Concentrations in the Aviation Sector: How to maintain the level playing field for airlines and airports?

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Table of Contents

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Abstract

Before the Covid-19 pandemic hit, the scheduled passenger air transport sector was already subject to several horizontal concentrations. The mix of free competition and strict regularization in the air transport sector in the EU raises the question whether the current framework will still be able to provide a level playing field to the market participants, notably airlines and airports. The study focusses on how EU competition law has influenced horizontal concentrations (i.e. mergers and horizontal co-operations) in the scheduled passenger air transport sector. The results of the discussion are the basis for a reflection of the effects of different types of horizontal concentrations on the negotiation power of airlines vis-à-vis airports. A third focus of the study is the identification of regulatory weaknesses with regard to airport financing under the Airport Charges Directive (Directive 2009/12/EC), how those weaknesses benefit airlines and how they might interfere with efforts made under the application of competition law.

Keywords: Aviation Sector, Airline, Airport, Horizontal Agreements (Art. 101(3) TFEU), Airport Charges Directive

A. Introduction

The aviation sector is arguably one of the sectors most hit by the Covid-19 pandemic. In November 2020, IATA[1] estimated that the system-wide global commercial airlines would suffer revenue losses of 60.9 %, the operating loss being 31.3 % in the year 2020.[2] The availability of a vaccine in the second half of 2021 is anticipated to be a turning point, but the recovery will still take time.[3] IATA expects that the level of 2019 with regard to the Revenue Passenger km (RPK) will only be reached again in

1 The International Air Transport Association (IATA) is the trade association for the world's airlines, representing some 290 airlines or 82% of total air traffic.

2 *IATA Industry Statistics*, Fact Sheet November 2020, available at: https://www.iata.org/en/iata-repository/publications/economic-reports/airline-industry-economic-performance---november-2020---data-tables/ (6/4/2021).

3 *IATA*, Economic Performance of the Airline Industry, 24/11/2020, available at: https://www.iata.org/en/iata-repository/publications/economic-reports/airline-industry-economic-performance---november-2020---report/ (6/4/2021).

2024.[4] Against that background, governments in the EU and elsewhere have provided subsidies to the struggling aviation sector. The large-scale government intervention in the aviation sector, triggered by the Covid-19 pandemic crisis, might hold back sector consolidation for up to five years.[5] Since the governments' financial resources (as well as the political willingness) are not unlimited and airlines will run out of liquidity likely before the end of the Covid-19 pandemic is reached, there is an expectation that the Covid-19 pandemic will, nevertheless, lead to a consolidation in the aviation sector.

The scheduled passenger air transport sector[6] was already subject to several horizontal concentrations over the last decade. However, the previous concentration process may have led to dysfunctionalities in the sector which could be further intensified in the concentration process triggered by the Covid-19 pandemic. The mix of free competition and strict regularization in the air transport sector in the EU raises the question whether the current framework will still be able to provide a level playing field to the market participants in the aftermath of the Covid-19 pandemic.

The analysis of the Commission's decision practice in the past years in merger cases and horizontal co-operations between airlines will provide the ground for a reflection of the effects of different types of horizontal concentrations on the negotiation power of airlines vis-à-vis airports. A focus of the study is the identification of regulatory weaknesses with regard to airport financing under the Airport Charges Directive, how those weaknesses benefit airlines and how they might interfere with efforts made under the application of competition law.

B. Brief history of competition law in the aviation sector in the internal market

I. Establishing a level playing field

The beginnings of civilian aviation were dominated by national flag-carriers, i.e. airlines operating commercially, but promoted – and frequently owned – by national governments. The liberalization of the Community aviation market was achieved through three liberalization packages:[7]

- First liberalization package of December 1987: Removal of the "single designation" provisions so that any number of airlines were able to operate on the major international routes in the Community; overriding the insistence of several Member States that their national airline be given a 50+1 % share of the market; removal of

4 *IATA*, Covid-19 Outlook for air transport and the airline industry, 24/11/2020, available at: https://www.iata.org/en/iata-repository/publications/economic-reports/airline-industry-economic-performance-november-2020---presentation/ (6/4/2021).

5 *Alexandre de Juniac*, Director General of IATA, in an interview with Reuters, 17/3/2021, available at: https://www.reuters.com/article/us-health-coronavirus-airlines-iata-idUSKBN2B92F4 (6/4/2021).

6 This study will focus on competition law challenges arising in the context of scheduled passenger air transport services in the internal market.

7 For details see https://researchbriefings.files.parliament.uk/documents/SN00182/ SN00182.pdf (21/8/2020).

most capacity restrictions; giving airlines automatic but limited right to operate 'Fifth Freedom of the Air'[8] services in the territories of two or more other Member States; removing the ability of Member States to block proposals for economic low fares.[9]

- Second liberalization package of July 1990: Clearer criteria according to which the Member States' authorities have to evaluate proposed air fares (a system of 'double disapproval' of air fares being the objective); opening up of routes between almost all European Community airports; relaxing restrictions on Fifth Freedom services; easing restrictions on multiple designation on airlines on particular routes.[10]
- Third liberalization package of June 1992: Introduction of common specifications and criteria for the licensing of carriers and the provisions of a Community air transport certificate, i.e. any airline which meets common safety, nationality and fitness (such as insurance to cover liabilities) criteria is entitled to an operating license anywhere in the Community; abolishing restrictions on charter airlines and limits on the number of 'seat only' sales; further removal of barriers to access for Community air carriers to intra-Community air routes (Seventh[11] and Eighth[12] Freedom of the Air); introduction of safeguards for new inter-regional services; prevention of capacity limitations except for environmental and/or air traffic reasons; further liberalization of the price setting, i.e. airlines became able to set their

8 The right or privilege, in respect of scheduled international air services, granted by one State to another State to put down and to take on, in the territory of the first State, traffic coming from or destined to a third State (https://www.icao.int/Pages/freedomsAir.aspx (21/8/2020)).

9 Council Regulation (EEC) No 3975/87 of 14 December 1987 laying down the procedure for the application of the rules on competition to undertakings in the air transport sector OJ L 374 of 31/12/1987, p. 1; Council Regulation (EEC) No 3976/87 of 14 December 1987 on the application of Article 85 (3) of the Treaty to certain categories of agreements and concerted practices in the air transport sector OJ L 374 of 31/12/1987, p. 9; Council Directive 87/601/EEC of 14 December 1987 on fares for scheduled air services between Member States OJ L 374 of 31/12/1987, p. 12.

10 Council Regulation (EEC) No 2342/90 of 24 July 1990 on fares for scheduled air services OJ L 217 of 11/8/1990, p. 1; Council Regulation (EEC) No 2343/90 of 24 July 1990 on access for air carriers to scheduled intra-Community air service routes and on the sharing of passenger capacity between air carriers on scheduled air services between Member States OJ L 217 of 11/8/1990, p. 8; Council Regulation (EEC) No 2344/90 of 24 July 1990 amending Regulation (EEC) No 3976/87 on the application of Article 85 (3) of the treaty to certain categories of agreements and concerted practices in the air transport sector OJ L 217 of 11/8/1990, p. 15.

11 The right or privilege, in respect of scheduled international air services, granted by one State to another State, of transporting traffic between the territory of the granting State and any third State with no requirement to include on such operation any point in the territory of the recipient State, i.e. the service need not connect to or be an extension of any service to/from the home State of the carrier (https://www.icao.int/Pages/freedomsAir.aspx (21/8/2020)).

12 The right or privilege, in respect of scheduled international air services, of transporting cabotage traffic between two points in the territory of the granting State on a service which originates or terminates in the home country of the foreign carrier or (in connection with the so-called Seventh Freedom of the Air) outside the territory of the granting State (https://www.icao.int/Pages/freedomsAir.aspx (21/8/2020)).

own fares on services within and between Member States (no more 'double disapproval' requirement); establishment of rules regarding the procedure for the application of the rules on competition to undertakings in the air transport sector and rules on the application of Art. 85(3) of the EC Treaty to certain categories of agreements and concerted practices in the air transport sector.[13]

Hence, as of 1 January 1993, the European single aviation market came into effect (with some exceptions). The Licensing of the Air Carriers Regulation, the Route Access Regulation and the Fares Approval Regulation were replaced by a single Air Services Regulation in 2008.[14]

In parallel to the liberalization process of the aviation sector, the rules on State aid to airlines and airports became continuously stricter. The Commission addressed this notably in a communication of 1 June 1994.[15] Shortly after, the Commission adopted revised guidelines on the application of the State aid rules in the aviation sector.[16] In 2005, the Commission adopted guidelines on financing of airports and start-up aid to airlines departing from regional airports ('2005 Aviation guidelines').[17] Those guidelines specified the conditions under which certain categories of State aid could be declared compatible with the internal market. The Guidelines were revised in 2014 ('2014 Aviation guidelines').[18] Art. 56a of the GBER[19] foresees exemptions for investment and operational aid to regional airports. The Commission is currently reviewing these legal frameworks. A key issue considered by the Commission is the power wielded by low-cost airlines over regional airports, along with general consid-

13 Council Regulation (EEC) No 2407/92 of 23 July 1992 on licensing of air carriers OJ L 240 of 24/08/1992, p. 1; Council Regulation (EEC) No 2408/92 of 23 July 1992 on access for Community air carriers to intra-Community air routes OJ L 240 of 24/8/1992, p. 8; Council Regulation (EEC) No 2409/92 of 23 July 1992 on fares and rates for air services OJ L 240 of 24/8/1992, p. 15; Council Regulation (EEC) No 2410/92 of 23 July 1992 amending Regulation (EEC) No 3975/87 laying down the procedure for the application of the rules on competition to undertakings in the air transport sector OJ L 240 of 24/8/1992, p. 18; Council Regulation (EEC) No 2411/92 of 23 July 1992 amending Regulation (EEC) No 3976/87 on the application of Article 85 (3) of the Treaty to certain categories of agreements and concerted practices in the air transport sector OJ L 240 of 24/8/1992, p. 19.

14 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 L 293 of 31/10/2008, p. 3.

15 'The European Commission – is of the opinion that financial State support for restructuring air carriers can be accepted only if it does not distort or threaten to distort competition.', *Commission of the European Communities*, The Way Forward for Civil Aviation in Europe, COM(94) 218 final, available at: http://aei.pitt.edu/4740/1/4740.pdf (23/8/2020).

16 Application of Articles 92 and 93 of the EC Treaty and Article 61 of the EEA Agreement to State aids in the aviation sector OJ C 350 of 10/12/1994, p. 5.

17 *European Commission*, Communication from the Commission – Community guidelines on financing of airports and start-up aid to airlines departing from regional airports, OJ C 312 of 9/12/2005, p. 1.

18 *European Commission*, Communication from the Commission – Guidelines on State aid to airports and airlines OJ C 99 of 1/7/2014, p. 3.

19 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 OJ L 187 of 26/6/2015, p. 1, hereinafter 'GBER'.

erations of sustainability.[20] On 2 July 2020, the Commission announced the prolongation of the validity of certain State aid rules which would otherwise have expired at the end of 2020.[21] The GBER and the De minimis Regulation were prolonged by three years, i.e. until 2023.[22] The 2014 Aviation Guidelines are currently under review, too, but do not face an expiry date, which is why they do not need prolongation.[23]

II. The success of LCCs and multi-hub strategies

The outcome of the liberalization in the aviation sector is remarkable and the landscape has fundamentally changed since the first liberalization package.[24] Following the liberalization there was a big increase in the late 1990s in the number of flights and routes served. The airline business models evolved, with a growing distinction between the services of Full Service Carriers (FSC) and Low-Cost Carriers (LCC). Whereas some LCCs expanded into low-cost long-haul, FSC increased multi-hub strategies. FSCs have expanded their presence in airports. Other than their presence in traditional hubs, a number of large airline groups now operate multiple hubs and there are now recent examples of these groups even moving aircraft between these hubs (a recent example being Lufthansa's transferral of A380 from Frankfurt to Munich, see below footnote 133). As a result of these developments, these groups have greater buyer power than they did in the past. In addition, LCCs are starting to provide feeder services connecting to long-haul networks, and to offer low-cost long-haul services that often bypass traditional hub airports.[25]

20 *Strom*, Air & Space L. 2020, p. 104.

21 *European Commission*, Press Release of 2/7/2020 (IP/20/1247), available at: https://ec.europa.eu/commission/ presscorner/detail/en/ip_20_1247 (25/8/2020).

22 *European Commission*, Communication from the Commission concerning the prolongation and the amendments of the Guidelines on Regional State Aid for 2014-2020, Guidelines on State Aid to Promote Risk Finance Investments, Guidelines on State Aid for Environmental Protection and Energy 2014-2020, Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty, Communication on the Criteria for the Analysis of the Compatibility with the Internal Market of State Aid to Promote the Execution of Important Projects of Common European Interest, Communication from the Commission – Framework for State aid for research and development and innovation and 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, OJ C 224 of 8/7/2020, p. 2.

23 See 2014 Aviation Guidelines.

24 *Iván*, Air & Space L. 2018, pp. 319, 324; *Frontier Economics (Elliott/Ong),* Coming down to Earth – Airport Ownership and Productivity (2019), available at: www.frontier-economics.com/uk/en/news-and-articles/articles/article-i6391-coming-down-to-earth/ (19/8/2020).

25 *Oxera*, The continuing development of airport competition in Europe (2017), available at: www.oxera.com/publications/the-continuing-development-of-airport-competition-in-europe (19/8/2020), p. 7.

C. Maintaining the level playing field in the internal market in the sector of scheduled passenger air transport services

After the third liberalization package, the Commission's focus was on maintaining the fair competition in the now liberalized market, especially in the scheduled passenger air transport services.

I. Market definition for scheduled passenger air transport services

Regardless of whether the Commission investigates a merger, a cartel or an exemption under Art. 101(3) TFEU, the same market definition applies. Each service of air transport between the point of origin and the point of destination is considered a relevant product market and, at the same time, the relevant geographic market.[26] From case to case, the commercial conditions applicable to this transportation service can be further narrowed, i.e. an identifiable group of customers could constitute in itself a significant submarket. For instance, sometimes a distinction can be made between business and leisure travellers.[27]

II. M&A decisions

Nationality restrictions in national laws and in bilateral 'Air Service Agreements' between two countries (ASA) provided that majority ownership and effective control of airlines were vested in the country of airline designation and/or its nationals. This forced the airlines to establish themselves in their homelands. Cross-border airline mergers, to the extent that they modify airlines' ownership and control regime, put traffic rights at risk.

The concept of a 'Community carrier' was supposed to ease that barrier to intra-Community mergers and acquisitions. Regulation (EC) No 1008/2008 established that a valid operating licence granted by a competent licensing authority entitles the 'Community air carrier' to operate any intra-Community air services (Art. 15(1)), in particular the transport of passengers, cargo and mail without further authorisation.[28] The two elements of (i) ownership in excess of 50 %, and (ii) effective control, by Member States or their nationals, are distinct and cumulative.[29] However, the Member States seem to be locked in a prisoner's dilemma: Abolishing restrictions under national laws unilaterally without, at the same time, phasing out ownership and

26 *Van Houtte*, C.M.L.R. 1990, p. 536.
27 For instance *Air France/KLM/Alitalia/Delta* (Case AT.39964), Commission Decision, OJ C 212 of 27/6/2015, p. 5.
28 *European Commission*, Commission Notice – Interpretative guidelines on Regulation (EC) No 1008/2008 of the European Parliament and of the Council – Public Service Obligations (PSO), OJ C 194 of 17/6/2017, p. 1, para. 2.
29 *European Commission*, Commission Notice – Interpretative guidelines on Regulation (EC) No 1008/2008 of the European Parliament and of the Council – Public Service Obligations (PSO), OJ C 194 of 17/6/2017, p. 1, para. 4.

control clauses in bilateral agreements, would jeopardize airlines' traffic rights under the bilateral agreements; likewise, waving the ownership and control clauses in bilateral agreements would disadvantage domestic airlines over foreign airlines. Therefore, it seems that, for as long as Member States negotiate market access bilaterally, the nationality rule will remain in effect.[30] As a result, airlines refrained from merging for the longest time and forged horizontal co-operations and alliances instead.[31]

Against that background, it is not surprising that only a few mergers and acquisitions were notified to the Commission under the Merger Regulation[32] over the past years.

The Commission could not identify competition concerns in the following cases:

- Qatar Airways/Alisarda/Meridiana (M.8361),[33]
- EasyJet/certain Air Berlin assets (M.8672),[34]
- Ryanair/LaudaMotion (M.8869),[35]
- Delta/Air France-KLM/Virgin Group/Virgin Atlantic (M.8964).[36]

Air Canada and Transat (M.9489) withdrew their proposed merger before the Commission could come to a final decision.[37]

Other merger approvals were conditional to structural remedies (which aim at changing the allocation of property rights, for example, through full or partial divestitures of products) and/or behavioural remedies (which impose constraints on the merged firms' property rights, for example, through regulatory-type interventions):

- Alitalia/Etihad (M.7333),[38]
- IAG/Aer Lingus (M.7541),[39]
- Lufthansa/certain Air Berlin assets (M.8633),[40]
- Connect Airways/Flybe (M.9287).[41]

30 *Lykotrafiti*, Air & Space L. 2019, p. 361.
31 Ibid., p. 348.
32 Council Regulation (EC) 139/2004 on the control of concentrations between undertakings (EC Merger Regulation) [2004], OJ L 24, p. 1.
33 *Qatar Airways/Alisarda/Meridiana* (Case M.8361), Commission Decision, OJ C 122 of 19/4/2017, p. 1.
34 *Eaysyjet / Certain Air Berlin Assets* (Case M.8672), Commission Decision, OJ C 27 of 25/1/2018, p. 1; *Rabinovici*, J.E.C.L. & Pract. 2018, pp. 282, 285.
35 *Ryanair/Laudamotion* (Case M.8869), Commission Decision, OJ C 366 of 10/10/2018, p. 1.
36 *Delta/Air France-KLM/Virgin Group/Virgin Atlantic* (Case M.8964), Commission Decision, OJ C 15 of 14/1/2021, p. 1.
37 *European Commission*, Press Release of 2/4/2021 (Statement/21/1562), available at: https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT_21_1562 (6/4/2021).
38 *Alitalia/Etihad* (Case M.7333), Commission Decision, OJ C 31 of 30/1/2015, p. 1.
39 *IAG/Aer Lingus* (Case M.7541), Commission Decision, OJ C 314 of 23/9/2015, p. 1.
40 *Lufthansa/Certain Air Berlin Assets* (Case M.8633), Commission Decision, OJ C 60 of 16/2/2018, p. 3; *Rabinovici*, J.E.C.L. & Pract. 2018, p. 286.
41 *Connect Airways/Flybe* (Case M.9287), Commission Decision, OJ C 408 of 27/11/2020, p. 2.

In all of these decisions, the Commission's remedy of choice was primarily the release of slots to new entrants at the relevant airports. This remedy was used in all the cases where there was a competition concern. Choosing the release of slots is comprehensible, as this remedy has, on the one hand, the most immediate effect, and on the other hand, can be easily monitored by the Commission.

However, other remedies, especially the obligation to enter into special prorate agreements, fare combinability agreements and interline agreements as well as access to FFP, were imposed as accompanying measures. Those measures can have effects that go beyond the relevant market (i.e. airport-pairing), but rather have implications on the airline's business at large.

Apparently, the slot release per se is in the Commission's view not sufficient to remove the competition concerns on the relevant routes. This is interesting in two aspects: On the one hand, compared to the slot release, such remedies require the willingness and ability of third-parties to enter into such agreements in order to be successful. They also probably have no immediate effect since they require a negotiation phase. Both factors impede the Commission's ability to monitor the commitments. On the other hand, the release of more slots instead of the other types of remedies appears not to be a suitable option for the European Commission, or at least not proportionate. What remains is the realisation that the opening up of slots and grandfathering rights is apparently not sufficient from the Commission's point of view to completely eliminate competition concerns. Rather, the Commission recognizes network effects in the aviation sector and explicitly includes into its assessment the effects of the restriction of competition that go beyond the relevant market.

III. Decisions on horizontal agreements between airlines

Few cartel cases have been investigated by the Commission over the past years, the most prominent ones being the Airfreight cartel case, which was triggered after an immunity application by Lufthansa in 2005,[42] and Brussels Airlines/TAP Air Portu-

42 The following investigation revealed that multiple airlines conspired to raise fuel and security charges for all their customers, thus eliminating several parameters of competition on the market. But the Airfreight cartel case also raised preliminary issues concerning the Commission's jurisdiction to review the infringement in relation to third country routes prior to 1 May 2004, and also put under scrutiny the Commission's single complex and continuous infringement concept to aggregate all the alleged infringements. On 9 November 2010 the Commission adopted a decision addressed to eleven airline cargo carriers, whereas the Statement of objection was previously addressed to even 23 aviation carriers (Summary of Commission Decision of 9 November 2010 relating to a proceeding under Article 101 of the Treaty on the Functioning of the European Union, Article 53 of the EEA Agreement and Article 8 of the Agreement between the European Community and the Swiss Confederation on air transport (Case AT.39258) (notified under document number C(2010) 7694) OJ C 371 of 18/10/2014, p. 11). The Commission's decision was later annulled by the GC for all applications based on procedural ground (GC, case T-46/11, *Deutsche Lufthansa et.al. v. European Commission*, ECLI:EU:T:2015:987, in relation to British Airways this annulment was partial based on its application and Quantas did not brought an appeal). British Airways' appeal of the GC's decision remained unsuccessful (GC, case T-48/11,

gal. [43] Most recently, Ryanair submitted a price-fixing complaint against Lufthansa and three Italian airlines. Ryanair suspects an alliance against low-cost airlines between Air Dolomiti (a Lufthansa subsidiary) and Alitalia, Neos and Blue Panorama (all Italian local airlines). Ryanair based its assertion on reports in the Italian media in June 2020 that four local airlines had 'teamed up against low cost' to introduce minimum prices. The media reports said that the chief executives of the four Italian carriers recently met in Rome to discuss how they could collaborate in areas such as code-sharing, maintenance and sales.[44]

There is a fine but momentous line between Art. 101(3) TFEU and a hard core infringement under Art. 101(1) TFEU.

Many airlines have, since the liberalization process, in part successfully argued their cases under Art. 101(3) TFEU (and its predecessors) and obtained confirming exemption decisions. This contributed to the great success story of airline alliances since the liberalization in the 1990s. True global airlines were not possible because of the nationality restrictions in national laws and ASAs. However, it became clear, firstly, that a single airline was not able to efficiently serve every destination its customers require with its own aircraft, and secondly, that only few city-pairs can generate sufficient demand on a daily basis to sustain non-stop services. Carriers therefore must seek commercial partners that can help them provide greater network coverage and increased service option.[45] Airline alliances became the industry's survival mechanism in the context of the globalization of competition.[46] The pioneers were KLM and Northwest, whose co-operation was first approved by an US DOT antitrust immunity in January 1993.[47]

British Airways v. European Commission, ECLI:EU:T:2015:988). The Commission the was obliged to reinitiate the proceedings and, on 17/3/2017, adopted a new decision, rectifying in particular the defective statement of reasons and the contradiction on procedural grounds (Summary of Commission Decision of 17/3/2017 – Relating to a proceeding under Article 101 of the Treaty on the Functioning of the European Union, Article 53 of the EEA Agreement and Article 8 of the Agreement between the European Community and the Swiss Confederation on Air Transport (Case AT.39258) (notified under document C(2017) 1742) OJ C 188 of 14/6/2017, p. 14; *Leandro*, Air & Space L. 2020, p. 201, 217.

43 *European Commission*, Press Release of 8/11/2018, available at: https://ec.europa.eu/competition/ antitrust/cases/dec_docs/39860/39860_4248_3.pdf (23/8/2020).

44 https://corporate.ryanair.com/news/ryanair-to-challenge-lufthansa-bailout/ (23/8/2020); www.mlex.com/GlobalAntitrust/DetailView.aspx?cid=1202269&sited=190&rdir=1 (23/8/2020).

45 *European Commission and United States Department of Transportation,* Transatlantic Airline Alliances: Competitive Issues and Regulatory Approaches, 2010, p. 3.

46 *Lykotrafiti*, Air & Space L. 2019, pp. 386 f.

47 A summary of the negotiations and arguments exchanged is provided in *Lykotrafiti*, Air & Space L. 2019, p. 362.

1. Economic reasoning behind horizontal agreements between airlines

The reasons for airlines to form alliances are various:

- Achievement of better network reach through a comprehensive route network, more convenient and better coordinated schedules, single online prices, single point check-in, coordinated service and product standards, reciprocal frequent flyer programs (FFP), service upgrade potential, co-operation for feeder traffic;
- Wider brand recognition at limited cost, i.e. an alliance member can familiarize customers with its individual brand and an alliance member can benefit of the association with the brand, which can be of particular importance to smaller alliance members with a limited marketing budget;
- Providing better offers to corporate customers, certain of which may be interested in a single contract covering a large network and offering attractive schedules; however, outside of a revenue-sharing joint venture and a code-sharing joint venture with price coordination any coordination on prices is prohibited by law;
- Seeking to minimise risk exposure,
- Sharing the risks of launching new routes,
- Creating information technology projects.[48]

Generally, two types of alliances can be distinguished:

- 'Strategic Alliance', or 'Global Alliances': Members coordinate on a multilateral basis to create the largest possible worldwide joint network, the coordination typically applies to the entirety of member airlines' network. Generally, the larger scale offers a much wider scope for revenue synergies; however, strategic alliances can vary in their level of co-operation. Membership in a strategic alliance usually does not prevent the members from also forming tactical alliances with non-allied carriers and in some limited cases with members of other global alliances.[49]
- 'Tactical Alliance': Formed to address a specific deficiency in their networks, those agreements typically involve only two carriers and cover a limited number of routes, with the principal objective of providing connectivity to each carrier's respective networks. Tactical alliances often involve at least one independent carrier that is not a member of a strategic alliance.[50]

The deeper the co-operation between airlines, the more synergies can be created. At the same time, the deeper the co-operation, the more the co-operation resembles a merger-like integration.[51] However, on the one hand, the degrees of co-operation are not definitive and do not capture all the unique characteristics of each specific co-

48 *European Commission and United States Department of Transportation,* Transatlantic Airline Alliances: Competitive Issues and Regulatory Approaches, 2010, p. 8.
49 Ibid., p. 4.
50 Ibid.
51 *Lykotrafiti,* Air & Space L. 2019, p. 366.

operation between carriers.[52] On the other hand, large alliances unavoidably increase the complexity of governance and risk of inefficiencies that could ultimately 'eat up' the gained efficiencies and synergies.[53]

That being said, especially legacy carriers are particularly tempted to adhere to an alliance, as they have to face the competitive pressure by LCCs by expanding their global networks (which are an important comparative advantage versus LCCs) and making their overall costs more competitive with the growing LCC sector.[54] LLCs, on the other hand, are reluctant to join airline alliances, since they typically view independence or limited commercial co-operation as beneficial to their competitive strategies.[55] LCCs appear more likely to continue developing simplified forms of co-operation, which are less integrated and thus less costly than the global alliance model.[56]

Different elements can be part of the alliances. The benefits of the alliance depend on the level of co-operation within the alliance.

a) Interlining

Interlining means linking the networks of routes and selling tickets on the flights of their commercial partners, thereby offering travellers access to hundreds of destinations around the world on a single virtual network.[57]

b) Co-operation on FFP and lounge access

Although FFP are only secondary services to the main service 'air travel', FFP have become a centre of attention for competition authorities due to their potential for market foreclosure.

c) Simple code-share agreements

A simple code-share agreement allows for certain seats on a flight operated by one carrier also to be marketed by another carrier under its two-letter designator code.[58] Thus, code-sharing allows two carriers to market each other's service as if they were

52 *European Commission and United States Department of Transportation,* Transatlantic Airline Alliances: Competitive Issues and Regulatory Approaches, 2010, p. 5.
53 Ibid., p. 9.
54 Ibid., p. 3.
55 Ibid., p. 9.
56 Ibid., p. 10.
57 Ibid., p. 8.
58 For example, when United and Lufthansa code-share on flights between the United States and Germany, the Lufthansa designator (LH) can be found on flights operated by United (UA), long with UA's own designator, and the UA designator can be found on flights operated by LH, along with the LH code; *European Commission and United States Department of Transportation,* Transatlantic Airline Alliances: Competitive Issues and Regulatory Approaches, 2010, p. 4.

their own, thereby providing at least the appearance of seamless service.[59] Generally, two types of code-share agreements can be distinguished:

- Free sale arrangement: each carrier markets the flight, selling as many – or as few – seats as consumer demand requires, with no particular revenue goal;
- Blocked space arrangement: the marketing carrier will have a set number of seats to sell; if it fails to sell its full quota of seats, it bears the loss resulting from this excess inventory alone.[60]

Furthermore, hybrids of those types can be agreed on, such as a 'block space/give back' arrangement, where the marketing carrier is allocated a certain number to fill, but can give back seats to the operating carrier. Depending on the type of booking arrangement, the relationship between code-sharing partners may be fairly cooperative or may actually result in some level of competition between the two carriers to fill their respective seats.[61]

Code-share agreements raise concerns from a competition law perspective, apart from the general incentive for anticompetitive collusion. Simple code-share agreements trigger double mark-ups/double marginalization: When two airlines in a supply relationship mark up prices, they charge their respective partner above their respective marginal costs. This leads to allocative inefficiency, also called deadweight loss.[62] As a result, the final price paid by consumers in the downstream market is higher than the price that would be set by a vertically integrated company.[63] *Gilo* and *Simonelli* observed that ticketing carriers involved in code-sharing charged fares more than 4% higher than fares set by their code-sharing partner and almost 10% higher than other airlines in the same market.[64]

d) Complex code-share agreements: coordination on prices, routes, scheduling, and facilities

Code-share agreements can vary from simple sharing of a two-letter designator up to coordination on the operations side, i.e. instalment of coordinated schedules (in order to provide more convenient connecting times), sharing ticketing and gate facilities at various airports, and coordination of baggage handling.[65] The positive effects of coordination of schedules are important: Increased co-operation among airlines partners may allow for more efficient distribution of departures to account for partner connections.[66] Code-share agreements can also allow airline partners new or additional access to more markets, the partners will gain traffic, some stimulated by the new

59 *Harris/Kriban*, Air & Space L. 1998, p. 166.
60 Ibid., p. 167.
61 Ibid.
62 *Mohan*, Air & Space L. 1998, p. 157.
63 *Gilo/Simonelli*, J.C.L. & E. 2014, p. 72.
64 Ibid., p. 83.
65 *Harris/Kriban*, Air & Space L. 1998, p. 166.
66 *Calzaretta/Eilat/Israel,* J.C.L. & E. 2017, p. 515.

service, and some diverted from incumbents.[67] It further enables carriers to expand their route structure without the need for expending large amounts of capital.[68] Additionally, because of the network expansion, economies of density occur.[69]

e) Revenue sharing or profit/loss sharing joint ventures

The double marginalization problem can be overcome by increasing the co-operation to a point, where the effects of the respective pricing decisions are internalized in the co-operation (i.e. the transfer price is equal to marginal costs).[70] Depending on the parties' interest these forms of co-operation can be designed as revenue sharing joint ventures or profit/loss sharing joint ventures.[71] The associated capacity expansions, improved network planning, seamless ticketing, and integrated FFP and corporate programs provide direct benefit to nonstop as well as connecting passengers. In addition, these types of benefits are expected to increase demand for the cooperating carriers' services, and as traffic increases, airlines' costs may be lower due to economies of density. These reduced costs are expected to be passed on to passengers, at least in part, in the form of lower fares.[72]

f) Metal neutrality

The ultimate form of co-operation, which does not yet qualify as a merger, is discussed under the name 'metal neutrality', meaning that the partners in an alliance are indifferent as to which operates the 'metal' (aircraft) when they jointly market services.[73] This high degree of co-operation happened in few cases so far, sometimes leading to the creation of 'an alliance within an alliance'. This phenomenon first appeared in Sky Team, where the mergers between Air France-KLM and Delta-Northwest resulted in a four-way, metal-neutral joint venture.[74] However, the urge to achieve metal neutrality has left smaller, typically regional airlines behind, which *de facto* become feeders of large airlines' networks: Their job is to bring traffic from remote national markets to the hub airport and feed it to large airlines for further carriage to international markets.[75] Such dependence makes small airlines extremely vulnerable in a scenario where large airlines re-design their network and abandon a hub airport.[76]

67 *Harris/Kriban*, Air & Space L. 1998, p. 168.
68 Ibid.
69 *Calzaretta/Eilat/Israel,* J.C.L. & E. 2017, p. 504.
70 Ibid.; *Mohan*, Air & Space L. 2014, p. 158.
71 *European Commission and United States Department of Transportation,* Transatlantic Airline Alliances: Competitive Issues and Regulatory Approaches, 2010, p. 5.
72 *Calzaretta/Eilat/Israel,* J.C.L. & E. 2017, p. 504.
73 *Lykotrafiti*, Air & Space L. 2019, p. 349.
74 Ibid., p. 381.
75 Ibid., p. 385.
76 Ibid.

2. Legal thresholds when applying Art. 101(3) TFEU

According to Art. 101(1) TFEU, all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market are prohibited as incompatible with the market. Yet, according to Art. 101(3) TFEU, the provisions of Art. 101(1) TFEU may be declared inapplicable in the case of (1) any agreement or category of agreements between undertaking, (2) any decision or category of decisions by associations of undertakings, (3) any concerted practice or category of concerted practices, which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives, and (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

In other words: Art. 101(3) TFEU opens the door for an efficiency based assessment. An agreement must satisfy four cumulative, and exhaustive, conditions: (i) The agreement must contribute to improving the production or distribution of goods or contribute to technical and economic progress ('efficiency gain'), (ii) restrictions must be indispensable to the attainment of these objectives ('indispensability test'), (iii) the agreement must not afford the parties the possibility of eliminating competition in respect of a substantial part of product(s) in question ('possibility to eliminate competition'), and (iv) consumers must receive a fair share of the resulting benefits ('fair share to consumers').[77]

The procompetitive aspects of airline co-operation must be carefully balanced against the possible anticompetitive harm that might result from coordinated activities of competitors.[78]

a) Effects on the market price, notably through removal of double marginalization

The basic line of reasoning found in the literature is that co-operation between airlines, given the complementary nature of the product, removes double marginalization, thereby reducing the price for the interline trip, and allowing undertakings to make a higher profit. Additionally, any benefits of higher traffic due to co-operation between airlines are enhanced through economies of scope and traffic density, which in itself should also reduce the market price.[79] Still, the effects on the market prices need to be assessed on a case-by-case basis.[80]

77 *Mohan*, Air & Space L. 2014, p. 158.
78 *Harris/Kriban*, Air & Space L. 1998, p. 169.
79 *Bilotkach/Hüschelrath*, J.C.L. & E. 2011, p. 346.
80 Ibid., p. 351.

b) Effects on non-price parameters

The airline alliance will offer the passengers higher frequency of service (which could also lead to lower schedule delay and time savings), and better scheduling coordination between the partner airlines. Airlines also use their FFP to create horizontal product differentiation via brand loyalty.[81] In many cases, the Commission found strong evidence that the airlines flying into airports dominated by their FFP partners are able to get under the umbrella of what is known as the airport dominance effect, and perhaps most importantly, the scale of alliance-wide FFPs creates an additional potentially important entry barrier.[82]

c) Out of market efficiencies

Out-of-market efficiencies are efficiencies which are generated on markets other than the markets where concerns were identified.[83] According to the standard test set out by the Commission in its Guidelines, efficiencies on other markets can be accepted where two markets are related, and, cumulatively, the group of consumers affected and benefiting are substantially the same.[84] For the aviation sector, out-of-market effects can be the impact of a transaction on 'behind and beyond routes'. The Commission found that efficiencies on the related behind and beyond routes would also create efficiencies on the route of concern, including for those consumers who did not belong to the common consumer group between the route of concern and the related behind and beyond routes. For example, the elimination of the double marginalization would increase the number of passengers on the behind and beyond routes and, therefore, on the route of concern.[85] However, out-of-market efficiencies enjoyed by the passengers on the related behind and beyond routes, who do not travel on the route of concern, were not considered by the Commission. Hence, the broadened test does not weigh the harm suffered by one customer group against benefits perceived by another customer group.[86]

According to *Mohan*, the Commission's way to restrict out-of-market efficiencies to related markets is not in line with the Union court's case law. The Court of First Instance held in *Compagnie Générale Maritime v. Commission*,[87] that for the purpose of Art. 101(3) TFEU, considerations should be given to the advantages arising from the agreement in question not only for the relevant market, but also for every other market on which the agreement in question might have beneficial effects – and even, in a more general sense, for any service, quality or efficiency that might be improved

81 Ibid., p. 345.
82 Ibid., pp. 352 f.
83 *Mohan*, Air & Space L. 2014, p. 157.
84 Ibid., p. 155.
85 Ibid., p. 160; *Brueckner/Lee/Singer*, J.C.L.& E. 2011, p. 574.
86 *Mohan*, Air & Space L. 2014, p. 160.
87 Court of First Instance, case T-86/95, *Compagnie générale maritime v. Commission*, ECLI:EU:T:2002:50, ECR II-01011, paras. 350 ff.

by the existence of that agreement. The Court further stated that the exemption aimed to favour, amongst others, agreements which contribute to promoting technical or economic progress, without requiring a special link with the relevant market.[88]

d) Potential for market foreclosure

Market foreclosure involves denying actual or potential competitors access to either an essential input or customers. Doing so might be perfectly rational for the alliance members, as it not only increases their revenue, but also lowers their cost via economies of scope and traffic density (and increases the rivals' costs for the same reason). In the end, foreclosure will entail non-alliance carriers lowering their traffic from and into an alliance hub airport while alliance members keep increasing this traffic.[89] Furthermore, although foreclosure may not reduce overall competition between alliances (as the alliances will still channel their interline passengers via respective hubs, and may not technically exit any city-pair markets), non-stop competition on some important routes may be reduced.[90]

Barriers to entry, i.e. market dominance of an airline or an airline alliance at an airport, are mainly addressed through slot divestments. Interestingly enough, the US DOT for a long time refrained from slot remedies, considering them heavy-handed and overly invasive on the proposed transaction's business rationale, and preferred 'carve-outs', i.e. time-limited prohibitions on the parties to cooperate on certain routes where competition is limited. Since 2010, however, the US DOT applies slot remedies, too.[91]

e) Potential for collusion

Generally, it has been observed that the potential for collusion among firms or alliances increases with shrinking numbers of competitors as it becomes easier to reach and maintain a tacitly or overtly formed agreement.[92] Whenever a situation arises where competitors cooperate with one another, there is some risk that they will decide to extend that co-operation beyond the bounds of lawful activity.[93] Instead of trying to beat the competition, alliance partners may see the 'competition as a part of themselves' that is, partners in a long-term arrangement where both could benefit if they decide to cooperate. Thus, instead of trying to undercut one's code-sharing partner in order to sell all of the seats it has obtained under a blocked space arrangement, a carrier may decide to simply match its partner's prices, for that decision is likely to promote better alliance relations over the long-term.[94]

88 *Mohan*, Air & Space L. 2014, p. 161.
89 *Bilotkach/Hüschelrath*, J.C.L. & E. 2011, p. 345.
90 Ibid., p. 354.
91 *Lykotrafiti*, Air & Space L. 2019, p. 386.
92 *Bilotkach/Hüschelrath*, J.C.L. & E. 2011, pp. 356 f.
93 *Harris/Kriban*, Air & Space L. 1998, p. 169.
94 Ibid.

Further, according to the theory of multimarket contact, a firm will be less reluctant to compete aggressively in any given market against the firms with which it also competes in other markets.[95] Since airlines and airline alliances compete over thousands of city-pairs and therefore over thousands of markets, there is a strong incentive that airlines refrain from putting competitive pressure on their competitors on certain city-pair routes. Against that background, it is surprising that *Bilotkach* and *Hüschelrath* observed that the literature does not pay particular attention to the extent of multimarket contact and possible negative effects on competition intensity between the three global alliances.[96]

3. Case study

As of August 2020, the airlines have founded three global alliances:

- Star Alliance: Founded in 1996 by Air Canada, Lufthansa, SAS, Thai Airways and United Airlines, Star Alliance was the first global airline alliance linking five major airlines into a single network. Today, Star Alliance counts 26 member airlines and offers a comprehensive network spanning 195 countries worldwide.[97]
- Oneworld: Founded in 1999 by American Airlines, British Airways, Cathay Pacific, Canadian Airlines and Qantas; Oneworld as of June 2020 counts 13 members[98] and offers flights to 180 territories.[99]
- SkyTeam: Founded in 2000 by Delta, Air France, Aeroméxico and Korean, SkyTeam as of June 2020 counts 19 members[100] and offers flights to 175 countries.[101]

All three global alliances offer different degrees of integration to their members, i.e. only some members of the respective alliances have formed fully integrated joint ventures. The three global alliances form an effective triopoly in international aviation, especially in the transatlantic market.[102] Over the past decades, inter-airline competition has partially evolved to an inter-alliance competition between three global alliances.[103]

Alliances on a lower scale have only been subject to few Commission investigations. Two investigations were closed without further commitments:

- Deutsche Lufthansa/ Turkish Airlines (AT.39794),[104]

95 *Bilotkach/Hüschelrath*, J.C.L. & E. 2011, pp. 356 f.
96 Ibid.
97 www.staralliance.com/documents/20184/443290085/Star+Alliance+History.pdf/0e1057 7 d-4604-0b0a-8def-25a639981560?t=1571239100421 (14/6/2020).
98 www.oneworld.com/members (14/6/2020).
99 www.oneworld.com/world-travel (14/6/2020).
100 www.skyteam.com/en (14/6/2020).
101 www.skyteam.com/en/round-the-world-planner (14/6/2020).
102 *Bilotkach/Hüschelrath*, J.C.L. & E. 2011, p. 335.
103 *Lykotrafiti*, Air & Space L. 2019, pp. 386 ff.
104 *European Commission*, Press Release of 8/11/2018, available at: https://ec.europa.eu/competition/ antitrust/cases/dec_docs/39860/39860_4248_3.pdf (23/8/2020).

- Brussels Airlines/ TAP Air Portugal (AT.39860).[105]

Three investigations let to decisions in which the parties agreed to slot releases, special prorate agreements, fare combinability agreements and access to FFP:

- Continental/ United/ Lufthansa/Air Canada (AT.39595),[106]
- American Airlines/ British Airways Plc/ Iberia Líneas Aéreas de España (AT. 39596),[107]
- Air France-KLM/Alitalia/ Delta (AT.39964).[108]

There are probably much more airline co-operations out there than the overview on the case law suggests. However, most airline co-operations are never assessed by the Commission since there is no notification requirement for horizontal co-operations under Art. 101(3) TFEU. Unfortunately, this leads to a situation where there is only little decision practice. The worrying part for undertakings that wish to rely on case law precedents is that nowhere in any case was there any reference to reasons as to why the Commission allowed or disallowed the exemption under Art. 101(3) TFEU.[109] The Commission would probably argue that there is a detailed guidance on applicability of Art. 101 TFEU available.[110] Yet, the case law can provide some indications as to where the Commission's concerns lie and how to appease them.

Most importantly, the case law demonstrates that the Commission is not shy in imposing remedies on the involved parties. For this purpose, the Commission uses the same tools it already has experience with under the Merger Regulation (Section C.II.), i.e. a careful mix of the release of slots at the relevant airports and the obligation to enter into fare combinability and special prorate agreements with third parties. Providing access to FFP is the fourth tool to address the competition concerns.

D. Effects of concentrations on the airline level on airports

The concentrations in the airline industry either through mergers or through exempted forms of horizontal co-operations under Art. 101(3) TFEU are not without effect

105 Ibid.
106 *Continental/United/Lufthansa/Air Canada* (Case AT.39595), Summary of Commission Decision, OJ C 201 of 13/7/2013, p. 8.
107 *American Airlines/British Airways Plc/Iberia Líneas Aéreas de España* (Case AT.39596), Summary of Commission Decision, OJ C 278 of 15/10/2010, p. 14.
108 *Air France-KLM/Alitalia/Delta* (Case AT.39964) Decision; *Air France-KLM/Alitalia/ Delta* (Case AT.39964) Commitments; *Air France-KLM/Alitalia/Delta* (Case AT.39964), Summary of Commission Decision, OJ C 212 of 27/6/2015, p. 5.
109 *Sharma*, Air & Space L. 2016, p. 348.
110 For instance *European Commission*, Commission Notice – Guidelines on the application of Article 81(3) of the Treaty, OJ C 101 of 17/4/2004, p. 2; *European Commission*, Communication from the Commission – Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements, OJ C 11 of 14/1/2011, p. 1.

for both sides of the markets, i.e. their customers and their suppliers. In particular the airports, as their specialised suppliers, have to face their increased buying power. After all, the mergers and horizontal co-operations narrow the number of counterparts an airport has to deal with.

However, airports have an upper hand because they are the sole supplier of the desired service, i.e. the provision of airport infrastructure and all the airport services that go with it. Finding a balance between airlines and airports is the main purpose of the Airport Charges Directive (ACD)[111] as well as the State Aid legislation applicable to airlines and airports. Whereas the EU law is in theory strict when it comes to determining the airport charges (Section D.I. and D.II.), the few remaining loopholes are frequently used and enable airlines and airline associations to put negotiation pressure on airports (Section D.III.). This raises the question whether the regulatory framework will still be acceptable in post-Covid-19 times.

I. EU framework of airport infrastructure financing

According to Union law, airports are supposed to finance themselves through their revenue and should not depend on State aid.[112] Since the *Aéorport de Paris*[113] and *Leipzig/Halle* judgements[114] it is clear that major parts of the airport activities, such as the management of the airport infrastructure or the setting of airport charges, are an economic activity. Generally, airport revenues can be derived from two sources: charges for aeronautical services and revenues from commercial services. In order to maintain a level playing field between the airports in the EU, the Union legislator quickly realized that the State aid rules were not sufficient. The EU legislator considered it necessary to establish a common framework regulating the essential features of airport charges and the way they are set, as in the absence of such a framework, basic requirements in the relationship between airport managing bodies and airport users may not be met. The ACD establishes a common framework for regulating features of airport charges, airports' operations and airports' interactions with airlines. Meanwhile, the ACD does not impose an accounting method, but allows all common accounting principles:

- Single till: the airport revenues from aeronautical and non-aeronautical activities are considered in determining the level of airport charges;
- Dual till: only the revenues from aeronautical activities are considered and the two business branches remain separate;

111 Directive 2009/12/EC of the European Parliament and of the Council of 11/3/2009 on airport charges, OJ L 70 of 14/3/2009, p. 11.
112 2014 Aviation Guidelines, para. 14.
113 CJEU, case C-82/01 P, *Aéroports de Paris v. Commission,* ECLI:EU:C:2002:617, ECR I-09297.
114 CJEU, case C-288/11 P, *Mitteldeutsche Flughafen AG and Flughafen Leipzig-Halle v. Commission,* ECLI:EU:C:2012:821.

- Hybrid till: combination of single till and dual till where airport costs are recovered using the single till in one cost centre and the dual till in another cost centre.[115]

In theory, the choice of one of the till methods should not account for advantages. In 2007, however, the Commission expressed the view that the use of single till creates an indirect subsidy to airline operating costs which may not be available to competitor airlines operating from other airports.[116]

II. Bilateral agreements between airlines and airports under scrutiny

The ACD provides a framework for a non-discriminatory and transparent charging system: The ACD requires non-discriminatory and cost-related airport charges (Art. 3 ACD), regular consultation between airports and users (Art. 6 ACD), and transparency on how airport charges are calculated (Art. 7 ACD). It also provides for the establishment of independent supervisory authorities (ISAs), which can intervene in the event of a disagreement between an airport and its users over decisions on airport charges (Art. 11 ACD).[117]

In practice, airports find and adopt several strategies to vary their charges by carrier, i.e. exhaust the borders of non-discriminatory charges. For example, airports regularly offer a discount, or other incentives, for airline operators to open new routes ('marketing alliances') or to choose the airport as home basis or a hub-airport, providing the airport with financial certainty for the upcoming years and, for instance, incentivizing the airport to infrastructure investments ('strategic alliances').

The EU framework does not explicitly prohibit bilateral agreements between airlines and airports. The 2014 Aviation Guidelines actually suggest that bilateral agreements can be compliant with EU State aid law.[118]

However, this does not take into account other areas of EU law. The ACD does not say anything about the legality of bilateral agreements between airlines and airports. Recently, the Court of Justice of the European Union (CJEU) found that deviations from the charging system are unlawful under the ACD. The CJEU pointed out that the above mentioned principles to the ACD (i.e. non-discriminatory and cost-related airport charges) as well as the approval procedure for charging systems set up in the ACD indicate that all deviations must be incorporated in the charging systems, i.e. deviations cannot be made after the fact:

115 *Varsamos*, Air & Space L. 2019, p. 410.

116 *European Commission*, Commission Staff Working Document Accompanying Document to the Proposal for a Directive of the European Parliament and of the Council on Airport Charges, Full Impact Assessment of 24/1/2007, COM(2006) 820 final; *Varsamos*, Air & Space L. 2019, p. 418.

117 *Oxera and CMS*, Market power assessments in the European airports sector (2017), available at: www.oxera.com/publications/market-power-assessments-in-the-european-airports-sector (19/8/2020), p. 3.

118 2014 Aviation Guidelines, para. 62.

> In light of the wording of Article 6(5)(a) of Directive 2009/12, it must be considered that both the mandatory nature of the procedure provided for in Paragraph 19b(1) and (3) of the LuftVG and the fact that the independent supervisory authority approves the system of airport charges established by the airport managing body mean that that body cannot in a way depart from that system of charges without that authority's approval of its effectiveness.
> It follows that, when a national provision such as Paragraph 19b(1) and (3) of the LuftVG provides for a mandatory procedure by virtue of which the system of airport charges is to be approved by an independent supervisory authority, that system must also be mandatory for all users, without it being possible to set, together with a particular airport user, charges different from those previously approved.[119]

The CJEU, however, does not prohibit bilateral agreements in their entirety. It (merely) says that they cannot comprise deviations from previously approved charging systems:

> It follows that a modulation of the airport charges cannot be made within the confidential framework of contractual negotiations between the airport managing body and an individual airport user. On the contrary, such a modulation cannot be accepted unless it is confined to implementing criteria known to all airport users in so far as those criteria are part of the system of airport charges approved by the independent supervisory authority. The criteria allowing the airport charges to be modulated must therefore be contained in a system of airport charges submitted for approval to the independent supervisory authority, which presupposes that the airport users were also consulted on those criteria.[120]

Yet, the outreach of the CJEU's judgment remains limited: The ACD is only applicable to airports with more than 5 million passengers per year, as well as the largest airports in each EU Member State (Art. 1(2) ACD). Also, the ACD defines 'airport charge' as

> a levy collected for the benefit of the airport managing body and paid by the airport users for the use of facilities and services, which are exclusively provided by the airport managing body and which are related to landing, take-off, lighting and parking of aircraft, and processing of passengers and freight.[121]

Any other compensation for using airport facilities not related to 'landing, take-off, lighting and parking of aircraft, and processing of passengers and freight' is therefore not regulated by the ACD. Also, charges for the ground handling are regulated under a proper directive[122] and a specific set of rules applies concerning the rights of disabled persons and persons with reduced mobility when travelling by air.[123]

119 CJEU, case C-379/18, *Deutsche Lufthansa AG v. Land Berlin*, ECLI:EU:C:2019:1000, paras. 38 f.
120 CJEU, case C-379/18, *Deutsche Lufthansa AG v. Land Berlin*, ECLI:EU:C:2019:1000, paras. 51 f.
121 Art. 2(4) ACD.
122 Council Directive 96/67/EC of 15 October 1996 on access to the ground handling market at Community airports, OJ L 272 of 25/10/1996, p. 36.
123 Regulation (EC) No 1107/2006 of the European Parliament and of the Council of 5 July 2006 concerning the rights of disabled persons and persons with reduced mobility when travelling by air (Text with EEA relevance), OJ L 204 of 26/7/2006, p. 1.

Therefore, charges set under the remaining void should effectively not be affected by the CJEU's judgment that prohibits any derogation from the charging system. It appears as if this void allows for more freedom and room for derogations as it might appear at first sight. Since airports have to become financially independent under the State aid rules, alluring airlines to their airports has become of crucial importance in order to obtain such financial independence, maybe creating more of a vicious circle than a solution to the issue of sensible financing of infrastructure.

Against the background that airports are allowed to deviate from the general rule in some fields or under certain conditions,[124] airlines will wish to make use of the remaining room for manoeuvre and will ask airports to provide them with specific incentives.

The question arises whether the ACD can still meet its initial purpose in this situation, i.e. fight the discrimination between airlines and provide for charging transparency. A dual till system suggests that the airport can separate its expenses for alluring airlines from the charging system, thereby preventing other airlines that are not involved in bilateral agreements from effectively paying for the bilateral agreements between airlines and airports. Still, not every airport has installed a dual till system because it is not mandatory. Furthermore, winning over an airline to use an airport naturally creates revenues for the airport in the non-aeronautical segment, too. It becomes an accounting challenge to keep the costs and profits separated from each other. Whilst this is probably of no concern to the airlines involved, it is a factor that airports surely have in mind in their negotiations of bilateral agreements with airlines and which does not necessarily strengthen their position. A lack of flexibility might on the one hand be an excuse towards an airline not to pursue certain economical endeavours, however, on the other hand, it also limits the margin of manoeuvre and thereby their negotiation power.

III. Negotiation power of airlines and airports

Airports and airlines bring different strengths to the table and have different outside options that allow them to put competitive pressure on their counterparts. The number and strength of the airlines' outside options relative to the airport is the primary determinant of the relative bargaining strength of the parties.[125] The airlines' outside options are primarily driven by two factors:

- Switching costs, such as:
  - Costs of relocating staff and assets, including redundancy and recruitment costs if some staff are unable to relocate,
  - Capital investment costs at the new airport,

124 The limits of the remaining room for manoeuvre still need to be clarified in the light of the recent CJEU judgment. This will not be covered by the present article.

  - Sunk costs relating to any assets that cannot be relocated to other airports or from breaking long-term commitments,
  - Loss of economies of scale from reducing the scale of operations at an airport, resulting in increased average costs and reduced competiveness for the airline's remaining services,
  - Marketing costs associated with raising awareness of new routes launched at the alternative airport(s), particularly where operations are transferred to a country or a route that the airline has not previously served;[126]
- Existence of appropriate alternatives, i.e. ability to access broadly comparable capacity at a reasonable price elsewhere and sufficient demand at the alternative airport to replace the lost demand, as well as potential loss of network effects from switching when an airport provides transfer passengers.[127]

For airports, outside options will be affected by factors such as the extent of alternative airlines available to take up spare capacity, sunk costs in relatively large-scale infrastructure unsuitable for other uses and the resulting economies of scale in operating that infrastructure.

A study by *Oxera* found that market outcomes show a mixed picture in terms of airports' ability to raise charges, with an approximately equal divide between those raising charges in real terms and those lowering them, which suggests that there is no systematic ability for airports to raise charges.[128] However, airports not only compete on prices/charges, but also on service. *Oxera* found that the service quality (as measured by passenger satisfaction) has increased across all airports and that larger airports also increased their capacity. According to *Oxera*, this indicates increasing competitive pressure among the airports, suggesting that competition on service quality and capacity as well as price is important to them.[129]

As mentioned above, airports generally have to generate income through charges for aeronautical services and revenues from commercial services. This is a particularity in this sector, as for each passenger/airline loss, the airport loses not only aeronautical, but also non-aeronautical revenue. These double effects increase the airports' sensitivity to volume loss. At the same time, airlines are very cost sensitive with regard to airport charges. If some airlines are willing and able to relocate some of their capacity or allocate new capacity to an alternative airport following a price increase, such that the price increase is unprofitable, airlines are likely to have some degree of buyer power.[130]

The actual countervailing buying power of both sides depends on the representation of the airline at the airport. If a few airlines represent a large share of an airport's traffic,

125 *Oxera/CMS*, Market power assessments in the European airports sector, 2017, available at: www.oxera.com/publications/market-power-assessments-in-the-european-airports-sector (19/8/2020), p. 30.
126 Ibid., p. 90.
127 Ibid., pp. 90 f.
128 Ibid., p. 11.
129 Ibid.
130 Ibid., p. 88.

those airlines are likely to have buying power. Airports, however, find themselves in a weaker position. This development could be observed over the past years notably with regard to LCCs. LCCs typically establish multiple bases and operate many point-to-point routes. These airlines can more easily relocate capacity at lower (and possibly minimal) costs. They are therefore more likely to have buyer power as they can more credibly threaten to move capacity in terms of either aircraft or routes. Often, only the threat of switching capacity might be enough to put pricing pressure on the airport. Also, the threat of moving services to a different airport or reducing the number of services could qualify as an outside option for airlines.[131]

However, as long as airlines negotiate individually and the airport is attractive to more airlines than it actually services, the airport might have the upper hand. The rise of airline alliances, however, reduces the airports' outside options, since this reduces the number of alternative airlines. As discussed above, members of an alliance could be, on the one hand, hesitant in competing against each other fiercely just to keep the other alliance members at peace, and on the other hand, might not have a strong enough economic interest in competing fiercely, since they might be able to offer the connecting route through code-share agreements with their alliance partners anyways. In addition, it might not only be strategically important for the airport to have a particular airline at the airport, or if that airline significantly contributes to the airport's profitability,[132] but also to be able to call an airline alliance a strategic partner. Today, larger, hub-based airline groups are increasingly following a multi-hub strategy, which enables them to move aircraft between these hubs more easily than it was the case historically.[133] A recent example was Lufthansa's decision to relocate its A380 carriers from Frankfurt to Munich, which incentivized Fraport to enter into a new agreement with Lufthansa that provided for reduced costs to Lufthansa.[134]

E. Conclusion

The liberalization of the scheduled passenger air transport sector has provided for great progress: customers have benefited from more activity, new routes, greater choice, lower prices and an increased overall quality of service. However, the question arises as to who is really bearing the costs of this customer benefits. Airlines often receive State aid by the Member States. Moreover, most of the airports are still state-owned, which naturally opens the gate for State interventions to attract airlines to national airports. According to the Commission's registry, on the one hand, the Commission has opened investigations into State aid in the aviation sector in over 400 cases in the past 20 years alone, part of which were then subject to extensive judicial review by the EU Courts. On the other hand, those incentives were apparently not sufficient, since the recent (pre-Covid-19) airline insolvencies indicate that the operation of

131 Ibid.
132 Ibid., p. 89.
133 Ibid., p. 52.
134 Ibid.

scheduled airline passenger services is not profitable per se. This also has consequences on the negotiation power of airlines vis-à-vis the airports, i.e. airlines are very cost sensitive with regard to airport charges.

The ACD is not sufficiently effective in protecting the airports against the negotiation power of airlines, especially with regard to LCCs who can easily switch airports. Until the beginning of 2020, the fleet orders suggested that the growth in LCCs was likely to continue, with some LCCs placing large fleet orders for aircraft that can cover all distances.[135] However, the protection of the airports against the negotiation power of the airlines was never the purpose of the ACD in the first place. Still, the lack of regulatory protection of the airports could be the starting point for a vicious circle because airlines can play the airports off against each other, especially when it comes to the integration into a hub-model.

This is even more the danger in the most recent developments in the aviation sector. Covid-19 hit the aviation sector in early 2020, which forced multiple airlines to cancel their fleet orders and proceed to even sell aircrafts in the spring and summer of 2020.[136] Whilst the EU is still in the middle of fighting Covid-19 and its economic impact, the impact on the aviation sector can already be expected to be huge with multiple airline insolvencies ahead, possibly reshuffling the whole airline industry and putting new challenges on both business models FSC and LCC. Some predicted a consolidation in the airline sector for a long time, the economic effects of Covid-19 will probably accelerate this development. Member States will only be able to maintain the liquidity of the different players in the aviation sector over a limited time period. They won't be able to save them all.

Still, the existing regulatory framework and the relevant case law is not redundant, but will likely be welcomed by the regulation bodies as well as the market participants as things to hold on to in these uncertain times for the sector. The Covid-19 pandemic will also not overshadow the tremendous efforts made: Over the past decades, internal market barriers have been lifted, making cross-border mergers become economically viable. This increases the chances of intra-EU cross-border acquisitions of assets in a liquidation procedure. Additionally, the market is *de facto* already highly concentrated: joint ventures of different degrees have been formed. This would also facilitate mergers. It looks like Covid-19 could become the domino that triggers the foundation of truly 'Union carriers'. Hopefully, the EU regulator will also take the opportunity to reform the ACD and provide the airports with better instruments to oppose the increasing negotiation power of the airlines and airline alliances.

135 *Oxera*, The continuing development of airport competition in Europe, 2017, available at: www.oxera.com/publications/the-continuing-development-of-airport-competition-in-europe (19/8/2020), p. 7.

136 Airbus' 2020 gross orders by 31 July 2020 totalled 369 aircraft with net orders, after cancellations, of 302 aircraft; the Company registered four new orders in July 2020, available at: www.airbus.com/aircraft/market/orders-deliveries.html (23/8/2020); According to news reports, Boeing had to endure 150 order cancellations in March and 108 in April, followed by 18 cancellations in May and then 60 cancellations in June 2020, available at:https://edition.cnn.com/2020/07/14/business/boeing-canceled-orders/index.html (23/8/2020).

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