies are focused on increasing the number of players on single routes, such remedies could be inefficient in terms of competition constraints exercised by new entrants.

Slot allocation itself is a relatively meaningless tool for the aim of preserving level playing field. With the continuing inaccurate approach toward a catchment area and market definition, slot allocation serves no practical purpose. Bilotokavich and Huschelrath's survey[673] on the competitive effects of antitrust immunity indicated that beyond the price effects, airline cooperation can affect the non-price product characteristics, such as schedule coordination, flight frequency as well as lead to market foreclosure as previously suggested by theoretical models of Chen and Gayle[674] and other authors such as Bilotkach.[675] In reality, slot allocation as a remedy is not able to address those effects, the argument which is further examined and substantiated by case law in this Chapter.

669 Marco Benacchio. 'Consolidation in the air transport sector and antitrust enforcement in Europe'. June 2008. European Journal of Transport and Infrastructure Research 8(2):91-116

670 Ibid.

671 *Airtours/First Choice* [1999], Case No IV/M.1524; *Tetra Laval/Sidel* [2003], COMP/M.2416; *General Electric/ Honeywell* [2001] COMP/M.2220.

672 Damien J Neven, 'Competition economics and antitrust in Europe' [2006] 21(48) Economic Policy 21741.

673 V Bilotkach, K Hüschelrath, 'Airline alliances, antitrust immunity and market foreclosure' (2012) ZEW Discussion Papers, No. 10-083 [rev.], Zentrum für Europäische Wirtschaftsforschung (ZEW), Mannheim

674 Y Chen, P. Gayle "Vertical Contracting Between Airlines: an Equilibrium Analysis of Codeshare Alliances" (2007) 25 International Journal of Industrial Organization, 1046-1060.

675 V Bilotkach, (2007) "Complementary versus Semi-Complementary Airline Partnerships" *Transportation Research Part B*, 41, 381-393.

An indicative example is *IAG/Aer Lingus*[676] which is analysed in depth below. IAG has been a European group rather than a single airline in its classic meaning, with a regular launch of new airline projects, for instance, Level, low-cost, long-haul airline, as well as Iberia Express operated from Gatwick and British Airways who bought Gatwick slots from collapsed Monarch[677] which allowed to expand its presence. After all, IAG commitments to release several daily slot pairs at London Gatwick which could be used on the specific routes of concern seem rather impractical. This raises the questions of who benefits from the overall network gains and whether the beneficiary's competition has truly been constrained. In *AIG/Aer Lingus* it appears not to be the case.

Additionally, taking into the consideration that IAG acquired Aer Lingus as a result of a series of unsuccessful attempts by Ryanair, the overall transaction does not look truly competitive. Normally, when it comes to the that aviation market it is highly unlikely to have a 'green light' to a Merger deal unless there is a counter proposal in the form of competition remedies which have been agreed and will be applied. Consideration shall be given to the fact, that in general terms, the remedies are designed to strengthen smaller competitors as well as encourage potential newcomers by reducing barriers to entry, while preventing big players from market monopolisation.

4. The current approach does not work in practice:

Overall, remedies of various types have been used by the competition authorities as a settlement for deals and could be classified as structural and behavioural remedies, which include divestitures remedies, price, output, and capacity-related measures, as well as behavioural remedies.

In general, while new participants infrequently enter monopoly markets and, in particular, are unlikely to enter congested hubs, in certain business sectors, existing contenders use given slots to build their frequencies. This can be seen in Germany and Switzerland, where airlines are additionally portrayed as having high development rates and, consequently, empowering competition.

This raises an interesting point that an airline relinquishing a hub will not affect consumers over the long run, since low-cost carriers (LCCs), in most cases, will make up for the shortcoming. There is also an argument that LCCs have been successful in capturing market share from network carriers and

676 Case No M.7541 - IAG / Aer Lingus.

677 Peggy Hollinger and Tanya Powley, 'British Airways owner IAG buys Gatwick slots from collapsed Monarch' *Financial Times* (27 November, 2017) <https://www.ft.com/content/11eac09a-d3b4-11e7-8c9a-d9c0a5c8d5c9> accessed 15 March 2018.

the network carriers of the classic model have steadily lost market share to a variety of more innovative business models[678]. LCCs fight the network carriers with lean processes and operating point-to-point networks instead of hubs.

The problem with this theory is that:

- There is no assurance that LCCs, with their further limited resources, will do so; and
- Even when an LCC joins a hub, prices only fall on certain routes, not on all routes. In fact, a rise in ticket prices is particularly frequent on routes linking the former rivals' hubs.[679] Therefore, as explained later in this chapter, airlines do not pass their savings on to consumers and a fare increase can be a common consequence of the consolidation.

Although it was initially thought that the divestiture of slots could effectively remedy the anti-competitive effects of certain mergers, experience has shown that additional measures are required, which ensure that potential entrants have effective access to actual traffic. In future cases, additional or different remedies may be required. At times, when the overlap is extremely generous and potential contestants few and frail, denial of the exchange may be the only arrangement.

While this thesis admits that in some cases the Commission extends its classic city pair analysis and also examines whether other means of transport (car, train, ship or connecting flights) might be an alternative for consumers, the Commission's relatively traditional approach is still limited and does not reflect the reality of the overall impact that the transactions might have on the market and on consumers in general. In the majority of instances, market power is wrongly assessed by application of the traditional market definition. For instance, there is an argument[680] that an assessment which is entirely based on the availability of slots at the airport and does not take into account the degree of substitutability between different routes from the demand side should be reviewed in line with distributive issues as switching capacity between routes which are not typical of antitrust analysis.

Another huge challenge posed is the design of effective remedies that are not in conflict with the market definition in the airline industry; this is a main priority, taking into consideration the potentially

678 JG Wensveen and Ryan Leick, 'The long-haul low-cost carrier: A unique business model' [2009] Journal of Air Transport Management 127.

679 Consumers Union before the United States Senate Judiciary Subcommittee of antitrust, competition policy and consumer rights, 'Testimony of William J. McGee. on the United/Continental Airlines Merger: How will consumers fare?' (27 May 2010). <https://consumersunion.org/wp-content/uploads/2013/02/Continental-United-Merger-Test-0510.pdf> accessed 10 August 2018.

680 Marco Benacchio, Consolidation in the air transport sector and antitrust enforcement in Europe. EJTIR, 8, no. 2 (2008), pp. 91-116

static effects in terms of quantity on specific routes. If the remedies aim at maximising the number of players on single routes, they could be inefficient in terms of competition constraints exerted by new entrants. The minimum required to compete within a network industry suggests, on the opposite, is to give priorities in accessing the released slot to already operating competitors, in order to strengthen their counterbalance power.[681] Other considerations may be raised when competitive concerns are not strictly "route-specific", but, for instance, related to the profitability of entry in the bundle of routes originating from the base-airport by actual and potential competitors. In fact, consistently with the O&D market definition and the competition assessment based on single markets (i.e., routes), remedies have always been market-targeted; they modify competition conditions on each market where the market power of the merging entities cannot be countervailed by competitors.

The released slots have to be operated by competitors on the same routes where the dominant position of the merged entity has been assessed. A partial amendment is the provision of a fixed period (up to 4-6 IATA seasons) where the destination clause is valid, after which, if fully operated, slots pass in the grandfather's right of the competitor that benefited from release. This specification helps in screening efficient competitors from opportunistic behaviours aiming at cream-skimming.

On the one hand, this measure prevents the risk of a decreasing supply on a given market after the intervention by the competition authority, which would damage consumers in the short run. On the other hand, especially when the airport cannot increase the capacity, the remedy could be non-effective in promoting real competition.

5. Specific Weaknesses of the Slot-Allocation Approach

The failure of the slot-allocation approach can be seen in a number of examples. In the first instance, in *easyJet v. Commission,* the General Court dismissed the argument that divestiture of slots in the Air France/KLM consolidation was insufficient[682], EasyJet argued that the Commission characterised the product market in the narrow terms based on point of origin/point of destination ('O&D') approach, any combinations comprising a different market from the perspective of interest. EasyJet suggested that the Commission ought to have evaluated the 'leisure travel via air' market with a broader coverage than city-pair route. Moreover, the Commission should have thought about whether the consolidation was likely to make or fortify a predominant situation on any market in the European Union. For

681 Ibid.

682 Case T-177/04 *EasyJet v. Commission* [2006] ECLI:EU:T:2006:187.

instance, the Commission neglected to consider the impacts of the consolidation on routes which Air France and KLM did not cover at that time. Specifically, easyJet asserted that the Commission was ineffective in deciding over future advantages (fortifying its situation on those routes) from the consolidation and expansion in Air France's organisation and its essence at worldwide level which would be also in line with the suggested [by this thesis] network competition approach. EasyJet believed the Commission had strayed from the existing practice of examining the strengthening of a predominant position. This was apparent from the cases based on Article 8(2) of Regulation No 4064/89, in which the broader impact of the concentration was taking into the consideration.

In summary, the Court considered easyJet failed to substantiate pertinent issues to illustrate such reinforcement and thus evidence an error in appraisal with respect to the Commission's decision.

The Court perceived that as a result of consolidation the parties would benefit from economies of scale at both airports as well as the increased leverage to negotiate for the pricing with a third-party service provider such as engineering, ground handling services and airport facilities etc.' It likewise affirmed that; 'the merged entity would have a very strong position on [the Paris-Amsterdam] hub-to-hub route'.[683] Findings of the Court also concluded that while the Commission recognised that impacts on competition at hubs may result from a consolidation, the Court's view was that the Commission's affirmation of the presence of the detrimental effects for competition in regard of the business of the parties to the transaction at the hubs, without doing an exact examination of those business sectors, was not an adequate assessment to justify illegality of the decision. Furthermore, the conclusion reached by the Commission led the Commission to the commitments the purpose of which was to balance the enhanced power of the consolidated entity at the hubs. As per the Commission's view,[684] it has been illustrated that the principal barrier to operations in a transport area is the absence of accessible slots at airports. Amongst other contentions, it was considered that a potential new entrant should have the inclination to work the best number of frequencies daily on the Paris-Amsterdam route.

In *Air France/KLM,* the Commission authorised the merger subject to surrendering 47 slot pairs per day to enable, for instance, a competitor to start six new daily return flights between Paris and Amsterdam and the same for another competitor to also offer one daily return flight between

683 Ibid.

684 Ibid.

Amsterdam and New York.[685] Again, the essence of the concern is inadequate criteria, i.e., economies of scale which has been based on the demand side.

Other cases with the slot allocation remedies have followed a similar pattern. Among them, *US Airways/American Airlines* were to address the monopoly on the London-Philadelphia route, also worked by British Airways (BA); the undertakings agreed to deliver one daily slot pair at London Heathrow and Philadelphia airports and introduce different measures to encourage market entry, for example, the opportunities for another participant to procure 'grandfathering' rights after a specific period.

In *IAG/Aer Lingus*[686], five daily slot pairs were required at London Gatwick airport to facilitate new entry to Dublin and Belfast routes, and these were taken up by Ryanair. As already mentioned, this is a questionable development, at least in the light of previous arguments raised by the Commission during numerous but unsuccessful attempts by Ryanair to acquire Aer Lingus. For example, one of the fundamental outcomes of an unsuccessful attempt to acquire the stake in *Ryanair/Aer Lingus*[687] case was that while remedy package offered by Ryanair consisted of the divestiture of Aer Lingus' operations on 43 overlap routes to Flybe and the cession of take-off and landing slots to IAG/British Airways at London airports, so that IAG/British Airways would operate on 3 routes (Dublin-London, Shannon-London, and Cork-London) with Additional slot divestitures on London-Ireland routes were also offered, nevertheless a slot remedy failed to address the major barriers to entry. The Commission's investigation also showed that these remedies were insufficient to ensure that customers would not be harmed, taking into account the scope and magnitude of the competition concerns raised by the proposed transaction.[688]

Additionally, the significant competition threat to traditional airlines in the European Union, particularly those with global network, comes from the east, predominantly from the Gulf district, including three successful and far-reaching air carriers: Emirates Airlines, Qatar Airways and Etihad. Gulf Airlines offer clients high quality service with very competitive fares range, particularly on the rotations from Europe to Asia, and from Australia, Africa, and the Middle East. Emirate Airlines, Qatar Airways, and Etihad depend on the hub and spoke model, with just a few passengers arriving at their

685 John Milligan, *European Union Competition Law in the Airline Industry* (1st edn Kluwer Law International 2017).

686 Case No M.7541 – *IAG/Aer Lingus* Commission Decision of 14 July 2015.

687 Ibid*;* Please see Chapter 5.5 for further discussion.

688 Press release, Brussels, 27 February 2013 [https://ec.europa.eu/commission/presscorner/detail/en/IP_13_167] accessed on July 2021

destination in the hub, and most passengers treating the centre as a transit point for their final destination.[689] Hence, the approach of the European Commission to remedies and combinations in the airline industry will require major changes in order to effectively address anticompetitive concerns, and deliver objectives focused on bringing the benefits to the consumers. The conventional, European air carriers have begun to lose the market and are remarkable to contend with the goliaths of the Middle East on equivalent balance, regardless of the subsidies of government which will unavoidably lead to some changes within the overall market environment.

In order to design remedies when crucial supply-side problems arise in limiting existing and potential competition between airlines certain conclusion can be derived from the Commission decision concerning *Ryanair/Aer Lingus* (prohibited) takeover. According to the analysis of the case, appropriate remedies should in fact incentive at least one competitor to operate from the base airport where limitations occur, according to a scale that allows to exploit base economies comparable to those of the merging entities.

The risk of such a radical analysis is to evaluate as un-remediable a number of mergers due to market considerations other than the technical slot availability; this seems to go far beyond the established existing procedure of slot release in order to give the possibility to competitors (actual and potential) to enter single routes.[690] Another concern relates to the route-specificity of the remedies. Route specific remedies might in fact reduce the likelihood of new entries and, hence, might make the discipline of potential competition much weaker and less effective. Therefore, if in order to be effective remedies have to be not strictly route-related, they may become inconsistent with the demand-based market definition, by ignoring the routes affected by the merger. Hence, the thesis argues that currently there is significant inconsistency between market definition and remedies.

In principle, if a carrier consolidation builds productivity, some advantage will reach consumers. However, for certain business sectors, competition may be reduced and remedies are used by competition authorities to prevent this, without disallowing the whole consolidation. However, in certain business sectors, active competitors or new contestants may later bring a halt to operations. This does not necessarily mean poor practice by the new contestant or competitor, as other factors may have caused the market exit.

689 O'Connell, J.F., 'The rise of the Arabian Gulf carriers: An insight into the business model of Emirates Airline" (2011) Volume 17, Isue 6, November, Journal of Air Transport Management, 339-346.

690 Ibid.

As it has been already stated, from the regulatory perspective, a Mergers & Acquisitions (M&A) deal is the concentration that requires an approval from the competition authority. Likewise, EU Merger regulation (EUMR)[691] applies a substantive test of 'significant impediment of effective competition' (SIEC).

Indeed, focus on further cooperation between the Commission and the Member States has recently been of a substantial significance. In the White Paper Towards more effective EU merger control[692], the European Commission has proposed measures in order to ensure that the Merger Regulation addresses all sources of possible hinderances that might be caused by the concentrations or reorganisations to the competition together with consumers.

III. Practical challenges and solutions

1. Practical challenges

Structural remedies targeting eliminating competition concerns are the most commonly used in merger transactions. This includes slots divesture which are used by the Commission in endorsing airlines mergers. The most indicative examples include *Air France-KLM*[693] consolidation and remedies imposed for city-pair markets between the Netherlands and Italy, because of the tight connection between Air France and the Italian carrier Alitalia as part of a bilateral co-operation agreement in the frame of Skyteam which the Commission also investigated.[694] The Commission requested the carriers to divest a number from slots for an inconclusive timeframe. This was the first time that a slot surrender was requested for an indefinite period. The Commission likewise imposed the standard that those slots which were abused or underused by the new contestant must be returned to the slot coordinator instead of to the merging carriers. New participants, however, could procure purported grandfather rights over the slots acquired for the Paris-Amsterdam route, given that the new contestant utilised the slots for six successive IATA seasons.

The consolidation of the national carriers of France and the Netherlands is as yet held as the biggest and apparently one of the most questionable transactions throughout the entire existence of the European Union's aviation market. The merger required significant commitments from both

691 Council Regulation (EC) No 139/2004

692 COM/2014/0449 final 'White Paper Towards more effective EU merger control' (09 July 2014).

693 COMP/M.3280 *KLM/Air France* (2004).

694 Case No COMP/38.284 Air France/Alitalia.

organisations, who were particularly concerned as their market positions in Europe were especially solid. Further, the transaction resulted in the largest airline consolidation in terms of the global turnover index of EUR 19.2 billion[695]. Popular opinion and also the carrier contenders communicated their interests broadly; it was expected that the arranged transaction would bring about reduced capacity and more expensive tickets.[696] Clearing the consolidation was reliant on various concessions offered by the parties which allowed the merging parties to receive approval from the European Commission.

The parties asserted that the proposed consolidation would ultimately provide advantages to consumers through decrease of costs, improvements attributed to the quality of services and the foundation of new routes. The European Commission communicated its interests for 14 routes (both Intra-European and intercontinental); the airlines were considered as genuine or possible contenders, thus permitting those organisations to consolidate would decrease or even dispose of rivalry entirely for those business sectors. Other factors jeopardising the pro-competitiveness of the concentration were critical landing slots at Paris and Amsterdam, as well as national regulatory limitations in France and the Netherlands.[697] Due to the concerns of the European Commission, the applicants offered the undertakings to address those concerns. Initially, parties proposed to give up 94 landing and take-off slots every day, equivalent over time to the opportunity for 31 new return flights which would according to some views encourage more competitive prices on a given route as well as improve the quality of services.[698] Further, landing slots were protected from abuse; if given up, they would not be returned to the consolidated entity indefinitely regardless of whether their rivals indicated no interest in taking them over. This aimed to attach more value to the surrendered slots as well as to remove the obstacles preventing any new entry.[699] Thirdly, the involved incumbents agreed not to expand their proposals on routes affected by the transaction (‘frequency freeze’) thus allowing rivals to reach the market and giving them a reasonable opportunity to contend, particularly at the start of their activity.

Moreover, the airlines concerned consented to go into intermodal agreements with land transport organisations, to set up a typical assistance so that passengers using Thalys railroad connections

695 SV Gudmundsson, ‘Mergers vs. Alliances: The Air France-KLM Story’ (2018). available online at <https://ssrn.com/abstract=2142915> accessed 22 March 2022 or http://dx.doi.org/10.2139/ssrn.2142915 accesssed February 2021.

696 John Tagliabue, ‘Air France and KLM to Merge, Europe’s No. 1 Airline’, The New York Times (1 October 2003) https://www.nytimes.com/2003/10/01/business/air-france-and-klm-to-merge-europe-s-no-1-airline.html> accessed on 07 September 2020.

697 Szymon Murek, ‘Remedies in airline mergers in the European Union’, (2017) available online at; <http://www.icc.qmul.ac.uk/media/icc/gar/gar2017/4.Szymon.pdf> accessed on 08 September 2020.

698 IP/04/194, Brussels, 11 February 2004 Commission clears merger between Air France and KLM subject to conditions. https://ec.europa.eu/commission/presscorner/detail/en/IP_04_194 accessed February 2021.

699 Carsten Bermig, and others ‘New Developments in the Aviation Sector, Consolidation and Competition: Recent Competition Cases’, (2004), Summer, 69, Competition Policy Newsletter < https://ec.europa.eu/competition/publications/cpn/2004_2_66.pdf> accessed on 08 September 2020.

between Paris and Amsterdam could 'mix and-match' their movement decisions, for example going by plane on the outward journey and by train on a return trip. Finally, the national authorities of France and the Netherlands guaranteed the European Commission that they would give traffic rights to all airlines wanting to stop over in Paris or Amsterdam when in transit to other, non-EU nations, which guaranteed admittance to the market of air carriers from outside the EU and enhanced rivalry on long-haul flights, particularly transatlantic flights. The authorities further vowed not to manage costs on long haul flights.[700]

Ultimately, the Commission, in spite of having many questions during the introductory stage, straightforwardly conceded that it predicted that the effect of the concentration would be positive. As a result, the deal was cleared in Phase I of the investigation, subject to the mentioned commitments. During the public interview following the consolidation, Competition Commissioner, Mario Monti, underlined that: 'The outcome of this case shows that the long-awaited consolidation of the European airline sector can be done in full respect of competition rules. The merger between KLM and Air France will present air passengers with a better choice of destinations and services without having to pay a higher price on those routes where their presence is the strongest."[701]

In reality, market entry eventually took place on two routes only i.e., Amsterdam-Milan and Amsterdam-Rome.[702] Hence, overall the involved parties did not face much of new competitive pressure, which was the fundamental objective of the slots divestiture proposal. In this way, after the consolidation of Air France and KLM, the European Commission recognised that the way to deal with remedies offered by the parties in airline consolidation cases needed revising to ensure that the responsibilities bring about new market passage. This, without a doubt, demonstrates that slot divestiture may make up a sound answer for anticompetitive issues if extra responsibilities are included, for example, administrative responsibilities, frequencies freeze and fleet undertakings. However, as per Murek,[703] regardless of the administration figures before the consolidation, the concentration did not prompt significant cost reserve funds or collaboration impacts. For 2016, Air

700 Press Release, European Commission, Commission Clears Merger between Air France and KLM Subject to Conditions, (11 February 2004) <http://europa.eu/rapid/press- release_IP-04-194_en.htm> accessed on 30 October 2017.

701 Press Release IP/04/194. Brussels, 11 February 2004. https://ec.europa.eu/commission/presscorner/detail/en/IP_04_194. Accessed January 2021.

702 Franz Fichert, 'Remedies in Airline Merger Control The European Experience' (2011) 16th International Conference of Hong Kong Society for Transportation Studies delivered on 17 December 2011, available online at; < http://userpage.fu-berlin.de/~jmueller/gapprojekt/downloads/SS2012/Fichert_Remedies_GAB.pdf> accessed 22 March 2022.

703 Szymon Murek, 'Remedies in airline mergers in the European Union', (2017) available online at; <http://www.icc.qmul.ac.uk/media/icc/gar/gar2017/4.Szymon.pdf> accessed on 08 September 2020.

France/KLM had one of the most noteworthy unit costs[704] in Europe. As per CAPA,[705] Air France has not had the option to make a positive working outcome since the monetary year finished in March 2008, preceding the worldwide monetary emergency. Air France has experienced successive lengthy periods in the red, confronting billions of operational debt. Additionally, since the consolidation, Air France's working fringe has reliably been 3–6% beneath than that of KLM. Its Dutch sister organization fell into a working misfortune in only one financial year up to March 2010, but has, however, recorded a positive outcome from that point onwards.

Furthermore, Air France is positioned among the most noticeably poorest performing carriers among the Stock Exchange listed European airline groups and their principal subsidiaries.[706]Following the merger, both Air France and KLM were permitted to stay somewhat autonomous (regarding marking, hubs and so on), although pressure keeps emerging between the Dutch and the French arms of the organisation, (with potential to harm the entire venture), particularly because of solid trade unions in Air France, which are not ready to acknowledge the inescapable cost cutting and also because of assumptions regarding lack of improvement.[707] From a few perspectives, a definitive split of the organisation may be the lone answer for the rising issues between the two branches. It would be a very fascinating and very negative result of the greatest carrier consolidation in the European Union, a consolidation which should have brought about significant reserve funds and less expensive air tickets; however, according to a few trained professionals, the consolidation ought not to have been cleared.[708]

The bottom line is that not only *Air France/KLM* merger has not brought the benefits to the customers welfare that were promised by Leo van Wijk, former President and CEO of KLM and Jean-Cyril Spinetta, Chairman and former CEO of Air France[709], but also led to the continuous losses, that ultimately resulted in Air France facing a severe business upheaval and an episode of pilot's strike, which had forced the French airline to cut down almost 3,000 jobs, KLM had deferred some of its pending 787 deliveries, KLM's cargo subsidiary Martinair to retire six McDonnell-Douglas MD-11

704 cost per accessible seat kilometer.

705 Air France: Seven years of losses before Works Council clash reveals a cracked mirror (16 October 2015) https://centreforaviation.com/analysis/reports/air-france-seven-years-of-losses-before-works-council-clash-reveals-a-cracked-mirror-248600 accessed February 2021.

706 Ibid.

707 Elco Van Groningen, Andrea Rothman, 'The Dutch Half of Air France-KLM Isn't Happy with the French Half', *Bloomberg* (4 July 20160 https://skift.com/2016/07/04/the-dutch-half-of-air-france-klm-isnt-happy-with-the-french-half/ accessed on 08 September 2020.

708 Jonathan Parker, 'Air France/KLM: an assessment of the Commission's approach to consolidation in the air transport sector', (2005), European Competition Law Review, 128.

709 '… The complementary nature of the two airlines, which will each retain their brands and unique values, will ensure that the new group is more attractive for passengers, as they will gain access to an enhanced offering, and will create substantial shareholder value.' *(PDF) Mergers vs. Alliances: The Air France-KLM Story.* Available from: https://www.researchgate.net/publication/256033317_Mergers_vs_Alliances_The_Air_France-KLM_Story [accessed Nov 16 2020].

airplanes, and Air France–KLM to suffer as a company.[710]While other indicative examples will be addressed in the following sections of this Chapter, it is worth to expound on the issues of the practical solutions in order to have a greater scope of the instruments to be suggested while the cases are analysed.

According to John Milligan [711] within the air transport services sector, structural commitments such as divesture of a business have not been employed, although their use is not necessarily excluded. For instance, divestiture of a business including assets and comprising 43 overlap routes to a competitor, Flybe, was among remedies offered in *Ryanair/Aer Lingus III*[712]. Nevertheless, the Commission, did not approve the remedy package as it was unlikely to enable Flybe or other carriers to enter all the overlap routes in the short term or to restrain effectively the merged entity.[713]

This thesis argues the divestiture of slots is insufficient and an inadequate remedy that does not effectively encourage new entry. While commitments in airline consolidation cases seek to facilitate market entry or expansion of services by existing competitors, in reality market entry can be facilitated only in combination of different instruments, with the slot allocations being the supplementary measures only. This argument is supported by Michele Giannino in his analysis that slot remedies are inappropriate instruments when dealing with route dominance mergers[714] with the Commission and the merging parties should agree on other more effective commitments - behavioural remedies or structural remedies.

In some instances, where parties have high frequencies at an airport, the Commission has found that competitors tend not to operate routes to a significant extent, without a base at either end of a given route, to generate considerable cost savings through economies of scale and greater flexibility to react to changes in supply and demand on routes out of its base.[715] In a much similar fashion, *Lufthansa/Austrian*, where there were concerns on routes between Vienna and five other destinations, the Commission required the parties to make a large number of slots available at Vienna to facilitate

710 Mathieu Rosemain, (5 October 2015) https://www.bloomberg.com/news/articles/2015-10-05/air-france-plans-almost-3-000-job-cuts-after-failed-pilot-talks accessed 10 October 2016.

711 John Milligan, European Union Competition Law in the Airline Industry (Kluwer Law International 2017).

712 Law Insider. (n.d.) 'Definition of Air Traffic Rights' https://www.lawinsider.com/dictionary/air-traffic-rights accessed 12 December 2020.

713 Ryanair/Aer Lingus III; Aegean/Olympic I.

714 M Giannino,. 'European Commission Appraisal of Airline Mergers The Rise of a New Generation of Slot Remedies', (2012), Issue 52, Airlines Magazine available online at; < https://aerlinesmagazine.files.wordpress.com/2012/03/52_giannino_eu_slot_remedies.pdf> accessed on February 2021.

715 Ryanair/Aer Lingus I. paras 381–382, 939; Aegean/Olympic.

the establishment of a base by a new entrant and/or the enlargement of the bases of competitors already present at Vienna airport.[716]

However, the problem with that view is that economies of scale is based not only on demand behaviour, but also ascribed to firms' cost structures.[717] Some literature suggests that various collective measures of size, without sufficient rectification for network or technological characteristics, do not confer, per se, any measurable cost advantages.[718] Change in demand is also a very important factor in understanding the profitable business model. Changes in demand and costs are also following a trend associated with changes in network structure with less emphasis on hub airports and a greater number of direct flights.[719]'

Therefore, the fact that slots are available does not make the economies of scale work unless there are more substantial commitments. Some authors even suggest that although economies of scale may contribute to cost reductions, turnover growth does not generally manifest itself in this manner. Empirical evidence has shown that economies of scale only help those airlines which do not lose their 'identity' when demand increases. That is, airlines which do not lose the control of the service delivery. In fact, economies of scale are of little importance in accounting for increasing returns, since these return rates are also related to other factors such as external economies or industrial differentiation. [720]

So, although the economies of scale may be relevant in terms of the expansion strategies of airlines[721] it is not the most efficient way to address anticompetitive concerns attributed to the markets and merging entities to preserve the level playing field. Among other essential considerations, to enter a new marker (as a result of the slots allocation) would require a lengthy and thorough modelling and business planning to be conducted prior. It would be wrong to expect that the market players will be adjusting their business strategies as soon as the news on the proposed M&A between the competitors have spread.

716 Lufthansa/Austrian Phase II clearance, paras 329, 397.

717 'Economies of Density, Network Size and Spatial Scope in the European Airline Industry' (2006) https://www.researchgate.net/publication/5022530_Economies_of_Density_Network_Size_and_Spatial_Scope_in_the_European_Airline_Industry?enrichId=rgreq-406d769487245291aba583987b6c5a00-XXX&enrichSource=Y292ZXJQYWdlOzUwMjI1MzA7QVM6OTk5MDc5NzczNTExODlAMTQwMDgzMTMyNjk3NA%3D%3D&el=1_x_3&_esc=publicationCoverPdf

718 Andreas Antoniou, 'Economies of scale in the airline industry: the evidence revisited' (1991) 27 The Logistics and Transportation Review. https://go.gale.com/ps/anonymous?id=GALE%7CA11076399&sid=googleScholar&v=2.1&it=r&linkaccess=abs&issn=00474991&p=AONE&sw=w accessed 22 November 2020.

719Steven Berry, Panle Jia, 'Tracing the woes: An empirical analysis of the airline industry' (2010) 2 American Economic Journal: Microeconomics available online at; <https://economics.mit.edu/files/7763/> accessed 01 November 2020.

720 RH Grieve, 'Time to Ditch AD-AS?' (2010) 42 Review of Radical Political Economics 315, 320.

721 Manuel Romero-Hernandez and Hugo Salgado, 'Economies of Scale and Spatial Scope European Airline Industry' (ERSA conference papers ersa06p905, European Regional Science Association, 2006).

Hence, the entire concept of allocating the slots is wrong, because other airlines might have no resources and capacities in a short or mid-term to enter that specific route/ submarket in order to achieve, as suggested, the economies of scale, unless more effective remedies alike the regulatory associated restrictions apply.

IV. Mergers

1. Overview

In line with the Commission's Merger Remedies Notice, over 80 percent of conditional merger clearances in either Phase I or in Phase II involve a structural remedy.[722] Conversely, only a limited number of mergers have been cleared subject to behavioural remedies. In this regard it is worth recalling that the small share of merger decisions including behavioural remedies includes decisions in which behavioural remedies were accepted as part of a remedy package that also included other types of remedies. Pursuant to European competition law as far as mergers are concerned, structural remedies are, as a rule, preferable[723] as they are generally more clearly defined and/or identifiable and they are easier to enforce.[724]

The key factor is whether the proposed remedies are capable of tackling the dynamics of the aviation market. For instance, the effectiveness of behavioural remedies to address competition problems in a merger review, especially those remedies that involve some form of access to infrastructure, have proven at times to be especially difficult for the Commission to monitor. That task is rendered somewhat easier for the Commission where the activities concerned are already subject to a regulatory regime which mandates access. This gives the Commission a benchmark in terms of the legal standard that needs to be satisfied.[725]

In *American Airlines*,[726] Commission has attempted to use wider interpretation and relied on the Airport Slots Regulation to provide the basis of interpretation of the scope of an access remedy involving access to airport slots, rather than merely the modalities of access. In this way, any ambiguity

722 European Commission's notice on remedies acceptable under Council Regulation (EEC) No 4064/89, and under Commission Regulation (EC) No 447/98, OJ 2001/C 68/03, para. 9.

723 Case T-102/96 – *Gencor v Commission* [1999] ECR II-753, para. 319.

724 Report of the ECA Air Traffic Working Group. Mergers and alliances in civil aviation [https://www.konkurrensverket.se/globalassets/publikationer/ovrigt/mergers-and-alliances-in-civil-aviation.pdf] accessed on May 2021.

725 https://www.gibsondunn.com/wp-content/uploads/2020/12/european-courts-rule-on-range-of-competition-issues-in-pre-christmas-case-load-clearance.pdf] acccssed on May 2021

726 Case T-430/18 *American Airlines v. Commission*, [2020] EU:T:2020:603.

in the meaning of the behavioural remedies that formed part of the Commission's conditional clearance Decision involving the American Airlines' merger could be resolved by reference to the structure and policy purpose behind the Regulation. In September 2015, American Airlines claimed that Delta Air Lines had failed to operate the relevant slots at London Heathrow and Philadelphia airports, which it had obtained in the context of commitments given by American Airlines and US Airways in order for their merger to be approved. American Airlines has failed in its appeal.[727]

On 30 April 2018, the Commission concluding that the Delta Air Lines had made an appropriate use of the slots, despite the fact that the commitments did not include a definition of such term. While the Commission concluded that the term 'appropriate use' should be interpreted as meaning 'the absence of misuse', and not as 'use in accordance with the bid', as had been argued by American Airlines and analysed the significance of the commitments by interpreting their scope in accordance with the meaning attributed under the Airport Slots Regulation attributing higher value to the policy direction of a regulatory instrument in the sector rather than the express words agreed under the commitments, it is arguably a case which adds little to the goal of legal certainty. Overall, it could be said that the initial remedies have lacked accuracy with regard to the affected market.

V. Practical analysis and critique of the Commission's approach based on case studies

This section will examine most indicative transactions in the airline industry with further suggestions with regard to the most practical and effective remedies based on the options provided earlier. it will focus on three key players on the European market – IAG, Lufthansa and KLM (part of Air France[728]) with additional illustration of the approach taken by the Commission with the regard to the non – European investments and entrances as part of the *Etihad/Alitalia*[729] case. In summary, it will be evident that the European Market at lease in a passenger segment is moving towards the oligopoly model with a few exemptions attributed to the LCCs.[730]

727 Ibid; The grandfathering rights are defined as "*The Prospective Entrant will be deemed to have grandfathering rights for the Slots once appropriate use of the Slots has been made on the Airport Pair for the Utilization period. In this regard, once the Utilization period has elapsed, the Prospective Entrant will be entitled to use the Slots obtained on the basis of these Commitments on any city pair ('Grandfathering')*".

728 France–KLM is the result of the merger in 2004. Case No COMP/M.3280 - AIR FRANCE / KLM.

729 Case No COMP/M.7333 Alitalia/Etihad [2014], OJ C31/01.

730 Although it could argued that the LCC's market is also relatively limited. However, it is not the theoretical argument of this thesis.

1. IAG / Aer Lingus[731]

In 2015, one of the most notable transactions was cleared by the European Commission under the EU Merger Regulation that has raised various significant concerns. International Consolidated Airlines Group (IAG),[732] holding organisation of British Airways, Iberia and Vueling acquired Irish air carrier Aer Lingus[733] with Aer Lingus becoming eventually part of IAG. The deal was notified to the Commission on 27 May 2015. Shortly after, on 14 July 2015 the contingent clearance was given contingent upon commitment offered by the parties in order to address the Commission's concerns.

The Commission's enquiry found that the arrangement, as was at first informed, would have prompted a soaring in market shares of the overall industry on the Dublin–London, Belfast–London and Dublin–Chicago rotations. The merged entities would have experienced inadequate competitive pressure from the competitors which could eventually prompt increase in fares. The Commission additionally assessed if there was a danger that IAG would stop passengers flying on Aer Lingus' short-haul flights, from Dublin, Cork, Shannon, Knock and Belfast, from connecting with long-haul flights operated by competing air carriers from other European air airports, including Heathrow, Gatwick, Manchester, Dublin and Amsterdam. This is in line with the approach suggested by this thesis that the network shall be assessed wider than a route/routes overlapping between the merging airless. However, in this particular case the major concern has been identified pertaining not to the market definition but the effectiveness of remedies agreed by the Commission.

Based on the Commission assessment, IAG submitted commitments to deliver five daily slot pairs at London Gatwick that could be utilised on the particular routes of concern, specifically Dublin–London and Belfast–London. The accessibility to these slots, together with the incentives such as the procurement of grandfathering rights after a certain timeframe, meant to encourage the new entries of contending carriers.

IAG has also agreed to go into accords with competing carriers operating long-haul flights out of London Heathrow, London Gatwick, Manchester, Amsterdam, Shannon and Dublin in order to ensure that Aer Lingus continues to provide the capacity for the connecting flights with these airlines which would in theory guarantee a choice to the passengers when it comes to the connecting flights at the named airports.

731 Case No M.7541 -*IAG / Aer Lingus* (2015) 32015M7541.

732 Ibid.

733 Ibid.

The main purpose of such concessions from the Commission perspective was an attempt to guarantee that travellers will keep on having a choice of airlines at competitive fares even after IAG's takeover of Aer Lingus.[734] Margrethe Vestager, the European Commissioner accountable for the competition strategy that time said that measures were focused on ensuring that air passengers will continue to have a choice of airlines at competitive prices as well as protecting passengers on connecting flights between Ireland and the rest of the world.[735] Thus, the decision was dependent upon the following associated commitments, to address the Commission's concerns:

1. In order to encourage the entry of competing airlines on routes between London and both Dublin and Belfast, the release of five daily slot sets at London-Gatwick airport was requested; and
2. Aer Lingus was required to continue to operate the connecting flights for the long-haul flights of competing carriers out of London-Heathrow, London-Gatwick, Manchester, Amsterdam, Shannon and Dublin.

On the one hand, the remedies offered by the parties in order to clear the deal highlights the Commission's tendency to accept more extensive scope of commitments, not just of fundamentally structural nature.[736] However, looking into the business strategy of IAG, commitments do not appear to have been obstacles to their business and IAG has in fact benefitted from the failure of rival airlines, rather than having stimulated the competition environment. For instance, in 2018 the London Gatwick–Dublin route has been covered by three operators only i.e., Ryanair, Aer Lingus, and British Airways. Additionally, IAG has launched a new project – level, low-cost, long-haul airline. IAG also has Iberia Express operating from Gatwick, among other airports. Also, British Airways' parent company, IAG, has recently bought Gatwick slots from collapsed Monarch[737]. This transaction has allowed the airlines of IAG's group — principally British Airways — to launch 'new destinations and extra frequencies' from Britain's second airport and expand its occurrence. The restrictive measures do not seem to have served as prevention instruments, considering the full scope of the services within the network of British Airways and its affiliates. While expansion might seem benefit consumers, IAG has increased

734 With 5,000,000 passengers travelled every year from Dublin and Belfast to London it ought to give several competitive options.

735 IP/15/5371, Press release 'Mergers: Commission approves acquisition of Aer Lingus by IAG, subject to conditions' European Commission (14 July 2015).

736 Szymon Murek, 'Remedies in airline mergers in the European Union', (2017) available online at < http://www.icc.qmul.ac.uk/media/icc/gar/gar2017/4.Szymon.pdf> accessed on 08 September 2020.

737 Peggy Hollinger and Tanya Powley, 'British Airways owner IAG buys Gatwick slots from collapsed Monarch' *Financial Times* (London 27 November, 2017) <https://www.ft.com/content/11eac09a-d3b4-11e7-8c9a-d9c0a5c8d5c9> accessed 15 March 2018

its presence which naturally led to further obstacles for the rival airlines to make its presence on the same routes. Based on the limited frequencies, which is inherent in the airlines networks, such results cause rather detriment to the market in general. This significant presence by British Airways led to the dependency and reliability of the market on the operational and corporate elements of the airline's activities. Indicative example is a Strike in September 2019 that has caused chaos for an estimated 280,000 passengers who were due to fly with the airline which has also rocketed up fares to destinations around the world by up to 2,100%, leaving the UK isolated amid sold-out routes and stratospherically priced flights. While air ticket prices are typically fluid and rises during periods of heavy demand are not uncommon, the level of increase seen during this strike was particularly extreme.[738]

Of course, it does not mean that the mergers should have been prohibited at all. This thesis proposes, however, that more practical remedies should be applied by the Commission, including a frequencies reduction similar to the remedies applied in *KLM/Alitalia*,[739] where parties were mandated to reduce their frequencies, when a new entrant initiated on a given route, for two years after its entry, and to freeze the frequencies at this level for four consecutive IATA seasons.[740] Surprisingly, according to John Milligan[741], such commitments have not tended to appear in later cases. What was the adequate and practical initiative has unfortunately not been effectively used by the Commission further down the road.

2. Lufthansa/certain Air Berlin assets[742]

Another example indicates a trend towards a more thorough scrutiny by the European Commission. In October 2017, Lufthansa airlines reached an agreement to acquire to buy half of Air Berlin's assets for approximately Euro 210 m[743]. The operations included Niki Luftfahrt GmbH ('Niki'), Air Berlin's Austrian holiday airline, its regional carrier, LGW, and 20 aircraft. It has also proposed to divest some landing rights to mitigate the Commission's concerns. Under the proposal, Lufthansa would occupy all slots at congested airports in Munich and Berlin Tegel, peak-time slots in Dusseldorf, and the rights

738 Julia Buckley, 'British Airways Sees Fares Rise by up to 2,100%' CNN, 9 September 2019, available online at: <https://edition.cnn.com/travel/article/british-airways-strike-fare-hikes/index.html> accessed 22 March 2022.

739 Case AT.39964 *Air-France/KLM/Aliatalia/Delta* Commission Decision of 12 May 2015.

740 Ibid.

741 European Union Competition Law in the Airline Industry (2017 Wolter Kluwer).

742 Case M.8633. https://ec.europa.eu/competition/mergers/cases/decisions/m8633_2370_3.pdf accessed June 2021.

743 Rochelle Toplensky, 'Lufthansa's Air Berlin deal faces further antitrust scrutiny' *Financial Times* (London 07 December 2017) <https://www.ft.com/content/021d053c-db3a-11e7-a039-c64b1c09b482> accessed 15 March 2018.

for many popular holiday destinations, while also agreeing to amend its sale and purchase agreement with dropping its proposed transaction of acquisition of Niki and offering to reduce slots at Dusseldorf airport for the summer season to the number of slots used by two aircraft[744]. Ultimately, the Commission decision only concerned acquisition of LGW. The decision was made on 21st December 2017 and approved the deal[745]. In reality, however, the situation developed into the different scenario. Another airline, LaudaMotion was then formed as a largescale carrier after Niki Lauda successfully bid for the assets of his namesake carrier in December 2017.

The following year, however, it was also reported that Lufthansa failed to adhere to the terms of the ruling which in its essence allowed LaudaMotion to resume operations.[746] Ryanair was actively advocating for such failure. In its statement, Ryanair claimed that Lufthansa attempted to undermine LaudaMotion's operations by removing nine aircraft it was obliged to lease out as part of the Commission's decision.[747]

Ryanair also claimed a failure by Lufthansa to deliver two of the 11 aircraft being part of the Commission's decision. Furthermore, some of the aircraft that Lufthansa had undertaken to deliver had been delayed until after the Summer 2018 season with Laudamotion losing the benefit of the aircraft during the peak summer months. As a result, Laudamotion has only been able to operate a fleet of nine own A320 aircraft during a summer season when the aircraft are required at most with other ten B737-800s wet-leased from Ryanair. As a result, Laudamotion's ability to take up slots and offer summer-time services was significantly reduced. Lufthansa, on the other hand, used the "needed aircraft" for its own low-cost arm Eurowings.[748]

Ryanair appealed to the competition authorities to "halt Lufthansa's repeated abuses of its dominant position, which are designed to harm competition and consumers"[749]. It was suggested among other things that the lease costs of the aircraft it has leased to Laudamotion are substantially higher than market rates for Airbus A320's of this age, while Laudamotion has honoured both its aircraft lease payments and maintenance reserves to Lufthansa, Lufthansa's claims of "repeated failure" to pay is

744 Press release 21 December 2017 Mergers: Commission approves acquisition by Lufthansa of Air Berlin subsidiary LGW, subject to conditions Brussels. https://ec.europa.eu/commission/presscorner/detail/en/IP_17_5402.

745 Rochelle Toplensky, 'Brussels approves Lufthansa-Air Berlin merger' *Financial Times* (London 21 December 2017) <https://www.ft.com/content/e453d592-e662-11e7-97e2-916d4fbac0da> accessed 13 March 2018.

746 Ch Aviation, 'Ryanair, Lufthansa in Tussle over Laudamotion' available online at; <https://www.ch-aviation.com/portal/news/68957-ryanair-lufthansa-in-tussle-over-laudamotion> accessed 03 February 2021.

747 Ibid.

748 https://www.travelweekly.co.uk/articles/307718/lufthansa-hits-back-over-ryanair-laudamotion-claims accessed 03 February 2021.

749 https://worldairlinenews.com/category/laudamotion/page/2/

false. Finally, it was suggested that Lufthansa withdrew some business from Laudamotion (which Lufthansa had originally agreed) and then refusing to pay over €1.5m of lease payments properly due to Laudamotion for flying carried out on behalf of Lufthansa in March, April and May. Even though Lufthansa owed Laudamotion over €1.5m in overdue lease payments Lufthansa has attempted to terminate all 9 aircraft leases on allegedly unsubstantiated legal grounds.

Applying the suggested approach by this thesis, the European Commission should address the operational concerns by the practical measures such as the fleet freeze to prevent allocation of the aircraft between affiliated (after the merger transaction) airlines. That would allow to maintain the fleet level and encourage new leadership of the target airline to improve the operational performance. The same remedy should apply to *Olympic Aegean Airlines* [750] case, which will be discussed further. Interestingly, IAG was also bidding for Niki in late 2017 – early 2018, however, without success[751].

3. Lufthansa/SN Airholding[752]

The securing of stakes by German public carrier Lufthansa, in SN Airholding, the holding organisation of Brussels Airlines, presents another illustration of a significant merger transaction in the European Union aviation market and following implementation of the non-effective remedies. The Commission was notified on the arrangement on 26th November 2008. On 22nd June 2009 the transaction was cleared, subject to number of commitments. During the enquiry, the European Commission recognised that in the initially proposed structure, the arrangement would prompt a significant obstacle to healthy competition on a few passenger routes inside the European Union, predominantly on the routes: Brussels-Hamburg, Brussels-Munich, Brussels-Frankfurt and Brussels-Zurich. As a result of the likelihood of anticompetitive issues, Lufthansa presented a comprehensive package of remedies allegedly directed at lessening detrimental effect and encouraging opportunities for other market players on the affected routes. Initially, the German carrier offered to slots' divesture in every one of the four routes, which would permit in theory other airlines to operate the flights on the routes in question. It was suggested that the proposed divestiture shall address the relevant concerns and is the adequate and effective instrument. New participants would also acquire the 'grandfather rights' to those slots in the event that those participants had operated on the route previously for a specific time. Additional remedies, intended to enhance the fundamental element of the commitments offered, were

750 *Olympic Aegean Airlines* [2011] Case COMP/M.5830, C174/08; *Aegean Airlines/Olympic II* [2013] Case No COMP/M.6796

751 https://www.flightglobal.com/iag-disappointed-after-losing-niki-to-rival-bidder/126799.article

752 Case COMP/M.5335 Lufthansa / SN Airholding [2009], OJ C295/11.

code-share arrangements and Lufthansa's frequent flyer programme. The European Commission accepted the package offered by the entities concerned and cleared the consolidation in Phase II, subject to said conditions.

Nonetheless, despite the Commission's recognition of all alleged benefits targeting the issue of slot congestion and enhancing the attractiveness for the new entries, the divestiture did not create an adequate level of competitive pressure on the merged carrier.[753] According to the available data[754] even after a few years the slots were not used by the new entrants. Giannino has made a presumption that the slots could be used later on in the event of the merging carriers deciding to increase fares. However, this is an unlikely scenario, especially for the carriers with the intention to control or at least preserve its position on the relevant submarket. Additional facts that shall be taken into consideration is further development of that merger. In accordance with the acquisition agreement between Lufthansa and SN Airholding, Lufthansa initially acquired 45 % of SN Airholding's shares, with call options on the remaining shares which can be exercised as of the first quarter of 2011.[755] Subsequently, as Lufthansa has loaned 45 million euros to Brussels Airlines over the course of several years, the German carrier was able to acquire the rest for as little as 2.6 million euros more in order to expand the business of its low-cost airline Eurowings which was successfully accomplished. Remaining 55% were acquired with effect from 9 January 2017. [756] Ultimately, it appeared to be a "win-win" situation for Lufthansa as it has been an effective strategy to acquire the target airline in a mid-term prospect.

What should be done by the Commission is application of the complex remedies and commitments including commitments related to further increase in shares in future. Essentially, remedies could be linked to the level of control as control over the company might also dictate the strategy regarding fleet allocation and network planning. General idea is not to discourage the airlines to merger but to create a mechanism that would allow to balance the increase over the shareholding over the company and potential detriment it might cause to the market, competitors and consumers. Such package could be supported by the commitments associated with the fleet divesture and special prorate agreements, for instance.

753 M Giannino. 'European Commission Appraisal of Airline Mergers The Rise of a New Generation of Slot Remedies', (2012), Issue 52, Airlines Magazine available online at; < https://aerlinesmagazine.files.wordpress.com/2012/03/52_giannino_eu_slot_remedies.pdf> accessed on 10 September 2020.

754 Ibid.

755 Case No COMP/M.5335- LUFTHANSA/ SN AIRHOLDING

756 Deutsche Lufthansa AG acquired the remaining 55 per cent of the shares in SN Airholding SA/NV (Brussels, Belgium) with effect from 9 January 2017 and became therefore the sole shareholder of the Brussels Airlines group. Lufthansa Group. Annual Report. 2017. https://investor-relations.lufthansagroup.com/fileadmin/downloads/en/financial-reports/annual-reports/LH-AR-2017-e.pdf accessed Februtary 2021.

4. Lufthansa/Austrian Airlines[757]

Another notable European merger transaction executed by Lufthansa as part of its business extension was acquisition of Austrian Airlines. The two airlines had already collaborated in Star Alliance[758], one of the largest international airline alliances. The consolidation was cleared on 28th August 2009, subject to the undertakings given by Lufthansa including the divestiture of slots, with the option of grandfathering rights.

During the assessment of the merger, the European Commission identified concerns related to substantial obstacles to effective competition and launched a Phase II Investigation. Further down the line, the Commission limited the scope of the risks associated with the concentration to the rotations between Vienna-Frankfurt, Vienna-Munich, Vienna-Stuttgart, Vienna-Cologne and Vienna-Brussels, where consumers would probably face reduced choice and higher prices. During a Phase II in-depth analysis, Lufthansa offered a series of undertakings, which were alike the one previously proposed in *Lufthansa/SN Airholding*.[759] As it was mentioned above such commitments contained the divestiture of slots and some extra measures, including the participation by new entrants in Lufthansa's frequent flyer programme.[760] Ultimately, the Commission concurred with the commitments offered and concluded that the consolidation would not prompt huge hindrances to the level playing field subject to the compliance with the concessions made. The Commission's decision was challenged by Niki Lufthart, one of the principal competitors of the Austrian Airlines in Austria before the General Court. The main argument was based on the fact that remedies offered by Lufthansa were not proportionate to the size of anticompetitive effect of the consolidation[761] which is a frequent practice outcome of the majority of the remedies approved by the Commission.

The European Commission's concerns were focused around the lack of competition on routes between Vienna, Austrian Airlines' hub, with Lufthansa gaining a dominant position on routes into Austria from Germany and Switzerland.[762] Empirical studies clearly demonstrate that while the intent of the slot release was to preserve competition on overlapping routes served at that time by Austrian and Lufthansa, there have been no independent competitors in any of these markets, indicating that the

757 Case COMP/M. 5440 Lufthansa/Austrian Airlines [2009], OJ C16/11.

758 Star Alliance has 26 member airlines including Air Canada, Lufthansa, Austrian Airlines, Brussels Airlines, Scandinavian Airlines, Thai Airways and United Airlines.

759 Case COMP/M.5335 Lufthansa / SN Airholding [2009], OJ C295/11.

760 IP/09/1255. Brussels, 28 th August 2009. https://ec.europa.eu/commission/presscorner/detail/en/IP_09_1255

761 Case T-162/10 Niki Luftfahrt GmbH v Commission, [2015] C 213/44.

762 Nikki Tait, James Wilson 'Lufthansa makes further Austrian concessions.'. July 2009. Financial Times. https://www.ft.com/content/1f677a6a-7b52-11de-9772-00144feabdc0 accessed on Feburary 2021.

remedies designed to address competition issues on these routes were unsuccessful. What makes it worse is the fact that the frequency in the majority of the markets was also declined.[763] Ultimately, Lufthansa/Austrian have strengthened the size and control of their home market, and reduced the number of competing alternatives available to consumers as also supported by the model developed by Bilotkach and Huschelrath.[764] This is also supported by foreclosure phenomena. The model makes it clear that competition authorities should consider the competitive impact in a network context, and in much greater detail. Instead, the Commission should apply more practical remedies such as fleet divesture to address the identified concerns and most importantly to tackle them. In this case it would mean to create the operational opportunities for the competitors by allowing them to lease/sub-lease aircraft on favourable terms for certain period in order to create or enhance level playing field. Alternative would be to limit frequencies of the flights of Lufthansa and Austrian while also fix the fares to the reasonable market prices' range in order to create customers' demand for the independent airlines. Another issue relevant to the transaction which raised criticism was state aid of EUR 500 million by the Austrian government.[765]

5. *KLM/Martinair*[766]

The consolidation of KLM and Martinair carriers serves as an illustration of the reserved methodology of the European Commission to remedies, if they do not address anticompetitive concerns. The two airlines were dynamic on the market, particularly of moving passengers and cargo from Amsterdam to various destinations around the world; Martinair was especially centred around intercontinental routes. When the proposed transaction was communicated to the Commission on 17th July 2008, KLM had already taken control over the half of a share capital of Martinair and was endeavouring to purchase the remainder of the organisation in order to become a sole shareholder.

During the initial phase of the investigation, the Commission reasoned that the deal raised questions regarding its compatibility with the internal market and chose to open a top to bottom examination. Competition concerns were recognised principally corresponding to passenger routes of Amsterdam-Aruba and Amsterdam-Curacao. Following the common practice, in order to address the competition

763 Exhibit 6: Case Study of LH-OS Slot Divestitures. 11 October 2017. https://eutraveltech.eu/wp-content/uploads/2019/11/Airline-consolidation-limits-competition-and-reduces-consumer-choice-study-confirms.pdf accessed on February 2021.

764 V Bilotkach, K Hüschelrath,'Airline alliances, antitrust immunity and market foreclosure' (2012) ZEW Discussion Papers, No. 10-083 [rev.], Zentrum für Europäische Wirtschaftsforschung (ZEW), Mannheim

765 Nikki Tait, James Wilson 'Lufthansa makes further Austrian concessions.' July 2009. Financial Times. https://www.ft.com/content/1f677a6a-7b52-11de-9772-00144feabdc0 accessed on Feburary 2021.

766 Case COMP/M.5141 KLM/Martinair [2008], OJ C51/4.

concerns, a commitment proposition was offered by the parties. The submitted remedies were unique, as they did not contain a common arrangement of responsibilities (for example slots divestiture), but instead zeroed in on benchmarking the cost of the ticket in economy class on affected routes to the value of the ticket on practically identical routes. The Commission viewed this as excessively convoluted and hard to set up and investigate in the future. Accordingly, the proposal was rejected by the Commission as it did not remove the original competition concerns.

According to Murek,[767] in spite of the refusal of the proposed commitments, the European Commission chose to clear the merger in Phase II, for the most part due to the survey conducted in the airport, which showed that most passengers on the affected routes would prefer to switch their destination, or not travel at all, if confronted with a cost increment. The review indicated that the passengers were happy to switch in case of increase of fares. The merged entity would have no motivating force to altogether raise the costs on the affected routes, and in this manner as indicated by the Commission there was no danger of harm to the consumers. Additionally, the Commission came to the conclusion that the chance of the new market entry were high, with no significant risk of KLM being motivated to increase costs more as a result of that.[768]

As indicated by Murek,[769] *KLM/Martinair* is an illustration of a case where the narrow and inflexible methodology applied by the European Commission to mergers in the aviation sector in the EU is clearly evident. the Commission concurred that proposed transaction on its original terms would not obstruct competition. Hence, the consolidation was cleared without the additional concessions from the parties involved. Overall, it has served as further proof that of the Commission's approach seemed, by all accounts, to be uncertain and even conflicting.

767 Szymon Murek, 'Remedies in airline mergers in the European Union', (2017) available online at; <http://www.icc.qmul.ac.uk/media/icc/gar/gar2017/4.Szymon.pdf> accessed on 08 September 2020.

768 Press Release, European Commission, Commission clears proposed take-over of Martinair by KLM (17 December 2008) <http://europa.eu/rapid/press-release_IP-08-1995_en.htm> accessed on 11 September 2020.

769 Szymon Murek, 'Remedies in airline mergers in the European Union', (2017) available online at; <http://www.icc.qmul.ac.uk/media/icc/gar/gar2017/4.Szymon.pdf> accessed on 08 September 2020.

6. Olympic/Aegean[770]

On Oct. 23, 2013, Olympic Air became a subsidiary of Aegean Airlines following a €72 million ($82 million) deal that was approved by the European Commission.[771] While *Aegean/Olympic II*[772] case has shown that the standard that the parties must fulfil for a successful FFD is very high, it also illustrated an assumption that Falling Firm Defence might be used as a tool for a takeover. Indeed, merger of the two largest airlines in Greece prompted a heated discussion and huge public debate. Originally, the consolidation was communicated for clearance on 24th June 2010. After a month, a Phase II investigation was started, as the Commission perceived that the merger raised significant anticompetitive issues that might affect the level playing field. After a protracted examination, with two packages of remedies offered by the parties, on 26th January 2011 the European Commission chose to impede the proposed deal.

Primary concerns of the authorities were regarding the nine domestic routes, where two airlines before the consolidation held around 90% of the share of the overall industry; in this manner, the merged entity would have achieved a quasi-monopoly in light of the concentration. Parties involved failed to persuade the Commission that the market was wrongly defined with other methods for transport, such as ferries, ought to have been also considered. Two bundles of remedies offered by the parties contained a broad slot divestiture on affected routes. While the investigation performed by the Commission indicated that the accessibility of the slots in Greek airports, including Athens, was sufficient and other participants would not face issues with getting landing slots, the major issue was the absence of the competitors to the merged entity. Regardless of whether the organisations had given landing slots, there would have been no airline to take them over and the circumstances were unlikely to change. Consequently, the Commission presumed that the proposed transaction would hinder viable competition on the internal market completely.[773]

Following the disallowance decision from the Commission, parties continued attempts to receive an ultimate approval is not uncommon. However, acquiring, a clearance decision for a similar transaction within three years is relatively rare case. The proposed consolidation of Olympic and Aegean was

770 *Olympic Aegean Airlines* [2011] Case COMP/M.5830, C174/08; *Aegean Airlines/Olympic II* [2013] Case No COMP/M.6796 C124/01.

771 https://www.theguardian.com/world/2013/nov/01/olympic-airlines-subsidiary-aegean-airlines-72-million-euro-deal accessed on July 2021.

772 *Olympic Aegean Airlines* [2011] Case COMP/M.5830, C174/08; *Aegean Airlines/Olympic II* [2013] Case No COMP/M.6796.

773 European Commission Press Release, Mergers: European Commission blocks proposed merger between Aegean Airlines and Olympic Air (26 January 2011), <http://europa.eu/rapid/press-release_IP-11-68_en.htm> accessed on 30 October 2020.

communicated on 28th February 2013. The European Commission in its assessment arrived at a similar resolution to those two years previously and commenced a Phase II investigation in April 2013, on account of the genuine anticompetitive concerns. This time, the merging parties did not focus on how the market would not be influenced by the arrangement, but rather guaranteed that Olympic, in the light of the progressing financial emergency in Greece, was a weak firm and would therefore leave the market soon regardless.

Thus Aegean, as a consequence, would become a predominant firm on the influenced routes in any case. The Commission's exhaustive investigation established that Olympic was unlikely to become profitable.[774] Additionally, there was no other entity ready to acquire Olympic other than Aegean. However, two airlines dominated around 90% of the domestic flights in Greece, with Aegean and Olympic having around 52%, and 38% respectively and the following greatest contender being Astra Airlines, with around 3%.[775] Thus the consolidation of the two leading Greek carriers established an accepted two to one merger, the most tricky from the competition law perspective, as it almost annihilated any current competitive pressure.[776]The consolidation of Aegean and Olympic right up till this day remains the solitary case in aviation sector, where the European Commission has acknowledged the failing firm defence. Olympic was undoubtedly almost bankrupt at the time of the concentration; the Commission's decision thus appears appropriate, particularly with the presence of another strong entrant to the Greek domestic market, Ryanair, which chose to open two operational bases in Athens and Thessaloniki in 2014 and expanded its seat limit by half.[777]

Notwithstanding the consolidation of the two largest carriers in 2013 Competition for the domestic flights in Greece, stayed at a significant level (mostly as a result of a few market entries).[778] While Murek[779] argues that this demonstrates that failing firm defence can be in fact an effective instrument if implemented appropriately, it could be also argued that the failing firm defence was used as a justification for another attempt for the fleet's extension of Aegean based on the fact that as a result of

774 Szymon Murek, 'Remedies in airline mergers in the European Union', (2017) available online at; <http://www.icc.qmul.ac.uk/media/icc/gar/gar2017/4.Szymon.pdf> accessed on 08 September 2020.

775 Centre for Aviation (CAPA), 'Aegean Airlines' acquisition of Olympic: approved by European Commission, but questions remain(2013) <http://centreforaviation.com/analysis/aegean-airlines-acquisition-of-olympic-approved-byeuropean- commission-but-questions-remain-133583> accessed on 30 October 2020.

776 Press Release, European Commission, Mergers: Commission approves acquisition of Greek airline Olympic Air by Aegean Airlines, (9 October 2013) <http://europa.eu/rapid/press-release_IP-13-927_en.htm> accessed on 30 October 2020.

777 Centre for Aviation (CAPA), 'Ryanair's growth in Greece threatens Aegean's turnaround only months after Olympic acquisition (2014) <http://centreforaviation.com/analysis/ryanairs-growth-in-greece-threatens-aegeansturnaround- only-months-after-olympic-acquisition-149078> accessed on 30 October 2020.

778 Alexandra Kassimi, 'Greek air market proves very attractive to foreign carriers', *Kathmerini* (16 May 2016) https://www.ekathimerini.com/208704/article/ekathimerini/business/greek-air-market-proves-very-attractive-to-foreign-carriers> accessed on 30 October 2020.

779 ibid.

the merger, the airline inherited Olympic's fleet - one A319, four Dash 8-100s, and ten DHC-400s.[780] It has allowed Aegean to access to and consolidate such assets within its fleet which would not be available to Aegean if it wished to acquire those on a market under the normal commercial conditions.

The bottom line is that failing firm defence was used as a justification for Aegean's fleet extension with the Olympic Air livery continued to "proudly fly over Greek skies, all Olympic Air aircraft have a decal noting the aircraft's parent company."[781]

7. Etihad/Alitalia[782]

For quite a long time, non-EU airlines did not invest within the European Union, mostly on account of the European rules on the ownership and control[783] which have focused on securing that contribution of airlines was only permitted by foreign entities up to a level, preventing unequivocal impact over a carrier. However, recently some provisional endeavours to gain resources in Europe were made by Etihad, perhaps the biggest carrier in the Gulf region. From the beginning, Etihad bought a 29% stake in Air Berlin[784] and proceeded with its extension into Europe by obtaining a 49% stake in Jat Airways which was subsequently rebranded to Air Serbia.[785] The influence of Etihad over strategic decisions of Air Serbia, mostly owned by the Serbian government, caused some level of contention and even urged the Commission to open an investigation into Air Serbia's proprietorship structure in 2014.[786] Following a two-year examination, the European Commission has acknowledged that Air Serbia was operating within European standards on foreign ownership and that the Serbian government had the influence over the essential business conduct of the organisation.[787] This case plainly shows the intentions of Etihad towards its business development in Europe, which undoubtedly will develop increasing strength.[788]

780 PlaneSpotters, 'Olympic Air Fleet Details and History' available online at; <https://www.planespotters.net/airline/Olympic-Air> accessed on July 2021.

781 Airline Geeks, 'Conversation with the CEO: An In-Depth Look at Aegean Airlines' available online at; < https://airlinegeeks.com/2019/03/19/32109/> accessed 27 April 2022.

782 Case No COMP/M.7333 *Alitalia/Etihad* [2014] OJ C31/01.

783 Regulation (EC) No 1008/2008 of the European Parliament and of the Council of 24 September 2008 on common rules for the operation of air services in the Community (recast) OJ L293.

784 Reals, K. 'Etihad acquires 29% stake in Air Berlin', Flight Global (19 December 2011) <www.flightglobal.com/news/articles/etihad-acquires-29-stake-in-air-berlin-366143/>, accessed on 07 October 2020.

785 Haider, H. 'Etihad Airways acquires 49% stake in Jat Airways'*Khaleej Times* (2 August 2013) <www.khaleejtimes.com/business/aviation/etihad-airways-acquires-49-stakein-jat-airways> accessed on 07 October 2020.

786 EXYUaviation 'EC clears Air Serbia after investigation' EX-YU Aviation News (16 July 2016) <www.exyuaviation.com/2016/07/ec-clears-air-serbia-after-investigation.html> accessed on 07 October 2020.

787 Ibid.

788 Clark, N., '*Upstart Abu Dhabi Airline Becomes Ally to European Carriers'* The New York Times (4 October 2013) <www.nytimes.com/2013/10/05/business/international/upstart-abu-dhabi-airline-becomesally- to-european-carriers.html?_r=0> accessed on 07 October 2020.

The third step of Etihad's development in Europe, was to secure joint control of Alitalia. The deal was communicated on 29th September 2014. After a short investigation on 14th November 2014 the transaction was cleared. Clearance was contingent upon commitments. The merged airline, New Alitalia was a totally different entity under the control of Alitalia Compagnia Aerea Italiana S.p.A. and Etihad Airways, with the latter acquiring the highest admissible share value, 49%. In the course of its investigation, the European Commission raised concerns with respect to the Rome-Belgrade route. Te new entity would most likely have a monopoly with only two carriers – Alitalia and Air Serbia - present on this particular route. It is worth mentioning that Etihad already had a 49% interest in Air Serbia. Concerns were addressed by the package of commitments with slot divestitures.[789]

The consolidation of Alitalia and Etihad is an example of two patterns in airline consolidations in the European Union: first, in instances of minor rivalry issues identified by the Commission, [unpractical] slot divestiture remains a leading commitment expected to tackle potential monopoly concerns for a given route. Secondly, non-EU airlines (primarily from the Gulf region), which are keen on the European carrier market will carry on with further attempt to extend its presence in Europe in various ways.[790] As a result, remedies have not provided for the European players an adequate guarantee for the fair competition environment and ultimately allowed the non-EU competitor to enter into the European market with the additional capacity and substantial financial resources. Such trend will certainly lead to the oligopoly on the market when the competition will be between limited number of the reach EU and non-EU-Airlines (like IAG, Etihad and Lufthansa).

As for the merger assessment, in such circumstances the network competition approach shall be applied based on the overall network of both airlines together with the capacities and financial position of the merged entity after the transaction. For the time being, 49.9% rule seems as a backdoor solution for the non-EU airlines to enter the European air transport dimension.

789 European Commission, Press Release, Mergers: Commission approves Etihad's acquisition of joint control over Alitalia, subject to conditions (14 November 2014) <http://europa.eu/rapid/press-release_IP-14-1766_en.htm> accessed on 09 October 2020.

790 Silver, V, Kamel Yousef. D., 'Etihad Seals $2.4 Billion Deal to Buy 49% of Ailing Alitalia', Bloomberg (8 August 2014) <www.bloomberg.com/news/articles/2014-08- 08/etihad-seals-2-4-billion-deal-to-acquire-49-of-ailing-alitalia> accessed on 09 October 2020.

8. Ryanair/Aer Lingus

8.1. Ryanair/Aer Lingus. Approach towards proportionality

Despite its generally affirmative approach to airline mergers in the European Union, in some cases the European Commission has claimed that the potential benefits arising from concentration have been outweighed by supposedly anti-competitive constraints derived from the proposed transactions. Given the lack of any effective concessions in certain cases, there can be no alternative to complete prohibition, as the Commission found in the case of *Ryanair/Aer Lingus*.[791]

Ryanair/Aer Lingus is a very indicative example case of the that the Commission's failure to achieve the outcome that has been anticipated along the assessment processes. In *Ryanair/Aer Lingus* the Commission prohibited the merger in EU1[792] because in its spirit, the proposed concentration involved direct horizontal competitors based at the same Dublin airport. Efficiencies claimed by Ryanair as effective measures to rectify the reduction of competition that might be identified by the Commission was deemed insufficient to remedy the competitive disadvantage. the Commission's view was also supported by the independent analyses.[793]

The Commission's decision in *Ryanair/Aer Lingus* is based on a detailed economic analysis of the merger. Whereas in the past the Commission was criticised for poor reasoning by the courts and for a failure to implement modern sophisticated analytical tools, in this case it undertook a detailed analysis and its decision would appear to be based largely on quantitative rather than qualitative analysis.'[794] It was also argued that *Ryanair/Aer Lingus* was characterised by an 'absence of airport substitutability,' and 'closeness of competition between the merging parties.'[795]

8.2.Ryanair/Aer Lingus. Facts

The acquisition of the stake in Aer Lingus by Ryanair was notified on 30th October 2006. The dimension of the merger was horizontal in nature, unlike other airline mergers in the European Union.

791 Case No COMP/M.4439 – *Ryanair/Aer Lingus* Commission decision of 26 July 2007.

792 ibid.

793 Kai-Uwe Kühn and othersr, 'Economics at DG Competition 2010-2011' (2011). 39 Rev Ind Organ 311–325 available online at;
<https://ec.europa.eu/dgs/competition/economist/rio_article_2011_en.pdf accessed on February 2021.

794 Case No COMP/M.4439 – *Ryanair/Aer Lingus* Commission decision of 26 July 2007.

795 Kai-Uwe Kühn and othersr, 'Economics at DG Competition 2010-2011' (2011). 39 Rev Ind Organ 311–325 available online at;
<https://ec.europa.eu/dgs/competition/economist/rio_article_2011_en.pdf accessed on February 2021.

During the investigation, the European Commission questioned the competitors of the merging parties, transport authorities, slot allocation authorities and civil aviation authorities. The Commission acknowledged that the airlines were close competitors in the Irish market (especially at Dublin airport), where they operated on similar routes, offered comparable (low-cost) quality of service and customers regarded their services as relatively equal alternatives. As a consequence, the merged entity would gain monopoly or at least dominant position on 35 routes which undeniably amplified the potential anticompetitive effects of the concentration. Furthermore, after the merger, the two companies would operate around 80% of the short-distance passenger traffic from Dublin. Naturally, to address the concerns of the Commission, Ryanair offered an inclusive package of remedies.

The package included a comprehensive slot divestment in relation to affected routes, supplemented with an 'upfront buyer' solution; Ryanair committed to finding a suitable airline to take divestment slots with a mechanism to calculate Aer Lingus fares while guarantying their level to be acceptable. Although at the beginning of Phase II, the Commission had a critical view of the proposed concentration and remedies, the proposed package was extended with additional slot divestment and was eventually gone ahead at the end of Phase II.[796]

8.3.Ryanair/Aer Lingus. Commission investigations and discoveries

The Commission's in-depth investigation not only used 'classic' investigative techniques such as questionnaires and telephonic interviews but also launched a specific customer survey at Dublin Airport, and complemented its work with a number of detailed analyses[797]. According to Ryanair due to the uniqueness of its business model and its exceptionally low-cost base, its pricing is not restrained by any airline's market behaviour but rather by consumers' flexible spending. The Commission accepted that Ryanair was a 'classic' no-frills carrier, but the market analysis did not lead to a conclusion that Ryanair was not in competition with other airlines. While both airlines were active in a differentiated market for scheduled passenger air transport services, where different airlines work with many different business and service models, Aer Lingus undeniably remained more 'up-market' than Ryan Air. Aer Lingus operated and provided additional services via major airports while Ryan Air has operated only via secondary ones, which was also evident by the fact that Aer Lingus' overall fares were higher than Ryanair's. Nonetheless, both Ryanair and Aer Lingus were considered as 'low-

796 Press Release, European Commission, 'Mergers: Commission Prohibits Ryanair's proposed takeover of Aer Lingus, IP/07/893' (27 June 2007) <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/07/893> accessed 1 September 2020.

797 Case No COMP/M.4439 – *Ryanair/Aer Lingus* Commission decision of 26 July 2007.

frills' carriers by customers. As a result, although there has been a certain level of product differentiation, both companies have been competitors on the affected routes.

Moreover, although on some instances in the past concerning network carriers such as Lufthansa or Air France the Commission differentiated between *time-sensitive* and *non-time-sensitive* passengers (or business and leisure passengers), the market scrutiny in this particular case established that the merger parties and their operational model could not justify subdividing the markets in the current case. While a certain differentiation of the two customer segments could be the case, it was not feasible to appraise the customers as two distinct and separate groups. There is also a broad scale of various passenger types. Ultimately, no separate market was defined for these groups of passengers.

The proposed deal led to an overlap between the merging parties in 35 markets defined as individual O&D pairs. Such conclusion was reached based on the defined market definition and assessment of the flights offered by the merging parties at the time of the Commission's decision. It is interesting to note that the deal also raised competition related questions on some other markets where only one of the merging parties was present while another party was considered to be the most likely entrant [798], which is exactly what the evaluation criteria shall be based upon.

The Commission confirmed that the barriers to entry into the affected markets were estimated to be high with the considerable obstacles to entry into the routes where the activities of the merging parties overlap. These obstacles to entry are particularly related to: (i) a disadvantage caused by not having a large operational bases in Dublin; (ii)substantial entry costs and risks associated with that especially for any new competitor in a market with the significant presence of two strong airlines with well-known established brands in Ireland; and (iii) Ryanair's reputation for aggressive response to players; (iv) Lack of capacity at some destination airports along with Dublin Air Port. Furthermore, based on the evidence obtained by the Commission, the Commission confirmed that a large base in Dublin would provide significant flexibility and cost benefits for the carriers operating to/from Dublin. Hence, the Commission came to the conclusion that the elimination of Aer Lingus as the definitive or potential competitor of Ryanair based in Dublin, will inevitably reduce the competitive barriers facing Ryanair on Irish routes. Furthermore, the Commission also evaluated the scenario based on the intention and most importantly ability of the individual competitors to enter into direct competition with Ryanair/ER Lingus after the merger transaction in assuming a price increase. The investigation

798 Richard Gadas and others, 'Ryanair/Aer Lingus: Even "Low-Cost" Monopolies Can Harm Consumers' (2007) 3 Competition Policy News Letter 65, 65.

further revealed that a possibility of a post-merger entry was limited to only few routes and that would not guarantee a significant competitive barrier to the merged organisation.

The decision also examined the potential players including Air France/CityJet, Aer Arann, EasyJet, British Airways, bmi/bmibaby, Flybe/BA Connect, Sky Europe, Air Berlin and Clickair. Nevertheless, a conclusion was reached that most of these carriers were unwilling to compete directly with Ryanair/Aer Lingus, due to the obstacles to entry and problems they would face in setting up their operations against the merged organisation's significant position. It was further inferred that no airlines could be expected to compete directly against Ryan Air/ Aer Lingus on the short-haul routes to/ from Ireland at a larger scale with a competitive constraint similar to the current one (of Aer Lingus). On the basis of this, the Commission reached the conclusion that possible entry or expansion on the individual overlap routes would be questionable and inadequate to exercise a competitive constraint for the merged organisation that would compensate for the loss of the competition between Ryan Air and Aer Lingus on the affected routes.[799]

After completing two phases of the investigation, three packages of remedies were offered by Ryanair; the Commission finally concluded that the deal would significantly hamper effective competition and resolved to block the merger. The market test which was carried out by the Commission indicated insufficiency of the commitments in order to remove the risk of competitive impediments caused by the parties. Parties attempted to appeal the decision to the General Court, but the appeal was dismissed.[800]

The final remedy package offered by Ryanair consisted mainly of the divestiture of Aer Lingus' operations on 43 overlap routes to Flybe and the cession of take-off and landing slots to IAG/British Airways at London airports, so that IAG/British Airways would operate on 3 routes (Dublin-London, Shannon-London, and Cork-London). Flybe and IAG committed to operate the routes for 3 years. Additional slot divestitures on London-Ireland routes were also offered. However, the Commission's investigation demonstrated that these remedies were insufficient to ensure that customers would not be harmed, taking into account the scope and magnitude of the competition concerns raised by the proposed transaction on the 46 routes.[801] After analysing the proposed commitments and conducting a comprehensive market test, the Commission concluded that measures to address the identified

799 ibid.

800 Case T-342/07*Ryanair v. Commission*, [2010], OJ C 221/55; Case T-411/07*Aer Lingus v. Commission* [2010] OJ C221/56.

801 European Commission, Press release, Brussels, 27 February 2013, available online at; https://ec.europa.eu/commission/presscorner/detail/en/IP_13_167 accessed on July 2021

competition problems were insufficient based on both formal and concrete grounds. The conclusion of the Commission was based on following considerations.

First, it was uncertain whether the means of slot allocation was suitable for transaction. Aer Lingus and Ryan Air being the low- frill airlines were focused on and flying predominantly to the secondary and non-congested airports rather than primary congested ones. Therefore, airport congestion was not the main reason why other airlines did not enter Ireland. As a result, a slot remedy failed to address the major barriers to entry. Second, as it was already mentioned, it was observed that the market test of the proposed measures clearly indicated that they were unlikely to lead to any substantial entry on overlap routes. There were no significant indications that the new entry was likely to happen based on the proposed remedies. Third, it was also observed that the scope of the commitments was inadequate. Even if the remedies could have led to entry to the full extent proposed, the scope of such entry would still have been extremely small to sufficiently address the competitive overlap of the parties. Furthermore, market testing confirmed that the number of aircraft offered, based in Dublin, would not be sufficient to change the competitive barrier currently faced by Aer Lingus. As a matter of fact, Aer Lingus and Ryanair operated in Dublin with 23 and 20 planes. The investigation further confirmed that even 4 to 8 aircraft would be insufficient to serve all overlap routes in order to create valid competitive constraints. Fourth, some of the significant airports' slots were missing in the proposal. Firth, the commitments did not in fact provide any guarantee that a significant entry of a single airline with a suitable business model could happen in order to ensure that the rivalry between two low-frills carriers is restored. Additionally, there were considerable suspicions that Ryanair could legally surrender Aer Lingus' Heathrow slot due to the existing internal corporate veto rights held by minority shareholders including trusts of the Irish government or Air Lingus employees which would enable them to block the slot transfer, for instance.

Another important element to consider is that neither of the various behavioural commitments offered by Ryan Air including 10% reduction of Aer Lingus' fares, eliminating fuel surcharges, frequency freeze, maintaining different brands directly addressed any of the identified competition concerns. Additionally, a number of questions regarding monitoring and enforceability are raised by the commitments. These commitments also contain elements that can reduce competition rather than strengthen it. Because of the many contradictions and vague or ambiguous content in the commitment

proposal, the feasibility of the commitments is questionable; commitments presented may not be practical or enforceable.[802]

8.4.Ryanair/Aer Lingus. Conclusion

It can be said that despite the fact that the support for the Commission approach is not universal[803] with a group of commentators for instance has criticised the approach taken in EU1 as being 'remarkably strict'[804], the slot remedies proposal itself and its ineffectiveness was accurately addressed by the Commission in *Ryan Air/Aer Lingus* case with the main problem to be attributed to the market definition instead.

However, what is really worrying is the decision to allow Aer Lingus to become part of IAG after 95.77% of its shareholders backed the takeover. So, instead of enhancing competition, the decision concentrated the revenue and control within the hand of one of the most dominant groups. This leads to negative consequences related to maintaining the level playing field i.e., such approach does not remove impediments in the market created by the concentration especially of this size and does not effectively promote access to it either. This is against the entire concept of liberalisation, which is additional proof of the theoretical argument of this thesis that numerous attempts to create the liberalisation of the single aviation market have failed. Allowing oligopoly model to finally become market reality will not contribute to the level playing field and its endurance c, while also abolish the presence of the smaller players. It might be even accurate to say that in the post-pandemic period oligopolistic market model will completely vanish any realistic opportunity and initiative for the new entries.

An interesting point has been raised by Furse[805] on a field of jurisdiction. In 2015 the UK authorities were able to effectively act in relation to the acquisition of the minority shareholding in *Ryan Air/Aer Lingus* while the EU Commission was unable to do so. Prior to that, on 9 July, 2014, the EU Commission published a White Paper[806] in which the EU Commission pointed to the UK approach in the *Ryanair/Aer Lingus* case as dealing with one of the fundamental theories of competitive harm

802 Richard Gadas and others, 'Ryanair/Aer Lingus: Even "Low-Cost" Monopolies Can Harm Consumers' (2007) 3 Competition Policy News Letter 65, 65.

803 M Furse, 'Testing the limits: Ryanair/Aer Lingus and the boundaries of merger control' (2017) 12 European Competition Journal 462, 463.

804 G Drauz and others, 'Recent Developments in EC Merger Control' (2010) 1 Journal of European Competition Law & Practice 12.

805 M Furse, 'Testing the limits: Ryanair/Aer Lingus and the boundaries of merger control' (2017) 12 European Competition Journal 462, 463.

806 COM(2014) 449 White Paper Towards more effective EU merger control; P Elliott, JV Acker, 'A critical review of the European Commission's proposal to subject acquisitions of non-controlling minority stakes to EU merger control,' [2015] European Competition Law Review 97.

arising from the acquisition of minority shareholdings: that this may 'raise competition concerns when the acquirer uses its position to limit the competitive strategies available to the target, thereby weakening it as a competitive force'. According to the White Paper[807], 'this theory of harm was at the core of the UK authorities' inquiry into the *Ryanair/Aer Lingus* case. In *Ryanair/Aer Lingus* I, Ryanair had already acquired a significant minority shareholding in its competitor, Aer Lingus, when it notified the Commission about its proposal to acquire control in 2006. The Commission prohibited the acquisition due to serious concerns that it would hurt contest by creating or strengthening Ryanair's dominant position on a number of routes. However, it had no jurisdiction to review Ryanair's minority shareholding in Aer Lingus, which the UK [CC] proceeded to do. The importance of the failed concentration of *Ryan Air/Aer Lingus* case and unsuccessful attempt of concentration to the European Union's merger control cannot be underestimated, as it was the first airline merger blocked by the European Commission in its history.[808] The prohibition of this concentration is particularly interesting because of the generally positive outlook of the Commission towards consolidation of the airline sector in the European Union. It clearly marks a shift in the approach of the Commission related to remedies in airline mergers towards a more rigorous approach, potentially caused by the collapse of commitments approved in a merger of *KLM/Air France*[809], where slot divestitures in practice did not result in market entry. Another factor, which undeniably affected the Commission's decision, was the fact that both Aer Lingus and Ryanair were based in Ireland; breaking down national markets and strengthening bonds between the Member States, therefore, did not occur. It has been suggested[810] that in its evaluation, the Commission ought to have focused more on the way that Aer Lingus was a conventional Irish national carrier while Ryanair was a relatively new and dynamic player with a flexible business model and recognisable benefits in regards to 1) improved passengers traffic in the European Union together with market integration, and 2), 'clean' reputation with no history of infringing activates alike costs increase. Permitting the consolidation with Aer Lingus may have helped Ryanair in accomplishing its business aims without causing any purchaser harm. After that, Ryanair considered another attempt to acquire Aer Lingus; however, on that occasion it did not find support of the shareholders.[811] The third, but last endeavour of Ryanair to acquire control over Aer Lingus occurred in 2013. During the investigation, the European Commission inferred that the transaction would create anticompetitive environment on 46 routes, where the two airlines were competing. Since

807 ibid Para 33.

808 Miglena Rahova, 'Remedies in Merger Cases in the Aviation Sector: Developments in the European Commission's Approach' (2013) 12 Issues in Aviation Law and Policy 516.

809 Case M.3280 *Air-France/KLM* Decision of 6 February 2019.

810 Szymon Murek, 'Remedies in airline mergers in the European Union' (2017) available online at; <http://www.icc.qmul.ac.uk/media/icc/gar/gar2017/4.Szymon.pdf> accessed on 08 September 2020.

811 Miglena Rahova, 'Remedies in Merger Cases in the Aviation Sector: Developments in the European Commission's Approach' (2013) 12 Issues in Aviation Law and Policy 516.

Ryanair had just experienced dismissal from the Commission, it immediately offered a thorough arrangement of remedies, apparently one of the greatest in history of carrier consolidations in the EU. The remedy contained slot divestitures on the entirety of the affected routes enhanced with a upfront buyer arrangement. In essence, there were airlines ready to assume control over the slots as well as to operate on the affected routes for at least three years. In any case, the European Commission's conclusion was that the remedies offered were not effective enough to remove the concerns pertaining to anticompetitive impact on the affected routes and blocked the deal on 27 February 2013.[812]At the last attempt to succeed with their endeavour, parties submitted probably the most comprehensive and greatest bundle of remedies possible. Also, a unique upfront buyer arrangement was proposed, which provided extra assurance for the entrance of other players to the market. it appears that a general trend characterising the European Commission's assessment, is that remedies in airlines mergers are appropriate if a potential anticompetitive impact are relatively minor. In instances of greater concentrations, the Commission remains conservative and is reluctant to accept commitments regardless of their structure. The principle of proportionality has to be always considered when effective measures are being structured. While in the majority of cases, remedies are directed at reducing existing entry barriers and enabling new airlines to enter the market, [813] in practice, remedies may have the opposite effect. One instance is prohibition of the Ryanair potentially healthy business expansion. Another is a completely opposite approach taken in *IAG/Aer Lingus*[814] which is also examined in this thesis.

9. Conclusion

In conclusion, the common feature among the various mergers examined above is a trend towards an oligopoly model in which there has not been any real opening for new market entrants, nor has there been any real acknowledgment of the barriers to entry such new entrants face. Once upon a time, the oligopolistic model was regarded as a threat to the market in the airline industry in general, and it is of interest to see how this fear has receded in practice over the years.[815]

Indeed, the current market model already has essential elements of the oligopoly model which leads to the reduction of competition and potentially higher prices for consumers with no additional value

812 European Commission, Press Release 'Mergers: Commission prohibits Ryanair's proposed takeover of Aer Lingus' (27 June 2013) proposed takeover of Aer Lingus (27 June 2013) <http://europa.eu/rapid/press-release_IP-07-893_en.htm?locale=en> accessed 17 September 2020.

813 Rosario Macario, Eddy Van de Voorde, *Critical Issues in Air Transport Economics and Business* (1st edn Routledge 2011).

814 IAG/*Aer Lingus* [(2015] Case No M.7541 32015M7541.

815 Peter C. Reiss and Pablo T. Spiller, 'Competition and Entry in Small Airline Markets' (1998) 32 The Journal of Law and Economics S179, S179.

created. It can be concluded that there are a few market players who influence the airline market *IAG / Aer Lingus*[816]and *Lufthansa/certain Air Berlin assets*[817] cases are the good examples in a way to demonstrate the mid-term strategy goals and their achievements via merger's transactions. It is perhaps the case that this was accepted on the assumption, or premise that there were sufficiently advanced and effective remedies available to the Commission to help redress the balance. This assumption, in light of the findings set out above, is wrong. There is a lack of effective counterbalancing remedies which have been able to help beneficially aid competition in the sector which is otherwise imbalanced, and damaged, by the growing oligopolistic trend identified.

VI. Articles 101 and 102

1. Overview

With respect to the air traffic sector, the design of remedies which have to be effective in preventing the anticompetitive effects of an alliance is a complex task. The specific features of the participants as well as markets concerned, in particular the conditions of market entry, shall give an indication as to the possible types of remedies. Normally, the competition authority faces a trade-off between the overall positive welfare effect the alliance is expected to have and a risk that effective competition will not be maintained on every affected route.[818]

The Commission has monitored the increasing trend towards establishing alliances in the air transport sector. On the one hand, there is an argument that airline alliances can benefit consumers by providing a larger product offering or more competitive prices. On the other hand, competition issues may arise if the airlines are particularly strong on certain routes and/or if they hold numerous slots on capacity constrained airports. The Commission has assessed the compatibility with Article 101 of a number of 'partial function' Joint Ventures (JVs) or even looser collaborations through agreements creating a 'strategic alliance' for instance, *LH/SAS*,[819]; *bmi/LH/SAS*,[820]; *AuA/LH*,[821]; *BA/SN Brussels Airlines*[822]; *British Airways/Iberia/GB Airways*,[823]. Even though such arrangements are frequently found to be

816 Case No M.7541 -*IAG / Aer Lingus* (2015) 32015M7541.

817 Case M.863 *Fortum/Uniper* available online at;<https://ec.europa.eu/competition/mergers/cases/decisions/m8633_2370_3.pdf> accessed June 2021.

818 Marco Benacchio, 'Consolidation in the air transport sector and antitrust enforcement in Europe' (2008) 8 EJTIR 91, 116.

819 OJ 1996 L54/28.

820 European Commission, Press Release, 'BM/Lufthansa/SAS' IP/01/831 (13 June 2001).

821 OJ 2002 L242/25

822 COMP/38477, Press Release IP/03/350 (10 March 2003). [https://ec.europa.eu/competition/antitrust/cases/dec_docs/38477/38477_18_3.pdf] accessed July 2021.

823 CASE COMP/D2/38.479: British Airways / Iberia / GB Airways [https://ec.europa.eu/competition/antitrust/cases/dec_docs/38479/38479_24_8.pdf] accessed July 2021.

compatible with Article 101, in many cases they are subject to conditions designed to facilitate new entry into the routes affected, in particular by the requirement that the partners surrender a number of slots at the relevant capacity constrained airports.

As was highlighted in *TAP Portugal/Brussels Airlines*[824] by the former commissioner Vestager, 'Code-sharing by airlines can bring benefits to passengers in terms of wider network coverage and better connections', but the concern was also raised that, 'Brussels Airlines and TAP Portugal may have used their codeshare to restrict competition and harm passengers' interests' by discussing and then implementing a capacity reduction and alignment of fare structure and pricing policy on the Brussels-Lisbon route, and by granting each other unlimited rights to sell seats on each other's flights on that route.[825]

The types of remedies which the Commission has found acceptable in the case of airline alliances can be summarised into summarised by four categories:[826]

I. Remedies concerning operations on the relevant route or routes, such as the freezing or reduction of capacity, and constraints on fares, in respect of services operated by the parties.

II. Remedies which involve the parties agreeing to allow would-be competitors access to certain facilities they need in order to mount effective competing services. The most common of such facilities applied by the Commission are airport slots—at any rate at airports which are congested, although clearly it is not an available remedy at airports where there is no difficulty for an airline to obtain slots at satisfactory times. Other remedies of this type which have become common include allowing competitors to interline with the parties and to have access to their frequent flyer pro-gramme(s). Interlining enables tickets to be provided for a journey partly on the competitor's services and partly on services operated by the parties, and also enables a flexible ticket for travel on a competitor's services to be used for travel on the parties' services, and vice versa, subject to payment of any price difference and reasonable formalities. The recent growth in popularity of frequent flyer programmes can provide a significant barrier to competition, at any rate for smaller airlines, which cannot offer many opportunities to earn miles or bonus points or various ways in which to use them.

824 Case AT.39860 *Brussels Airlines/TAP Portugal*, Press Release IP/16/3563 (27 October 2016).

825 David Bailey and others, *Bellamy & Child: European Union Law of Competition* (8th edn OUP 2018).

826 John Balfour, 'EC competition law and airline alliances' (2004) 10 Journal of Air Transport Management 81-85.

III. Remedies involving governments. As mentioned above, bilateral constraints may provide a legal barrier to entry by a would-be competitor. One way of removing this particular constraint is for the government in the home state of the airline(s) concerned to agree to relax bilateral constraints in order to allow competition—at least to the extent that the matter is entirely within that government's control. Where the consent of a third country is required, then of course this solution cannot be assured without the concurrence of the third country.

IV. Wider remedies. More recently, the Commission has sought to impose conditions regarding matters which go beyond competition on the routes identified as comprising the relevant market(s), in an attempt to provide solutions to wider competition problems[827]—for example, by obtaining undertakings from the airlines concerned that they will not offer volume-related discounts or bonus commissions to corporate customers or travel agents, and that they will display their flights in computer reservation systems in a way which will not have anti-competitive effects.

2. Development of Commission's Policy

It is worth to examine in greater detail the remedies which the Commission has accepted in the main cases within the scope of Articles 101 and 102 of TFEU, and thus to see how the Commission's policy has developed. Overall, the test of elimination of competition does not depend merely on whether the agreement in question eliminates competition between those parties and whether the parties hold a large share of the relevant market. Furthermore, the concept of elimination of competition is separate from the existence of acquisition of a dominant position. Hence, it is necessary to take into account and analyse external competition, both actual and potential. Potential competition must be taken into consideration before concluding that an agreement eliminates competition for the purposes of Article 101 (3).[828] In practical terms, however, the Commission has demonstrated inability to deal with the assessments in an expeditious manner.

Cases below illustrate general trend that has led to the ineffectiveness of the Commission approach and remedies applied as part of the assessments under Articles 101 and 102. The first airline alliance

827 European Commission, 'Support Study Accompanying the Evaluation of the Commission Notice on the Definition of the Relevant Market for the Purposes of Community Competition Law: Final Report' (2021) available online at; <https://ec.europa.eu/competition-policy/system/files/2021-06/kd0221712enn_market_definition_notice_2021_1.pdf> accessed 22 March 2022.

828 David Bailey and others, *Bellamy & Child: European Union Law of Competition* (8th edn OUP 2018).

examined by the Commission as such was that between Lufthansa and SAS[829] in 1996. Such an alliance was clearly likely to have a significant effect on competition between Scandinavia and Germany. Consequently, the Commission secured undertakings from the two airlines designed to assist and encourage new competitors on the eight principal routes between Scandinavia on the one hand and Germany on the other—i.e., the giving up of slots at congested airports, a capacity freeze and agreement to allow competitors access to interlining and FFPs.

An indicative case to illustrate acceptance by the Commission of commitments under Article 9 of Regulation 1/2003 is that of *BA/AA/Iberia*[830] in relation to agreements between British Airways, American Airlines and Iberia to establish a revenue-sharing joint venture covering passenger air transport services on certain routes between Europe and North America. The agreements provided for extensive cooperation between the parties on the routes involved, including on pricing, capacity, coordination of schedules and revenue sharing. The main commitments related to the making of slots available at London airports, the parties entering fare combinability and special pro-rate agreements (to set the terms and conditions of interlining) with competitors, the parties opening their frequent flyer programmes to competitors and offering regular report data concerning the parties' cooperation to the Commission.

3. Case studies

i. British Airways/Iberia/GB Airways[831]

Market research pertaining to *British Airways/Iberia/GB Airways*, indicated that for routes between London and Madrid, corporate customers would normally require up to a maximum of four daily frequencies out of Heathrow or Gatwick. Hence, the Commission requested up to a maximum of four daily slots pairs at London Gatwick and at Madrid for one single competitor.[832] In order to balance the competitive effect, it was suggested that the maximum of four daily slot pairs which were granted would be decreased by the number of services already operated by this competitor on the said route. Ultimately, slots were allocated to easyJet.

829 COMMISSION DECISION of 16 January 1996 relating to a proceeding under Article 85 of the EC Treaty and Article 53 of the EEA Agreement (IV/35.545 - LH/SAS). Official Journal L 054 , 05/03/1996 P. 0028 - 0042

830 Case COMP/39.596 — British Airways/American Airlines/Iberia (BA/AA/IB)

831 CASE COMP/D2/38.479: British Airways / Iberia / GB Airways available online at; <https://ec.europa.eu/competition/antitrust/cases/dec_docs/38479/38479_24_8.pdf accessed July 2021.

832 British Airways/Iberia/GB Airways (2003) CASE COMP/D2/38.479.

This is again rather bizarre development, because easyJet has substantial operations from the UK (Luton, Gatwick, Stansted, East Midlands, Liverpool, Newcastle, and Bristol) to Spain, including Madrid (from Luton, Gatwick, and Liverpool[833]). Indeed, there was economy of scales here; however, it was not achieved by the Commission's assessment, but by simply allowing the already established network of easyJet to benefit from the slot's allocation. It is certainly not a remedy addressed to mitigate the anticompetitive effect by encouraging a new entry, but rather a distribution of the efficiencies among existing incumbents.

ii. ***Lufthansa/Austrian Airlines[834]***

Further developments are evident in the Commission's treatment of the Lufthansa/Austrian Airlines alliance in 2002. This was a particularly serious case, because the Commission found that it would give the two airlines almost a total monopoly on air services between Germany and Austria. Consequently, in addition to the now traditional conditions, the Commission persuaded the airlines to accept three further conditions: The airlines agreed, each time they reduced a fare on a route on which a new competitor commenced services, to apply an equivalent fare reduction (in percentage terms) on three other routes between Austria and Germany on which they did not face competition. The purpose of this was to make it more difficult for the two airlines to engage in anti-competitive pricing strategy intended to discourage or drive out new competitors. They also agree to enter into a blocked space agreement with a competitor. A blocked space agreement is similar to a part charter of an aircraft, whereby an airline which operates a service sells to another airline a number of seats on the aircraft for it to sell under its code as its own services. The potential attraction of this for a smaller airline is that it is thus able to offer a higher and more attractive number of frequencies, and to compete more effectively with a larger airline.

The two airlines also agreed to enter into an agreement with the railway or other transport companies to provide an intermodal service, hence increasing the possibilities for such surface transport operators to compete with the airlines and foster intermodal competition. This remedy was only available because of the close geographic proximity of Germany and Austria and would not necessarily be available in other cases. It is particularly noteworthy that the Commission has paid significant attention

833 EasyJet 'Airline Maps' (2018) available online at; https://airlinemaps.tumblr.com/post/175036155462/easyjet-where-we-fly-maps-2003-easyjet-where-we accessed 22 March 2022.

834 Case No. COMP/M.5440 *Lufthansa/Austrian Airlines* Decision of 28 August 2009.

to the existence of competing airlines, both from Austria and from neighbouring countries in Central and Eastern Europe, which either had actually started operating services on the routes in question, or had expressed a serious intention to do so. Indeed, it now appears to be highly advisable for parties to a proposed alliance which would otherwise be likely to have effects on competition actively to seek out competitors and encourage them to compete, in order to remove the Commission's competition concerns.

*iii. **British Airways and SN Brussels Airlines**[835]*

In March 2003, the Commission approved a cooperation agreement between British Airways and SN Brussels Airlines (the successor to Sabena). The Commission found that the two airlines 'networks were largely complementary, rather than overlapping, and that their cooperation would bring benefits for passengers, by allowing each airline's passengers to have access to the different long-haul networks of the other. The airline's operations over-lapped on two routes, Brussels–London and Brussels–Manchester. With regard to Brussels–London, the Commission concluded that, although the airlines had a significant joint market share, the alliance would not eliminate competition because there were powerful competitors on the route in the form of Bmi British Midland and the rail services operated by Eurostar. However, as the parties' joint market share on Brussels–Manchester would be 100%, and as there was a shortage of slots at peak times at Brussels Airport, the Commission requested undertakings from the airlines to release sufficient slots at Brussels Airport to enable a new entrant to operate three daily services to/from Manchester.[836]

4. Effectiveness of the Articles 101 and 102 remedies

There is a trend that prevalence of behavioural remedies is stronger in Article 101 cases than in Article 102 cases. For instance, historically, in the period from February 2010 to October 2014 almost all Article 9 decisions relating to infringements of Article 101 included some behavioural remedies.[837] The exceptions are two aviation cases (AT.39596 – *British Airways/American Airlines/Iberia* and AT.39595 – *Continental/United/Lufthansa/Air Canada*) in which airport slot release and other commitments were accepted that have been categorized as access remedies. No case has been

835 CASE COMP/A.38.477/D2 British Airways/SN Brussels Airlines (2003).

836 John Balfour, 'EC competition law and airline alliances' (2004) 10 Journal of Air Transport Management 81-85.

837 Frank Maier-Riguad, Benjamin Loertscher, 'Structural vs Behavioural Remedies' CPI Antitrust Chronicle, April 2020, available online at; https://www.nera.com/content/dam/nera/publications/2020/PUB_CPI_Remedies.pdf accessed 22 March 2022.

identified in which a decision relating to an infringement of Article 101 led to structural remedies. The occurrence of structural remedies is also very rare in Article 102 cases.[838]

5. Concerns about the timeframe of the investigations

Overall concern is the effectiveness especially in terms of the time it takes for the Commission to assess cooperation between airlines. One of the best illustrations is approach taken by the Commission towards the SkyTeam airline alliance. Following the founding of the SkyTeam alliance, the Commission launched an investigation in July 2000. After almost 6 years, in June 2006, the Commission confirmed sending a Statement of Objections to members of SkyTeam (addressed to Aeromexico, Air France, Alitalia, Continental Airlines, CSA, Delta Airlines, KLM, Korean Air Lines and Northwest Airlines).[839] In the statement, the Commission found that it was very unlikely that cooperation between the parties results in negative effects on competition in most of the several thousand city pairs worldwide. On the contrary, the Commission expected that substantial consumer benefits will result from the alliances, such as better connectivity, cost savings, and synergies between the parties. Nevertheless, the Commission identified a number of markets (between the EU and the US, within the EU, as well as between the EU and other third countries) in which the agreement might cause negative effects on competition. This view was repeated in October 2007, when the Commission invited comments from interested parties on commitments.

On 27 January 2012 it was reported that the European Commission has opened another investigation to assess whether a transatlantic joint venture between Air France-KLM, Alitalia and Delta, all members of the SkyTeam airline alliance, breaches EU antitrust rules. The goal is to ensure that this tie-up does not harm passengers on EU-U.S. routes. An opening of proceedings means that the Commission will deal with the case as a matter of priority, it does not prejudge the outcome. Simultaneously, the Commission has closed formal antitrust proceedings in relation to cooperation agreements between eight members of SkyTeam: Aeromexico, Air France, Alitalia, Continental Airlines, Czech Airlines, Delta, KLM and Korean Air Lines. Facts were dates back to2009 and 2010, when several members of the SkyTeam airline alliance - Air France-KLM, Alitalia and Delta - signed agreements establishing a transatlantic joint venture focusing on the routes between Europe and North America. Pursuant to these agreements, the parties fully coordinate their transatlantic operations with

838 ibid.

839 MEMO/06/243, Brussels, 19 June 2006, 'Competition: Commission confirms sending Statement of Objections to members of SkyTeam global airline alliance' available online at; <https://ec.europa.eu/competition/antitrust/cases/dec_docs/37984/37984_406_10.pdf accessed July 2021

respect to capacity, schedules, pricing and revenue management. The parties also share profits and losses of their transatlantic flights.[840]

7. Conclusion

It is very clear that the types of remedies relied upon and accepted by the Commission together with timeframe applicable to the investigations and relevant agreements between alliance members with the potential detrimental outcomes do not match. It does not benefit either participants of such agreements or market players and consumers who might be affected since implementation of those agreements.

840 IP/12/79. Press release. 27 January 2012. 'Antitrust: Commission opens a probe into transatlantic joint venture between Air France-KLM, Alitalia and Delta and closes proceedings against eight members of SkyTeam airline alliance'. [https://ec.europa.eu/commission/presscorner/detail/en/IP_12_79] accessed on July 2021.

VII. State Aid

1. State Aid prior to 2019/2020

The Commission is without any doubt the gatekeeper of the competition environment on the European market and its primary objective is to decrease any anticompetitive conduct, with potential to harm consumers. It should not, however, interfere into each transaction, without considering the longer benefits which could be achieved, even with some level of interference to the market. As rightly argued by Kokkoris, 'The competition authorities should adopt a different approach towards remedies in periods of crises.'[841] From a State Aid perspective, the most indicative illustration is the approach recently taken by the European Commission since the pandemic outbreak. In fact, based on the results of 2020, State aid has been granted on a selective basis, which is likely to affect trade between Member States in longer term.

2. State Aid post-Covid-19

The aviation sector has faced substantial challenges during the COVID-19 pandemic as a result of an intrinsically high-cost base and because of the almost complete disruption of services which combined in a form of perfect storm against the sector.[842] Bearing in mind that the aviation sector has always been seen as one of high risk in terms of State aid scrutiny and challenge, such challenges have only been increased during the pandemic crisis.

With a detrimental impact of the pandemic upon airports and airlines with the restrictions on passengers' flow, national Governments stepping in to provide financial support for carriers with the European Commission quickly clearing such measures. However, other market participants also actively oppose such measures. For example, Ryan Air has complained against several EU's approvals of Covid-19 loan guarantees including guarantees provided to Scandinavian Airlines by Denmark and Sweden, each worth €137 million, as well as the EU's approval of a €600 million loan guarantee to Finnair from the Finnish government.[843]

841 Ioannis Kokkoris, Howard Shelanski, *The EU Merger Control* (1st edn OUP 2014) 554.

842 OECD, 'Policy Responses to Coronavirus (COVID-19) (2020) available online at; < https://www.oecd.org/coronavirus/policy-responses/covid-19-and-the-aviation-industry-impact-and-policy-responses-26d521c1/> accessed 22 March 2022.

843 DWF, 'State Aid and the Aviation Sector' available online at; https://dwfgroup.com/en/news-and-insights/insights/2020/7/state-aid-and-the-aviation-sector accessed 22 March 2022.

Ryanair Group CEO Michael O'Leary depicted State Aid to KLM[844] as 'subsidy doping' expressing this as 'bad news for competition and consumer interests' as it would additionally postpone the vital changes needed at the enlarged *Air France-KLM*, while for **"***€200 KLM subsidy, every Dutch man, woman and child could buy 5 flights with Ryanair, instead of paying for the failure and inefficiency at Air France-KLM***"**.[845] Mr O'Leary has further claimed that the arrangement will additionally decrease rivalry and purchaser decision in the Dutch and French business sectors.

With an end goal to restrict hindrances to the industry's level battleground, the Commission is attaching contingency statements under the Temporary Framework, particularly in the instances of recapitalization help. These contain conditions on need and size, an unmistakable exit plan for the state throughout the span of six or seven years, conditions on administration, such as limitations on acquisitions.

According to some experts,[846] aid financing may be credit positive in the short term as it boosts airlines' liquidity, enabling them to operate until traffic recovers. Yet, if it comes with the conditions that significantly restrict airlines' operational and financial flexibility, then it may be said that in the longer-term outlook is uncertain. Aid terms may contain ambitious decarbonisation targets (for example, Air France's and proposed KLM's packages[847]), job retention conditions (Swiss government's airline bailout package[848]), minimum air fares or 'climate conditions' (Austrian bailout[849]). Often such bailouts even appear to be harmful to the creditors. Norwegian Air Shuttle was required to obtain concessions from existing creditors and convert some debt into equity prior to accessing Norway's state-aid packages.[850]

844 Press release, 13 July 2020, Brussels. 'State aid: Commission approves Dutch plans to provide €3.4 billion in urgent liquidity support to KLM' available online at; https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1333 accessed July 2021

845 Ryanair, Press Statement, 'Ryanair Calls On The EU To Block €3.4bn Illegal State Aid To KLM' (2020) available online at; <https://corporate.ryanair.com/news/ryanair-calls-on-the-eu-to-block-e3-4bn-illegal-state-aid-to-klm/> accessed 15 October 2020.

846 Fitch Ratings 'Airlines' State Aid Risks Altering European Aviation Landscape' available online at; <https://www.fitchratings.com/research/corporate-finance/airlines-state-aid-risks-altering-european-aviation-landscape-30-06-2020> accessed 06 November 2020

847 Cirium, 'French Government Sets Green Conditions for Air France Bailout' (2020) available online at; < https://www.flightglobal.com/strategy/french-government-sets-green-conditions-for-air-france-bailout/138160.article> accessed 22 March 2022.

848 IISD, Bailout package is tied to several carbon performance targets. The carbon conditionalities require the airline to reduce their domestic emissions by 50% by 2030, reduce their total emissions by 30% by 2030 compared to 2005 levels, improve fuel efficiency by 1.5% per year to achieve an average carbon footprint per 100 passenger kilometre of 8.5kg by 2030 compared to a current footprint of 9.55kg, and shift passenger travel from short distance flight to rail where train connections below 3 hours are available online at; <https://www.iisd.org/sustainable-recovery/news/climate-conditions-for-austrian-airlines-bailout/> accessed on 06 November 2020.

849 Transport & Environment, 'Austrian Airlines bailout climate conditions explained' (2020) available online at; <https://www.transportenvironment.org/publications/austrian-airlines-bailout-climate-conditions-explained> accessed 06 November 2020.

850 Norwegian Air, Press Release, 'Norwegian Finalises Recapitalisation and Secures State Aid' (2020) 20 May 2020, available online at; < https://media.uk.norwegian.com/pressreleases/norwegian-finalises-recapitalisation-and-secures-state-aid-3000961> accessed 22 March 2022.

Also, financial support is predominantly provided in the form of loans and loan guarantees and in fact does not help to decrease level of debt. It may be even contrary to that with increased leverage, adding to a debt recovery in the longer perspective.[851] Indeed, very importantly, state aid does not address the need for structural changes as airlines will operate in smaller and more competitive markets owing to lagging demand recovery. Going through the crisis, it is anticipated that airlines' debt capacity will reduce. Hence, airlines will be required to reinforce their capital structures by various measures such as deleveraging, execute cost and capex saving programmes, while also implementing more conservative strategies in order to continue to be competitive market participants.[852]

The emergency in air transport in the European Union is a current reality. The opportunity has arrived to change appraisal model in the airline business in the European Union's dimension. In cases where aid has been granted subject to conditions and where such aid is to be implemented over a relatively long period of time, the Commission may, to properly manage and monitor such implementation, vary the conditions governing the implementation in response to a subsequent change in external circumstances.[853]. Such variation is possible without the need to re-open the formal investigation procedure as long as the variation does not rise compatibility's concerns.[854]

While it was previously suggested that the investors and executives at competing airlines have decried any form of assistance to financially struggling carriers insisting that the government should let the marketplace decide the faith of the airlines, Covid-19 outbreak has changed that approach. It was said in 2010 that in the future, big players might claim that a mega-carrier will be too big to fail:[855] the overnight shutdown of such a large percentage of the nation's commercial airlift would have immediate and adverse effects on the economy, infrastructure, and even security. It was also concluded that the greater concentration of market share among just a handful of mega-carriers, a much greater threat of travel or cargo transportation disruptions the industry might face. One of the key determinants here is the balance of interests between the government, employees and consumers. On the one hand, airlines create employments opportunities and add value to the national budget by way of taxation. On the other hand, substantial financial support that some struggling companies receive might be

851 Fitch Ratings, 'Airlines' State Aid Risks Altering European Aviation Landscape' (2020) available online at; <https://www.fitchratings.com/research/corporate-finance/airlines-state-aid-risks-altering-european-aviation-landscape-30-06-2020> accessed 06 November 2020. https://www.fitchratings.com/research/corporate-finance/airlines-state-aid-risks-altering-european-aviation-landscape-30-06-2020

852 ibid.

853 David Bailey and others *Bellamy & Child European Union Law of Competition* (8th Edition OUP 2018).

854 Ryanair v Commission [1998] Case T-140/95 ECR II – 3322, EU:T:1998:201. Para 89.

855 Carl Unger, 'Would Merged United be "Too Big to Fail"?' (2010) Smart Travel, available online at; https://www.smartertravel.com/would-merged-united-be-too-big-to-fail/ accessed 22 March 2022.

overwhelming actual benefits their bring to the society and consumers. This is exactly what the airline industry is facing now.

In fact, fragility is endemic to a sector whose fixed costs are high and whose working capital requirements swing dramatically between summer and winter.[856] The International Air Transport Association warned in the early stages of the Covid-19 crisis that 75 per cent of airlines had cash covering less than three months of costs. Before the pandemic only around 30 airlines worldwide were profitable (as defined by a return on invested capital exceeding the weighted average cost of capital), and most of those were based in North America. Below the top 30, according to the IATA, debt was already averaging 5.5 times operating income before fleet finance costs. by June 2021, the vast majority of European airlines survive. Enforced groundings were not the existential event imagined for already structurally lossmaking businesses, in part because national governments have been spooked by ideas of losing their flag carriers to foreign invaders.

Interestingly, by June 2021 large EU airlines have tapped debt markets for €6.5bn in the year, according to Bank of America, which estimates that even if all flights are grounded they have enough cash to last for nearly two years on average.[857] The pandemic has also caused a few changes in the approach taken by the national competition authorities. For instance, the pandemic caused the UK Competition and Markets Authority ("CMA") to stop its examination concerning the Atlantic Joint Business Agreement (AJBA) between British Airways, Iberia, Aer Lingus, American Airlines, and Finnair. These carriers have made a deal to avoid competition between the UK and the United States and in 2010 offered commitment to the European Commission which required them to give up slots to the competitors and give different supportive measures in order to encourage competition on specific routes. Commitments were binding for 10 years. On expiry of the parties' commitments, due in 2020, the European Commission has an authority to re-assess the agreement. As 5 of the 6 routes that have been subject to commitments are from the UK as well as to ensure its readiness for the time when the European Commission no longer has responsibility for competition in the UK[858], the CMA decided to review the competitive impact of the agreement. During its enquiry (incited as a result of the UK's exit from the EU), the CMA found that there is a considerable measure of equivocalness about the degree and length of the effect of the pandemic on the overseas flying sector, and this has view has been

856 Bryce Elder, 'Wizz Air takes on the airline zombies created by state aid.' *Financial Times*, June 3, 2021, available online at;<https://www.ft.com/content/b937265c-8bb1-4cab-9234-c7458e0b86a2> accessed July 2021

857 ibid.

858UK Gov Press release. CMA consults on BA and American Airlines commitments. https://www.gov.uk/government/news/cma-consults-on-ba-and-american-airlines-commitments accessed 04 February 2020.

reinforced substantially since. The CMA has concluded that it cannot be sure that its assessment of rivalry concerns, and any remedies that may address them, can adequately mirror the post-pandemic conditions of rivalry in the long term. It has resolved to keep its examination open and forced 'interim measures,' extending the 2010 commitments for an extra three years until March 2024, by which time the CMA estimates that the airline sector should be in a steadier position.[859]

3. Restrains and measures applied to the State Aid in the attempt to balance the level playing field

There is no doubt that the airline business is among the areas of the global economy most affected by COVID-19 pandemic. Passenger air traffic has reduced significantly and a critical number of the airlines have grounded all or the vast majority of their fleet. As a result of that, the European Union governments have stepped in to help to the airlines. These packages have depended either on the Temporary Framework embraced by the Commission in light of the pandemic, which has Article 107(3)(b) TFEU as its legal instrument to implement the said assistance, or on Article 107(2)(b) TFEU, which takes into consideration state aid intended to make great to "damages as a result of … exceptional occurrences".[860]

The new principles likewise incorporate a few measures, intended to shield the level battleground and avoid unjustifiable twists of rivalry. As EU Commission Executive Vice President Margrethe Vestager said "If Member States decide to step in, we will apply today's rules to ensure that taxpayers are sufficiently remunerated and their support comes with strings attached, including a ban on dividends, bonus payments as well as further measures to limit distortions of competition."[861]

In recapitalisation, on top of the restrictions attributed to dividends and bonus payments additional measures might also include conditions identifying with the suitability of the aid; entry and exit specifics; a prohibition on share buybacks; restrictions with regard to cross subsidisation relevant to the business or its parts that had financial difficulties prior to 31 December 2019; and acquisition ban that prevents acquiring more than 10% in competitors or other operators in the same line of business

859 Competition and Markets Authority, 'Decision to issue interim measures directions. Competition Act 1998. Investigation into the Atlantic Joint Business Agreement. Case number 50616' Available online at: <https://assets.publishing.service.gov.uk/media/624ac1c5d3bf7f32b2e52601/Investigation_Atlantic_JointBusinessAgreement_InterimMeasures_--.pdf> accessed 12 June 2023.

860 Case T-142/21, Judgment of the General Court (Tenth Chamber, Extended Composition). 29 March 2023 available online at: https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:62021TJ0142, accessed 12 June 2023.

861 IP/20/838. State aid: Commission expands Temporary Framework to recapitalisation and subordinated debt measures to further support the economy in the context of the coronavirus outbreak. Press release 8 May 2020 Brussels available online at: <https://ec.europa.eu/commission/presscorner/detail/en/ip_20_838> accessed 12 June 2023.

(including suppliers and customers) as long as at least 75% of the recapitalisation measures have not been redeemed.[862]

Another demonstrative instance is Lufthansa's rescue package.[863] On 24 May 2020, the German government informed that it had approved a substantial €9 billion rescue package for Lufthansa, including a recapitalisation prompting a state shareholding of 20%. The European Commission conditioned an approval to slots divestitures at Lufthansa's Frankfurt and Munich hubs. After certain hesitation, Lufthansa's supervisory board had accepted the slot allocation condition on 30 May 2020 with 24 landing slots at Frankfurt and Munich were given up in exchange for the rescue package.[864] With a huge capital infusion and solid investor, slot allocation appears to be even more inadequate remedy that should aim to balance the market and create opportunities. However, it is very difficult to image how the released/divested slots will assist to address the overall downfall of the airline sector during the pandemic and post-pandemic times. Ryanair, not surprisingly, has taken several legal actions and appealed decisions including State Aid has been given by their respective countries to SAS, Finnair, TAP, Air France, KLM, Lufthansa[865] and Condor[866]. The main arguments have been discrimination based on nationality and free movement of services underpinning the liberalisation of air transport in the EU and ignoring the role of pan-European airline low-cost airlines. Ryanair argued that the decisions allowed certain countries to provide financial aid exclusively to the airlines with the national operating licenses. Strong argument has been raised to support the claims that while Article 107(2)(b) TFEU provides for an exception to the prohibition of State aid under Article 107(1) TFEU, it does not provide an exception to the other rules and principles of the TFEU. It has been further suggested that an evident error of assessment in its review of the proportionality of aid for damage caused by the COVID-19 has taken place.[867] In general, the effectiveness of the state aid conditions is very doubtful. These are predominantly corporate restrictions related to the business activities; their application is doubtful even in the normal course of business conduct in accordance

862 Thomas Wilson, Philip Gnatzy, 'COVID-19 and EU State Aid Recapitalisation' Kluwer Competition Law Blog, available online at; <http://competitionlawblog.kluwercompetitionlaw.com/2020/05/15/covid-19-and-eu-state-aid-recapitalisation/ accessed February 2021.

863 Joe Miller, Laurence Fletcher 'Lufthansa shareholders back €9bn bailout package'. Financial Times. 25 June 2020 available online at; <https://www.ft.com/content/e7f87a03-e77f-46cc-933e-95cd50a60640> accessed on 26 November 2020.

864 Joe Miller, Peggy Hollinger 'Lufthansa chief says €9 bn bailout larger than needed for survival' available online at: https://www.ft.com/content/5c32cd83-e639-4421-9ae2-8165ecdd5097 accessed 12 June 2023; Simple Flying, 'Lufthansa Board Approves Giving Up Slots For A Bailout'. May 30, 2020 available online at: <https://simpleflying.com/lufthansa-approves-bailout-package/> > accessed 12 June 2023.

865 Valius Venckunas 'Ryanair to take six airlines to European Court of Justice' (31st August 2020) https://www.aerotime.aero/valius.venckunas/25766-ryanair-to-take-six-airlines-to-european-court-of-justice accessed 26 November 2020.

866 *Ryanair v Commission* T-665/20 before the General Court.

867 Case T-259/20 *Ryanair v Commission*: Action brought on 8 May 2020.

with corporate law provisions (i.e., distribution of the dividends is generally prohibited in the loss-making companies under the UK Companies Act 2006[868]).

VIII. General Conclusion

In general, the airline business is receptive in relation to various external factors, which cannot be controlled or predicted. Pandemic monetary emergencies or terrorist attack of 9/11 have affected the airline business significantly. In spite of the fact that the exact fate of the airline business is difficult to be forecasted, some patterns have already been seen on the European Union market with the undeniable trend of changes.

As for the existing remedies attributed to the transactions within the aviation sector and intended to maintain the level playing field, most of them do not address concerns related to increased market power as a result of consolidations. As a result, the approach regularly taken by the Commission is ineffective and requires significant changes.

Decisions based on the current methodology of the Commission to remedies in the airline sector – regardless of whether they fit during the last 'merger wave' of 2008 and 2009[150] and should not be completely denounced – should be critically revaluated, particularly in the light of the emergency in the air transport industry in the European Union. Although slot divestiture should continue to be offered as the additional element of the packages of commitments proposed, some extra more significant factors should be considered and reassessed by the Commission, including:

(i) The very narrow market definition (city pair air approach) prevented to see the 'bigger picture' and consider more extensive ramifications of the informed deal on the organisation. The European Commission should not be unreasonably concerned about anticompetitive impacts on short-haul routes;
(ii) The dynamic aspects of the market, and consequently more extensive acknowledgment of the Failing firm defence – particularly as the 'traditional' European air carriers may soon fail following the COVID-19 pandemic, alongside broad development of Gulf airlines;

868 Section 830 states: 'A company may only make a distribution out of profits available for the Intention… its accumulated, realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated, realised losses, so far as not previously written off…'

(iii) The evidence of past market conduct of the specific airline should be taken into account for the evaluation. For example, it may be imperative that the airline, even at times of its dominance in the applicable market, maintained competitive prices together with the good quality of services, in which case the Commission should take these factors into consideration;[869]

(iv) Up-front purchaser arrangements should be considered as the one of the most effective arrangements in the majority of the circumstances to address concerns attributed to an anticompetitive practice. In the event that the carrier can urge rival airlines to assume control over the divested slots on the affected routes and work the course for a sensible timeframe, the European Commission should acknowledge this remedy.

Devising an individual remedy in a specific case in question targeting particular concerns with the opportunity to monitor its implementation in order to address any deviations in the future is the key objective of the remedy and vital for the successful endurance of the market, while also preventing the potential impediments. In addition to reassessing the accuracy of the data, it would be prudent to monitor the implication of the remedies, by establishing a regular public reporting system with the data collection mechanisms. This could be conducted by the monitoring trustees and/or companies involved in order to evaluate the practicality of measures applied.

The alternative may be changes in regulatory regimes, which may also bring their own costs, of course, to the national economies and interests. With the international services provided by the European airlines, reductions in barriers (predominantly traffic rights) may diminish the unfair competition conditions, including dominance of certain airlines on certain rotations.

In summary, the current Commission's approach does not stimulate a competitive environment among the small and medium sized players or liberalise the process, overall. Remedies have no significant value for consumers and third parties (i.e., in a supply chain), due to lack of practical application with positive outcomes. Any new policy of the Commission must predominantly focus on providing a framework to motivate small players as new entries to the market rather than restricting activities of existing participants.

869 For instance, Ryanair adheres to its approach for sensible estimations of air tolls, even for routes where it does not confront observable competitive pressure from the competitors.

CHAPTER 8.
CONCLUSION

Competition is crucial to any liberalisation process, where a plurality of economic agents shall prevail. Only free and open markets, in fact, force companies to compete on their merits. If competition, by its nature, implies rivalry and exclusion of less efficient undertakings, the issue is to keep the competitive strategies within the space of compliance to competition law.

In the aviation market, European aviation policy has always been the product of conflicting and competing legal, economic and political interests. The key stakeholders include major publicly owned airlines, the European Union itself, and a number of air transport associations such as EASA. The complexity of the regulatory regime is characterised by several factors, including the state-owned heritage of the major airlines, attempts by the governments to protect national interests, high fixed cost structure and rather low variable costs.

The aim of this thesis has been to consider the role of the European Commission as the enforcer of EU competition policy in the regulation of the liberalising process of the airline market with the focus on the transactions such as mergers, alliances and joint ventures as well as state aid provided by the national governments and to substantiate the argument that the concept of the Single Aviation Market has not been fully implemented. Practical instruments have been suggested to address the occurring conflicts with a robust and comprehensive approach to guarantee the accurate evolution of the transactions in question. It is necessary to restate briefly the conclusions reached in this thesis.

Firstly, it was shown that the apparent decline of competitive levels in aviation sector is a troubling trend that requires appropriate policy responses to prevent the counterproductive detrimental effects on social welfare that non-competitive environment would unavoidably lead to. In addition, the thesis has suggested that aviation market is moving to the oligopoly model.

The solutions have been proposed by this thesis with the practical analysis in relation to their effectiveness and critique of the Commission's approach in the most significant transactions within the European Union's dimension in the last decade. As mentioned throughout this thesis, it has been the tendency of very limited assessment criteria alike O&D approach applied by the Commission.

The aim of this thesis has been focused on the Network Competition Approach as the most accurate approach to apply. It has been concluded that a network effect shall be taken into the consideration with increase of the value and diminishing effect within the overall network. It was demonstrated that the foundation of the Network Competition Approach is the fair-trade concept with a social welfare's consideration in a centre of the analysis together with such critical variables of assessment as the overall network, operational elements and financial strength that a transaction might lead to.

This thesis has advocated the concept that the level playing field shall stimulate equality of opportunities and maintain such equality by means of the preventing the reduction of the players as well as ensuring equal access to the market on the equal terms while also prevent favouritism of less efficient airlines.

In Chapter 3 the market definition was critically reviewed to demonstrate that the relevant market is defined inaccurately by the Commission as the Commission has neglected a number of criteria which can help it to analyse the behaviour of the airlines in the market and its [market] specific conditions.

Having examined the legal aspects of the Commission O&D approach this thesis has demonstrated that such approach does not follow the dynamics of the aviation market. Airlines have ability to enter the new markets, substitute fleets, pilots, and enhance their presence. To reiterate, for the airlines, the ultimate target of mergers in the majority of the circumstances is not the routes (city pairs) but assets and opportunities they bring. As a result, O&D approach has led to underenforcement and, therefore, the competition rules, in this respect, have not played an effective role in liberalisation. The only scenario for city pair approach to be justified is when the incumbents are limited to the existing network and are not allowed to extend its operations subject to further approvals by the competition authorities.

Chapters 4 to 6 have examined the substantive tests applied in mergers transactions, Articles 101 and 102 as well as State aid cases and identified weaknesses of the narrow approach taken by the Commission. It was argued that network aspects as well as financial strength are critical leverage in many aspects including access to the aircraft market, workforce and ability to observe losses in a short/mid-terms. For example, in case *Alitalia/Volare*,[870] the Italian Competition Authority considered the financial strength of Alitalia together with its distribution capacity a relevant factor in the overall competition assessment are of a significant relevance in the competition assessment.

870 Italian Competition Authority, *Alitalia/Volare*. Autorità garante della Concorrenza, decision in the case Alitalia/Volare Group, July 2003.

The counterfactual method in EU law has also been analysed with the Network Competition Approach has been suggested as an instrument to rectify the existing gaps within the Commission's assessment practice. Additionally, in regard to the application of the relevant standards, the willingness of the Commission to explore wider factors to gauge the effects of mergers requires a more structured set of guidelines in order to explain the various theories of harm that the Commission is pursuing. The main finding of Chapter 4 was that the network-based approach was able to provide an effective way of applying competition law prohibitions in EU law, and particularly those set out in Article 102(3) TFEU. The case-study of *British Airways/Virgin*[871] conducted in that chapter indicated that the Commission has, in more recent years, been seeking a way to identify real market-effects as part of an assessment of the nature of competition law breaches and this thesis suggests that this is very much the way in which the law ought to be applied in this area.

Chapter 5 conducted an empirical study of the case law and indicated fundamental elements of the network assessment in relation to Articles 101 and 102 and underlined the ultimate dimension for the assessment of the transaction in question i.e., both hub-to hub and interline markets, which should be also applied to the appraisals.

In addition, a question has been raised of whether discrimination that harms particular trading parties, but benefits consumer welfare overall is objectively justified under Article 102 and is therefore of considerable practical importance. It was concluded that as part of the substantive test any agreement under the assessment shall be examined on whether it have benefitted consumers and ultimately increased the value of services which is part of the network competition analysis.

Furthermore, a necessity for the evidence of the competitive disadvantage has been examined. As it was stated, it has been understood that Article 102 required a material competitive disadvantage. Difference in treatment is contrary to Article 102 "only if it gives rise to a significant competitive disadvantage". Since the dominant enterprise will not necessarily know enough regarding non-associated companies' business to be able to judge this, the key question is "whether a reasonable company in the position of the dominant enterprise should have known that a significant competitive disadvantage was likely to arise". *British Airways/Virgin*[872] supported the need for some evidence of

871 Commission Decision of 14 July 1999 *Virgin/British Airways* (1999) OJ L 30.

872 Commission Decision of 14 July 1999 *Virgin/British Airways* (1999) OJ L 30.

a non-trivial distortion of competition between the parties. It was argued that the economic analysis might be a misleading tool for the assessment purpose and broader scrutiny shall be applied in order to elicit the most accurate outcome of the aid in question.

It was concluded that the approach of the Commission is most likely to be shifted towards the urgent industrial policies and social welfare concerns as a predominant driver in its decision-making process.

Chapter 6 identified a significant challenge in the wake of Covid-19 for European airlines which had resulted in a growing and identifiable trend towards consolidation. There had, moreover, been a generally rather poor approach towards compliance with State Aid rules by States who are seemingly stubbornly convinced of the need to continue to subsidise failing and insolvent national 'champion' flag-carriers in particular. This negatively impacts the market, competition, and overall social and consumer welfare, but there does appear to be something of a political reluctance to tackle this which has led to a static and rather ineffective approach in the wake of Covid-19.

Chapter 7 constructed approach towards remedies and has given the criticism that has been targeted at ineffective nature of the current remedies applied by the Commission. It was illustrated that current remedies and approach in their application do not restrict the incumbents in the mid and long terms. It proposed new remedies based on a synthesis of the existing instruments defined in the thesis while also concluded that the Commission's assessment should not be based upon mere economy of scale; increased demand itself does not necessarily lead to efficiencies with inadequate criteria of economies of scale based on the demand side applied. Although the merged airlines may 'offer' some measures to address the anticompetitive concerns, it may not either be used to the full extent or may be used by other large incumbents which leaves small players with no opportunity to rely upon the benefits that such remedy is intended.

Finally, the state aid related concerns have been presented with the indicative arguments raised in regard to the urgent but anticompetitive decisions made in light of the Covid-19 outbreak. This thesis also provides grounds for further research and should also act as encouragement for further study of the proposed Network Competition Approach.

Ultimately, the Commission must consistently enforce the Competition law in such manner as to the avoid misapplication of the Competition principles and policies due to external, non-legal considerations. Overall, the thesis has led to a definite conclusion that the current methodology and

practical remedies within the European jurisdiction offered by the parties and accepted by the Commission are inadequate and require critical review.

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