EU transportation

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This article covers recent developments in the maritime and air transport sectors. In relation to maritime transport, the main issues arising from the current review of Regulation 4056/86[1] are reviewed. In relation to air transport, predatory pricing is addressed in the context of the upsurge in low-cost airlines. Finally, state aid questions of specific relevance to airports are briefly touched upon.

Maritime transport—review of regulation 4056/86

Council Regulation 4056/86 contains a block exemption for liner conferences. In short, the block exemption allows the members of a liner conference to fix prices and regulate capacity. It is often referred to as the most generous exemption granted, and the European Commission (the Commission) has interpreted the scope of the exemption strictly.

Furthermore, Regulation 4056/86 is the implementing regulation for Articles 81 and 82 of the EC Treaty ('Articles 81 and 82') in relation to maritime transport. In other words, it lays down the detailed rules for the application of those articles to maritime transport, in respect of which Council Regulation 17/62 (now repealed) did not apply. However, cabotage and tramp vessel services were excluded from the scope of Regulation 4056/86 and as result were not covered by any implementing measures.[2] For the Commission, the effect of this lacuna was that it had very limited enforcement powers in those areas. The new and generally applicable implementing regulation for Articles 81 and 82 is Council Regulation 1/20003, which entered into force on 1 May 2004. With that, the implementing measures in Regulation 4056/86 as well as Regulation 17/62 were repealed. The exceptions for cabotage and tramp vessel services were, however, maintained unchanged in Regulation 1/2003.

In 2003 the Commission decided to initiate a review of Regulation 4056/86.[3] The purpose of the review is first and foremost to allow the Commission to determine whether, in the light of changes in market conditions, developments in other jurisdictions and at the level of the OECD, there still is a sufficient justification for upholding the far-reaching block exemption.

In its consultation paper[4] published in 2003, the Commission takes the preliminary view that "the justification for retaining the most controversial aspect of the Regulation, ie the liner conference block exemption, appears […] to be open to challenge. There is a need to examine further the impact of conferences on the marketplace and the alleged causal relationship between the exempted activities (eg price-fixing and supply regulation) and the supposed benefits for transport users (stability of prices and the provision of reliable, adequate and efficient scheduled liner shipping services). It should also be examined whether these benefits could be, or perhaps are already being, achieved through less restrictive forms of cooperation (eg consortia, vessel-sharing agreements, slot-charters)."

After having completed the first stage of the review in June this year, DG Comp published a paper that sets out its preliminary conclusions.[5] It concluded that "the conditions for an exemption [of liner conferences' price fixing and capacity regulation] would appear to be no longer fulfilled. There is no conclusive economic evidence that the assumptions on which the block exemption was justified at the time of its adoption in 1986 are, in the present market circumstances and on the basis of the four cumulative conditions of Article 81(3) of the Treaty, still justified." Accordingly, DG Comp is currently poised to recommend abolishing the block exemption or at least amending the block exemption so that it covers only less restrictive forms of cooperation.

The second important question that the Commission has raised as part of its review is whether the exclusion of cabotage and tramp vessel services from the scope of Regulation 1/2003 should be upheld. In the consultation paper, the Commission suggested that there was no justification for the exceptions and that they should be repealed. DG Comp's conclusions after the first stage of the consultation confirm that position.[6]

DG Comp's suggestion to include cabotage and tramp services within the scope of Regulation 1/2003 at first appeared to raise only limited questions. The relevant part of the Commission's consultation paper is remarkably short as are the replies received from the industry. The Commission sees no justification for maintaining the exceptions, whereas the industry, as well as some Member States, sees no need for change.

Following the first round of formal consultations, however, the 'tramp vessel sector', including, for example, dry bulk, and tanker operators, initiated more detailed discussions with the Commission. The purposes of those discussions are, from the industry's point view, to explain to the Commission first of all how the different affected markets function and, secondly, the challenges that carriers in those markets are faced with. Third, the industry is likely to wish to address the assessment under Article 81 of some of the prevailing forms of cooperation. As there is no case law regarding the application of Article 81 to the sectors in question or to the special forms of cooperation engaged in, carriers will be looking to the Commission for guidance.

White paper

The Commission is planning to publish a white paper before the end of term of the Prodi Commission that will set out the conclusions and recommendations from the review and contain specific proposals for Community action.

More specific details of what the white paper will cover are not yet available. It may reasonably be expected that the white paper will explain what changes (including withdrawal) to the liner conference block exemption the Commission considers necessary, and whether tramp vessel and cabotage services should be included within the scope of Regulation 1/2003.

On the other hand, based on information available at the time

of writing, it appears less likely that the white paper will outline what forms of cooperation between shipping lines (acceptable under Article 81) could replace the conference system. Early on, the Commission made it clear that it did not see it as its responsibility to come up with possible alternatives to conferences and thus clearly placed the onus on carriers to do so. Only in August this year did the European Liners Affairs Association submit a proposal to the Commission for a new regulatory structure replacing the conference system. In short, the proposition is to allow the industry to set up discussion bodies through which aggregated, historical data can be exchanged in order to achieve stability of supply. The Commission published the paper on its website in September, stressing that it is not the result of any negotiation or agreement with the Commission and that the proposed cooperation framework will have to be carefully scrutinised as to its compatibility of the EC competition rules, taking into account the impact on the overall liner shipping industry, including on the interests of independent operators, customers and final consumers. The Commission therefore will invite interested third parties to submit their comments on the proposal in the context of the white paper.

Similarly, it seems unlikely, based on information available at this stage, that the white paper will outline what guidance, if any, tramp carriers may expect to receive on the application of Article 81 to the main forms of cooperation (assuming those sectors are brought under Regulation 1/2003). The difficulty that the Commission seems to face in this regard is that it has very limited experience, for example in the dry bulk or tanker sectors in general, and in dealing with pools and other important forms of cooperation in particular. The Commission is therefore unlikely to issue a block exemption. It might issue general guidelines or, taking into account its limited experience, case-by-case informal guidance letters. The problem with such guidance letters (or indeed general guidelines) is, of course, that they are not Commission decisions and do not bind Member States' competition authorities or courts, which have the power to apply Articles 81 and 82.

Joint sales

A potential question that would seem likely to be raised in the above context of new legislation or guidance, is how joint sales within liner consortia or tramp pools should be dealt with under Article 81(3), particularly if the conference block exemption is abolished.

Liner consortia

It has been suggested, during the Commission's consultation with the industry, that a withdrawal of the liner conference block exemption could be accompanied by a broadening of the scope of the liner consortia block exemption to cover more restrictive forms of cooperation.[8]

One of the obvious areas in which to broaden the scope for cooperation in consortia is the prohibition on 'price fixing' currently contained in the liner consortia block exemption. In practice, the prohibition is understood to cover not only price fixing as that engaged in by conferences, but in particular common pricing resulting from joint sales by the participants in a consortium.

The exclusion of joint sales from the list of exempted activities under the liner consortia block exemption appears largely to be linked to the liner conference block exemption. As consortia are currently allowed to operate within conferences, external price competition is limited. Allowing consortia to engage in joint sales would in addition have eliminated internal competition on prices, and would have further restricted external price competition. Withdrawing the exemption for conferences would therefore seem to open the door to a consortia exemption covering joint sales as well.

The main argument for broadening the consortia exemption lies in the role that joint sales could play in achieving efficiencies. While consortia clearly can operate without joint sales and still achieve substantial efficiencies (as demonstrated by the current block exemption), it is conceivable that additional efficiencies could be achieved by allowing joint sales. In particular, it would appear that the increased degree of integration that is achieved by combining capacity and net revenue pooling (both are currently exempted) with joint sales would facilitate more flexible and long-term contracts. Such contracts would help the carriers and shippers overcome market fluctuations and pave the way for more efficient long-term planning.

The consortia block exemption expires on 25 April 2005. The Commission recently published a paper in which it consults the industry and Member States on possible options for the future regime of consortia. In view of the close relationship between the consortia and conference block exemptions, the Commission is suggesting a renewal of the consortia block exemption, with only minor modifications. Possible further amendments would be addressed once the review of Regulation 4056/86 is completed. It would then seem appropriate to reconsider the prohibition against joint sales.

Tramp pools

An important form of cooperation between carriers in the tramp markets is capacity and revenue pooling, ie a form of cooperation very similar to liner consortia. The principal aims of a pool are to achieve stabilisation of revenues and optimisation of services through more efficient use of capacity.

Generally, and notably in the dry bulk and tanker markets, a pool manager is given exclusive authority to fix the pool vessels under individual contracts and to negotiate the freight rates. In other words, the pools rely on joint sales and internal competition on prices is eliminated.

Drawing a parallel with liner consortia, the question arises whether pools can benefit from an Article 81(3) exemption as long as they include joint sales.

It can be assumed that pooling of capacity and revenue in these markets, just as in the liner markets, is beneficial, provided that the pools face effective competition and do not give rise to either spillover or network effects or illegal information-sharing between competitors.

Indeed, very much like the liner carriers, the majority of carriers providing tramp vessel services face large investment costs, high fixed costs, strong fluctuations in income driven by constant over- or under-supply of capacity, and demand driven by developments in the global economy. Furthermore, the tramp markets are just as (if not more) highly fragmented as the liner markets. Tramp pools claiming the benefit of Article 81(3) would therefore be able to rely on arguments very similar to those relied on by liner consortia. These include the creation of stability in income and rationalisation of capacity through pooling.

The argument in favour of engaging in joint marketing and sales is even more cogent for tramp pools. Rather than individual slots or parcels, entire vessels are generally committed to individual customers and services are performed ad hoc rather than on the basis of a schedule. In such circumstances it would give rise to substantial difficulties to pool capacity and revenues without also engaging in joint sales. If dependent on the individual pool members concluding a contract, the pool manager would be unable to efficiently allocate capacity. In other words, joint sales are necessary to achieve the benefits of capacity and revenue pooling in these markets.

Air transport

Recent developments

The dynamics of competition in the European airlines market are changing. The upsurge in low-cost airlines has put the flag carriers

under obvious pressure to cut costs and lower fares. The EJC's *Single Skies* judgment puts an end to the bilateral aviation agreements, which may help pave the way for the consolidation that started with the merger between Air France and KLM. The Commission approved the *Air France/KLM* merger with the announcement that "consolidation is welcome". Bankers and other industry experts also regularly speculate that many incumbents are not fit to survive in the medium to long term.

In addition, state aid cases have popped up en masse in the context of restructuring efforts (Olympic Airways and Alitalia) and regional airports competing for business (such as in the case of Ryanair and Brussels South Charleroi Airport).

On the antitrust side, the focus is on issues such as discrimination, predation and abusive rebates.

Predatory pricing

There is very little European case law on predatory pricing in the air transport markets. Two recent national cases include the German Federal Cartel Office's (FCO) ruling against Lufthansa and the Norwegian Competition Authority's (NCA) investigation of SAS and SAS Braathens. Reportedly, the Danish competition authority has also investigated SAS, but has found no infringement.

The FCO's decision is particularly remarkable. In 2002 the FCO found that Lufthansa had abused its dominant position on the route between Berlin and Frankfurt by engaging in predatory pricing as a reaction to the entry of low cost airline Germania. Lufthansa had lowered its fare from €485 round trip to €105 one way in response to Germania's €99 one-way fare. The FCO took the view that in spite of the price difference, Lufthansa had in fact undercut Germania, because Lufthansa provided a higher quality of services, which were attributed a value of €35. Furthermore, in order to demonstrate that Lufthansa was pricing below costs, the FCO took account of foregone revenues as one of the components of average total costs.

The approach adopted by the FCO is difficult to reconcile with the ECJ's case law. Rather than relying on a strict cost-based test, the FCO attempts to valorise quality of services. Furthermore, by including foregone revenues, the cost determination becomes inherently speculative.

Predation by incumbents

Judging by case law, proving predatory pricing by incumbents is difficult. The cost analysis is in most cases performed against data relating to particular routes, rather than individual flights or at least on particular flights rather than on individual seats. In most cases, incumbents engaging in (limited) price wars will, as a result of critical scale, not be operating the route or even individual flights at a loss. A new entrant or a competitor that cannot keep up due to less efficient operations or shallower pockets cannot therefore rely on rules of presumption.

Although case law is reasonably clear as to when predation occurs and although, from a policy perspective, less efficient players should not be over-protected, questions remain from a legal as well as a policy perspective as to the requirements for proving predation in airline markets. Some of these questions are outlined below.

In view of the difficulties in proving predation by incumbents, would it for example be more appropriate to look at fare classes instead of entire routes or individual flights? This would to some extent eliminate the scope for incumbents to 'cross-subsidise' low fares with revenues from higher-priced tickets, although it would raise complex market definition issues and might undermine the finding of dominance.

Would it amount to (immediate) recoupment (one of the elements in proving predation) to eliminate losses on low fares (sold at prices below average total costs) with revenues from higher fares? To answer that question, it is necessary to take account of the incumbent's ability to add capacity by redeploying aircraft to the route in question. And where aircraft are redeployed, should the cost of aircraft ownership be included in the calculation, and in what proportion? Predation claims are easier to substantiate if significant capacity increases are involved, but the answers to the above questions are not obvious.

Should foregone sales on the same or other routes be included in the cost-calculation? The answer to the latter is submitted clearly to be 'no' as this is too speculative a test requiring calculation of hypothetical future revenues.

State aid and airports

In the present section, the aspects of two recent and high-profile state aid cases are briefly considered in the context of competition between airports.

Altmark Trans

Under the ECJ's *Altmark Trans* judgment[9], state compensation offsetting the cost associated with public service obligations does not involve state aid. Prior to that judgment, compensation for public service obligations had to be approved by the Commission.

For the *Altmark* principle to apply, it is, amongst others, a condition that the compensation is granted in return for clearly defined public service obligations and that it is calculated on the basis of parameters established beforehand in an objective and transparent manner. In addition, the compensation must not exceed what is necessary to cover the net costs incurred in discharging the public service obligations, taking into account a reasonable profit.

As a result, it has become more critical than ever for companies with public service obligations to correctly allocate costs. State-owned airports may need to review their compensation schemes.

Ryanair

The overall question raised in the *Ryanair* case[10] was whether Ryanair had received illegal state aid under an agreement concluded with Brussels South Charleroi Airport, when it established a new hub. Other questions of principle also surfaced in the Commission's decision, some of which may have important consequences for future case law. One of those questions related chiefly to overcompensation of the airport management company (BSCA) for public service obligations imposed and BSCA's proper separation of public service and commercial activities.

The Commission found it highly unclear what the extent of BSCA's public service obligations was and how the compensation for discharging those obligations had been calculated. There was therefore a risk of overcompensation, which led to a risk of cross-subsidisation. Furthermore, it appeared that BSCA, without payment, had access for commercial purposes to infrastructure financed by the Walloon Region.

The Commission commented on the points in the context of the application of the private-investor test. The Commission argued that, as a result of overcompensation and apparent cross-subsidisation, BSCA would not have faced all the risks that define the activity of an entrepreneur. It was therefore questionable whether the private investor principle could be applied to the situation at hand.

It is not immediately apparent why cross-subsidisation would affect the applicability of the private investor test. If the analysis of BSCA's investment decision showed that it was supported by reasonable expectations of profitability, the test would appear to be satisfied, regardless of the fact that the investor (BSCA) had relied on income illegally allocated to its commercial activities. The true problem in relation to cross-subsidisation is rather whether BSCA (not Ryanair) had received illegal state aid, which distorted competition

between airports. The Commission did not address this and in fact, quite remarkably, did not address the impact on competition between airports at all.

Notes

1 Council Regulation 4056/86 of 22 December 1986, laying down detailed rules for the application of Articles 81 and 82 of the Treaty to maritime transport.

2 Cabotage, in this sense, means maritime transport between the ports of the same Member State. Tramp vessel services are defined as "the transport of goods in bulk or in breakbulk in a vessel chartered wholly or partly to one or more shippers on the basis of a voyage or time charter or any other form of contract for non-regularly scheduled or non-advertised sailings, where the freight rates are freely negotiated case by case in accordance with the conditions of supply and demand". It is uncertain exactly which sectors of maritime transport can be said to provide tramp vessel services based on the definition in Regulation 4056/86, which has been retained in Regulation 1/2003, but the following broad groups may possibly fall within that category: dry bulk (eg grain, iron ore, coal), oil tankers, chemical tankers and gas tankers.

3 For further details, see *The European Antitrust Review 2004* 'Competition in the EC Transport sector' pp 64-67.

4 Consultation paper on the review of Council regulation 4056/86, available at http://www.europa.eu.int/comm/competition/antitrust/legislation/maritime/en.pdf

5 Discussion paper on the review of Regulation 4056/86—available at http://www.europa.eu.int/comm/competition/antitrust/others/maritime/review_4056.pdf

6 See footnote 5.

7 See footnote 5.

8 Commission Regulation 823/2000 of 19 April 2000 on the application of Article 81(3) of the Treaty to certain categories of agreements, decisions and concerted practices between liner shipping companies (consortia).

9 Case C-280/00, judgment of the European Court of Justice of 24 July 2003.

10 2004/393/EC: Commission Decision of 12 February 2004 concerning advantages granted by the Walloon Region and Brussels South Charleroi Airport to the airline Ryanair in connection with its establishment at Charleroi.

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Arnold & Porter opened its Brussels office in August 2003 and it has since expanded to a team of 10 competition/antitrust lawyers. Most recently, Luc Gyselen, a senior official with the Directorate-General for Competition (DG Comp) at the European Commission, joined the office as a partner. Heading the European competition practice from Brussels is EU competition expert Marleen Van Kerckhove. Ms Van Kerckhove and Mr Gyselen are joined by partner Susan Hinchliffe, who is permanently based in Brussels, and Tim Frazer, head of the UK competition practice, who divides his time equally between Brussels and London. The team collaborates with the head of Arnold & Porter's global antitrust practice, William Baer, who is based in Arnold & Porter's DC office but also spends a significant portion of his time in Brussels.