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AIRLINE COMPETITION

-- Note by Hungary --

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Introduction

1. The following submission provides an overview of the competition law issues arising in the Hungarian air transport markets. It starts by describing the characteristics of these markets and then details the framework and parameters of competition. It places particular emphasis on the types of cooperation and the individual parameters of competition such as price, schedule, quality, network based parameters and sales/distribution. Although the experience of the Gazdasági Versenyhivatal (Hungarian Competition Authority) is rather limited with regard to air transport cases, the submission still tries to highlight the most important issues the authority is likely to examine or consider in a future investigation. The submission also discusses the potential competition issues that could have arisen in the past when the national flag carrier, Malév Hungarian Airlines was still in operation. It must be emphasised, however, that the Gazdasági Versenyhivatal provides the below overview only in theory and does not intend to exclude certain competition law problems from its enforcement activities on a permanent basis.

1. Characteristics of the Hungarian air transport markets

2. Due to the small size of Hungary and the central location of the biggest travel-generating location, Budapest, there is no domestic air travel in Hungary. For decades, the only significant Hungarian airline providing scheduled air services was the national airline, Malév Hungarian Airlines. It operated an entirely international hub-and-spoke route network out of Budapest Liszt Ferenc International Airport (Budapest Airport). With Hungary's accession to the EU in 2004 and the full liberalisation of air transport markets, numerous new entrants appeared in the market, mainly in the form of low-cost airlines, such as Wizzair, SkyEurope, easyJet, Air Berlin and later Ryanair and Norwegian.

3. Airport infrastructure is centralised. The only airport capable of handling significant international traffic is Budapest Airport. There are several regional airports, however, they are either too small or not equipped with the infrastructure needed to accommodate high volumes of air traffic.

4. The most important market development in the last 10 years, not including the 2004 market liberalisation, the long saga of the struggling national airline, Malév, ended in February 2012 when it declared bankruptcy. Prior to this the airline had been privatised and re-nationalised twice but had been unable to successfully achieve sustainable operations, especially in the liberalised market environment. Malév was not big, efficient or specialised enough to survive in a competitive environment on a long-term basis. It had the classical problem of small- and mid-sized European airlines, such as CSA, LOT, Tarom, Air Baltic, Estonian Air, Austrian Airlines, etc.

5. Hungary, as an EU Member State, is part of the open aviation area created by the EU liberalisation process that started in 1987, and which was completed in three steps, by 1 April 1997.¹ Ever since, through its external aviation policy, the EU has constantly been broadening this open aviation area with the involvement of neighbouring countries even if they are not EU Member States. In this open aviation area, airlines are free to decide independently on key parameters of competition and the way they serve markets with State influence kept to a minimum level. The current regulatory system in the EU ensures the functioning of the internal aviation market based on a common EU-wide licensing regime for

¹ Council Regulation (EEC) 2407/92 of 23 July 1992 on licensing of air carriers [1992] OJ L240/1; Council Regulation (EEC) 2408/92 of 23 July 1992 on access for Community air carriers to intra-Community air routes [1992] OJ L240/8; Council Regulation (EEC) 2409/92 of 23 July 1992 on fares and rates for air services [1992] OJ L240/15.

airlines, full exchange of traffic rights and free pricing.² In practice, this means that the European aviation market is an open aviation area with a single set of rules: (1) every airline that has obtained an appropriate operating licence within the EU (2) is entitled to operate between any EU airports and (3) is free to set fares on its flights according to its own business considerations. EU legislation also deals with slot allocation in the form of a directly applicable regulation, while ground handling and airport charges are regulated by directives which establish some common principles and requirements.³

2. Applicability of competition rules, the experience of the Gazdasági Versenyhivatal

6. Both Articles 101 and 102 of the Treaty on the functioning of the EU (TFEU) and the relevant national competition law provisions are fully applicable to the airline industry in Hungary without statutory exemptions. The Gazdasági Versenyhivatal has only limited experience with air transport as despite the historically strong position of Malév (40-50% even in the last years of its operations), competition from other airlines and especially low-cost airlines has been consistently strong. While Malév was a member of the oneworld alliance, cooperating with British Airways and Finnair, other strategic alliances were also strong in the Hungarian market through Lufthansa (Star Alliance) and Air France/KLM (SkyTeam). Furthermore, the penetration of low-cost airlines has been significant right from the beginning and since the demise of Malév, they have been providing over 50% of the air traffic at Budapest Airport.

7. There have been no cases dealing with the restrictive agreement, abuse of dominant position or merger aspects of airline competition before the Gazdasági Versenyhivatal. Our limited case experience relates to Budapest Airport and services indirectly connected to airline competition. The only major investigation that has taken place concerning the Hungarian aviation market has been the State Aid investigation of the European Commission that ended with a decision ordering Hungary to recover the incompatible State Aid given to Malév over the last years of its operations.⁴

8. However, should there be any complaint or investigation in the future, the Gazdasági Versenyhivatal would follow the approach outlined below when dealing with airline cases. The type of competition problems that could have arisen under the market conditions existing when Malév was still in operation will also be discussed below.

3. Framework and parameters of competition

3.1 Types of airline business models in short-haul air transport

9. In the fully liberalised intra-EU aviation market, airlines are free to choose their business models and the services they offer, including whether they cooperate with other airlines. Airlines currently offering scheduled air transport services within Europe, e.g. to/from Budapest Airport are a heterogeneous group, with significant differences among them. Such differences between airlines are mainly related to the operating models they employ (i.e. hub & spoke or “network” airlines as opposed to point-to-point models) and the level and types of services they offer passengers (i.e. full service as opposed to low-costs or no-frills model).

² Parliament and Council Regulation (EC) 1008/2008 of 24 September 2008 on common rules for the operation of air services in the Community [2008] OJ L293/3.

³ Council Regulation (EEC) 95/93 on common rules for the allocation of slots at Community airports; Directive 96/67/EC on Ground Handling Services.

⁴ Case SA.30584 Malév Hungarian Airlines, decision of 09/01/2012, see also press release IP/12/7.

10. Airlines operating hub-and-spoke networks provide connecting services throughout their networks by using centrally located airports. Within hub-and-spoke networks, flights are concentrated in time and space to these airports (hubs). Network airlines serve different passenger segments, such as passengers flying short-haul or long-haul, time sensitive and non-time sensitive passengers and passengers connecting or flying point-to-point, with a series of complex operations at their hub airports.

11. In the case of Budapest Airport, Malév was a network airline operating a hub at the airport. Currently, there are still network airlines present on routes to/from Budapest, such as Lufthansa, British Airways and Air France/KLM, however, they do not operate hubs at Budapest Airport. These airlines use the airport only as a spoke destination that they connect to their main hubs in Frankfurt, London, Paris or Amsterdam.

12. Point-to-point airlines concentrate on local traffic and offer point-to-point services on many different city pairs. The most important point-to-point operators at Budapest Airport are Wizzair, Ryanair, easyJet, Germanwings and Norwegian. They focus on fewer passenger segments than network airlines and have simplified operating models that enable them to avoid the additional costs and complexity involved in creating and operating hubs. To increase their operational efficiency, point-to-point airlines often concentrate their activities on particular airports (bases). Currently, Wizzair and Ryanair operate a base airport at Budapest. In addition, they either charge extra for so-called 'frill' services (i.e. low-cost/low-frill airlines), such as catering, lounges, frequent flyer programmes, seat allocation and extra comfort or, alternatively, they choose not to offer these services at all (i.e. no-frill airlines).

13. The different operating models used by these airlines, however, cannot be grouped clearly into distinct categories. As part of their product differentiation, airlines create their individual combinations of service elements without clearly falling into any category. Any assessment of the competitive behaviour of airlines should take into account the above distinctions on a case-by-case basis, which might be relevant at the level of market definition, the competitive assessment or the examination of potential competition.

3.2 *Common types of cooperation between airlines*

14. While, in general, most point-to-point low-cost airlines are not part of any type of cooperation, network airlines usually cooperate with other airlines.

15. Network airlines providing comprehensive transport services usually cooperate with other airlines in order to extend their networks or increase their frequencies on existing routes. Under airline cooperation agreements, airlines either try to transfer passengers to/from the partner airlines' complementary route to extend the reach of their services or they sell seats on competing services to increase the number of frequencies offered. Generally speaking, airline cooperation agreements range from simple bilateral interlining agreements to various forms of highly integrated strategic alliances such as joint ventures, often with a world-wide span (such as the three major alliances: oneworld, SkyTeam and Star Alliance).

3.2.1 *Interlining*

16. Interlining is an industry practice applied by the vast majority of network airlines; this is the least intense form of cooperation. Under an interlining agreement, one airline can issue tickets that include a segment from the issuing airline and a segment with another airline. Due to Malév's market exit, this type of cooperation is less and less relevant in the Hungarian market, since the remaining airlines cover the Hungarian market with their own services or have alliance internal codeshare/joint venture cooperations, while low-cost airlines do not cooperate with other airlines.

3.2.2 *Joint ventures within strategic alliances*

17. A strategic alliance is a cooperation for mutual benefit, which is intended for a longer period, pursuing strategic aims whilst the partner companies remain independent. A degree of activity integration is achieved via the contribution of assets or knowledge to the alliance. The most intensive form of cooperation within a strategic alliance is a metal neutral joint venture. This type of cooperation is at the heart of each of the three global airline alliances: oneworld, SkyTeam and Star Alliance.

18. This type of agreement between airline alliance members achieves more far-reaching objectives through the sharing of revenue or profit and cooperation on all key parameters of competition. Joint venture agreements include coordination on network, capacity and product planning, pricing and revenue management, passenger sales, marketing and distribution, frequent flyer programmes, codesharing, ground handling, maintenance, joint procurement, etc. The purpose of metal neutrality is to prioritise the interests of the alliance as a whole as opposed to the partner airlines' incentives to act solely in their own interests. These agreements represent an almost merger like integration. Alliance agreements also have the potential to create efficiencies by connecting airlines' networks and increasing the number of connecting passengers travelling between and within these networks. This would create economies of density, scope and scale.

19. Although Hungary is within the geographic scope of all three transatlantic joint venture agreements (oneworld Transatlantic Joint Business, Star Alliance A++ and SkyTeam Transatlantic Joint Venture Agreement), stand-alone short-haul markets to/from Budapest are not served by these joint ventures. Joint venture cooperations are relevant only on long-haul connecting markets to/from Budapest.

3.2.3 *Codeshare agreements*

20. Codeshare agreements are mostly part of the wider strategic alliance membership, nevertheless they do not entail the same level of integration or geographic depth as a joint venture. Codeshare agreements are also possible between non-aligned airlines on a route specific basis.

21. A codeshare agreement is a commercial agreement between airlines whereby the airline operating a given flight (operating airline) allows one or more other airlines to market this flight and issue tickets on this flight as if they were operating the flight themselves (marketing airline). Under a codeshare agreement, flights are displayed with more than one airline designator code, namely that of the operating airline and that of the marketing airline(s). Codeshare partners also agree on how they will compensate each other for the seats they sell on one another's flights. The most commonly used codeshare agreement is the free-sale/free-flow agreement, where the marketing airline has free access to the seat inventory of the operating airline and, therefore, each of them book seats in the same inventory.

22. Just as in the case of joint ventures, codeshare agreements have lost much of their significance in the Hungarian market as low-cost airlines operate independently on the routes to/from Budapest while network airlines operate their own flights and codeshare agreements are only used for complementary, mainly long-haul services. Malév used to have codeshare agreements on many of the routes it served, both with alliance partners (British Airways, Finnair, Iberia) and other airlines (Brussels Airlines, Air France, KLM).

3.3 *Main parameters of competition relevant for routes to/from Budapest*

23. Competition amongst airlines providing short-haul passenger air transport services takes place on the basis of various key parameters, such as pricing, scheduling, frequencies, product and service quality, network-based parameters (e.g. network coverage and frequent flyer programmes) and sales/distribution.

24. The importance of each parameter may vary depending on the type of customer (e.g. time-sensitive v. non-time sensitive). In practice, competition takes place on the basis of a combination of these parameters. The parameters of competition for long-haul services can be somewhat different, however, due to the lack of long-haul passenger flights to/from Budapest, we will not discuss these differences.

3.3.1 Pricing

25. Pricing is a fundamental element of airline operations as its aim is to maximise revenue from the price inelastic part of demand (time-sensitive passengers) and to stimulate demand from the elastic part (non-time sensitive passengers) in order to fill otherwise empty seats.⁵ Pricing is instrumental on short-haul flights where airline products are more commoditised.

26. Given that passenger groups travelling on the same aircraft have different preferences and price-elasticity, airlines apply differential pricing. Network airlines offer seats at varying prices (fares) with different corresponding conditions and obligations. Most of the network airlines offer different cabin classes, which represent clearly identifiable, different levels of services. A distinction is therefore made between business and economy classes. On the other hand, most low-cost airlines and certain network airlines only offer one cabin class.

27. In addition, fares in each cabin class are further split into booking classes (also called fare classes). Network airlines can have 25-30 booking classes on their flights, while low-cost airlines use up-to 10 booking classes. Booking classes can be differentiated by the selling conditions attached to the airline tickets, the so called “fences”. Fences include conditions such as duration limits on stay, ticket refundability, change fees, purchase time restrictions, Saturday night stay requirements, itinerary restrictions, return fare pricing, baggage allowance limits, flight specific limitations, etc.

28. Finally, within a booking class there can be different fare bases. Fare bases are individual fares in each booking class differentiated by certain conditions, which vary depending on the business model of the airline. The multitude of prices or fare products available on a flight (price dispersion) depends on the market circumstances. For example on routes with heavy competition, airlines tend to offer a larger number of booking classes and fare bases because in this way their products are more tailor-made for the needs of customers.

29. Pricing creates a tariff/fare structure including the various booking classes with the respective conditions attached, while revenue management allocates seats to these booking classes and manages the seat inventory among them until the date of departure. Revenue management is the practice of controlling the availability of seats for sale at different fares and subject to different conditions, with a view to maximising airline revenue from the flight.⁶ Network airlines and many low-cost airlines employ sophisticated revenue management systems to set the price for each seat on the airplane at a given point in time, based on capacity and demand to achieve price maximisation.

30. The above mentioned tariff structure can be modified almost instantly in reaction to market developments, since there are no specific requirements to keep it fixed or to submit it to civil aviation authorities, as was the case before the market liberalisation. On third country routes with a more restrictive air service agreement based regulation, modification of the tariff structure is more time consuming. Although airlines have the possibility for instant price changes, airlines usually review their tariff structures twice a year in order to maintain a certain level of price stability.

⁵ S Holloway, *Straight and level: practical airline economics* (3rd ed. Ashgate Publishing 2008) p. 133-136.

⁶ Ibid p. 522.

31. While low-cost airlines also use several booking classes just as revenue management systems, their pricing is substantially simpler than those of network airlines. Their systems mainly differentiate based on the time of purchase. However, these airlines have the same objective in terms of customer segmentation and differential pricing. They apply the approach of unbundling and charge for service elements separately, achieving substantial ancillary revenues. In unbundling, certain service features (such as checked-in baggage, priority boarding, extra legroom, reserved seating, more ticket flexibility, use of lounges, etc.) are available for separate fees and can be combined with any ticket even at the time of check-in.

32. For network airlines, besides the tariff structure described above and depending on the distribution channels used, a distinction can be made between the following fares:

- Published fares – these are the fares on a specific route made publicly available by airlines to everyone. Published fares have the above described tariff structure with booking classes and fare basis.
- Corporate fares – these are net fares, discounts of published fares or rebates negotiated between airlines and corporate customers and specified in formal agreements. The benefits under corporate agreements are usually conditioned on meeting specific targets by the purchasing company in terms of market share, travel spend or number of journeys.
- Travel agency fares/discounts – these are net fares/discounts agreed upon by airlines with travel agencies and set out in written agreements. Airlines also provide a number of other incentives to travel agencies, such as fixed payments.

33. Unlike published fares, corporate and travel agency fares/discounts are contained in private contracts and are not publicly disclosed. Hence, this price element is less transparent for competing airlines.

34. In general, low-cost airlines concentrate their sales effort mainly on direct sales through their websites and call centres, since they do not have corporate or travel agent fares. However, certain low-cost airlines are increasingly present on indirect sales channels and also have special deals with corporate customers.

35. Airlines also attract particular customers with special price offers. Promotions may also be used to react to seasonal effects (such as overcapacity during periods with low demand).

36. Price is usually considered to be the main selection criterion for non-time sensitive customers. This is less so for time-sensitive passengers, who attach important value to other factors such as the convenience of schedules, or flight frequency. As the Hungarian market is overwhelming comprised of low-cost airlines, the role of price competition has clearly increased.

3.3.2 *Schedules and frequency*

37. The availability of multiple frequencies and the timing of each flight strongly affect passenger convenience and have a significant influence on demand, especially for time-sensitive passengers because of their preference to make a same day return from their business trips. For example, low frequency flights during the day may not be attractive to time-sensitive passengers, who would want to fly outbound in the morning hours and return by the evening at the latest. At the same time, depending on how their business schedules develop, they may wish to have the possibility of returning earlier if needed. Flight schedules and to a lesser extent service frequency are usually ranked among the most important criteria determining the choice of an airline for premium passengers.

38. From a supply-side perspective, ideal scheduling to meet customers' needs and preferences requires corresponding landing and take-off slots. Without access to a sufficient number of slots at suitable times, a competitor will be unable to operate a regular service, and as a result, will not be able to provide an effective competitive constraint. Availability of slots is therefore an essential condition for the creation of a stable regular service. Due to the needs of time-sensitive passengers, the launch of a viable service requires slots at least at peak times in the morning and evening. Operations using non-peak time slots reduce the attractiveness of a service to high yield time-sensitive passengers and thus may deter the entry or undermine the service's sustainability.

39. Low-cost airlines habitually have lower frequency services from less congested, often secondary airports where slots are more easily available. Their schedules are therefore often less attractive for time-sensitive passengers focusing on flexible travel options.

40. While the market exit of Malév resulted in low-cost airlines immediately reacting to the bankruptcy by increasing their capacity on routes to/from Budapest, their schedules often did not perfectly substitute the old Malév schedule. Therefore, on some routes, the operations of network airlines were largely unaffected by the increased presence of low-cost airlines. On the other hand, the remaining network airlines adapted their schedules to market demand, for example Brussels Airlines now flies according to the old schedule of Malév and has taken over the latter's early morning flight out of Budapest and late evening flight out of Brussels.

3.3.3 *Product and service quality*

41. Product and service quality include both the on-board and off-board features of a flight. On-board services can include aspects such as seat pitch and food quality. While these may influence consumer choice, especially in relation to time-sensitive passengers, they do so to a lesser extent on short-haul routes such as those to/from Budapest. Changing the products offered may not be that costly and time-consuming on short-haul flights, as on-board features of a flight have less influence on competition on these routes, where the time spent in the aircraft is limited. With the wide penetration of low-cost airlines in intra-EU short-haul markets, airline products have become more and more commoditised, with the principal focus being on fares.

42. Off-board features concern, amongst others, the airport used (primary v. secondary airports), on-time performance, the availability of airport lounges, express check-in services, or speedier fast-lane security screenings. These features are important service instruments that differentiate airline products and can retain the loyalty of passengers. In short-haul intra-EU markets, where on-board aspects have a limited effect, the choice of airport can be especially important in achieving differentiation between the competing services of airlines. The choice of primary airports in close vicinity to the city served can minimise the ground connection time needed to get to the airport of departure/arrival. Time-sensitive passengers highly value time and therefore the amount of time that needs to be spent getting to/from an airport can be decisive when choosing a particular airline. In addition, if extra time is needed to get to an airport this may also hinder same day return flights and can substantially limit the effective time available for business purposes.

43. Just as in the case of schedules and frequency, the bankruptcy of Malév and the subsequent large scale entry of low-cost airlines have not resulted in the perfect replacement of the earlier existing supply for time-sensitive, as the new services are often only available to secondary airports. On the other hand, the larger group of non-time sensitive passengers now have an even wider choice of destinations and services.

3.3.4 *Network based parameters*

44. Offering a large number of destinations out of a given city can be an advantage for an airline. This is particularly important for corporate customers who need to travel on a large number of city pairs (employees of multinationals). A large number of destinations offered out of a city can be vital to the attractiveness of an airline's frequent flyer programme (FFP), since it provides customers with more possibilities for accruing and redeeming miles.

45. Frequent flyer programmes are common marketing devices that are used by airlines to induce customer loyalty. Such programmes give passengers enrolling in them an incentive to remain loyal to the airline.⁷ For some passengers, in particular frequent travellers, the scope and the quality of an FFP may be a criterion influencing their choice of an airline. The popularity of FFPs depends on a number of features, such as the fare, the conditions and scope for earning and redeeming miles, which largely depends on the size of an airline's own network and eventually on the size of the network of the third parties with whom an airline concludes an FFP cooperation agreement.

46. A particular feature of customers' decision as to which FFP it will choose is that often the person benefiting from the FFP is not the same as the one paying for the service.⁸ While the frequent traveller may be a company employee, the person paying for the service is often an employer or client. The person travelling usually has a margin of discretion in choosing the airline. Hence, an employee may choose an airline based on his or her FFP preferences, rather than price, quality, etc. This increases the impact of FFPs on competition between airlines.

47. Low-cost airlines usually do not operate FFPs and their networks are not necessarily organised around one particular hub airport. Although they try to concentrate their traffic on base airports, their entry decisions on a route are made on the basis of route specific factors and the availability of point-to-point demand.

48. Due to the increased competition from low-cost airlines and the price driven competition in short-haul intra-EU aviation markets, network coverage and FFPs have a less influential role as a competition parameter than on long-haul markets. This is even more true for the Hungarian market where low-cost airlines play a significant role.

3.3.5 *Sales and distribution*

49. Airlines which have better access to distribution channels (e.g. travel agencies, internet sites, tour operators, codeshare airlines) are better positioned to sell their tickets. The mix of distribution channels chosen is of particular importance. Especially in short-haul markets, the relevance of an airline's direct distribution channels (i.e., website and call centre) is growing. However, for network airlines sales through the traditional computerised reservation systems, also known as global distribution systems (GDSs), are still the predominant channel.

50. Airlines launch marketing campaigns and spend vast amounts of money on advertising in order to raise passenger awareness of the services they offer, particularly in the catchment areas of the airports where they operate.

⁷ FFPs are particularly effective with repeat customers, who are mostly time-sensitive travellers. These passengers often take advantage of the rewards of these programmes, such as free tickets for private use.

⁸ See "There is no Such Thing as a Free Lounge – A Report on Frequent Flyer Programmes", Swedish Competition Authority, 2003.

51. The majority of low-cost airlines rely on direct sales channels such as their own websites. Their tickets are therefore not available in computerised reservation systems and they do not have contacts with travel agents or tour operators.

3.4 *Market definition*

52. Market definition is a tool to identify and define the boundaries of competition between undertakings. This process identifies the competitive constraints that the undertakings concerned are faced with. The main sources of competitive constraints are demand substitutability, supply substitutability and potential competition. If conducting an investigation into an airline's market conduct, the Gazdasági Versenyhivatal would follow the practice under EU competition law due to the inevitable cross-border nature of the industry. Therefore it would examine substitution issues of origin and destination, city pairs v. network markets, substitution between various airports, non-stop and one-stop flights, different modes of transport (air transport v. rail or road transport), and different passenger groups.

3.4.1 *The origin and destination approach*

53. The main disciplinary force, according to the Commission's practice, is demand substitution, which exerts a more immediate and effective constraint on undertakings than other sources of competition. The relevant market is usually comprised of two dimensions, a product-specific dimension and a geographic dimension. However, as an air transport service inherently involves a geographic dimension, it is less useful to draw a clear dividing line between the product and geographic dimensions of air transport. Passengers rarely fly for the pure pleasure of air transport; rather, they want to get from A to B. In other words, when passengers book flights to a desired destination, the flights themselves are an intermediate product. Under this interpretation, the product demanded could be defined as the transportation from A to B, rather than flying for the sake of flying. Under these circumstances, determining a geographic market would seem to be somewhat superfluous. However, this does not necessarily mean the analysis is flawed.

54. This approach is called the origin and destination approach, in short 'the O&D approach'. Such a market definition corresponds to the demand-side perspective whereby passengers consider all possible alternatives of travelling from a city of origin to a city of destination, while they do not generally consider a particular city-pair as a substitute to a different city pair.

55. The Ahmed Saeed case was the first case that dealt with market definition concerning scheduled air transport in EU competition law.⁹ Here, the Court of Justice adopted a test which sought to determine whether a scheduled flight on a particular route can be distinguished from alternatives, like charter flights, railways and road transport 'by virtue of specific characteristics'.¹⁰ The Court of Justice stated that the test can result in different outcomes depending on the case. The analysis may conclude that there exists an airline route where no effective competition is likely to arise. The Court of Justice has found that in principle, within the EU, air transport on O&D city pairs or several substitutable O&D pairs can be defined as the relevant market. The O&D approach has been confirmed in several subsequent court cases¹¹ and has been applied in the Commission's practice ever since.

⁹ Case 66/86 *Ahmed Saeed Flugreisen and Silver Line Reisebüro GmbH v Zentrale zur Bekämpfung Unlauteren Wettbewerbs eV* [1989] ECR 803.

¹⁰ *ibid* paras 39-40.

¹¹ Case T-2/93 *Air France v Commission* [1994] ECR II-323 para 84; Case T-177/04 *EasyJet v Commission* [2006] ECR II-1913, at paragraph 56; case T-342/07 *Ryanair Holdings plc v Commission* ECR II-3457 para 102.

3.4.2 *Network competition*

56. Many argue that competition in the aviation industry should be understood and assessed as competition between regional/global networks. Accordingly, competition analysis should concentrate on the competitive effects of agreements or transactions on competition between these networks. The European Commission has assessed network competition issues on several occasions. It has acknowledged that network competition exists and increases with the rapid extension of alliance networks in a liberalised environment. Nonetheless, the Commission has so far concluded that it is unnecessary to change its well-established approach since it has found no convincing evidence suggesting the contrary. Network effect and supply side substitution can be captured partly with a route-specific analysis, while other aspects form part of the competitive assessment at a later stage.

57. There is one notable exception to the generally applied O&D approach. Certain passengers, travelling for holiday purposes can be indifferent as to which destination they choose, provided it is warm and sunny.

3.4.3 *Airport substitution*

58. The issue of airport substitution can be used in two ways to modify the original O&D city pair approach. It can serve to narrow down the relevant market to only certain airport pairs (e.g. Heathrow-Budapest Airport) or, contrastingly, it can result in the inclusion of additional city pairs (e.g. Budapest-Manchester/Vienna-Liverpool). The Commission regularly examines the substitutability of airports. Passengers beginning or ending their journeys in the catchment areas of two or more airports can choose between those airports. Services from those airports can be substitutes from a demand side point of view. The number of passengers in the overlapping catchment areas of airports should be sufficiently large to discipline the competitive behaviour of airlines operating at those airports.

59. When defining the relevant O&D markets for air transport services, the Commission has previously found that flights to/from airports which have sufficiently overlapping catchment areas can be considered as substitutes in the eyes of passengers. The size or overlap of an airport's catchment area largely depends on the overall travelling time of the journey the passenger intends to undertake and often on its purpose. Time-sensitive passengers travelling on the same city pair may not regard services between secondary airports as substitutes. Non-time sensitive passengers, on the other hand, may consider them on each occasion they fly. Passengers take into account the convenience and cost of getting to an alternative airport. Good public transport connections at affordable prices may convince passengers to consider services to/from other airports as well. Passengers evaluate the services offered from an airport, ie the flight times, schedules and frequencies. Time-sensitive passengers, for example, prefer high frequencies with flight times enabling them to return on the same day. Secondary airports with predominantly low-cost traffic usually offer one daily or less frequent flights, at flight times not optimal for time-sensitive passengers. Time-sensitive passengers may choose a primary airport also due to the availability of extra services like lounges, which they are entitled to use by reason of their membership in FFPs. In the Ryanair/Aer Lingus merger investigation, the Commission, based on responses from airports, established a proxy of either a distance of at least 100 km or a driving time of at least 1 hour as the typical minimum catchment area. However, this is only a first proxy and does not eliminate the need for a detailed case-by-case analysis concerning the individual airport pairs.

60. Airport substitution should also be examined from a supply side or airline perspective. The relevant question concerns the ability of airlines to change airports and reschedule their services at alternative sites. Network airlines have limited possibilities to do so, since they operate hubs and need

traffic feed. Therefore, network carriers need enhanced airport infrastructures with large capacities. Point-to-point carriers, on the other hand, have lower expectations and increased mobility.¹²

3.4.4 *Non-stop v. one-stop competition*

61. The inclusion of network competition aspects in market definition can be achieved also by including one-stop or multi-stop flights within the relevant market. This acknowledges the fact that certain airlines can exert a competitive constraint on the non-stop services of competitors by operating one-stop services through their own networks via their hubs. The importance of one-stop services can differ from route to route depending on the distance of the flight, the geographic position of the hub or the time penalty that the extra stopover imposes. Time-sensitive and non-time sensitive passengers may attribute different values to one-stop services since they have different preferences in terms of convenience, price or the total time of travel. Indirect flights are generally of lower quality in the eyes of consumers since they need to make a stopover.

62. As a general rule, on short-haul routes one-stop flights provide a suitable alternative only under exceptional circumstances. The issue requires a case-by-case assessment. This would be the case if the proportion of passengers travelling on one-stop flights was considerable due to the better schedules of those services. The limited number of non-stop frequencies can induce a large proportion of time-sensitive business passengers, but also non-time sensitive passengers, to choose one-stop services. Irrespective of the precise determination of substitution from one-stop flights, all one-stop services can be taken into account in the assessment since their low competitive value will be reflected in any case in the small proportion of bookings (market share) they represent.

63. If there is a non-stop service suitable for time-sensitive passengers, it is unlikely that a large number of passengers will be ready to choose one-stop or less suitable low-cost services even in the absence of direct competition. The bankruptcy of Malév has shown that the network airlines remaining alone on the same routes (e.g. Brussels Airlines on Brussels-Budapest) have lost relatively little in certain passenger groups (time-sensitive Passengers), as their services are considered to be so much better than the much longer one-stop or lower quality non-stop low-cost services.

3.4.5 *Substitution from other transport modes*

64. Given the geography of Europe and Hungary itself, it is possible for air transport to be substituted with other modes of transport. The substitution of air transport with rail transport and road transport on certain routes can be considered as a competitive constraint.

3.4.6 *Time-sensitive v. non-time sensitive passengers*

65. Passengers can be grouped into distinct categories according to their different characteristics. This market segmentation has important implications for airlines' pricing policies and the way network airlines operate and organise their network structures. The question arises as to whether and how this market segmentation should be taken into account at the level of market definition. The question is all the more important, given that the aforementioned substitution from alternative airports, transport modes or one-stop flights may be decided differently depending on the composition of the relevant market. Time-sensitive or premium passengers as a separate group may have different preferences for substitution than the overall group of air transport passengers, including the large amount of non-time sensitive or non-premium passengers.

¹² Ryanair is famous for significantly and instantly downgrading services at airports where they have commercial disputes.

66. A distinct group of customers may constitute a narrower, distinct market when such a group can be subject to price discrimination. This will usually be the case when two conditions are met: (1) it is possible to identify clearly which group an individual customer belongs to at the moment of selling the relevant products to him/her, and (2) trade among customers or arbitrage by third parties is not feasible. Air travel can have many attributes that are perceived differently by time-sensitive and non-time sensitive passenger groups. Frequency, seat availability just before departure, flexibility in terms of reservation changes, short flight times (no stopovers or just a minimal number of them), quality of in-flight services and prices are all important elements of air transport services.

67. Airlines apply very sophisticated methods designed in such a way that passengers self-select themselves and reveal their degree of price sensitivity. When purchasing their tickets, time-sensitive passengers present special needs, which reveal them as high-yield travellers. Their inability to book well in advance, the times of the day and of the week they travel, their need for flexibility and their relatively short business trips compared to holidays, all indicate their characteristics as a passenger. The so-called ‘fences’ around the different fare products such as duration and departure time limitations, purchase time restrictions, payment and refund conditions all serve the purpose of hindering arbitrage between the different consumer groups. The aim is to make all time-sensitive passengers buy airline tickets according to their willingness to pay. The remaining seats can be sold at discounted prices, although only to prevent empty seats on flights. Another effective tool supplementing price discrimination is revenue/inventory management which is used to induce the purchase of more expensive tickets by changing the availability of discounted fares close to the flight departure and only leaving open more expensive fare categories.

68. To conclude, the specificities of airline pricing and the existence of passenger groups with different demand characteristics, in most of the cases, warrant the definition of separate relevant markets for time-sensitive (premium) and non-time sensitive (price-sensitive, non-premium) passengers.

3.5 Potential competition problems

69. The bankruptcy of Malév significantly changed the structure of the Hungarian air transport market. While at one point in its operations around 40% of passengers travelled with Malév, including a significant number of connecting passengers, in February 2012 the national airline disappeared from one day to the next. The market responded swiftly; within just 5 days 60% of Malév’s point-to-point traffic had been taken over by competitors or new entrants, while within five weeks the same figure had reached 80%. As a result, the market share of low-cost airlines increased from around 30% to above 50%. This restructuring also changed the type of traffic handled on Hungarian routes. While Malév served 1.5 million connecting passengers with its services through Budapest Airport, after the bankruptcy those were replaced by point-to-point passengers. At the end of 2012, overall traffic dropped only by 4.7% despite the almost complete disappearance of connecting traffic.

70. These changes also had an effect on the type of competition law problems that may arise on these markets and also require the new aspects to be taken into account in any future competition law assessment. In the following part we will briefly address the competition law problems that could have arisen when Malév was still operating and the potential competition law problems that may arise now that it has exited the market. Our discussion will highlight the problems and issues that are most likely to attract antitrust scrutiny. However, this does not mean that the Gazdasági Versenyhivatal would limit itself to examining only these issues.

3.5.1 Restrictive agreements

71. Malév was a member of the oneworld alliance, cooperating among others with British Airways, Iberia and Finnair. Although the cooperation included various aspects such as codesharing, frequent flier

programmes, mutual lounge access, etc, Malév never formed part of any of oneworld's revenue sharing, metal neutral joint venture cooperations.

72. Any investigation would have mostly likely concentrated on the routes with direct overlaps between the alliance parties, where the combined market share of the alliance was high and the increment resulting from the cooperation was significant. There would have also been an examination as to whether the routes were protected by high barriers to entry due to regulatory issues, scarcity of slots and other infrastructure, hub advantage, or frequency advantage.

73. From a competition law point of view, these bilateral cooperations had an anticompetitive aspect due to the lower level of competition between the alliance partners on the routes between their respective hubs (e.g. London-Budapest) and a procompetitive effect by providing, for example, ample connecting possibilities for passengers to/from Budapest through the network of British Airways. On the short-haul routes, consumers also had the choice of low-cost airlines' services, while competitors or new entrants faced relatively low barriers to entry. On long-haul routes, given Budapest's secondary airport status, non-stop flights (e.g. to/from New York or Toronto) never operated with higher than a daily frequency, while one-stop flights through numerous European hubs were always available. Due to the geographic position of Budapest and its good connections to major European hubs, these one-stop flights provided a viable alternative.

74. The most important route concerned would have been London-Budapest where Malév cooperated with British Airways. Right from the moment of liberalisation, low-cost airlines were present and are still present with numerous daily flights. Wizzair, easyJet, Skyeurope and later Ryanair operated non-stop services to London as competitors on the short-haul segment. With regard to transatlantic flights, services through Frankfurt, Munich, Amsterdam, Paris, Rome or Zurich provided equally good or even better services to/from Budapest than the Malév/British Airways flights through London.

75. The Gazdasági Versenyhivatal never received any complaints or information indicating serious distortions of competition arising out of Malév's membership in oneworld.

76. Another competition law issue would have been the assessment of certain codeshare agreements of Malév, especially those which were concluded with direct competitors on routes with little competition, a predominantly point-to-point and large traffic volume. In theory, routes such as Budapest-Brussels could have been a candidate for an antitrust probe due to the high number of time-sensitive passengers travelling for daily or other short duration trips with the need to have a convenient schedule between primary airports. Most likely, a codeshare cooperation on a route like this between direct competitors could have had on balance resulted in more significant competitive harm as efficiencies can arise only to a limited extent from schedule optimisation and more flexibility. Free-flow codeshare agreements may especially have this effect since the partner airlines sell their joint seat inventory on a first come, first serve basis, thereby creating incentives which act against fierce competitive behaviour on both sides. Of course, the individual outcome of balancing the negative and positive effects of a codeshare agreement would largely depend on the special circumstances of the cooperation and its environment.

77. In both the alliance and the codeshare cases, the relevant markets would have been determined on an O&D basis, probably making a distinction between time-sensitive and non-time sensitive passengers. Besides the parties' market positions and incentives, the barriers to entry and especially the possibility of new entrants/potential competition would have been examined in detail. The latter exercise would have included an assessment of slot availability, airport infrastructure, hub and frequency advantages, the role of connecting passengers and access to distribution channels. In the event that a competition law infringement would have been found, either a cease and desist order (in the case of a narrow, bilateral and route specific cooperation agreement) or remedies would have been imposed to facilitate new entry.

78. In the new environment, where low-cost airlines provide the majority of services in the Hungarian market, competition problems resulting from restrictive agreements would most likely be very different. Low-cost airlines, as a general rule, do not cooperate with other airlines, since they operate on a point-to-point basis without supporting the possibility of connections to other airlines' services. It seems that the only way restrictive agreements would be likely to arise is if the low-cost airlines were to enter into secret cartel agreements with either each other or network airlines with the aim of not entering certain routes in direct city pair or airport pair overlaps. This would be the case if, for example, Wizzair entered into an agreement with Ryanair in which they both agreed not to open new routes that would be in direct competition with each other, or if Wizzair agreed to refrain from competing with the network airline still operating on the routes previously operated by Malév.

79. Due to the significant repositioning in the Hungarian market, it seems that it made no sense for the most efficient companies (low cost airlines) to restrain themselves from highly competitive behaviour. Ryanair re-entered the Hungarian market by establishing a base airport serving over 20 destinations, while Wizzair significantly increased its market presence. These two airlines have seemed to compete head to head on several routes ever since. In the absence of their Hungarian counterpart Malév, network airlines on routes to/from Hungary have no direct competitors to collude with. It is possible that various airline alliances could collude on connecting routes to/from Budapest (e.g. Budapest-Frankfurt-New York and Budapest-Paris-New York), however this infringement would be extremely difficult and therefore highly unlikely to be dealt with by a national competition authority, such as the Gazdasági Versenyhivatal.

3.5.2 *Abuse of dominant position*

80. Even though Malév had a relatively strong position at Budapest airport with a market share of approximately 40%, its constantly weak financial situation and its struggle to compete with mainly significantly bigger and/or more efficient counterparts, did not enable it to behave independently from its customers and competitors. These circumstances hindered Malév's ability to pursue predatory strategies against new entrants. In fact, its own inefficient operations and its competitors drove the national airline out of the market with their low-costs and better network strategies.

81. Malév was also unable to use strategic behaviour against its competitors as it did not control any scarce resources, e.g. airport infrastructure. Budapest Airport has never had any significant constraints in terms of terminal or runway capacity. In a situation to the contrary, Malév could, for example, have used the scarcity of slots as an advantage over its competitors. Malév's strong position at the airport could have been used for slot hoarding. Malév could have applied for an abusively high number of slots without the actual intention of using them. If these unused slots were then to be given back at a time when competitors would no longer be able to use them efficiently, this could have hindered the access of competitors to the airport under competitive terms. An airline with a large slot portfolio could argue that the additional requests are necessary to ensure operational flexibility, however in practice these additional applications can deprive competitors of valuable slots.

82. In the case of network airlines, such as Malév, finding a dominant position would have been easier than establishing the same for a low-cost airline in the new, post-Malév era. From a demand side point of view, passengers would be willing to fly to/from Budapest on determined city pairs in both cases and another airline operating at another airport would not have been a substitute for them or a competitive constraint on the behaviour of Malév.

83. However, from a supply side point of view, the same conclusion would not be so obvious. With a network airline operating its hub airport at a given airport it is unlikely that another airline would choose to do the same even in the presence of an adequate airport infrastructure. Consequently, Malév's strong

position would not have been challenged by others, also because competitors already operated their hubs at other airports and this would have required a restructuring of their whole network.

84. On the other hand, it seems that low-cost airlines are likely to be substantially more mobile and primarily concerned only about market opportunities on a route-by-route basis. The demise of Malév provided an excellent example when Ryanair re-entered the Hungarian market with a five aircraft base, even though Wizzair already operated a base at Budapest and other low-cost airlines also had a significant presence. It is true that currently Ryanair operates a somewhat smaller base at Budapest, however it has remained at the airport on a continuous basis ever since. Considering the growth rate and aircraft orders of certain low-cost airlines, it is not excluded that the issue of supply side substitution can be raised when determining the relevant market and market position of low-cost airlines with market power.

85. Furthermore, in a market with predominantly low-cost airlines, the importance of traditional aviation related barriers to entry seem to be less important. The use of secondary, less congested airports, the reliance on internet sales, and the point-to-point business model all make traditional barriers to entry less of a concern.

86. The dynamic nature of competition between low-cost airlines also seems to decrease the likelihood of abuse of dominance. With the constant withdrawal of network airlines from short-haul European transport markets, low-cost airlines seem to still have enough growth opportunities before they consolidate.

87. An abuse of dominant position would be (or would have been) possible on certain third country (from EU to non-EU destinations) routes where the traditional international law based regulatory regime still applies. On these routes, entry is determined by the contracting States through the designation of a limited number of airlines. In this regime, price-control mechanisms and fair balance requirements could also hinder effective competition. After the bankruptcy of Malév, which operated exclusively from Hungary in these markets, the network airlines of the other contracting State remained alone on these routes protected by significant regulatory barriers to entry. In this environment a substantial price increase would have indicated that the airlines remaining alone on the routes was taking advantage of its temporary opportunities.

88. Nevertheless, on most of these routes Malév was more or less quickly replaced by Wizzair, which due to its lower cost base, and therefore lower prices, remedied any potential problem. Furthermore, due to the EU's external aviation policy, more and more of these third country markets are joining the European common aviation area or market conditions are at least being substantially liberalised. It seems that currently there are no significant third country markets to/from Budapest where due to the regulatory setting abuses of dominant position would harm a large number of consumers.

3.5.3 *Mergers*

89. Before the bankruptcy of Malév in 2012, the acquisition of the national airline would have been subject to national, and depending on the buyer, most likely also EU merger investigations. Such investigations would have followed the usual practice concerning airline mergers and set out to determine separate markets for time-sensitive and non-time sensitive passengers due to the network airline business model of Malév. Competition problems would have most probably only arisen on a limited number of O&D routes, mainly between Budapest and the hub airports of the buyer where both airlines were present. Besides these horizontal issues, despite the significant number of connecting passengers travelling through Budapest, it seems unlikely that there would have been any vertical issues arising from the transaction. The latter would have been the case if Malév would have stopped providing connecting passengers to certain airlines operating out of Budapest thereby weakening competition on routes to/from Budapest.

90. It would have also been likely that the parties would have raised a failing firm defence arguing that Malév is neither big, efficient or specialised enough to remain on the market independently in the absence of the transaction. The question would have been whether the competitive structure of the market would have deteriorated to at least the same extent in the absence of the transaction. This would have required an examination as to whether: (1) the allegedly failing firm would have in the near future been forced out of the market because of financial difficulties in the absence of the merger; (2) there would have been no less anti-competitive alternative purchase than the notified merger; (3) in the absence of a merger, the assets of the failing firm would have inevitably exited the market.

91. Knowing how the story of Malév ended in 2012, it can be argued that this argumentation would have had good chances of success in a merger investigation.

92. Under the current environment, in the absence of Malév, any transaction concerning market players on routes to/from Budapest would be dealt with by the European Commission. Both network and low-cost airlines active in Hungary operate on a pan-European basis, therefore any transaction would concern a multitude of Member States. Moreover, an EU level investigation would also be warranted due to the size of these airlines. A merger between two network airlines would hardly create any competition problems on routes to/from Hungary, since they usually operate on these routes as the only network airlines often in competition with low-cost airlines.

93. Considering the latest practice of the Commission, the most problematic transaction would most likely be a merger between two airlines operating a base at Budapest Airport. This would have an effect on base competition, i.e. the airlines' competitive behaviour of operating and opening routes in direct competition with each other out of Budapest. The investigation would follow the example of the Ryanair/Aer Lingus investigations (cases COMP/M.4439 and COMP/M.6663), where the likelihood and possibility of entry at Budapest Airport would be of high relevance.

94. Under the current market conditions, a transaction like this could be the (highly unlikely) merger between Ryanair and Wizzair, which would create similar base competition issues at several other airports too in the Central and eastern European region.