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AIRLINE COMPETITION

-- Note by Brazil (CADE) --

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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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Introduction

1. Over the last two decades, the air transport sector in Brazil has evolved rapidly, both in terms of its regulatory framework and of market tendencies. The air transport sector evolved from a price-controlled sector to a modern, independently regulated, liberalized sector.
2. Brazil followed the global market trend of liberalization and deregulation of the sector and experienced the entrance of new companies and the refinement of services provided. Aiming at increasing their profits and range of services provided, many airline carriers have merged and formed alliances. The need of large investment and the existence of high barriers to the entry of new players led the sector to be naturally concentrated in Brazil, with two main players – TAM and GOL – detaining together a market-share of around 75% in the market of air transport for passengers.
3. In the scope of its competition promotion and enforcement activities, CADE strives to maintain a healthy, competitive environment in the air transport market. CADE has intervened various times in this sector, both by way of its competences in merger control and antitrust enforcement.
4. This paper will firstly set out the evolution of the regulatory framework of the airline sector in Brazil, and then it will outline some of the main competition issues in the airline sector tackled by CADE in its enforcement experience, namely market definition and cartelization.

1. Regulatory framework

5. The Brazilian air transport sector underwent various phases of regulation in its history. From the 1970s until the mid 1980s, regulation policy of the air transport sector was closely tied to the strong development-related policies of the military government in Brazil. Prices and availability of flights were established by the government, which also decided over the entrance of new competitors in the market.
6. In the 1990s, Brazil experienced a gradual liberalization of its economy as a whole. Federal Decree nº 99.179 of 1990 established that economic activities should be guided by the free-market principle. In the late 1990s, the implementation of a new model of regulation to the Brazilian economy introduced important modifications to the existing practices. This includes the gradual discontinuation of the government's price control policy, which left companies free to compete among themselves, as well as the creation of an autonomous and independent regulatory agency. Its mission was to observe the guidelines of sector policies and oversee their fulfillment. At that time, the main concerns in the sector were related to the elimination of geographic limitations and to the economic viability of the activity in order to maintain the offer of air transport services.
7. In 2005, the National Civil Aviation Agency (ANAC) was created. The agency is responsible for regulating and supervising the activities of civil aviation and of aeronautical and airport infrastructure, aiming at implementing the sector's guidelines, policies, and regulations developed by the government, and preserving a favorable environment for free competition¹.
8. The need for regulation in the air transport sector resulted from technical reasons, such as safety and staff training in air operations, and economic reasons, such as optimizing the services provided, seeking to diminish the costs and enhance competition. ANAC's competences include the regulation of airports, oversight of the monopoly power of concessionaires and inhibition of the use of structures by a short number of carriers.

¹ National Civil Aviation Agency: <http://www.anac.gov.br>.

9. Before the creation of ANAC, the competition environment in the sector was unstable. As few airlines carriers were allowed to operate, prices were high for both passenger and cargo transportation. Barriers were raised to the entry of new carriers, especially regarding the concession of routes and the access to airports. Thus, the regulator should standardize rules to produce incentives to efficiency and allow competition.

10. In what concerns competition, ANAC performs an important role in competition enforcement cases of the Administrative Council for Economic Defense – CADE. Its expertise provides valuable inputs to CADE’s investigations on merger and antitrust cases.

2. Merger control and competition between airports in the same city: a key issue for market definition

11. This section will address an important aspect of market definition based on recent merger cases: competition between airports situated in the same city or metropolitan area, in particular the substitutability of airports situated in the same city or metropolitan area. For this purpose, it considers three recent cases: (i) the merger between the Chilean LAN and the Brazilian TAM, which created “LATAM”; (ii) the acquisition of WEBJET by GOL, two Brazilian companies in the sector; and (iii) the transaction involving the unification of AZUL and TRIP, two Brazilian companies in the sector.

12. This issue is particularly important in the cities of São Paulo, Rio de Janeiro and Belo Horizonte, as they are each served by two metropolitan airports: “Congonhas” and “Guarulhos” in São Paulo²; “Santos Dumont” and “Galeão” in Rio de Janeiro; and “Pampulha” and “Confins” in Belo Horizonte”. The respective distances between them are shorter than 50km, which could imply they were perfect substitutes for competition analysis purposes, as similar situations in other countries seem to indicate³.

13. However, due to the particularities of these metropolitan areas, CADE considered these airports as inadequate substitutes of each other, so the routes that jointly led to other cities were considered a separate relevant markets for purposes of competition analysis.

14. In the LATAM case⁴, this issue was raised indirectly because, although São Paulo has two airports (“Guarulhos” and “Congonhas”), only “Guarulhos” offers international flights. Nevertheless, the issue was addressed concerning the two international airports situated in the city of Buenos Aires in Argentina. The Reporting-Commissioner Olavo Chinaglia considered that the two Argentinean airports were interchangeable since the distance between both airports, as well as the distance between each one of them and the city center of Buenos Aires, was relatively short.⁵ He recognized, nevertheless, that the substitutability in these cases should be weighed in function of the type of flight, particular needs of passengers and distance between airports, indicating already that in cities such as São Paulo and in Rio de

² In the metropolitan area of São Paulo, one could also consider “Viracopos” as a third airport within this discussion.

³ As simple reference, see the decision issued by the European Commission in the case COMP/M.5141 – KLM/MARTINAIR (17.12.2008), in which the two airports situated in New York (JFK and Newark) as well as the two airports situated in Milan (Linate and Lapensa) were considered substitutable for merger review analysis. It seems that the distance of 100km and the time lapse of 1 hour were the parameters identified to draw a line on the substitutability of the concerned airports.

⁴ Merger file no. 08012.009497/2010-84, Reporting Commissioner Olavo Chinaglia.

⁵ The vote indicates that (i) the distance between the two airports is 38,8 km and (ii) the distance between “Jorge Newbery” airport and the city center is 8,0 km, and the distance between “Ministro Pistrani” airport and the city center is 31,9 km.

Janeiro, despite the short distance between airports, they should not be considered substitutable due to particularities of the cities, airports and consumer profile.

15. In the GOL/Webjet case⁶, the issue of competition between airports situated in the same city was directly addressed and it may serve as an important reference for future Brazilian cases in this sector. The Reporting-Commissioner Ricardo Ruiz considered that “Guarulhos” and “Congonhas” were not substitutes for one another, nor “Galeão” and “Santos Dumont”. The reasoning was based on the main argument that they did not work with the same passenger profile, since there was a (i) considerable time difference between the airports and the city center (in particularly during week days due to the heavy traffic) and the (ii) airports’ different infrastructure and functions.

16. Although the distance between the airports is considered relatively short, the time duration between one airport and the other can easily take more than 1 hour, especially during week days due to the heavy traffic. Moreover, the distance between the “domestic airport” and the “international airport” to the city center is significant, in particular if consider the time spent travelling. In Rio de Janeiro, for instance, it is possible to go on foot from “Santos Dumont” airport to the city center, while a taxi ride from “Galeão” to the city center may take over an hour depending on traffic. So, the transportation design of some cities, many of which suffer from often heavy traffic and lack of efficient public transportation, makes small distances into long journeys.

17. Of course, tourists are usually more susceptible to accept longer distances in exchange for lower fares, but business travelers, with rigid schedules, often cannot afford this time expenditure and prefer closer locations even if that means higher prices. So, profile of passengers seemed to be quite different in airports situated in the metropolitan areas under analysis.

18. The airports’ infrastructure and functions were also analyzed. The route “Congonhas”-“Santos Dumont” is well established as an important connection between the cities of São Paulo and Rio de Janeiro. Both airports are in a good location with quick access to the cities and highly interconnected to each other. The “Guarulhos” airport has a different profile in the sense of functionality as it serves many national destinations and it is considered the main gateway of international flights of the country. It does not serve as many connections as “Congonhas”, but it offers many national flights for tourists. The same happens with the airports in Rio de Janeiro.

19. Despite a certain profile of passengers for tourism which could consider these airports as substitutes, a small but significant and non-transitory increase in price would normally not lead a standard passenger to switch to the other airport situated in the same metropolitan area. For this reason, CADE’s case law has considered these airports as different relevant markets for merger review purposes. A similar understanding was reached in the Azul/Trip case⁷, which had the same Reporting-Commissioner.

3. Enforcement against anticompetitive practices: the recent international cartel air cargo condemnation

20. This section will briefly describe the international cartel air cargo case, which has been recently sanctioned by CADE.

⁶ Merger file no. 08012.008378/2011-95, Reporting Commissioner Ricardo Ruiz.

⁷ Merger file no. 08700.004155/2012-81, Reporting Commissioner Ricardo Ruiz.

21. In 2013, CADE's Tribunal condemned airlines *ABSA Aerolineas Brasileiras S.A.*, *Varig Logistica SA*, *American Airlines Inc.*, and *Alitalia Linee Aeree Italiane S.P.A.*, plus seven individuals for cartel formation in the international air cargo sector.⁸ The parties were condemned for fixing prices and dates for application of additional fuel charge in international air cargo in Brazil. The fines amount surpasses BRL 293 million.

22. The exchange of information aimed not only at coordinating the implementation of fuel charge, but also at coordinating the final price of air freight, since the fuel charge value was a substantial part of the full price. The cartel had resulted in international condemnation and agreements in various jurisdictions such as the European Commission, the United States, Canada, South Korea and Australia.

23. In Brazil, the air cargo sector has an important impact on the country's logistics costs. Collusion occurred between 2003 and 2005 and the participating companies came to control about 60% of the market during that period. The price cartel generated abusive prices that were passed on to consumers and to the supply chain.

24. The investigation of air cargo cartel began in 2006 following the signing of a leniency agreement between CADE and airlines *Deutsche Lufthansa AG*, *Lufthansa Cargo AG*, *Swiss International Airlines*, plus five individuals who denounced the illegal activity. In 2007, a dawn raid was held at the headquarters of the investigated companies. The evidence obtained confirmed the existence of collusion. At trial, the Tribunal removed any punishment against leniency signatories.

25. Before trial, the airlines *Société Air France*, *KLM*, and two individuals had already signed a Cease and Desist Agreement with CADE, whereby they confessed involvement in collusion and pledged to cease the practice and pay about BRL 14 million of cash contribution, collected by the Brazilian Diffused Rights Fund.

26. It has been a major anticompetitive practice condemnation in Brazil, considering the companies involved, the fines imposed and the impact that collusion in the air cargo sector has in the Brazilian economy as a whole, considering it serves as relevant network for the distribution of various products and services.

4. Conclusion

27. The rapid evolution of the air transport sector demanded deeper studies from CADE to allow a more detailed examination of the nuances and special features of each case. Cases investigated and tried by CADE in the past years are able to enrich the Brazilian experience concerning competition enforcement activities in the airline sector.

28. A substantial number of merger transactions have enabled CADE to acquire experience when analyzing the sector and what challenges it can present. Conduct cases also contribute with providing key information of what characteristics of the market can enable anticompetitive behaviors.

29. The maturity gained with previous experiences continuously encourages CADE to keep its efforts towards maintaining competition in the air transport sector.

⁸ Administrative Proceeding no. 08012.011027/2006-02.