

The European Commission Appraisal of Airline Mergers

The Rise of a New Generation of Slot Remedies

Airliners intending to implement mergers with economic effects in the EU aviation transport markets have to seek the previous authorization of the European Commission under the European Merger Control Regulation (EMCR). Since 1989 the Commission blocked two airliners mergers (Ryanair/Aer Lingus, Case M.4439 and Olympic/Aegean Airlines, Case M.5830) and conditionally cleared many more by agreeing with the



parties on remedies to fix the expected competition problems. The commonest remedy is the divestiture of landing and taking off airport slots, although the effectiveness of these remedies was questioned because in some cases no competitors used the freed slots. The purpose of this article is to discuss the Commission policy on slot remedies. In particular, it focuses on the questions whether slot remedies are effective tools to resolve the competition problems arising out of airline mergers and which elements should be included in slot remedy packages in order to enhance their effectiveness. These are questions of practical relevance given the cautious approach of the Commission in clearing mergers on the basis of efficiency defence. Thus, offering a set of suitable remedies to restore competition may be the only way for the merging parties to obtain the go-ahead from the Commission for a problematic merger.

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The slot remedies relied on by the Commission can be divided into remedies of the IATA Conference slots or a following at all IATA Conference first and second generation. The Commission applied the former on the first years of enforcement of the EMCRC. As it gained more experience in this field, it introduced the second generation with the objective to make them more appealing to new entrants. The article examines the differences between these groups of remedies in order to ascertain whether the second is more effective than the first generation.

The Examination of Competition Impact of Airline Mergers under the EMCRC

Under the EMCRC the Commission is empowered to block a con-

centration that may significantly impede effective competition in the relevant markets. In airline merger review the Commission defines relevant markets on the basis of the demand-side O&D approach, therefore each route between a given point of origin and of destination constitutes a distinct relevant market. Market shares and conditions for market entry are the factors considered by the Commission to detect problematic mergers. In particular, airline merger may restrict competition in the slot dominance and route dominance scenarios. The former occurs in case of slots shortages affecting routes from/to hub airports, where take off and landing slots are scarce resources in high demand. The latter arises when the merged carrier has high market shares and/or advantages, such as brand recognition and reputation for aggressive competition.

The parties to an anticompetitive merger can obtain the Commission approval by agreeing with it on a set of remedies suitable

to resolve the competition problems of the transaction. The commonest remedy is to oblige the party to yield a certain amount of slots, whose purpose is to lower entry barriers raised by scarcity of slots. The Commission also imposes a number of ancillary behavioral undertakings aimed at increasing the attractiveness of the slots for new entrants.

The Remedies of First Generation

Slot remedies of first generation are those imposed by the Commission in the earlier decisions dating back to the period starting from the inception of ECMR through the years 2004-2005. First generation remedies had a limited duration such as 5 years (Swissair/Sabena, Case IV/M.616 and British Airways/TAT, Case IV/M.259) or 4 consecutive IATA seasons (United Airlines/US Airways, Case M.2041). Moreover, there were no clear cut rules on the bracket periods by which the parties had to give the slots to the applicants. In Swissair/Sabena the Commission held that the merging carriers had to make slots available within a period of 60 minutes from the requested time. In British Airways/TAT the time bracket was raised to 90 minutes for the slots regarding the Gatwick-Lyon route and lowered to 30 minutes for the slots relative to the Gatwick-Paris CDG routes. Apparently, the determination of time brackets depended on the factual circumstances concerning each airport or route considered by the Commission.

A further important condition on the use of the freed slots was that the slots had to be employed only to operate the problematic routes with respect to which they were made available (Swissair/Sabena). In case the new operator ceased to operate the routes, the slots had to be returned to the parties (United Airlines/US Airways). Finally, application for the slots had to be filed within a certain period of time starting from the closing of the relevant IATA Scheduling Conference for the coordination of slots for that season. A final decision on the slot application could be made up to two months after the closing of the IATA Scheduling Conference.

The Commission recognized that the mere divestiture of slots did not constitute a strong enough incentive for new competitors to enter the market. Indeed, the merging parties still enjoyed a considerable market power with too many frequencies at often slot-

Illustration 1: *Merging airlines. Courtesy of Ried Brown*



constrained airports. Hence, hardly new entrants could profitably launching new routes competing with the merged carrier on the basis of the few freed slots.

Therefore, the Commission started imposing behavioral remedies in support of slot release. These ancillary measures included a frequency freezing obligation and the parties' commitment to enter into interline agreements with new entrants and to grant them access to their frequency flyer programs (FFP). Incidentally, the Commission relied on slot remedies also to clear airlines alliances (Lufthansa/SAS/United Airlines, cases COMP/D-2/36.201, 36.076, 36.078), which were reviewed under the then Article 85 EC on anticompetitive agreements instead of the ECMR.

An important issue surrounding the first generation slot remedies was effectiveness, as testified by the fact that no carrier came up to make use of the slots freed by the parties to the Lufthansa/SAS/United Airlines and Swissair/Sabena transactions. That came as little surprise, considering the conditions and limitations placed under the first generation remedies concerning the utilization of the slots. Thus, the time was ripe for a rethinking of slot remedy design.

The Emerging of the Second Generation of Slot Remedies

A new breed of slot remedies surfaced in the Air France/KLM merger (Case M.3280). In this case the Commission obliged the parties to divest a number of slots for an unlimited period of time. This was the first time that slot surrender had an unlimited duration. The Commission also imposed the rule that the slots misused or underused by the new entrant had to be returned to the slot coordinator rather than to the merging carriers. Moreover, new entrants could acquire grandfather rights over the slots obtained for the Paris-Amsterdam route, provided that the new entrant used the slots for at least six consecutive IATA seasons. The Court of First Instance (CFI) in Luxembourg upheld this decision (Case T-177/04, easyJet Airline v Commission). The CFI pointed out that such measures were suitable to resolve the competition problems of the transaction which were due to the unavailability of sufficient slots. Arguably, the judgment strengthened the Commission confidence that the emerging new policy was a step in the right direction to enhance the effectiveness of slot remedies.

By the 2008 Merger Remedies Notice the Commission set out the conditions to accept slot remedies. Importantly, these measures were qualified as access remedies in that they gave competitors of merging parties access to essential inputs for carrying out their economic activities. The Commission made clear that only the slot remedies that actually make the entry of sufficient new competitors timely and likely can be regarded as having a similar effect as divestiture. Therefore, only slot remedies meeting the above conditions are acceptable.

In the same year the Commission conducted a survey on the effectiveness of slot remedies with a number of carriers. Unfortunately, the results of this survey have not been disclosed because for reasons unknown to this author the Commission decided to keep the survey confidential. However, it can be assumed that these results may have had a bearing on the successive merger decisions through which the Commission shaped the second generation of slot remedies.

An Analysis of the Second Generation Remedies

The recent global recession hit the aviation industry hard, which reacted by accelerating the pace of consolidation. Over the past

years the European Commission reviewed several airline mergers, but a trilogy of decisions, Lufthansa/SNAH (Brussels Airlines) (Case M.5335), Lufthansa/Austrian Airlines (Case M.5440) and Iberia/Vueling/Clickair (Case M. 5364) are of particular relevance. All those transactions raised competition problems and what is interesting is the slot remedy packages shaped by the Commission to fix such problems. To this end, it relied on the new type of slot remedies successfully tested in Air France/KLM, which can be labeled as the slot remedies of second generation.

A first qualifying element of these remedies is the enhanced slot allocation procedure. Unlike the first generation remedies, carriers interested in slots have to file an application by a deadline expiring before the IATA Scheduling Conference. And the final decision on the slot applications has to be made within 3 weeks from the end of the IATA Conference. Such arrangements are much more favorable for new entrants than the corresponding rules under the first generation remedies, as indicated by the positive feedbacks received by the respondents to the market tests conducted by the Commission. In fact, the merging parties now have to allocate slots early in the season, which enables new competitors to learn sooner whether their request has been successful. This is an important innovation in that it gives new entrants more time to organize the launch of new services to be operated with the freed slots.

The second generation remedies also provide for a fast-track dispute resolution mechanism. Slot applicants and transferees of slot can refer to it when they have reason to believe that the merging carriers are not complying with obligations deriving from the conditional authorization decision. The Commission also appoints a monitoring trustee to verify merging parties' compliance with such obligations.

Moreover, second generation remedies contains detailed rules on the time interval from the initial request within which slots have to be re-allocated. The merging carriers have to allocate the slots within 20 minutes from the initial request made by the applicant. This innovation should suit in particular the business model of low cost carriers that is based on shorter turn-around time than legacy carriers. Also the lack of any limitation on transfer of slots in peak times should strengthen effectiveness.

The most innovative aspect of the second generation remedies is that new entrants can acquire grandfather rights on the slots after a certain period of utilization. As a general rule, the required utilization period is four consecutive IATA seasons. However, this period is lowered to two when the reduced utilization period clause applies because the new entrant requested slots to operate a wide range of identified routes from the same airport (Iberia/Vueling/Clickair).

This period, instead, is extended to 8 seasons for slots at congested airports such Frankfurt (Lufthansa/SNAH, Lufthansa/Austrian Airlines). With the acquisition of the grandfather rights the divestiture of slots is definitive. Consequently, new entrants will be able to use the slots for any other routes, not only for the problematic city pairs identified by the Commission. For this reason the Commission rightly believes that the prospect of acquiring grandfather rights should boost the attractiveness of slots for new entrants.

Finally, also the second generation remedies include a number of ancillary behavioral measures. Therefore, the parties may be required to enter special prorate and code-share agreements. They also have to grant new operators access to their frequent flyer programs. The ratio for these conditions is to enable new entrants to have access to connecting traffic, thereby increasing the profitability of the routes operated with the released slots.

While slot remedies ought to restore competition lessened by slot dominance merger, it is questionable whether they can also fix competition problems related to route dominance mergers. The recent prohibition of the Ryanair/Aer Lingus and Olympic/Aegean Airlines mergers seems to suggest that the reply to this question is in the negative. Ryanair/Aer Lingus, a merger between two low-cost carriers sharing the same hub airport, was found to be likely to restrict competition on many routes due to the parties' high market shares. The Olympic/Aegean Airlines merger, on the other hand, was held to result in a monopoly or quasi-monopoly position on many routes in the Greek domestic market. In both the cases the parties offered slot divestments, but their proposals were rejected by the Commission for the competition problems with the merger were unconnected to slots.

The prohibition decisions in Ryanair/Aer Lingus and Olympic/Aegean Airlines do not mean that route dominance mergers are irremediable. Instead, the question is which remedies other than slot divestiture can be effectively deployed. In that regard, different options are available to competition authorities. Aircraft divestiture is one of them, though the Commission has voiced concerns over its effectiveness in the AirFrance/KLM case. Firstly, it pointed to the difficulties in establishing whether the transferee of the aircrafts used them on the affected routes. Secondly, it noticed that airplane availability was unlikely to constitute an entry barriers since new operators could fulfill their requirements on secondary markets. Interestingly, aircraft divestiture was considered at some time by the parties in Ryanair/Aer Lingus and Olympic/Aegean



Airlines. Yet the Commission rejected the Ryanair offer because it included an insufficient number of airplanes, whereas Olympic and Aegean Airlines turned down the Commission suggestion to sell a certain number of their aircrafts. Alternatively, carving out remedies can be also used to deal with route dominance mergers. Under these arrangements, the parties undertake to not commonly set prices for a given category of passengers on selected routes. This remedy has been applied by the US antitrust authorities especially in the context of anticompetitive agreements (see for example, US Department of Transportation United/Lufthansa). The European Commission, on the other hand, has taken a more cautious approach towards carving out remedies and has never relied on them, probably because it feared that implementing them is a difficult time-consuming task.

The Commission confidence on the effectiveness of the second generation slot remedies lies in the replies received by the respondents to the market test to which it subjected the remedies. The majority of the respondents praised the new design for enhancing the attractiveness of slot divestiture for prospective new entrants. In addition, the Commission confidence is also based on the expression of interests received from many carriers willing to use the freed slots in spite of the tough market conditions (Lufthansa/SNAH, Lufthansa/Austrian Airlines). However, looking through the timetable for the 2012 Winter Season of some of those carriers it results that apparently they are not operating flights with the freed slots. Nonetheless, the slots may be used later on and this can be the case especially if the merging carriers decide to rise fares. Fare increases are likely to provide competitors with strong

	First Generation	Second Generation
Length	Limited in time	Permanent
Bracket periods for slot allocation	No clear cut rule. Merging parties were required to divest the slots within a period ranging from 30 to 90 minutes, depending on the facts of the case.	20 minutes from the time requested by the applicant.
Slot allocation procedure	Application for slots had to be filed by a certain amount of days (15-20) from the closing of the IATA Conference Meeting The final decision on the application had to be made within the following 60 months .	Interested operators have to file an application for slots before the IATA Scheduling Conference. A decision on slot applications has to be reached by 3 weeks from the closing of the IATA Conference.
Grandfathering Rights	No prospect of acquisition of grandfather rights.	Acquisition of grandfather rights after a period of use of freed slots ranging from a minimum of two to a maximum of eight IATA Seasons when the concerned airport is congested .

incentive to enter as they are lured by the supra-competitive profits enjoyed by the dominant carrier. Intuitively, the availability of divested slots should be of help to new entrants by lowering a potential barrier to entry.

In conclusion, on the one hand, the second generation of slot remedies appear to be a suitable tool to resolve competition problems created by slot dominance mergers. On the other hand, slot remedies are inappropriate when dealing with route dominance mergers. In this case the Commission and the merging parties should agree on other tools, be they behavioral, such as carving out measures, or structural remedies. The latter can be divestiture of aircrafts or even of stand-alone business comprising planes, brands, personnel and any other relevant assets.

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Conclusive Thoughts

Arguably, the driving force behind the development of the second generation slot remedies is that non-structural remedies are acceptable when they have structural effects on the market similar to those of divestments. Therefore, the Commission has reshaped the slot remedy design so that the market impact of the second generation remedies would be much similar as possible to those of structural remedies. The policy options chosen to pursue this objective include the unlimited duration of slot release and the possible acquisition of grandfather rights. It may be worth noting that, according to the CFI, permanent slot divestiture can be assimilated to structural remedies (easyjet/Commission).

Having said that, it is now time to consider whether and how the second generation slot remedies work in practice. Any such assessment must be carried out bearing in mind that the remedies at hands have been imposed during a severe recession. Recession is not the optimal timing to enter the market for aviation transport as carriers may be less inclined than normal to take up new services in declining markets. Nevertheless, the Commission is upbeat on the effectiveness of second generation remedies and it believes that with the recovery of economy and return of normal market conditions the new remedies will ensure entry of new operators or expansion of existing ones.