An air transport marketing initiative: are frequent flyer programmes desirable from the point of view of consumer protection and competition law in Europe?

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1. Frequent Flyer Programmes as a marketing strategy - introduction

Frequent Flyer Programmes were created during the period of deregulation in the US. The American airlines were suspected by the US Competiton Authorities of substituting new marketing stategies for the former regulatory barriers which until deregulation had regulated air transport and competition between airlines. Frequent Flyer Programmes were one such marketing strategy. The new marketing startegies were commercial and individual in nature and often based on a collaboration between different transport services, but they created perhaps even more efficient barriers to competition and new entry than the former regulatory barriers. Thus the market for air transport functioned only imperfectly after deregulation and the American Competition Authorities began to take a closer look at this situation.

In Europe, the European Commission which has the powers of keeping market conditions and competition in the common/internal market under surveillance also had occasion to examine more closely the market for air transport at this time. The Commission examined structural problems such as the grant of state aid to national airlines by the Member States and the way in which the Aviation Authorities of the Member States awarded slots to the national airline and to other airlines respectively. Various commercial strategies used by airlines such as Computer Reservation Systems (CRSs), code sharing and inter-lining were subject to Commission intervention either in the form of the issue of general rules (directives or regulations), guide-lines (codes of conduct) or as individual decisions. As regards Frequent Flyer programmes (FFPs), the Commission expressed its doubts on several occasions about whether this type of loyalty programme was compatible with EC competiton law. Nevertheless, FFPs were neither made subject to any in depth analysis nor to regulation, so that at present - even though the programmes do not represent perhaps the most important form of restriction of free competition on the market for air transport - they are still an uncontrolled commercial practice. Potentially they are a very efficient marketing instrument in the hands of airlines. Neither should their effect on consumer choice of airline be underestimated nor the way in which they serve to make prices for air transport services less transparent for consumers. There are thus good reasons for examining the position of the programmes in relation to the competition provisions of the EC Treaty (Articles 81 and 82), and their postion in relation to EC provisions for consumer protection. In the following (2.) the emergence of the FFPs and their characteristics will be described very briefly. Then follows two analyses, the first of their relationship with the competition rules of the EC Treaty (3.) and the second of their relationship with EC provisions for consumer protection (4.).

2. The emergence of Frequent Flyer Programmes and their characteristics

2.1 The creation of FFPs in the USA. In 1978, the Carter administration introduced the US Airline Deregulation Act for the purpose of liberalizing air transport services on the domestic

market. The US airlines - as the effects on prices became noticeable - were quick to react. Following a strike in 1979, United Airlines (UA) offered coupons to those passengers who had been adversely affected by the strike, against which they could obtain price reductions on future flights with UA. This initiative proved so successful that another airline company, Western Airlines, introduced a reduction of $50 for all passengers when they had flown five flights with the company. This was the first programme which rewarded the loyalty of consumers during an extended period. The first proper FFP was introduced by American Airlines (AA) in 1981. The CRS, SABRE, which was owned by AA was an essential element of the FFP, as it enabled AA to register the information of the members of the FFP, including their bonus savings. Another essential element in the introduction of AA's FFP was the strategy of establishing hub-and-spoke networks. The airline no longer flew direct between cities in the US. Instead passengers were flown from local destinations via the "spokes" to one of the operating bases (hubs) of the airline. From this hub, the long-haul and transcontinental services were fed. The FFP was introduced to compensate passengers for the inconvenience of no longer being able to fly direct. As AA could offer free bonus flights to Hawaii, always an attractive holiday destination, the inconvenience of the new hub-and-spoke network was felt to a lesser degree. Very soon AAs competitors introduced similar programmes. Intense competiton ensued with airline companies offering a wide variety of bonus both to incite consumers to join their scheme and to retain those who already had done so: executive lounges, express check-in, flight-class upgrades, credit facilities and various gifts (flowers or gourmet meals brought to your own door). Membership of the FFPs swelled. Soon, however, the disadvantages of the programmes became apparent: the cost both of establishing and maintaining the programmes was considerable. The risk that programme members should decide to redeem their bonus savings with an airline all at the same time, which might involve the bankruptcy of the airline, became apparent. The airlines responded by introducing various limitations to the use of bonus points such as blackout periods during which bonus savings could not be redeemed. The overall result of deregulation and the introduction of the new marketing strategies in the US was a heavy concentration in the airline industry. This was strictly contrary to what had been the aim of deregulation.

2.2 The emergence of FFPs in Europe. Up until the late 1980s only the US airlines had FFPs and it became increasingly popular for European consumers to join the American programmes and therefore also to fly with the American airlines when crossing the Atlantic. Once this was established by a survey of the European passenger market, British Airways (BA) was the first airline in Europe to introduce an FFP called "Latitudes" in 1991. The other European airlines were quick to follow suit - by 1992 KLM, SAS, Air France, Iberia and Swissair had their own programmes though modest in size compared to their American counterparts. It is characteristic for the European market for air transport that the introduction of the FFPs was chiefly the result of a reaction to the American market. Once FFPs were introduced, however, it soon became apparent that they had come to stay.

2.3 How do FFPs function? The European FFPs differ from their American counterparts in one important aspect: whereas the American programmes can be used by all travellers irrespective of the class on which they travel, the European programmes are intended primarily for travellers on First or Business Class, i.e. business travellers. Otherwise the programmes are structured much in the same way: 1) Members of the programmes accumulate points or air miles when they fly. The number of points accumulated depends on the distance flown and the class flown - usually the two are combined. If a member does not accumulate points at all during the initial period of membership his or her membership may lapse entirely. 2) The European airline companies have established partnership agreements

with both American airline companies and other European airlines. These agreements may be tactical, strategic or joint partnership agreements. Tactical agreements, which may not be reciprocal, enable programme members to accumulate points when travelling with an alliance partner. Strategic alliances on the other hand permit travellers both to accumulate and use saved up points with a partnership airline. A joint agreement operates one FFP between the participating airlines. At present there are four major alliances on the European market (each with their American partners), namely Star Alliance, Oneworld, Wings and Qualiflyer. They are all strategic or mutual. None of the European companies seem willing to trust their partners with the information which the programmes contain about their high yield passengers. Thus there are no joint agreements at present. The alliances share their information technology (IT) to a greater or lesser extent. The Star Alliance, for example, operates a multilateral scheme "StarNet" which functions separately from the IT operated by each of the fifteen alliance partners. 3) All the European airlines usually have a more or less extended network of partnership agreements with other businesses so that members can also accrue points when doing business with these. Partners are, for example, credit card companies, restaurant and hotel chains, car rental companies, telecommunication companies, etc. 3) Once a member has saved up the required number of points or miles, these can be redeeemed by the traveller, who can obtain a free flight either with the airline itself or with one of its partner airlines, an upgrade from one class to a higher class on a flight or a free baggage allowance. The traveller may also choose a free overnight stay in a hotel, free car rental, other goods or services offered by the other partners of the airline. Usually members must accumulate a minimum number of points before they can start to redeem them. Points are valid for redemption only for a limited period of time. Points cannot be redeemed during black-out periods, such as busy periods during the summer holidays or at Christmas time. The airlines normally retain their right to terminate the programme with or without prior notice and to cancel accumulated points. 4) The programmes include services - such as a newsletter - to all their members. 5) The programmes also include elite membership which is granted to frequent travellers according to the number of flights flown on First or Business Class.

Having described the emergence and the characteristics of frequent flyer programmes, the next step will be examine the market for air transport in Europe in relation to the competition rules in the EC Treaty. This topic will be examined below under (3).

3. FFPs, the market for air transport and the competition rules of the EC Treaty

3.1 The European Market for air transport - its general characteristics. The 1944 Chicago Convention on Civil Aviation failed to reach an agreement on the multilateral exchange of commercial rights to operate air services. As a result the European governments each established their own regulatory systems chiefly with the object of protecting their national, state-owned airlines. Almost all the European countries established a monopoly for domestic air transport. International routes were served by two national air lines (or flag carriers as they were called), who divided the revenue between them. There was thus no incentive to reduce prices.

The EC Treaty lays down that the freedom to provide services in the field of transport - including air transport - is governed by the provisions of the Treaty relating to transport, i.e. Articles 70 - 80 (ex 74 - 84). From the beginning (1957) of the establishment of the common market, air and sea transport were not directly included under these provisions. Measures to this effect had first to be adopted by the Council of Ministers under Article 80(2), which

empowered the Council to take the appropriate action. The Council was reluctant to do. However, deregulation of domestic air transport in the US in 1979, the judgment of the European Court of Justice (ECJ) in the *Nouvelles Frontières* case of 30 April 1986 (Joined Cases 209 - 213/84, which emphasized that air transport is subject to the Treaty's general provisions including those on competition) and the signing in 1986 of the Single European Act, made the Council change its mind. The so-called three packages for the liberalization of air transport were adopted during the period 1987 - 1992 and the move from a bilateral to a multilateral system in Europe was made. The competition rules of Articles 81 - 82 (ex 85 - 86) became applicable to air transport. The result was that free tariff-fixing was allowed. The rules for licencing carriers were liberalized and harmonized so that any airline meeting the specified requirements was granted an operating licence. The last step was the abolition of the restrictions on cabotage as from 1 April 1997, which meant that Member States had to open their domestic markets for air transport provided by airlines from other Member States. Nevertheless, restrictive practices on the European market for air transport remained. This was partly a result of the Commission's adoption of rules for block exemptions in this area. It was also partly the result of the fact that the Commission had no powers to investigate and decide cases concerning airline alliances in which an airline from a third country was involved.This is still the case to-day. The Commission, however, uses its powers under Article 85 (ex 89) of the Treaty based on the ECJ judgment *Ahmed Saeed Flugreisen* case of 11 April 1989 (case 66/86 which established that the competition rules apply at least in principle to domestic air transport and to air transport between Member States and third countries). The Commission made use of this interim regime by referring to Article 85 (ex 89) in its decision concerning the Alliance between AA and BA in 1998. Despite the fact that the ECJ had stated in the *Nouvelles Frontières* case in 1986 that the rules in the EC Treaty on state aid (Article 87 - 89, ex 92 - 94) apply to air transport, the grant of state aid by Member States to their flag carriers, which had been privatized during this period, was quite common and represented another serious obstacle to the establishment of a liberalized market for air transport. Contrary to the situation which existed in the US where direct flights between city-pairs had been the rule until the establishment of hub-and-spoke networks, the network of the European airlines had been organized right from the beginning as hub-and-spoke networks, the hub being the national airport of the Member State in question and the spokes connecting it with domestic destinations, the network thus having the shape of a star.

3.2 FFPs, mergers and concentrations. Article 81 of the EC Treaty and the Merger Regulation. It is very popular for airlines to enter into partnership agreements or alliances in which the joint use of the alliance's FFPs is an essential element as described above under 2.3. Airlines may also enter into alliances in which other elements are important, for example to obtain slots in the national airports of other Member States. In such cases, the joint use of the participating airlines' FFPs figures only as a minor element. In 1992 the Commission considered on its own initiative the joint use of FFPs by airlines (no formal complaint had been lodged with the Commission). It sent a request for information to all the larger European carriers in order to assess the effects of the use of FFPs on competiton in the European Community. An informal (unpublished) study was made on the basis of the information gathered. The Commission concluded that FFPs in themselves cannot be considered anticompetitive. In the case of alliances and mergers, however, FFPs might constitute a barrier to entry in the same way as the limited availability of slots. The Commission has since then considered the potential anti-competitive effects of FFPs in connection with airline alliances under Article 81(1) or mergers under Regulation 4064/89. The Commission has quite wide powers of discretion under Article 81(1), because it has the powers of making individual exemptions under Article 81(3). It also has a wide margin of appreciation under the

Merger Regulation. What the Commission did in these cases was to require the alliance partners to offer to competitors who did not themselves operate or participate directly or indirectly in an FFP the opportunity to participate in the partnership's FFP under reasonable and non-discriminatory financial conditions. The Air France-Sabena (1992), the BA-TAT (1995), the Sabena-Swissair (1995), the Lufthansa-SAS(1996) alliances are all examples where the Commission proceeded in this way. The Commission's present standpoint is that FFPs may be considered anticompetitive in relation to Article 81 or the Merger Regualtion, if they are items in alliances or mergers which themselves are anticompetitive and incompatible with the common market. This is decided on a case-by-case basis. If an alliance or merger is permitted, it is on the condition that the partners allow new entrant airlines to participate in their FFP on fair and equal terms.

The Commission's decision to permit alliances and to allow the members of the alliance (or merger) to have joint FFPs on condition that new entrants are allowed to participate in them is likely to reduce overall social welfare. Those who benefit from the existence of the FFPs and accordingly from the Commission's decision, are the airlines themselves and the business travellers on travel paid for by their employers. The losers will be the employers and the ordinary travellers.

3.3 FFPs and Article 82 of the EC Treaty. Article 82 does not prohibit large airlines from taking advantage of their networks by exploiting size-related advantages when marketing their services. As long as a particular airline's FFP does not constitute an abuse in the sense of Article 82, then difficulties arising for smaller competitors because the large airline exploits its network size must be accepted. So far neither the Commission nor the ECJ has considered cases involving FFPs in relation to Article 82. It is possible, however, to indicate in rough outline the line of argument which the Commission might use, if such a case were to crop up, as it is the accepted way of proceeding both for the Commission and the ECJ:

1) The Commission must define the relevant market, namely the product market and the geographical market. The *product market* is the market for air transport of passengers (i.e. distinct from the market for air transport of goods). The product market, however, must be divided into two markets, namely a market which comprises business travellers (time-sensitive travellers) and a market for travellers who travel for other purposes, chiefly for holiday purposes (non-time-sensitive travellers). Roughly they correspond to the division of passengers into First or Business Class travellers and passengers who travel Economy Class, though of course not always (some passengers who travel for holiday purposes are also time-sensitive and some business travellers choose to fly Economy Class). The airlines have, however, been successful in distinguishing between the two classes as only tickets on First and Business Class can be changed at short notice. The test is whether there is substitution or not, and business travellers cannot normally accept substitution and fly Economy Class. The *geographical market* is determined according to whether passengers choose direct or indirect flights. So far when establishing the relevant market in relation to Article 81, the Commission has fixed it as point-to-point flights or city-pairs or direct flights from the point of departure to the destination (within the internal market). This is because the European market is small at least compared to the transatlantic one and it would make no sense to fly London-Paris, for example, via another airport. This situation may be changing as airlines who are alliance partners offer cheap flights to European destinations via their national hub. Nevertheless it is a fair assumption that the relevant product and geographical markets will be defined as suggested above.

2) The Commission must establish market dominance. The European market for air transport is still characterized by the existence of monopolies and duopolies (oligopolies) and competition remains ineffective. The former national, now privatized airlines remain dominant on their national hub. The main reason for this is the limited availability of slots. These airlines are also the most attractive choice for business travellers as they dispose of the greatest number of direct flights. It is therefore a rather easy task to establish market dominance and the threshold seems to be fixed at 45% - as done by the Commission in the Lufthansa-SAS-United Airlines merger case in 1998. It need not be 45% on the entire hub but only on point-to-point flights.

3) The Commission must decide if FFPs are an abusive instrument contributing to the distortion of competition on the market for air transport. The problem must be considered according to which market is discussed: the market for business travellers, the time-sensitive travellers, or other travellers, the non-time-sensitive travellers.

The market for business travellers: the problem here is a very special one and connected with the fact that the employer on behalf of whom the business traveller travels pays his or her ticket but the traveller obtains personally the benefits resulting from the use of the FFP. Business travellers are assumed to make use of this principal-agent relationship (i.e. travelling on behalf of their employer) to maximize the benefits which they derive from being members of an FFP. It becomes advantageous for business travellers to buy air travel from the same airline and this influences their choice of airline. This means that the business traveller will choose to fly with the dominant airline on the hub which usually has the largest network. These travellers are no longer price sensitive, but the FFP becomes the most important element in choosing an airline. The dominant airline on the hub (the incumbent) is thus enabled to offer to its FFP members a better service than the new entrant airline with a smaller network and fewer destinations. An incumbent airline with a large network and an FFP has such a strong position on the market that a smaller competitor wanting to enter on one of the incumbent's routes is unable to do so. The incumbent is able - through the programme - to keep prices at a higher than normal level, at the same time keeping new entrants out and thus earning higher than normal profits.

There are several possible solutions to this problem. A radical one would be to prohibit FFPs. The political will to do so seems to be lacking, however, perhaps because FFPs are a world-wide phenomenon and only a world-wide prohibition would be effective. There is no framework - at least not at present - for making such a prohibition effective. To the extent that it is not possible to eliminate the principal-agent problem, the anti-competitive effects of the FFPs could be mitigated for new entrant airlines by imposing a duty on the incumbent airlines to offer participation in the programme to the new entrant airline on fair and equal terms. It can be argued that FFPs are an *essential facility* and should thus be opened for other interested airlines - a solution which the Commission has already adopted when considering airline alliances. A third solution would be to attempt to eliminate the principal-agent problem by taxing bonus points. It is a technically difficult solution. In fact the tax authorities of some of the Member States, namely the Danish, Swedish and the British tax authorities (and in fact also the US tax department), have attempted this. The attempts came to nothing as the authorities were unable to devise a method by which the value of the bonus points could be calculated and assessed as income for the programme members and which could then be made taxable. The solution cannot be implemented at Community level - at least not yet - because taxation of personal income is not a subject for Community legislation. A more basic difficulty relates to the fact that there is no income for the employee/business traveller until he

or she actually obtains a free bonus flight, whereas the anticompetitive effects appear much earlier, namely when the employee makes his or her choice of airline. Perhaps the most viable solution would be for the companies themselves, who pay for the travel of their employees travelling on their behalf, simply to introduce more control of the way in which the employees travel on business. With the appearance of low-cast carriers, they could demand that their employees make use of these when travelling on business. They may also demand that points accrue to the company for the use of the company or that the employee must use bonus points on future business travel. The costs of introducing and maintaining these types of control would be considerable and perhaps even higher than the value of the free bonus flights. Some companies accept that their employees save bonus points for their own future use when travelling on the company's business at its expense. They consider this a way of compensating their employees for the many inconveniences of business travel. None of these solutions or indeed any other have been attempted by the Commission. So far the FFPs flourish and business travellers continue using them unmolested. Anyway, it seems justified to conclude that the Commission does not consider FFPs as abusive under Article 82 when they are expoited in the principal-agent relationship. The question whether this result is satisfactory is another matter. The argument above has tried to establish that is is not.

The market for other travellers, the non-time-sensitive travellers: the question here is if FFPs can be regarded as abusive when used by travellers who do not travel for business purposes but for other purposes, chiefly holiday purposes. It seems fair to assume that the programmes in themselves cannot be regarded as abusive outside the principal-agent relationship. The question here is therefore, if a particular FFP creates constraints on travellers which are particularly strong and hence perhaps abusive. If the characteristics of a FFP are such that the programme has the same effects on travellers as a *fidelity rebate* or a *target rebate*, then there is a basis for an evaluation of the programme as possibly abusive.

The ECJ has been concerned with the basis upon which dominant companies grant *rebates* to their customers. The normal function of a rebate is to encourage a customer to do business with a supplier on a regular basis by offering the customer a retrospective cash payment calculated on his or her purchases over the year or other fixed period. It has the same commercial purpose over a longer period as does the offer of an individual discount on a single particular transaction: to encourage the buyer to do business with that seller rather than with competitors. A rebate, although sometimes offered in addition to ordinary discounts, is in effect an aggregation of discounts seeking to bind customers to a particular supplier. Rebates are often used quite legitimately, particularly in markets where there is active price competition, and in cases where the seller can reasonably show that his costs are lower, if customers show loyalty by placing high orders with him. Rebates can, however, be used by a dominant company so as to make it difficult for customers to switch purchases between suppliers, for example, in order to take advantage of price fluctuations or other changes in the market conditions, or because the products of another supplier are considered of better quality or suitability. The use of a rebate by a dominant company is thus often linked with that company's desire to ensure "fidelity" from its buyers, in the present case by using the FFP to compel travellers to acquire all their need for air travel from the incumbent airline with the FFP so that a form of "tying" is involved for the traveller.

The ECJ has distingushed between fidelity rebates and target rebates. A fidelity rebate is a rebate in which the purchaser explicitly or implicitly undertakes to obtain all or most his suppplies from the same supplier. A target rebate on the other hand is a system whereby the granting of the rebate is made conditional upon the attainment of a certain target. The FFPs

are in fact a very sophisticated combination of both the fidelity and the target rebate systems. The ECJ considered both fidelity and target rebates in the *Hoffman-La Roche* case (85/76) and in the *Michelin* case (322/81). Hoffman-La Roche is a multinational group selling vitamins. It was found guilty of a number of abuses, one of them being that it had entered into exclusive or preferential supply contracts with major industrial purchasers, containing fidelity rebates which placed considerable pressure on the buyers to obtain virtually all their vitamin requirements from Roche. Michelin held a strong position in the Dutch replacement tyre market for heavy vehicles including trucks and busses. Michelin had fixed rebates in return for the achievement of sales targets of individual distributors which the ECJ held were not sufficiently objective. In the Court's opinion Michelin's rebate schemes were characterized by a general lack of transparency and the method of administering the schemes through frequent personal visits by Michelin representatives applying pressure to its distributors to attain the targets was considered an abuse. Overall the result of the Michelin and Hoffman-La Roche cases was that the use of rebates by dominant companies is not prohibited outright but that a careful analysis must be made of the services for which they are granted. It is not allowed to tie them to exclusive purchasing obligations. They can be linked to the achievement of objective sales targets, however, provided that the operation of the system is sufficiently objective and transparent so as not to impose undue pressure on dealers.

If this line of argument of the two judgments is applied to FFPs, the following results are obtained: 1) An FFP can be regarded as a fidelity rebate, as it is based on the explicit or implicit condition that the passenger obtains all or most of his or her supplies from the airline operating the FFP. As the programmes grant bonuses to the consumer on a non-linear basis, the programme members find it advantageous to concentrate all their purchases of air transport with one programme-holding airline. Thus, membership of a programme will limit the customers' willingness to obtain supplies of air transport from competing airlines. 2) FFPs may also be considered as target rebates, as the granting of the rebate is conditional upon the attainment of a certain target, for example saving up a certain number of bonus points within a specific reference period in order to obtain a free flight. Particularly towards the end of the reference period, the passenger is under pressure to reach that target. Many FFPs are designed in this way and accordingly fall within the scope of Article 82. If, as in many of the schemes, the cut-off dates are rolling, i.e. linked in each case to the date on which the points were awarded, the result is less certain though. On the other hand, the application of Article 82 seems justified in cases where airlines reserve their right to alter the terms of the programme and to introduce new time limits, black-out periods and to terminate the scheme from day-to-day, which most of the programmes do.

3.4 Policy Conclusions. All the accessible studies and the economic models used by authors such as Cairns and Galbraith (1990 - focussing almost entirely on the behaviour of business travellers)
and Bannerjee and Summers (1987 - assuming that consumers have homogenous preferences) indicate more or less unanimously that FFPs create customer loyalty and that this has adverse effects on market access for new and smaller airlines. Even though the Commission has not taken a position as regards FFPs as such neither in connection with Article 81 nor under Article 82 - but only in connection with airline alliances, the Commission has at least tried to limit the harmful effects which FFPs are considered to have on market access for competing airlines. However, the Commission has not taken into account the consumer aspect of FFPs and this despite the fact that lower prices on air fares might be the result, if the Commission were to prohibit or at least regulate the FFPs for the benefit of the consumer. In the following this consumer aspect of regulating FFPs will be considered in more detail.

4. FFPs and the EC consumer protection aspect

Much of general EC consumer protection law applies directly to the air transport sector covering issues such as unfair terms in consumer contracts (Directive 93/13), general product safety (Directive 92/59), comparative and misleading advertising (Directive 84/450 as amended by Directive 97/55) and package holidays (Directive 90/314). (However, air transport is excluded from the key provisions of Directive 97/7 on protection of consumers in respect of distance contracts, despite the fact that a growing number of air tickets are reserved and paid for over the telephone and via the internet). The 1997 Amsterdam Treaty gave a new priority to the protection of consumers by adding a new clause to Article 153(1) (ex 129a) according to which "...the Community shall contribute ...to promoting [consumers'] right to information, education and to organise themselves in order to safeguard their interests." This new emphasis also applies to air passengers. As mentioned briefly above (1.) some legislation which involves the protection of consumers as individual air travellers (not package travellers) was already in existence before the Amsterdam Treaty came into opeartion in May 1999, for example on compensation in the event of denied boarding (Regulation 295/91), on improved levels of air carrier liability for passengers (Regulation 2027/97) and the EC Code of Conduct for CRSs (Regulation 2299/89 as amended by Regulation 323/99). The Code of Conduct for computer reservation systems (CRSs) ensures that passengers can get complete, transparent and unbiased information on schedules, fares and the identity of the air carrier operating the flights when they book and purchase their tickets. In the Commission's action programme 1998-2004 for transport, the protection of consumers was particularly referred to and the Commission undertakes in it to give special priority to civil aviation and the improvement of passenger information as regards new commercial developments of companies.

In spite of this legal framework, the Commission has received many complaints concerning the quality of the product and service offered by European air carriers indicating that this is not always up to the expected standard: passengers receive insufficient information about their flights, there are baggage problems, confusion over tariffs, delays and other circumstances which cause a rising number of air passengers to be highly frustrated. On this background the Commission sent out for consultation a document on Consumer Protection in Air Transport in January 2000 for the purpose of assessing whether further Community initiatives in this field are needed. The document covers four areas: 1) the contract between the airline and the passenger; 2) the business practices of the airlines, such as code-sharing, interlining and frequent flyer programmes; 3) conditions in the aircraft cabin; 4) information and transparency. At one point, the Commission's Directorate-General for Energy and Transport suggests in the Document a solution to the problem of the FFPs: "Trading points, albeit at a discount has been suggested as a way of increasing the value of the schemes to the consumer and of reducing competition worries. Unsurprisingly, given that the FFPs were designed to promote loyalty among consumers, the airlines are not very positive about the idea of turning the schemes into more generalised discounts." (p. 17, paragraph 3.6 of the document). Based on the ideas set forth in the Consultation Document in May 2000, the Commission launched a campaign to make passengers aware of their rights through an information campaign with posters prominently displayed in airports, travel agents and airline booking offices. The Commission drafted a Charter of Passenger Rights featuring sections on information about flights and reservations, overbooking, compensation in case of accidents, data protection and package holidays. The Commission communicated its further plans for the protection of air passengers in the European Union in June 2000 to the Council and the

European Parliament (COM/2000/365 final). The problems of FFPs were not mentioned in this document. However, the main concern in respect of consumer protection of individual travellers which at present is that consumers should be better informed and know their rights also covers FFPs. The Commission's policy is based not only on Community legislation but also on voluntary commitments by the air transport sector to improve service quality. It is therefore an important aspect to find the right balance between legislation and voluntary action.

Even though the FFPs do not figure in the Commission's policy considerations - except for a casual mentioning here and there, perhaps two solutions to the problems raised by the FFPs and consumer protection are possible. One is the establishment of a grey market for the selling and buying of bonus points, the other the introduction of a Code of Conduct. From the consumer protection point of view FFPs as a marketing strategy have at least three negative aspects: 1) FFPs make it difficult for the consumer to know what he or she is actually paying for the ticket. Bonus points are never awarded according to their cash value and it involves quite a complicated calculation to find out what the cash value actually is. There is accordingly a lack of transparency here. 2) Consumers are apt to stay loyal, i.e. to fly with the airline offering the FFP without considering if another airline offers better quality service or lower prices. This loyalty effect limits the free choice of the consumer. 3) Consumers become divided into two classes, the members of the FFP and those who are not members. It is only guesswork, but it does not seem far-fetched to suppose that non-member passengers help to pay the costs of running the FFP without themselves benefitting from it.

The first solution concerns the establishemnt of a grey market for selling and buying bonus points. A grey market for selling and buying bonus points existed for some time in the US in the early 1980s. At that time, bonus points were not registered as belonging to a particular user. The bonus savings could be exchanged or sold on the grey market by brokers who specialized in this. Magazines were published which advertised the offer of bonus points for sale. The annual turnover amounted to over 100 million USD. This market no longer exists as a result of a number of actions in court which the airlines brought against the brokers and which they subsequently won. A grey market for selling and buying of bonus points is based on the idea that programme members are not getting what they are paying for, because they are unable to accumulate enough bonus points. This applies to ordinary holiday travellers in particular. Travellers who realize that they will be unable to travel the required number of trips in order to reach the target for a free bonus trip, may still benefit from being programme members by selling their bonus savings on the grey market. If bonus points can be sold on the market, more travellers will be able to redeem bonus points and obtain free bonus trips at one time or another. As the Commission points out, the solution is not attractive to the airlines, because it diminishes the loyalty effects of FFPs. At present bonus points are always registered by the airlines under the FFP member's name and they are non-transferable. This would need to be changed for this solution to be practicable. It is not a bad solution as it can be done without government intervention.

The second solution concerns the introduction by the Commission of a Code of Conduct for FFPs. There are already codes for CRSs, for the allocation of slots for landing and take-off and guide lines for travel agent commissions (TACOs) in existence. In the Nordic countries, The Danish, Finnish, Swedish and Norwegian Consumer Ombudsmen have issued joint guidelines for loyalty programmes generally, which also cover FFPs. Based on these guidelines, a Code of Conduct for FFPs could lay down the following rules: 1) A standard of good marketing practice ensuring correct and adequate information about the FFP so that the

consumer is able to compare different programmes, their advantages and disadvantages. 2) A requirement that bonus savings must be indicated according to their cash value. 3) A requirement that bonus savings can be redeemed also in those cases where the customer has not saved enough points to obtain a free flight.

To sum up, this paper has focused on one aspect of the effect of deregulation on air transport, namely the effect of FFPs on air transport markets. The effects of FFPs on air transport markets in connection with competition policy and Articles 81 and 82 of the EC Treaty have been considered. It was shown that the Commission has only considered FFPs in connection with Article 81 and mergers. Otherwise the Commission has not taken a position according to which regulation of the programmes is needed. Some possible solutions to the problems which FFPs raise have been proposed above. Time will show if they are viable and if the Commission is likely to act along the lines indicated. This paper contains only few references. A full list of references can be found in report 14/1999 published by Research Centre Bornholm written by Susanne Storm: *Air transport Policies and Frequent Flyer Programmes in the European Community - a Scandinavian Perspective.* A list can also be found on the website at www.tlc.unn.ac.uk by clicking on issue four 2000 of International Travel Law Journal.