



OFFICE OF FAIR TRADING

Competition issues associated with the trading of airport slots

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Trading and Civil Aviation Authority**

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SECTION ONE: INTRODUCTION AND EXECUTIVE SUMMARY

Introduction

1.1 This paper has been jointly prepared by the OFT/CAA to assist discussion on the proposal for introducing market mechanisms for allocating airport slots. While the Department for Transport is the UK lead respondent to DG Tren on these issues, they requested that the OFT and CAA examine whether any competition issues arise.

Executive summary

- 1.2 Liberalisation of the air transport sector in the European Union has led to significant new entry, most notably from low cost airlines. As a result, competition for air transport services within the EU has improved considerably. A recent study for the DTI found that UK consumers now benefit from 'lower airfares, more convenient travel times and a greater choice of airlines and quality of service.'¹
- 1.3 DG Tren's recent consultation on changes to airport slot regulation raises the possibility of introducing *secondary trading* of airport slots with the promise of delivering further tangible benefits to users of air transport services.
- 1.4 If airlines are able to buy, sell and lease slots, this will sharpen up the opportunity cost of holding onto slots. It will provide them with far greater incentives to sell slots to airlines that would use them more efficiently. This should reduce current rigidities in the system and increase the opportunities to obtain slots.
- 1.5 In turn this would increase the ability of new airlines to launch downstream services and for existing second tier airlines to expand and better challenge incumbent airlines. Placing greater competitive pressure on airlines will bring benefits to consumers.

¹ DTI Economics Paper No. 9 *The Benefits from Competition: some illustrative UK cases*, the Centre for Competition policy, University of East Anglia (July 2004)

- 1.6 The OFT and CAA thus believe the arguments for introducing secondary trading are strong.**
- 1.7 The extent to which the benefits are realised will partially depend on how the new arrangements are introduced. Any restrictions on airlines' commercial freedom to compete need to be targeted and proportionate to potential concerns (market failures). Heavy-handed regulation risks stifling the benefits that DG Tren is seeking to obtain.
- 1.8 We have considered under what circumstances airlines could use the ability to trade slots to restrict competition, and how such concerns might be addressed so as to maximise the benefits from secondary trading.
- 1.9 The combination of capacity constraints and the historical and efficiency advantages that hub airlines benefit from can result in such airlines holding the majority of slots at their hub airports. Where this outcome is driven primarily by efficiency benefits, air travellers will benefit from a more frequent and comprehensive range of services to and from the hub airport.
- 1.10 If, however, an airline is or becomes dominant it may have an incentive and the ability to restrict the ability of other airlines to compete with it in downstream markets through its behaviour in the secondary slots market. Such dominance is only likely to be possible where an airline obtains a significant share of airport slots and where rivals' services from nearby airports or competing hubs are poor substitutes.
- 1.11 Under these circumstances, secondary trading could provide a mechanism for such airlines to purchase additional slots and increase market power, to the detriment of air travellers. More broadly, competition could be dampened through strategic behaviour by airlines when selling or leasing slots. For example, they may try to enforce restrictive covenants that prevent the purchasing airline from competing directly with them following the sale or lease of the slot or the onward sale of the slot to airlines that are considered vigorous downstream competitors.
- 1.12 We have considered how well placed existing competition law is to address these two potential concerns. We note that:

- it appears unlikely that slot trades would qualify as mergers
- in this sector there are potential difficulties in applying Article 81 (the control of agreements and concerted practices) and Article 82 (the control of abuse of dominance) to particular types of behaviour because, for example, the fungibility of slots makes it difficult to identify which downstream market is likely to be affected, and
- **furthermore in view of the cost and time involved in competition investigations, if there are issues that can be addressed through proportionate adjustments to the trading system, such changes should be made.**

1.13 Our view is that there are some simple safeguards that could be introduced to boost the improvements in competition and efficiency that secondary trading stands to bring. These are:

- a **prohibition on the inclusion of restrictive covenants** in slot trades or leases
- **publication of trading information to increase transparency**, clarify the opportunity cost of holding onto slots, and hence promote trade. This information could be collected and published by an independent authority. The simplest approach would be for the publication of some price and volume information after trades have taken place. In view of the heterogeneity of slots, the risk of facilitating collusion would appear relatively small, but care would need to be taken to ensure that commercially confidential information was not revealed.

1.14 **These rules would be applied universally across all coordinated airports. Additionally, National Competition Authorities (NCAs) could conduct a detailed investigation and propose remedies** at airports where potential concerns arise. This would also enable the relevant authority to provide a solution tailored to the specific market circumstances, which could be implemented before trading commences. The NCA would also be able to launch an investigation after trading had been introduced. Such post-trading investigations would be triggered by a formal complaint or by *prima facie*

evidence that trading activity in slots was having a detrimental effect on downstream markets. DG Comp could also provide an overall check through the ability to carry out a European-wide sectoral investigation.

- 1.15 Together, the above safeguards should minimise the burden of regulation at airports where slot trading is unlikely to give rise to competition concerns. They recognise that competitive conditions can vary immensely and avoid unnecessary distortions that can arise from higher levels of 'one size fits all' regulation.

Structure of this paper

- 1.16 The paper is structured as follows:

- Section 1: Introduction and executive summary
- Section 2: Airport slot regulation: the current situation and proposals for change.
- Section 3: Potential competition concerns
- Section 4: What form or forms of additional regulation may be appropriate, whilst avoiding over-regulation?
- Section 5: Summary of way forward.

SECTION TWO: AIRPORT SLOT REGULATION: THE CURRENT SITUATION AND PROPOSALS FOR CHANGE

Background

- 2.1 Planning regulations and other constraints such as environmental restrictions on flight movements severely restrict the construction of new runways. As a result, for some airports in Europe, airlines' demand for slots exceeds airport capacity.
- 2.2 Although most acute at the major London airports, the problem of congestion is also experienced outside the UK. Düsseldorf, Frankfurt, Madrid, Milan Linate, and Paris Orly all experience excess demand for slots throughout the day and another 14 airports experience excess demand at peak times of the day.²
- 2.3 Capacity is divided into time slots during which the holder of an airport slot is entitled to schedule services. These slots form an essential input to the provision of air transport services at congested airports.
- 2.4 Ideally airport slots should be allocated to the airline that will use them most efficiently. This would represent the best use of a scarce resource. This may also need to be balanced against ensuring competition exists in the downstream air routes offered using the slots. Competition ensures benefits are passed on to air travellers and, in the longer term, should itself promote greater efficiencies from the airlines. Usually these two objectives will be in tune and thus no balancing is required.

Current slot allocation system

- 2.5 The current slot allocation system is primarily an administrative procedure and is set out in Council Regulation (EEC) 95/93. Slots are allocated by the designated Co-ordinator primarily on the basis of historic use. Incumbent airlines have so-called grandfather rights, giving them preferential access to

² See NERA (2004), 'Study to Assess the Effect of Different Slot Allocation Schemes: A Final Report for the European Commission, DG Tren', Table 3.2, page 24.

slots regardless of the value of the service they provide. This is subject to a 'use-it-or-lose-it' provision to ensure slots are utilised.

- 2.6 Slots can become available either through airport capacity expansion through slots being reallocated from the 'pool'. Fifty percent of 'pool' slots are prioritised to new entrants³. In addition, airlines can exchange slots on a one-for-one basis; however they are not free to buy or sell them as they choose.
- 2.7 Thus, the current system implicitly assumes that historic users are likely to be the most efficient users of a particular slot (unless they choose to return slots to the pool). The new entrant rule could be seen as one attempt to build competition objectives into the slot regime to ensure competitive pressure is still exerted on incumbent airlines, although it is not clear that this aim is achieved through its operation.

Weaknesses of the current slot allocation system

- 2.8 Taking the two broad objectives of efficiently allocating capacity and maintaining effective competition, the current slot allocation system has weaknesses in both dimensions.
- 2.9 The allocation system should allow for the reallocation of slots as the most efficient users of slots change over time. There should be flexibility within the system. At present, airlines or alliances can reallocate slots internally, but there are restrictions on how slots can move between airlines and alliances or to new entrants.
- 2.10 These transfers can happen in three different ways: if an airline voluntarily returns a slot to the pool and it is then reallocated to another airline; if a slot is taken from an airline because it fails to meet the use-it-or-lose-it rule; or if airlines choose to swap slots in a one-for-one transaction. These measures do introduce some flexibility, but have substantial weaknesses:
- *The pool:* An airline receives no benefit from returning a slot to the pool. Thus such a transfer is unlikely to occur unless the airline in question is losing significant amounts of money on the associated route, is likely to

³ As officially defined in the Regulation.

continue to do so and has no alternative profitable routes with which to employ the slot.

As a result the proportion of slots available in the pool is typically small and the timings unattractive, making it difficult for an airline to obtain additional slots at the times they need. If an airline were to give up a slot it would be very difficult to regain one at a similar or better time. This gives airlines incentives to hold on to slots for longer than they otherwise would and generates rigidities.

- *Use-it-or-lose-it provision:* Although there is a 'use it or lose it rule' in place to reduce such slot hoarding, airlines may choose to 'baby sit' routes by using the slots inefficiently themselves,⁴ or let alliance partners or domestic subsidiaries use them, rather than lose them altogether.
- *One-to-one swaps:* these can and do occur but are dependent on airlines identifying mutually advantageous exchanges. These do not necessarily represent transfers to the most efficient user, just more efficient users.

2.11 The current allocation mechanism also implicitly assumes that providing new entrants with priority of access to 50 per cent of slots placed in the slot pool will, in the long run, resolve any current competition issues. Even putting aside the issue of what slots are available in the pool, this is generally acknowledged to be an ineffective way of generating effective rivalry to the main carriers. The new entrant definition is primarily based on new entry to an airport, which means that it is essentially only applicable to very small carriers with low frequency services.⁵ Such carriers often do not offer a serious competitive threat to the main carriers and it is questionable whether easing the expansion of such services enhances rivalry as much as allowing expansion of well-established second tier airlines or alliances.

2.12 Overall, the current system creates rigid incumbent slot holdings that are slow to respond to changes in demand conditions and this inertia creates significant barriers to entry and expansion. Although there is a market for

⁴ For example employing smaller aircraft on the air route associated with the slot.

⁵ The new entrant definition also extends to carriers wishing to offer intra-Europe services on routes where there are currently at most two other carriers within an airport system. Among the London airports at least, there are few routes that meet this criterion.

so-called junk slot exchanges, the lack of a formal regulatory framework for these swaps inhibits the extent to which such exchanges take place (see Annexe A). As a result airlines have typically needed to merge with one another⁶ or form alliances to secure significantly greater access to slots.

Potential benefits of increased liberalisation of slot mechanisms

2.13 Liberalisation of the air transport sector in the European Union started in December 1987 and has led to significant new entry, most notably from low cost airlines. In particular, the development of new low cost airlines has provided substantial benefits to the ultimate customers of airline services both directly and indirectly through the competitive pressure they have exerted on the incumbent airlines on short-haul routes. However, bilateral Government restrictions continue to restrict the ability of both new entrants and existing airlines to enhance rivalry on many long-haul routes. Nevertheless progress is being made in this area and we would anticipate future loosening of such restrictions.

2.14 The proposed changes to the current restrictions on trading in airline slots have the potential to increase the incentives on current users of airport slots to transfer them to airlines that value them more highly. The additional flexibility of being able to sell slots for cash; or for other less valuable slots plus cash etc., would provide airlines with greater incentives to transfer slots. This should increase the number of slots available to airlines wishing to expand. This is likely to have a **pro-competitive** effect in several ways:

- it increases the possibility of new entry by increasing the opportunities for carriers to obtain slots at capacity constrained airports
- it facilitates the growth of efficient airlines and alliances. In particular it increases the ability of second tier airlines/alliances to challenge the main incumbents

⁶ The extent to which airlines of different countries have been able to merge has been limited by nationality provisions in bilateral agreements. These will also be typically subject to competition clearance.

- it sharpens the opportunity costs faced by incumbent airlines as the value of the alternative use of the slot would be more clearly known, especially if trading involved some *ex-post* transparency (such as through publication of trading information by an independent authority)
- it may also have other benefits. For example, mergers/alliances of airlines have well-recognised efficiency enhancing effects and pro-competitive – as well as potentially anti-competitive – impacts. It may be possible to eliminate the latter by requiring divestiture of slots as a means of allowing an otherwise desirable merger to go ahead. Under secondary trading, airlines would be able to sell slots to meet regulators' conditions rather than give them away. This should encourage such mergers and alliances, to the general benefit of consumers.

2.15 Above and beyond these pro-competitive effects, allowing the transfer of slots to those airlines who value them most should increase efficiency⁷. These effects will be of relevance to those airports within the EC which are capacity constrained either throughout the day or within peak periods. It is these airports where the difficulties of obtaining slots can (depending on the circumstances) dampen competition in downstream markets. These changes can be expected to yield tangible benefits to consumers of air services.

Summary

2.16 Overall, the introduction of secondary trading will offer a substantial improvement on the current allocation mechanism. It is important to note that the transfer of slots (liquidity) is not an aim in itself, nor is it a self-standing solution to competition concerns brought about by other restrictions. However, it could be an important facilitator of benefits. Thus, if renegotiating bi-lateral treaties loosens the restrictions on entry to long-haul markets then the increased ability of foreign carriers to acquire slots to operate services within those markets should enhance the benefits to long-haul air travellers.

⁷ It will generally be the case that the most efficient airlines for a particular route should value the slots most highly. It is possible, however, that additional value is derived from market power (for example by a dominant hub airline) which may act against this. This issue is explored in paragraphs 23.5 to 23.7.

SECTION THREE: POTENTIAL COMPETITION CONCERNS

- 3.1 As noted in Section 2, we expect secondary trading to bring significant improvements in competition and efficiency, with benefits for air transport users. Nevertheless, it is prudent at this stage to consider under what circumstances airlines could use the ability to trade slots to restrict competition. In this section, we draw upon previous experience to consider potential competition concerns that may arise under secondary trading, and the extent to which existing competition law can remedy them.
- 3.2 A key point to make first of all is that the *underlying problem stems from capacity constraints* at popular airports. Where demand exceeds existing capacity, new entry and expansion will inevitably be restricted and there may be scope for strategic behaviour by airlines that distorts competition. In particular under the current system, there are incentives to hold on to slots (slot hoarding), as outlined in Section 2.

Observations from recent competition cases

- 3.3 The airline industry has been considered by competition authorities within Europe and further afield in a number of different contexts⁸. Consequently we have a lot of experience in this sector, which can be drawn down upon. Annexe B summarises key aspects of this experience. The main points which are of relevance to airport slot allocation are:
- An airport slot is a flexible asset, which can be used by an airline to provide air travel services in a wide range of downstream markets. Any single airport slot cannot be automatically associated with one particular downstream market. A single airport slot may not even represent the basis to offer a serious competing service to an incumbent airline. A series of lined up slots may be required.
 - Rivalry between airlines can occur on single routes. Such routes are usually defined on the basis of origin and destination and customer types. In some circumstances the origin (or destination) may be associated with

⁸ For example, within merger control, legislation relating to abuse of market power and in terms of amending regulations.

a single airport, but this need not be the case. *The relevant downstream markets, which are where our ultimate interest lies, may be broader than the airport in question and extend to include services from nearby airports.*

- Rivalry between airlines can occur on the basis of networks, which yield significant benefits both for the airlines and their customers. Hub airlines (and alliances)⁹ can derive substantial efficiency advantages and compete against one another on this basis. Hub networks offer benefits to customers because they can provide frequent services to a wide range of destinations. Hub carriers typically hold significant shares of slots at their hub airports, but may nonetheless face strong competition either on particular routes from non-hub carriers or across a range of routes from other hub carriers within Europe.
- Airlines can act strategically and oligopolistic concerns¹⁰ have arisen in respect of airline conduct, e.g. market sharing of routes.

3.4 Drawing down on these broad points we can explore the potential impact of secondary trading. In so doing we can also look to the US which has practical experience of implementing secondary trading.

Hub dominance

3.5 As noted above, hub carriers benefit from network effects, and compete on the basis of offering frequent services to a wide range of destinations. In the main, hub operators will face competition from other major operators at the same - or other substitutable – airports. However, in some cases, a hub operator may dominate slot holdings at an airport and, *assuming no effective competition from other hubs or nearby airports*, may be able to achieve higher margins in some downstream markets than would be possible under more rigorous competition.¹¹ The rents associated with such market power could provide hub airlines with the highest valuation of slots at their main

⁹ A hub airline is one which has concentrated flights through a major airport allowing them to operate a hub and spoke network and thus improve the connections it can offer its customers.

¹⁰ Such concerns reflect airlines acting strategically to their mutual benefit but not necessarily their customers.

¹¹ These are most likely to be for direct flights from the hub for time-sensitive passengers.

airports. In such a situation, the hub airline is unlikely to be a net seller of slots and may well acquire more.

3.6 Under the restricted circumstances outlined above, a hub carrier may:

- use slots inefficiently to limit downstream rivalry by denying access to slots to other airlines (slot hoarding) and thereby prevent (or limit) downstream competition. This can be seen as a 'refusal to supply,' and is only likely to arise where a hub airline had already built up a strong position prior to secondary trading (and is thus not an impact of secondary trading in itself)
- acquire further slots to secure the rents associated with additional downstream market power. Such an increase in market power may also result in an increased likelihood of other conduct designed to protect market power (i.e. predatory pricing). This, however, is a second order concern.

3.7 When considering these potential concerns, care must be taken; in particular:

- A hub airline acquiring slots may do so to expand services to the benefit of air travellers who are offered new destinations or more frequent services to existing destinations. Just because an airline is the main hub operator does not mean it holds significant market power or that an acquisition of a slot is predicated on strengthening market power. Hub airlines can be more efficient than non-hub airlines and thus may value slots more highly.
- A hub airline obtaining additional slots at the hub airport may be revealing little about what is occurring to rivalry in specific downstream markets. The airline in question may face strong competition in particular downstream markets from rival services at the same or from an adjacent airport. It is key therefore to consider what constraints are provided by rivals operating out of the same and nearby airports.¹²

¹² For example, a city may have two or more airports for which flights from these airports are in competition for some passenger types on particular routes.

- Observed high prices of air routes originating and terminating at a congested airport may reflect scarcity rents,¹³ rather than market power. Where demand for flights at a particular airport is high, relative to capacity, we would also expect the price of slots to be high. Therefore scarcity rents will also affect the sale value of associated slots. Just because a potential new entrant will not consider purchasing at that price does not mean anti-competitive behaviour is taking place.

Other issues

- 3.8 The way in which airlines trade may also impact on competition. Strategic actions by airlines could include, for example, refusal to sell slots to strong rivals¹⁴, attaching restrictive clauses to sales to prevent the purchasing airline from competing directly following the transfer of the slot¹⁵ or to prevent the possibility of onward sale of a slot to airlines who may represent strong downstream rivals. Similar actions could also occur if slots are leased rather than sold.
- 3.9 Similar concerns have arisen in the US especially in view of discrimination with whom airlines are prepared to trade. However, again this appears to be more of an issue in how secondary trading is implemented rather than whether it should be implemented. The current situation provides new airlines and second tier airlines more limited options for acquiring slots. Furthermore, as discussed later, there exist potentially simple rules to prevent the system being abused in this manner.
- 3.10 The ability to restrict airlines' ability or incentives to engage in such conduct would therefore be desirable- an issue that is considered in more detail in section 4.

¹³ Scarcity rents represent the increase price due to demand exceeding supply, as such it acts as an efficient rationing of demand as well as signaling the extent of excess demand and thus desire for additional capacity.

¹⁴ Despite realizing a lower price because of this, it may still be attractive if the dampening of competition protects profits elsewhere.

¹⁵ A requirement not to use the slot to compete on a particular route may not be sufficient. An airline could use the slot to release another slot, which it would then use to provide an additional service. To make the restriction watertight an airline would need to include a broader non-compete clause along the lines of no new flights on specified routes.

The ability of competition law to address these issues

3.11 In terms of EC competition law, there are three key areas of legislation to consider: the European Community Merger Regulation (ECMR); Article 81 and Article 82. There also exists national competition law, which can differ in certain respects; and in the UK there exists options for wider market studies and investigations. These are discussed briefly below and are explored in more depth in Annexe C.

Merger control

3.12 The sale and purchase of an airport slot is the sale of an asset we have therefore considered whether merger control might apply to slot trades. There are several reasons why this may not be an effective safeguard:

- it is doubtful whether slot transactions will qualify for investigation under merger control
- to the extent they do, individual slot transactions may not result in any substantive reduction in competition whilst the cumulative effect of a series of slot transactions may. Merger control is poorly placed to address these issues
- finally, merger control is designed to address the sale and purchase of an ongoing business. It will not be able to address slot hoarding where no sale and purchase is involved.

Article 81

3.13 Article 81 essentially prohibits agreements, decisions and concerted practices that restrict competition. It is likely to be very difficult to apply Article 81 to individual slot transactions, because:

- a slot transaction that involves only one or a small number of slots is unlikely to have an appreciable effect on competition on its own, either upstream or downstream

- it is therefore likely to be seen as *de minimis*, unless it is part of a series of individual transactions that together have an appreciable effect on competition.
- 3.14 However, under certain circumstances, slot sales or leases that contain non-compete clauses could be seen as *agreements whose object is market sharing* and as such, prohibited under Article 81 without any need to examine appreciability. Article 81 would be well placed to deal with this type of explicit conduct.
- 3.15 Article 81 faces the same issue raised under merger control. It was not designed to address the situation of a firm refusing to supply a product and, in this case, is poorly placed to address the issue of slot hoarding by a hub airline.

Article 82

- 3.16 Article 82 prohibits the abuse of a dominant position. The ownership of a substantial proportion of slots at an individual airport has the potential to amount to a dominant position in the market for slots. Without a series of slots at a suitable time, a competitor cannot operate on its desired route. This creates a potential argument that a refusal to supply by an undertaking owning all or most of the slots at a particular airport could, in some circumstances, amount to an abuse of a dominant position.
- 3.17 The burden of evidence required for intervention to require a dominant firm to provide access to its competitors is high. The circumstances when a refusal to supply by a dominant undertaking is likely to be found to be abusive and not capable of objective justification include refusals to supply which are made with a view to eliminating competition in a downstream market and refusals which are harmful to the achievement of the single market.
- 3.18 In relation to slot hoarding this could occur if a dominant owner of slots leased slots to another carrier which it then refused to renew the leases on in order to prevent the airline competing in downstream markets. If an airline is using all the slots it owns itself, it could argue quite strongly that it was making good use of the slots, exploiting network effects to the fullest extent

with benefits for consumers. It would also be difficult to identify the downstream markets effected by a refusal to supply a slot (or series of slots) given their fungibility.

3.19 In summary, the burden of evidence on refusal to supply cases is high and this may be inappropriately so in relation to the potential issues raised by slot trading.

Sector investigations

3.20 DG Comp generally wishes to pursue an increasingly pro-active competition policy, and has stated that sectoral studies, market investigations and sectoral inquiries will be used to identify factors restricting competition.¹⁶ It is possible that airport slots and the air transport sector could be looked at by DG Comp in this manner.

3.21 In the UK, under the Enterprise Act, the OFT can conduct market studies and make market investigation references to the Competition Commission (CC) where existing feature(s) of the market appear to be preventing, restricting or distorting competition. Suppliers' conduct can amount to a feature of the market. The form of regulation that exists for slot allocation could also be identified as a market feature. This has several advantages:

- it has the ability to look at wide-ranging aspects of competition and features of the market(s), which will be important in slot trading and thus has more flexibility than say Article 82
- it also has equally wide ranging remedial powers, which are enforceable. This can include obligations to acquire or divest assets. It can also make non-binding recommendations to other bodies such as the European Commission.

3.22 Such market investigations could act as both a check and deterrent on hub airlines actions in a similar way to conventional application of Article 82 in other sectors. Furthermore, market studies, if carried out in advance of

¹⁶ *A pro-active competition policy for a competitive Europe*, A communication from the Commission 20.4.2004 (<http://europa.eu.int/comm/competition/publications/proactive/en.pdf>)

trading would act as a useful method to determine whether any additional controls are required in advance of formal introduction of slot trading. The wide ranging powers of what to investigate and how to remedy any competition issues means that such investigations would be well placed to tackle these types of issues.

- 3.23 On a practical level, many member state's NCAs do not currently possess the necessary powers to carry out such investigations. In addition, even where the investigatory powers do exist, they are not necessarily complemented by appropriate remedial powers. Thus, as a safeguard, it only currently exists within some Member States.

Wider considerations

- 3.24 The application of Article 81 and 82 is intended to correct and, where appropriate, penalise infringements of the competition rules *ex post*. In other words, the enforcement of Articles 81 and 82 are essentially backward looking instruments, and they may not always prevent in advance agreements or conduct that would lead to significant competition problems. Where certain types of behaviour would clearly fall foul of Articles 81 and 82, the legislation may have some *ex ante* effect through its deterrence of such conduct. However, as identified above, there are some potential concerns, which may fall outside the scope of Articles 81 and 82. Furthermore, the time-scale for correcting problems caused by infringements may be quite lengthy. This may be the situation, *a fortiori*, in cases where establishing an infringement to the requisite standard may take some time, owing to market definition challenges, for example. Consequently, it may be preferable to provide additional *ex ante* safeguards to prevent such problems arising, particularly as merger control rules would not be able to fulfil this role.
- 3.25 As some of the above competition issues appear to fall between the main planks of competition rules, it is worth considering whether, and if so how, new rules should be implemented to meet these circumstances.

Summary

- 3.26 It is important not to attribute some problems inherent to capacity constrained airports to the type of slot regulation in place. For the relevant airports in Europe, we start with a second best position, where entry and exit is impaired by capacity constraints. In this context, slot trading may offer considerable competition and efficiency benefits particularly if combined with the liberalisation of extra-European markets.
- 3.27 The degree of concern that authorities will have about competition will depend on the precise conditions in those markets (i.e. the level of airline and alliance competition for the route at all the substitutable airports). Ultimately, the regulator's goal should be to maximize the potential benefits to consumers whilst controlling for the potential risks to the downstream market. This points to a *proportionate* regulatory stance that allows for *flexibility* in the application of rules to suit the conditions faced in the markets served by each capacity constrained airport.
- 3.28 Current competition law can address *ex post* some of the potential competition issues that slot trading may give rise to such as market sharing. However, as section three has explored, its ability to address all the potential issues in relation to airport slots is limited. This points to the need to consider additional elements that are *proportionate* to the risks identified.

SECTION FOUR: WHAT FORMS OF ADDITIONAL REGULATION MAY BE APPROPRIATE?

4.1 In this section we consider whether there are simple measures that could be taken to either minimise the likelihood of concerns arising, or that could be put in place to deal with concerns if and when they do arise. As the NERA report for DG Tren highlighted, it is likely that market mechanisms will only be applied at a small number of capacity constrained airports and that competitive conditions at those airports will vary widely. As a result, we would ideally want to introduce controls which:

- maximise the potential pro-competitive and efficiency benefits from slot trading to consumers of air travel services
- keep any distortionary effects from additional regulations to a minimum
- minimise the burden on industry and government from administration, and
- can be applied flexibly to take into account different market circumstances.

4.2 This suggests that any additional rules should be:

- targeted only at areas where competition concerns are likely to arise.
- reflect the fact that the likelihood and extent of concerns will vary.¹⁷

4.3 Thus there could be two layers of potential rules. One would implement basic rules of trading to address issues, which could arise at all capacity constrained airports. A second level would deal with specific concerns, which may arise in respect of the competition situation prevailing in markets served from individual airports.

4.4 We have considered three types of measures, **which are not mutually exclusive**:

¹⁷ The extent of pre-existing competition between airlines operating at the same airport or nearby airports and the extent of capacity constraints will vary between Europe's main airports.

- **Option 1: Changes to the design of the trading mechanism** (e.g. banning of restrictive covenants)
- **Option 2: extending the remit of competition policy** to allow, for example, for *ex-ante* evaluation of individual slot trades or groups of slot trades
- **Option 3:** the possible use of **sectoral investigations** as a more flexible tool to assess and remedy competitive conditions at particular airports or groups of airports.

4.5 These options are considered in more detail below.

Option 1: Changes to the design of the trading mechanism

4.6 The design of the trading system can have an important role to play, not only in controlling for potentially adverse effects of trading on competition but also in affecting how 'liquid' the trading in slots becomes. We stress that it is the potential for greater liquidity that is more important than actual liquidity; a good set of regulations will promote the *ability* to trade without making it onerous to do so.

4.7 There are several broad options for moulding the trading system to address the potential concerns identified:

- **clear-cut prohibition of specific activities by all airlines** involved in slot trading, such as a ban on restrictive covenants (terms which unduly restrict commercial freedom)
- **increasing the transparency of slot trading**, such as publication of achieved prices or volumes of slots traded
- **rules governing how slot trading should occur**, indirectly restricting activities by all airlines involved in slot trading. For example a non-discrimination rule which may take the form of invisibility of buyers and sellers or requirements to sell to the highest bidder
- **controls aimed at limiting the actions of specific airlines**, for example a cap on slot holding, and

- **enforced sale of slots** to increase liquidity.

4.8 These rules would address different types of concerns and they are examined in turn below.

Clear-cut prohibition of specific activities by all airlines involved in slot trading

4.9 The main potential rule that could be introduced is *a ban on attaching restrictive covenants to slot trades or leases*. Although this may decrease the volume of trading, there are unlikely to be sound efficiency arguments behind such covenants.¹⁸ Consequently the benefits of such rule are likely to exceed the costs.

4.10 It may be the case that Article 81 could pick up and differentiate between problematic restrictive covenants and other, benign, clauses. However, Article 81 cases would be expensive in terms of time and resources, and there remains the possibility that the conclusion of the case would be that Article 81 did not apply.

4.11 Given these considerations it appears there may be a case for introducing a ban on attaching restrictive covenants to trades in airport slots.

Increasing the transparency of slot trading

4.12 It is possible that if most trades take place through bilateral negotiations, there may be a lack of transparency in relation to the market price of slots. This may inhibit slot sales by restricting the pressure on airlines to take into account the opportunity cost of holding a slot¹⁹.

4.13 In addition, a lack of transparency over how many slots are being bought and sold at a particular airport could lead airlines to underestimate the level of trading and encourage them to hold on to their slots for longer than they

¹⁸ Where slot trades occur, there may be a need to transfer money where the values differ and tie this to the swap (in effect a dual rather than single transaction), but this is very different to attaching conditions which restrict commercial freedom in the use of the slot (or in other ways).

¹⁹ It is worth considering the extent to which visibility of prices may facilitate anti-competitive coordination among airlines. In this case we do not believe this to be a major issue given the nature of participants as both buyers and sellers and the likely heterogeneity of slot transactions.

otherwise would, for fear of being unable to regain a similar slot once sold. Another aspect of this is that if the large carriers are seen as obvious buyers, small and medium sized carriers may have less opportunity to buy slots.

- 4.14 This suggests that there may be scope for increasing transparency to boost liquidity within the new system, through requirements to publicise information on slots prior to, or after, slot sales. Post-trade declarations would provide a level of transparency that would be particularly helpful in quantifying the opportunity costs faced by airlines holding slots, and would also provide information on the volume of trades. This could be relatively simple to implement. Further requirements could also be considered such as requiring sellers to advertise slot details, pre-sale, although the effect of such measures on liquidity would also have to be considered.
- 4.15 Thought is also required on who should keep information on slot trades. Not all information may need to be published, however, it would seem sensible to collect full information on slot trades to inform regulatory authorities of any potential concerns. Thus full information on all transactions could be required to be lodged with an independent authority²⁰ that could also be responsible for what information should be made public, e.g. quarterly statistics on volume and value²¹. In this respect the authority can take a view of what information should not be published (if, for example, collusion is a potential concern).
- 4.16 Given the above, it would appear sensible that some trading information is made public by an independent authority after trades have been completed.**

Rules governing how slot trading should occur

- 4.17 The main options here would be aimed at preventing airlines selecting with whom they trade. These could, in theory, tackle the issue of airlines refusing to sell to rivals they view as a competitive threat. Measures to deal with this could include a requirement to sell to the highest bidder, or a requirement

²⁰ In this respect we note that the current slot coordinators at Europe's main airports may not all be independent.

²¹ If, however, full information is published, the need for an independent authority is lessened (there will be little inside information which could confer competitive advantage).

that trades take place in an environment where the identity of the buyer and the seller remains unknown.

Sale to highest bidder

- 4.18 Requiring sale to the highest bidder *could* help ensure non-discrimination in the sale of slots ensuring they go to those with the highest valuation. However, this would not be a complete answer. In particular, it would always be possible for an airline to withdraw a slot from sale if it objected to the purchaser, unless such behaviour was ruled out by the Regulation, which would further impact on liquidity.
- 4.19 Such a rule also raises some practical issues (such as whether it would be beneficial to allow counter-bids to the highest initial bid and which authority should monitor the sale and ensure compliance). Depending on how such a rule were applied, it could also serve to prevent slot swaps, despite there appearing to be some significant operational and consumer benefits from retaining carriers' ability to swap slots²². In particular, swaps involving slots plus cash would be particularly difficult to accommodate. In practice, these are likely to be important and the prevention of these can significantly affect the volume of potential sales, with adverse consequences for competition and efficiency.

A 'blind market'

- 4.20 The option of creating a 'blind market' where the identity of buyers and sellers are not known may have some theoretical attractions and could still allow for swaps. However, on a practical level, the market for slots is one of the most 'visible' markets and it would be near impossible to hide the identity of a seller, particularly as the user of that slot would be evident on the runway. Furthermore, it may be hard to maintain the 'blind market' because

²²We know from the history of slot trading within the UK that trades can involve straight swaps where, for example, an airline wishes to concentrate flights at a single airport. This is not surprising if an airline wishes to continue to offer a destination for its customers but wishes to change the airport or timing. This can facilitate the transfer of slots to an airline that values them more highly. Without the ability to swap slots, an airline may not be able to find an appropriate replacement slot, which may discourage the sale of the slots it does hold particularly if liquidity is low. Given the disparity in value of slots, which can occur, such exchanges may still include a cash consideration.

it would be difficult to stop airlines informing each other of their identity. Thus the ability to prevent discrimination would be limited.

A formal market – 'the slot exchange'

- 4.21 Requiring all slot trades to take place through an official market would be another option. This would create a comprehensive formal market place, and if straightforward swaps are included within it this could help to kick-start the formal market and increase liquidity. A 'slot exchange' could make it easier for airlines to find willing traders, (including for swap deals) and create greater transparency about prices and trading volumes, all with knock-on benefits in terms of liquidity.
- 4.22 However, if such a system were mandatory and the only way an airline could buy or sell a slot then this could limit airlines' willingness to trade and hamper their choice of trading options (such as bilateral deals). This could in turn reduce the amount of slots becoming available for purchase so may have a negative overall effect. It could also be costly to set up and could preclude the development of other intermediaries.
- 4.23 These three options may offer some protection in terms of non-discrimination. However, they also may adversely affect liquidity. In addition, there would be practical difficulties in relation to how any of the options listed above could be monitored and by whom, how they would be enforced and what additional costs could be incurred.
- 4.24 The scope for non-discrimination would be limited by a prohibition on restrictive covenants as this will ensure the possibility of onward sale (and thus arbitrage if a sale is not to the highest bidder²³). Maintaining the possibility of onward sales reduces the need for a non-discrimination provision.

²³ Discrimination implies that the vendor is selling to someone for less money than it could achieve through not selling to, say, an effective rival. However, the subsequent purchaser can make immediate profits through selling on to this rival. In order for this not to occur you would need some form of coordination between the buyer and seller – an explicit agreement not to sell on is one way of achieving this.

4.25 **Given these arguments, there is little justification for universal rules forcing trades to be conducted in a certain way, particularly as a majority of the benefits could be captured through other, less costly, means. Local circumstances may well be important here and trying to implement the same system at all capacity-constrained airports is not recommended.**

Controls aimed at limiting the actions of specific airlines

4.26 The concern highlighted in relation to hub dominance is arguably an extreme case and only ever likely to be relevant to a very small proportion of firms/alliances within Europe. It would be possible to target controls at these firms.

4.27 In particular, a cap on slot holdings need only be applied to hub airlines operating out of capacity constrained airports. An absolute cap on slots held may appear to directly tackle one of the main potential issues that of increasing market power downstream through the acquisition of slots at a particular airport upstream.

4.28 However, deciding at which level the cap should be set is extremely difficult, and would need to be reviewed regularly to take into account changes in circumstances. Judgements need to be made about the level and nature of market power. If the wrong judgement were made and a cap applied, then the firm in question would be needlessly restricted in its ability to compete. The ability for an airline to expand its services can be a beneficial form of competition. Restricting this can thus potentially have large disbenefits to users of air transport.

4.29 The introduction of a cap also raises some difficult questions about the nature of competition at different airports, for example:

- should the cap be set at slot holdings at a single airport or across several airports (such as Heathrow and Gatwick)?
- should the cap have an adjustment mechanism so that changes over time can be taken into account?

- should the cap take into account peak hours or be averaged across the time slots?

4.30 Clearly these are not questions that can be easily answered and the answers will differ between airports. Our view is that while a cap may have some benefits in certain circumstances, we are sceptical that these would offset the disbenefits that are likely to arise with such a significant intervention if applied across the board. We also consider that there are likely to be significant practical difficulties of identifying the correct method of capping and the appropriate level of any cap. This would not appear an appropriate way forward without much more detailed investigation and this may need to be carried out on an airport specific basis and reviewed regularly.

4.31 **Overall, imposing caps across the board would seem too blunt an instrument, would risk adverse outcomes, and would be particularly onerous to implement effectively. Caps are not therefore recommended as a way forward.**

Enforced sale of slots

4.32 A proposal outlined in DG Tren's recent consultation²⁴ is to redistribute grandfather rights if slot trades fall below a certain percentage of liquidity. Again, this may have some theoretical attractions in terms of promoting liquidity, but it starts from the premise that liquidity is an end in itself, whereas our real concern is focused on the possible knock-on effects on competition. It also raises some significant negative issues:

- it is not clear whether the Commission would have the legal right to enforce sale of grandfathered slots and consequently this could lead to a prolonged legal battle which would delay the introduction of trading and may endanger its potential success

²⁴ Commission of the European Communities, Commercial slot allocation mechanisms in the context of a further revision of Council Regulation (EEC) 95/93 on common rules for the allocation of slots at Community airports, 17th September 2004.

- again the issue arises of whether redistribution should be considered at each airport individually or in relation to groups of airports (as discussed in paragraph 4.29)
- there is a practical issue that it may be quite easy for an airline, or group of airlines artificially to meet liquidity targets by trading low value slots between each other. Alternatively small airlines (who may hold a significant proportion of slots) may see value in not trading, even though this may be the most rational economic decision for them, in order to increase the chances of receiving windfall gains through triggering an administrative redistribution of slots.

4.33 It is also worth questioning whether an administrative reallocation is really the best way forward if such a churn provision were to be implemented. It would seem strange to penalise firms for failing to sell slots and then resort to an administrative reallocation. In particular, the firms that gain slots via administrative allocation may sell on such slots if they do not hold the highest valuation of them. An administrative reallocation would undermine the broad objective of slot trading to allocate slots most efficiently. To achieve this, an auction would seem more sensible.

4.34 In summary, it is believed that, whilst there may, at first blush, appear to be some theoretical attraction to a 'churn' mechanism, this does not stand up to detailed scrutiny. Furthermore, there are some very real practical difficulties with implementation; and there is concern about the potential negative consequences of such a rule.

4.35 **The arguments suggest a forced sale mechanism would be undesirable.**

Option 2: Extending the remit of current competition policy

Merger control (and equivalent domestic legislation)

4.36 As discussed previously, the purchase and sale of a business asset such as an airport slot has some similarities to the structural changes investigated within the context of a merger investigation. Hence a legitimate question is

why not make slot trades qualify as relevant mergers for the purposes of the ECMR (or domestic legislation²⁵)?

- 4.37 An efficient filter to pick up slot trades that qualify for investigation should only capture those trades likely to raise competition issues. Such a filter could be related to overall slot holdings of the acquiring airline at a particular airport (or slot holdings during peak hours or across a group of closely located airports). However, the examining authority would still then be faced with individual trades, which are unlikely to raise substantial issues in themselves (whilst groups of trades may well do so). Expanding this further to allow for *ex-post* examinations of groups of trades would then lose the benefit of prospective merger control, and this becomes more akin to a market investigation which is discussed in more detail later.

Extending Article 81/ Article 82 (and equivalent domestic legislation)

- 4.38 In theory, a similar approach could be taken of trying to extend the remit of Articles 81 and 82 so that they could play a similar filter role in relation to slot trades. In practice, however, it is not clear how this would be implemented or designed and there is a danger that a large amount of effort could be expended in trying to do this while simpler options are available.
- 4.39 **Options for extending the remit of the ECMR or Articles 81 and 82 (or equivalent domestic legislation) do not seem to be a sensible way forward.**

Option 3: Sectoral investigations

- 4.40 Given the likely limitations of existing competition law to control for some issues raised and the problems associated with trying to apply, or extend, competition law, it is worth considering whether there is a role for a more wide ranging competition investigation. Such investigations could take place before and/or after trading is introduced:

²⁵ There is a similar example within the UK, the Railways Act 1993 requires the OFT to consider rail re-franchises as merger situations.

- an *ex ante* study would be a method of tailoring any safeguards to local conditions prior to the introduction of trading
- an *ex post* investigation would act as safeguard, exercised only when judged necessary, on transparent criteria,²⁶ which can fully take into account local circumstances.

Pre-trading studies

- 4.41 The objective of a pre-trading investigation would be to assess the competitive conditions in downstream markets served from an airport, the potential impact that trading may have, and whether any further controls beyond the basic prevention of restrictive covenants etc. are required. The importance of capturing the individual local market conditions would suggest that such an investigation should occur at the level of the Member State rather than a single pan-European investigation, and should only be carried out if the competition authority has significant concerns about competition for services provided to and from an airport or group of airports.
- 4.42 The advantage of such an investigation is that it would allow time and resource to be spent assessing competition in downstream markets served by airports where potential issues arise. It would also allow any remedies to be tailored to the particular circumstances at hand.
- 4.43 Where the relevant NCA does not have sufficient powers or resources to undertake an assessment of their own, it could be made possible for DG Comp to carry out an assessment.

Post-trading investigations

- 4.44 These investigations would be conducted by the relevant NCA and would deal with particular competition issues and concerns in airline markets, as and when they arose. Member States who do not have the means or

²⁶ The OFT has published guidance on Market Investigation references, see paragraph 2.1 of Office of Fair Trading, 'Market investigation references: Guidance about the making of references under Part 4 of the Enterprise Act', March 2003.

resources to carry out such an investigation when needed could delegate this responsibility to DG Comp.

- 4.45 The investigations could be complaint-driven or initiated separately by the NCA or DG Comp where they had significant concerns. For example, if there were evidence of detrimental downstream effects that were, *prima facie*, linked to activity in the slots market, then such an investigation could be one way of ascertaining with greater certainty whether there is genuinely anti-competitive behaviour in the slots market.
- 4.46 The availability of such a tool lays open the option of introducing secondary trading with minimal additional rules. Thus it allows for the possibility that no adverse effects may arise, and does not attempt the difficult task of trying to predict the outcome. If concerns arise they can be dealt with under such an investigation. Thus it could be seen as minimising potential distortions from unneeded regulations, whilst maintaining an effective safeguard if concerns subsequently arise.
- 4.47 Whilst such studies could occur at a national level there could also be an option for DG Comp to carry out a broader European investigation. If member states have implemented different arrangements this will allow the EC to compare which have been more successful and whether recommendations could be passed down to other member states. It is also the case that, whilst airports lie within individual member states, the effects of trading will be felt across Europe. Increasing competition and efficiency in markets served from, one European airport may benefit consumers throughout Europe. Consequently other member states will have a legitimate interest in how successful trading has been at all capacity constrained airports.
- 4.48 **The above discussion suggests that if competition is not considered to be working well, NCAs and/or DG Comp should carry out pre- and/or post-trading sectoral investigation.**

Summary

- 4.49 This section explored a number of ideas for the regulation of the slots market to minimise the risk of anti-competitive behaviour impacting on the

downstream market. The solutions vary in how far they meet the guiding principles set out in paragraph 4.1. Light-touch market-design changes, such as restrictions on the application of restrictive covenants, or sell-on clauses seemed to provide an adequate solution to a clearly identified risk present in all markets, without detracting from the benefits of trading and imposing low regulatory and administrative costs. In contrast, measures such as the imposition of an arbitrary cap on slot holdings would potentially distort the operation of the market, impose huge costs on the industry (and ultimately its end consumers) and achieve little as the rule would be unrelated to the conditions in evidence at the markets served by the affected airports.

- 4.50 The report does not completely rule out approaches such as caps on individual airline or alliance holdings on an airport-by-airport basis, although it highlights the difficulty in stipulating such remedies in response to concerns in specific markets. However, importantly, the findings suggest that this should only be contemplated once a thorough sectoral study has been undertaken covering the markets served by the airports in question. Even at the airport level, the consequences of introducing such caps should be considered very carefully.

SECTION FIVE: SUMMARY OF WAY FORWARD

5.1 The OFT/CAA's views on possible ways to proceed are as follows:

- There are some **basic trading rules** that should be made applicable to all slot trades. These would yield sound benefits without creating undue burdens at those airports where slot-related competition issues in downstream markets are less likely to arise. Specifically there should be:
 - a prohibition on restrictive covenants associated with sales and leases of airport slots which would unduly limit the commercial freedom of the purchasing airline to compete in downstream markets or sell on to potential competitors, and
 - publication of information on slot trades to increase transparency. This could be achieved by publication, by an independent authority, of information after trades have been completed.
- NCAs should **conduct studies and implement /recommend remedies at an airport or group of airports where significant competition concerns arise**. This power could be available to be exercised both before trading begins, in case additional rules are judged necessary, as well as after trading has begun, if and when concerns arise. The decision on whether to carry out a pre-trade sector study would be the responsibility of the NCA, once it had considered the circumstances in place at the airports concerned. Post-trade sectoral investigations would be triggered by formal complaints or by *prima-facie* evidence that slot-trading activity was having a detrimental effect on the downstream market. DG Comp could also carry out a broader European investigation.

5.2 These suggestions recognise that, for the vast majority of airports, competition concerns are low and, for these, a set of simple measures, with low regulatory burden, will be suitable. For those airports, where such concerns are higher, the suggested way forward would introduce a mechanism by which member states can protect competition by tailoring measures specifically to the circumstances at hand.

ANNEXE A: THE UK'S EXPERIENCE

- A.1 The rapid expansion of aviation in the UK over the last twenty years combined with relatively limited airport capacity expansion, especially for the South East, has led to significant pressure on slots at the UK's major airports, most notably at Heathrow and Gatwick.
- A.2 This annexe outlines the UK's experience of secondary trading and the likely impact of a formalisation of trading.

Trading on the secondary market

- A.3 In the UK, the practice of exchanging slots has evolved over time to incorporate the exchange of valuable slots for slots at less sought after times, together with a monetary payment. For example, BA has been involved with Swissair in an exchange of eight slot pairs plus cash compensation of £35m at Heathrow, and a deal of a similar magnitude was recently reported between Qantas and FlyBe at the same airport.¹
- A.4 Trading principally takes place at Heathrow and Gatwick. The pattern of trading is discussed below, along with an outline of what might happen if secondary trading were formalised.

Heathrow

- A.5 Heathrow is capacity constrained and characterised by severe excess demand. Utilisation is therefore very high.² As Table A1 illustrates, the main slot holder is British Airways, which operates a hub at Heathrow. There are no charter airlines at Heathrow, neither are there are low cost carriers.

¹ *BA finds further slots for growth at Heathrow*, www.ft.com, 14 October 2003; *BA outbid for Heathrow slots package*, www.ft.com, January 21 2004

² See Figure 3.4 of the NERA report.

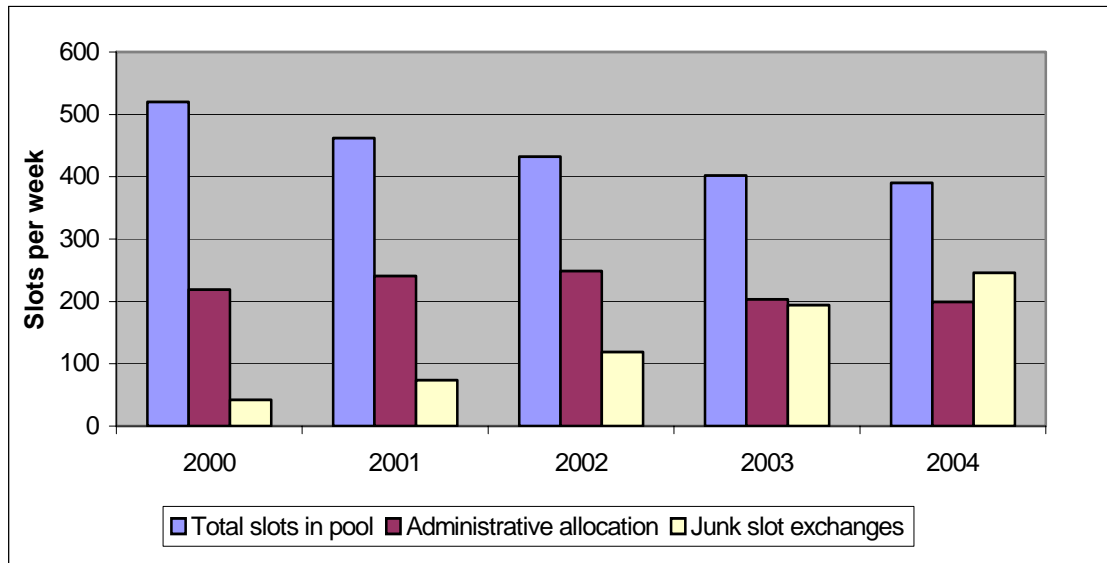
Table A1: Airlines' shares of slots at Heathrow

	Summer 2001			Summer2004			
Airline	Heathrow Slots (total = 9308)	Share	Rank	Heathrow Slots (total = 9332)	Share	Rank	% Change in slots
British Airways	3372	36.2%	1	3742	40.1%	1	+ 11.0%
British Midland	1256	13.5%	2	1096	11.7%	2	-12.7%
Lufthansa	348	3.7%	3	416	4.5%	3	+ 19.5%
Aer Lingus	320	3.4%	4	290	3.1%	4	- 9.4%
Virgin Atlantic	216	2.3%	8	284	3.0%	5	+ 31.5%
SAS Scandinavian Airlines	300	3.2%	5	280	3.0%	6	- 6.7%
American Airlines	224	2.4%	7	222	2.4%	7	0.0%
Iberia	210	2.3%	9	210	2.3%	8	0.0%
Air Canada	182	2.0%	13	196	2.1%	9	+ 7.7%
KLM - Royal Dutch Airlines	192	2.1%	10	190	2.0%	10	0.0%

Source: ACL

- A.6 There has been a significant increase in slot mobility at Heathrow since 9/11 due to the existence of more willing sellers in the form of airlines in financial distress. The recent increase in press attention received by slot transfers may also have encouraged trading, by giving airlines more confidence to trade and highlighting the amount of money that slots can be sold for. Figure A1 illustrates the increase in junk slot trading since 2000.
- A.7 Although the proportion of slots transferred through junk exchanges is small (approximately 3% of all slots at Heathrow), some of the changes in airlines' holdings over recent years have been significant (see the last column of Table A1 above). Figure A1 illustrates that the number of slots available from the pool is small and declining, suggesting that trading is becoming more and more important as a way of obtaining slots at Europe's most congested airport.

Figure A1: Statistics on slot mobility at Heathrow



Source: ACL

- A.8 The UK's experience is that airlines buy slots on the grey market primarily to obtain series of lined-up daily slots and to secure the use of slot pairs throughout the year (i.e. for both summer and winter seasons), neither of which can be obtained from the slot pool. The main purchaser of slots at Heathrow has been BA (see Table A1). This has been at least in part due to its recent decision to focus on Heathrow rather than develop a hub at Gatwick.
- A.9 The other main purchasers have been airlines offering long haul services, which are typically more profitable than most other services. Here we note that British Airways' purchase of slots at Heathrow has been entered as an asset on their balance sheet.
- A.10 The lack of liquidity at Heathrow means that airlines may buy slots before they are ready to use them (it can be difficult to coordinate the acquisition of slots and planes). As a result, they may use slots sub-optimally for a period of time.
- A.11 The main sellers at Heathrow have been airlines in financial distress, or those with relatively low slot valuations, in particular airlines providing short haul services have slot slots to those providing long haul services.

- A.12 The *formalisation of secondary trading* could increase slot trading at Heathrow, but is not likely to do so to any great extent, the main problem being the relative lack of willing sellers. Airlines intending to maintain a long term presence at Heathrow are unlikely to sell slots because of the lack of liquidity at the airport.
- A.13 BA is likely to continue to increase its slot holdings at Heathrow, although it is not clear whether this would happen more quickly under formalised secondary trading compared to the present situation.
- A.14 Low cost airlines are unlikely to want slots at Heathrow. Therefore the main buyers are likely to remain BA and other long haul service providers.

Gatwick

- A.15 Gatwick is the second major airport in London. It experiences excess demand throughout the day at least in part because it benefits from a spillover of the excess demand at Heathrow.
- A.16 Airlines, particularly BA, appear to be unsure of their strategy at Gatwick. BA previously sought to develop Gatwick as a second hub but changed its strategy in the wake of 9/11. Since then it has reduced its share but still remains the major slot holder (see Table A1).
- A.17 Gatwick is increasingly becoming a base for low cost carriers, particularly easyJet, which is now the second largest slot holder (see Table A2). It is also a base for charter airlines. Leasing thought to be more prevalent here than at Heathrow.

Table A2: Airlines' shares of slots at Gatwick

	Summer 2001			Summer 2004			
Airline	Gatwick Slots (total = 5571)	Share	Rank	Gatwick Slots (total = 5657)	Share	Rank	% Change in slots
British Airways	2228	40.0%	1	1452	25.7%	1	- 34.8%
Easyjet	30	0.5%	-	551	9.7%	2	+ 1736.0%
GB Airways	205	3.7%	5	356	6.3%	3	+ 73.7%
First Choice	260	4.7%	3	274	4.8%	4	+ 5.4%
Excel Airways Limited	134	2.4%	8	274	4.8%	5	+ 104.5%
Britannia Airways Ltd	168	3.0%	7	233	4.1%	6	+ 38.7%
Thomas Cook Airlines	349	6.3%	2	231	4.1%	7	- 33.8%
Monarch Airlines Ltd	229	4.1%	4	180	3.2%	8	- 21.4%
FlyBe – British European	202	3.6%	6	166	2.9%	9	- 17.8%
Mytravel Airways	119	2.1%	9	132	2.3%	10	+ 10.9%

Source: ACL

A.18 Table A2 illustrates that there has been much greater movement of slots at Gatwick. In particular, easyJet has increased its share of slots significantly, while BA and some charter airlines have reduced their holdings.

A.19 If *secondary trading* were formalised, we might expect to see charter airlines further reducing their share of slots, and possibly an increase in slot holdings by short haul services providers that are squeezed out of Heathrow. Overall there is likely to be greater liquidity at Gatwick than at Heathrow.

ANNEXE B: COMPETITION EXPERIENCE

B.1 There is considerable experience of competition analysis within the airline sector. This annexe does not attempt to summarise all of this but draws down upon those parts of most relevance to airport slots.

Market definition

B.2 Competition analysis typically starts with posing the question of what the relevant market being examined is. This is defined in terms of which set of goods and/or services are worth monopolising. As such this is a useful starting point in considering how this has been previously approached in airline cases.

B.3 Although the relevant market can vary from case to case, the starting point is usually an Origin and Destination ('O&D') pair. Passengers will generally want to travel to a specific destination and would not be prepared to substitute another destination when faced with an increase in price. Therefore, every combination of a point of origin and point of destination is a separate market.

B.4 O&D pairs are usually defined as city pairs. The definition may be narrower than this if distinctions are drawn between different types of passengers or different types of air services. Distinctions that have been found in the past include:

- Types of passengers – A distinction has frequently been made between time-sensitive and price-sensitive passengers or point-to-point and connecting passengers.
- Non-stop versus one-stop flights – Although it is possible to travel between an origin and destination via an intermediate point, most passengers prefer a non-stop flight if one is available. In many cases the preference for non-stop flights has been sufficiently strong for them to be regarded as a separate market.
- Other modes of transport – Charter flights, low cost carriers, regional carriers, feeder flights, and other forms of transport can be considered in the course of delineating a market.
- Airports within a city – In some cases the different airports serving a particular city are not viewed by passengers as substitutable. As a result, the relevant market may be narrowed to airport pairs rather than city pairs.

B.5 The substitutability of airports within a city and between non-stop and indirect flights may also vary between different types of passenger. It has sometimes been found that for time sensitive passengers the relevant market is restricted to non-stop flights from primary airports whereas for non-time sensitive passengers the market includes indirect flights and flights from secondary airports.

B.6 Where one or both of the points on a single route includes a capacity constrained airport it can be difficult for airlines, even those already operating at one of the airports, easily to switch services to the route in question. A series of lined up slots (which can be used to offer comparable service to an incumbent to a specific destination) may be required to offer a significant constraint to an incumbent on a specific route. It may also be the case that specific time slots are of great importance here as well, for example slots allowing flights to land in early morning (enabling business customers to attend meetings that day).

- B.7 It may be possible therefore to define very narrow markets for time sensitive passengers. It is thus possible for market power to exist in relation to particular routes and this has been reflected in, for example, EC merger decisions where divestment of slots has been required to meet competition concerns on specific routes.
- B.8 Within this context, very specific competition concerns on city-pair routes can and have arisen. For example:
- anti-competitive agreements to withdraw from particular routes as in SAS/Maersk, or
 - exclusionary abuses of dominance such as predation in relation to particular O&D routes.
- B.9 The interaction between slot transactions and the downstream markets affected will depend on a number of factors particular to those markets.

Potential concerns relating to slots

Hub dominance

- B.10 The most congested airports in Europe are also, usually, bases for hub operations by a major airline or alliance. Hub dominance may occur where a hub airline represents a substantial proportion of flights to and from such an airport.
- B.11 An airport hub is one where an airline (typically a national flag carrier) has concentrated its air routes at a single airport to benefit from network efficiencies. In particular, adding additional destinations to the network and scheduling flights to optimise direct and indirect traffic can generate significant economies of density. Such potential benefits were recently recognised in the Air France / Alitalia alliance,³ an alliance aimed at creating a European multi-hub system based on Paris Charles de Gaulle (CDG), Rome Fiumicino and Milan Malpensa.

³ COMP/38.284 - Air France / Alitalia, certain slot divestments were also required to address specific concerns on certain routes.

- B.12 The potential competition concern with hub dominance is that a hub carrier could own such a high share of slots at an *airport* that it could restrict the ability of other airlines to compete for services to and from the *geographic market* that airport serves.
- B.13 Nevertheless, hub airlines can and do compete with each other and it is to be expected that hub airlines will face a combination of constraints from city-pair competitors and other hub airlines. For example, within Europe, the growth of secondary airports and low-cost competition has provided effective rivalry on short-haul point-to-point markets between most big city pairs. For longer-haul routes, the existence of alternative routings from primary or secondary airports can provide good substitute services to those provided by the main hub-carrier. Nevertheless, there remain concerns that certain market segments, such as time-sensitive passengers living in close proximity to the hub airport may face limited choice for certain thin, short-haul routes or direct, long-haul services.
- B.14 The issue of hub dominance has been the subject of much research within the US (which may reflect the more pronounced nature of hubs there). A US Department of Transport study in 1990 of competition on routes at seven of the most concentrated US hubs found, among other things, an observed 'hub premium'. Yields at the eight most concentrated hubs were 18.7% higher on average than the industry norm.⁴ Hub dominance has also been considered in respect of European merger and alliance cases. For example, in the Air France / Sabena merger case, the Commission found that combining Air France's services and slots with the existing Sabena hub and spoke operation at Zaventem airport in Brussels would reinforce the dominant position of the parties over all existing routes between Belgium and France and create barriers to entry for any other airlines wishing to establish such services in those markets⁵.
- B.15 The historic situation within Europe has led to the flag carriers establishing hub operations at the main city airports for which it has proved difficult for

⁴ US Department of Transportation, Secretary's Task Force on Competition in the US Domestic Airline Industry, 1990.

⁵ Case IV/M.157 Air France / Sabena

other airlines or alliances to establish a fully competitive alternative set of services (with the possible exception of the Star Alliance at Heathrow). There may be many reasons why such hub airlines have not seen their slot portfolios reduced in the aftermath of liberalisation of EU services, including the network benefits that flow from the existence of a single airline or alliance with a wide range of destinations. However, another reason may be the rigidity in slot allocations produced by grandfather rights and the difficulty of obtaining slots in the absence of a formalised market. Existing slot holders can either continue to use a particular slot themselves, or release it for use by another airline. At present the latter can only take place through a slot exchange or by placing the slot in the pool for reallocation by the slot coordinator. There is therefore little incentive for hub airlines to return such slots to the pool.

B.16 Slot trading should, in principle therefore, improve this situation by increasing the opportunity cost⁶ of inefficiently holding slots and thus increasing the incentive for hub airlines to realise the value of otherwise under-utilised slots. Slot trading will also potentially give greater flexibility for competitors to alter their flight schedules in order to seek economic rents, which may arise where a hub airline is in a particularly strong position and consequently would tend to increase competition where these excessive profits are being generated. This, if successful, would be a more general and flexible constraint than individual regulators trying to address the issue through administrative allocation of new slots.⁷

B.17 There is a residual risk of anti-competitive slot hoarding and refusal to sell slots but this problem already exists today, and the introduction of trading should lessen the risk.

⁶ The opportunity cost of an action is the best alternative foregone. In respect of an airline owning a slot but using it inefficiently (and hence by definition, there are other airlines who could use the slot more profitably), this cost represents the revenue that could be realised through the sale of the slot.

⁷ It should also be recognised that slot trading is not a universal panacea. In addition hub airlines, as discussed earlier, can benefit from significant efficiencies consequently this could lead to more slots gravitating to the hub airlines who can use them most efficiently. This is not necessarily a competition concern, customer will also benefit as long so sufficient competitive constrain remains to ensure such efficiencies are passed on.

- B.18 A hub carrier will have little incentive to sell slots if the likely value from the sale plus any negative impact on its future profitability from the competitor's new slot-dependent operation outweighs the future revenue stream from continuation of the service. Where this is the case, it may prefer to utilise the slots on routes whose revenue generation would not normally justify such routes at a particular airport. This sub-optimal use of slots could for example include the use of smaller aircraft on routes than would otherwise be the case.
- B.19 By hoarding slots in this way a hub carrier could leave other carriers facing significant barriers to entry and expansion and, in the extreme, risks foreclosing the market to competitors altogether over time. Such a restriction of competition could pay dividends to the hub airline through higher ticket prices and would be to the ultimate detriment of consumers of air travel. This possibility is remote where other airports serve the same markets.
- B.20 A hub carrier may also seek to increase market power through acquisition of slots that become available under slot trading, especially peak period slots which can enable a rival to offer a more effective competing service. The value of these slots to a hub carrier may include a premium reflecting market power and thus the hub carrier may be able to outbid other carriers in purchasing these slots.
- B.21 Alternatively, a hub carrier may choose to sell some of the slots it owns.⁸ Where the seller holds a significant number of slots at an airport, it may seek to exploit its position by placing unreasonable conditions on the sale. Behaviour may include attempting to sell slots at excessive prices or only at unattractive times, although this will be difficult where there are other potential sellers willing to trade at lower prices. This temptation will be particularly strong where sales to strong competitors are considered; at its extreme, sellers may try and withhold slots entirely from those buyers. Such

⁸ The incentives of a hub airline with market power does not imply that they would not sell any slots if secondary trading is introduced. While these carriers are likely to be net buyers, they may seek to sell some slots in order to replace them with others at times that better meet their needs. In addition, it may imply that they would sell less slots than they would otherwise do without the rents associated with their market power.

actions would clearly raise concerns about the impacts on rivals and future competition. However, many of these problems are only applicable where there is dominance of an airport's slots by one airline or alliance or where there is inadequate substitutability from other airports. Furthermore, by exposing the holder to the full opportunity costs associated with holding slots, a number of the problems will be lessened by secondary trading.

Anticompetitive agreements and predation in downstream air transport markets

B.22 Apart from the issues of hub dominance, other competition issues that have arisen in respect of airlines have been exclusionary practices and anti-competitive agreements in downstream air transport markets. This has involved single firm conduct such as predation as well as oligopolistic⁹ behaviour such as market sharing. Examples of these include market sharing, such as SAS/Maersk where agreements to withdraw from particular routes occurred. In the US there have been cases of predation such as the American Airlines case¹⁰ and evidence of price fixing through the Airline Tariff Publishing Company.¹¹

Experience of slot trading

B.23 There have been several studies of the impact of both primary and secondary slot trading within the US.¹² The US introduced secondary trading of 'grandfathered' slots which led to an initial surge in trading which subsequently slowed. There is some evidence that this allowed greater

⁹ An oligopoly is a market structure comprising of a few large firms. Because each firm is large its individual actions substantially effect the market and oligopolists may act strategically because of this. Whilst some types of oligopolistic behaviour, such as cartelization, can be anti-competitive, a variety of market outcomes can result from oligopolies.

¹⁰ For example, see Edlin, A and Farrell, J. 'The American Airlines Case: A Chance to Clarify Predation Policy', No 1048, Department of Economics, Working Paper Series from [Department of Economics, Institute for Business and Economic Research, UC Berkeley](http://www.econwpa.wustl.edu/eps/le/papers/0401/0401003.pdf) available at <http://www.usdoj.gov/atr/cases/indx199.htm>

¹¹ See case filings at <http://www.usdoj.gov/atr/cases/dir23.htm>.

¹² For example, see Appendix C of the NERA (2004) report for a summary of the US experience and references of relevant papers.

concentration of hub airlines due to their higher valuation of slots¹³. An issue that has arisen here is how to differentiate between increased slot holdings by hub airlines to improve efficiency by centralising airline operations at one airport and possible anti-competitive actions¹⁴. In 1991 the US Federal Trade Commission's Bureau of Economics carry out a study of the impact of slot trading which was updated in 1994. This tested the theory of anti-competitive concentration at the effected airports. Whilst acknowledging the deficiencies in the data they found that the large carriers did not appear to restrict supply and this pointed to no anti-competitive effects of the concentration.

B.24 Nevertheless, a clear potential concern is for hub airlines to increase market power through acquisition of slots. More recently consultations on proposals of reform to slot allocations at LaGuardia and Chicago O'Hare airports have led to submissions from the Department of Justice's Antitrust Divisions.¹⁵ They acknowledge the problems with hub carriers' valuation of slots due to market power. They also point to the potential for market mechanisms to increase efficiency and to encourage competition if enough slots become available.

¹³ Some concentration was also due to failures of airlines

¹⁴ The two can occur at once, although it then can be difficult to determine the likely effect on final customers. See <http://www.ftc.gov/be/v940013.htm>

¹⁵ See <http://www.usdoj.gov/atr/public/comments/11398.htm> and <http://dms.dot.gov/search/document.cfm?documentid=332095&docketid=20704>

ANNEXE C: IS EXISTING LEGISLATION WELL PLACED TO ADDRESS POTENTIAL COMPETITION ISSUES WHICH MAY ARISE?

C.1 In terms of EC competition law, there are three key areas of legislation to consider: the European Community Merger Regulation (ECMR); Article 81 and Article 82. There also exists national competition law, which generally reflects the three areas of EC competition law identified above but can also differ in certain respects for example the UK has additional scope to conduct a market study and investigation. These are discussed below.

Merger control

The applicability of merger controls – legal position

- C.2 The sale and purchase of an airport slot is the sale of an asset for a business purpose we have therefore considered whether merger control might apply to slot trades.
- C.3 The ECMR applies to mergers where there is a Community dimension. Under the revised ECMR, a merger is deemed to take place under two situations. The first is where two or more previously independent undertakings or parts of undertakings come under joint control on a lasting basis. This would not appear to apply to free standing slot transactions because slots are not undertakings.
- C.4 The second situation is the acquisition of control by one undertaking of at least part of another undertaking, which can include assets. The new definition of a concentration is in part a codification of the Notice on the Concept of a Concentration.¹⁶ This Notice explicitly refers to the need for a change in control of a meaningful business, which the previous ECMR did not. This suggests that an asset needs to amount to a meaningful business before its transfer would amount to a concentration requiring scrutiny under the ECMR. The transfer of a slot seems unlikely to meet this requirement. It

¹⁶ As set out in the Note accompanying the latest draft of the new ECMR.

is a component in any airline's business but does not amount to a business in itself.

- C.5 In addition, Article 3 of the revised ECMR makes it clear that however the control is acquired, it needs to confer the possibility of exercising a 'decisive influence' on another undertaking. Again, the acquisition of slots from another airline (or other business) is unlikely to amount to this.
- C.6 Although it would be important to look at the substance of a transaction rather than the form in which it takes place, it seems very unlikely that a slot transaction would entail the alteration of control of an undertaking or part of an undertaking that is required for the ECMR to apply.
- C.7 In the UK, it is also unlikely that national merger law would apply. Under the Enterprise Act 2002, two or more enterprises, (defined as 'the activities or part of the activities of a business'), must be brought under common ownership or control. It seems doubtful that this test could be met by slot transactions. Again it is difficult to categorise a slot as a business in its own right or as an essential component that allows a business to be passed on. Therefore we do not believe that UK merger law would apply to slot transactions.

The applicability of merger controls – economic considerations

- C.8 Even if slot transactions were to fall under merger legislation, it is likely to be difficult for competition authorities to identify a particular downstream market that would be affected by a transaction because slots are not route-specific. Furthermore, the sale of a small number of slots is also, by itself, unlikely to have a significant effect on competition in a downstream market. These two factors make it unlikely that the purchase of slots could be characterised as a substantial lessening of competition¹⁷. It appears more likely that competition concerns would arise due to a sustained trend in slot acquisition by an airline with market power than through any single transaction. Merger control may not be best suited to deal with this type of 'salami slicing'.

¹⁷ This has been phrased under the UK merger control's substantive test but holds equally for the substantive test under the European Commission Merger Regulation.

C.9 Furthermore, merger control will not be able to address slot hoarding by dominant carriers.

Application of Articles 81 and 82

C.10 When considering the application of Articles 81 and 82 to slot transactions it is important to first check whether Articles 81 and 82¹⁸ could be applied to slots even though they constitute a form of property rights. The European Commission has made it clear that it is permissible to interfere with property rights to apply Articles 81 and 82. For example in the Frankfurt Airport¹⁹ case, it was argued that application of Article 82 to the ground handling services would amount to an interference with property rights contrary to Article 295 of the Treaty. However the Commission rejected this argument, drawing on the judgment of the ECJ in Hauer.²⁰ This has since been further endorsed by AG Cosmas in Masterfoods.²¹ As long as the intervention is no more than is necessary to achieve the application of Articles 81 and 82, intervention in property rights would be seen as justifiable.

C.11 For competition law to provide potential solutions to any restrictions of competition, the starting point would be either to establish that an airline had a dominant position or that a transaction between airlines would have an appreciable effect on competition.

C.12 We discuss below the main points relating to the application of Articles 81 and 82.

¹⁸ We have focused in this section on Articles 81 and 82 of the EC Treaty rather than domestic competition law as any slot transaction will arguably have an effect on trade between member states. By virtue of Article 3(1) of Regulation 1/2003, in any case where a national court or national competition authority applies domestic competition law agreements or conduct that have an effect on trade between EU Member States, then they must also apply Article 81 or Article 82, as the case may be.

¹⁹ Frankfurt Airport OJ 1998 L72/30

²⁰ Hauer v Land Rheinland-Pfalz 44/79 [1979] ECR 3727

²¹ Masterfoods Ltd v HB Ice Cream LTd C-344/98 [2000] ECR I-1

Article 81

The applicability of article 81 – legal considerations

- C.13 Article 81 essentially prohibits agreements, decisions and concerted practices that restrict competition. It is likely to be very difficult to apply Article 81 to individual slot transactions.
- C.14 A slot transaction that involves only one or a small number of slots is unlikely to have an appreciable effect on competition on its own, either upstream or downstream. It is therefore likely to be seen as *de minimis*, unless it is part of a series of individual transactions that together have an appreciable effect on competition.
- C.15 The Commission notice on agreements of minor importance,²² now also applies to networks of agreements. This is based on aggregate market shares of the parties to the agreement being above 10 per cent (as opposed to the slots which form the agreement), which would seem likely to be met on slot trades involving hub carriers.
- C.16 The Delimitis²³ decision provides for a two-limb test in respect of networks of agreements. Firstly, if an examination of all similar contracts and other relevant factors shows that the agreements do not cumulatively affect entry to the market, the individual agreements cannot infringe Article 81(1). Secondly, if they do have a restrictive effect, then the contribution made by the individual agreement in question to the overall effect must be assessed. Only if its contribution is appreciable can the agreement be an infringing one. Connecting a reduction in future rivalry to a series of agreements linked to slot trades would not be straightforward.
- C.17 However, slot sales or leases that contain non-compete clauses are likely to be seen as *agreements* whose object or effect is market sharing and as such, prohibited under Article 81 without any need to examine appreciability:

²²Commission Notice on agreements of minor importance, which do not appreciably restrict competition under Article 81(1) of the Treaty establishing the European Community (*de minimis*). OJ C 368/13, 22.12.2001.

²³Case C-234/89, Stergio Delimitis v Henninger Braü AG, Judgement of the Court of February 28, 1996.

- There is some scope for companies to include such terms where it is necessary to allow the parties to achieve a legitimate commercial purpose and the restraint is proportionate to this aim.²⁴
- However, if the term prevents the buyer from operating on a particular route at all, then the agreement would have the 'object' of preventing competition on that route. The buyer would be agreeing to keep out of that particular market, or at the very least a part of that market, which is likely to amount to market sharing.
- If the term prevents the buyer from expanding on a route on which it is already present, the buyer will continue to compete but in a constricted way. This could also amount to market sharing.
- The scenarios discussed above are similar to that in SAS/Maersk, where the two airlines agreed to withdraw from certain routes where the other airline operated. This was found to be market sharing and the parties were fined €39.375 million and €13.125 million respectively.²⁵

C.18 In the UK, it is possible that the Land and Vertical Agreements Order 2000²⁶ would exempt slot transactions from the Chapter I prohibition, (the UK's domestic equivalent of Article 81).²⁷ However, because any slot transaction is likely to have an effect on trade between member states,²⁸ it is likely that EC law (Article 81) would in any case apply. The Land and Vertical Agreements Order 2000 does not exempt slot transactions from Article 81.

C.19 Furthermore, where an agreement infringes Article 81, then it would seem that even if the exclusion order applied to a slot transaction agreement, then

²⁴ The line of cases that cumulated in Reuters and Remia seem to establish this proposition. The principle also finds expression in the ECMR at Article 8 dealing with the deemed clearance of those restrictions directly related and necessary to the implementation of the concentration.

²⁵ Commission fines SAS and Maersk Air for market-sharing agreement 18.07.2001 <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/01/1009&format=HTML&aged=0&language=EN&guiLanguage=en>

²⁶ From 1 May 2005 a revised version of this order will apply, which will remove the verticals exclusion but retain the land exclusion from Chapter I.

²⁷ A slot is a right of access to a runway at a particular time. It is at least arguable that this is an interest in land as defined in the Order and as a result there might be problems in applying Chapter I to slots.

²⁸ The threshold for finding an effect on trade does not appear to be high.

it would need to be disapplied to ensure the agreement was not being upheld under national law²⁹.

Applicability of Article 81 – economic considerations

- C.20 To the extent that slot trades are used to collude explicitly then Article 81 is designed to deal with this issue and is well placed to do so.
- C.21 As noted previously, a slot could be used for any number of routes. Unless a slot transaction specifies the route for which the slot will be used (or must not be used), we may not be able to identify which downstream market will be affected by the slot transaction. Consequently it may be difficult to address other potential competition issues through Article 81.

Article 82

Applicability of Article 82 – legal considerations

- C.22 Article 82 prohibits the abuse of a dominant position. For Article 82 to apply upstream, an airline must be found to be dominant in a slot market. Where a city is served by a number of airports, it is only likely that an airline would hold a dominant position in a slot market if that market could be restricted to slots at one particular airport. In turn this is only likely to be the case where we can identify that, in the downstream air services markets, there are time sensitive passengers located near or travelling to a major airport who do not consider flights from alternative airports to be close substitutes.

Refusal to supply / essential facilities

- C.23 A refusal by a dominant undertaking to supply a good or service to an existing or a new customer can, in some circumstances, amount to an abuse of a dominant position. The refusal need not be absolute – constructive refusal, such as deliberately delaying supply or supplying at unreasonable prices, could amount to an abuse. However, there will be no abuse if the dominant undertaking can show that the refusal to supply is objectively

²⁹ See e.g. para. 6 of the commission notice on co-operation between the Commission and the courts of EU Member States in the application of Articles 81 and 82 (OJ 2004 C101/4).

justified, for example the undertaking seeking access is not creditworthy or has been refused access following a competitive bid process.

- C.24 The circumstances when a refusal to supply by a dominant undertaking is likely to be found to be abusive and not capable of objective justification include refusals to supply which are made with a view to eliminating competition in a downstream market and refusals which are harmful to the achievement of the single market. For example, if a hub carrier with a dominant position in the supply of slots leased slots to another airline but then refused to renew the lease in order to prevent the airline competing with its own service on a particular O&D route, the refusal could amount to an abuse in breach of Article 82.
- C.25 Refusal to supply case law includes the strand which has developed the 'essential facilities' doctrine. Under the essential facilities doctrine, a dominant undertaking that 'both owns and controls a facility or infrastructure to which competitors need access in order to provide services to customers, cannot refuse access to [such] competitors or grant them access only on less favourable terms than it gives to its own operations.'³⁰ As with cases of refusal to supply, a refusal to provide access to an essential facility will not be an abuse if it can be objectively justified.
- C.26 An essential facility is one where access to it is indispensable in order to compete in the relevant market because:
- there are no other products or services available which provide an alternative solution to the facility (albeit less advantageous); and
 - it is not economically viable to duplicate the facility.
- C.27 The term 'essential facility' was first used by the Commission in Sealink/B&I³¹ where it was held that a sea port was an essential facility. There have also been other cases involving a refusal to supply which have related to essential facilities in the passenger transport sector. In Frankfurt Airport,³² the denial of access to an airport for the purposes of providing

³⁰ Whish *Competition Law*, fifth edition, page 205

³¹ [1992] 5 CMLR 255.

³² Flughafen Frankfurt/Main AG 98/190 [1998] OJ L72/31.

ground handling services was found to be an abuse of a dominant position by the airport. In London-European/Sabena³³ a computerised airline reservation service was found to be an essential facility so that an unreasonable refusal to supply access to it amounted to an abuse of a dominant position.

C.28 In the context of refusal to supply and the essential facilities doctrine, issues may arise where an undertaking owning all or most of the slots at a particular airport refuses to sell slots to its competitors. Assuming the undertaking is dominant, it could be alleged that its refusal to sell slots to competitors amounts to an abuse of this dominant position. However there are at least two important factors that need to be considered in relation to such an allegation:

- whether the slots in question are indispensable to the provision of the airline service in question;
- whether there is an objective justification for an airline's refusal to supply on reasonable terms and conditions.

C.29 In order to show that access to a hub carrier's slots was indispensable, it would be necessary to show that it would be virtually impossible to obtain slots from airlines other than the hub carrier; and that slots at alternative airports were not reasonable substitutes. This might apply for some downstream markets (e.g. time sensitive travellers) and not others.

C.30 It has been suggested that slots are so costly that an airline would never own a sufficiently high share for the essential facilities doctrine to apply. At present, hub carriers' share of slots at their hub airport varies but it is important to note that there is no 'magic' share of slots at which point a hub carrier would be considered dominant,³⁴ even less so for control of an essential facility.

C.31 It would also be necessary to demonstrate that the hub carrier should be required to sell some of its slots, even though this would directly restrict its ability to compete. This is likely to be a tough test (and not one that would arise if an airport owned the slots).

³³ OJ [1988] L317/47.

³⁴ Although if an airline had 50% or more of a relevant economic market, the presumption would be that it was dominant.

C.32 For example, if a hub carrier used all the slots it owned itself, or only sold or leased slots at unattractive times, it could argue quite strongly that it was making good use of the slots itself, exploiting network effects to the fullest extent possible with knock-on benefits for consumers in the form a more comprehensive timetable and network of destinations. On the other hand, if the hub carrier imposed restrictive conditions on slot sales or leases (e.g. non-compete clauses), it would be easier to establish that it was doing so for anti-competitive reasons and, by the same token, harder for the hub carrier to objectively justify its conduct.

Applicability of Article 82 – economic considerations

C.33 The essential concern potentially arising from trading in slots which is directly linked to the concept of dominance is slot hoarding. This could arise in two ways:

- an existing position of market power is maintained through a refusal to sell slots which are systematically being underutilised, or
- a position of market power is enhanced through acquisition of additional slots.

so that prices (or other factors such as quality) in the downstream air transport markets are adversely affected.

C.34 The key concern in downstream markets under either case, is that the end consumers face higher prices and/or lower quality of service than would otherwise occur. Article 82 can in theory address this type of exploitative abuse but it is hard to secure the necessary level of evidence to take action.

C.35 Moreover, Article 82 is poorly placed to address the upstream issues which can give rise to the downstream effects in this particular context. As noted above refusal to supply cases are usually subject to especially high hurdles and are difficult to prove, even when there is an observed correlation with high prices in the downstream market. This reflects that the remedy of mandating access to a company's assets is a major intervention and will reduce the incentive to invest in these assets.

- C.36 The situation in airport slots is very different, the incentives for an airline to invest in more slots is of much lesser relevance. Airport capacity expansion decisions are unlikely to be driven by the value of airport slots (although this can be a useful indicator of the extent of capacity constraints), nor would it be the airline that makes such decisions (which are typically heavily regulated). In these circumstances the force of the arguments on investment incentives for such a high evidentiary burden is diminished.
- C.37 However, requiring an airline to divest itself of slots has significant implications for its ability to provide services to air travellers. Only one airline can use a slot at a particular time and within capacity constrained airports the supply is fixed. Consequently divestment of slots is likely to impact on the divesting airline's ability to compete and should not be undertaken lightly.