[*PG71]THE "DOMINANT POSITION" DOCTRINE AND THE EUROPEAN UNION'S RESPONSE TO THE BRITISH AIRWAYS/AMERICAN AIRLINES ALLIANCE

Introduction

Companies are increasingly adopting global strategies as a means of marketing their products and services.1 One such global strategy that has recently gained momentum in the airline industry is the "strategic alliance."2 In 1998 alone, the number of alliances between both national and international carriers rose by 38%, to a total of 502.3 Previously there were only a few limited alliances and the impact on competition was correspondingly limited.4 Recently, however, tightly knit alliances have become the rule rather than the exception and a very large share of the North Atlantic air travel market "is being or will be served by alliances."5 The dominant feature of these alliances is code-sharing—the use of an airline's two-letter designator on a partner's flight, producing the equivalent of an online connection and, as a result, a more favorable Computer Reservation System (CRS) display.6 Airline alliances, however, are often very similar to mergers in that the companies involved operate on the market like one entity, eliminating all competition between them.7 Accordingly, these airline alliances raise important competition issues and gain the attention of antitrust authorities.8

[*PG72] Internationally, the most noteworthy airline alliance is between British Airways (BA) and American Airlines (AA), which was first proposed in 1996.9 Since then, European Union (EU) competition authorities have been looking into the BA/AA alliance and several other notable international airline alliances.10 In July of 1998, the EU competition authorities announced a preliminary position on the BA/AA alliance.11 As the trend towards international airline alliances is a relatively recent development in the airline industry, the July opinion was the first time the EU competition authorities ruled on this issue.12

The purpose of this Note is to analyze the competition issues raised by the BA/AA alliance and the response of the EU competition authorities to those issues. This analysis is done within the context of the relevant EU competition laws—specifically, the "dominant position" doctrine. Part I provides a general background on the relevant EU competition authorities and the relevant law as delineated in treaty provisions, regulations, and case law. Part II discusses the background of the BA/AA alliance and the competition issues raised by the alliance within the context of the competition law discussed in Part I. This section concludes by summarizing the proposed conditions for approval of the alliance. Part III analyzes the competition issues raised by the BA/AA alliance and critiques the conditions for approval delineated by the EU competition authorities. Finally, this Note concludes that the EU needs to expand its ability to regulate air travel between EU Member states and non-Member States.

[*PG73]I. Overview of EU Competition Authorities and Summary of Relevant Competition Law

A. *Overview of Enforcement/Regulatory Authorities and their Role in EU Competition Law*

The primary institutions that set and enforce the EU competition policies are as follows: the Council of Ministers (Council), the Commission of the European Communities (Commission), the Court of First Instance (CFI), and the European Court of Justice (ECJ).13 The Council is the EU's legislative body and can enact subordinate legislation on proposal from the Commission.14 Essentially, it is the EU's main decision-making body.15 The Commission is the executive arm of the EU and is composed of 20 members.16 Each Commission member is responsible for one or more specific policy areas.17 Members are served by a secretariat, divided into Directorates General (DGs).18 DG IV is the Directorate General for competition.19 The Commission enforces the EU competition rules.20 The Commission's enforcement decisions can be appealed to the EU courts.21

The CFI is usually the first court to hear competition-related cases and its decisions can be appealed to the ECJ.22 The purpose of the ECJ is to ensure that the law, as delineated in treaties as well as [*PG74]legal acts and decisions of the Council and the Commission, is observed and applied in a uniform manner.23 The ECJ has the final say in interpreting matters of EU law.24

B. *Overview of Relevant Treaty Provisions and Regulations*

The Treaty Establishing the European Community (EC Treaty) delineates the overall framework for EU competition policy.25 For purposes of this Note, the most relevant competition provisions of the EC Treaty are: Article 2, Article 3(1)(g), and Articles 81–85.26 In addition, Regulation 3975/87 grants the Commission its ordinary investigative powers in the air transport industry.27

Article 2 outlines several tasks of the EU.28 The task most related to preserving competition is the task of promoting "throughout the [*PG75]Community a harmonious, balanced and sustainable development of economic activities."29 Article 3(1) lists 21 activities of the Community which shall be carried out for the purpose of achieving the aims set out in Article 2.30 Article 3(1)(g), which includes the establishment of "a system ensuring that competition in the internal market is not distorted," embodies the most relevant activity for competition policy.31

Articles 81 and 82 of the EC Treaty outline the primary framework for the regulation of competition in the EU.32 Article 81 generally prohibits actions by undertakings33 "which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market;" it then lists several actions in particular.34 Article 82 outlines the dominant position doctrine.35 It prohibits any abuse of a dominant position within the EU by any undertaking occupying a dominant position to the extent that the abuse "may affect trade between Member States."36 Under Article 82, four activities in particular [*PG76]constitute an abuse of a dominant position.37 Briefly stated, these activities include price discrimination, production or technical development limitations, application of "dissimilar conditions to equivalent transactions," and tying arrangements.38

This list of abusive practices, however, is not meant as an "exhaustive" or exclusive list of conduct that may constitute an abuse of a dominant position.39 The ECJ has stated that no exemption can be granted for abuse of a dominant position under Article 82 and that the prohibition outlined in Article 82 is "fully applicable to the whole of the air transport sector"—that is, flights between Member as well as non-Member States.40 The prohibitions in Articles 81 and 82 should be interpreted and applied in light of the goals of Articles 2 and 3(1)(g) of the EC Treaty discussed above.41 Articles 81 and 82 are not to be viewed in a mutually exclusive, or "contradictory" sense, as they are both intended to achieve the same goal.42 With respect to both Articles 81 and 82, EU authorities have jurisdiction over the activities [*PG77]of firms as long as the conduct of these firms occurs in or will have an effect on the EU.43

Article 83 of the EC Treaty empowers the Council, on proposal from the Commission, to "adopt any appropriate regulations or directives44 to give effect to the principles set out in Articles 81 and 82."45 Article 84 of the EC Treaty enables Member States to rule on the admissibility of competition practices with respect to Articles 81 and 82 of the EC Treaty.46 Article 85 of the EC Treaty empowers the Commission to "ensure the application of the principles laid down in Articles 81 and 82."47

Investigation of international airline alliances must be done under Article 85 of the EC Treaty because Regulation 3975/87, which gives the Commission its ordinary investigative powers in the air transport industry, is not applicable to flights between EU Member States and non-Member States.48 Regulation 3975/87 grants the Commission the power to apply Articles 81 and 82 of the EC Treaty to intra-community routes only.49 Therefore, with respect to international airline alliances, the Commission must take action against practices it feels may be restrictive on routes between the EU and non-Member States only under Article 85 of the EC Treaty.50 Article 85 allows the Commission to "introduce monitoring provisions in the ab[*PG78]sence of any specific implementing regulation."51 While the recent wave of international airline alliances prompted the Commission to adopt a May 1997 memorandum containing a proposal for the extension of the scope of Regulation 3975/87 to include routes between EU airports and airports in non-Member States, to date that extension has not been made.52 Accordingly, international airline alliances, such as the one between BA and AA, continue to be monitored only under Article 85 of the EC Treaty.53

C. *ECJ Case Law on Article 82—Determination of Existence of a Dominant Position and When an Abuse Occurs*

To fully understand the idea of a dominant position and its abuse, as discussed in Article 82 of the EC Treaty, the idea of a dominant position and its abuse must be viewed in the context of its application and definition in ECJ case law. Therefore, the discussion that follows will provide a case law context in which to understand the application of Article 82 with respect to the case law development of the following three issues: 1) What constitutes a dominant position?; 2) What factors are relevant in assessing the existence of a dominant position?; and 3) What type of conduct will be

deemed an abuse of a dominant position?

1. What Constitutes a Dominant Position?

The ECJ has determined that the “dominant position” referred to in Article 82 describes “a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition [from] being maintained on the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers.”54 The primary feature of a dominant position is an undertaking’s ability to take actions without having to consider its competitors’ undertakings in the market with respect to its market strategy and without “suffering any [*PG79]detrimental effects from such [independent] behavior.”55 A dominant position does not mean that an undertaking deemed to be in a dominant position has no competitors; it simply means that an undertaking is in a position to have an “appreciable influence on the conditions” under which conduct in the relevant market will develop and to act largely in disregard of its competition “so long as such conduct does not operate to its detriment.”56 It is not illegal for an undertaking to have a dominant position; however, where a firm is found to be in a dominant position it “has a special responsibility not to allow its conduct to impair genuine undistorted competition on the Common Market.”57

2. What Factors Are Relevant in Assessing the Existence of a Dominant Position?

According to the ECJ, there are two primary factors involved in assessing the existence of a dominant position.58 The first factor is a determination of the relevant market and the competitive conditions of supply and demand and interchangeability of products in that market.59 This determination allows for, and must include, an analysis of the totality and interchangeability of products in the relevant market.60 The second factor is the relationship between the market shares of undertakings in the relevant market.61 This factor allows for a determination of a particular undertaking’s competitive strength both in general and with respect to its next largest competitor.62

Many of the ECJ decisions involving Article 82 demonstrate that the ECJ places a tremendous amount of importance on the existence of a large market share held by one main undertaking in relation to [*PG80]its competitors.63 In *Hoffman-La Roche,* where the ECJ considered the issue of whether a vitamin manufacturer had a dominant position in seven relevant vitamin markets, the ECJ stated that “although the importance of market shares may vary from one market to another, the view may legitimately be taken that very large shares are in themselves, and save in exceptional circumstances, evidence of the existence of a dominant position.”64 In *United Brands,* where the ECJ considered whether a large, international banana import/export company (UBC) occupied a dominant position in a specific banana market, the ECJ stated that an undertaking in the relevant market “can only be in a dominant position on the market for a product if [it] has succeeded in winning a large part of this market.”65 The ECJ then illustrated the importance of an undertaking’s market share in relation to its next largest competitor in determining the existence of a dominant position.66 Finally, in *Michelin,* where the ECJ considered whether Mich[*PG81]elin NV occupied a dominant position on the Dutch market for new, heavy vehicle replacement tires, the ECJ stated that the Commission correctly considered Michelin NV’s market share of 57 to 65% in comparison to the market share of its next largest competitor of 4 to 8% in determining that it had a dominant position in the market for new, heavy vehicle replacement tires.67

The ECJ has already applied the two-factor test illustrated above to the airline industry.68 The first part of the test determining the relevant market and the interchangeability of products on the market in the airline industry involves a determination of whether a “scheduled flight on a particular route can be distinguished from the possible alternatives” because of its specific characteristics which make it “not interchangeable with those alternatives” and cause it only to be minimally affected by competition from them.69 Furthermore, within the context of the first part of the test, the determination of an airline’s market power on a specific route will depend on both its “economic strength” and on the “competitive position of other carriers operating on the same route or on a route capable of serving as a substitute.”70

3. What Type of Conduct Will Be Deemed an Abuse of a Dominant Position?

In analyzing whether a dominant undertaking has engaged in the abuse of its dominant position, the necessary determination is whether the dominant undertaking has used its position in a manner that allowed it to obtain competitive advantages or benefits that it could not have obtained through “normal and sufficiently effective competition.”71 In general, abusive behavior may be found where a firm in a dominant position strengthens that position to an extent that “substantially obstructs” the competitive ability of competitor undertakings in the relevant market.72

Within this context, where an un[*PG82]dertaking occupies a dominant position, and where that dominant position has already weakened the competitive structure of the relevant market, any additional weakening of the competitive structure on that market may constitute an abuse of a dominant position.73 Specific abuses that are illustrated in ECJ case law include: tying purchasers to an exclusive distributor,74 predatory pricing,75 discriminatory prices,76 restrictive contract clauses enforced by a dominant competitor,77 and conditional discounts.78

II. The BA/AA Alliance, the Competition Issues Raised by the Alliance, and the Commission's Recent Reaction to those Issues

A. *Background on Framework of BA/AA Alliance and General Competition Issues Raised*

On June 11, 1996, BA and AA concluded an agreement to establish a worldwide airline alliance.79 This alliance would combine two of the world's most powerful airlines.80 The alliance involves a coordination of BA and AA's passenger and cargo services between the U.S. [*PG83]and Europe, schedule meshing, the establishment of fully reciprocal frequent-flier programs, and code-shares across each other's global networks.81 The code-shares enable flights of each airline to carry the designator codes of both carriers regardless of who is operating the flight.82 The code-sharing combined with the schedule meshing is designed to provide consumers with a type of one-stop shopping between both airlines.83

This coordination would include BA's 244 flights a week from the U.K. to 22 gateways in the U.S., and AA's 238 flights a week from 7 U.S. gateways to 12 European destinations.84 Under the planned alliance, BA and AA would remain independent and no exchange of equity or cross-ownership is planned.85 However, BA and AA do expect to share profits from their transatlantic services.86 Within this context, the BA/AA alliance, like other international airline alliances, can be viewed as very similar to a merger in that the companies involved operate on the market like one entity, eliminating all competition between them.87 In fact, the extensive form of code-sharing in the BA/AA alliance where seats and revenues are pooled can be viewed as "a merger in all but name," as computer terminals are blind as to which airline's flight a passenger chooses.88 Thus, as the BA/AA alliance effectively eliminates competition between two large international airlines and essentially has the effect of a merger, it has raised competition concerns that the Commission feels must be addressed.89 That is, where airlines decide to act as one entity, in principle they create barriers to entry that may preclude competitors from entering markets served by an alliance.90

B. *Primary Competition Issue—Tremendous Market Power of the BA/AA Alliance*

Perhaps the reason that the BA/AA alliance draws the most attention of all the international airline alliances is the seemingly over[*PG84]whelming market power the alliance affords the combined airlines.91 At the time of the proposed alliance in 1996, BA already provided 39% of the seats available in London's Heathrow Airport market.92 Overall, the alliance would give the two airlines more than 60% of the overall traffic between the U.S. and the U.K.93 and control over as much as 64% of the total seats between Heathrow and the U.S.94 With respect to the highly lucrative Heathrow-New York JFK Airport route, the alliance would give the combined airlines a 70% share of that market.95 According to BA/AA officials, the combined slot holdings of BA/AA at Heathrow will equal about 40% of available slots.96 Overall, the alliance is said to give the two airlines 25% of the entire North Atlantic market.97

Perhaps most important for a determination of whether the BA/AA alliance creates a dominant position are the figures showing a comparison of the overall size of the BA/AA alliance in terms of market share in 1996 as compared to the other large international alliances at that time.98 The BA/AA alliance was reported to be 50% larger than the Delta alliance, four times larger than the Northwest/KLM alliance, and more than twice as large as the United/Lufthansa alliance.99 Such overwhelming market power in comparison to its competitors certainly allows for the presumption that the BA/AA alliance would be in a dominant position on the transatlantic market, in particular the U.S./U.K. market.100 Moreover, the alliance gives BA the ability to extend its network in the U.S. and gives AA the benefit of feeder services operated by BA.101 Within that context, the alliance essentially gives each airline the ability to accomplish something it could not accomplish without the other; this ability [*PG85]may distort normal competition, and therefore, the alliance can be viewed as constituting an abuse of a dominant position.102

C. *Commission's Response to the Competition Issues Raised by the BA/AA Alliance*

In light of the obvious competition issues raised by the BA/AA alliance, the Commission quickly decided to initiate

proceedings under Article 85 of the EC Treaty to investigate the alliance to the extent that it related to air transport services between the U.S. and Europe.103 On July 8, 1998, after a two-year investigation, the Commission issued its preliminary opinion on the BA/AA alliance.104 The Commission found that the current proposed agreement for establishing the BA/AA alliance "in its entirety infringes on Article [81]," and also may violate Article 82 with respect to certain hub-to-hub routes "if implemented without the measures envisaged by the Commission."105 The Commission was particularly concerned that the BA/AA alliance would reinforce BA/AA's dominant position on three specific hub-to-hub routes—London-Dallas, London-Miami, and London-Chicago; as such, it felt that the alliance would raise significant barriers to entry on those routes.106

As a result of its concerns over the impact of the alliance on competition, the Commission proposed several conditions necessary for its approval of the alliance.107 The primary conditions with respect to the alliance's potential damaging effects on competition focus on a reduction of the frequency of flights on major routes and a surrender of a certain number of slots.108 Specifically, the number of flights of the combined carriers on hub-to-hub routes must be reduced where: 1) total annual traffic is greater than or equal to 120,000 passengers; [*PG86]and 2) BA/AA currently operates more than 12 flights per week.109 Further, BA/AA will be required to reduce its combined number of weekly flights if requested to do so by a competitor airline within six months after the Commission's authorization of the alliance.110 Moreover, the total number of slots required to be released without compensation is 267 and, where necessary, BA/AA will be required to give up any airport facilities necessary for the use of relinquished slots.111 The EU's Competition Minister in 1998, Karel Van Miert, reportedly stated that any London Heathrow slots given up must be for transatlantic service and at desirable times.112 Further, where a competitor airline wants to launch or expand an existing service and is unable to obtain the necessary slots in accordance with the procedure delineated in the EC slot regulations, BA/AA will be required to make available the necessary slots in London.113

III. Analysis of EU Issues Raised by BA/AA Alliance and Critique of Commission Opinion and EU Competition Policy

A. *Analysis of Competition Issues Raised by Large International Airline Alliances Such as BA/AA*

In the airline industry the evidence is not conclusive that "bigger is better."114 Size may in fact merely bring with it the ability to "crush smaller airlines and jack up prices."115 These statements are not so far-fetched when one considers what a large alliance such as BA/AA really means; it means that two large airlines that once competed with one another would instead cooperate to achieve the same goal—an increase in both of their revenues.116 While airlines claim that alliances sometimes intensify competition, considering that the main [*PG87]point of an alliance is a joint approach to the market, damaging price competition would not make much sense.117 In fact, airline alliances result in fewer remaining competitors with less overlap and thus less inclination to compete on prices.118 In contrast, multiple carriers, each with different strengths and weaknesses and a variety of structures, would likely lead to instability and in turn produce fare competition.119 As a result of the large airline alliances, competition has already diminished on some routes to gateway European cities dominated by alliances.120 AA eliminated its Miami-Frankfurt flights in the face of the United/Lufthansa alliance, leaving only a single daily flight operated by Lufthansa with a United code-share.121 AA also pulled out of its New York-Zurich route in the face of the Delta/Swissair alliance.122 As a result, according to a Scandinavian company, Volvo Aero, business-class tickets on the Miami-Frankfurt and New York-Zurich routes have risen by 18% compared with an international average of 13%.123

Such general factors and evidence do not bode well for airlines that would have to compete with an alliance as powerful in the market for traffic between the U.S. and the U.K. as the BA/AA alliance would prove to be.124 The BA/AA alliance would have control of: 60% of overall traffic between the U.S. and the U.K.;125 64% of seats between London's Heathrow Airport and the U.S.;126 and control of 70% of the highly lucrative Heathrow-New York JFK Airport route.127 Thus, it is not surprising that the proposed BA/AA alliance has been criticized by both British and American competitor airlines in the transatlantic market.128 The chairman of Virgin Atlantic Airways said that an approval of the BA/AA alliance with complete immunity from competition laws would amount to the establishment of a "legalized cartel."129

Similarly, the president and CEO of Continental Airlines was quoted as stating that, "[t]he two largest transatlantic carriers should [*PG88]not be allowed to combine their operations without requiring a substantial divestiture of assets to assure genuine competition."130 While the chairman and CEO of AA contends that the BA/AA alliance's shares in key markets will be much lower than shares in other markets held by similar airline alliances, the "other markets" may

not be comparable.131 The airlines where other alliances have large shares involve smaller European countries with a limited level of service, whereas the market where BA/AA would have a tremendous market share—the New York-London route—would be the largest international city-pair with restricted entry.132

B. *Critique of Commission Opinion and EU Competition Policy*

In light of the potential effect on competition on the transatlantic market posed by the BA/AA alliance, the Commission could not allow the BA/AA alliance to go through without issuing its opinion on necessary conditions for approval of the alliance.133 Questions remain within the industry, however, as to whether the Commission's opinion goes far enough.134 Virgin Atlantic's Chairman is quoted as saying that the Commission's recommendations "don't go nearly far enough" and that the number of slots to be given up is "woefully inadequate."135 A Delta senior vice president felt that the BA/AA alliance would still have the ability to "dwarf their competition" at Heathrow airport.136 Nevertheless, there is general agreement that the surrender of slots by the BA/AA alliance is necessary137 and that is in fact one of [*PG89]the primary focuses of the Commission's opinion.138 Moreover, the competitor airlines complaining that the number of slots BA/AA must give up is inadequate seem to overlook the fact that the proposed conditions allow for the relinquishment of additional slots in London if a competitor airline wants to launch or expand an existing service and is unable to obtain the necessary slots in accordance with EC slot regulations.139 Accordingly, at the present time, the Commission's proposed restrictions are an adequate means of attempting to control the BA/AA alliance without destroying the alliance altogether.

Ultimately, given both the reaction from those within the airline industry and the tremendous competitive issues raised by the BA/AA alliance, the Commission's present opinion may be most appropriately viewed as a step in the right direction in terms of the Commission's role of enforcing Articles 81 and 82 of the EC Treaty. Issuance of the opinion allows the Commission to assert itself as the primary competition authority in the EU and to serve notice that it will take steps to enforce Articles 81 and 82 of the EC Treaty in situations where the Commission and many industry insiders feel that a large alliance would harm competition and thus violate these Articles. While competitor airlines may feel the Commission's opinion does not go far enough, the fact is that the BA/AA alliance has been forced to give up an apparently large number of slots—267—with provisions allowing for the relinquishment of additional slots. These measures directly address competitor airlines' concerns that they would be unable to obtain slots with which to compete against the BA/AA alliance. The opinion is, after all, only preliminary, and interested parties were provided 30 days to respond with comments.140 In the end, there is no way to know whether the regulations proposed in the Commission's opinion go far enough until they have been in operation for a few years.

Of further general interest in this discussion, however, is the fact that in investigating the BA/AA alliance, the Commission's powers were limited to investigation through Article 85 of the EC Treaty, allowing the Commission only to introduce monitoring provisions rather than specific implementing regulations.141 The reason for this limitation is that Regulation 3975/87 currently applies only to intra-[*PG90]Community flights.142 This situation does not allow the Commission to respond to international airline alliances with the necessary effectiveness.143 In order to be able to adequately deal with the emerging trend toward international airline alliances, the scope of current EU competition policy—specifically, Regulation 3975/87—must be expanded to allow the Commission to have the power to apply Articles 81 and 82 of the EC Treaty to air transport routes between the EU and non-Member States.144 An expansion of Regulation 3975/87 would provide the Commission with the appropriate legal tools for applying EU competition policy both within the EU and in relations with non-Member States by allowing direct application of Articles 81 and 82 of the EC Treaty to flights between member and non-Member States.145

Conclusion

The EU's current competition law—specifically, the dominant position doctrine—provides an initial framework for dealing with large international airline alliances such as the BA/AA alliance. The tremendous market power that this alliance will have on certain key transatlantic markets, and evidence of the detrimental effects of similar alliances in operation, demonstrate that the BA/AA alliance should be subject to scrutiny under the dominant position doctrine. Therefore, the Commission's preliminary opinion proposing conditions necessary for the approval of the BA/AA alliance is an adequate response to the alliance. While it may not currently please all industry insiders, the realization that the Commission must take a position on such alliances is a step in the right direction. The Commission's current EU competition policy, however, does not go far enough to allow the Commission to adequately apply the dominant position doctrine to international airline alliances. The Commission's powers in this area must be extended to allow it

the same power to enforce the dominant position doctrine to flights between EU Member States and non-Member States that it currently has with respect to flights between Member States.

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