

# Slot Trading: The New Proposal Of The European Commission

On 1st December 2011, the European Commission adopted a comprehensive package of measures whose declared aim is, among others, to address capacity shortage at European airports. The so called “better airports” package covers three main areas: slots, groundhandling, and noise. This article focuses on the proposed recognition of a secondary market for slots and presents the evolution of the Commission’s position on this topic since the adoption of Regulation No. 95/93 on common rules for the allocation of slots. If the overall proposal of the Commission on slots has been partially criticized by the associations of airlines, the recognition of a secondary market for slots has been welcomed by the entire industry as a definite step forward that would favor decongestion of heavily congested European airports.



by: Giulia Mauri

## Secondary slot trading under Regulation No. 95/93

Allocation of slots at European airports is regulated by Regulation No. 95/93 which provides that slots are allocated at coordinated airports (i.e. the most congested airports) by a coordinator on the basis of the rules set forth in the Regulation.

The general rule, the so-called grandfather right, is that an air carrier having operated its slots for at least 80% during the summer/winter scheduling period is entitled to the same slots for the following year. According to the so-called rule of “use-it or lose-it”, slots which are not sufficiently used by air carriers return to the pool of slots managed by the coordinator at the relevant airport. The coordinator will then assign such slots in accordance with the rules established by the Regulation.

On the basis of these rules, a primary market of slots is not allowed and cannot evolve. Newly-created slots are assigned by coordinators and are not traded on a market.

Regulation 95/93 does not contain any provision on a secondary market for slots, i.e. a market where slots may be freely traded between air carriers.

It was the position of the Commission during the 90s, when the Regulation was discussed and approved, that trading of slots was illegal. This position was clearly mentioned by the EC Commissioner for Transport, Mr Neil Kinnock, in 1997: “*The regulation in no way provides for slot trading, but simply for the exchanges foreseen in Article 8(4). In addition, there can be no reason re-*

*lated to Article 85(3) EC to envisage monetary considerations for transfers. On the contrary, such requirement would make it more difficult for a competitor to gain access to a route”.*

Article 8(a) of the current version of the Regulation (as amended in 2002, 2003 and 2004) provides that slots may be:

- a. Transferred by an air carrier from one route or type of service to another route or type of service operated by that same carrier;
- b. Transferred in very limited cases such as an intragroup transfer, as part of the acquisition of control over the capital of an air carrier or in the case of a partial or total take over;
- c. Exchanged, one for one, between air carriers.

The rules of Regulation 95/93 have generally been interpreted, also based on the position taken by the Commission on this topic, as forbidding any sale of slots against consideration.

However, at Heathrow airport in London, one of the most congested community airports, air carriers developed the practice of exchanging slots against consideration. Regulation 95/93 allows exchanges of slots, but it is silent on whether such exchange could be completed with a monetary compensation.

These exchanges against consideration have been considered as “artificial” as they are, in fact, proper sales of slots.

In this form of exchange, one airline, the seller, exchanges its highly valuable slots during peak times at a congested airport against so called “moonlight” or “junk” slots, i.e. slots without commercial value, at the same airport. The air carriers receiving



**Photo 1:** London Heathrow Airport. Photo by Hubert Croes

the high valuable slots at peak time (the buyer), pays a monetary consideration to the “seller” and transfers its moonlight slots to the seller. These junk slots are then returned to the pool by the seller since it has no intention of using them.

With the exception of the UK airports, these artificial exchanges have not been practiced very often as there persists uncertainty as to their legality. Indeed, many countries do not allow exchanges of slots against consideration.

### The case of Heathrow

Secondary slot trading in the form of exchanges against consideration developed in the UK and, in particular, at the very congested airport of Heathrow.

In their report commissioned by the European Commission, Mott McDonald evaluate the implications of the formal introduction of secondary trading mechanisms for runway slots at congested community airports.

In their study, they have analyzed the current (in 2006) status of secondary slot trading at several airports. The final result of their analysis is that the most developed secondary trading of slots has taken place at Heathrow.



Mott McDonald identifies six different forms of slot transactions at Heathrow:

- ✦ An outright sale of slots on commercial terms,
- ✦ A lease of slots on commercial terms,
- ✦ As part of the transfer of a route from one carrier to another,
- ✦ As part of the restructuring of a bankrupt air carrier (eg Sabena or Swissair)
- ✦ To redeploy slots within an airline alliance or other group of carriers,
- ✦ To temporarily babysit surplus slots.

Secondary trading at Heathrow has been favored by the existence of a clear case law declaring exchanges of slots with consideration perfectly legal.

In other countries no such case law has developed and the general feeling has been that an exchange of slots against compensation was a practice that infringed the law.

In the UK, the English High Court ruled at the end of the 90s that exchanges of slots against monetary compensation do not infringe Regulation 95/93. The case known as the “Guernsey” case opened the door for the development of secondary trading of slots in the UK.

The case concerned a transfer of slots between Air UK and British Airways at London Heathrow. Air UK was a regional air carrier serving the London Heathrow/Guernsey route. This route was extremely important to the economy of Guernsey as it constituted the link between the island and the most important London hub. Air UK had no intention to continue operating that route and exchanged its slots against “moonlight” slots held by British Airways and against payment of monetary consideration. The moonlight slots were then returned to the pool. British Airways used the newly acquired slots on routes other than the Guernsey/London Heathrow therefore depriving Guernsey of its main link to London Heathrow. The Guernsey government brought an action against the airport coordinator at London Heathrow for having approved such exchange of slots. The High Court ruled in favor of the coordinator and also found, incidentally, that there was nothing prohibiting monetary compensation in Article 8(4) (now article 8(a)) of the Regulation.

Even if the decision of the English High Court did not have the value of a precedent and could therefore not be used in other jurisdictions, its findings allowed the development of a secondary market for slots in the UK.

### The 2008 Communication of the Commission

The reasoning followed by the English High Court was also partially taken on board by the Commission in its communication of 2008 on the application of Regulation No. 95/93. The Commission indicated in its communication that “*where there is no transparent market for the scarce resource of slots at congested airports, incumbent air carriers are often not aware of, or confronted with, the full opportunity costs of the slots they hold. As a consequence an air carrier may retain a slot even when its market value far exceeds the value that the air carrier generates from retaining and using the slots. [...] the Commission*

recognizes that exchanges of slots for monetary and other consideration, more commonly referred to as secondary trading, are taking place at a number of congested community airports. This has had certain advantages, notably in allowing the creation of additional services on specific routes”.

If the 2008 communication of the Commission partially recognized the value added by the creation of a secondary trading for slots, it failed to clearly authorize transfers of slots for monetary compensation.

The Commission merely stated that it would not pursue infringement proceedings against Member States where such exchanges took place in a transparent manner. This meant that each Member State continued to apply existing practices and regulations and therefore where exchanges of slots against compensation were not allowed, things did not change.

However, as the Mott McDonald report shows, most of the players in the market (including airlines and airports) recognized that a clear authorization of secondary trading of slots at community airports would allow a better use of scarce resources such as slots at congested airports.

A second report, issued in March 2011 and commissioned to Steer Davies Gleave to assess the impact of revisions to Regulation 95/93, identified several advantages in a clear authorization of a secondary trading of slots.

### The proposed amendments to Regulation No. 95/93 concerning slot mobility

The proposal of the Commission suggesting amendments to Regulation 95/93 contains an explicit recognition of secondary trading of slots.

In the introduction to the proposed revised text of the Regulation, the Commission explicitly indicates that, in order to encourage greater slot mobility, the new regulation should expressly allow airlines to buy and sell slots.

According to the proposal of the Commission, Article 8(a) should become Article 13 and should provide that slots may be “[...] (b) transferred between two air carriers, with or without monetary or any other kind of compensation; (c) exchanged, one for one, between air carriers, with or without monetary or any other kind of compensation”.

The proposed article allows the creation of a secondary trading of slots. It is interesting to note that transfers or exchanges have always been considered to be allowed between slots of one and the same airport even if there is nothing in the Regulation that would forbid an exchange of slots between different airports. By elimi-

nating the need to put in place an artificial exchange of slots, the new proposal sets airlines free, as long as they comply with the provisions of the Regulation, to buy and sell slots. It remains to be seen whether airlines will consider advantageous to eventually proceed with exchanges of slots at different airports or will prefer to proceed with separate direct sale and purchase agreements.

According to the draft regulation, only airlines will be allowed to transfer or exchange slots. This is an important point as, under other jurisdictions, and namely in the US, slots have been used as collateral to secure financing. This will not be easily done under European law as, in case of default of the airline, creditors will not be able to sell or exchange the relevant slot.

The proposed draft regulation imposes on Member States a duty to establish a “transparent framework” to allow contact between air carriers interested in transferring or exchanging slots in conformity with Union law. The choice of the Commission has been not to regulate this aspect of the sale and transfer of slots.

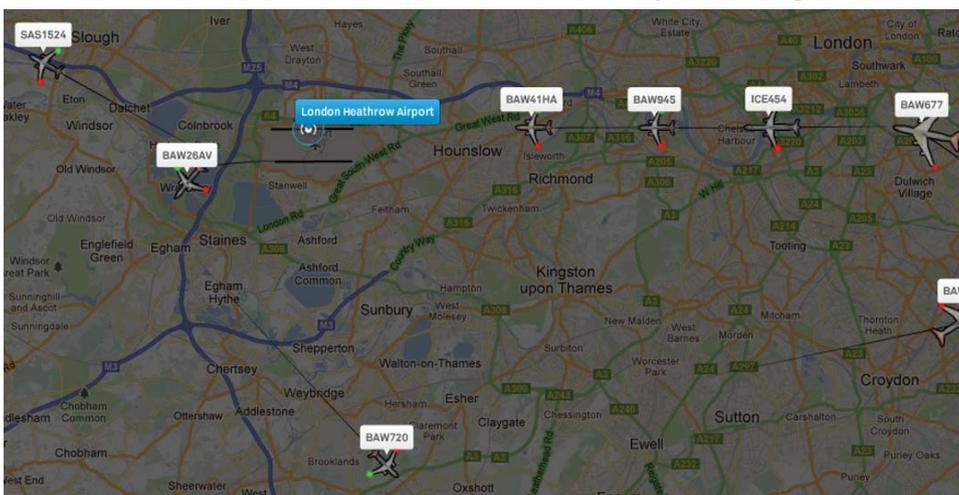


Photo 2: Aircraft lined up for landing at congested London Heathrow Airport. Source: Casper Live Aircraft Tracking (<http://casperflights.com>)

Member State are left free as to the framework better suited to grant a transparent exchange of slots.

An example that could be used by other Member State is what has been done in the UK. Airport Coordination Limited, the company responsible to coordinate slots at UK airports, has set up a service offered to

airlines wishing to buy, sell, lease and swap airport slots.

The service, called Slot Trade, is a web-based facilitator of slot exchanges. Airlines interested to sell, swap or lease a slot may complete an online posting form which helps them initiate dialogue with an account manager at Slot Trade. The posting is then published on the web platform and information about the desired transaction is sent to all interested parties.

If any one party is interested to buy the slot, they will have to respond to the announcement and manifest their interest through the web platform.

At this point, the account manager puts the parties in contact and the negotiations proceed off-line. If agreement is reached between the parties, then a slot transaction is enacted with the coordinator of the airport who will confirm feasibility.

Upon completion, the details of the slot trade are posted on the web platform therefore ensuring transparency of the slot trading process. Airlines may disclose the price paid on a voluntary basis.

The system devised by ACL ensures transparency of the slot trading process. It would be interesting to know how many parties actually disclose the price paid for the relevant slots. Indeed, disclosure of the price would make the market more transparent, however, price is usually considered as a confidential informa-

tion and I would expect a certain resistance from parties to disclose this element of the transaction to the public.

The proposed regulation, on the other hand, disposes that air carriers shall give the coordinator the details of any monetary or any other kind of compensation paid for the transfer.

It will be interesting to see how this proposed article will evolve through the legislative process and whether it will be accepted by airlines and Member States.

### **Towards a free secondary market and an accountability of slots ?**

The proposal of the Commission of a secondary market for slots has been welcomed by all interested parties as a development in the right direction in addressing slots' shortage at congested community airports.

The proposal will now need to go through the legislative process before becoming law. This may take about a year and amendments to the current drafting of some articles may be expected. However, the principle of tradability of slots has now been set. At UK airports, airlines will no longer need to use artificial exchanges in order to sell or buy slots. A straightforward sale will be sufficient.

As regards other less liberal European airports where there were doubts about the legality of exchanges of slots with monetary compensation, such exchanges will now be allowed together with direct sale of the same. Local airports will be invited to create systems to allow a transparent trading of slots.

If these measures will benefit airports and congested traffic, they will certainly benefit airlines as well.



**Photo 3:** A busy Terminal 5 at London Heathrow. Photo by Hubert Croes.

Slots may be very valuable possessions. However, until now, airlines have been reluctant to include slots on their balance sheet. As indicated by a study prepared in 2011 by accounting firm Deloitte, “historically, airlines have only capitalized landing slots which they have purchased”. However the vast majority of slots remain “off balance sheet”.

According to Deloitte, BA's landing slots could be worth at least £2bn.

It remains to be seen if the express recognition of a secondary trade in slots and the creation of a transparent market through the obligation to communicate the price paid for the purchase of slots (if this article is maintained as such in the final drafting) would not convince airlines to account for slots on their balance sheet. This accounting should however be carefully supported by an evaluation methodology that would allow to estimate useful economic lives of slots as well as consider impairment - for example, should the airport decide to build a new runway.

Even if slots may be accounted for on airlines' balance sheets in the future, I doubt that they will be used as security in financings as it has been done in the US.

As already mentioned, the draft regulation provides that exchanges or transfers may only happen between air carriers. This means that enforceability of a security on one or more slots of an airline will be extremely difficult if not impossible. Indeed, in case of default of the relevant airline, the creditor will be stuck with an “asset” that it cannot sell.

However, human creativity cannot be underestimated. We have witnessed the development of a secondary market for slots even in the presence of a Regulation that seemed to forbid it and I would not be too surprised if we should witness in the future a creative use of slots as security in financings.

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### **About the Author**

Giulia Mauri started working in aviation more than 10 years ago after the bankruptcy of Sabena and since then, she has been passionate about aviation.

After graduating from the Turin Law Faculty (Italy) in 1996, she obtained a Diplôme d'Etudes Universitaires Françaises from the university Jean Monnet – Lyon III (France) and a Master of Laws in international and European law from the KU Leuven (Belgium). She is currently in charge of the aviation and transport department of law firm Verhaegen Walravens in Brussels and eager to contribute to Aerlines a practitioner's perspective.