Mergers, acquisitions and 'fair' competition in the airline industry[*]

ABSTRACT

This article attempts to introduce new thought on the subject of consolidation in the airline industry. The rapid consolidation witnessed in the years following deregulation and liberalisation of North American and European markets is arguably different from the more recent experience. Only a few 'mega' legacy carriers and their subsidiaries remain today in the wake of significant and widespread waves of consolidation of recent years. Are unfair practices and market distortions the catalysts? In this article, 'mergers and acquisitions' in the airline industry are briefly considered in light of wider global efforts to safeguard 'fair' competition in the airline industry.

INTRODUCTION

With the many airline consolidations that transpired in the decades following market deregulation in the United States (U.S.) and liberalisation of the single market for air services in the European Union (EU), the market today comprises only some of the so-called 'legacy' carriers of yesteryear. In the U.S., for instance, of ten major airlines on the market in 2001, the only four remaining brands today are American Airlines, Delta, United and Southwest. The respective consolidations take the form of mergers between two or more airlines on the one hand, and by way of acquisitions of companies and of shares in companies on the other hand. While there has been new entry on the market by low-cost carriers (LCCs) in particular, which on the whole can be viewed as 'successful', LCCs are beyond the scope of this article. Instead, we seek to understand the experience of insolvent national 'flag' carriers, which have been forced to bow out of the market and those that, facing financial difficulty, have been propped up by State capital injections, or acquired in part or in full by foreign companies. Within the EU, there are numerous examples of mergers and acquisitions in the airline industry: Lufthansa, Swiss, Austrian; KLM, Air France; British Airways, Iberia and Aer Lingus – to name just a few.

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This article very briefly describes some of the topics presented in the author's published manuscript as presented at the Rzeszow Aviation Conference 2017. See S. Truxal, *Economic and Environmental Regulation of International Aviation: From Inter-National to Global Governance*, (Routledge 2017).

Competition on the global market for air services can easily be described as 'fierce'. It comes as no surprise to many, then, that the industry in the past was fraught with price-fixing cartels; by its very nature, it still remains prone to anticompetitive behaviour.[1] There are also sufficient examples in the industry of price discrimination and State guarantees and subsidies – commonly referred to as 'State aid'. In the EU, for instance, the core challenge has been to work towards 'competitive neutrality' and at the same time see to it that previously State-owned and controlled national 'flag' carriers of each of its Member States are privatised; in many cases, the airlines are foreign direct investment.

Over the years, airlines operating in a deregulated market environment have also devised innovative tactical and strategic alliances and business ventures in an attempt to survive in a very competitive global market. Applying economic theory, it is this author's view that but for historical, protectionist ownership and control rules which are in place in most jurisdictions, major airlines around the globe would consolidate even further – *vis-à-vis* cross-border mergers and acquisitions.

The hurdle is two-fold: antiquated ownership and control rules on the one hand, and economic nationalism on the other hand, protecting the domestic market from foreign investment. This author argues that nowadays airlines should be viewed as *global* actors – playing in a global market; and therefore, economic regulation of airlines should recognise the potential for economic and social benefits of further global consolidation.

At present, however, the practice of competition (enforcement) authorities is to apply the antitrust rules of one State to respective foreign firms. In acting with extraterritorial effect, the resulting difficulty is manifested in rather fragmented and overlapping governance and competition between authorities in the jurisdictions of the parties to a potential cooperation, acquisition or merger. Owing to the global nature of the airline industry, this can also produce confusing and at times conflicting regulation of a single actor at multiple levels. With that said, there are also great possibilities for "collaboration and convergence in competition policy to ensure consistent practice in global markets whereby States align national policies more to the global economy, even if said policies remain termed 'national'."[2] Indeed, further collaboration and convergence – *vis-à-vis* fair competition safeguards for a start – are necessary to overcome the economic challenges facing the global aviation sector. But how can this be achieved? The next section considers 'fair' competition in air services between States in the context of their respective bilateral or 'plurilateral' air services agreements.

AIR SERVICES AGREEMENTS

The background to the European strategy in action today can be gleaned from a European Commission statement made in 2012: "EU's external aviation policy and initiatives should

[1] See S. Truxal, *Competition and Regulation in the Airline industry: Puppets in Chaos*, (Routledge 2012).
[2] S. Truxal, *Economic and Environmental Regulation of International Aviation: From Inter-National to Global Governance*, (Routledge 2017), p. xix–xx.

promote and defend European interests more vigorously and continue to promote and share European values, standards and best practices on a collaborative basis. It should aim at the highest possible standards to be applied in the industry, through regulatory cooperation and convergence. These goals will not be achieved without coordinated EU-level negotiations with key partners."[3]

Traditionally the major hurdle to the liberalisation of aviation globally has been the common practice of incorporating ownership and control clauses in air services agreements (ASAs) negotiated between States. The consensus view within industry seems to be that greater liberalisation is required; the trend however appears to be the converse, with many States retreating as they roll-back liberalisation of aviation. The view in Europe is that the system is antiquated. According to the European Commission, "…ownership and control regimes remain fundamentally stuck where they were negotiated in 1944 in the Chicago Convention. The difficulties encountered as a result of current ownership and control provisions are significant and require negotiations with partner countries and highly complex governance structures. Inevitably this means that the full benefits of consolidation cannot be achieved. Alliance members cooperate more and more closely to offer customers a seamless integrated global multi–hub network service."[4] It can be observed that airlines which form part of global alliances cooperate more and more closely to offer customers a seamless integrated global multi-hub network service – as an apparent alternative to the non-prospect of a cross-border, full merger – legally speaking.

The EU's current External Aviation Policy – implemented in 2012 – includes an important normative caveat that EU carriers should be able to compete in the global market on an 'open, fair and undistorted basis'. The EU External Aviation Policy has three main objectives:

(i) creating consumer benefits (which suggests a strong continued focus on market opening);
(ii) safeguarding competitiveness, which suggests stronger EU–level measures to insist on ownership and control reform, reductions of the regulatory burden and an international level playing field (all difficult to secure at Member State level); and
(iii) wider public policy objectives going beyond traffic rights (the EU approach will therefore seek to ensure overriding public safety, security and environmental goals)[5]

According to the European Commission's brief progress report, published in 2016:

> "Just three months after its adoption by the European Commission, the Aviation Strategy is starting to deliver its first results. The Council has yesterday authorised the European Commission to open negotiations with China and Japan in view of

[3] Communication from the Commission to the European Parliament, The Council, The European Economic and Social Committee and the Committee of the Regions, 'The EU's External Aviation Policy – Addressing Future Challenges', COM(2012) 556 final, available online at: http://ec.europa.eu/transport/modes/air/international_aviation/doc/com_2012_556_fr.pdf.
[4] *Ibid.*
[5] *Ibid.*

> concluding Bilateral Air Safety Agreements (BASA). Such agreements enhance air safety worldwide and contribute to the global competitiveness of the European aviation industry by cutting red–tape and facilitating exports."[6]

Under the new European Aviation Strategy, the EU has elevated negotiation of new external aviation agreements with its 'global partners' as one of its key priorities. Looking towards the Gulf, where airlines have been flourishing, the European Commission noted that "aviation systems against which EU airlines and hubs compete in the Gulf are the result of clear decisions taken to develop aviation as a strategic economic sector generating benefits for the overall economy"; however, "Gulf carriers insist that they do not enjoy unfair competitive advantages from these systems."[7] In an attempt to safeguard fair conditions of competition, the EU also intends to incorporate "standard 'fair competition clauses' … into the respective bilateral air services agreements'.[8] Examples include the current open skies agreements between the EU and key trade partners such as the U.S. and Canada. But this is not altogether novel. 'Fair competition clauses' already appear in EU and U.S. ASAs with third countries.[9]

The U.S.–Qatar Open Skies Agreement of 2001, is a good example of just such an ASA insofar as it contains the following provision: "Each Party shall allow a fair and equal opportunity for the designated airlines of both Parties to compete in providing the international air transportation governed by this Agreement."[10] This particular clause is modelled on the standard terms of open skies agreements. How should it be interpreted? It has been argued that the open skies agreements do not provide an equal exchange of rights – but rather an opportunity to compete among carriers. "Fair and equal opportunity to compete", it has been advocated, should be interpreted as meaning: a *level playing field*.

But this author argues that only a 'fair and equal opportunity to compete' clause coupled with national competition legislation in place in both State Parties to the agreement would be effective in allowing 'designated airlines' under the agreement to manoeuvre commercially – while also restraining their activities, ultimately, within the four corners of the competition rules.[11] This would of course require transparent systems of regulation and enforcement in all relevant jurisdictions which, needless to say, is easier said than done.[12]

The European Commission has taken significant steps to identifying that, within the current "commercial context, it is both important and legitimate that the EU is able to act effectively internationally to safeguard the competitiveness of EU airlines against unfair competition

[6] European Commission News, 'Aviation: EU to launch negotiations with China and Japan for new safety agreements' (Transport 2016), available online at: http://ec.europa.eu/transport/modes/air/news/2016-03-08-china-japan-safety-agreements_en.htm.
[7] COM(2012) 556 final, p. 8.
[8] *Ibid.*
[9] Truxal (2017), p. 120.
[10] Article 11(1), U.S.-Qatar Air Transport Agreement 2001, available online at https://www.state.gov/e/eb/rls/othr/ata/q/qa/114294.htm.
[11] Truxal (2017), p. 121.
[12] See Truxal (2017).

and/or practices wherever they may come from".[13] As a result, Regulation (EC) 868/2004 was adopted, which provides a framework for prohibiting subsidies to, or unfair pricing by, third country air carriers insofar as those activities cause or threaten to cause a material injury to the Community air transport industry by allowing the investigation of actual or potential injury following a complaint issued on behalf of the EU air transport industry or on the Commission's own initiative.[14]

Regrettably, the tools presently available are modelled not on services but on trade in *goods*. They provide relief in the form of anti-dumping and countervailing duties measures to counteract foreign subsidies; as such, the current tools appear to be ineffective for air transport. In fact, the European Commission concludes that the "considerable difficulties for EU stakeholders to use Regulation 868 are mostly due to its approach based on trade defence notions and practices – for instance 'like air service' is based on the notion of 'like product' used in trade defence instruments, and is defined in Article 3(d) of the Regulation as 'air services which are supplied on the same route or routes as the air services under consideration or such air services that are supplied on a route or routes closely resembling the route or routes on which the air service under consideration is supplied'.) which are difficult if not impossible to apply in air transport unless better adapted to the special features of the sector which is regulated by bilateral air services agreements between sovereign states."[15]

Another hurdle is the *national* limits to foreign ownership of air carriers tend to remain strict in many parts of the world. But this cannot last forever. As the global order changes, "governments seek coherent strategies of engaging with a globalizing world".[16] As more national airlines flail, governments are growing more willing to attract and accept much needed foreign investment. "This is presented as a possible 'push factor' for States – a business opportunity involving financial support for national airlines for some States, and a business or values opportunity for other States as leaders."[17]

In response to this challenge, the International Civil Aviation Organization (ICAO) encourages States to liberalise air services agreements through various initiatives and policy guidance updates. ICAO suggests, for instance, that States utilise common criterion for airline designation: "principal place of business and effective regulatory control".[18]

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[13] COM(2012) 556 final, p. 9.
[14] Regulation (EC) No 868/2004 of the European Parliament and of the Council of 21 April 2004 concerning protection against subsidisation and unfair pricing practices causing injury to Community air carriers in the supply of air services from countries not members of the European Community, [2004] OJ L162/1, 30 April 2004.
[15] European Commission, 'Roadmap: Protection against subsidisation and unfair pricing practices causing injury to Community air carriers in the supply of air services from countries not members of the European Community' (July 2013), p. 1, available online at: http://ec.europa.eu/smart-regulation/impact/planned_ia/docs/2014_move_009_unfair_pricing_practices_en.pdf.
[16] David Held *et al.*, Global Transformations: Politics, Economics, and Culture (Polity Press 1999), p. 9 (emphasis added).
[17] Truxal (2017), p. 134.
[18] ICAO, 'Liberalization of Air Carrier Ownership and Control' (Worldwide Air Transport Conference, Montreal, March 2013), p. 4, available online at: www.icao.int/Meetings/atconf6/Documents/WorkingPapers/ATConf6-wp012_en.pdf.

Unfortunately, standard texts used in ASAs have not changed very much in this regard.[19] Whilst views on regulatory approaches to ownership and control remain divided across the international community, some success at regional level is notable. Nonetheless, there is significant room for evolution in this area, which is also crucial for liberalisation of the global airline business.

Ownership and control restrictions prevent airlines mergers and acquisitions, which may otherwise make sound business sense, to be legally effected across national borders.[20] Article 6 of the Chicago Convention lays the foundation for the negotiation ASAs between States. The incorporation of ownership and control clauses in those ASAs has indirectly given way to the emergence of international airline alliances as a means to overcome the restrictions on market access.[21] Whilst the EU appears to be prepared in principle to remove ownership and control restrictions in ASAs with third countries, this author does not believe it will go away from the bargaining table empty–handed. Granting rights for foreign nationals to establish operations in the EU and freely invest in EU airlines remains conditional upon other trading partners offering the same or similar rights.[22]

According to the European Commission, for any "global reform…to advance, the logical starting point is the trans–Atlantic market. Since between them, the EU and U.S. account for nearly half of global aviation, they represent a powerful bloc and the emergence of genuinely trans–Atlantic carriers would create important momentum."[23] To that end, "the U.S.–EU dialogue peaked in 2007 with the signing of the U.S.–EU Air Transport Agreement though the agreement fell short of achieving true, fully liberalized 'open skies' status."[24] Further work on this has stalled.[25] However, the Canada–EU Air Transport Agreement signed in 2009 removes ownership and control restrictions altogether to create a fully 'Open Aviation Area'. This has been heralded as **'**the most ambitious air transport agreement between the EU and a major partner in the world.'[26] Whilst this not proved a catalyst for radical liberalisation elsewhere, in June 2016 the European Council adopted mandates to allow the European Commission to negotiate new, comprehensive air transport agreements with the Association of Southeast

[19] *Ibid*.
[20] The EU's single and internal market is an exception.
[21] P.S. Dempsey, *Public International Air Law* (McGill University 2008); One can also argue that airlines are creative, responding to a difficult regulatory environment in innovative ways. See Truxal (2017).
[22] The EU allows up to 49% foreign ownership of EU carriers whilst the U.S. allows up to 25% of American carriers. However, the EU is prepared to make exceptions to the rule in negotiations with key trading partners. See European Commission, 'Memo: EU External Aviation Policy', MEMO 12–714 (27 September 2015), available online at: http://europa.eu/rapid/press-release_MEMO-12-714_en.htm.
[23] COM(2012) 556 final.
[24] Truxal (2017), p. 161.
[25] The U.S.–EU Air Transport Agreement has liberalized the U.S.–EU transatlantic market insofar as it provides both U.S. and EU carries with Third, Fourth and Fifth Freedom of the Air rights for passenger services and Seventh Freedom rights for all–cargo services. It also contains a 'fair competition' clause. However, it does not fully liberalise the market as the agreement retains 'substantial ownership and effective control' provisions in Article 4. See U.S. Department of State, 'Air Transport Agreements Between the U.S. and the European Union', available online at: www.state.gov/e/eb/rls/othr/ata/e/eu/.
[26] European Commission, 'International Aviation: Canada', available online at: http://ec.europa.eu/transport/modes/air/international_aviation/country_index/canada_en.htm.

Asian Nations (ASEAN), Qatar, the UAE and Turkey.[27] In forthcoming negotiations, the EU will press for market development and growth based on common rules for fair and transparent market conditions and transparency. The EU recognises this as an opportunity for ICAO to step up on liberalisation of the global aviation market:

> "Changes are also needed within the global context of aviation. This is where ICAO can play a leading role in modernising the existing framework governing the global aviation market, as it does in other key areas such as safety and security. ICAO can help to further develop the economic regulatory framework for the global aviation sector, including in liberalising ownership and control of airlines, ensuring a worldwide framework for fair competition and ensuring environmentally sustainable' development of the sector."[28]

CONCLUSION

The current structure of bilateral regulation of 'fair competition' is inclusion by some States of 'fair competition' clauses in ASAs, as we have seen above in the case of the U.S. and Qatar. This author argues that in addition to 'fair competition' clauses, provisions for 'settlement of disputes' and 'fair and equal opportunity' must be incorporated into bilateral and 'plurilateral' agreements in future. To be effective, however, such provisions would require a shared understanding of core, objective principles on fairness and a willingness to follow through with enforcement.

For now, we have the safeguards model clause, developed by ICAO's 5th Air Transport Conference[29] in 2008, which reads:

> Safeguards against anti-competitive practices
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> 1. The Parties agree that the following airline practices may be regarded as possible unfair competitive practices which may merit closer examination:
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> a) charging fares and rates on routes at levels which are, in the aggregate, insufficient to cover the costs of providing the services to which they relate;
> b) the addition of excessive capacity or frequency of service;
> c) the practices in question are sustained rather than temporary;
> d) the practices in question have a serious negative economic effect on, or cause significant damage to, another airline;
> e) the practices in question reflect an apparent intent or have the probable effect, of crippling, excluding or driving another airline from the market; and
> f) behaviour indicating an abuse of dominant position on the route.

[27] European Council, 'Comprehensive EU air transport agreements: Council adopts mandates' (7 June 2016), available online at: www.consilium.europa.eu/en/press/press-releases/2016/06/07-comprehensive-eu-air-transport-agreements/.
[28] COM(2012) 556 final.
[29] ICAO, Doc. 9587, ATConf/5 Conclusions for agenda item 2.3 Part I – Safeguards to Ensure Fair Competition (Appendix 4, 2008) A4–8 to A4–9, available online at: www.icao.int/sustainability/documents/doc9587_en.pdf.

2. If the aeronautical authorities of one Party consider that an operation or operations intended or conducted by the designated airline of the other Party may constitute unfair competitive behaviour in accordance with the indicators listed in paragraph 1, they may request consultation in accordance with Article __ (Consultation) with a view to resolving the problem. Any such request shall be accompanied by notice of the reasons for the request, and the consultation shall begin within 15 days of the request.

3. If the Parties fail to reach a resolution of the problem through consultations, either Party may invoke the dispute resolution mechanism under Article __ (Settlement of disputes) to resolve the dispute.

From a legal perspective, the clause seems to be well constructed. With that said, prospects for effect are built upon the principle of comity; the parties *may* request consultation. Thus, the effectiveness of the clause will depend entirely on the common understand of the two parties on what constitutes an 'unfair competitive practice', what is 'a serious negative economic effect', and 'which behaviour indicates an abuse of dominant position'. And so on...

If there are competition rules in place in both States but the air transport sector is excluded from the scope in one State – because airlines are State-owned and therefore very protected – how likely are the States to agree?

Finally, a 'fair competition' safeguards clause really must be included when the agreement is made. It is possible to amend the agreement – but this unlikely to be a popular option. Another possibility would be to agree a memorandum of understanding. But, in reality, all will boil down to the perceptions – common or not – of 'fair' competition. Anticompetitive market behaviour of States and/or airlines (which may include State-owned and controlled airlines) will be difficult to combat absent an explicit provision in the relevant ASA upon which to rely.

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