US/EU Open Skies Agreement - Some Issues

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I. INTRODUCTION

There has been some polarization in the discussions regarding the advantages and disadvantages of the open skies negotiations between the United States and the European Union ("EU"), particularly on the U.S. side. This divergence has largely been due to the perennial dichotomy between interests of the legislature, which ensures national control of U.S. airlines, and the aviation industry, which is regularly in the red and is looking for openings to put U.S. airlines back on their feet. Both manufacturers (such as Boeing) and airlines (such as United Airlines) have claimed that the infusion of foreign capital in U.S. airlines could help bail domestic carriers out of financial instability. However, U.S. legislators have argued that an open-skies agreement between the United States and the EU, where it has been proposed by the EU that current U.S. restrictions on ownership and control of U.S. airlines, pegged at 25% for foreigners, be relaxed, could have serious consequences and could allow foreign interests to restructure the U.S. airline industry.

It has been reported that U.S. Secretary of Transportation Norman Y. Mineta stated that an open-skies agreement between the United States and the EU would provide the United States with a historic opportunity to increase travel, reduce fares, expand commerce, and bring the two continents closer together.¹ He also noted that an agreement would provide airlines of both the United States and the EU with opportunities for healthier competition in a growing travel market and more connections between cities and towns of all sizes on both sides of the Atlant-
tic. Additionally, Jeffrey N. Shane, U.S. Undersecretary for Policy at the Department of Transportation, appearing before the Aviation Subcommittee of the House Transportation and Infrastructure Committee on February 8, 2006, underscored the fact that, to continue to be effective, U.S. carriers required significant capital investments in facilities, technology, and a variety of commercial arrangements. In this endeavor, the U.S. airlines should have access to global capital markets as allowed by law. Mr. Shane assured the Subcommittee that, while an open-skies agreement between the United States and EU would enhance the ability of U.S. airlines to compete and their potential to create employment opportunities, it would by no means allow for the amendment of the current ownership limits requiring 75% of the voting stock in airlines to be owned by U.S. citizens. Furthermore, Mr. Shane added that the president and two-thirds of the board of directors and other managing officials would be U.S. citizens and airline companies would remain under the control of U.S. citizens.

Mr. Shane went on to point out that the department has a statutory mandate to foster a safe, healthy, and competitive airline industry that will remain capable of sustaining U.S. economic growth by meeting the people’s needs in transportation. He further stated that the Department of Transportation’s Proposed Notice of Rulemaking would also require reciprocity in that, for a non-U.S. investor to enjoy the benefits of the flexibility that would be available, U.S. investors would have equal opportunity and right in the home country of the foreign investor. The main point made by Mr. Shane was that there was well-established policy in major industries such as financial services, automobile manufacturing, information technology, steel, and pharmaceuticals allowing for capital to flow freely across borders enabling competitors to establish a global market presence, effectively exploit economies of scope and scale, and respond to customer demand. The Department’s proposal for U.S. air-

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2 Id.
4 Id. at 2.
5 Id.
6 Id. at 3.
7 Id. at 2
8 Id. at 3-4.
lines was along similar lines, placing maximum reliance on competitive market forces in air transport.\(^9\)

The apprehension of U.S. legislators regarding the possible lack of control of U.S. airlines by U.S. citizens under an open-skies agreement with the EU is not the only issue at stake for both parties to the negotiations. There are other issues that this article will address along with the ownership and control issue.

The *Economic Briefing* of the International Air Transport Association ("IATA"),\(^10\) issued in February 2006, notes that over 2000 aircraft were ordered in 2005 from the two largest aircraft manufacturers—Airbus and Boeing.\(^11\) These large orders have been placed despite the airline industry incurring an estimated net loss of $6 billion in 2006.\(^12\) The main concern with such large orders is that the injection of large capacity might adversely affect price competition in the years to come.\(^13\) The only consolation, however, is that the current trend of aircraft orders tends to suggest a managed delivery schedule, which will compare favorably with the two previous peak cycles of 1991 and 1999.\(^14\) Another encouraging fact is that a large number of aircraft will be delivered to burgeoning markets in China and India, which have already proven the need for more capacity in their markets in the next five years.\(^15\)

Still concerning, though, is the fact that orders from North America and Europe are quite substantial, raising questions as to whether a liberalized regime between the two great regions across the Atlantic might result in capacity dumping and pricing inconsistencies, particularly from 2007 when large orders are

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\(^9\) *Id.* at 4.

\(^10\) *Id.*

\(^11\) IATA was formed in 1919 to provide a forum for the exchange of ideas and experiences gained during the pioneering years of international air transport. Formally established in 1945, IATA is now an association of the airlines and represents them and watches out for their interests. The mission of IATA is to promote safe, reliable and secure air services for the benefit of the peoples of the world; provide means of collaboration among airlines engaged directly or indirectly in air transport; and cooperate with the International Civil Aviation Organization and other relevant organizations. See Int'l Civil Aviation Org. [ICAO], *Manual on the Regulation of Int'l Air Transport*, at 38-1, ICAO Doc. 9626 (2d ed. 2004) [hereinafter ICAO Doc. 9626].

\(^12\) *Id.*

\(^13\) *Id.*

\(^14\) *Id.*

\(^15\) *Id.*
scheduled to be delivered. Of particular concern is that, in the event demand growth in services takes a downward path, large-scale new deliveries could force airlines to enter into cutthroat price competition just as airlines are beginning to make a profit in 2007. IATA acknowledges that the airline industry has not shown much wisdom in the timing of new orders and delivery dates and that the industry, being capital intensive, could therefore be adversely affected by the timing of orders and deliveries which dictate profit and loss in the industry.

It is against this backdrop that the United States and the European Union have launched a new round of negotiations toward open skies, calculated to bring about unfettered competition among their airlines. The fundamental aim of the US/EU negotiations is to do away with the existing tapestry of bilateral air-services agreements between individual European Union member States and the United States and set up one system regulating transatlantic aviation. One of the issues on the

16 The estimates of IATA show net profits for the airlines of $6.5 billion in 2007 after incurring $46.4 billion of losses over the previous six years. Id. at 2.

17 Id. at 2.

18 The European Union or the EU is an intergovernmental and supranational union of twenty-five European countries, known as member states. European Union (last visited Feb. 24, 2007), Wikipedia, http://en.wikipedia.org/wiki/European_Union. Two new member states will join in 2007—Romania and Bulgaria. Id. The European Union was established under that name in 1992 by the Treaty on European Union (the Maastricht Treaty). Id. However, many aspects of the Union existed before that date through a series of predecessor relationships, dating back to 1951. Id. The European Union's activities cover all areas of public policy, from health and economic policy to foreign affairs and defense. Id. However, the extent of its powers differs greatly between areas. Id. Depending on the area in question, the EU may therefore resemble any one of the following: a federation (for example, on monetary affairs, agricultural, trade and environmental policy, economic and social policy); a confederation (for example, on home affairs); or, an international organization (for example, in foreign affairs). Id. A key activity of the EU is the establishment and administration of a common single market, consisting of a customs union, a single currency (adopted by twelve of the twenty-five member states), a common agricultural policy, a common trade policy, and a common fisheries policy. Id.

19 An open-skies agreement is defined as a type of agreement which, while not uniformly defined by its various advocates, would create a regulatory regime that relies chiefly on sustained market competition for the achievement of its air-services goals and is largely or entirely devoid of a priori governmental management of access rights, capacity and pricing, while having safeguards appropriate to maintaining the minimum regulation necessary to achieve the goals of the agreement. See ICAO Doc. 9626, supra note 10, at 2.2–2. Open-skies agreements are believed to provide for more competition, lower prices, and higher passenger volumes in markets between signatory nations. See id.
table is cabotage rights, particularly for European carriers who cannot carry revenue passengers from point to point in the United States. One offer by the United States has been the right for European carriers to fly from anywhere in the EU to any point in the United States. However, the United States has sought in return beyond fifth-freedom rights (in other words, the right for U.S. carriers to carry revenue passengers from a European point to points beyond Europe) and vice versa offered rights beyond the United States for European carriers.

Another key issue is ownership and control of carriers. Where the United States limits foreign voting rights in its airlines to 25%, the EU has placed a ceiling at 49% foreign voting rights. The United States's compromise to this impasse has been to offer global investors more flexibility in marketing, routing, and fleet structures, while retaining the 25% cap on foreign investment in U.S. airlines. The United States has categorically stated that U.S. investment rules cannot and indeed will not be a topic for negotiation. The increased leverage given to foreign investors is meant to facilitate the influx of foreign capital by airlines in the red, such as Delta, United, and Northwest Airlines, who are facing bankruptcy proceedings.

Despite the setbacks of its major carriers, the United States has taken a courageous step towards liberalization in the belief that deregulation has to continue and that liberalization of air transport between the United States and Europe would result in increased market share for U.S. carriers, as well as further

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20. A cabotage right or cabotage privilege is a right or privilege granted to a foreign State or foreign carrier to carry revenue traffic from one airport of a State to another in the same contiguous territory of that State. See id. at 4.1-10.


23. Id.

24. The effects of open skies agreements signed by the United States with Latin American countries has been beneficial to U.S. carriers. A report released on this subject in 2000 revealed that an open skies arrangement with these countries is particularly advantageous for U.S. carriers. See THE IMPACT OF OPEN SKIES BETWEEN THE UNITED STATES AND LATIN AMERICA, 78 (available from AvMAN, 6355, NW 36th St. Suite 601 Miami, Fl 33166). The study showed that from 1997 to 1998 the capacity of U.S. carriers in countries with open skies increased by 24.2%, while local carriers boosted their capacity by only 12.3%. Id. Also, in the same period, Origin-Destination ("OD") traffic between the United States and open-skies countries in the region grew by 22.2%, while the same traffic rose only 3.5% in countries without open skies. Id. The study mentions that market shares of
strengthening already robust competition between North American carriers and their European counterparts. Jeffrey Shane, Undersecretary for Policy at the U.S. Department of Transportation, has categorically stated that aviation liberalization is not "for the faint of heart," and that a possible breakthrough towards open skies between the United States and EU would bring an entirely new level of liberalization to trans-Atlantic air services. The United States believes that open skies and open-market access for United States and EU carriers will not only bring 750 million people together, but will also create a template for other regions of the world to follow.

The United States claims that one of the issues on which both parties are in agreement is that there should be service by every European and every American carrier between all points in Europe and all points in the United States, although the EU has not confirmed this statement. Broadly, the United States is seeking the right for every U.S. carrier to fly from a European Union member state to another European Union member State and beyond to third countries, which essentially means that all traffic restrictions currently in place at some major European airports, including London Heathrow, should be lifted.

From the European perspective, the hope was that an aviation agreement could be reached in early 2006 once the United States clarified its position on control of airlines. On November 23, 2005, both the United States and the EU issued a joint statement that referred to their meeting, which took place from

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U.S. carriers in Latin American OD markets began to rise dramatically in the 1990s regardless of whether open skies existed. The study also points out that between 1990 and 1998, the U.S. flag market share between the United States and South America jumped from 43.1% to 57.4%, while it climbed eight points to 60.4% in Central America and Mexico. Results of the study also indicate that in 1998, South American airlines lost "more than 1.2 million passengers to their U.S. competitors," while Central American and Mexican carriers lost 1.3 million.

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25 At a lecture delivered to the Royal Aeronautical Society, Montreal Branch, on December 8, 2005, titled Air Transport Liberalization: Ideal or Ordeal, Mr. Shane asserted that liberalization begets more liberalization, and that liberalization is the classic good deal that will not go unpunished. See Jeffrey Shane, Undersec'y of Transp., Air Transport Liberalization: Ideal or Ordeal, Address Before the Royal Aeronautical Society (Dec. 8, 2005).

26 Jeffrey Shane, supra note 22, at 80.


28 Id.

November 14th through the 18th, 2005, and stated that progress was made toward the signing of an aviation pact between the two parties that would authorize every EU and U.S. airline to fly between every city in the EU and every city in the United States without restrictions on the number of flights, aircraft types, or routes selected, and would also involve unrestricted rights to fly beyond the EU and United States to points in third countries. Such an agreement would authorize every EU and every U.S. airline to set fares freely in accordance with market demand and to enter freely into cooperation agreements with other airlines, including code sharing and leasing agreements. A precondition to such flexibility is that there should be a fundamental commitment to the highest standards of aviation safety and security.

II. THE ISSUES INVOLVED

Individual European States, which until 1987 were separately charting their destinies and their carriers’ fortunes in their operations of international air services, showed an initial inclination to work towards collective interests by partially liberalizing European pricing policy in 1987. In 1993, the European countries of the European Economic Community agreed to full liberalization of pricing and liberalization of market access to apply on an intra-European basis. The culmination of the unification of European air transport came in 1997 when the European Union agreed to accord cabotage rights to carriers of the EU member States within the Union.

The European Economic Community, which was an economic union of States, had its genesis in the Treaty of Rome of March 25, 1957, and became the European Union by virtue of

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31 Air transport in the European Community is fundamentally regulated by two treaties: the Treaty which establishes the European Coal and Steel Community (ECSC Treaty) and the Treaty which establishes the European Economic Community (EEC Treaty, now called the EC Treaty). The former, which was signed in Paris in 1951, addresses issues related to the carriage of coal and steel through the media of rail, road and inland waterways and as such is not directly relevant to aviation. The latter, on the other hand, admits of issues relating to all modes of transport in the carriage of persons and goods and is of some relevance to aviation.

The EEC Treaty, which was signed in Rome on 25 March 1957, has at its core a Common Transport Policy ("CTP") concept which is calculated to achieve the fundamental purposes of the European Community. One of the most salient features of the EEC Treaty is that the tasks of the Community are set out succinctly in Article 2 of the Treaty, which provides *inter alia* for the adoption of a
the Treaty of Maastricht of February 1992, which was amended by the Treaty of Amsterdam of October 1997. The EU is a monetary union and not a political union as yet. It is founded on the basic premise that there is no discrimination based on nationality. The application of this premise to air transport can be translated to the fact that only nationally owned carriers of the EU member States could be the subject of bilateral air-services agreements negotiated by the Union with third countries. As such, individual state members of the EU cannot separately negotiate bilateral air-services agreements with third countries on issues of nationality, as member States have the obligation to honor European Community law when they negotiate air services with third countries. However, as the result of a decision of the European Court of Justice handed down in November 2002, sovereign member States of the EU could not be deprived of their power and right to conclude agreements with third countries, due to the fact that the EU common free market only applied to intra-community air transport.32

From a legal perspective, air carriers of the member states of the EU cannot have a European nationality since the EU does not have the sovereign status of a state. This notwithstanding, the Council of Ministers of the EU has given the European Commission33 the mandate to negotiate with the United States CTP as provided for in Article 3(1) of the Treaty. This provision is linked to Article 74, which in turn provides that the objectives of the Treaty in relation to issues of transportation would be pursued by State Parties within the parameters of the CTP, which is established by the Council of Europe through secondary legislation.


33 Two of the most important EU institutions are the Council of the European Union and the European Commission (the other two being the European Parliament and the European Court of Justice. The Council of the European Union contains ministers of the governments of each of the European Union member states. It is sometimes referred to in official European Union documents simply as the Council or the Council of Ministers (which will become its official name if the Treaty establishing a Constitution for Europe is adopted). The Council has a President and a Secretary-General. The President of the Council is a Minister of the state currently holding the Presidency of the Council of the European Union, while the Secretary-General is the head of the Council Secretariat, chosen by the member states by unanimity, providing general advice, qualified legal advice, translation services, and impartial negotiation assistance. The Council of the European Union should be distinguished from the European Council, which meets four times a year in what is informally known as the European Summit (EU summit), and is a closely related but separate body, made up with the heads of state and government of the member states, whose mission is to provide guidance and
and other third countries, particularly to have such countries accept the fact that carriers of member states of the EU are "Community air carriers" established in the territory of the EU irrespective of their national ownership.

European carriers would like the right to operate between the EU and the United States from any point within the EU (which would translate as a seventh freedom right in operating from a country other than the carrier's national territory) and extend that service to points within the United States (which is the eighth freedom right or consecutive cabotage). EU carriers also seek the right to own and control U.S. carriers and, therefore, operate air services between points in the United States, which is identified in the context of air law as the ninth freedom or "stand alone cabotage." In order to obtain these rights, European carriers seek the abolition of ownership of U.S. carriers by U.S. nationals so that they (European carriers) can attract capital from international money markets and enter into mergers and acquisitions of foreign carriers. If this were allowed by the United States (which is seemingly an impossibility under current U.S. policy) European carriers would still have to operate on the basis that they remain "Community carriers" by their European ownership.

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high level policy to the Council. It is also to be distinguished from the Council of Europe, which is a completely separate international organization and not a European institution.

The European Commission (formally the Commission of the European Communities) is the executive body of the European Union. Alongside the European Parliament and the Council of the European Union, it is one of the three main institutions governing the Union.

34 The seventh freedom of the air is the right or privilege in respect of scheduled international air services, granted by one State to another State, of transporting traffic between the territory of the granting State, and any third State with no requirement to include on such operation any point in the territory of the recipient State (in other words, the service need not connect to or be an extension of service to or from the home State of the carrier). See ICAO Doc. 9626, supra note 10, at 4.1-10.

35 The eighth freedom of the air is the right or privilege, in respect of scheduled international air services, of transporting cabotage traffic between two points in the territory of the granting State on a service which originates or terminates in the home territory of the foreign carrier or (in connection with the seventh freedom of the air) outside the territory of the granting State. Id.

36 Id.

37 The ninth freedom of the air is the right or privilege of transporting cabotage traffic of the granting State on a service performed entirely within the territory of the granting State. See id. at 4.1-10-11.

38 Id. at 4.1-11.

39 Bakes, supra note 21, at 76.
U.S. carriers seek free access to London Heathrow and seventh-freedom carriage within the EU for express carriers. In broad terms, the U.S. interests are focused on turning the North Atlantic aviation market into an open-skies area, giving rise to a common international air traffic market untrammeled by any conditions on market access, capacity, and pricing. This would, of course, exclude the internal U.S. market and any incursion of current U.S. policy on majority ownership of U.S. carriers by U.S. nationals.

In reality, the United States has already acquired for its carriers the rights to operate between European States through current bilateral air-services agreements negotiated with individual European States and as such, any demand by the United States for fifth-freedom rights within the EU cannot be considered cabotage. As Wassenbergh correctly observes, in the absence of a single, unified, sovereign EU airspace, the EU cannot consider operations between sovereign states within the EU cabotage. Nonetheless, the open-skies judgments of the European Court of Justice of November 5, 2002, were to the effect that the eight EU members, by concluding individual bilateral agreements with the United States, had breached EC law in that the individual nationality clauses in all agreements infringed the right of establishment under Article 43 of the EC Treaty by dis-

41 Wassenbergh, supra note 36, at 55.
42 The European Court of Justice (ECJ) is formally known as the Court of Justice of the European Communities (in other words, the court of the European Union (EU)). It is based in Luxembourg, unlike most of the rest of the European Union institutions, which are based in Brussels and Strasbourg. The ECJ is the Supreme Court of the European Union. It adjudicates on matters of interpretation of European law, most commonly: claims by the European Commission that a member state has not implemented a European Union Directive or other legal requirement; claims by member states that the European Commission has exceeded its authority; and references from national courts in the EU member states asking the ECJ questions about the meaning or validity of a particular piece of EC law. The Union has many languages and competing political interests, and so local courts often have difficulty deciding what a particular piece of legislation means in any given context. The ECJ steps in, giving its ruling which is binding on the national court, to which the case will be returned to be disposed of. The ECJ is only permitted to aid in interpretation of the law and cannot decide the facts of the case itself. Individuals cannot bring cases to the ECJ directly. An individual who is sufficiently concerned by an act of one of the institutions of the European Union can challenge that act in a lower court, called the Court of First Instance. An appeal on points of law lies against the decisions of the Court of First Instance to the ECJ. See, e.g., Case C-467198, Comm’n v. Denmark, 2002 E.C.R. I-9855.
criminating on grounds of nationality.\textsuperscript{43} The ECJ also held that the agreements infringed the exclusive external competence of the European Commission.\textsuperscript{44} The essence of the judgments was that in areas where EC legislation affects third countries, only the EU could enter into international commitments.\textsuperscript{45} The new framework of EU air services negotiations is enshrined in Regulation 847/2004, which allows the EC to exercise a "horizontal mandate" to negotiate comprehensive agreements with third countries.\textsuperscript{46} This means that the third country acknowledges the existence of a single European market and the concomitant fact that EU airlines can operate international flights from any member state where they are established.

The European Council of Ministers' Conclusions of June 2005 introduce three lines of action: the EC could continue to bring existing bilateral agreements between EU member states and third countries into line with Community law through horizontal agreements; the EC will establish a common aviation area with neighboring countries by 2010; and global negotiations with key partners would be opened.\textsuperscript{47} In this context, EU carriers claim that their negotiations with the United States go beyond an open-skies regime, leading to total market opening and regulatory convergence. The latter—regulatory convergence—is calculated to establish a level playing field by increasing regulatory cooperation in the fields of competition policy, state aid, aviation security, environmental protection, and safety.

The EU claims, with the advantage of a combined negotiating power of twenty-five member states and a coherent framework for industry within the EU, partners of the Union, such as the United States, could gain unrestricted access to the EU market and have legal security (through horizontal agreements), achieved through a single negotiation.\textsuperscript{48} At the time of writing, the EU was waiting for a final rule from the United States as to whether the U.S. rule regarding ownership and control of U.S. airlines would be aligned towards opening U.S. carriers to over-


\textsuperscript{44} Id. at 497-98.

\textsuperscript{45} Id. at 486-87.


\textsuperscript{47} See Communication from the Commission Developing the Agenda for the Community's External Aviation Policy, at 1, COM (2005) 79 final (Mar. 11, 2005) [hereinafter Communication].

\textsuperscript{48} Id. at 1.
One commentator has predicted that, should a major U.S. carrier be threatened with Chapter 7 liquidation and a European carrier were to offer investment in that carrier, the United States may just be inclined to revisit their existing rules. The above notwithstanding, and despite the slow pace of negotiation between the United States and the EU, both parties have been vigorously forging liberal deals with third countries. At the time of writing, the EC had negotiated and concluded twenty-two horizontal agreements with third countries, while fifty-nine countries had accepted community clauses. The EU internal market had been recognized in 385 bilateral air-services agreements. The EC had also established contact with major partners such as China, Australia, India, and the Russian Federation.

III. EFFECT OF OPEN SKIES ON COMPETITION

A. LEGAL CONSIDERATIONS

Whatever the outcome of the US/EU negotiations is in terms of cabotage for EU carriers and the U.S. rule on ownership and control of its carriers, it seems certain that the two parties could agree on free market access between points in the United States and points in the EU along with fifth-freedom rights. As a corollary, free market access with no limitations on pricing and capacity would certainly open up competition between U.S. and EU carriers.

Competition in the air transport industry is a complex process, and there is no consensus among airline economists as to the exact nature of the industry. The demand for air services, particularly in the context of the airline passenger, is a contrived demand emerging from other demands based on activities such as business and leisure. This calls for a certain segmentation in travel where, in business travel, the passenger does not usually pay for the travel himself, whereas in leisure travel it comes out of his own pocket. Therefore, the leisure market calls for a different kind of competition, primarily based on the fare, whereas in business travel, although the fare is important, other consid-

50 Baker, supra note 21, at 37.
51 Baker, supra note 21, at 37.
operations, such as facilities on board, may also play a considerable role in competition.\textsuperscript{52}

One argument for the retention of regulation is that the very nature of air transport, being either naturally monopolistic or interdependently oligopolistic, calls for regulation in order that fares are not arbitrarily raised and remain competitive. Another theory in support of regulation is that some form of control should be exercised over "mushroom" airlines that may sprout up to exploit a liberalized market, thus disturbing the existing balance of an integrated network. Of course, each route is a separate market in itself and would require separate consideration. Although principles of economies of scale may apply generally to airline competition, where a fact such as larger aircraft being more efficient than smaller aircraft would apply on a general basis, individual assumptions for different markets have caused the two major aircraft manufacturers, Boeing and Airbus Industry, to concentrate on manufacturing aircraft with strengths in speed and capacity, respectively.

The European Union has expressed some concern as to the possibility of having to face potential dangers stemming from predatory pricing practices, particularly with regard to incumbent airlines dropping their prices in the short term to deter new entrants. However, irrespective of the opening of market access and liberalization of pricing and capacity between the United States and EU, there is no room for doubt that neither the United States nor the EU would allow an absolute "free for all," as there are strict legal regimes against anticompetitive conduct and cutthroat practices in pricing in both jurisdictions. The regulation of competition within the European Community is governed by the EC Treaty.\textsuperscript{53} Two provisions in particular, Articles 85 and 86, contain principles which outlaw anticompetitive conduct.\textsuperscript{54} While the former prohibits the prevention, restriction, or distortion of competition, the latter makes itself applicable against abuse by one or more undertakings of a dominant position within the market.\textsuperscript{55} The former essentially con-

\textsuperscript{52} Org. for Econ. Coop. & Dev. [OECD], Deregulation and Airline Competition 20-21 (1988).

\textsuperscript{53} The EC Treaty, also called the Treaty of Rome, was concluded in 1957 to forge "an even closer union among the people of Europe." See Jeffrey Goh, European Air Transport Law and Competition 15 (John Wiley & Sons eds., 1997).


\textsuperscript{55} Id.
tains provisions for agreements, decisions, or practices with anticompetitive effects, and the latter concerns itself with abuses of a dominant marketing position.\textsuperscript{56} The aim of these two provisions is to preclude distortion of competition within the Common Market by supplementing the basic principles enshrined in Articles 81 and 82 with substance.\textsuperscript{57} The goals of the Treaty in general and Articles 85 and 86, which promote the free movement of services, goods, persons, and capital whilst effectively obviating barriers to trade within the community, is to enforce some regulation.\textsuperscript{58} Both these provisions relate generally to all sectors of transport unless explicitly excluded by the Treaty.\textsuperscript{59}

Article 85 prohibits agreements that directly or indirectly fix purchase or selling prices or any other trading conditions; limit or control production, markets, technical development, or investment; share markets or sources of supply; apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; and make the conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of those contracts.\textsuperscript{60} These conditions are imposed on agreements between undertakings, which are defined as independent entities performing some economic or commercial activity.\textsuperscript{61}

Article 86 provides that any "abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the Common Market insofar as it may affect trade between member states."\textsuperscript{62} The Article prohibits the following: direct or indirect imposition of unfair purchase or selling prices or unfair trading conditions; limitation of production, markets, or technical development to the prejudice of consumers; application of dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; and conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or ac-

\begin{itemize}
\item \textsuperscript{56} Id.
\item \textsuperscript{57} Id.
\item \textsuperscript{58} Id.
\item \textsuperscript{59} Case 167/73, Comm'n v. French Republic, 1974 E.C.R. 52.
\item \textsuperscript{60} EEC Treaty art. 85.
\item \textsuperscript{61} Id.
\item \textsuperscript{62} Id.
\end{itemize}
cording to commercial usage, have no connection with the subject of such contracts.\textsuperscript{63} 

In implementing these two provisions, air carriers must not assuming that a bloc exemption on air transport in the Treaty pertaining to a particular issue, a related practice would be exempt from the prohibitions contained in Articles 85 and 86.\textsuperscript{64} In the air transport section of the Treaty, it is abundantly clear that block exemptions may apply only if abuse of dominant position is not evident in a given transaction.\textsuperscript{65} Articles 85 and 86 are independent and complementary provisions and any exemption under Article 85 will not necessarily render the provisions of Article 86 nugatory.\textsuperscript{66} "Dominant position" was defined in the 1979 decision of \textit{Hoffman-La Roche v. Commission}\textsuperscript{67} as a position of economic strength enjoyed by an undertaking that enables it to prevent effective competition in the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, its customers, and ultimately of its consumers.\textsuperscript{68} Such a position may necessarily preclude some competition except in monopoly or quasi-monopoly situations. There is every indication, from existing jurisprudence and EC practice, that an assessment on an abuse of dominant position would not be predicated upon one factor alone or single characteristic, but would rather be anchored on numerous factors such as market structure, barriers to entry, and conduct of the business enterprise concerned.

In the United States, the term "antitrust laws" encompasses federal and state legislation (statutes) which regulate competition with a view to wiping out unfair trade practices and preserving competition among sellers and buyers. Needless to say, antitrust laws apply equally to international air services, and are calculated to preclude both conduct and structural changes in business enterprises. A typical example of conduct coming under antitrust laws in the United States is a merger between competitors which would unduly limit competition. These laws are also meant to prevent producers or purchasers of goods

\textsuperscript{63} Id.

\textsuperscript{64} See id. arts. 85-86.


\textsuperscript{68} Id.
from exercising a monopoly that imposes prices that significantly deviate from expected free market competition norms.

Antitrust legislation in the United States goes back to 1890 and the enactment of the Sherman Act, which makes it criminally illegal for any contract, combination, or conspiracy to be formed in restraint of trade. This all-encompassing legislation prohibits price fixing, antidiscouraging agreements, divisions of markets by pooling agreements and capacity agreements, and exchanges of information that can be considered as competitively sensitive. The Act also prohibits monopolies and conspiracy to monopolize in section two.

In 1914, the United States Congress legislated the Clayton Act, primarily to supplement the Sherman Act. The Clayton Act outlaws certain types of "exclusive dealing" and "tied sales" and prescribes standards for determining the legality of mergers and acquisitions. Both the Acts award compensation to persons injured in their trade or business up to three times the amount of their loss plus attorney fees. Courts have also permitted consumer class actions in antitrust activity, allowing for significant recovery of damages.

There is strong precedent against cutthroat pricing in the United States, couched in the judgment of the 1993 Brooke case, which brings to bear U.S. regulation and judicial policy on predatory practices in an oligopoly setting. The case involved a competitor in the cigarette industry who sold his product below cost, resulting in an action being brought by another cigarette manufacturer under Article 2 of the Sherman Act. The Supreme Court held that for an action to succeed, the plaintiff must show that the defendant's low prices are below an appropriate level of the plaintiff's costs. The fundamental principle establishing the illegality of predation is that the predator must ultimately be recouped by the act of predation.

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70 Id.
71 Id. § 2.
72 Id. § 13.
73 Id.
74 Id. §§ 1, 13.
76 Id.
77 Id. at 222.
78 Id. at 224.
The Court cited an earlier decision\textsuperscript{79} and held that "recoupment is the ultimate objective of an unlawful predatory pricing scheme. It is a means by which a predator profits from predation. Without it . . . consumer welfare is enhanced."\textsuperscript{80} In both the \textit{Brooke} and \textit{Matsushita} cases, the court found no recoupment and therefore no justification to conclude that the defendants had indulged in predation.\textsuperscript{81}

In a regulatory context, the International Civil Aviation Organization ("ICAO"), in its role as the sole international regulatory body in the field of air transport, has issued clear policy and guidance material on the avoidance or reduction of conflicts over the application of competition laws to international air transport.\textsuperscript{82} ICAO has issued these guidelines to address the conflicts that may arise between states which adopt policies, practices, and laws relating to the promotion of competition and restraint of unfair competition within their territories.\textsuperscript{83} ICAO urges states to ensure that their competition laws, policies, and practices, and any application thereof to international air transport are compatible with their obligations under relevant international agreements.\textsuperscript{84} Within this guideline, there is a strong recommendation for close consultation between states and all interested parties in order that uniformity in practice be achieved across borders to the maximum extent possible.\textsuperscript{85} Accordingly, when a state is adopting laws pertaining to competition, it is expected to give full consideration to views expressed by any other state or states whose interests in international air transport may be affected.\textsuperscript{86} States are urged to give full regard to principles of international comity, moderation, and re-

\textsuperscript{80} \textit{Brooke}, 509 U.S. at 224.
\textsuperscript{81} The Areeda-Turner test defines criteria that determine predatory pricing. \textit{See} Hugo B. Roos & Niels W. Sneek, \textit{Some Remarks on Predatory Pricing and Monopolistic Competition in Air Transport}, 22 \textit{AIR} \& \textit{SPACE} L. 154, 154 (1997). According to this test, a short run profit maximizing price as well as a price above full costs are non-predatory. \textit{Id.} The test also goes to consider that a price at or above reasonably anticipated short-run marginal costs is non-predatory. \textit{Id.} Also, a price at or above reasonably anticipated average variable cost should be considered to be within legal limits. \textit{Id.}
\textsuperscript{83} ICAO Doc. 9587, \textit{supra} note 93, at A2-1.
\textsuperscript{84} \textit{Id.}
\textsuperscript{85} \textit{See id.} at A2-2.
\textsuperscript{86} \textit{Id.}
The Guidelines also provide direction on dispute resolution and problem solving.\(^{88}\)

**B. COMMERCIAL CONSIDERATIONS**

It is likely that an open-skies agreement between the United States and EU will lead to increased competition resulting in a wider range of services carried out with greater efficiency and at competitive fares.\(^{89}\) The main effect of an open-skies agreement between the United States and EU would be that London’s Heathrow Airport would be open to carriers other than the two U.S. carriers—United Airlines and American Airlines—that are currently allowed to fly there. It would also enable broader marketing agreements between European and U.S. carriers and help cargo airlines like FedEx and UPS build larger networks. European carriers would have broader access to U.S. destinations as well. In addition, when the travel and tourism industry combined are contributing tremendously to the world economy, an opening of two of the world’s largest markets to open competition would lead to significant secondary effects in employment opportunities. Compared to other regions, the air transport industry in Europe and North America makes the greatest contribution to the world GDP.\(^{90}\) IATA records indicate that in 2004 North America accounted for 37% of global employment in aviation (4.6 million in direct employment and 0.8 million employed as a result of the catalytic effect of such direct employment) and 50% of the contribution of air-transport to the global GDP.\(^{91}\) In comparison, Europe accounted for 27% of global air-transport employment and GDP.\(^{92}\) The liberalization of the US/EU air-transport market will undoubtedly open the doors for both American and European carriers to have in-

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\(^{87}\) Id.

\(^{88}\) Id. at A2-2 to -3.


\(^{91}\) Id.

\(^{92}\) Id.
creased commercial arrangements, such as code sharing,\textsuperscript{93} that would maximize the utilization of market potential both across the Atlantic and beyond.\textsuperscript{94}

The American version of "open skies" is conducive to open competition as it comprises, \textit{inter alia}, the basic elements of open entry to all routes; unrestricted capacity and frequency on all routes; unrestricted route, traffic rights, double disapproval pricing in third and fourth freedom markets in intra-EC markets; liberal charter arrangements; liberal cargo regimes; open code sharing opportunities; and explicit commitment on non-discriminatory operation of access to computer reservation systems.\textsuperscript{95} Although in the nineties Europe thought this concept of open skies and its elements would "endanger the whole process of deregulation of Europe's civil aviation market,"\textsuperscript{96} the overall approach of the EU to current negotiations with the United States has been to accept the philosophy of the United States on open skies. However, the scales would tip in favor of the U.S. carriers under this philosophy, as they would be able to consolidate fifth-freedom rights through a network of routes, whereas the European carriers would not have a comparable variety of points to exercise fifth-freedom rights beyond the United States.

Another inhibitor for European carriers could be the antitrust exigencies that could arise under U.S. law, which may put European carriers at a substantial disadvantage in the U.S. market\textsuperscript{97} For this and the more significant distinction between U.S. own-

\textsuperscript{93} One of the common uses of code sharing is to signify that two airlines conclude an arrangement according to which two or more connecting flights are offered under a common designator code and flight number or those of both airlines, although individual segments are operated with aircraft of one airline. \textit{See} \textsc{R.I.R. Abeyratne, Legal and Regulatory Issues of Computer Reservation Systems and Code Sharing Agreements in Air Transport} 119 (1995).

\textsuperscript{94} It will be recalled that, when the United States and the Netherlands entered into what was the first open skies agreement between the United States and a European country, KLM, who already had access to all U.S. points, consented to the agreement on the condition that both parties accept the KLM/Northwest alliance with antitrust immunity and mutual code sharing. By code sharing, KLM could provide its "own" on-line services to U.S. points without operating services itself. \textit{See} Henri Wassenbergh, \textit{Common Market: Open Skies and Politics}, 25 \textsc{Air \\& Space L.} 174, 176 (2000).


\textsuperscript{96} Neil Kinnock, Undersec'y of Transp., Address Before the Association of European Airlines (Apr. 28, 1995).

\textsuperscript{97} The Department of Transportation and Department of Justice of the United States review antitrust cases on a case-by-case basis. \textit{See} Delta Airlines, D.O.T. Order No. 96-5-26 (1996).
ership and control restrictions (which are placed at 25% for foreign nationals) and leverage given to foreign nationals (49%) in the EU, it would be structurally, economically, and legally more advantageous to U.S. carriers to have an open-skies agreement with Europe while their European counterparts may not be as well placed under such an agreement. Therefore, an open-skies agreement with EU might just help the American carriers in improving their revenues, which have shown a $9.1 billion loss in 2004, followed by a $10 billion loss in 2005, and a projected $6.5 billion loss in 2006. In contrast, the European carriers have shown profits in the triennium, with $0.6 billion in 2004, $1.3 billion in 2005, and a projected $0.6 billion in 2006.\(^8\)

One of the commercial considerations with regard to achieving enhanced competition through an US/EU open-skies agreement is the extent to which the EU will have the authority to negotiate all aspects of the Department of Transportation standard open-skies agreement, which includes slots. Another is whether individual EU member States could still, after the EU signs an open-skies agreement with the United States, negotiate a bilateral air-services agreement with the United States. From the EU perspective, where the Council of Ministers has given a mandate for the Commission to negotiate an agreement with the United States, there is no express prohibition so long as there is recognition of the EU as one single area and the Community clause is signed. The consequence of the European Court of Justice, particularly from a competition angle, was that the core element of the bilateral air-services agreement, which is market access involving the award of air traffic rights, was untouched by the Court except in instances where an EU member, in its agreement with the United States, explicitly precludes another EU member from operating air services from that member’s territory.\(^9\) In other words, Belgium is not permitted to agree that Air France will not or can not operate services between Brussels and New York. This prohibition is entrenched in the Treaty of Rome, which forms the substance of legislative legitimacy of the EU and incorporates the right of equal national treatment for all EU member states.\(^10\) Therefore, if one EU member state precludes the right of another member state’s airline from operating air services to the United States from the

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\(^8\) Mark Smyth & Brian Pearce, IATA, IATA Economics, Presentation Before the ICAO (Jan. 24, 2006).

\(^9\) Case C-467198, Comm’n v. Denmark, 2002 E.C.R. I-9855.

\(^10\) EEC Treaty art. 8.
territory of the first EU state, it would be tantamount to discrim-
inination by the first state against the second state.

Also, the Court decided that certain specific provisions and
areas covered in the questioned bilateral agreements between
individual EU members and the United States were contrary to
EU law since they encroached upon internal EU regulations
pertaining to non-EU nationals. These laws concern the
following:

1. provisions pertaining to the allocation of airport slots;
2. provisions governing pricing, or fares and rates of intra-Euro-
pean air services;
3. agreements on computer reservation systems insofar as they
appear as provisions of the open skies agreements in question; and
4. provisions which reserved the right to grant permission under
the open skies agreements only to airlines substantially owned
and effectively controlled by nationals of the EU member State
that is party to a particular agreement. 101

Yet another issue to be considered is the position of the
United States and the EU on the issue of public subsidies. This
extends both to carriers as well as to manufacturers. On the one
hand, one recalls the Anglo-French Concorde, which sustained
its services through subsidies by the British and French govern-
ments. 102 On the other hand, both parties are in dispute over
subsidies purportedly given to Boeing and Airbus by the United
States and EU, respectively. 103 Further impediments to competi-
tion under a US/EU open-skies regime could be the pervading
influence of national interest, where member States of the EU
must continue to ensure an “inside track” to their carriers,
which may include insistence that nationals of a country fly on
their national carrier; 104 placement in a computer reservation
system where interested parties could give prominence in the

101 See, e.g., Denmark, id.

102 There are other instances, such as Alitalia, where the Italian government
saved the carrier by converting its debt into equity and the subsidies given by the
Scandinavian countries to SAS.

103 See Ruwantissa Abeyratne, The Airbus-Boeing Subsidies Dispute—Some Prelimi-

104 Doganis cites the example where, under the “fly America Policy,” officials
or others traveling on behalf of the U.S. government were and are required to fly
on U.S. airlines or U.S. carrier code-shared flights irrespective of open-skies
agreements applying to the sectors flown. RIGAS DOGANIS, THE AIRLINE BUSINESS
system to their carriers; and the use of excessive user fees to discourage foreign carriers.

As to whether there should be absolute, untrammeled competition within the Americas and between the Americas and Europe is a critical issue for the coming years. Of course, one recent suggestion has been to crystallize a "convergence of regulatory principles" between Europe and the United States in competition by establishing a Transatlantic Common Aviation Area ("TCAA"). This concept, suggested by the Association of European Airlines ("AEA") in a policy statement, puts forward detailed and realistic proposals on how to bring about an ideal regulatory convergence between the European region and the United States, addressing three areas:

1. matters in respect of which harmonization is necessary;
2. those in respect of which convergence could take the form of mutual recognition; and
3. those which could in principle be left at the discretion of each party.

The TCAA concept advocates the freedom of the parties to provide services; addresses issues pertaining to airline ownership and the right of establishment; provides recommendations with regard to competition policy; and offers guidelines on the leasing of aircraft.

Since the TCAA aims at replacing traditional governmental regulatory control of such aspects of competition as market entry and pricing, the issues emerging from competition policy become by far the most complex and difficult to deal with, within the parameters of the TCAA. Although the fundamental postulates of competition in Europe (as followed through by European Union regulations) and the United States are broadly similar in intent, and both depend to a certain extent on the application of extra-territoriality in their regulations, there are obvious differences, such as those embodied in the different approaches to transatlantic airline alliances. Also, the United States stringently relies on a principle of "public interest" in its air transportation policy, while European competition rules are not as explicit in their policies. The basic essence of a TCAA

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106 Id.
107 Id.
108 Id.
109 Id.
110 Id.
would therefore establish the principle that matters of route sharing, capacity, pricing, and frequency of services should be driven by market forces rather than be determined by governmental intervention. This way a certain commonality might be established between air transports of the two regions.

IV. CONCLUSION

The United States has, over the past few decades, steadfastly advocated the need for open-skies agreements with its partners in aviation. At the bilateral level, thirty-eight “open-skies” bilateral air-services agreements have so far been concluded by seventeen states or areas in the Asia Pacific region, with the United States being one of the partners in twelve cases. With Africa, the United States has concluded open-skies agreements with sixteen African States. While no U.S. carriers have been directly serving Africa, they have expanded code-share services with European carriers. Also, several African carriers inaugurated services to the United States.

For its part, the EU has also made progress. That the European Commission has concluded horizontal agreements so far with Australia, New Zealand, and Singapore, all of which were initialed in 2005. The European Commission has also asked the Council of the EU to grant more comprehensive negotiating mandates for the creation of open aviation areas with Australia, China, and New Zealand.

With regard to Africa, the EU has achieved a significant level of progress. One of the European Commission’s negotiating mandates conferred by the Council of the EU is to negotiate, on behalf of all member states, a Euro-Mediterranean aviation agreement with Morocco. This agreement was initialed in December 2005 and will eventually replace all the bilateral air-services agreements between Morocco and the EU member

111 See Hearings, supra note 3.
114 Ass’n of European Airlines [AEA], EU Seeks to Extend Aviation Talks with Non-EU States (Feb. 16, 2004).
The European Commission has also been conferred a horizontal mandate to replace certain specific provisions in the existing bilateral agreements declared contrary to Community law. In response to the European Commission's negotiating mandates, African ministers agreed in May, 2005, that it was necessary to adopt a common external policy and recommended carrying out a two-phase plan of action for this purpose.

As can be noted, irrespective of the difficulties arising from the transition from a traditional and entrenched bilateral method of negotiation, both the United States and EU have forged ahead towards their goal of open skies with an impressive list of precedent. The collective position of these two giants is rife with complex realities of competition and cannot be compared with other nations that might place open skies on a bilateral negotiation table and consider it a done deal if the other party accepts. Nor can the US/EU open their territories to unlimited and untrammeled open skies. There has to be a sense of where the two parties are headed when capacity, pricing, and frequency are open. This direction should address the outcome of open skies and the various exigencies that might follow, such as complexities in slot allocation, national interest, possible carrier alliances, and secondary business stemming from open skies.

All inhibitors to open skies, notwithstanding the overall benefits of liberalization, must outweigh the consequences of protectionism. As one commentator has stated, when all is said and done, "every argument against open skies is an argument in favor of protecting some airline or other against competition... on the flip side of capacity dumping and predatory pricing you find a smashing deal for the markets in and out of the country, more business and tourist travelers, more goods moving by air, hotels flourishing, the overall economy better off and everybody's happy." If the United States and the EU were to adopt this philosophy, the negotiations would end with a "win-win" deal.

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115 Press Release, European Union, European Union Signs Aviation Agreement with New Zealand (June 21, 2006).