European Competition Authorities

Code-sharing agreements in scheduled passenger air transport

– The European Competition Authorities' perspective –

The analyses set out in the present document do not legally bind the members of ECA in any way and thus cannot form the basis for any legal action. The paper is the result of discussions within the institutional framework of the ECA Air Traffic Working Group and does not have the status of an official notice or guideline published by one of the national authorities, the European Commission or the EFTA Surveillance Authority. Moreover, it should be stressed that each individual matter will be decided on a case by case basis.

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1. Introduction

1. During the sessions in Athens on 15 and 16 April 2002 the European Competition Authorities (ECA)[1] set up an Air Traffic Working Group in order to improve cooperation between them in relation to their dealings with the air traffic industry and to seek to enhance the present degree of competition in this sector. The ECA are of the opinion that competition between airlines is influenced by some specific features of the airline industry, in particular its network character. In view of the ongoing consolidation process in the European airline industry and new market developments, high priority has been given to a more uniform and consistent application of the competition laws of the national states and the European Community.

2. On 1 May 2004, a new system of application of competition rules has entered into force in the EU. Council Regulation (EC) No.°1/2003[2] [hereafter: Reg. 1/03 EC) empowers all national competition authorities to apply Articles 81 and 82 EC in their entirety and makes it compulsory to apply community law whenever the agreement or practice in question may appreciably affect trade between member states and the case falls under the national law of an NCA. In this system, not only the Commission but also the national competition authorities will be responsible for enforcing community competition rules.

3. The rules for the application of the exception from the prohibition of agreements which restrict competition have changed fundamentally as Article 81(3) EC is now directly applicable by the national competition authorities. Besides the fact that the number of potential enforcers of this Article has been increased, the authorisation and notification system has been abolished by Reg. 1/03 EC and replaced by a legal exception system. A number of national competition authorities have experienced the same phenomenon and are in the process of either abolishing or at least slimming down substantially their notification system.

4. Under this legal exception system, complaints and leniency application are an essential source of information for detecting infringements of competition rules whereas the previous notification system created a high administrative burden on

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1 The European Competition Authorities consist of the competition authorities in the European Economic Area (EEA) (the 25 Member States of the European Community, the European Commission, the EFTA States Norway, Iceland, Liechtenstein and the EFTA Surveillance Authority).

2 Council Regulation (EC) no. 1/2003 of 16 December 2002 on the implementation of rules on competition laid down in Articles 81 and 82 of the Treaty.

the antitrust enforcers which distracted them from the detection and repression of severe violations which, of course, were never notified.

5. The legal exception system seems to alleviate the administrative burden on the undertakings. However, it requires that undertakings carry out an ex ante evaluation of their agreement by themselves instead of notifying them routinely for clearance.

6. In this respect, the Air Traffic Working Group of the European Competition Authorities (ECA) aims to publish this paper to promote a coherent application of the competition law throughout the EU/EEA and to explain to the airline industry the competition concerns raised by code sharing agreements. The enforcement practices of the ECA show that code-sharing agreements may fall under Article 81(1) EC and not always fulfil the prerequisites for exemption laid down in Article 81(3) EC.

7. This paper deals mainly with intra EU/EEA code-sharing agreements. However, agreements concluded with airlines from third countries may also raise competition issues, similar to the ones described in this document.

8. This paper is the result of discussions within the ECA Air Traffic Working Group on whether or not code-sharing arrangements are in line with competition law. In order to conduct the discussion on a broader basis a questionnaire was circulated among the members of the ECA Air Traffic Working Group. 22 answers to the questionnaire were received. Replies came from Austria, Denmark, Estonia, Finland, the French Conseil de la Concurrence, Germany, Greece, Hungary, Iceland, Italy, Latvia, Lithuania, Norway, Portugal, Slovenia, Spain, Sweden, The Netherlands, the United Kingdom, the European Commission and the EFTA Surveillance Authority. Although not a member of the ECA, the Working Group asked the Swiss Wettbewerbskommission to answer the questionnaire and was pleased to receive its reply.

9. It is stressed that this paper does not have the status of an official notice or guideline published by one of the national authorities, the European Commission or the EFTA surveillance authority. It should also be emphasised that given the specific facts and circumstances each individual code-sharing agreement has to be assessed on a case-by-case basis.

2. Definitions and characteristics of code-sharing agreements

2.1 Code-sharing agreements – definition of terms

10. This paper follows up the ECA Air Traffic Working Group's publication "Mergers and alliances in civil aviation"[3]. For the purpose of that paper, **mergers** were defined as "all operations which imply structural changes caught either by the EC Merger Control Regulation or Article 57 of the EEA-Agreement, or by one or more merger control regimes of the national states"[4]. **Alliances** were defined as "cooperation agreements by which airlines integrate their networks and services and operate as if they were a single entity (but without the implied irreversibility of a concentration) while retaining their corporate identities (as in particular strategic alliances) and which are caught either by Article 81(1) EC and/or Article 53(1) of the EEA-Agreement or by the corresponding provisions in the competition laws of one or more of the national states"[5].

11. A **code-sharing agreement** is an agreement between two or more air carriers whereby the carrier operating a given flight allows one or more other carriers to market this flight and issue tickets for it as if they were operating the flight themselves. In practice, these other carriers add their own carrier designator code and flight number onto that of the operating carrier. Code share partners also agree on how they compensate each other for the seats they sell on one another's flights.

12. Code-sharing agreements between airlines may go beyond a mere sharing of the designator codes and may be supplemented by other elements of cooperation: e.g. coordination of the frequent flyer programmes, route and schedule planning, coordination of marketing, sales and distribution networks, joint pricing, sharing of facilities and services at airports, integration and development of information systems etc.

13. For the purposes of this paper forms of cooperation between code-share partners which go beyond the definition given in para. 11 are not considered to

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3 European Competition Authorities (2004): Report of the ECA Air Traffic Working Group. Mergers and alliances in civil aviation – an overview of the current enforcement practices of the ECA concerning market definition, competition assessment and remedies. In: ERA-Forum 2/2004, p. 297-322 (available online: http://www.bundeskartellamt.de/wDeutsch/download/pdf/ECA/mergers-and-alliances-final-report.pdf).

4 Ibid, para 4.

5 Ibid, para 5.

form part of or constitute a code-sharing agreement. Still, as such elements of cooperation[6] can reinforce the competition effects of a code-sharing agreement, they are considered relevant factors in assessing whether the agreements that exist between code-share partners taken as a whole have the object or effect of restricting competition.

2.2 Code-sharing agreements – diversity and ubiquity

14. Code-sharing agreements can vary in several aspects. First of all, airlines might give their code-sharing agreement partners free or limited access to their seats. **Free flow** (free sale) code-sharing agreements give the marketing carrier access to the operating carrier's inventory and allow it to market seats independently of the operating carrier. The risk is completely on the operating carrier since the marketing carrier functions almost as an agent. Moreover, seats availability is determined solely by the operating carrier that can decide e.g. to close seats availability at the prices set by the marketing carrier. **Blocked space** (blocked seat) agreements allocate the marketing carrier a certain number or percentage of reserved seats on flights provided by the operating carrier. Under a 'hard' blocked space code-sharing the revenue risk is borne by both, as operating and marketing carrier are responsible for the sale of their allocated number of seats. The marketing carrier has to pay to the operating carrier the agreed financial contribution for the reserved seats independent of whether or not he succeeds in selling the blocked seats. However, in the context of a 'soft' blocked space agreement the marketing carrier can return seats to the operating carrier according to the terms concluded on a bilateral basis.

15. With respect to **pricing**, airlines might set the price of the seat sold under a code-sharing agreement either in a coordinated way, which may lead to the result that the seat will be sold at the same price wherever (operating or marketing carrier) the ticket is bought, or each airline participating in the agreement can set its prices independently.

16. Where the code share does not entail a blocked space agreement, airlines have to agree on how to compensate each other for the seats sold on one another's flights. This is normally done in special pro-rate agreements which establish the terms of revenue proration between the partners.

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6 The extreme case would be a cooperation agreement constituting a fully-fledged alliance.

17. Moreover, airlines may decide to **reciprocally** add their codes on their partner's flights or to refrain from doing so. When airlines operate on connecting services (e.g. a short haul service to a hub and a transatlantic service from the hub), the short haul leg of the flight might carry both codes, while the long haul leg might carry only one airline's code. Or, both airlines place their codes on the entire flight.

18. With respect to the **extent of network overlap** between code-share partners a distinction between parallel code-sharing agreements and complementary code-sharing agreements can be made**.** Parallel code-sharing agreements are between airlines which both operate the O&D routes concerned, whereas complementary agreements connect adjacent routes which the airlines previously have not both operated. The category of complementary code-sharing agreements can be distinguished further: On the one hand there are behind-beyond code-shares, where the operating carrier gives access to its route networks beyond the gateway which the marketing carrier does not operate. On the other hand there are the other types of complementary code-shares, particularly on routes between the marketing carrier's hub and gateways in the operating carrier's country that the marketing carrier currently does not serve.

19. Code sharing agreements are widely adopted among European airlines. A glance at any airline's web site shows that it generally has a huge number of code share partners. Even the airlines engaged in a fully-fledged alliance have code-sharing agreements with non-members of the alliance to serve certain destinations. Last but not least, besides the agreements made to reach remote airports located at the outskirts of Europe, some inter-hub and thick routes are operated exclusively by airlines under a code-sharing agreement.

3. Competition assessment

3.1 Methodology

20. The welfare effects of code-sharing agreements between airlines are two edged. On the one hand, code sharing agreements have the potential to increase the quality of services by increasing the number of flights or destinations at the consumers' choice or by promoting seamless service. The code-share partners might exploit network economies. Furthermore code-sharing agreements may increase the airplanes' load factor triggering cost efficiencies.

21. On the other hand, a code-sharing agreement between two previously competing airlines may significantly dampen competition on the routes covered by the agreement which may lead to price increases. Given the multi-market nature of the airline industry, where airlines compete on various routes, the exchange of commercially sensitive information that might take place in a code-sharing agreement could favour tacit collusion between the code-share partners also with respect to routes not covered by the agreement.

22. The European Competition Authorities acknowledge the fact that code-sharing agreements have the potential to create economic benefits but with respect to likely restrictions of competition their aim is to maintain competition on all routes affected. Thus, from a competition analysis perspective, any efficiency enhancing effects of the code-sharing agreements have to be balanced against their likely competitive restraints.

23. The current case law of the ECA with respect to code-sharing agreements is limited. Two cases are worth mentioning because of their subject matters: the SAS/Maersk Air case[7] and the Alitalia/Volare case[8]. Aside from Alitalia/Volare there were also two other Italian cases about code-sharing agreements. One is Alitalia/Meridiana, in which the Authority considered the agreement restrictive but the tribunal of first instance reversed the decision, and the other is Alitalia/Minerva in which the Authority considered the code-sharing agreement not to be restrictive.

24. Neither national nor European competition laws provide specific rules for code-sharing agreements. The legal test applied in the assessment of code-sharing agreements is similar, if not the same, for all ECA-Members. The assessment is made according to Article 81 EC and/or Article 53 of the EEA-agreement or the corresponding provisions of the competition laws of the ECA Member States[9]. Although there may be some (in particular procedural) differences as to the legal test which is applied under Article 81 EC or Article 53 of the EEA-agreement respectively and according to the corresponding provisions of the competition

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7 European Commission decision COMP/37.444 – SAS/Maersk Air and COMP/37.386 – SUN Air/SAS and Maersk Air, 18.7.2001 (2001/716 EG).confirmed by CFI decision T-241/01, 18.07.05.

8 Decision by the Italian Competition Authority 10.07.03. The case has been reversed by the Tribunale Amministrativo Regionale (first instance) and it is now pending before the Consiglio di Stato (second instance).

9 Cf. European Competition Authorities (2005): Loyalty programmes in Civil Aviation. In: European Competition Journal, Vol. 1 No. 2, p. 375-400, para 20 ff. and 26 (available online: http://www.bundeskartellamt.de/wDeutsch/download/pdf/ECA/Loyalty_Paper_final_ECJ.pdf).

laws of some of the Member States, the analysis under these provisions is largely similar. Against this background, the following discussion is based on Article 81 EC. Where necessary and/or appropriate, existing differences between national competition law and European law are explicitly mentioned.

25. The competition assessment under Article 81 EC consists of two parts or, respectively, two stages[10]: the analysis under Article 81(1) EC (chapter 3.3) and under Article 81(3) EC (chapter 3.4). In the first stage it has to be assessed whether the code-sharing agreement has an anti-competitive object or anti-competitive effects. Where an agreement is found to be restrictive, in the second stage it has to be assessed whether the code-sharing in question generates economic benefits and whether these benefits outweigh the determined anti-competitive effects. The balancing between anti-competitive effects and benefits is restricted exclusively to an analysis within the framework provided by Article 81(3) EC. Before applying the respective legal test, the relevant market(-s) have to be defined (chapter 3.2) as the definition of the relevant market is a key element in identifying whether a code-sharing agreement will give rise to competition concerns.

3.2 Relevant markets and identification of affected markets

26. The definition of relevant product and geographic market in the field of passenger air transport has been discussed in more detail in the ECA Working Group's earlier paper on 'Mergers and Alliances in Civil Aviation'[11], where specific consumer groups among the purchasers of scheduled air transport services have been distinguished with regard to the product market (in particular, **time-sensitive** and **non time-sensitive** passengers)[12].

27. As to the geographic dimension of passenger air transport markets the European competition authorities consider the so-called 'point-of-origin/point-of-destination pair'-approach (hereinafter: **'O&D-approach'**) useful and to be at least a good starting point for the analysis.[13] According to this approach to market definition every combination of a point of origin and a point of destination is to be considered a separate market from the consumer's perspective.

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10 Cf. Commission notice – Guidelines on the application of Article 81(3) of the Treaty, (2004/C 101/08) [hereafter: '81(3) notice'], para 11.

11 Supra no. 3, para 6ff.

12 Ibid, para 8ff with further references to the case law.

13 Ibid, para 12ff.

28. The competition assessment of code-sharing agreements between airlines is complicated by the network character of the industry and the high number of routes which may be competitively affected. Regarding network effects a distinction can be made between those aspects of network competition that can easily be dealt with in the framework of the O&D approach (e.g. the role of connecting traffic, the substitutability of indirect services) and those aspects that possibly cannot (e.g. corporate customer issues). Once it has become common practice that the same companies sign code-sharing agreements for different routes, the definition of relevant markets may have to include a discussion on the importance of multi-market relation between carriers. Whether network effects in the air traffic sector can be taken into consideration when defining the markets cannot be conclusively answered at this stage.[14]

29. Due to the high number of routes a multitude of markets has to be taken into account when analyzing the effects on competition of an individual cooperation agreement. In Alitalia/Volare[15] the Italian Competition Authority analysed all the markets concerned which meant 14 national and 8 international routes. It was revealed that the code-sharing agreements were not restricting competition on the international routes because some of them were new routes and on others there was a sufficiently high level of competition. The Commission in its SAS/Maersk Air decision[16] focused on those markets covered explicitly by the cartel agreement.

30. A filter process that might be applied is described in the Working Group's report on 'Mergers and Alliances in Civil Aviation'[17]. Here two broad categories of affected markets were differentiated: overlap markets which generally address actual competition issues and non-overlap markets (addressing potential competition issues e.g. whether a route is either directly linked to one of the involved airlines' hubs or whether there is sufficient local traffic to allow market entry on a point-to-point basis). With respect to intra-European code-sharing agreements competition concerns on overlap-markets may generally arise only in relation to direct overlap routes[18]. With respect to (third country) long haul routes also certain indirect routes may belong to the same market and have to

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14 For a more general discussion see supra no. 3, para 25f.

15 Supra no. 8.

16 Supra no. 7.

17 Supra no. 3, chapter 4.2.

18 Direct overlap routes are direct routes where the parties to the agreement have been actual competitors previous to the agreement.

be taken into account as overlap-routes. Thus, in individual cases attention can be focused on those routes where competition concerns are likely to arise. With respect to non-overlap markets in general a non-operating code-sharing partner should only be considered a potential competitor to the operator if there is a real commercial possibility of entry.[19]

3.3 Article 81(1) EC

31. According to Article 81(1) EC all agreements between undertakings, decisions by associations of undertakings and concerted practices which have as their object or effect the prevention, restriction or distortion of competition within the Common Market are prohibited.

3.3.1 Agreements between undertakings

32. In general, code-sharing agreements are concluded between **undertakings** within the meaning of Article 81(1) EC as was stated, for example, by the Commission for SAS and Maersk Air[20].

33. The notion of **agreement** within the meaning of Article 81(1) EC will generally be applicable to code-sharing agreements. A code-sharing agreement can be distinguished easily from a unilateral measure. Moreover, a cooperation between airlines in form of a code-sharing agreement usually requires the conclusion of a written agreement. However, the notion of agreement within the meaning of Article 81(1) EC does not require a written agreement. Such an agreement may also be concluded orally or secretly. The Commission in SAS/Maersk concluded that SAS and Maersk Air had engaged in an agreement within the meaning of Article 81(1) EC. In addition, the fact-finding of the Commission showed that the parties pursued a number of (secret) objectives they did not declare in the notification.

3.3.2 Prevention, restriction or distortion of competition

3.3.2.1 General remarks

34. Article 81(1) EC is applicable to code-sharing agreements only if the agreements have as their object or effect a prevention, restriction or distortion of competition (hereafter: restrictions of competition). In contrast to alliances, where there is the

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19 See CFI, T-374/94 - European Night Services, ECR 1998, II-3141, para. 137.

20 Supra no. 7, para 61.

general presumption that a fully-fledged alliance between competitors is caught by Article 81(1) EC, with respect to code-sharing agreements there is not always an easy answer to the question whether Article 81 (1) EC is applicable. According to Article 2, 1st sentence, of Reg. 1/03 EC the burden of proof rests on the parties or the authorities alleging the infringement.

35. The question whether a code-sharing agreement is caught by Article 81(1) EC or not may sometimes be difficult to answer for several reasons. Firstly, the nature of code-sharing agreements can vary significantly because airlines usually engage in **different types of code-sharing agreements**. Secondly, the effects of a code-sharing agreement on competition may differ to a great extent depending on the scope of cooperation between the parties which may contain **further elements of cooperation** in addition to the mere sharing of the airline codes. Thirdly, the assessment of the effects on competition of a code-sharing agreement raises further questions e.g. which **markets are affected** by the agreement. Finally, the official agreement is sometimes used as a **disguise** for a clearly unlawful secret agreement.

36. Moreover, it should be stressed that a static assessment of a code-sharing agreement is not always sufficient. An agreement which is renewed and changed from one flight plan period to another needs to be assessed on a periodical basis. According to the European Competition Authorities' experience code-sharing agreements tend to evolve from an initially low degree of cooperation towards closer forms of cooperation - even as far as the decision to merge. With respect to the members of one of the global alliances (Star, oneworld, Skyteam), in many cases the first step in joining the alliance was a code-sharing agreement between the aspirant and one or more alliance members at that time.

37. For example, in May 1997 Aer Lingus engaged in code-shared flights with Finnair on flights from Helsinki via Stockholm to Dublin. Finnair became a oneworld member in September 1999 and in December 1999 oneworld announced that Aer Lingus would become the ninth member of the alliance. Also Malév has a code-sharing agreement with oneworld member Finnair. According to its webpage, “Malév will be discussing additional bilateral co-operation with various members of oneworld."[21] Oneworld announced that “Malév is set to become part of the alliance in early 2007.”[22]

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21 www.malev.hu/BP/ENG/I_NEWS_ENG/2005-0524-1703-46PVMX.asp

22 http://www.oneworld.com/home.cfm

3.3.2.2 Framework for the assessment under Article 81(1) EC

38. The European competition authorities are aware of the fact that the competition assessment of code-sharings should be carried out on a case-by-case basis. Notwithstanding, from an analytical perspective it might be helpful to broadly categorize horizontal code-sharing agreements for assessment under Article 81(1) EC into

    (1.) agreements that **do not or almost never** fall under Article 81(1) EC,

    (2.) agreements that **always or almost always** fall under Article 81(1) EC and

    (3.) agreements that **may** fall under Article 81(1) EC.

    Code-sharing arrangements as discussed in the present paper may either fall in the first, the second or the third of these categories. Nevertheless, it cannot be excluded that an individual code-sharing agreement may change category over time.

39. According to that categorization some kinds of code-sharing agreements by their very nature do not or almost never fall under Article 81(1) EC (**1st category**). Firstly, code-sharing arrangements are not caught by Article 81(1) EC when they are concluded between **non-competitors**. However, the answer to this question may be complicated by the high number of routes potentially involved and by network competition issues among other things. As to potential competition it may be difficult to establish whether the parties in non-overlap markets are potential competitors or not. Secondly, Article 81(1) EC will not be infringed in cases of a code-sharing between **airlines that cannot independently carry out the air transport services** made possible by the code-sharing cooperation.

40. A code-sharing agreement is always caught by Article 81(1) EC (**2nd category**) if its object is to restrict competition by means of one or more **hard core restrictions**. This includes price fixing, capacity or frequency limitations or the sharing of markets or customers. For example, in SAS/Maersk Air[23] the Commission established that the parties to the agreement had engaged in market sharing agreements; the Commission's decision was upheld by the Court of First Instance (hereafter: CFI).[24] In cases where a code-sharing **agreement is part of an airline alliance** as defined in the ECA Air Traffic Working Group's

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23 Supra no. 7.

24 CFI decision in SAS/Maersk T-241/01, 18.7.2005.

earlier paper the overall agreement - by definition - falls "almost always" under Article 81(1) EC.[25]

41. A number of individual code-sharing agreements will belong neither to the 1st nor the 2nd category but rather to the **3rd category**. I.e. they may fall under Article 81(1) EC depending on the facts and the circumstances of the case. In some cases it may be a rather complex exercise to establish whether an individual agreement prevents, restricts or distorts competition in the meaning of Article 81(1) EC. This depends on several circumstances, e.g. the size of the airlines involved, the thickness of the route or the presence of market entry. With regard to multi-market competence also code-sharing between non-competitors – prima facie belonging to the first category – may fall under category three, particularly if many routes are covered by the agreement(s). Table 1 summarises the findings.

Table 1: Categories of code sharing agreements

"Does the agreement fall under Article 81(1) EC or not?"		
"no, it generally does not"	*"yes, almost always"*	*"it may fall"*
1st category	**2nd category**	**3rd category**
- agreement between non-competitors - Airlines cannot independently carry out the air transport services made possible by the CSA	- the object of the CSA is to restrict competition by means of - price fixing, - output limitation or - market sharing or - customer sharing - the CSA is part of a fully-fledged alliance	- CSAs that neither belong to the first nor to the second category - requires an assessment of the circumstances and the restrictive effects of the CSA in question

3.3.2.3 Restrictions by object

42. Restrictions of competition by object are restrictions that **by their very nature** have the potential of restricting competition.[26] This has to be established on the

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25 Cf. supra no. 3, para 5 and 29.

26 Cf. supra no. 10, para 21.

basis of the actual context in which competition would occur in the absence of the agreement with its alleged restrictions.

43. Code-sharing agreements engaged in between airlines may constitute a restriction by object in the meaning of Article 81(1) EC. In order to establish whether a code-sharing agreement has a restrictive object several aspects have to be taken into account. These include primarily the **content** (the terms) and the objective **aims** of the agreement.[27] The assessment should include all the relevant documents including for example ancillary agreements. In addition, the context in which the agreement is applied as well as the behaviour of the code-share partners on the markets may play a role.

44. European Competition Authorities' case law gives examples of alleged restrictions by object: In the Alitalia/Volare case[28] the Italian Competition Authority objected to, for example, a reduction of the number of flights on some routes and the fact that it involved two major national carriers which were direct competitors on most of the routes before the code-sharing agreement existed. The Commission in SAS/Maerk Air[29] concluded that by their very nature the market sharing agreements which had been identified had the object of restricting competition.

45. In this context from the viewpoint of the European competition authorities one particular concern arises: namely, that a traditional code-sharing arrangement between competitors can be used as a **disguise for a clear anti-competitive arrangement**. In this case the official code-share agreement is accompanied by a secret agreement. The true objective and/or content of such a (disguised) arrangement can be simply one or more **hardcore restrictions** such as, in particular, market allocation, capacity restraints, price fixing or market foreclosure. For example, in SAS/Maersk Air, the Commission by virtue of a competitor's complaint was able to detect and terminate a secret market sharing agreement between the two code-share partners. The Commission's decision in this case was upheld by the CFI.[30]

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27 Ibid, para 24.

28 Supra no. 8.

29 Supra no. 7, para 71.

30 Supra no. 24.

46. In cases where it has already been established that an agreement has as its object a restriction of competition, there is no need to consider its concrete effects.[31]

3.3.2.4 Restrictions by effect

47. If a restriction by object can not be established it has to be examined further whether the agreement in question is **likely to restrict or has even actually restricted competition**. The establishment of a likely restrictive effect of an agreement requires that it effects actual or potential competition to an extent that on one or more relevant markets negative effects on prices, output, innovation or the variety or quality of goods and/or services can be expected with a reasonable degree of probability.[32] The assessment must be carried out within the actual context in which competition would presumably occur in the absence of the agreement with its alleged restrictions.

48. Possible restrictive effects of code-sharing agreements have to be assessed with respect to all markets actually and potentially affected by the agreement. In order to do this the links between the code-sharing agreement and, as the case may be, further elements of cooperation agreed between the parties on the one hand and competition on the affected markets on the other hand have to be understood well. **Relevant factors** with respect to the code-sharing agreement as such are among others

- the **allocation of the commercial risk** between the parties, since restrictive effects are less likely when the commercial risk is borne by both parties. In this context, the type of the code-sharing plays an important role; under a blocked space agreement the revenue risk lies with both parties providing incentives for airlines to compete for passengers to fill their share of seats on the plane.

- the **extent of network overlap:** whilst complementary code-sharing agreements connect adjacent segments operated by different airlines into a new O&D city pair, parallel code-sharing agreements may lead to a decrease of competition on an O&D route;

- the specific **terms of the** underlying **pro-rate agreement:** restrictive effects are likely if the pro-rate agreement sets incentives making it improbable for economic reasons for the parties to continue to set prices independently;

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31 Ibid, para. 130.

32 Supra no. 10.

- the **likelihood of spill-over effects**: If the codeshare partners compete in parallel on a number of markets not covered by the CSA under certain conditions negative spill-over effects cannot be excluded.

With particular respect to the elements of cooperation which go beyond the mere code-sharing agreement, relevant factors are among others

- the number and content of **the elements of cooperation that go beyond the code-sharing agreement** (e.g. joint planning of flight schedules, joint usage of FFPs or various kinds of reciprocal arrangements concerning ground-handling activities);

- the **duration** of the agreement (a code-sharing agreement concluded for only one or two flight plan periods is ceteris paribus less likely to give rise to serious restrictive effects than a long-time agreement);

- the kind of **information that is exchanged** (if sensitive business information is being exchanged between the parties restrictive effects are more likely).

49. As to the **effects on prices**, for example, the competition effects of a pro-rata agreement on the flight tariffs have to be looked into. In order to be able to exclude a restrictive effect on prices it does not suffice to include a provision in the written agreement stating that the freedom of the parties to set prices independently will remain. For example if, in contrast to such a provision, the tariffs for flight tickets on individual O&D-markets covered by the agreement de facto converge over time, a restrictive effect on prices cannot be denied. In Alitalia/Volare the Italian Competition Authority established that the kind of information exchanged between the parties did not permit to establish whether the operating carrier and the marketing carrier still were independent in defining their pricing strategies or whether such strategies were convergent.

50. In addition, a code-sharing agreement may give rise to restrictive effects on competition in respect of a coordination of **frequencies** and/or of the **routes served** by the parties even if such a coordination has not been explicitly concluded. Such effects can be analysed on the basis of a comparison of the respective flight schedules of the parties with and without the agreement. A restrictive effect is evident if the behaviour of the parties to the agreement on the markets de facto leads to a coordination of frequencies or of the routes served. For example, this might be the case if one party to a code-sharing agreement that covers a whole route network withdraws from long-haul routes and primarily engages in serving the short-haul routes and the other party does vice versa.

51. A point of consideration when assessing the possible restrictive effects of a code-sharing agreement is **market power**. Negative effects on competition are likely to occur when the code-sharing partners – individually or jointly – have or obtain market power and the code-sharing agreement contributes to the creation, maintenance or strengthening of that market power or allows the parties to exploit such market power.[33] For example, the Italian Competition Authority in Alitalia/Volare concluded that due to the code-sharing agreement the parties increased barriers to entry at Milano Linate airport. The issue of market power is discussed in more detail below.

52. The restrictive effects must be **appreciable**. In the opposite case the prohibition of Article 81(1) EC is not applicable. With respect to Article 81 EC the Commission has published a so-called de minimis notice.[34] According to this notice agreements between undertakings which are actual or potential competitors do not appreciably restrict competition in the meaning of Article 81 (1) EC if the aggregate market share held by the parties does not exceed 10 % on any of the markets affected. Under their national laws many ECA Member States have published **de minimis notices.** However, these are not necessarily identical to the Commission's notice.[35] In any case, the de minimis rules may constitute a safe harbour only if the thresholds are met, which in air transport markets due to high market shares is often not the case. Nevertheless, assessing whether code-sharing agreements are appreciable is complicated by cumulative effects which seem to play an important role.

3.4 Article 81(3) EC

53. Article 81(3) EC has **four cumulative conditions** to be fulfilled:

    1) The agreement must contribute to improving the production or distribution of goods or contribute to promoting technical or economic progress,

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33 Cf. supra no. 10, para 25.

34 Commission 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), (2001/C 368/07).

35 For example, Greece has no de-minimis provisions at all; the Netherlands' law aims at the number of involved parties and their revenue, Austrian law sets a 5% market share threshold on the relevant Austrian market (or 25% on a respective smaller part of the market); Denmark aims at a low revenue threshold or a somewhat elevated revenue threshold (~133T €) combined with a market share minor to 10%. The traditional understanding of de minimis in Germany is that it is about the discretion of the authority not to take up a case, not about substantive law. Therefore the 10% rule would not constitute a safe haven in the proper sense.

2) Consumers must receive a fair share of the resulting benefit,

3) The restrictions must be indispensable to the attainment of these objectives,

4) The agreement must not afford the parties the possibility of eliminating competition in respect of a substantial part of the products in question.

54. The burden of proof to show that the four conditions are fulfilled rests with the parties invoking the benefit of the exception rule. In theory Article 81(3) EC can be applied to any kind of restriction no matter how severely it restricts competition, nevertheless agreements containing hard core restrictions rarely fulfil all four conditions.

3.4.1 First condition: Efficiency gains

55. Code-sharing agreements can bring about efficiencies of both qualitative and quantitative nature. They can improve existing services by increasing frequencies or better connections. They can create new services by connecting services operated so far separately, providing seamless travel. By adding extra passengers to the other airline's flights, code-sharing agreements can contribute to economies of scope and traffic density thereby creating cost efficiencies and the better utilisation of indivisibilities like an aircraft. For example, the Italian Competition Authority considered efficiencies in its assessment of the code-sharing agreements Alitalia/Volare and Alitalia/Meridiana. In these cases the claimed efficiencies were measured mainly on the basis of load factors obtained after the agreement.[36]

56. Under the first condition of 81(3) EC benefits have to be objective, efficiencies should not be assessed from the subjective point of view of the parties. The claimed efficiencies should be transaction-specific, verifiable and benefit, at least in part, consumers as required by the second condition. In the light of the more economics based approach applied by more and more competition authorities and given the data availability in the airline industry[37], cost efficiencies[38] must be accurately and reasonably calculated or estimated and accompanied by a description of the computing method.

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36 Cf. supra no. 3, para 59.

37 Computerised reservation systems and the airline's revenue management systems can provide plenty of data as to the operational specificities of market participants.

38 The *81 (3) notice (para 64ff.)* mentions cost efficiencies arising from technological leaps, synergies, economies of scale and scope, learning economies, better planning of production, or better capacity utilisation. There are also efficiencies of qualitative nature, i.e. when costs are not reduced but the quality of the product is improved or a new feature is added or a new product/service is created.

57. However a benefit realised by the exercise of **market power**, **output reduction** or **market sharing** is not taken into account. For example, if the only two airlines on a particular route or routes conclude a code-sharing agreement with the help of which they increase their load factors and add new frequencies, nevertheless decrease overall capacity or frequency, that benefit or cost saving cannot be taken into account.

3.4.2 Second condition: Fair share to consumers

58. Under the fair share criterion consumers must be at least compensated for the actual or likely negative impact caused by the restriction of competition, the net effect should be at least neutral.[39] A first indication that consumers had received a fair share would be an observed price decrease. However, it is not required that consumers receive a fair share of every efficiency and the form of compensation can be increased quality in exchange for slightly higher prices. Generally, the greater the restriction and the later the pass-on to consumers, the greater the efficiency gains and their pass-on to the consumers have to be.

59. The pass-on of cost efficiencies depends on the characteristics and structure of the market, the nature and magnitude of the efficiency, the elasticity of demand and the extent of the restriction of competition.[40] The role of residual competition is important as it could spur the undertaking achieving the efficiency to increase output and lower prices. One example from a national case is that in Alitalia/Volare and Alitalia/Meridiana the Italian Competition Authority assumed with respect to the claimed efficiencies “that the greater the number of competitors operating on the route in question, the more likely it was that the benefits would be passed on to consumers.”[41] In an oligopolistic environment on the other hand the threat of retaliation can hinder a firm from passing on the benefits and instead it will increase profits. A cost reduction in variable and marginal costs is usually preferred to lowering fixed costs.

60. Passing on benefits to consumers could largely depend on the type of code-sharing agreement. In the case of a **complementary code-sharing agreement** the parties may be more interested in passing on the benefits than in a **parallel code-sharing agreement** where two existing rivals cooperate. Here proving any benefits to the consumer is hard, particularly when the number of airlines on a particular route is limited.

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39 Cf. supra no. 10, para 85.

40 Ibid, para 96.

41 Cf. supra no. 3, para 59.

3.4.3 Third condition: Indispensability

61. Indispensability requires that the restrictive agreement as such must be **reasonably necessary** in order to achieve the efficiencies. In addition the individual restrictions of competition that flow from the agreement must also be reasonably necessary for the attainment of the efficiencies.[42] The relevant question is not whether in the absence of the restriction the agreement would not have been concluded, but whether more efficiencies are produced with the agreement or restriction than in the absence of it.[43] Concerning the indispensability of the agreement as such the question is whether there are less restrictive albeit economically practicable solutions for attaining the claimed benefits.

62. In assessing indispensability the **type of code-sharing agreement** again plays a decisive role. A code-sharing agreement might help to overcome regulatory barriers, related to airports, traffic rights, problems caused by constrained capacity. In some circumstances a code-sharing agreement is the only way of entering a new market, creating a new service or increasing competitiveness vis à vis the incumbent. On the other hand code-sharing agreements between direct competitors on a fully liberalised market might raise competition concerns. For example, the indispensability of an agreement applied on intra-European routes between the leading airlines of those routes could require more attention.

3.4.4 Fourth condition: No elimination of competition

63. According to the last element of Article 81(3) EC the agreement must not afford the parties the possibility of substantially eliminating competition. As already pointed out code-sharing agreements should be assessed in view of the specific facts and circumstances of each individual case. The key aspect in this assessment is **market power**.[44] Generally, a number of factors such as (combined) market shares, market access, actual or potential competition, financial power, links with other undertakings, supply flexibility or the power of the opposite market side are taken into consideration.

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42 Supra no. 10, para 73.

43 Ibid, para 74.

44 However, the concept of elimination of competition in Article 81 (3) EC is an autonomous concept of Community law specific to Article 81 (3) EC (see joined cases T-191/98, T-212/98 and T-214/98, Atlantic Container Line (TACA), para. 939, and case T-395/94, Atlantic Container Line, [2002] ECR II-875, para 330).

64. When analysing market power with respect to a code-sharing agreement the following factors which are directly related to the carriers should be (additionally) examined or highlighted: the financial strength (in particular, with respect to flag carriers; see for example the cases Alitalia/Volare and Alitalia/Meridiana); the carrier's reputation; the respective market segments in which parties to the agreement are active (e.g. network carriers; point-to-point carriers; regional carriers) and conditions of market entry (particularly slot availability).

65. The assessment of **market shares** in the context of air traffic cases has already been discussed in the ATWG's earlier paper.[45] It has been underlined that the (combined) market share of the parties in the relevant market(s) is one important indicator of market power. Generally, market power is more likely to exist if an undertaking has a (persistently) high market share. When calculating market shares in passenger air transport cases different methods and proxies are used.[46]

66. The application of the fourth condition of Article 81(3) EC requires an analysis of actual and potential competition as well. Important competitive constraints as to **potential competition** derive from sector specific **barriers to entry**.[47] They can be created by structural factors (as e.g. slot shortages at airports), regulatory factors (e.g. bilateral air service agreements restricting market entry and capacity expansion), network effects (in particular the hub-and-spoke systems), information asymmetries with regard to demand conditions or by the necessity of sequential market entry facilitating strategic behaviour[48].

67. As airlines compete simultaneously on different O&D markets (**multi-market competition**) strategic code-sharing regarding the coordination of route allocation (creating spill-over effects on other markets) has to be taken into account when assessing whether competition is eliminated by the agreement. This requires a look into the parties' other cooperation agreements such as in particular other code-sharing agreements or strategic alliances.

68. Whether competition is being eliminated within the meaning of the last condition of Article 81(3) EC depends on the **degree of competition existing** prior to the agreement and on the impact of the restrictive agreement on competition, i.e. the

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45 Supra no. 3, para. 36 ff.

46 Ibid., para 37.

47 Ibid., para. 39 ff.

48 Successive market entry enables the dominant airline to set limit or predatory prices in relatively small markets discouraging potential newcomers from entering the market.

reduction in competition that the agreement brings about. This depends among other factors on the size and number of the remaining competitors. The more competition is already weakened in the market concerned, the less any further reduction is required for competition to be eliminated within the meaning of Article 81(3) EC. Moreover, the greater the reduction of competition caused by the agreement, the greater the likelihood that competition in respect of a substantial part of the products concerned risks being eliminated. [49]

69. Furthermore it has to be asked whether the cooperation indirectly influences other competition parameters not covered by the agreement. In the Alitalia/Volare case the Italian competition authority concluded that although the coordination was on schedule and capacity, it also had a huge influence on the competition on prices and output which were reducedsignificantly.

70. **Other factors** which can be helpful in the analysis according to Article 81(3) lit. b EC are the present level of integration between the partners, the number of frequencies represented by the partners, the type of routes concerned by the agreement (domestic/international, size of the market, non hub/hub-to-hub) or the proportion of business and economy class passengers on the route.

4. Enforcement and procedural issues

71. Reg. 1/03 EC provides the Commission with the necessary **enforcement powers** to fully apply Articles 81, 82 EC and strengthens their application by the competition authorities of the Member States and the national Courts applying their respective national enforcement systems.[50] According to Article 11 of Reg. 1/03 EC the Commission and the EU Member States apply Articles 81 and 82 EC in close **cooperation**. The Commission and the EU Member States can even exchange confidential information for the purpose of applying Articles 81 and 82 EC.[51] Moreover, the ECA Air Traffic Working Group provides an important forum for a (non confidential) information exchange among its members, however on a non-formalised basis.

72. When investigating a suspected infringement of competition rules the European Competition Authorities have several **powers of investigation**. For example,

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49 Supra no. 10, para 107 and 108.

50 The EFTA Surveillance authority and the EFTA States are endowed with similar enforcement powers.

51 Article 12 Reg. 1/03 EC.

according to Article 17 ff. Reg. 1/03 EC the Commission has the power to conduct an inquiry into a particular economic sector, to require undertakings to provide all necessary information and to carry out all necessary inspections of undertakings or associations of undertakings. The ECA Member States and the EFTA Surveillance Authority have similar enforcement powers. In SAS/Maersk Air the Commission suspected that the cooperation between the parties went beyond what was notified as a code-share agreement and consequently carried out an inspection in June 2000.[52]

73. When an infringement of competition rules has been found the European Competition Authorities, acting on a complaint or on their own initiative, have the power to bring such an infringement to an end. If, for example, based on Article 7 Reg. 1/03 EC, the Commission finds that there is an infringement of Article 81 EC or Article 82 EC, it may by decision require the undertaking or associations of undertakings concerned to bring such an infringement to an end. Moreover, the European Competition Authorities may, by decision, also impose fines on undertakings or associations of undertakings. In SAS/Maersk Air the Commission adopted a decision stating that SAS and Maersk Air had infringed Article 81 EC ("very serious infringement") by entering into an overall market sharing agreement as well as specific market sharing agreements, and imposed fines.[53]

74. Many of the European Competition Authorities also have the power to declare by decision **commitments** offered by the undertakings concerned to be binding on these undertakings. The legal basis for a commitments decision is provided by the relevant European or national competition law. For instance, the Commission, where it intends to adopt a decision requiring that an infringement be brought to an end and the undertakings concerned offer commitments to meet the competition concerns, may by decision make those commitments binding on the undertakings (Article 9 of Reg. 1/03 EC). The following table gives an eclectic overview of the enforcement possibilities of European Competition Authorities:

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52 Supra no. 7, para. 6.

53 Ibid., para. 102, Article 1 ff.

Table 2: Enforcement possibilities throughout Europe (selection)

	Prohibition	Fine (administrative procedure)	Fine (criminal procedure)	Declaring commitments as binding	Orders, interim measures
COM	**X**	**X**		**X**	**X**
DA	**X**	**X**		**X**	
DE	**X**		**X**	**X**	**X**
ES	**X**	**X**		**X**	**X**
GR	**X**	**X**		**X**	**X**
HU	**X**	**X**		**X**	**X**
LT	**X**	**X**			
LV	**X**	**X**		**X**	
NE	**X**	**X**			**X**
NO	**X**	**X**	**X**	**X**	**X**
PT	**X**	**X**			**X**
UK	**X**	**X**	**X**	**X**	**X**
CH	X	X		X	

75. In general, the European Competition Authorities where necessary encourage undertakings offering commitments to meet competition concerns expressed by the competent competition authority since commitments allow to take into account the principle of proportionality. However, with respect to code-sharing agreements at present no reference to respective case law can be made.

76. As a general rule, the commitments offered by the undertakings primarily have to meet the concerns expressed to them by the relevant competition authority. Accordingly, the commitments offered in an individual code-sharing case have to be specific as to its facts and circumstances. Nevertheless, insofar as the competition concerns identifiable with respect to code-sharing agreements are similar to those identifiable in airline alliance cases, the commitments approach developed in alliance cases may be adapted to code-sharing agreements.[54] As with alliance agreements, competition concerns that may arise in relation to code-sharing agreements are related to particular routes within the route

[54] However, the difference between code-sharing agreements and alliances is that the first often do not eliminate all competition between the parties and therefore cannot be regarded as a full integration.

networks of the airlines. Consequently, commitments offered by the undertakings should address the competition concerns identified on the routes identified. For example, the Commission in its decision on the alliance agreement between Austrian Airlines and Lufthansa declared certain conditions binding on the parties.[55]

5. Summary and Outlook

77. Within the framework of the legal exemption system established by Reg. 1/03 EC the **self-assessment** of cooperation agreements by the respective parties plays a crucial role. The present document has outlined the key aspects of such a competition assessment with particular respect to code-sharing agreements. Where possible reference has been made to the European Competition Authorities' relevant enforcement practices. These enforcement practices show that code-sharing agreements may be in conflict with European or national competition law.

78. Both Article 81(1) EC and 81(3) EC are relevant for assessing whether a code-sharing agreement is in line with competition law. Code-sharing agreements are quite heterogeneous particularly with regard to their scope and design. Clear cases not caught by Article 81 (1) EC are rather the exception, and the conclusion that a code-sharing agreement falling under Article 81 (1) EC meets the conditions of Article 81 (3) EC is not easy to draw in general. Consequently, code-sharing agreements usually have to be examined on a case-by-case basis.

79. Important restrictions by object to be considered are all hard core restrictions such as in particular market allocation, capacity restraints or price fixing, be they open or disguised. Restrictions by effect become more important with increasing market power of the parties involved. Here questions like e.g. whether the agreements concerned are of a parallel or of a complementary nature gain importance.

80. As to the four conditions laid down in Article 81(3) EC cost efficiency related arguments are expected to be prevalent. Here benefits obtained through output reduction or market sharing are not to be taken into account. As to parallel code-sharing agreements the fair share to the consumers may be hard to prove. With regard to the indispensability criterion institutional barriers such as availability of slots play an important role. Finally, both the code-sharing parties' market power

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55 Cf. European Commission decision COMP 37.730 – AuA/LH (OJ, 10.09.2002, L 242, p.25).

and the degree of actual and potential competition – closely related to barriers to entry such as not only regulatory but network effects or strategic behaviour, too – are particularly relevant when assessing whether competition is eliminated through the code sharing agreements or not (fourth condition).

81. Although the cited cases were either prohibition or fine decisions, European and most national competition laws know other types of decisions which may be applied as well, particularly the possibility of declaring commitments as binding.

82. However, there might be cases where, although they have carried out an in-depth self-assessment, the parties to a code-sharing agreement do not reach a clear conclusion as to whether the envisaged agreement is in line with competition law or not. In such cases the parties might wish, on a voluntary and informal basis, to approach the competent competition authority for advice in the assessment of the agreement in question. But, unlike the former system of notification, the legal exception system generally does not provide for the possibility of a formal clearance decision.