



**BEFORE THE**  
**COMPETITION COMMISSION OF PAKISTAN**  
**IN THE MATTER OF**

**Pakistan International Airlines**  
(File No. 14/DIR (M&TA)/PIA/CCP/09)

Dates of Hearing	12 October 2009 3 November 2009
Present:	Dr. Joseph Wilson, Member
Present for Pakistan International Airlines	Mr. Suhail Mahmud, GM Legal Mr. Rashid Aziz, GM (Revenue & Management) Mr. Ali Tahir Qasim, Deputy GM (Revenue & Management) (Present at 2 <sup>nd</sup> hearing only)

**ORDER**

1. At issue in this case is whether Pakistan International Airlines' policy to charge a fee for rescheduling of domestic reservations within 48 hours of flight based on a percentage of air fare amounts to price discrimination, among passengers holding reservations in a particular flight and cabin, constituting abuse of dominance proscribed under section 3 of the Competition Ordinance, 2009 (hereinafter, "the Ordinance"). I conclude in the affirmative.

## **Factual Background**

2. Pakistan International Airlines (hereinafter “PIA”) was incorporated under Pakistan International Airlines Corporation Ordinance 1955, which was subsequently replaced by the Pakistan International Airlines Corporation Act, 1956. The Government of Pakistan is the largest shareholder of PIA having around 89.93 % of the total shares.<sup>1</sup> The remaining shares are held by public and are traded on all three stock exchanges of Pakistan. PIA’s main business is to provide domestic and international passenger and cargo air transport services within Pakistan and on 30 international routes.<sup>2</sup> As a body corporate engaged in the provision of goods and services, PIA is an undertaking in terms of Section 2(1)(p) of the Ordinance.
3. The Competition Commission of Pakistan (the “**Commission**”) received various complaints of the fact that PIA charges a percentage of the ticket fare whenever passengers reschedule or cancel flights which is not only contrary to the practice followed by other domestic and international carriers, and is also discriminatory.
4. PIA policy was verified from its customer services department and was found to support the complaints received by the Commission. Preliminary research was conducted by collecting information from the official websites of both national and foreign air carriers to assess the national, regional and international industry practice regarding fee charged for rescheduling. On 18 June 2009, PIA was asked to explain the rationale for charging a fee based on a percentage of ticket fare for rescheduling of reservation –which makes an expensive ticket more costly for the passenger to reschedule than the one holding an inexpensive ticket for the same flight – as opposed to the industry standard of charging a fixed fee.

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<sup>1</sup> PIA Annual Report 2007

<sup>2</sup> Civil Aviation Report

5. PIA responded on 02 July 2009 stating that their cost structure model is based on their social responsibility as the national carrier of Pakistan which necessitated operating on non-profitable routes as well. The relevant excerpts of the letter are reproduced below:

- a) ...being the national carrier [PIA] operates on profitable as well as socio economic non-profitable routes on domestic sectors whereas other carriers like, Airblue and Shaheen Air are operating purely on profitable routs.
- b) "PIA is charging only Rs. 400/ as refund/change of booking charges 48 hours prior to flight departure whereas Airblue and Shaheen is collecting Rs. 500/ per ticket"
- c) PIA with the spirit to offer competitive fares to our valued passengers has introduced Revenue Management System.
- d) For lower demand flights, PIA offers law fare booking classes for sale which subsequently allow passengers to refund and change their booking at a lower cost if they desire to do so. However, during high season or in the case of prime flights when the utilization of the available capacity is at its maximum, the revenue loss associated with cancellation/change of bookings/no-shows needs to be off-set by collecting more charges as compared to low demand/season flight. (Emphasis added).<sup>3</sup>

6. The preliminary research and the letter of PIA dated 02 July 2009 warranted a formal inquiry into the matter. The Commission thus took *suo moto* notice, and constituted an Inquiry Committee on 16 July 2009, under section 37(1) of the Ordinance, comprising Mr. Ahmed Qadir, Director and Mr. Umair Javed, Assistant Director, to conduct a formal inquiry in the matter.

7. The Inquiry Committee completed its report on 24 August 2009 and recommended that proceeding under section 30 of the Ordinance may be initiated against PIA.

8. A show cause notice, dated 10 September 2009, was issued to PIA, which in relevant parts reads as follows:

4. **Whereas**, the Inquiry Report concluded that, *prima facie*, the Undertaking's conduct in question is in violation of Section 3(1) read with clauses (a & b) of sub-section (3) of Section 3 of the Ordinance;
  - a. **Whereas** there are two identifiable relevant markets; the market for scheduled commercial domestic air transportation services offered by carriers licensed in Pakistan and the market for scheduled

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<sup>3</sup> PIA letter dated July 02, 2009, bearing reference No. MDS/305/2009, signed by Mr. W. J. Bornshin, Special Assistant to the Managing Director.

commercial international air transportation services that originates or terminates in Pakistan.

- b. **Whereas** the Undertaking, *prima facie*, has a dominant position in both the relevant market in terms of clause (e) of sub-section (1) of Section 2 of the Ordinance;
- c. **Whereas** the Undertaking charges a percentage of the fare as flight rescheduling charges, as opposed to fixed fee which is the industry practice, which appears to result in price discrimination under clause (b) of sub-section (3) of Section 3 of the Ordinance, since passengers who have paid a higher fare have to pay higher charges as compared to those who have paid a lower fare for the same service;
- d. **Whereas** the action appears to result in charging of excessive pricing for services rendered and is, in effect, an unfair trade practice under clause (a) of sub-section 3 of Section 3 of the Ordinance in case of passengers who have paid higher fare tickets;
- e. **Whereas** there is no, *prima facie*, economic justification for the imposition of rescheduling fee based on a percentage of air fare, which, *prima facie*, amounts to abuse of dominance;

### **Reply to Show Cause by PIA**

9. PIA replied to the Show Cause *vide* its letter dated 01 October 2009.

The relevant parts of the submission by PIA are reproduced below:

2. Regarding the contents of para # 2, it is explicitly stated that the undertaking charges a percentage of the ticket fare whenever passengers re-schedule or cancel flights and these charges are not collected when the passenger re-schedules his journey for the first time. The charges on the re-scheduling of the ticket have been established after a detailed study of cost, benefit and market analysis. This strategy aims to minimize the last moment cancellation by the passengers and travel agents, who through their fake reservations used to book the seats earlier and in the nick of the departure hours would back out of it, resulting in inventory spoilage and thereby denying seats to the genuine passengers and thereby incurring revenue loss to the undertaking which is the major source of its survival, and that such practice is followed by all major airlines for instance, Air Blue and Shaheen are charging Rs.500/- per ticket as Refund/Change of Booking Charges, 48 hours prior to flight departure whereas PIA charges Rs.400/-. Secondly all other airlines keep on changing the charges on re-scheduling/canceling the flight time-by-time but PIA has since long maintained the same rate of charges and it has consistent polity (*sic*) in this respect and it is pertinent to mention here that PIA has never received any complaint out of its million

passengers all over the network. Further, it can be termed as cancellation fee or charges as it is being done on the choice and option of the passenger and it can not be termed as penalty, therefore, PIA is justified to collect these cancellation and re-scheduling charges.

3. It is also worth mentioning that the undertaking is a major airline on all the domestic routes in comparison to Air Blue and Shaheen Air which being small airlines of their dimensions, operate only on revenue generating routes, thereby, costing low on expenditure side and generating more on revenue side and a table is given below for your kind perusal:

Ticket refund and change policy	Refunds	Changes
More than 48 hours before flight departure	Rs. 500.00	Rs. 500.00
Within 48 hours of flight departure	Rs.1,200.00	Rs.1,200.00
After flight is open for check-in	Rs.2,000.00	Rs.2,000.00
30 days after flight departure	No refunds	No changes

4. In comparison to the aforesaid airlines the undertaking is being operated on all domestic sectors serving the masses equally and providing them access to every nook and corner of the country and under such situation many sectors prove to be loss incurring sides and resultantly dipping PIA more into the depths of loss. Even then, the undertaking is providing unique services with entire satisfaction of its customers and maintaining the high standard of the industry.

5. In terms of the contents of para # 4 (c), it is explicitly stated that as demand profile of domestic flights begins to peak up within 48 hours of flight departure, the cancellation during this critical period not only results in denial of seats to genuine passengers but also incurs revenue loss to the undertaking, as such, service fee structure has been designed to encourage passengers to plan and cancel their journey well in advance so that the vacant seats can be utilized by the genuine passengers and the undertaking could be saved from such irreparable loss of revenue. Therefore, the cancellation of booking by passengers within 48 hours of flight departure is discouraged in the wake of service fee based upon percentage of fare. (Emphasis added).

6. It is pertinent to mention here that the Revenue Management System of the undertaking operates on the rule of

demand and supply. Seats are available in abundance in lower fare classes on the weak-demand flights, however, on peak-demand flights, lower classes are closed earlier and seats are available in higher classes near to flight departure. If the seats are cancelled at the eleventh hour on such high demand flights before departure, it results in major revenue loss to the undertaking as it is difficult to re-sell the available seats due to cancellation within short span of time, which results in revenue loss. For this genuine reason, high service fee is charged for high fare classes. It is also important to mention that different airlines operating on a particular route have different price and service fee structure based upon their passengers and market profile, as such charging a different pattern of service fee is not tantamount to any unfair trade practice and such charges based on a percentage of the ticket fare are neither excessive nor discriminatory and nor in direct contrast to the undertaking standard both nationally and internationally. During ticket re-scheduling not only the undertaking but all other major carriers, nationally and internationally charges the customers the difference between the old ticket and the newer/rescheduled one as the same fare is not guaranteed and such instructions have been printed on the reservation page of every major carrier and such charges are not opposed to the standard of the undertaking, though the said amount of fee for Air Blue and Shaheen are opposed to the charges of the undertaking but they keep on changing their fee time-by-time but PIA has maintained the same percentage in terms of ticket fare which is absolutely upto the standard of the undertaking.

7. . . . .

8. The undertaking as a major operator on domestic routes has been operating on demand and supply principle and offers quality service with competitive pricing on all major routes, and plays lead role in offering the discounted fares on all major routes, for instance effective 20<sup>th</sup> July, 2009 till 14<sup>th</sup> September, 2009, PIA introduced a special fare of Rs.3989/- (inclusive of all taxes) for Karachi to Lahore /Islamabad / Peshawar/Quetta and vice-versa which was the lowest fare in the market, thereby encouraging other competitors to accordingly reduce their fares to the overall benefit of the passengers.

9. Additionally, the undertaking offers other benefits like ticket validity of six months, refund facility upto three years from the date of issuance of ticket, scheduled flexibility, credible punctuality, extremely discounted fares on socio-economic route like Skardu, Gilgit, Chitral, Makran Coast sector and offering attractive pricing during period of low demand.

10. In view of above all foregoing, it is respectfully submitted that the Show Cause Notice under Section 30 of the

Competition Ordinance, 2007 may kindly be averred (*sic*) on the justifications that the undertaking's service fee structure is not a source of revenue but an (*sic*) strategy of deterrence against last moment cancellation by the passengers and travel agents who through their fake reservations used to book the seats earlier and in the eleventh hour of the departure would back out of it, which resulted in seat denial to genuine passengers and revenue loss to the undertaking. Through this fees structure, passengers are encouraged to plan their journey and its cancellation well in advance rather than cancel it on the nick of the departure time and sustain percentage deduction. Hence, the undertaking is bound to charge the service fee which is not as unfair trade practice under Section 3(3a) and economically justified and not tantamount to abuse of dominance.

10. The two major arguments raised by PIA in support of its policy are:

a) **Revenue Loss**

If the seats are cancelled at the eleventh hour on such high demand flights before departure, it results in major revenue loss to the undertaking as it is difficult to re-sell the available seats due to cancellation within short span of time, which results in revenue loss. For this genuine reason, high service fee is charged for high fare classes.<sup>4</sup>

b) **Deterrence for Last Moment Cancellation**

The undertaking's service fee structure is not a source of revenue but a strategy of deterrence against last moment cancellation by the passengers and travel agents who through their fake reservations used to book the seats earlier and in the eleventh hour of the departure would back out of it, which resulted in seat denial to genuine passengers and revenue loss to the undertaking.<sup>5</sup>

I will address these arguments below

## ANALYSIS

11. Section 3 of the Ordinance prohibits abuse of dominant position. Section 3 is reproduced below for ease of reference:

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<sup>4</sup> Paragraph 6 of the Reply to Show Cause by PIA dated 01 October 2009. *See also* para 5. *Id.*

<sup>5</sup> *Id.* Paragraph 10; *see also* paragraph 2.

**3. Abuse of dominant position.**-(1) No Person shall abuse dominant position.

- (2) An abuse of dominant position shall be deemed to have been brought about, maintained or continued if it consists of practices which prevent, restrict, reduce or distort competition in the relevant market.
- (3) The expression “practices” referred to in sub-section (2) shall include, but are not limited to—
  - (a) limiting production, sales and unreasonable increases in price or other unfair trading conditions;
  - (b) price discrimination by charging different prices for the same goods or services from different customers in the absence of objective justifications that may justify different prices;
  - (c) . . . .

12. Section 3 applies only when where one undertaking has a “dominant position” or where two or more undertakings are “collectively dominant.”<sup>6</sup> A finding of dominance – whether individual or collective – involves a two-stage procedure. The first is the determination of relevant market<sup>7</sup>, and the second is the determination whether the undertaking(s) concerned enjoys dominant position as defined in section 2(e) of the Ordinance.

13. The relevant market comprises of relevant product market and relevant geographic market. The relevant product market in this case are the scheduled commercial domestic air transportation services offered by carriers licensed in Pakistan; and the geographic market is the whole of the Pakistan.

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<sup>6</sup> See Section 2(e) of the Ordinance defining “dominant position” of one undertaking or several undertakings in a relevant market shall be deemed to exist if such undertaking or undertakings have the ability to behave to an appreciable extent independently of competitors, customers, consumers and suppliers and the position of an undertaking shall be presumed to be dominant if its share of the relevant market exceeds forty percent.

<sup>7</sup> Section 2(1)(k) of the Ordinance defines relevant market as follows:

Relevant market means the market which shall be determined by the Commission with reference to a product market and a geographic market and a product market comprises of all those products or services which are regarded as interchangeable or substitutable by the consumers by reason of the products’ characteristic, prices and intended uses. A geographic market comprises the area in which the undertakings concerned are involved in the supply of products or services and in which the conditions of competition are sufficiently homogenous and which can be distinguished from neighbouring geographic areas because, in particular, the conditions of the Competition are appreciably different in those areas.



14. There are three major airlines licensed in Pakistan to offer scheduled commercial air transportation services in Pakistan, namely PIA, Air Blue, and Shaheen Air. Aero Asia has limited operations in the country. According to the market share data available PIA's enjoys dominant position in the domestic commercial aviation market. PIA has admitted that it enjoys dominant position in the relevant market.<sup>8</sup>

<b>PIA Market Share 2007-2008</b>				
	2007 Int'l	2008 Int'l	2007 Domestic	2008 Domestic
<b>Total Air Traffic</b>	11,901,162	10,915,203	6,320,405	5,406,466
<b>PIA Air Traffic</b>	4,986,878	4,363,229	4,717,011	4,034,342
<b>PIA % Share</b>	41.90	39.97	74.63	74.62
<b>PIA Avg. 2007-08 - International</b>				<b>40.94</b>
<b>PIA Avg. 2007-08 - Domestic</b>				<b>74.63</b>

Air Transport Sector Note<sup>9</sup>

15. Having defined the relevant market and determined the dominant position of PIA, the next step is to determine whether the practice of charging rescheduling fee based on the percentage of air fare amounts to price discrimination and thus abuse of dominance.
16. Price discrimination by a dominant player is anticompetitive.

In *Vogel v. American Society of Appraisers*,<sup>10</sup> Vogel, an experienced gem appraiser, charged a flat rate of one percent. Although he had been a member of the American Society of Appraisers, the group expelled him out of the belief “that it [was] unprofessional and unethical for the appraiser to do work for a fixed percentage of the amount of value . . . which he determine[d] at the conclusion of his work.” Vogel sued, alleging price fixing.

Judge Posner observed that Vogel's system of charging a one percent appraisal fee was not a charge related to the time, skill, or effort needed to perform the appraisal. Rather, it was a way to charge more to wealthier or less sophisticated customers. He called Vogel's fees a form of "price discrimination, which is normally

<sup>8</sup> Paragraph 3 of the Reply to Show Cause by PIA dated 01 October 2009. (the undertaking is a major airline on all the domestic routes).

<sup>9</sup> The note was prepared by Charles E. Schlumberger of the World Bank for the Civil Aviation component of the Second Trade and Transport Facilitation Project, Pakistan 26 to 31 January 2009.

<sup>10</sup> 744 F.2d 598 (7th Cir. 1984).

anticompetitive.<sup>11</sup> (Emphasis added).

17. Rescheduling fee is an administrative fee levied to perform the service of rescheduling rendered by an airline. In the case of PIA, the rescheduling fee retains the character of administrative fee, if rescheduling is requested prior to 48 hours of flight departure. That is, everyone pays a fixed fee of Rs. 400 regardless of the type of ticket purchased. However, the moment one wants to reschedule the reservation within 48 hours of the flight, the rescheduling fee changes its character from fee charged for performing services to fee charged to recover losses. It a way to charge more to those who paid more for their ticket than from those who paid less for their ticket. This amounts to price discrimination and proscribed under section 3 of the Ordinance.
18. PIA argued that the industry practice of charging different fares from different passengers for the same flight than also amounts to price discrimination. As the economy/business class cabins are divided into different classes, each having a different fare structure. For instance, the economy class fare structure on flight from Islamabad to Karachi, as of 1 October 2009, was as below:

Sector	Class	Base Fare	30% of Base Fare	50% of Base Fare
ISB-KHI OR ISB-KHI	I	3,180	954	1,590
	O	5,020	1,506	2,510
	N	6,100	1,830	3,050
	T	7,100	2,130	3,550
	M	7,700	2,310	3,850
	K	8,300	2,490	4,150
	Y	9,000	2,700	4,500

19. The concept of multiple fares is not unique to PIA. The objective in setting fares is to maximize the revenue from each flight, by offering the right mix of full-fare tickets and various discounted tickets. It is globally

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<sup>11</sup> See Robert H. Lande & Howard P. Marvel, *The Three Types of Collusion: Fixing Prices, Rivals, and Rules*, 2000 Wis. L. Rev. 941 at p. 989 (2000). (footnotes omitted)

known as *versioning*, which implies that one version of the product, in this matter, airline tickets, is deliberately made less attractive. Economic studies have shown that versioning, even though amounts to price discrimination, is welfare enhancing and therefore allowed. An excerpt from one study is reproduced here at length for the benefit of the undertaking and other stakeholders.

Versioning implies that all consumers are facing the same price schedule. They can choose to buy an expensive, high quality version or a cheap, low quality version. Technically, this is an example of second degree price discrimination. The consumers pay different prices for different amounts of quality of the good purchased.

Versioning usually implies that one version of the product is deliberately made less attractive. The consumer with a low willingness to pay is offered this inferior version, while a full quality version remains available to those with a high willingness to pay.

The inferior version must be sufficiently unattractive to the customers with a high willingness to pay, that they choose to adhere to – i.e., pay for – the superior quality version. Otherwise the seller will only be able to charge the same low price from (almost) every customer. Typically, the airline carrier would offer the leisure traveller a «damaged» – i. e., inflexible – ticket, in order to make the inexpensive version unattractive to the less price elastic business traveller segment.

At first sight this may seem clearly detrimental to welfare. Such is, however, not necessarily the case. It depends on what the alternative to versioning might be. According to Varian (1996), the key question is whether versioning leads to an increase in total output. If versioning implies that some groups are served that would otherwise not have been served, versioning may lead to higher welfare. In the airline industry, an increase in total output is typically related to frequency. Higher demand means that the airline can find it profitable to offer more flights and thereby to increase the frequency. If so, versioning has a positive externality. In the business segment, in particular, higher frequency is valuable, since a typical business passenger would benefit from a large choice of departure times.

Given that the airline needs a certain revenue in order to cover its fixed costs, a discriminating price structure may in fact be the most appropriate one from a societal and economic perspective. The welfare loss due to prices above marginal costs is at a minimum if the price-cost margins are high in segments with price inelastic demand and low in segments with price elastic demand. This is exactly what we observe in an airline industry environment with versioning and competition.

Steen and Sørgard (2002) suggest three conditions that may contribute to welfare improving versioning: (i) the fraction of consumers with high willingness to pay is large, (ii) their valuation of

extra quality is high, and (iii) the other group's valuation of quality degradation is limited.

It may be argued that all of these conditions are commonly present in the air travel market. A large part of the market is made up by business travellers, whose willingness to pay for quality is high. The product damaging is harmful for those who do not buy the inexpensive ticket, but probably not very harmful to those who do buy it. A leisure traveller might travel during the weekend, and then a Saturday night stay-over is not harmful at all.

Moreover, the alternative to versioning might be that no low quality version would be offered. Without the ability to price discriminate, many routes would become unprofitable to the airline and hence not be served at all. Other routes would have a much less frequent service, the capacity being determined by the volume of business travel demand. In such a case, the segment with low willingness to pay would have been hurt by a shift from versioning to no versioning.

Finally, empirical studies indicate that competition leads to a cheaper «damaged» product. Since this segment is typically quite price elastic, it would lead to a substantial output increase and thereby a substantial welfare increase at the end of the day.

In conclusion, Steen and Sørsgard (2002) therefore suggest that versioning, as practiced in the airline industry, is ultimately welfare improving. This is so in a monopoly situation, and probably even more so in a competitive setting. One aspect, however, that should not be overlooked is the fact that versioning reduces price transparency. The more versions are offered in the market, at different prices, the harder it becomes for a consumer to compare prices and quality between suppliers. An incumbent supplier may exploit this to reduce a new entrant's potential for attracting customers through price rivalry, thus easing the competitive pressure.<sup>12</sup>

### **Reply to PIA Arguments**

20. As paragraph 2 of its reply, PIA “stated that the undertaking charges a percentage of the ticket fare whenever passengers re-schedule or cancel flights and these charges are not collected when the passenger re-schedules his journey for the first time.” This is true for international passengers only and not for domestic passengers. We are here seized with the matter that pertains to domestic flights, and to that extent this assertion is incorrect.

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<sup>12</sup> Competitive Airlines: Towards a More Vigorous Competition Policy in Relation to the Air Travel Market, Nordic Competition Authorities, 2002. [www.kilpailuvirasto.fi/tiedostot/competitive-airlines.pdf](http://www.kilpailuvirasto.fi/tiedostot/competitive-airlines.pdf)

21. **Revenue Loss.** The representatives of PIA argued at length that the measure is taken to recover revenue loss. I fail to see how PIA would suffer revenue loss when a passenger is simply asking to reschedule him from flight to A to flight B. The passenger has already paid the fare, and the revenue is accrued to PIA; how would rescheduling occur in revenue loss?
22. **Deterrence for Last Moment Cancellation.** This Commission has discussed in other cases that one of determinants of a competitive market is choice for consumers. An effort to limit that choice by imposing higher fee for rescheduling is anti-competitive.
23. PIA after having understood the concern of the Commission, has volunteered to remove the discriminatory fee structured and offered a proposal on 19 November 2009 through email to Director (M & TA), which is reproduced below:

In line with recommendation of Competition Commission, Revenue Management, division of PIAC has worked out the following proposal for application of Rescheduling / Cancellation / Refund fee for Economy Class to absolute / fixed amount as against existing percentage based fee structure:

		<b>Proposed Fee</b>
Before 48 Hrs of Flight Departure	<b>Prim</b>	400
	<b>Seco</b>	400
	<b>Feeder</b>	400
Within 48 Hrs. before flight departure or 01 hrs. before flight departure	<b>Prim</b>	1800
	<b>Seco</b>	1500
	<b>Feeder</b>	900
No-show	<b>Prim</b>	3000
	<b>Seco</b>	2500
	<b>Feeder</b>	1500

Once the above proposed amounts are agreed by the Competition Commission, we will put same for higher management approval for further implementation with effect from 1st January, 2010.

24. This bench appreciates the understanding and cooperation of PIA, and order as follows:

- a) That the proposed non-discriminatory rescheduling fee structure be implemented in letter and spirit as of 1 January 2010.
  - b) That a passenger who wishes to reschedule his/her flight to an immediate preceding flight be allowed to do that without any charge.
25. In light of PIA cooperation and understanding, I have taken a lenient view and exonerated the undertaking from any penalty.
26. It is so ordered.

(DR. JOSEPH WILSON)  
Member

Islamabad the    of December 2009.