

ACI EUROPE WORKING PAPER underpinning the revision of Regulation 95/93

Practices and Recommendations related to Secondary Slot Trading

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1. INTRODUCTION

- 1.1. Currently, the process for the allocation of scarce airport capacity at EU airports in the form of airport slots relies on purely administrative decision-making mechanisms, with little or no economic ('market-based') considerations playing a role in the allocation of slots.
- 1.2. To mitigate inefficiencies resulting from the administrative allocation process, academics and UK regulators have advocated the redistribution of slots under a market-based mechanism, either after the primary allocation has been completed by the coordinator (e.g. secondary slot trading) or instead of the current allocation process (e.g. slot auctioning). Such mechanisms may increase slot mobility and enhance market access at congested airports. However, there are also certain drawbacks to secondary slot trading which require careful consideration by regulators prior to the implementation of the practice.
- 1.3. A proposal to revise Council Regulation (EEC) No 95/93, henceforth also referred to as the Slot Regulation, which openly allowed secondary slot trading at EU airports, was tabled in 2011 as part of the Commission's Airports Package. This proposal remains blocked in the Council since 2013, whereas the market conditions which necessitated the 2011 revision have grown.

2. PROBLEM DEFINITION

- 2.1. Secondary slot trading involves transactions of slots between airlines. Slot transactions fall into two different categories: i) slot transfers and ii) slot leases. Secondary slot trading may, though not always, generally take the form of a one for one slot exchange and includes monetary or other forms of compensation. It results in a sale or leasing arrangement.
- 2.2. The Slot Regulation only sets out specific circumstances in which slot transfers and one-for-one slot exchanges are permitted in Article 8a(1)(b) and (c). The Slot Regulation is silent on whether slots, once allocated, may be exchanged accompanied by monetary or other considerations. Notably, the terms "sale" or 'leasing' do not appear anywhere in the Regulation, despite the fact that slot sales and leases are taking place in practice
- 2.3. By way of a Communication in 2008, the Commission has clarified that it will not pursue infringement proceedings against Member States where secondary slot trading is allowed, so long as it takes place in a transparent manner and in accordance with all other administrative requirements for slot allocation. Each Member State may thus adopt its own rules and policies with regard to secondary slot trading.
- 2.4. An active secondary market for airport slots has developed at UK airports following the 1999 *Guernsey* case, the great majority of them at Heathrow and Gatwick. Although there is no 'hard' evidence of secondary slot trading at EU airports, 'grey trading'¹, may already be going on at a number of airports. Slot leases between unrelated airlines may occur through the joint operations clause offered by Article 10(8) of the Slot Regulation. Generally, airlines sign contracts that commit them to an initial exchange at a particular time and then to reverse the exchange at a future date. It is not clear what conditions are attached to exchanges or leases.
- 2.5. Secondary slot trading may bring certain benefits. By making explicit to incumbent airlines the so-called 'opportunity cost' of a slot, the mechanism of secondary slot trading may enhance market access at congested airports and result in an increasingly efficient use of scarce airport capacity, productive (e.g.

¹ Once slots have a value, administrators will seek to realise that value for the benefit of creditors and this can prevent slots from being permanently re-allocated while any legal disputes are settled. See ACI EUROPE WORKING PAPER on Airline Bankruptcies and Airlines Ceasing Operations.

larger planes) and/or allocative.² It will also inform governments, regulators and the general public about the economic value of slots.³

- 2.6. However, there are drawbacks to the practice. Currently, slot trades are private agreements between airlines, and the trade revenues go to the selling airline, even though the legal owner of slots has not yet been pinpointed.⁴ Accordingly, airlines accrue windfall profits from slots that were initially allocated to them for free. Airlines may also be further incentivized to resist capacity expansion, as any expansion would reduce the scarcity of slots and therefore dilute overall value of incumbents' slot portfolios in the secondary market. Moreover, there are concerns relating to further market concentration around already dominant airlines at already congested airports, and the entry of airlines with 'deep pockets'.⁵
- 2.7. Furthermore, the UK experience has shown that secondary slot trading does not necessarily result in the maximum possible use of airport capacity. Although productive efficiency has increased, secondary trading may give greater scope to incumbent carriers to 'hoard' and/or 'babysit' slots, while preventing competitive entry. Instead of maximizing their opportunity, slots may be strategically leased out to others or operated with smaller aircraft to satisfy the 80% threshold at minimum cost.
- 2.8. Once slots have a value, they are no longer voluntarily returned to the pool. The role of the coordinator is reduced as slots are moved directly between carriers rather than being returned to the pool and reallocated. This erodes the role of the independent coordinator as exclusively designated capacity allocator pursuant to Article 4(5) of the Slot Regulation. All up to the extent that dominant, incumbent carriers may act as 'shadow coordinators' with decisive influence over which airlines can and cannot participate in the slot market and under what conditions so as to protect their competitive positions. This furthermore negates other elements of the Slot Regulation, which are intended to increase competition and efficient capacity use yet which depend on the ready availability of slots in the pool in order to function.
- 2.9. Secondary slot trading may also not lead to the most efficient use of capacity from an airport's or societal point of view. An airline's willingness to pay for a slot may be an imperfect indicator of the socio-economic value of the service provided by that airline.⁶ It depends on the reason of the high willingness to pay if trading fits within the applicable policy context. In particular, the value of the service may not reflect in full the external effects caused by that service (e.g., including noise, emissions, and loss of connectivity) which could harm the public interest. Moreover, slot trading is also paired with extra costs for the buying airline, which will have to be passed on to the final user and may therefore negatively impact the consumer.
- 2.10. In sum, the pros and cons of secondary trading call for a careful and tailor-made approach. Regarding applicability, secondary slot trading is currently demonstrated at a limited number of airports only. There is currently no strong evidence proving the effectiveness of secondary trading that would be applicable to all airports. The UK experience is therefore not necessarily representative in predicting the potential impacts of secondary trading on a wider scale. Competitive effects may be different at different airports, given variances in size of local markets, types of passengers and the specific functions of an airport.

3. RECOMMENDATIONS

- 3.1. ACI EUROPE recommends that any decision on whether to permit the implementation of secondary slot trading should be left to the discretion of individual Member States, thus allowing them to take into account local market circumstances and the potential drawbacks as illustrated above.
- 3.2. ACI EUROPE stresses that where, after careful consideration of the pros and cons, secondary trading is implemented, it should be paired with clear rules and conditions to avoid adverse impacts on capacity utilization, market access, connectivity and the public interest.

² See Steer Davies Gleave (2011).

³ See Odoni (2019).

⁴ There is a pressing need for addressing the slot ownership question, which is central to much of the contentiousness surrounding secondary trading and to many other issues related to the allocation and management of slots in general.

⁵ See, among others, Starkie (2008).

⁶ See NERA (2004), Borenstein (2007) and SEO (2019).

- 3.3. ACI EUROPE stresses the need for airports to be involved in the process to ensure that the change of slot use can be delivered without adversely impacting on airport operations. Pre-trade transparency with the airport is essential to ensure that capacity requirements can be met. The slot coordinator should ensure that the conditions of the Slot Regulation and relevant national laws and/or procedures on secondary slot trading are met.

- 3.4. Post-trade transparency is also needed in order to give consideration to an infrastructure levy on the sale of slots, since airlines are financially benefitting from 'windfall profits' over something initially allocated to them for free and entirely dependent on airports providing the facilities from which airlines operate. Having learned from the UK experience with slottrade.aero, which was poorly used, coordinators could be given the powers to manage a trading platform which airlines are obliged to use for post-trade transparency reasons.