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AIRLINE COMPETITION

-- Note by Iceland --

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*More documents related to this discussion can be found at
<http://www.oecd.org/daf/competition/airlinecompetition.htm>.*

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COMPETITION PROBLEMS DERIVING FROM SLOT ALLOCATIONS AT KEFLAVIK AIRPORT

1. Introduction

1. Air transport is of vital importance for the Icelandic economy and the Icelandic people. The geographical position of the country means that other means of transport to and from the country are not a feasible option for most passengers. Therefore all constraints or hindrances to competition in this field can be very harmful. Similarly, active competition in this field can improve the living standard of the public and strengthen the Icelandic economy in many ways.

2. For this reason the Icelandic Competition Authority (ICA) has repeatedly investigated the conditions for competition in markets that are related to air transport. These investigations have mostly concentrated on the behaviour and the market position of Icelandair ehf. (hereafter Icelandair), the largest Icelandic airline, and the actions of the Icelandic aviation authorities and the operators of Keflavik Airport, the most important international airport in Iceland.¹

3. Formerly, Icelandair was the flag carrier airline of Iceland, and it has a very strong position in the market. Icelandair has, in earlier decisions of the Icelandic competition authorities, been defined as having a dominant position in the market. In two decisions, the authority has concluded that Icelandair abused its dominant position in the market by predatory pricing. In these cases a new competitor had entered the market on a particular flight route and tried to compete with Icelandair. The ICA has also fined a subsidiary of Icelandair that operates in ground handling services at Keflavik Airport, for abusing its position against a smaller competitor.

4. The geographical position of Iceland, which is in the middle of an air route between Europe and North America, makes it desirable for airlines that are headquartered in Iceland to operate passenger flights to and from Iceland using the same aircraft for flights between the two continents within the same day. For such a business plan to be feasible the airlines need to be allocated suitable time slots² at Keflavik Airport, in the morning for flights to Europe and in the afternoon for flights to North America. For decades, Icelandair has based its operations on transporting passengers between Europe and North America via Iceland. A large percentage of Icelandair's passengers on these flights are transit passengers travelling between North America and Europe. Most of the time, the airline has been the sole operator on this route. A few years ago a smaller competitor tried to compete with Icelandair using the same business model. The undertaking did not succeed. One of the main reasons for this seems to be that the undertaking was not allocated suitable timeslots.

¹ Keflavik Airport is the largest airport in Iceland and nearly all international flights to and from Iceland are routed through the airport. In 2013 over 3 million passengers used the facility. Of those a little under 1 million were transit passengers. Traffic through the airport has increased dramatically since 2009 when 1,8 million passengers used the facility. <http://www.kefairport.is/English/Shortcuts/Statistics/>.

² Slots are defined as follows: „An airport slot (or ‘slot’) is a permission given by a coordinator for a planned operation to use the full range of airport infrastructure necessary to arrive or depart at a Level 3 airport on a specific date and time.“ Worldwide Slot Guidelines, International Air Transport Association (IATA), 5th Edition, 2013, p. 16. <https://www.iata.org/policy/slots/Documents/wsg-5.pdf>

5. The present case concerns the allocation of time slots on peak hours at Keflavik Airport to a new competitor, Wow Air ehf. (hereafter Wow Air). Iceland is the base of operations of Wow Air and the undertaking has applied for slots on peak hours, i.e. in the morning and in the afternoon, in order to start scheduled flights between Iceland and the United States on the one hand and Iceland and Europe on the other, using Keflavik Airport as a hub. A previous competitor in the market, Iceland Express (active from 2003-2012), had also applied for the same time slots. In spite of repeated applications these new competitors have not been allocated necessary time slots in the peak hours in order to be able to start real competition on Icelandair's flight routes. Icelandair still has over 90% of the most important slots at Keflavik Airport at the peak hours, this percentage is considerably higher than can be found in the main airports in Europe.³

6. Iceland is a part of the European Economic Area on the grounds of the EEA Agreement. This means e.g. that Iceland is obliged to adopt into Icelandic law the rules on the allocation of time slots on airports in the European Economic Area, i.e. the Council Regulation (EEC) No 95/93 on common rules for the allocation of slots at Community airports. This regulation was incorporated into Icelandic law with regulation No. 1050/2008 on slot allocation.

2. The complaint of Wow Air about the allocation of time slots

2.1 The complaint

7. The airline Wow Air, which recently started scheduled flights to and from Iceland, submitted a complaint to the ICA about the arrangement of the allocation of time slots at Keflavik Airport. In the complaint it was argued that the arrangement of the time slot allocation was detrimental to competition. According to the aforementioned regulation No. 1050/2008 Keflavik Airport is a coordinated airport (third level airport), as are most of the international airports in Europe. This means e.g. that airlines that have been allocated slots and fly on schedule in at least 80% of the flights within in the scheduled time period keep their allocated slots on the basis of custom, the so called grandfather rights.

8. Most of the time slots in the peak hours at Keflavik Airport have been allocated to Icelandair on the basis of grandfather rights. Icelandair has a strong position on the market, with between 75 and 80% market share in scheduled flights to and from Keflavik Airport. Wow Air has pointed out that this arrangement for allocating slots hinders the undertaking in competing with Icelandair by building up flight routes and connecting flights between Europe and North America with Keflavik Airport as the hub of the connecting flights. The facts of the case were that it was necessary for Wow Air to have an allocation of slots in the peak hours, i.e. in the mornings (preferably between 7:00 and 8:00) and afternoon (preferably between 16:00 and 17:30). The findings of the ICA are that Icelandair has not only had a priority in the allocation of pre-existing time slots, but also a priority in the allocation of new slots in the peak hours, but the new slots were allocated in the summer of 2013 when the capacity of Keflavik Airport was increased and the number of gates increased. No consideration was given to competition when these new slots were allocated, but competition is nevertheless an important factor that should be considered when new slots are allocated.⁴ It is also important to bear in mind that Keflavik Airport is almost the only way through which passengers can travel to and from Iceland.

³ See for example a report for the EU commission, *Study to assess the effects of different slot allocation schemes*, Nera Consulting, January 2004, p. 43.

⁴ See for example, IATA, *Worldwide Slot Guidelines*, 5. ed. (August 2013, ch. 7.4.1): „Competition: Coordinators should try to ensure that due account is taken of competitive factors in the allocation of available slots.“

2.2 *The ICA issues an instruction concerning the allocation of slots*

9. In decision No. 25/2013, issued on November 1st 2013, the ICA came to the conclusion that Icelandair still had a very strong position in the market for scheduled flights to and from Iceland. The most important facts in this regard were a very high market share of the undertaking and a monopoly (100% market share) in some of the most important scheduled flight routes to and from the country. This applies especially to scheduled flight between Iceland and North America. The scheduled flight routes of Icelandair, which is based on connecting flights between Europe and the United States, gives Icelandair a strong advantage, because of transit passengers from connecting flights. The ICA has also found that time slots in certain hours of the day are especially important when building up such a system of scheduled flight routes, i.e. a so called hub and spoke system. This is important in order for the airline to be able to maximise the utilisation of its aircrafts, i.e. with two flights from Iceland per aircraft within the 24 hours. In addition to this there would be added number of transit passengers in connecting flights which would improve the efficiency of the operations. The ICA is of the opinion that it is an important prerequisite for competition in scheduled passenger flights to and from Iceland that other competitors that have Iceland as their base of operation be able to build up a system of scheduled flights between destinations in Europe and the United States with Keflavik Airport as a hub.

10. It was a known fact in the case that the capacity of Keflavik Airport to service aircraft would be increased in the summer of 2014 when a new gate would be opened. But the demand for time slots in the peak hours from both Icelandair and Wow Air exceeded the supply. The ICA came to the conclusion that the arrangement of the allocation of time slots in Keflavik Airport was detrimental to competition and not in accordance with the objective of the Competition Act. The ICA is of the opinion that the arrangement amounts to a barrier to the entry of new competitors into the market for scheduled flight to and from Iceland and is thereby harmful to the public.

11. There is a disclaimer clause in article 10 of regulation No. 1050/2008, where it is stated that the regulation does not affect the powers of public authorities to require the transfer of slots between air carriers and to direct how they are allocated pursuant to national competition law or to article 52 in the EEA Agreement or in regulations on the control of concentrations between undertakings. A materially identical clause can be found in article 8b in EEC Council Regulation No. 95/93. These clear disclaimers in article 10 of regulation No. 2050/2008 and article 8b in the EEC Council Regulation No. 95/93 show that the ICA, just as other competition authorities in the European Economic Area, can use its powers in cases related to the allocation of time slots.⁵

12. Whenever Isavia ohf. (hereafter Isavia), which operates and is responsible for Keflavik Airport, allocates slots, Isavia is a public entity in the sense of provision b paragraph 1 in article 16 of the Icelandic Competition Act. According to the provision the ICA may take measures against acts of public entities to the extent that they may have detrimental effects on competition, provided that no special legislation contains any specific provisions regarding authorisation or obligation for such acts. With authorisation in article 16 of the Competition Act the ICA therefore directed instructions to Isavia, which operates Keflavik Airport. This intervention meant that Wow Air should be allocated certain slots in the peak hours at the airport. It was considered unacceptable, from the viewpoint of competition, that the arrangement of the allocation of time slots in Keflavik Airport hindered a new competitor to build up a new hub and spoke

⁵ In a report by British aviation and competition authorities on the allocation of time slots it is stated that national competition authorities can have powers that the European Commission does not have. British authorities have powers according to the Enterprise Act 2002 that enables them to resort to binding intervention against circumstances on a market that distort competition. The allocation of time slots can be included. Office of Fair Trading & Civil Aviation Authority, Competition Issues associated with the trading of slots, June 2005, pp. 14 – 18.

system of scheduled flights and be able to compete with Icelandair on a lasting basis. It is important in this context that Icelandair has a dominant position on Keflavik Airport, as is the fact that the airport is the only notable international airport in Iceland.

13. The ICA therefore directed the following instructions to Isavia:

- When allocating airport slots for the summer of 2014 Isavia shall give priority to Wow Air, so that the airline can compete with Icelandair by flying from Keflavik to North America in the afternoon and connecting those flights with morning flights to destinations in Europe.
- The priority shall entail allocating at least two slots every day in the week in the morning between 7 a.m. and 8 a.m. to Wow Air for flights to Europe and two slots in the afternoon between 4 p.m. and 5:30 p.m. for flights to North America.
- Isavia shall prepare guidelines for the independent slot coordinator to adhere to where it clearly states that the coordinator shall ensure that due account is taken of competitive factors in the allocation of available slots. The guidelines should require that if there are two or more applications for the same time slot for a particular destination, priority should be given to the airline that has the lower market share according to the number of passengers.

2.3 The decision of the ICA repealed – but the competition assessment not repealed

14. Both Isavia and Icelandair appealed the decision of the ICA to the Icelandic Competition Appeals Committee. By the ruling of the Appeals Committee in cases No. 10/2013 and 11/2013 on February 28th 2013, the decision of the ICA was repealed. In the ruling, the Appeals Committee came to the conclusion that the slot allocation coordinator for Keflavik Airport, which is a Danish entity, has independent administrative powers according to Icelandic law. Therefore Isavia has no authority to intervene in the allocations of the coordinator of slots in Keflavik Airport. This was held to apply in spite of a contractual clause allowing Isavia to terminate the contract with the coordinator at any time and that the coordinator could not under any circumstances be subject to complaints or be fiscally or otherwise responsible for his services according to the contract. These facts had no relevance in the ruling of the Competition Appeals Committee.

15. No stance is taken towards the substantive competition issues in Keflavik Airport that were the grounds for the ICA's decision. Therefore the ICA's conclusion still stands, that the present arrangement of the allocation of slots has led to the priority of Icelandair, which is by far the biggest competitor on the market, of almost all the most important time slots at the airport. The arrangement therefore limits the possibilities of other airlines to compete with Icelandair and is thereby detrimental to competition in the important field of passenger flights to and from Iceland.

16. Before the Appeals Committee both Isavia and Icelandair maintained that it was not proven that time slots within these time limits were better than other time slots for the purposes of building up a hub and spoke system of scheduled flights to and from Iceland. The substantive results of the ICA were however not in any way refuted. The fact stands that all airlines that have tried to build up a hub and spoke system of scheduled flights to and from Iceland in the recent years, i.e. Icelandair, Wow Air and Iceland Express (which operated in the years 2003 – 2012), have applied for time slots mainly within these time limits. The Competition Appeals Committee did not take a stance towards these issues and Wow Air was not able to start scheduled flights to the United States in the summer of 2014, as the undertaking was not allocated the necessary time slots.

2.4 *The case was submitted to the courts*

17. Wow Air appealed the ruling of the Competition Appeals Committee to the District Court of Reykjavik on March 20th 2014. The District Court delivered its judgment on May 9th 2014 and stated that the appeal was incomplete and that it was unclear that the airline had valid interests in having the case concluded. Therefore the case was dismissed. Wow Air appealed this result of the District Court to the Supreme Court with an appeal on May 13th 2014. In the appeal, Wow Air asked that the result of the District Court be annulled and the Court ordered to deliver a substantive judgment in the case.

2.5 *Wow Air submits a new complaint to the ICA*

18. The ICA received a new complaint from Wow Air at the same time as Wow Air disputes the ruling of the Competition Appeals Committee before the Courts. The new complaint was sent to the ICA in April 2014. In the new complaint Wow Air complains again over the arrangement of the allocation of time slots at Keflavik Airport and contends that the arrangement hinders the airline in starting scheduled flights to the United States with Iceland as a hub. The complaint is based on the same arguments as the former complaint.

19. In light of the former ruling of the Competition Appeals Committee it is unclear how the case is to be handled. For this reason the ICA has directed the new case both towards Isavia and the Danish entity that serves as coordinator for Keflavik Airport, Airport Coordination Denmark. It is worth mentioning in this context that there are indications that Council Regulation (EEC) No 95/93 was not correctly adopted and implemented into Icelandic law. This means that it may be doubted whether the coordinator is as independent as stated in the regulation. This is a matter for the EFTA Surveillance Authority to resolve. The EFTA Surveillance Authority has started discussions about this with Icelandic aviation authorities.

3. Summary – lessons from the case

20. This case shows that the arrangement for allocating time slots can be of great consequence for competition in scheduled passenger flights and also for it to be possible for new entrants to enter the market. This applies especially to Iceland, but passenger flights to and from Iceland almost exclusively use one single airport, Keflavik Airport. The case sheds light on how the arrangement of slot allocation in scheduled flights can lead to the protection of a big competitor against a new and smaller competitor. The authorities have decided that Keflavik Airport is to be a coordinated airport (third level airport). This means e.g. that airlines which have been allocated slots and fly on schedule in at least 80% of the flights within the scheduled time period keep their allocated slots in the next period as well, on the basis of custom, the so called grandfather rights. Icelandair has a strong position at the airport with 75 – 80% share in scheduled flights to and from Iceland and a monopoly in some of the scheduled flight routes to and from the country. The investigation has uncovered that Icelandair not only had priority when pre-existing time slots were allocated, but also when new slots were allocated.

21. As early as 2008 the ICA advised the authorities and interested parties that the arrangement of the allocation of slots in Keflavik Airport was detrimental to competition. The ICA requested that the arrangement be reviewed, especially the categorisation of the airport as a coordinated airport. The request was not heeded. In the aforementioned decision No. 25/2013 the ICA requested again that the aviation authorities reviewed and amended the present regulation No. 1050/2008 on the allocation of slots and ensured that competition issues are to be considered when slots are allocated.

22. The case which has been shortly described here also shows how difficult it is for competition authorities to intervene in the allocation of slots. The EEC Regulation No. 95/93 and the similar Icelandic regulation No. 1050/2008 assume that competition authorities can intervene in the allocation of slots because of the detrimental effects to competition which the arrangement of slot coordination can have. In reality, however, competition authorities rarely intervene in the allocation of slots except as a part of an intervention in a merger case.