Wet Lease Agreements and Competition Law

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Wet leasing is widely used in the airline industry, particularly in Europe. For many years the only approvals required for such an arrangement were in relation to safety compliance. The authors highlight an important new development by which merger control has been applied to certain wet leasing arrangements. There have been two instances where competition authorities have investigated wet lease agreements under merger control rules. The first was the European Commission and the German Federal Cartel Office in relation to Lufthansa/Air Berlin, and more recently the UK Competition and Markets Authority in relation to Aer Lingus/CityJet. In each case the question arose whether the broad commercial context of the wet lease meant that the lessee was somehow taking over the market position of the lessor. The authors outline the reasoning of the authorities and explore the implications for wet leasing and competition law compliance moving forward.

1 INTRODUCTION

Wet leasing in Europe is governed by Regulation 1008/2008[1] which imposes approval obligations for safety compliance in case a European carrier wet leases aircraft as a lessee. The approval conditions vary depending on the country where the aircraft is registered as to nationality: within or outside the EU. But, beyond these safety requirements, there were – until recently – no other regulatory approvals obviously required. This claim no longer holds true since two competition authorities – Germany and the UK – have in the past two and a half years examined wet lease arrangements under their respective merger control regimes. The European Commission also had a role in the German situation. In both cases there were particular commercial circumstances leading the authority to examine

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1 Regulation (EC) No 1008/2008 of the European Parliament and of the Council of 24 Sept. 2008 on common rules for the operation of air services in the Community (Recast), Art. 13.2 (31 Oct. 2008), O.J. L 293, at 3–20.

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whether the wet lessee was taking over the wet lessor's position on a particular market.

It is of course a truism that competition law applies to all industries, including the aviation sector, regardless of the framework in which a cooperation is formalized. Following the recent German and UK decisions, parties entering into a wet lease arrangement will not only have to consider issues in relation to cooperation between two industry players,[2] but also verify whether their particular agreement may be caught by a merger control regime and possibly require approval prior to commencement of the wet lease operations. This will not be the case for ad hoc contracts to address an emergency situation, but may be relevant for longer term arrangements which might, for example, facilitate the opening of a new route or bridge the time between order and delivery of new aircraft. That said, a bare long term wet lease is unlikely to fall under any merger control regime. In contrast, a wet lease with some 'plus factors', and in particular where the wet lease is linked to the existing operations of the lessor, will raise the question whether these 'plus factors' are enough to turn the service agreement into a merger by which the lessee is stepping into the market position previously held by the lessor on the basis of the wet-leased assets. The competition authorities' increased focus on slots as part of their competition analysis, and in particularly slot concentration at particular airports, will also be a relevant factor in the assessment. The analysis will be fact-intensive and each wet lease arrangement will have to be looked at individually.

This article first examines the application of merger control rules to wet lease arrangements and then also addresses the potential cooperation type issues. We examine both the European and Member State level as well as the UK which (post Brexit) will operate independently from the European regime.[3]

All European Member States have their own competition laws which largely mirror the European rules: national laws are essentially applied to domestic cases which do not have a cross-border impact. Non-European jurisdictions of course also have merger control laws which are often either based on the European or US systems. This article discusses only European competition implications for wet lease arrangements.

2 WET LEASING AND MERGER CONTROL IN EUROPE

European and national merger control rules seek to control acquisitions or other combinations of companies which risk bringing about anti-competitive effects in

[2] Consolidated version of the Treaty on the Functioning of the European Union, Art. 101 (26 Oct. 2012), O.J. C 326, at 1–390.

[3] For present purposes when the authors refer to 'European regimes' or 'European states', this includes the UK unless otherwise specified.

the European or national market(s). Or, in the words of the European Merger Control Regulation (hereinafter, the 'EC Merger Regulation')[4]: the system ensures that competition in the internal market is not distorted.[5] The EC Merger Regulation has created a 'one-stop-shop'[6]: transactions which meet the EU level thresholds must be notified to the European Commission's Directorate General for Competition (hereinafter, 'DG Competition'); combinations which do not meet those thresholds might need to be filed with national competition authorities. The thresholds in all jurisdictions are twofold:

(1) Structural impact of the transaction: although the legal form of a combination is not decisive, the structural change caused by a transaction must be significant. For example, under the EC Merger Regulation there must be a change in 'control' over an 'undertaking'. Or, in the UK, for example, two 'enterprises' must cease to be distinct.

(2) Economic value of the transaction: under the EC Merger Regulation the economic value of a transaction is measured by the financial weight of the parties to a transaction expressed through their revenues achieved in the most recent full business year. All European Member States[7] apply such turnover thresholds but some have additional thresholds based on, for example, the purchase price (transaction value) or the position of the parties in the markets to which the transaction relates.

For purposes of this article, and the assessment of wet lease arrangements, the first criterion is more important than the second. The 'economic value' criterion is more mechanical while the 'structural' criterion requires an in-depth legal analysis.

This section will first provide an overview of the existing 'structural' criteria applied by the EC Merger Regulation and the European Member States. It will then address how these criteria have recently been applied to wet lease arrangements by the German and UK competition authorities. Finally, we will also provide guidance on the types of wet lease arrangements which will likely be subject to merger control scrutiny and how this may affect the execution of contracts.

2.1 EU and National Merger Control Thresholds

2.1[a] *EC Merger Regulation*

The EC Merger Regulation applies to 'concentrations' which are deemed to arise when there is (1) a change of control (2) on a lasting basis and which (3) results from

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[4] Council Regulation (EC) No. 139/2004 of 20 Jan. 2004 on the control of concentrations between undertakings (the EC Merger Regulation) (29 Jan. 2004), O.J. L 24, at 1–22.

[5] *Ibid.*, recitals 2–6 and 24.

[6] The clear division of competence is e.g. reflected in the Commission Notice on Case Referral in respect of concentrations, para. 2 (5 Mar. 2005) O.J. C 56, at 2–23. Post-Brexit, the UK is not expected to form part of this 'one-stop-shop' regime, although matters remain in flux at the time of writing, and the UK may remain part of the 'one-stop-shop' at least during a possible transition period.

[7] The exception is Luxembourg which does not have merger control review.

the merger of two or more previously independent undertakings or parts of undertakings, or the acquisition, by one or more persons already controlling at least one undertaking, or by one or more undertakings, whether by purchase of securities or assets, by contract or by any other means, of direct or indirect control of the whole or parts of one or more other undertakings.[8] We will discuss the three different components of a 'concentration' at a general level in this section, while the application to wet lease arrangements is addressed in more detail in sections 2.2 and 2.3.

2.1[a][i] Undertaking

The term 'undertaking' is not defined in the EC Merger Regulation. The Commission's Consolidated Jurisdictional Notice (hereinafter, the 'Jurisdictional Notice') explains that assets constitute the 'whole or part of an undertaking' when they form a business with a market presence to which a market turnover can be clearly attributed.[9] Whether a combination of assets meets the 'market presence' test is determined on a case by case basis. Legal commentary often states that the concept of an undertaking is broadly defined and extends to almost any entity engaged in an economic activity, irrespective of the legal form, including public and private companies and partnerships.[10] Based on its decisional practice, DG Competition examines whether in a particular case a combination of the factors listed below constitutes a business. The factors which DG Competition has discussed in its decisional practice are the following:

- Employees:[11] are employees being transferred and/or does the transaction trigger the application of the European directive governing such employee transfers?[12]

[8] EC Merger Regulation, *supra* n. 4, Art. 3.

[9] Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings, para. 24 (16 Apr. 2008), O.J. C 95, at 1–48.

[10] *See* e.g. Nicholas Levy & Christopher Cook, *European Merger Control Law: A Guide to the Merger Regulation*, vol.1, §5.03[1][a] (Mathew Bender & Co. 2018).

[11] *See* e.g. Case No COMP/M.5727 – Microsoft/Yahoo ! Search Business (18 Feb. 2010), http://ec.europa.eu/competition/mergers/cases/decisions/M5727_20100218_20310_261202_EN.pdf (accessed 12 Feb. 2019); Case M.7940 – Netto/Grocery Store at Armitage Avenue Mittle Hulton (26 Feb. 2016), http://ec.europa.eu/competition/mergers/cases/decisions/m7940_133_3.pdf (accessed 12 Feb. 2019); Case No COMP/M.5363 – Santander/Bradford&Bingley Assets (17 Dec. 2008), http://ec.europa.eu/competition/mergers/cases/decisions/m5363_20081217_20310_en.pdf (accessed 12 Feb. 2019); Case No COMP/M.5091 – Tech Data/Scribona (28 Apr. 2008), http://ec.europa.eu/competition/mergers/cases/decisions/m5091_20080428_20310_en.pdf (accessed 12 Feb. 2019); Case No COMP/M.6323 – Tech Data Europe/MuM VAD Business (27 Oct. 2011), http://ec.europa.eu/competition/mergers/cases/decisions/m6323_20111027_20310_2071532_EN.pdf (accessed 12 Feb. 2019).

[12] Council Directive 2001/23/EC of 12 Mar. 2001 on the approximation of the laws of the Member States relating to safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings and businesses (22 Mar. 2001) O.J. L 082, at 16–20.

- Goodwill[13]: will goodwill be transferred which can be determined by payment of a premium and/or discussions of such premium during negotiations?
- Contracts:[14] are any contracts (e.g. customers, suppliers, tenants) being transferred?
- Brand:[15] is the brand being acquired? In case a brand is transferred by way of license rather than an outright acquisition, and without any additional assets, the brand can only constitute a business if the license is exclusive at least in a certain territory and the transfer of the license also transfers the turnover-generating activity.[16]
- Assets such as power or other production plants.[17]
- Office, warehouse and/or production equipment.[18]
- Customer or client database and other business information.[19]
- Know-how.[20]

The more of the above listed factors are present, the more likely that the assets taken together will constitute an undertaking. However, in certain circumstances one factor by itself has been found sufficient to constitute a business.[21] In all situations, the analysis is fact and context specific.

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13 *See* e.g. M.7940 – Case M.7940 – Netto/Grocery Store at Armitage Avenue Mittle Hulton, *supra* n. 11.

14 *See* e.g. M.7940 – Case M.7940 – Netto/Grocery Store at Armitage Avenue Mittle Hulton, *supra* n. 11; Case No COMP/M.6947 – Antalis/Xerox Western Europe Paper Distribution Business (14 Aug. 2013), http://ec.europa.eu/competition/mergers/cases/decisions/m6947_20130814_20310_3235735_EN.pdf (accessed 12 Feb. 2019); Case No COMP/M.6143 – Princes/Premier foods canned grocery operation (5 Apr. 2011), http://ec.europa.eu/competition/mergers/cases/decisions/m6143_172_2.pdf (accessed 12 Feb. 2019).

15 *See* e.g. Case No COMP/M.6947 – Antalis/Xerox Western Europe Paper Distribution Business, *supra* n. 14; Case No COMP/M.6143 – Princes/Premier foods canned grocery operation, *supra* n. 14; Case No COMP/M.5859 – Whirlpool/Privileg Rights (7 July 2010), http://ec.europa.eu/competition/mergers/cases/decisions/m5859_473_2.pdf (accessed 12 Feb. 2019).

16 Jurisdictional Notice, *supra* n. 9, para. 24. This also applies to the transfer of patent or copyright licenses. As discussed further below, in particular in the case of licensing – as opposed to an outright acquisition – a license can only constitute a concentration if this is done on a lasting basis: Jurisdictional Notice, *supra* n. 9, para. 24 and n. 31.

17 *See* e.g. Case No COMP/M.3867 – Vattenfall/Elsam and E2 Assets (22 Dec. 2005), http://ec.europa.eu/competition/mergers/cases/decisions/m3867_20051222_20310_en.pdf (accessed 12 Feb. 2019); Case No COMP/M.6143 – Princes/Premier foods canned grocery operation, *supra* n. 14.

18 *See* e.g. Case No COMP/M.6947 – Antalis/Xerox Western Europe Paper Distribution Business, *supra* n. 14.

19 *See* e.g. *Ibid*.; Case No COMP/M.6323 – Tech Data Europe/MuM VAD Business (27 Oct. 2011), *supra* n. 11.

20 Case No COMP/M.6323 – Tech Data Europe/MuM VAD Business, *supra* n. 11.

21 In certain circumstances the transfer of a client base of a business has been sufficient to constitute a business with a market turnover: Case No COMP/M.2857 – ECS/IEH (23 Dec. 2002), http://ec.europa.eu/competition/mergers/cases/decisions/m2857_fr.pdf (accessed 12 Feb. 2019).

2.1[a][ii] Change of Control

The transaction must cause a 'change of control' over an undertaking. Control for EC merger control purposes is based on the concept of 'decisive influence'.[22] The most common means for the acquisition of control is the acquisition of shares or assets.[23] Control can, however, also be acquired on a contractual basis if the contract brings about a similar control of the management and resources of the other undertaking as in the case of acquisition of shares or assets.[24] The contracts must also be characterized by a very long duration (ordinarily without a possibility of early termination for the party granting the contractual rights).[25] Finally, control can also be established by other means, e.g. through purely economic relationships such as a very important long-term supply agreement.[26]

2.1[a][iii] Lasting Effect

Only transactions that bring about a lasting change in control of the undertakings concerned and in the structure of the market fall within the scope of the EC Merger Regulation.[27] 'Long lasting change' does not mean permanent or indefinite. A long lasting change can be triggered by agreements which have a limited duration as long as they are renewable or sufficiently long.[28] In *Microsoft/Yahoo*,[29] for example, DG Competition considered that ten years was sufficiently long. This criterion, however, remains subject to a case by case analysis and although the Jurisdictional Notice provides some guidance for specific types of transactions, it does not go beyond directions in case of successive transactions.[30]

2.1[b] *National Merger Control Regimes*

As mentioned above, the national laws of the European Member States are largely similar to the EC Merger Regulation but there are some differences. The 'economic value' thresholds vary between Member States and some countries apply 'structural thresholds' which differ or go beyond the EC Merger Regulation's

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22 EC Merger Regulation, *supra* n. 4, Art. 3.2.
23 Jurisdictional Notice, *supra* n. 9, para. 17.
24 *Ibid.*, para. 18.
25 *Ibid.*
26 *Ibid.*, para. 20.
27 EC Merger Regulation, *supra* n. 4, Art. 3.1; Jurisdictional Notice, *supra* n. 9, para. 28.
28 Jurisdictional Notice, *supra* n. 9, para. 28.
29 Case No COMP/M. 5727 Microsoft/Yahoo!Search Business, *supra* n. 11.
30 Jurisdictional Notice, *supra* n. 9, paras 29–35.

definition of a 'concentration'. The following national thresholds may be relevant in the context of wet leasing arrangements:

- Austria: the acquisition by one undertaking of all, or a substantial part of, the assets of another undertaking, especially by merger or transformation.[31]
- Germany: the acquisition of all or a substantial part of the assets of another enterprise.[32]
- Poland: an acquisition by the undertaking, of a part of another undertaking's property, if the turnover generated by the assets in any of the two financial years preceding the notification exceeded the equivalent of EUR 10 million on Polish territory.[33]
- Romania: control is defined as the possibility of exercising decisive influence on an undertaking. Control may arise on the basis of rights, contracts or any other elements which, either separately or taken together, and taking into account the legal or factual considerations involved, allow a party to exercise a decisive influence over the behaviour of an undertaking, in particular through ownership or usage rights over all or part of the assets of an undertaking.[34]

The UK applies a different structural test, i.e. a relevant merger situation will arise when two or more enterprises cease to be distinct. That is, they are brought under common ownership or control, or there are arrangements in progress or in contemplation that will lead to enterprises ceasing to be distinct.[35]

Two of the above listed countries – Germany and the UK – have indeed, as mentioned earlier, examined a wet lease agreement under their national merger control provisions. Each of these cases is discussed in more detail in the next section.

2.2 Merger control thresholds applied to wet lease arrangements

Mergers are usually broadly described as some form of combination between two businesses. This is not a description that readily fits a wet lease agreement. First, a

[31] Federal Act against Cartels and other Restrictions of Competition (Cartel Act 2005 – KartG 2005), s. 7, Federal Law Gazette I No. 61/2005.
[32] Act against Restraints of Competition (Competition Act – GWB), s. 37(1), http://www.gesetze-im-internet.de/englisch_gwb/ (accessed 12 Feb. 2019).
[33] Act of 16 Feb. 2007 on competition and consumer protection, Art. 13(2)(4), https://wipolex.wipo.int/en/legislation/details/14606 (accessed 12 Feb. 2019).
[34] Competition Law no. 21 of 1996, Art. 10, Official Monitor no. 875/2003.
[35] Enterprise Act 2002, s. 23, https://www.legislation.gov.uk/ukpga/2002/40/contents (accessed 12 Feb. 2019).

wet lease is a service agreement, i.e. the provision of capacity by an upstream party – the lessor – to a downstream party – the lessee. Second, the two contracting parties remain entirely separate except for the portion of their activities covered by the wet lease, and each of them needs to fulfil a specific role in order to operate the wet lease successfully. The lessor controls the operations of aircraft and crew while the lessee uses its brand and sales apparatus to commercialize these operations. Even with this cooperation and service focus, in certain circumstances competition authorities might consider that a wet lease amounts to a merger and should be examined under the applicable rules.

This section elaborates on the reasons why a wet lease will in most circumstances not be considered a merger under the EC Merger Regulation but also addresses the European Member States' regimes and the UK regime which may require a merger filing for particular wet lease arrangements, i.e. a 'wet lease plus' agreement.

2.2[a] *EC Merger Regulation*

DG Competition has never taken jurisdiction over a wet lease related transaction. On the contrary, they concluded in November 2016 that the wet lease arrangement between Lufthansa and Air Berlin did not amount to a concentration for purposes of the EC Merger Regulation.[36] This conclusion was shared with the parties by private letter, so no information is publicly available about DG Competition's reasoning.[37] Details about the transaction are nevertheless well known since, as discussed below, the Federal Cartel Office (hereinafter, 'FCO') subsequently examined the transaction and published a decision which deals with jurisdictional questions in relation to the wet lease arrangement.

Lufthansa entered into a wet lease with Air Berlin covering thirty-eight aircraft for six years, which could be extended. In addition to wet-leasing the aircraft from Air Berlin, the ownership (or superior dry leasing) of many of these aircraft would also be transferred to Lufthansa. Prior to the transaction with Lufthansa, Air Berlin held these thirty-eight aircraft under dry leases from third parties. These aircraft were then treated in three different ways: (1) Lufthansa was to acquire up to fifteen aircraft and dry lease them to Air

[36] The wet lease arrangement between Lufthansa and Air Berlin pre-dated Air Berlin's insolvency filing.

[37] No decision is publicly available but DG Competition's conclusion is mentioned in the decision from the German authority in relation to the same transaction: B9-190/16 – Lufthansa/Air Berlin Wetlease-Vertrag (30 Jan. 2017), n. 14 https://www.bundeskartellamt.de/SharedDocs/Entscheidung/DE/Fallberichte/Fusionskontrolle/2017/B9-190-16.pdf;jsessionid=A62BF4F5B3B6DB4A2E9573F60BDF2C01.1_cid387?__blob=publicationFile&v=4 (accessed 12 Feb. 2019).

Berlin; (2) Lufthansa was to become dry lessee of up to ten aircraft and sub-dry lease them to Air Berlin; and (3) the balance remained with Air Berlin under dry lease from third party lessors. In this way Air Berlin still had at its disposition the original thirty-eight aircraft and was able to wet-lease them to Lufthansa, while Lufthansa had also become owner or superior dry-lessor of the majority of the thirty-eight planes.[38] The aircraft were to be based at airports in Stuttgart, Hamburg, Düsseldorf, Vienna, Munich, Cologne/Bonn and Palma de Mallorca. The agreement did not cover slots, customers or other contracts, or goodwill. Nor did it relate to specific routes such as those previously flown by Air Berlin although, in practice, it is likely that Lufthansa will have tried to obtain the slots previously returned to the airport pools by Air Berlin to use them on some or all of the routes operated by Air Berlin before from the airports at which the aircraft and crew remained based.

As mentioned above, no information is publicly available about DG Competition's reasons for concluding that this transaction did not amount to a merger within the meaning of the EC Merger Regulation. Nor has DG Competition issued any guidelines about wet lease arrangements. However, there is something to learn about airline assets and EU merger control from a subsequent transaction between Lufthansa and Air Berlin which covered certain assets of Air Berlin.[39] Some of the DG Competition officials working on that case went on the record in an official DG Competition publication saying that '*it turned out that distinguishing, among airline assets, between those that are not more than inputs and those that, taken together, constitute a business with a market presence was a challenge*'.[40] As a minimum, this demonstrates that is it not clear-cut in airline cases what constitutes 'an undertaking'. In the case of *Lufthansa/Certain Air Berlin assets*, in addition to the regional airline Luftfahrtgesellschaft Walter GmbH (hereinafter, 'LGW') – a subsidiary of Air Berlin which was to be acquired by Lufthansa – the assets under review were additional aircraft, crew, and slots from Air Berlin which would be transferred to LGW prior to closing. Although not explicitly mentioned in the decision, the slots appear to have been an important

[38] *Ibid.*, at 1–2.

[39] Air Berlin filed for insolvency in Aug. 2017. In Oct. 2017 Air Berlin and Lufthansa entered into an agreement under which Lufthansa would acquire (1) NIKI with its aircraft, crew and slots; (2) Luftfahrtgesellschaft Walter GmbH ; and (3) a collection of additional Air Berlin aircraft, crew and slots at several EU airports, in particular in Austria, Germany and Switzerland. These assets were transferred to LGW. The LGW transaction was conditionally approved on 21 Dec. 2018: Case M.8633 – Lufthansa/certain Air Berlin Assets (21 Dec. 2017), http://ec.europa.eu/competition/mergers/cases/decisions/m8633_2370_3.pdf (accessed 12 Feb. 2019). The remainder of the deal, the acquisition of NIKI, was abandoned.

[40] Fanny Dumont, Ngoc-Lan Lang, Melanie Schmillen, Mauro Sibilia & Simon Vande Walle, *Lufthansa/Air Berlin – The Slot Machine*, Competition Merger Brief Issue 1/2018, at 11, http://ec.europa.eu/competition/publications/cmb/2018/kdal18001enn.pdf (accessed 12 Feb. 2019).

factor in DG Competition's decision since the decision in a short section discussing the concentration specifically mentions that '*LGW did not hold any slots but used Air Berlin's slots for its operations. However, the slots transferred to LGW by Air Berlin, together with the other transferred assets and resources, would form part of the undertaking that would … be acquired by Lufthansa*'.[41]

Although there is no precedent in which DG Competition considered a wet lease to fall within its merger control powers, the criteria which will need to be applied to assess jurisdiction are related to the structural impact of the transaction and set out above. As mentioned previously, in addition to the monetary thresholds, to be caught by the EC Merger Regulation a wet lease arrangement must cause a long-lasting change in control over assets which constitute an undertaking. There are at least two considerations which make it unlikely that many – or even any – wet lease arrangements would meet these criteria.

The assets under a wet lease agreement – aircraft and crew – remain under the control of the lessor. The lessee will have use of them but the lessor maintains full ownership and operational control. The lessee will use its own brand, sales and marketing apparatus to sell tickets. Further wet leases which go beyond an ad hoc situation might be labelled commercially as 'long term' but, in this context, 'long term' may mean only a few years, materially less than contracts of rather longer durations such as ten years which could confer control under the EC Merger Regulation.[42] Finally, as DG Competition's staff pointed out assets – even in combination – can be mere inputs and not amount to a business to which a market presence can be attributed.

2.2[b] *National Merger Control Regimes in Europe*

There are only two cases known in which a national competition authority investigated a wet lease agreement under its domestic merger control rules: the FCO in relation to *Lufthansa/Air Berlin* in 2016 and the Competition and Markets Authority (hereinafter, 'CMA') in relation to *Aer Lingus/CityJet* in 2018. These two cases are discussed in the remainder of this section.

2.2[b][i] Germany: Lufthansa/Air Berlin

As mentioned above, the wet lease arrangement between Lufthansa and Air Berlin was first notified under the EC Merger Regulation, but DG Competition informed the parties it had no jurisdiction. The parties then made a 'precautionary

[41] Case M.8633 – Lufthansa/Certain Air Berlin Assets, *supra* n. 39, para. 13.
[42] Jurisdictional Notice, *supra* n. 9, para. 18.

filing'[43] to the FCO. The filing was not made under the German equivalent of the 'concentration' structural threshold but under an additional provision, mentioned above, about the acquisition of '*all or a substantial part of the assets of another enterprise*'.[44] In the case under examination Lufthansa entered into a wet lease arrangement covering a quarter of Air Berlin's aircraft. In addition, as discussed above, Lufthansa also became the owner or superior dry-lessor for well over half of the thirty-eight aircraft.[45] The FCO found, however, that it did not need to take a final decision whether the wet lease fell under its merger control jurisdiction because the transaction would not cause any competition concerns. This echoes the precautionary nature of the filing but implies that the FCO believed that the transaction could trigger German merger control while preferring not to take a definitive view. It is not unusual for antitrust authorities to leave certain questions open when possible, so precedents are not set by cases which may not be sufficiently clear to carry good precedential value. And, as evidenced throughout this article, there is doubt as to when wet lease agreements might be classified as mergers.

Despite the absence of a definitive ruling on jurisdiction, the FCO pointed out a number of elements for consideration in relation to the threshold defined as 'the acquisition of all or a substantial part of the assets of an enterprise'. First, the FCO mentioned that a six-year wet lease is a contract of very long duration in the aviation industry which goes beyond the timeline usually applied to forward planning and forecasting for routes by airlines. In addition thirty-eight aircraft represented a significant part of Air Berlin's fleet (a quarter) which was to increase the Lufthansa fleet by 7%. Taken together, this was to lead to Lufthansa taking over Air Berlin's position on the market for short and medium haul flights to/from Austria and Germany for the duration of the wet lease agreement. Such a broad description of the market is rather unorthodox but was driven by the fact that the wet lease arrangement did not include slots and the FCO therefore concluded that it was not Air Berlin's market position on particular routes that was being transferred but more broadly Air Berlin's position on short to medium haul routes to/from Austria and Germany.[46]

While those elements will have militated in favour of identifying a concentration, that conclusion will have been placed in doubt by the absence of key features as identified by the FCO: transfer of slots, customer or any other types of contracts.

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43 In other words, a filing which may not have been required, but made in case the authority determined that it was required.

44 B9-190/16 – Lufthansa/Air Berlin Wetlease-Vertrag, *supra* n. 37, at 8.

45 *Ibid.*

46 *Ibid.*, at 3 and 8. In the substantive assessment of airline mergers, markets are usually defined by reference to particular routes (the 'O&D, or origin and destination, approach').

2.2[b][ii] UK: Aer Lingus/CityJet

Most recently the CMA examined a wet lease arrangement between the Irish national carrier Aer Lingus and regional carrier CityJet. CityJet used to operate scheduled flights but started implementing a strategy change from 2015 onwards which led to its decision over the course of late 2017 and early 2018 to focus solely on its wet lease operations and to exit all scheduled flight operations by the end of 2018.[47] In the framework of this strategic change, CityJet approached Aer Lingus about a wet lease cooperation between London City and Dublin.[48] Following the shift in strategy, CityJet had systematically proceeded to end all its scheduled operations since 2015. The London City to Dublin service was the final scheduled operation CityJet offered.[49]

As in any wet lease arrangement, CityJet, as the lessor, provided aircraft, crew, maintenance and insurance to the lessee, Aer Lingus. Subject to changes Aer Lingus could make to the flight schedule and route, the wet lease related to the operation of flights between London City and Dublin.[50] Aer Lingus also obtained the right to use City Jet's slots at London City and Dublin airports for the duration of the wet lease.[51] And finally, CityJet offered customers already booked on CityJet's flights, for a date after commencement of the wet lease, either a refund or a transfer to Aer Lingus if the passengers took no action to request a refund. This concerned only a limited number of passengers, as discussed below.[52]

As mentioned above, the 'merger' test under UK rules is whether two enterprises ceased to be distinct. The relevant Act, the Enterprise Act 2002, does not provide a definition of an enterprise but the CMA's guidelines explain what the most common components of an enterprise are: '*assets and records needed to carry on the business and the employees working in the business, together with the benefit of existing contracts and/or goodwill*'.[53] In making its assessment the CMA will have regard to three specific considerations: (1) the transfer of customer records is likely

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[47] ME/6782/18 – Completed agreement between Aer Lingus Limited and CityJet designated Activity Company (21 Dec. 2018), para. 56, https://assets.publishing.service.gov.uk/media/5c46de96ed915d38a2f5e262/AerLingus_CityJet_Full_Text_Decision.pdf (accessed 12 Feb. 2019).

[48] *Ibid.*, para. 63.

[49] *Ibid.*, para. 61.

[50] *Ibid.*, para. 17(a).

[51] The CMA's decision states that *'Aer Lingus also acquired landing slots at LCY [London City] and DUB [Dublin]'* (*Ibid.*, para. 29). This is, however, an overstatement since Aer Lingus did not obtain 'ownership' of the slots but purely a right to use them, by way of loan, during the duration of the wet lease agreement, as discussed further below.

[52] *Ibid.*, para. 34(a). CityJet also posted a notice on its website alerting customers who attempted to use the CityJet website to book flights between London City and Dublin that they could book with Aer Lingus as of the start of the wet lease operations.

[53] Mergers: Guidance on the CMA's jurisdiction and procedure ('CMA2'), para. 4.8 (Jan. 2014), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/384055/CMA2__Mergers__Guidance.pdf (accessed 12 Feb. 2019).

to be important in assessing whether an enterprise has been transferred; (2) the application of the Transfer of Undertakings (Protection of Employment) regulations (hereinafter, 'TUPE regulations')[54] would be regarded as a strong factor in favour of finding that the business transferred constitutes an enterprise; and (3) the CMA would normally (although not inevitably) expect a transfer of an enterprise to be accompanied by some consideration for the goodwill obtained by the purchaser.[55]

In addition to the CMA's guidelines, the UK Supreme Court's judgment in *Eurotunnel*[56] also clarified the enterprise concept which distinguished between the acquisition of bare assets and a combination of assets which amounts to an enterprise. Bare assets simply serve as factors of production in a new enterprise or as a means of achieving organic growth.[57] In order for the assets to constitute more than mere inputs the Supreme Court introduced a two-prong test: (1) the assets must give the acquirer more than the acquirer might have acquired by going into the market and buying factors of production; and (2) the extra must be attributable to the fact that the assets were previously employed in combination in the activities of the target enterprise.[58] The CMA believed that the 'extra' that Aer Lingus acquired was attributable to the fact that the assets were previously employed in combination by CityJet and that Aer Lingus was able to deploy a seamless service to customers due (at least in part) to the fact that those assets had previously been used in combination by CityJet in the same way on the London City-Dublin route.[59]

The CMA concluded that the wet lease agreement, slots and customer arrangements, taken together, constituted an enterprise – even though a number of components that are necessary to offer scheduled flight services were not being provided by CityJet, e.g. ground handling and brand;[60] and the wet lease did not involve certain features which are recurrently part of a business transfer such as a TUPE transfer.[61] The CMA considered that the two assets which went beyond a wet lease or ACMI (aircraft, crew, maintenance and insurance) agreement – slots at

[54] The Transfer of Undertakings (Protection of Employment) Regulations 2006 as amended by the Collective Redundancies and Transfer of Undertakings (Protection of Employment) (Amendment) Regulations 2014, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/275252/bis-14-502-employment-rights-on-the-transfer-of-an-undertaking.pdf (accessed 12 Feb. 2019).

[55] *Ibid.*

[56] Société Coopérative de Production SeaFrance SA v. The Competition and Markets Authority [2015] UKSC 75.

[57] *Ibid.*

[58] *Ibid.*, para. 30.

[59] ME/6782/18 – Completed agreement between Aer Lingus Limited and CityJet designated Activity Company, *supra* n. 47, para. 40.

[60] *Ibid.*, paras 29–30.

[61] *Ibid.*

London City and Dublin airports and certain customer relationships – appeared to be core elements of the business of providing scheduled flights and that, in the particular circumstances of the case, the combination of these with the wet lease appeared to support a degree of economic continuity that enabled Aer Lingus to carry on the CityJet business previously supported by them.[62] This creates a precedent under UK merger control representing a new low-watermark for identifying the existence of an 'enterprise'. It is worth pointing out in particular the modest factual basis for the CMA's decision, especially because it will not be tested in court (since the CMA cleared the transaction).[63] The substantive reasons for clearance are themselves of considerable interest, but outside the scope of the present article. In brief, the CMA recognized that CityJet's exit from the route was strategic, and that Aer Lingus was the only plausible entrant. This is an argument which largely depends on the evidence and is rarely accepted by competition authorities, including the CMA in particular in the first phase of the investigation.

As mentioned above, a significant number of components which, according to the CMA's guidelines,[64] most commonly form part of an enterprise were missing from the wet lease arrangement. First, no employees were transferred and TUPE regulations did not apply to the pilots and other aircraft crew who remain on CityJet's payroll.[65] The application of TUPE is, however, usually regarded as a '*strong factor in favour of a finding that the business transferred constitutes and enterprise*'.[66] This strong factor was absent in the Aer Lingus/CityJet agreement.

The second 'common component' which did not feature in the Aer Lingus/ CityJet arrangement was the transfer of goodwill. Based on the CMA's guidelines, the CMA would normally expect a transfer of an enterprise to be accompanied by some consideration for the goodwill obtained by the counterparty. The payment of a premium is indicative of goodwill being transferred.[67] Although the CMA normally considers goodwill as a typical feature of an enterprise, it is not discussed or mentioned in the *Aer Lingus/CityJet* decision.

The third element which the CMA normally accounts for in its assessment is the transfer of customer records which it considers an important element of an enterprise.[68] The CMA's decision does not identify any corporate customer or other type of records which CityJet would have passed on to Aer Lingus although,

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[62] *Ibid*., para. 29.

[63] CMA Press Release, *Aer Lingus/CityJet Deal Cleared for Take-off*, https://www.gov.uk/government/news/aer-lingus-cityjet-deal-cleared-for-take-off (accessed 12 Feb. 2019).

[64] Mergers: Guidance on the CMA's jurisdiction and procedure ('CMA2'), *supra* n. 53, para. 4.8.

[65] ME/6782/18 – Completed agreement between Aer Lingus Limited and CityJet designated Activity Company, *supra* n. 47, paras 27(a) and 29.

[66] Mergers: Guidance on the CMA's jurisdiction and procedure ('CMA2'), *supra* n. 53, para. 4.8.

[67] *Ibid*.

[68] *Ibid*.

as mentioned above, Aer Lingus honoured some of the existing bookings passengers had made with CityJet for flights departing after commencement of the wet lease. The CMA recognized that the total number of transferred passengers might have been trivial and that these transfers were not part of a joint strategy but a unilateral decision by CityJet[69] which had to honour its legal obligation to find an alternative solution for passengers who had already booked a CityJet flight. Nevertheless, based on these limited facts, the CMA concluded that the ticket transfers were a benefit for Aer Lingus which facilitated Aer Lingus' path to acquiring customers on the London City-Dublin route.[70] And that it reduced the risk for Aer Lingus that it would be short of customers in its initial period post-commencement of the wet lease operations.[71]

It is worth emphasising in this context that passengers being re-accommodated, when a carrier has sold tickets but then exits the relevant route before the date of travel, is unremarkable in itself: airlines are in fact obliged to either reimburse their passengers and/or to offer re-routing under satisfactory conditions.[72] If another carrier comes onto the route and is the natural candidate to take over those passengers, the mere fact that it does so appears to be a slender basis for identifying the transfer of a business under any regime, be it in the UK, EU or Germany.

Fourth, even though duration is not expressly mentioned as a relevant element in the CMA's guidelines to determine whether assets taken together constitute an enterprise, duration is de facto a relevant element in transactions which do not amount to an outright acquisition, such as the Aer Lingus/CityJet wet lease. In such cases the CMA, or its predecessors, have explicitly considered duration as one of the relevant factors of an enterprise analysis, i.e. whether there is a sufficiently long-term transfer of assets.[73] Similarly, the CMA's guidelines also recognize that when examining whether an outsourcing arrangement results in an enterprise, the permanent (or long-term) transfer of assets, rights and/or employees of the outsourcing service supplier is a relevant element in the assessment.[74] The duration of

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[69] ME/6782/18 – Completed agreement between Aer Lingus Limited and CityJet designated Activity Company, *supra* n. 47, para. 36.

[70] *Ibid.*

[71] *Ibid.*, para. 38.

[72] Regulation (EC) No 261/2004 of the European Parliament and of the Council of 11 Feb. 2004 establishing common rules on compensation and assistance to passengers in the event of denied boarding and of cancellation or long delay of flights, and repealing Regulation (ECC) No 295/91 (17 Feb. 2004) O.J. L 046, at 1–8.

[73] *See* e.g. Anticipated acquisition by Tramlink Nottingham Consortium of NET Phase Two concession (12 Sept. 2011), https://assets.publishing.service.gov.uk/media/555de2ffe5274a7084000058/tramlink.pdf (accessed 12 Feb. 2019); MTR Corporation (Crossrail)/Crossrail merger inquiry (15 Jan. 2015), https://www.gov.uk/cma-cases/mtr-corporation-crossrail-limited-crossrail (accessed 12 Feb. 2019).

[74] Mergers: Guidance on the CMA's jurisdiction and procedure ('CMA2'), *supra* n. 53, para. 4.9.

the Aer Lingus/CityJet wet lease is not disclosed in the CMA's decision but it is not unusual[75] for a long term wet lease agreement and does not exceed examples of contract terms which in other industries were found too short for 'an enterprise'.

Finally, the CMA's decision appears to put a particular emphasis on the acquisition of slots, referring to them as '*core elements of the business of providing scheduled flights*'[76] and '*landing slots at LCY [London City] and DUB [Dublin] [being] strategically critical assets within the context of the LCY-DUB route – in particular, as both LCY and DUB are capacity-constrained airports at which demand for slots exceeds supply*'.[77] The CMA's decision also refers to views submitted by third parties that slot availability is limited and that this would make entry for new airlines difficult on the London City to Dublin route.[78] The CMA therefore believed that slots at London City or Dublin airport were not readily available for Aer Lingus from alternative sources and that the inclusion of the slots in the wet lease arrangement was critical in enabling Aer Lingus to enter the London City-Dublin route.[79] As mentioned below, this emphasis on slots falls in line with a general trend among competition authorities to scrutinise arrangements involving slots. In this case, the slots were of course not permanently transferred but only loaned to Aer Lingus for the duration of the wet lease agreement.

Notwithstanding the broad conclusions drawn from narrow facts, the decision creates a precedent for certain future wet lease arrangements – 'wet lease plus' arrangements whereby an airline as lessee in some way continues the operations of the lessor – and lowers the bar to establishing a 'relevant merger situation'.

2.2[b][iii] Other European Member States: No Precedents

To the authors' knowledge, no national European competition authority – other than the cases discussed above – have analysed a wet lease agreement under their merger control rules. Since most European Member States apply merger control thresholds similar to those used at European level, the discussion about those European rules also applies across the European Member States. Nevertheless, as explained earlier, certain Member States have some specific thresholds which may – under certain circumstances – bring wet lease arrangements within the national merger control review. This is the case for Germany (and Austria). Although it remains untested and has not been explored, in theory at least, wet

75 Based on the authors' knowledge of the case.
76 ME/6782/18 – Completed agreement between Aer Lingus Limited and CityJet designated Activity Company, *supra* n. 47, para. 29.
77 *Ibid.*, para. 31.
78 *Ibid,*. para. 32.
79 *Ibid.*, para. 33.

lease agreements could also be caught by the black letter law of the Polish and Romanian competition law regimes. This would, under Polish law, be based on a concept quite similar to the German and Austrian regime of acquiring '*a part of another undertaking's property*'[80] although, of course, in the case of a lease there is no outright acquisition but a temporary loan so further analysis will be required and the duration of the agreement may be a critical factor in the decision on jurisdiction. Under the Romanian provisions 'decisive influence' – i.e. control – is inter alia referred to as rights of '*usage of the whole or part of an undertaking's assets*'.[81] Again, the duration of the wet lease agreement is likely to be key in the analysis.

2.3 Types of Wet Lease Arrangements Likely Caught by Merger Control and the Consequences

The key lesson to draw from the precedents is that only certain wet leases may be considered a merger, i.e. what we call a 'wet lease plus' which has a longer term and establishes cooperation between two commercial airlines rather than a commercial airline and a pure ACMI provider; and allows the lessee to take over the market position of the lessor. We will also address what this means for wet lease negotiations and provide some counsel of advice in relation to wet lease agreements including slots.

2.3[a] *Pure Wet Lease Versus a 'Wet Lease Plus'*

Wet lease contracts are capacity purchase agreements. A standard wet lease covers aircraft, crew, maintenance and insurance controlled by the lessor providing the lessee, for a limited period of time, capacity on the lessor's aircraft. Wet lease arrangements are commonplace in the aviation and other industries.

A simple wet lease covering a limited number of aircraft is unlikely to be considered a merger in any European jurisdiction. This may be different in certain jurisdictions if the wet lease arrangement includes some additional elements therefore creating what we have labelled a 'wet lease plus' arrangement. Which extra features may lead to the creation of a merger will vary between jurisdictions but based on the limited precedent, if a wet lease includes any of the following characteristics, the transaction may be considered a merger, in particular in Germany and the UK but also potentially in Austria, Poland and Romania (at European level, the wet lease would need to have at least an extremely long duration):

[80] *Supra* nn. 32–34.
[81] *Supra* n. 35.

- The wet lease covers all or a significant portion of an airline's fleet, e.g. a quarter.
- The wet lease has a long duration, e.g. it exceeds the normal term of future commercial route or business planning for commercial airlines.
- The wet lease includes the transfer of slots, even if temporary.
- The wet lease includes the transfer of customer contracts or records.

In this context, based on the CMA and FCO precedent, it will also be important whether the lessee is taking over the operations or position of the lessor. This can be in relation to one route such as in the Aer Lingus/CityJet situation or relate to the possibility of using a large set of wet-lease aircraft to expand a route network from airports where the lessor used to operate.

The 'taking over of a market position' criterion inevitably entails that a wet lease between two commercial airlines is more likely to be caught by merger control than an arrangement between a commercial airline and a pure ACMI carrier.

Finally, against this background, it is also highly unlikely that an ad hoc wet lease would have the necessary 'plus factors' allowing the lessee to take over the lessor's previous market position. Ad hoc wet lease agreements are typically entered into by an airline to avoid operational disruption due to one of its own aircraft becoming unavailable at short notice (typically in the case of aircraft damage or unexpected technical defects). In such circumstances the carrier must quickly replace the unavailable aircraft for a single flight (or for a series of flights) until its own aircraft can return to service. These arrangements are by their nature of a short duration, a couple of days or maybe weeks, and are interim solutions rather than a means to, for example, start operating new routes. These type of agreements will therefore not be considered to have any effect on competition dynamics in the market and would not be considered a merger.

In contrast, longer term wet leases do not respond to an unforeseen event but instead address a commercial airline's wish to add additional capacity without needing to purchase an aircraft or dry-lease an aircraft, or to employ additional crew. These type of wet leases are a commercial device offering operational flexibility, particularly for new and untested routes, where the commercial risk would not justify a truly long term investment. These agreements are longer term, ranging from two to three years to sometimes six or even longer, but they are finite. Depending on the precise duration and what is considered 'long-lasting' allowing the lessee to take over the lessor's former market position.

2.3[b] *Consequences for the Transaction Timetable if a Wet Lease Is Caught by a European Merger Control Regime*

If a transaction meets all thresholds under a particular merger control regime, the deal should be notified to the relevant competition authority. All European Member States require notification prior to closing of the transaction[82] and, in fact, any implementation needs to be postponed until the competition authority takes its final decision. If parties proceed with implementing a transaction which should have been notified, the competition authority can impose a fine for gun jumping and even potentially order divestments in case the examination brings to bear competition concerns.[83]

The UK's merger control regime is not suspensory.[84] However, the CMA can impose certain conditions if a transaction has been implemented prior to the start of its investigation[85] and it has the power to order changes or even a complete wind down of the transaction when it concludes its examination.[86]

When signing a wet lease contract which may be subject to merger control approval, parties should therefore insert an appropriate condition precedent to allow for this approval to be obtained and a potential ability to exit the contract if, maybe with reasonable commercial efforts, no approval can be obtained. The duration of a merger investigation process should also be calculated into the transaction timetable as it will at least take four to six weeks but potentially many months in case of more problematic transactions.

In case of doubt, it may be possible to contact the competition authority informally to discuss whether they would consider the particular wet lease a merger and thus require a merger filing.[87]

2.3[c] *Continuing Importance of Slots in Competition Law Analysis in Aviation Cases*

As already mentioned above, slots could transform a pure wet lease into a 'wet lease plus' which, depending on other factors, may fall within the merger control

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[82] EC Merger Regulation, *supra* n. 4, Art. 7(1).

[83] *Ibid.*, Art. 14(2). *See* also Case M.7993 – Altice/PT Portugal (24 Apr. 2018), http://ec.europa.eu/competition/mergers/cases/decisions/m7993_849_3.pdf (accessed 12 Feb. 2019); and Case No COMP/M.7184 – Marine Harvest/Morpol (23 July 2014), http://ec.europa.eu/competition/mergers/cases/decisions/m7184_1048_2.pdf (accessed 12 Feb. 2019).

[84] Mergers: Guidance on the CMA's jurisdiction and procedure ('CMA2'), *supra* n. 53, para. 6.1.

[85] Enterprise Act 2002, *supra* n. 35, s. 109.

[86] *Ibid.*, s. 72(1); Mergers: Guidance on the CMA's jurisdiction and procedure ('CMA2'), *supra* n. 53, paras 6.20–6.21.

[87] Commission Regulation (EC) No 802/2004 of 21 Apr. 2004 implementing Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings, recital 11 (30 Apr. 2004) O.J. L 133, at 1–39; Mergers: Guidance on the CMA's jurisdiction and procedure ('CMA2'), *supra* n. 52, paras 6.25–6.38.

jurisdiction of certain European Member States. Slots have indeed become more important for competition law analysis in the aviation sector. It goes beyond the subject matter of this article to discuss this evolution but it is useful at least to identify a few developments and cases illustrating the importance of slots and slot concentration in aviation and competition law.

First, traditionally the competitive effects of mergers between airlines were examined by reference to the so-called 'O&D approach'. In short this method analyses the impact of the merger on overlapping routes between certain airports on a city pair or airport pair basis, depending on the nature of the route. However, slot portfolio effects have also been assessed by DG Competition in *Aer Lingus/ Ryanair III*[88] and *IAG/BMI*,[89] but the *easyJet/Air Berlin*[90] and *Lufthansa/Air Berlin*[91] cases were the first in which slot portfolio effects were at the core of DG Competition's investigation. In those cases DG Competition did not conduct a route-by-route assessment based on the O&D approach but examined the slot portfolio effects. The increase in easyJet's slot portfolio at Berlin's airports (Tegel and Schönefeld) was not found problematic because it amounted to less than 25% post transaction with continued competition from other airlines with sizeable slot portfolios. By contrast, Lufthansa's increased share of slot holdings at Düsseldorf airport raising it above 50% was found problematic.[92]

Second, the UK's Department for Transport has shown an interest in revisiting the slot allocation rules because of alleged shortcomings of the current administrative slot allocation process. The Department of Transport asked the CMA for advice on the impact of the existing airport slot allocation regime on competition, and the benefits and risks of adopting a market-based allocation mechanism (e.g. auctions). The CMA published its recommendations in December 2018.[93] The Department of Transport has since issued a proposal on how to amend slot allocation post Brexit.[94]

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[88] Case No COMP/M.6663 – Ryanair/Aer Lingus III (27 Feb. 2013), http://ec.europa.eu/competition/mergers/cases/decisions/m6663_20130227_20610_3904642_EN.pdf (accessed 12 Feb. 2019).

[89] Case No COMP/M.6447 – IAG/BMI (30 Mar. 2012), http://ec.europa.eu/competition/mergers/cases/decisions/m6447_20120330_20212_2452290_EN.pdf (accessed 12 Feb. 2019).

[90] Case M.8672 – *Easyjet/Certain Air Berlin Assets* (12 Dec. 2017), http://ec.europa.eu/competition/mergers/cases/decisions/m8672_673_5.pdf (accessed 12 Feb. 2019).

[91] Case M.8633 – Lufthansa/Certain Air Berlin Assets, *supra* n. 39.

[92] Dumont, Lang, Schmillen, Sibilia & Vande Walle, *supra* n. 40, at 10.

[93] Advice for the Department of Transport on competition impacts of airport slot allocation (Dec. 2018), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/767230/cma-advice-on-impacts-of-airport-slots.pdf (accessed 12 Feb. 2019).

[94] The Airports Slot Allocation (Amendment) (EU Exit) Regulations 2019 (Draft), https://www.legislation.gov.uk/ukdsi/2019/9780111176580/contents (accessed 12 Feb. 2019).

3 WET LEASE ARRANGEMENTS WHICH FALL SHORT OF MERGER CONTROL EXAMINATION

If a wet lease agreement does not constitute a merger, it can still be examined by the competition authorities under the rules applied to cooperation agreements: Article 101 TFEU[95] and its national equivalents. In fact the FCO's *Lufthansa/Air Berlin* clearance decision ended with a statement that whether the agreement should be assessed under the rules of anti-competitive behaviour equivalent to Article 101 TFEU would be decided at a later moment in time.[96] This shows that parties to a wet lease agreement should be mindful of the rules on anti-competitive behaviour even though ordinarily wet lease arrangements are not inherently anti-competitive.

Article 101 TFEU and the national equivalents provide that agreements between undertakings – the lessor and lessee in the case of a wet lease – which have as their object or effect the prevention, restriction or distortion of competition are prohibited. This can apply to a wet lease between two commercial airlines which are considered competitors or potential competitors but also to two non-competing airlines or a commercial airline and an ACMI carrier. In the first situation the rules on horizontal cooperation apply; in the second situation only the rules on vertical cooperation apply.

Cooperation agreements are subject to a self-assessment regime: they are not notified to a competition authority for approval but they can be examined at any time if the authority suspects that the arrangement is anti-competitive. Any analysis of cooperation agreements is very industry and fact specific. It goes beyond the scope of this article to provide a detailed overview of the applicable rules and guidance but we provide some indication of the themes and principles to consider in the context of a wet lease agreement.

3.1 Wet leasing and the rules on horizontal cooperation

A wet lease between two commercial airlines could be considered a cooperation between competitors if the carriers are active on the same O&D pair, i.e. on the same route between city pairs or airport pairs. At European level, DG Competition has issued extensive guidelines allowing companies to ensure that their cooperation is lawful, the so-called 'Horizontal Guidelines'.[97] Each European Member State has adopted a similar

[95] Consolidated version of the Treaty on the Functioning of the European Union, *supra* n. 2.

[96] B9-190/16 – Lufthansa/Air Berlin Wetlease-Vertrag, *supra* n. 37, at 9.

[97] Communication from the Commission – Guidelines on the applicability of Art. 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements (14 Jan. 2011) O.J. C 11, at 1–72.

approach to cooperation agreements which affect only national territory and do not affect trade between Member States, i.e. wet lease agreements covering only domestic flights are subject to the relevant national jurisdiction; cross-border flights would be assessed under the European level rules. Similar rules exist in the UK but it remains to be seen whether some greater differences may arise post Brexit.

Horizontal agreements – including wet lease agreements between competitors – can create substantial economic benefits[98] but they may also lead to competition problems. For example, when parties agree to fix prices or capacity.[99] These are so-called 'hard core restrictions' which by their very nature have the potential to restrict competition.[100] In this case the agreement will be found unlawful even if in practice there was no effect on prices or output.

All other types of coordination may have a restrictive effect on competition: if the agreement has, or is likely to have, an appreciable adverse impact on at least one of the parameters of competition on the market, such as price, output, product quality, product variety or innovation.[101] Or in other words, the agreement reduces the parties' decision making independence.[102] The result of such an agreement would be a loss of competition between the parties which, e.g. may lead to a profitable price increase for the parties.[103]

A wet lease between competing commercial airlines is of course not unlawful by definition. If it does not fix prices or output and leaves each party's independent commercial decision taking untouched, the wet lease conforms with competition law. However, in this case parties should still be mindful of straying into unlawful territory by exchanging sensitive commercial information such as price or capacity information. Such exchanges could also be considered unlawful even if they have no effect on price or output: this is the case if forward-looking information is being exchanged.[104] Normally such commercially sensitive information is not exchanged between wet lease partners.

[98] *Ibid.*, para. 2.

[99] *Ibid.*, para. 3.

[100] *Ibid.*, paras 24–25; *see* e.g. Cases C-501/06 P, C-513/06 P, C-515/06 P and C519/06 P *GlaxoSmithKline Services Unlimited v. Commission*, [2009] ECR I-9291, para. 58.

[101] European Commission Guidelines on the applicability of Art. 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements, *supra* n. 97, paras 26–28.

[102] *Ibid.*, para. 27; Cases C-7/95 P, *John Deere Limited v. Commission*, [1998] ECR I-3111, para. 88; C-238/05, Asnef-Equifax, Servicios de Informacion sobre Solvencia y Crédito, SL, *Administracion del Estado v. Asociacion de Usuarios de Servicios Bancarios (Ausbanc),* [2006] ECR I-11125, para. 51.

[103] European Commission Guidelines on the applicability of Art. 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements, *supra* n. 97, para. 34.

[104] *Ibid.*, paras 72–74; Case COMP/39482 – Exotic Fruit (Bananas) (12 Oct. 2011), http://ec.europa.eu/competition/antitrust/cases/dec_docs/39482/39482_3130_4.pdf (accessed 12 Feb. 2019); Case AT.40136 — Capacitors (21 Mar. 2018), summary decision: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52018XC1211(01) (accessed 12 Feb. 2019).

3.2 Wet leasing and the rules on vertical cooperation

When two wet lease partners also compete as commercial airlines on the same routes or when a commercial airline contracts with an ACMI provider, the parties are active at different levels of production. This creates a so-called vertical relationship to which the EU's 'Vertical Guidelines' apply.[105] As with the 'Horizontal Guidelines' equivalent national rules exist which would apply to wet lease agreements with a purely domestic scope. In case of the UK, similar to the consideration mentioned above, only the future knows whether it will hold some deviation from DG Competition's practice.

There is no suggestion that wet lease agreements would inherently raise any issues of vertical concern. In fact, their quality is that wet leases allow for increased capacity which is certainly pro-competitive rather than anti-competitive. That said, there could be particular provisions or situations which require further assessment to determine whether a particular wet lease contract is competition law compliant. Caution should, for example, be applied to exclusivity clauses or provisions on pricing[106] or frequencies imposed by an ACMI provider who also operates routes on behalf of other commercial airlines on the same city pair.

4 CONCLUSION

Wet leases are not immune from competition law. They will usually create economic benefits because they increase capacity and may encourage route expansion for carriers. However, parties should of course not pursue an anti-competitive objective such as price or output fixing, or facilitate such unlawful coordination indirectly. The *Aer Lingus/CityJet* and *Lufthansa/Air Berlin* cases are further an important demonstration that broader commercial context may lead to wet leases being considered to be mergers requiring merger control approval. This may notably be so where the lessee steps into the shoes of the lessor and can be considered to take over its position on the market. This conclusion may prevail even in the absence of features usually regarded as key to the identification of a merger. While the authors do not believe that the recent cases reflect a change in policy at the competition authorities, it demonstrates that authorities interpret their definitions of 'a merger' widely if they consider that a transaction may have negative repercussions on the market and which they therefore consider worth investigating. Such transactions may lead the authorities to construe the range of deals subject to their merger control rules as wider than might otherwise be the case.

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[105] Guidelines on Vertical Restraints (19 May 2010), O.J. C 130, at 1–46.
[106] *Ibid.*, para. 48.