Opportunity for Trans-Atlantic Civil Aviation: From Open Skies to Open Markets

Benoit M.J. Swinnen

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AN OPPORTUNITY FOR TRANS-ATLANTIC CIVIL AVIATION: FROM OPEN SKIES TO OPEN MARKETS?

Benoit M.J. Swinnen*

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I. INTRODUCTION

On June 18, 1996, the Commission of the European Union (E.U.) secured a mandate\textsuperscript{1} to negotiate, on behalf of the Member States,\textsuperscript{2} a global “Open Skies”\textsuperscript{3} agreement with the United States. The mandate is split into two successive phases covering, on the one side, soft rights,\textsuperscript{4} foreign ownership,\textsuperscript{5} and cabotage,\textsuperscript{6} and on the other side, hard rights.\textsuperscript{7} The relevance and scope of this newly-acquired authority granted to the E.U. Commission by this mandate necessitates an understanding of the background in which it arises. First, according to Neil Kin-

\textsuperscript{1} On June 18, 1996, the European Community transport ministers rewarded the two-year efforts of Neil Kinnock, the E.U. Transport Commissioner since 1994, by granting the European Commission a mandate to initiate multilateral talks with the U.S. on behalf of the 15 Member States. This mandate, resulting from last minute compromises, is a reflection of the ambivalent attitudes of the individual Member States toward losing more sovereign control over a matter that international and national traditions customarily consider an appanage of national pride. The ministers reached an agreement on principles, but they did not complete a negotiation brief. Commission’s Multilateralism Mandate Comes in Phases, Maybe Too Late, Aviation Europe, June 20, 1996, available in 1996 WL 10773248.

\textsuperscript{2} Only 14 out of the 15 Member States voted in favor of the mandate. Reuters European Community Report, June 18, 1996, at 3.

\textsuperscript{3} See infra note 9.

\textsuperscript{4} Soft rights, in civil aviation, are rights granted to the airlines of the signatory states of a bilateral or multilateral agreement in the territory of another signatory that do not, by themselves, have direct economic value. Soft rights typically include ground handling at airports, services, maintenance, and more recently, computer reservation systems or code sharing. They are accessory to the exercise of hard rights. See infra note 7.

\textsuperscript{5} See infra notes 68-70.

\textsuperscript{6} See infra note 18.

\textsuperscript{7} Hard rights are principally the traffic rights defined by the Chicago Convention. See infra part IIA. They have direct economic value because they give access to routes, hence to markets. This Comment focuses on scheduled air traffic rather than on charter traffic of goods and passengers which has historically been treated differently. An accessory to routes, slots at airports have progressively gained economic value as airports become increasingly congested. They are key to the efficient, economic exploitation of air rights. They could, for that reason, be included in hard rights although traditionally they are treated as soft rights.
nock, Transport Commissioner of the E.U., the European civil aviation sector will be legally and formally liberalized by April of 1997.8 Second, the U.S. policy of "conquer and divide"9 through bilateral Open Skies agreements10 is reaping results.11 Third, public international air law, involved in economic regulation of air travel, is in a general state of confusion.12 Fourth, the airline


9 See Kinnock, supra note 8, referring to a statement made by U.S. Secretary of Transportation Pena in 1994 in response to the European Union's inability or unwillingness to pursue negotiations with the United States toward a multilateral Open Skies agreement. The U.S. efforts at that time came as a result of the report of the National Commission to Ensure a Strong and Competitive Airline Industry, which stated:

The principal challenge for our country is to fashion a new, growth-oriented international aviation framework that allows U.S. airlines to use their competitive strengths and international air services to realize their full potential. This goal will require a clear and decisive shift in policy by the United States away from the present system of bilateral regulation of air services to one based on multinational arrangements that may be regionalized at first, but eventually cover the globe.


10 On Open Skies agreements, see generally Adam L. Schless, Open Skies: Loosening the Protectionist Grip on International Civil Aviation, 8 EMORY INT'L L. REV. 435, 446-52 (1994).

11 See infra part III.A. (evaluating the effects of the U.S. policy to enter into Open Skies agreement with certain European countries, whether or not they are members of the European Union).

12 See Andras Vamos-Goldman, The Stagnation of Economic Regulation Under Public International Air Law: Examining Its Contribution to the Woeful State of the Airline Industry, 23 TRANSPL J. 425, 443-46 (1996) (arguing that the system of bilateral agreements has created an unmanageable and inefficient web of over 4,000 agreements worldwide and that the underlying principle of individual state sovereignty of the Chicago Convention does not reflect the unequal economic bargaining power of the individual states). See also Ruwantissa I.R. Abeyratne, Would
industry is either supporting or opposing changes, depending on its particular economic interests of the moment.¹³

The purpose of this Comment is to examine the stakes in the negotiation of a global Open Skies agreement between the U.S. and the E.U. These negotiations arise in a context far more favorable to the United States than to the E.U. for reasons (mostly extraneous to any action taken by the United States) that result from the European Union’s internal policy regarding competition in the civil aviation industry and the absence of a common external E.U. policy. The present success of the E.U. Commission in securing its long sought mandate is but a first and limited step toward a common external policy. This Comment argues that the E.U. Commission nonetheless could turn its present predicament into an opportunity to advance competition and economic stability, both on the home front and in relations with the U.S. Any advance in competition and economic stability in a globalized U.S.-E.U. market will benefit the U.S. airline industry, but cannot be achieved without changes that only the E.U. Commission can bring about.

In order to provide the general background to the argument that the U.S. airlines can benefit from a global U.S.-E.U. Open Skies agreement, the next section explores the evolution of the legal framework pertaining to civil aviation in the E.U. Thereafter, Part III reviews the stakes in the negotiations between the United States and the European Union and its individual Member States. Finally, Part IV will outline possible avenues for reaching improved competition on the trans-Atlantic routes in a global context.

II. HISTORICAL AND LEGAL BACKGROUND IN THE EUROPEAN UNION

Civil aviation emerged throughout the world shortly after the turn of the century. World War I brought home the importance of controlling air space to ensure national security. The exploits of the “Red Baron” and other aviators inexorably extended the battlefields into air space. In 1919, as a result of this new dimension of conflicts, the first multilateral attempt to regulate international air traffic was made in Paris.

The Paris Convention affirmed the principle of state sovereignty over air space, thus forcing the aviation industry into a maddening web of national regulations and international compromises. These compromises paved the way for the second multilateral codification of international air traffic, which took place in Chicago in 1944 as World War II ended. Indeed, while the security concerns regarding air space had not weakened, the economic importance of air travel had grown. The resulting agreement preserved state sovereignty as the means of protecting national security, and identified the economic components vital to the development of civil air traffic. It also laid a framework for granting defined air rights among signatory states. That agreement is universally known as the Chicago Convention.

A. CHICAGO CONVENTION

The Chicago Convention of 1944 defines the so-called “Freedom of Air Rights” and is the baseline for all bilateral agree-

15 See Abeyratne, supra note 12, at 795-99 (discussing, inter alia, the competing views of the United States and the United Kingdom during the 1944 Chicago Conference).
16 See infra notes 17-19 and accompanying text.
18 The First Freedom of the air grants a civil aircraft the right to fly over a country without landing; the Second Freedom grants the right to land in another country for non-commercial reasons like refueling or maintenance; the Third Freedom grants the right to maintain transportation from the carrier’s home country to another country; the Fourth Freedom entitles the carrier to carry traffic from another country to its home country; the Fifth Freedom is an extension of the Third and Fourth Freedoms, which grants the carrier the right to pick up passengers and goods in the other state in order to carry them into a third state as long as the flight originates or terminates in its home country. The combination of
ments through which countries grant one another true and commercially valuable rights of access to their air space and territory. The underlying principles of the Chicago Convention are a state’s sovereignty over its air space and the equal right of all signatories to participate in international air transportation.¹⁹ Regardless of the size of the country, the economic might of its airline(s) (whether state- or privately-owned), or the competitiveness of its market, each signatory trades rights of access with each and all other countries presumably on equal footing.

The trade of air rights eventually led to the worldwide signing of over 4,000 bilateral agreements.²⁰ The multiplication of bilateral agreements was, however, not a necessary consequence of the Chicago Convention;²¹ quite the contrary is true.²² Bilateral agreements were annexed to the Chicago Convention, but only the Inland and Air Services Transport Agreement, which dealt with over-flight and technical stops (the first two freedoms of the air), garnered enough signatures to come into effect. The

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³ The Third and Fourth Freedoms thus creates connections between two countries. For example, a route from Singapore to London via San Francisco starts in Singapore under the Third Freedom and carries on from San Francisco under the Fourth Freedom. Such a combination is also known as Sixth Freedom, even though it was not formally stated by the Chicago Convention. If a Fifth Freedom flight is not part of a route that originates or terminates in the home country, it is also known as Seventh Freedom. The right of a foreign-owned airline to pick up traffic in one inland point and carry it to another inland point is known as Eighth Freedom, or more generally as the freedom of cabotage. The Chicago Convention specifically prohibits cabotage unless expressly granted by the state. See generally Hedlund, supra note 9, at 265-68; Jurgen Basedow, Airline Deregulation in the European Community—Its Background, Its Flaws, Its Consequences for E.C.-U.S. Relations, 13 J.L. & COM. 247, 248-50 (1994); Howard E. Kass, Cabotage and Control: Bringing 1938 U.S. Aviation Policy into the Jet Age, 26 CASE W. RES. J. Int'l L. 143, 147-48 (1994).

¹⁹ Article 1 of the Chicago Convention stands for the absolute sovereignty principle; meaning that, unless granted by agreements, there is no freedom of traffic in a foreign country. Most countries are parties to Appendix III of the Chicago Convention (Two Freedoms Agreement), which grants first and second freedom rights. All other rights are part of bilateral agreements. Article 5 of the Chicago Convention treats non-scheduled international air service differently from scheduled traffic under Article 6. Article 6 restricts access to the air rights granted by sovereign states. See Chicago Convention, supra note 17; see also Vamos-Goldman, supra note 12, at 431-34.

²⁰ See Vamos-Goldman, supra note 12, at 427-28. All bilateral agreements are deposited with the Legal Department of the International Civil Aviation Organization (ICAO). The ICAO was created by the Chicago Convention to implement the Convention’s regulatory and coordinating objectives. See id.

²¹ See supra note 17.

²² See supra note 19. See also Vamos-Goldman, supra note 12, at 452.
International Air Transport Agreement, as a multilateral alternative covering traffic rights, was a failure.

Through bilateral grants of rights of access under the framework of the Chicago Convention, the United States has been very successful in securing routes for American carriers. In a world in which economic disparities prevail and where nationalism clouds efficient economic choices, it is hardly surprising that the economically powerful, or those detached from nationalistic politics, have become the beneficiaries of a system not designed to account for regional or economic differences. For example, Dutch KLM, left by its government to make economically rational choices because subsidies were not an option, and the American carriers, left to succeed or fail after the deregulation, have been very successful in deriving benefits from the bilateral policy of their respective governments against the background of the intrinsic inability of the Chicago bilateral system to accommodate the emergence of a European market as a single economic entity in the field of civil aviation. In this context, the expansion from beyond point traffic to Fifth Freedom was doomed to lead to a response by the E.U. Commission; namely, to seek the very mandate it has received. Though imperfect, it reflects the political emergence of a need created by the economic conditions and internal competition within the European Community. It is an unavoidable biproduct of the liberalization in the E.U. and the competitiveness, if not competition, of carriers deprived of regular state subsidies.

France’s renunciation of its bilateral agreement with the United States in 1992 was an early manifestation of these tensions. Limitations on access to slots, as evidenced at Heathrow, is a more recent one.

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23 See Council Resolution of October 24, 1994, on the Situation in European Civil Aviation, 1994 O.J. (C 309) 1919. "[T]o prevent distortions of competition for European aviation, State aids which have or might have negative effects on competition, must be ruled out." Id. See also Commission Guidelines on the Application of Articles 92 and 93 of the EC Treaty and Article 61 of the EEA Agreement to State Aid in the Aviation Sector, 1994 O.J. (C 350) 5. For a general discussion of state aids in the E.U., see Claus-Dieter Ehlermann, State Aid Control in the European Union: Success or Failure?, 18 FORDHAM INT’L L.J. 1212 (1995). For a recent decision in the matter of indirect fiscal aid given to German airlines in the form of accelerated depreciation, see European Commission Decision 296/369, 1996 O.J. (L 146) 42.


25 Carriers with historical presence at Heathrow, especially British Airways, benefit from this de facto anti-competitive scheme. See U.K. Authorities Ask for
The Fifth Freedom, which guarantees the right to carry traffic from the granting state to a third state, is one of the fundamental reasons the E.U. Commission was able to secure its mandate for global negotiations with the United States because it is a source of disturbance of internal competition. For example, an American airline, using Fifth Freedom rights, can fly into the Netherlands, pick up traffic, and continue its route to Frankfurt, Germany. If one looks at the European Union as a single market, it creates, in practice, a right to carry traffic from one inland point to another inland point. This is the definition of cabotage. The combination of Fifth Freedom rights with Sixth Freedom rights expands the opportunities for cabotage, since the carrier can fly into the country granting Sixth Freedom rights as part of a route that is otherwise not connected to the carrier’s home country. In addition, under Open Skies agreements, this may even include a change of gauge. The impact of this issue will be revisited in Part III of this Comment.

When existing bilateral agreements (those that are not Open Skies agreements) would limit access by use of a Fifth Freedom right granted by a third country, the economic objective may, nonetheless, be achieved through stock ownership of 49.9% of a European carrier that has free cabotage rights in the European Community as of April 1, 1997. These examples preview the difficult task ahead for the E.U. Commission as it sets out to negotiate a multilateral Open Skies agreement with the United States. A general understanding of E.U. political institutions is necessary in order to comprehend the E.U. Commission’s role and ambitions with respect to trans-Atlantic civil aviation.

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26 See supra note 18.
27 See Kinnock, supra note 8.
28 See supra note 18.


29 See infra notes 81-84 and accompanying text.
30 See infra note 66.
B. EC Treaty

The Commission's involvement in matters relating to civil air transportation originates in the political compromises laid by the founding members of the European Economic Community at its inception. The Treaty Establishing the European Community (EC Treaty), originally signed in 1957, and amended several times over the years, is the fundamental charter of the European Union. The principal political institutions created by the treaty are the Council of Ministers (Council), the Commission, the Parliament and the Court of Justice. The Council of Ministers is a hybrid body with both executive and legislative powers. The Council is composed of a representative from each Member State with authority to bind the government of that State. Collectively, the Council is responsible for carrying out the goals and objectives of the Treaty. It can act by non-binding recommendations or binding decisions, and regulations or directives. In this respect, the Council has the last word in the law-making process, but the first word, or right of initiative, in principle, belongs to the Commission.

The Commission is an independent body whose members are appointed by consensus of the Member States for fixed terms of four years. The Commission principally has executive powers to implement and enforce Community law. It is the "watchdog" of the Community. The Commission also has prospective legislative authority in formulating Community policy and preparing proposals for legislation by the Council. This role of legislative initiative brings the Commission to work closely with the Council. As discussed below, the evolution of the air transport policy of the European Community clearly illustrates the interaction between the Council and the Commission.

The Parliament consists of representatives directly elected by the people of the Member States. Its function in relation to the Council's legislative powers, however, is principally advisory, except that the Parliament exercises legislative authority in the

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94 See id. at 960.
95 See id. at 958.
96 See id. at 962-63.
97 See id. at 963.
Community annual budget process. It also has supervisory powers over the Commission. The Parliament can issue non-binding recommendations to the Council or comment on legislative proposals. In exceptional cases it has a right of action in the Court of Justice against the Council for failure to act under the Treaty. Such an action was initiated in the field of transportation and led to the declaratory decision known as the Transport Policy decision.

The Court of Justice is the highest court in the European Union. Its main objective is to ensure the interpretation, uniform application, and development of Community law. A distinguishing feature of the Court’s jurisdiction is the ability to render advisory opinions interpreting Community law.

Several provisions of the EC Treaty relate to transport in general and civil aviation in particular. Article 74 of the EC Treaty provides for the mandatory implementation of a common transport policy; Article 75 empowers the Community with the necessary authority to carry this out; Article 84, however: (1) limits the scope of the common transport policy to transportation by "rail, road and inland waterway," and (2) provides that the Council may extend common transport policy to sea and air transport. However, it was not until the adoption in 1986 of the Single European Act, which displaced the unanimous voting requirement under the Treaty, that the Council could act upon Article 84 without facing the veto power of any single Member State. The Single European Act introduced into Euro-

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38 See id. at 959-60.
39 See id. at 960.
40 See EC TREATY art. 175.
42 See Flaherty, supra note 33, at 967-68.
43 See EC TREATY art. 74.
44 Id.
45 See id. art. 84(1).
46 See id. art. 84(2). Air transportation between Member States of the European Union initially was regulated solely through a system of bilateral agreements as between any signatory states of the Chicago Convention. These agreements all contained capacity-sharing provisions, preferential treatment to the signatories' airlines, route limitations, and access limitations; in essence, restrictions to competition within the boundaries of the European Union. Regardless of state ownership of most European airlines, the bilateral agreements were bound to generate, if not designed to generate, distortions of competition and cartel-like conduct of business condoned or supported by the Member States (shareholders of the respective airlines).
pean politics the concept of a qualified majority. Nonetheless, what ultimately prompted the Council’s decision to regulate intra-Community air transportation was the European carriers’ involvement in cartel-like activities that were subject to the competition rules of the EC Treaty, as found by the Court of Justice in the *Nouvelles Frontieres* decision. Credit must also be given to the Commission for attempting to have the Council harmonize air transport several years before the *Nouvelles Frontieres* decision. The Council’s inaction, however, led to the *Transport Policy* decision. The threat to do “business as usual” for the airlines and the Member States served as a powerful trump card in the political standoff between the Commission and the Council. A regulatory framework or the enforcement of competition rules by the Commission was the choice faced by the Council. Winning the political struggle, the Commission readily traded so-called block exemptions under Article 85(3) of the EC Treaty for a common air transport policy. This trade-off led to the gradual liberalization of the civil aviation industry through what became known as the “Three Liberalization Packages.” This liberalization was, however, strictly aimed at the intra-E.U. market.

**C. THE THREE LIBERALIZATION PACKAGES**

1. *First Package*

The First Package covers four areas: (1) the applicability of Articles 85 and 86 to the civil aviation sector; (2) the block exemption of airline cooperation agreements, computer reservation systems, and ground handling agreements; (3) air fare rules; and (4) capacity sharing and market access rules. This

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48 Flaherty, *supra* note 33, at 944.
51 See *supra* note 41.
54 See Council Regulation 3976/87, 1987 O.J. (L 374) 9; Commission Regulation 2671/88, 1988 O.J. (L 239) 9 (block exemptions for airline agreements concerning capacity, revenue pooling, air fares, and slot allocations); Commission
First Package clearly illustrates the nature of the trade-off made between individual Member States and the European Commission. Rather than introducing sweeping changes in terms of deregulation, it changes and legalizes the framework in which the same activities are carried out. Regulation 3975/87 may well subject airlines to Articles 85 and 86, but Regulation 3976/87, pursuant to Article 85(3), is the enabling statute for rather generous exemptions from the competition rules through specific regulations issued by the Commission.\(^5\) Airline agreements covering capacity sharing, revenue pooling, air fare consultation and slot allocation were exempt under Regulation 2671/88 under rather flexible standards until January 1991. Computer reservation systems and ground-handling agreements were also exempt under Regulations 2672/88 and 2673/88, respectively, without imposing very strict conditions.\(^6\) The First Package's air fare, capacity sharing and market access rules have also had very limited effects,\(^7\) though it brought the principle of community control of civil aviation matters within the boundaries of the European Union.

2. Second Package

At the Commission's urging, the Council enacted the second phase of aviation liberalization in 1990.\(^58\) The Second Package consists of amendments to the First Package regulations, as well as new regulations on air fares, market access, capacity sharing, and block exemptions for fares, capacity and slot access.\(^59\) The

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\(^5\) Basedow, supra note 18, at 260.


\(^7\) See Weinberg, supra note 54, at 441.

most significant changes toward a more competitive intra-European market relate to air fare approval, route and slot access and capacity growth. The effects of the Second Package were clearly not intended to change the landscape of civil aviation in the E.U. but, more modestly, were another step toward controlled liberalization. Further measures were the object of the Third Package.

3. Third Package

The Third Package, introduced in 1992, replaces Regulation 2342/90 of the Second Package concerning route access and regulation 2342/90 concerning air fares and rates. In addition, for the first time it incorporates a licensing regulation. This package demonstrates the growing commitment of the Commission and the Council to bring about a competitive intra-E.U. aviation market.

In conformity with the ambitious goal of a single European market, the Council laid the groundwork for complete freedom of access to routes for Community carriers within the entire European Union. The initial effect of the new route access regulation has been limited to traffic between Member States, but the

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60 Regulation 2342/90 provides for expanded flexibility zones in which price approval is automatic, and a double disapproval system for fares that are 105% above the referenced air fare, as well as an approval by default for fares below the lowest flexibility zone if neither Member State on the route disapproves the fare. The reference fare is the average normal economy airfare on the route in question. See Dempsey, supra note 50, at 364-65.

61 Third and Fourth Freedom rights are granted subject to reciprocity of the Member State of the air carrier on a route per route basis. Fifth Freedom rights are also granted, provided the Fifth Freedom traffic does not exceed 50% of the capacity of the Third and Fourth Freedom service involved. See Duchene, supra note 56, at 135-36.

62 Bilateral agreements initially provided for shared capacity on a route on a fifty-fifty basis. The First Package increased this to a 60-40 ratio, and the Second Package allowed for seasonal increases of up to 7.5%. See id. at 136.

63 See Werner F. Ebke & Georg W. Wenglorz, Liberalizing Scheduled Air Transport Within the European Community: From the First Phase to the Second and Beyond, 19 Deny. Int'l L. & Pol'y 493 (1991); Duchene, supra note 56, at 132-36.

64 See Council Regulation 2407/92 on Licensing of Community Air Carriers, 1992 O.J. (L 240) 1; Council Regulation 2408/92 on Access to Intra-Community Air Routes, 1992 O.J. (L 240) 8; Council Regulation 2409/92 on Fares and Rates For Air Services, 1992 O.J. (L 240) 15.

65 See generally Duchene, supra note 56, at 137-48.
regulation provides for complete freedom, that is full cabotage, on domestic flights by April 1, 1997. This means that any E.U. carrier has access to any route within the E.U. In other words, E.U. carriers have full Third, Fourth, Fifth, Sixth, Seventh and Eighth freedom of air rights on intra-Community routes. Limited exceptions may arise as a result of a public service obligation that a Member State may impose in order to promote regional development when no carrier has offered service on the route.66 Unfortunately, Articles 8 and 9 of the route access regulation provide for what European policy makers often refer to as “safeguards.” These safeguards relate to: (1) the distribution of traffic between airports within an airport system (for instance Heathrow and Gatwick, which both serve London), which a Member State may regulate provided it does so on a non-discriminatory basis; and (2) the subordination of the exercise of air rights to Community, national, regional and local operational rules governing safety, the environment, and foremost, slot allocations. The latter is the traditional bottleneck of civil aviation at most European airports.67 Abuse of these exceptions (for instance, the granting of favorable treatment to the national flag carrier), is investigated by the Commission on its own motion or at the request of another Member State or of another carrier.68 The non-discrimination rule of the route access regu-

66 See Council Regulation 2408/92, supra note 64, art. 4(1)(d). In such a case, the state may attach an exclusivity to the route for up to three years, in order to invite bids from carriers. See Duchene, supra note 56, at 143.

67 Slot allocation is one of the stumbling blocks in the negotiations for an Open Skies agreement between the U.K. and the U.S. It is also the object of particular attention by U.S., U.K. and E.U. antitrust authorities in assessing the impact of the British Airways—American Airlines alliance. Everyone, including the affected carriers, seems to agree that slots will have to be made available to competitors of the alliance. The number of slots to distribute and how to make them available, are sources of substantial disagreement. See, e.g., UK Authorities Ask for Alliance Changes As Open Skies Stall, AVIATION DAILY, Dec. 9, 1996, at 387. See also Agreement Relating to Air Services, Feb. 11, 1946, U.S.-U.K., 60 Stat. 1499 [hereinafter Bermuda I]. Bermuda I was ratified in 1946 between the United States and the United Kingdom, and replaced in 1977 by the more restrictive Bermuda II: Air Transport Services, July 23, 1977, U.S.-U.K., 28 U.S.C. 5367. The contracting states are currently negotiating toward an Open Skies agreement.

68 See Council Regulation 2408/92 supra note 64, art. 8. For an application, see Commission Decision 2408/92 of April 27, 1994 on a Procedure Relating to the Application of Council Regulation, 1994 O.J. (L 127) 32. In that proceeding, France was found to have carried out the allocation of traffic rights in the Paris airport system in a discriminatory manner. France was trying to protect the monopoly of Air France's subsidiary, Air Inter, on the routes between Paris (Orly) and Marseilles. France's argument was that these exclusive routes were grand-
lation is broader than the prohibition of discrimination based on nationality of Article 6 of the EC Treaty, in that it adds the principle of non-discrimination on the basis of the air carrier identity. A Member State may, however, impose additional restrictions on, or even deny traffic rights to, a carrier to relieve serious congestion at an airport or to relieve existing environmental problems. The Commission has the same investigative powers in these instances as under the exception to operational rules. Finally, the route access regulation states that capacity limitations among carriers are illegal. Once again, the regulation provides for an exception to the prohibition if serious financial damage to a Member State’s air carriers would result. In such cases, the Member State may apply to the Commission for a waiver.

In the matter of air fares, the purpose of the Third Package is to achieve market-driven fares. The approval and disapproval system of the previous package is repealed. The regulation, however, only applies to Community air carriers, with the exception of public service obligations. The regulation further limits its own scope by establishing safeguards by which a Member State may disapprove air fares. Under this procedure, a Member State must show injury to consumers or widespread losses among all air carriers on the affected routes, as well as notify all other Member States and affected air carriers. A consultation will be initiated and the Commission, under certain conditions, may also conduct a review of the Member States’ decision.

fathered for three years under Article 5 of the regulation, but the Commission disagreed because airports within an airport system are viewed as a whole. Since France had granted traffic rights from Paris (Charles DeGaulle Airport) to Toulouse and Marseilles, France had foregone the exclusivity and was merely allocating traffic within an airport system to favor its flag carrier. See id.

See Council Regulation 2408/92, supra note 64, art. 8(1). “[T]his regulation shall not affect the Member State’s right to regulate without discrimination on grounds of nationality or identity of the air carrier the distribution of traffic between the airports within an airport system.” Id.

See id. art. 9.

See id. art. 10.

See supra note 60.

See supra note 66 and accompanying text.

See Council Regulation 2409/92, supra note 64, art. 6.

See id.
Council Regulation 2407/92\(^7\) organizes a common scheme of licensing requirements for the issuance and withdrawal of operating licenses by Member States to air carriers.\(^7\) The regulation’s requirements preempt Member States’ law.\(^7\) The license remains a state license granted by a Member State only to an undertaking having its principal place of business located in that Member State.\(^8\) Community ownership is the first essential requirement; it “requires that such Member States or nationals shall at all times effectively control the undertaking.”\(^8\) Financial fitness is the second requirement. It imposes upon the applicant the obligation to submit a business plan demonstrating its ability to meet its financial obligations for the next two years and its ability to meet its fixed and operational cost for the next three months without income.\(^8\) Financial fitness is also a continuing requirement for any existing license; the regulation provides for annual reporting mechanisms and reporting of changes in financial structure or ownership.\(^8\) All operating licenses existing at the time the regulation takes effect are grand-fathered for one year.\(^8\)

In 1993, the Commission enacted new regulations on airline agreements, block exemptions, slot allocation and computer reservation systems.\(^8\) In April 1997, full cabotage rights were

\(^{77}\) Council Regulation 2407/92, supra note 64.
\(^{78}\) See Duchene, supra note 56, at 138.
\(^{79}\) See Council Regulation 2407/92, supra note 64, art. 3.
\(^{80}\) See id. art. 4(1).
\(^{81}\) See Duchene, supra note 56, at 138 (citing Regulation 2407/92, art. 4(2) and art. 2(g)). The latter provides,

Effective control means a relationship constituted by rights, contracts, or any other means which, either separately or jointly and having regard to the considerations of fact or law involved, confer the possibility of directly or indirectly exercising a decisive influence on an undertaking, in particular by:

(a) the right to use all or part of the assets of an undertaking; (b) rights or contracts which confer a decisive influence on the composition, voting or decisions of the bodies of an undertaking or otherwise confer a decisive influence on the running of the business of the undertaking.

Council Regulation 2407/92, supra note 64, art. 2(g).
\(^{82}\) See Council Regulation 2407/92, supra note 64, art. 4(3).
\(^{83}\) See generally Duchene, supra note 56, at 139-41.
\(^{84}\) See id. at 142.
\(^{85}\) See Commission Regulation 1617/93, 1993 O.J. 1993 (L 155) 18; Council Regulation 95/93, 1993 O.J. (L 140) 1; Council Regulation 3089/93, 1993 O.J. (L 278) 1; Commission Regulation 3652/93, 1992 O.J. (L 333) 37. See generally Duchene, supra note 56, at 148-53. For a discussion of computer reservation systems, see generally Raffaele Cavani, *Computerized Reservation Systems for Air Trans-
TRANS-ATLANTIC CIVIL AVIATION extended to all E.U. carriers. All regulations apply to all E.U. flights, whether they are purely domestic or not.86

D. Competition Rules

The threat of Commission action against the anti-competitive conduct of the European airlines brought about the liberalization packages, which created a legal framework of competition rules that were of questionable validity. The politics of compromise led to the sacrifice of the EC Treaty’s fundamental principles of competition. The Commission has changed from the watchdog of competition rules into the shepherd of anti-competitive market participants.

The fundamental E.U. competition rules are laid out in Articles 85 through 94 of the EC Treaty. They complement the overriding principle of undistorted competition within the E.U. affirmed by Article 3 of the Treaty.87 Articles 85 and 86 form the cornerstone of competition law applicable to all private “undertakings.”88 Article 85 is the functional equivalent of a prohibition of agreements in restraint of trade. However, the focus is not on a general prohibition of agreements among enterprises, but rather strictly on concerted anti-competitive conduct aimed at producing or causing harmful effects in the market place.89 The threshold requirements under Article 85(1) for agreements or concerted practices to be considered among those “which have as their object or result the prevention, restriction or distortion of competition”90 are as follows: (1) that they are legally binding (binding agreements or practices may be inferred from circumstantial evidence);91 (2) that they affect trade among Member States; and (3) that the prevention, restriction or distortion be to an appreciable extent.92 Such agreements are void pursuant to Article 85(2). The Commission may, however, pursuant to Article 85(3), exempt a specific agreement from the provisions of Article 85(1). The Commission must be notified

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86 See Council Regulation 2407/92, supra note 64.
87 “The establishment of a system ensuring the competition shall not be distorted in the Common Market.” EC Treaty art. 3(f).
88 An “undertaking” may be loosely defined as any economic venture. See PAUL CRAIG & GRAINNE DE BURCA, EC LAW: TEXT, CASES, & MATERIALS 899 (1995).
89 See Dempsey, supra note 50, at 328.
90 EC Treaty art. 85(1).
91 See Dempsey, supra note 50, at 329.
92 See id.
by the parties seeking the exemption and the following four conditions, specified in Article 85(3), must be satisfied:

(1) The agreement must contribute to improving the production or distribution of goods or to promoting technical and economic progress;
(2) Consumers must get a fair share of the resulting benefit;
(3) The agreement may not impose restrictions which are not indispensable for the objectives under (1) and (2); and
(4) The agreement may not afford the parties the possibility of eliminating competition in respect to a substantial part of the products in question.

In applying the Article 85(3) conditions, the Commission and the ECJ have found the following types of agreements likely to be prohibited:

(a) agreements relating to prices and conditions of sale;
(b) limitations on markets and production;
(c) agreements whereby a vendor agrees not to compete within the market of the purchaser;
(d) exclusive dealing agreements, such as supply agreements and collective exclusive dealings; and
(e) joint purchasing and joint selling agreements.\(^9^3\)

In addition to agreement-specific exemptions pursuant to Article 85(3), the Commission may grant an industry-wide exemption or block exemption that removes the conduct proscribed in the regulation from scrutiny under Article 85(1). The block exemption regulations are issued by the Commission pursuant to a grant of specific authority by the Council.\(^9^4\) The Commission has used block exemptions extensively to pave the way for liberalization of civil aviation, balancing at least three policies: the interests of consumers, the interests of the airlines, and the social benefits of a progressive transition to a free market. As of the date of publication of this Comment, after the third liberalization package, the remaining block exemptions include computer reservation systems\(^9^5\) and airline cooperation agreements. The latter exemption has been limited in scope and eligibility since 1993.\(^9^6\) For example, the agreement may not cover shared

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\(^9^3\) See Dempsey, supra note 50, at 330.
\(^9^4\) See Basedow, supra note 18, at 260.
\(^9^5\) See Cavani, supra note 85.
\(^9^6\) See Commission Regulation 1617/93, supra note 85; see generally Duchene, supra note 56, at 148-49.
capacity, and joint capacity may not exceed a limited number of seats per year.

The overall problem with the mechanism of exemptions, as implemented by the E.U. Commission, is the resulting involvement of the Commission itself.

[A] conspicuous feature of block exemptions in the air transport sector is that the E.C. Commission itself gets involved in anti-competitive practices. With regard to consultations on tariff, slot allocation and airport scheduling, the Commission grants exemptions only when it is given ten days notice and is entitled to send observers.

It is astonishing to find at the same table both the members of a cartel and the members of "the single most important Community anti-trust institution, which serves as the Community's law enforcement arm."

E.U. competition law applies where anti-competitive conduct may "affect trade between Member States." The extraterritorial reach of the competition rules is not mandated by the text, but interpretation by the Court of Justice has resulted in an approach that confers jurisdiction over agreements reached outside the E.U. but implemented within. For all practical purposes, the Commission could, under this analytical scheme, assert jurisdiction over trans-Atlantic alliances. Tickets are sold within the European Union and, for some passengers, the trans-Atlantic flight is but one leg of a trip that originates or terminates in another Member State. Therefore, even absent any authority to negotiate air rights, the Commission can arguably challenge the subsequent agreements between airlines resulting

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97 See Commission Regulation 1617/93, supra note 85, art. 2.

98 See id. art. 3

99 Basedow, supra note 18, at 262-63.


101 EC TREATY arts. 85, 86.


from or relating to bilateral agreements between a Member State and a third country.\textsuperscript{104}

\section{Bilateral Agreements}

The lack of political incentive to expand the multilateral system, initiated in Chicago in the shadow of the Convention, caused the emergence of the bilateral regulatory framework as the norm. Though there have been several standards with more or less restrictive terms, typically a bilateral agreement will address capacity, fares and routes.\textsuperscript{105} Capacity is allocated or shared between the respective carriers designated by the contracting states. The terms may be very rigid, or may allow for some flexibility. Fares can be set directly by the bilateral agreement or deferred to the International Air Transport Association.\textsuperscript{106} Routes are the destinations in the other country of scheduled international flights. The bilateral agreement will specifically address which air rights can be used to fly the routes. For example, on the route from Chicago to Frankfurt, the U.S. carrier would fly to Germany under the Fourth Freedom. If the route, pursuant to the bilateral agreement, allows continuing service to Berlin, then the carrier flies under the Fourth Freedom and “beyond point” rights. “Beyond point” connotes an extension to a point beyond the point of entry in the same country. If the carrier can pick up additional traffic and fly to a third country, it would do so under the Fifth Freedom right. If it can pick up traffic on the inland leg, it also benefits from limited cabotage rights. Any such right must be granted in the bilateral agreement.\textsuperscript{107} The number of carriers that can be nominated for a route and the points of entry may be very limited. Competition is foreign to such arrangements; they are mostly allocative of capacity and protective of airline interests. Because air rights are a commodity, airline management or mismanagement supersedes consumers’ preferences. Although market pressure weighs heavily on route determination—no airline would will-

\textsuperscript{104} This extraterritorial authority is a point of contention between British Airways and the Commission. See Charles Goldsmith, \textit{American Air and British Air May Defy EU}, \textit{Wall St. J.}, Feb. 7, 1997, at A11A.

\textsuperscript{105} See Vamos-Goldman, \textit{supra} note 12, at 435-36.

\textsuperscript{106} The International Air Transport Association (IATA) is an international association of air carriers that was organized to set international tariffs. IATA’s regulatory role ended in the 1970s. See Schless, \textit{supra} note 10, at 441-42.

\textsuperscript{107} Some bilateral agreements are very restrictive and only allow Third and Fourth Freedoms; some grant beyond rights and limited Fifth Freedom.
ingly fly an empty plane—bilateral agreements generate, at best, monopolistic conditions at the expense of consumers and taxpayers. Fares and services are not fully competitive and tax revenue supports an inefficient state-owned or state-controlled industry. In response to these inherent inefficiencies, the U.S., which pioneered airline deregulation, proposed a new bilateral format: the Open Skies agreement.

F. **Open Skies Agreements**

Open Skies agreements are bilateral agreements that fall under the umbrella of the Open Skies policy of the United States defined by a Department of Transportation (DOT) order of August 1992.\textsuperscript{108} The following basic elements constitute Open Skies under that order:

1. Open entry on all routes;
2. Unrestricted capacity and frequency on all routes;
3. Unrestricted route and traffic rights, that is, the right to operate service between any point in the United States and any point in the European country, including no restrictions as to intermediate and beyond points, change of gauge, routing flexibility, co-terminalization, or the right to carry Fifth Freedom traffic;
4. Double-disapproval pricing in Third and Fourth Freedom markets and in intra-E.C. markets: price matching rights in third-country markets, and price leadership in third-country markets to the extent that the Third and Fourth Freedom carriers in those markets have it;
5. Liberal charter arrangements (the least restrictive charter regulations of the two governments would apply, regardless of the origin of the flight);
6. Liberal cargo regimes (criteria as comprehensive as those defined for the combination carriers);
7. Conversion and remittance arrangements (Carriers would be able to convert earnings and remit in hard currency promptly and without restriction);
8. Open code-sharing opportunities;
9. Self-handling provisions (right of a carrier to perform/control its airport functions going to support its operations);
10. Procompetitive provisions on commercial opportunities, user charges, fair competition and intermodal rights; and
11. Explicit commitment for nondiscriminatory operation of and access for computer reservation systems.\textsuperscript{109}


\textsuperscript{109} See Hedlund, supra note 9, at 299 n.72.
The United States signed the first Open Skies agreement with the Netherlands in October 1992. Conforming to DOT policy, this agreement “gives U.S. and Dutch airlines open entry into each other’s markets, unrestricted capacity and frequency on all routes and the greatest possible degree of freedom in setting fares.” Similar agreements were signed with other European countries, including Austria, Czech Republic, Belgium, Denmark, Finland, Germany, Luxembourg, Norway, Sweden, Switzerland, and Iceland. Each of these agreements grant unrestricted access and Fifth Freedom rights traffic. This means that international routes between the signatory states are solely determined by the airlines; in other words, by market conditions.

Although this greatly improves competition on the trans-Atlantic routes, this still does not mean deregulation of the international market. First, restrictive national regulations limit and constrain the operation of fully efficient hub and spoke systems. Second, any flight from an Open Skies signatory state to a non-signatory state is subject to the terms of the traditional bilateral agreement between the third state and the carrier’s national state. Therefore, since the airlines do not have free access to the respective countries’ internal markets, they remain unable to feed international routes at the lowest possible cost. Consumers thus continue to pay non-competitive prices and are limited in their choices of routes or flight schedules in planning their travel arrangements.

G. The General Agreement On Trade In Services (GATS)

Internationalization of the legal framework of civil aviation, at least conceptually, reached an unprecedented level through the inclusion of limited air rights in the General Agreement On Trade In Services (GATS). The only air services included in GATS are soft rights, and chances of expanding its scope to

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110 See id. at 298.
111 Id. at 271.
113 See Vamos-Goldman, supra note 12, at 436, 456.
116 See Vamos-Goldman, supra note 12, at 437.
include hard rights is unlikely, if not impossible, because the Most Favored Nation (MFN) provision would indirectly have the pernicious effect of eliminating any incentive or pressure to liberalize the industry. Indeed, the most liberal terms of any bilateral agreement would automatically extend to all GATS members. Countries with sophisticated aviation markets would completely lose their ability to pressure developing countries to open their skies or to prevent their airlines from "free riding" in more lucrative markets. Safety and security standards, would also be fundamentally compromised. In view of the fact that international civil aviation is heavily concentrated in specific markets, the chances or the need to include hard rights into GATS appear, at this time, marginal at best.

III. ISSUES RAISED BY THE MULTIPLICATION OF BILATERAL OPEN SKIES AGREEMENTS ON THE ATLANTIC ROUTES

The proliferation of bilateral Open Skies agreements in Europe, granting very liberal air rights has resulted in two diametrically opposed views. On one hand, it has been said that "[t]he United States has already given far too much and received far too little in return." Others, such as the E.U. institutions, crit-

117 See id. at 437-38. Vamos-Golman nonetheless suggests that GATS and Chicago Convention principles can be reconciled through a system of a multilateral agreements which would annex the respective bilateral agreements. Such a system would not be subject to MFN, but would offer a general framework in which bilateral agreements would evolve on a predetermined path, under the auspices of ICAO and WTO, toward a structured multilateral system. See id. at 439. See also Tycho H.E. Stahl, Liberalizing International Trade In Service: The Case for Sidestepping the GATT, 19 YALE J. INT'L L. 405, 452-53 (1994) (arguing strongly against extending GATT to services). For a comparative analysis of competitive rules under the scheme of bilateral agreements and the WTO, see Abeyratne, supra note 12, at 793.

118 Angela Edwards, Foreign Investments in the U.S. Airline Industry: Friend or Foe?, 9 EMBRY INT'L L. REV. 595, 618 (1995). Edwards proposes that there can be no reciprocity through bilateral agreements because the United States aviation market has no equivalent anywhere in the world, and therefore, no country can offer corresponding competitive opportunities in its own market. See id. at 640-45. Edwards views the success of American carriers in international markets as indicating a need to restrict access of foreign carriers to the U.S. domestic markets through cabotage or foreign ownership. See id. "[T]he fear of seeing U.S. dominance of the airline industry slip away, much as it has in the automobile and steel industries, compels the United States to take this position." Id. at 642. Edwards concludes with the non sequitur that "foreign investment will mean that the already rapidly declining U.S. airline industry will be forced to watch helplessly as
icize the U.S. Open Skies policy as excessively benefiting American interests.\(^\text{119}\)

### A. CRITICISM BY THE EUROPEAN UNION INSTITUTIONS OF BILATERAL OPEN SKIES AGREEMENTS

Though the Open Skies policy of the U.S. was meant to bring free competition into the international civil aviation sector,\(^\text{120}\) the European institutions now see it as granting undue advantage to the American carriers. Under bilateral Open Skies agreements, parties grant each other Fifth Freedom rights,\(^\text{121}\) and the cumulative effect of multiple Open Skies agreements with the E.U. Member States would be to "endanger the whole process of deregulation of Europe’s civil aviation market."\(^\text{122}\) As it stands now, although a carrier of an Open Skies signatory state can nominate any international airport in the U.S. as its port of entry, under U.S. law,\(^\text{123}\) it does not have access to cabotage.\(^\text{124}\) Cabotage is "the transportation of passenger, cargo or mail by a foreign airline between two points in the same nation."\(^\text{125}\) Therefore, even though the U.S. appears generous in granting foreign carriers a wide choice of landing in exchange for a geographically unequal choice of landing in a small (or not-so-small) European country, the scale tips in favor of American carriers if Fifth Freedom rights allow them to build and control a network of routes based on "hub and spoke" operations in the E.U.\(^\text{126}\) For example, Frankfurt is becoming a hub for U.S. domestic markets disintegrate and the ability to compete effectively becomes increasingly difficult."\(^\text{Id. at 643.}\)

\(^{119}\) See id. at 631. See also Scott Kimpel, Comment, Antitrust Considerations in International Airline Alliances, 63 J. AIR L. & COM. (forthcoming 1997) (also discussing Open Skies agreements and detailing the antitrust implications of airline alliances on both sides of the Atlantic).


\(^{121}\) See supra note 18.

\(^{122}\) Neil Kinnock, Speech to the Association of European Airlines, Luxembourg (April 28, 1995), available in LEXIS, Europe Library, Alleur File [hereinafter Kinnock Speech].


\(^{124}\) See id.


\(^{126}\) Kinnock Speech, supra note 122.
traffic to Eastern Europe. The United States, on the other hand, as a single and sizable market, does not offer the opportunity for European carriers to derive, from Fifth Freedom rights, the ability to build "hub and spoke" operations. Ownership of domestic carriers is restricted by law. Consequently, in an effort to simulate "hub and spoke" systems, carriers have developed code-sharing agreements, cooperation agreements, alliances, and franchise arrangements.127

Another concern for European carriers is the difference in antitrust exigencies in the U.S. that would put European carriers at a substantial disadvantage in the U.S. market.128 The E.U. antitrust policy129 is an integral part of the European integration process and goes beyond the concept of interstate commerce to include attempts at social engineering. Social cost and regional development are fundamental parameters in measuring acceptable distortions to competition in the exemption process under Article 85(3) of the EC Treaty.130 European social considerations go far beyond the rule of reason analysis of U.S. antitrust enforcement. In this respect, if European airlines were to enter the U.S. domestic market, to the extent these anti-competitive arrangements at home impact their ability to compete in the U.S., they would be reviewable under U.S. antitrust standards. It is also worth noting that the E.U. Commission, because of its involvement with airline cartel-like activity through its exemption policy, might have to seek U.S. immunity for itself.


128 European carriers do not benefit from block antitrust immunity in the U.S. Ownership restrictions are also more stringent in the United States. The DOT and the Department of Justice review agreements between airlines on a case-by-case basis for antitrust compliance. For a recent example, see DOT Order to Show Cause, 96-5-26, OST-95-618 (regarding the joint application of Delta, SwissAir, Sabena and Austrian Airlines for approval of, and Antitrust Immunity for Alliance Agreements pursuant to 49 U.S.C. §§ 41308 and 41309).

129 See supra note 18 and accompanying text.

130 See Commission Decision 96/180/EC of 16 January 1996 Granting Exemption to the Joint Venture Agreement between Deutsche Lufthansa A.G. (Lufthansa) and Scandinavian Airlines System (SAS) to Offer Scheduled Air Transport Access Between Germany and Scandinavia, 1996 O.J. (L 54) 1. The Commission found the joint venture agreement in violation of Article 85(1) but beneficial to consumers, provided certain conditions applied on routes with more than 30,000 seats per year. Competition on routes with less than 30,000 seats is not considered beneficial per se, because the regional interest prevails over the potential benefit of competition. See Council Regulation 2408/92, supra note 64.
In addition, under European licensing requirements, foreign ownership is limited to forty-nine percent, while U.S. law limits foreign ownership to twenty-five percent. Simply stated, it is structurally, economically and legally easier for American carriers to penetrate the European market than for European carriers to gain a share of the United States market.

Finally, for internal political reasons, the European Union would like to keep control over the pace of the liberalization of the European civil aviation market. For instance, Italy is still struggling with the privatization of its flag carrier and does not want to be forced into hasty decisions. Because the European Union is not a federalized state, self-serving political concerns weigh heavily in balancing the interests of the Community and the Member States, regardless of the clear commitment of the European institutions to achieve a free market.

All of these considerations comprise the underlying forces that led the European Union Member States to grant the mandate to the Commission. Nonetheless, the same considerations viewed in the light of self-serving interests led to the limitations imposed on the authority of the Commission under the mandate.

Thus, European criticism of DOT policies is not altogether justified. American carriers' success cannot realistically be blamed solely on policies when, at the same time, American carriers show substantial advances in efficiently controlling costs compared to European carriers. Furthermore, it is quite a stretch to attribute the disproportionate share of U.S. carriers on the trans-Atlantic routes to Open Skies agreements, when such disparity existed already under classic bilateral agreements. Finally, the shortcomings of the E.U.'s internal liberalization bear more heavily on the future of the European carriers' ability to compete in the international sector than the  

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131 See Council Regulation 2407/92, supra note 64.
132 See Duchene, supra note 56, at 124.
133 See 49 U.S.C. app §§ 1301-1557 (1992). DOT's willingness to pursue its liberal interpretation of ownership restrictions under the KLM-Northwest scheme, DOT Order 91-1-41, has not been tested lately. The DOT distinguished between voting equity limited to 25% and total foreign equity limited to 49% in a decision generally perceived as a reward to the Netherlands. See Grant, supra note 120, at 86-87.
134 See Kinnock, supra note 8.
135 In 1994, American carriers' costs were 48% lower than European carriers' costs on a mile per passenger basis. See Edwards, supra note 118, at 615.
136 See id. at 614-15.
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politics of liberalization of air traffic between the U.S. and the E.U. Member States.\textsuperscript{137}

The principal obstacles that stand in the way of the liberalization of the European air space and, ultimately, trans-Atlantic air space, are not only the privatization of flag carriers, ground handling, air traffic management and slot allocation as stated by the European Transport Commissioner,\textsuperscript{138} but also the political failure to enforce sound antitrust policies. A fundamental policy shift in applying competition rules to the airline industry is needed. Privatization and antitrust enforcement in the E.U. and relaxation of foreign ownership restrictions in both the U.S. and the E.U. are the keys to successful multi-lateralization of international air service between the E.U. and the U.S. Successful multi-lateralization will mean better fares and service for consumers, better utilization of scarce resources by airlines (routes and airports are congested), better opportunity for regulatory authorities to standardize licensing requirements in order to meet the safety and environmental concerns of air traffic, and less waste of governmental resources, whether in the form of subsidies, or more simply in the cost of monitoring and enforcing complex regulatory schemes. These are policy matters, not just air rights, that go far beyond the bottom line of a given airline. These are the true issues to be addressed, negotiated and eventually agreed upon between the U.S. and the E.U. In this respect, much is owed to President Carter's initiative in the late 1970s, when he offered to trade access rights to the U.S. market for commitments to apply and enforce competition rules in the international aviation sector.\textsuperscript{139}

\textsuperscript{137} See Basedow, \textit{supra} note 18, at 263-64. The European liberalization process did not produce the far-reaching effects of the U.S. deregulation of civil aviation, but that was also the very stated goal of the progressive liberalization implemented through the three packages. As a result, the structures of the U.S. and the European markets are still notably different, regardless of the many political differences on which the U.S. is banking to reach Open Skies agreements with specific countries rather than with the European Community as a whole. Professor Basedow strongly urges a straight-forward application of competition rules, doing away with all block exemptions. \textit{See id}. In essence, this would mean a move away from liberalizing toward deregulation. \textit{See id}.\textsuperscript{138}

\textsuperscript{138} See Kinnock, \textit{supra} note 8.

\textsuperscript{139} The Carter administration's policy was to trade landing slots at U.S. airports for increased competition in pricing. \textit{See} Edwards, \textit{supra} note 118, at 606.
B. **Analysis of the Mandate of the Commission to Negotiate a Multilateral Open Skies Agreement**

The Council of Transport ministers granted the Commission a nonexclusive mandate to negotiate a multilateral air transportation agreement between the U.S. and the E.U.\(^1\) The mandate does not allow the Commission to negotiate routes or access rights, but instead extends to matters that no individual Member State can address on its own: foreign ownership restrictions and cabotage. Antecedent to the questions of what and how to negotiate lies the question of the authority of the negotiator. Professor Basedow, relying on the European Court of Justice, argued in 1994 that "the Community gains implied powers to negotiate with third states in all areas where it has adopted measures to pursue a mandate of the [EC] Treaty."\(^2\) The Court of Justice, in a later opinion, held that "there is nothing in the Treaty which prevents [the council] from arranging . . . concerted action in relation to non-member countries or from prescribing the approach to be taken by the Member States in their external dealings."\(^3\) There is, thus, no requirement for exclusive competence, and the Council could concomitantly grant a mandate to the Commission and allow Member States to carry on separate bilateral negotiations.\(^4\) The U.S. Department of Transportation, therefore, should not let the intricacy of European Union law stand in the way of an opportunity to move ahead toward an internationalization of the civil aviation legal framework.

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\(^1\) See Commission’s Multilateralism Mandate, *supra* note 1.

\(^2\) See Basedow, *supra* note 18, at 274. Professor Basedow outlines the procedure applicable to the exercise of such competence under the EC Treaty. *See id.* at 275-76.

\(^3\) Opinion 1/94, Nov. 15, 1994, *reprinted in part* at 34 I.L.M. 689, 711 (1995). The court questioned the commission’s assertion “that the Member States’ continuing freedom to conduct an external policy based on bilateral agreements with non member countries will inevitably lead to distortions in the flow of services and will progressively undermine the internal market.” *Id.* The opinion answers the question of the competence of the Community to conclude the multilateral agreements of the Uruguay Round, which included GATS, by holding that “[t]he Community has sole competence, pursuant to Article 113 of the EC Treaty, to conclude the Multilateral Agreements on Trade in Goods. [In addition, the] Community and its Member States are jointly competent to conclude GATS.” *Id.* at 717. The court found that article 113 does not apply to services. *See id.*

\(^4\) *See id.* at 716.
C. Bargaining Chips of the European Commission

The internal liberalization of the European market was initiated well before the first Open Skies agreement was entered into between the Netherlands and the United States.\textsuperscript{144} The E.U. Commission, therefore, did not anticipate that the very implementation of the liberalization packages would lead to the erosion of substantive bargaining chips in future negotiations of multilateral agreements.\textsuperscript{145} Forty percent of trans-Atlantic routes are subject to existing Open Skies agreements. Furthermore, thirty percent of the routes represent traffic between the U.S. and the United Kingdom who are currently negotiating their own Open Skies agreement. The impact that a multilateral agreement would have is therefore no greater than thirty percent. It is hardly enough to make the Commission, on its face, a valid interlocutory to negotiate traffic rights to E.U. countries.

The European deregulation policy has limited Member States’ ability to subsidize their national carriers\textsuperscript{146} and has progressively implemented free cabotage among Member States. In and of itself, this policy gave sufficient motivation to smaller countries, who had little expectation to see their national carriers succeed in a competitive environment, to enter into bilateral agreements with the United States and sell off interests in their national carriers. Some even went as far as selling interests in their flag carrier to U.S. airlines.\textsuperscript{147} The separate ultraliberal Open Skies agreements between the United States and Belgium,

\textsuperscript{144} See Kinnock, supra note 8.

\textsuperscript{145} See supra note 52.

\textsuperscript{146} The liberalization packages do not contain any explicit provisions regarding state aid, but the Commission has grown increasingly inquisitive in applying Articles 92 and 93 of the EC Treaty. See Applications of Articles 92 and 93 of the EC Treaty and Article 61 of the EAA Agreement to State Aids in the Aviation Sector, 1994 O.J. (C 350) 5, 10, 12. In allowing Spain’s latest capital injection in Iberia, the Commission heeded the strong warning that it “could not authorize the granting of additional aid otherwise than in exceptional and unforeseeable circumstances beyond the control of the company.” Commission Decision of 31 January 1996, 1996 O.J. (L 104) 41. See also supra note 23 (discussing state aid to airlines generally).

\textsuperscript{147} If the bilateral Open Skies agreement between the Netherlands and the United States was an incentive or an opportunity for KLM to acquire an interest in Northwest Airlines, the need to privatize Sabena was the opportunity to promote Brussels Airport and therefore for Belgium to enter into a bilateral agreement with the United States notwithstanding the strong objections of the European Commission. U.S. Open Skies Bid Makes Many Europeans Jittery, Aviation Europe, Feb. 23, 1995, available in 1995 WL 2274322.
Luxembourg, Sweden, Finland, Denmark, and Austria, concluded in 1995, illustrate this pernicious twist, brought upon themselves by the European institutions.\footnote{148}{See supra notes 112-13. In addition, the Commission’s success in negotiating and concluding a bilateral agreement between the Community and Norway and Sweden in 1992 could have served as a precedent. See Council Regulation 92/384, Concerning the Conclusion of Agreement Between the European Community, the Kingdom of Norway and the Kingdom of Sweden on Civil Aviation, 1992 O.J. (L 200) 20, 21; see also Basedow, supra note 18, at 272.}

The E.U. Commission, prior to securing its mandate, had threatened to challenge, in the European Court of Justice, the legality of these bilateral Open Skies agreements under the EC Treaty.\footnote{149}{See Ebke & Wenglorz, supra note 63, at 505.} The Commission can probably make out a good case building on the Court of Justice’s precedents. In the \textit{Ahmed Saeed} case,\footnote{150}{Case 66/86, Ahmed Saeed Flugreisen v. Sentale zur Bekämpfung unlauteren Wettbewerbs E.V., 1989 E.C.R. 838.} the European Court of Justice held that Article 85(1) and Article 86 apply across the board to domestic, intra-E.U. flights as well as to flights between a Member State and a non-member state.\footnote{151}{See Ebke & Wenglorz, supra note 63, at 513-19. British Airways, however, continues to maintain that the Commission does not have jurisdiction over its alliance with American Airlines.} In addition, the Court held that the approval by a state of air fares violating Articles 85 or 86, as qualified by E.U. regulations, infringes upon the Member States’ obligations under Articles 5 and 90(1) of the Treaty.\footnote{152}{See id. at 516.} Expanding on this holding, the Commission could argue that a bilateral Open Skies agreement, to the extent it contains provisions that contradict or limit the terms of E.U. regulations, constitutes a violation by the signatory Member State of its obligations under Articles 5 and 90(1) of the Treaty. Further, the nationality provisions of bilateral agreements, to the extent they exclude nationals of other Member States, apparently also violate Article 6 of the EC Treaty, which prohibits “within the scope of the application of this Treaty, and without prejudice to any special provisions contained therein, any discrimination based on grounds of nationality.”\footnote{153}{EC TREATY art. 6.} Nonetheless, in view of the Court of Justice decision \textit{In re Community Competence},\footnote{154}{Case 1/94, \textit{In re} Community Competence, 1994 E.C.R. I-5276, [1995] 1 C.M.L.R. 205 (1994).} this argument may lose its impetus.\footnote{155}{See Basedow, supra note 18, at 270-71.} Arguably, the concurrent compe-
tence of the individual Member States would be meaningless if the Commission could trump bilateral agreements because they benefit the negotiating Member State's national carriers. On the other hand, one can also reason that the principle of non-discrimination was bargained in 1957 and cannot be recaptured merely because community standards are not yet formulated.

To up the ante, the Commission could also argue that it has the authority, under the Mergers and Acquisitions Regulation\textsuperscript{156} to review the terms of cooperation-ownership agreements of the kind entered into between KLM and Northwest or, more recently, between American Airlines and British Airways. Neil Kinnock has clearly stated that such challenges are not mere displays of political virility.\textsuperscript{157} At this stage in the negotiations between the E.U. and the U.S., however, threats with respect to existing arrangements are not openly expressed.\textsuperscript{158} Even more so, the mandate implies that, to the extent Open Skies agreements are more liberal, the goal of the negotiations is to not revert to less liberal conditions.

With respect to future or pending arrangements, the Commission is flexing its antitrust enforcement muscles. On January 10, 1997, Karl Van Miert, E.U. Competition Commissioner, warned the U.K. government of legal action if the British Airways-American Airlines alliance received clearance.\textsuperscript{159} The U.S. negotiators, on their part, have made clear that "[t]here can be no fruitful discussion on this subject [Open Skies] unless both sides can make and accept offers on core issues."\textsuperscript{160} The core issue in the U.S. view is that the European Commission is not authorized to negotiate all aspects of the DOT standard Open Skies agreement. These include routes, capacity, pricing, and slots. In other words, if the Commission has nothing else to offer than soft rights, which are already largely covered under traditional bilateral agreements, there is no incentive for the United States to bargain. The Commission may, therefore, be tempted to review, and possibly restate, its position with respect to antitrust

\textsuperscript{156} See Council Regulation 4064/89, on the Control of Concentrations Between Undertakings, 1989 O.J. (L 395) 1, amended by 1990 O.J. (L 257) 14. See supra notes 102-05 and accompanying text.

\textsuperscript{157} See Kinnock Speech, supra note 122.

\textsuperscript{158} See Kinnock, supra note 8.


matters under E.U. law relating to alliances between American and European carriers. It would indeed require more than simply stating a new policy; present regulations provide for exemptions under Article 85(3) of the EC Treaty.\textsuperscript{161} It is, nonetheless, the most valuable chip that the Commission could bring to the bargaining table. As discussed earlier, the Commission has already announced its intention to review the British Airways-American Airlines alliance. The Delta-Sabena-SwissAir-Austrian Airlines partnership and the Lufthansa-United-SAS partnership have also been earmarked for scrutiny.\textsuperscript{162} The Commission can hardly say that its intent to review the British Airways-American Airlines alliance is not motivated by its effort to gain authority over external relations, nor can it treat one alliance differently without undermining its own credibility.

D. The Vested Interests of the U.S.

1. Existing Open Skies Agreements

Since 1992, the U.S. has successfully entered into Open Skies agreements with Austria, Belgium, Denmark, Finland, Germany, Luxembourg, The Netherlands, Norway, Sweden, Switzerland, and Iceland.\textsuperscript{163} As demonstrated above, these agreements have assisted U.S carriers in gaining a solid foothold in the European Union. As it stands, these agreements have managed to secure not only the soft rights that the E.U. Commission is willing to negotiate but also some hard rights (about forty percent of the routes between the U.S. and E.U.), that the E.U. Commission is not offering in the first stage of the negotiation\textsuperscript{164} such as Fifth Freedom and route access rights.

2. Negotiations In Progress For Open Skies Agreements

The U.S. and the United Kingdom are currently negotiating an Open Skies agreement, the success of which the U.S. has made a condition precedent to antitrust review of the British

\textsuperscript{161} Council Regulation 3975/87 of Dec. 14, 1987 lays down the procedure for the application of the rules on competition in the air sector, as last amended by Regulation 2410/92, 1992 O.J. (L 240).


\textsuperscript{163} See Air Transport Agreement, supra note 112.

Airways-American Airlines agreement. A fundamental issue raised by this agreement is slot allocation at Heathrow Airport, one of the busiest airports in the world. Slot allocation, however, is getting more and more complicated. The alliance's competitors are seeking a chance to force it to release slots, and lobbying is the activity of the day. The DOT has indicated that thirty-two slots would have to be freed up for other airlines; the U.K. Merger Commission has raised this figure to 168, and the E.U. Commission has expressed, in Karl Van Miert's letter, that this latter figure is completely inadequate. A related issue is whether the alliance may sell these slots or whether it must surrender them without compensation. Spain, after repeated efforts to refinance its flag carrier with government subsidies, has finally expressed interest in negotiating an Open Skies agreement as well. For the E.U. Commission, the more hardly means the merrier.

3. Foreign Ownership Restrictions

In order to operate a commercial aircraft in the domestic U.S. market, an airline must satisfy the citizenship requirement under the Federal Aviation Act. Two criteria must be satis-

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166 See id. See also Sue Beenstock, Jet Set: A Tale of Two Airlines, P.R. WEEK, Jan. 31, 1987. British Airways claims that the short supply of slots is untrue. Conversely, Commissioner Van Miert claims that competition will be eliminated on 13 U.K. to U.S. routes. See id.
167 See Murray, supra note 159.
168 Regulation 2408/92 on slot allocation is unclear. The 168 slots on the gray market (there is no official market) are valued at $180 million. The Council is also expected to issue a new slot allocation by the end of 1997. See id.
169 On Spain's repeated efforts to subsidize Iberia, see Randall D. Lehner, Protectionism, Prestige, and National Security: The Alliance Against Multilateral Trade in International Air Transport, 45 DUKE L.J. 436, 454-55 (1995). See also Commission Decision, supra note 146 (relating to Spain's recapitalization of Iberia).
170 49 U.S.C. app. § 1301 (1992), which defines a U.S. citizen as:
   (a) an individual who is a citizen of the United States or one of its possessions, or
   (b) a partnership of which each member is such an individual, or
   (c) a corporation or association created or organized under the laws of the United States or of any State, Territory, or possession of the United States, of which the president and two-thirds or more of the board of directors and other managing officers thereof are such individuals and in which at least 75 per centum of the voting interest is owned or controlled by persons who are citizens of the United States or of one of its possessions.
fied: (1) U.S. citizens must control seventy-five percent of the voting rights, and (2) U.S. citizens must actually control the airline. The control component of the test is the object of a case by case review by Department of Transportation. Sovereignty claims and national security concerns are the traditional justification for foreign ownership restrictions.

Sovereignty, however, would not be challenged if ownership restrictions did not exist; the policing powers of a state over its air space have little to do with the ownership of airlines. Countries without national airlines still have sovereignty over their air space. The right to regulate access to and use of the airspace cannot legitimately serve as a proxy for national protectionism. National security concerns raise a completely different set of issues. The fear of disseminating military and technological secrets, of terrorism, and of foreign aircraft in the Civil Reserve Air Fleet (CRAF) are often cited justifications. Civil aviation, however, parted ways with its military cousin decades ago; the technology is widely available; terrorism has more to do with airport security than airline ownership, and CRAF is a voluntary program set up by the Department of Defense. “[N]ational security . . . [is] no more legitimate a basis for protection of airlines than [it was] for . . . steel.” The argument of national security does sound rather hollow. First, little would be lost in raising the limit of foreign ownership to forty-nine percent to match the European licensing requirement. Clearly, the more

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172 49 U.S.C. app. § 1508(a) affirms “[t]hat the United States of America is hereby declared to possess and exercise complete and exclusive sovereignty in the airspace of the United States . . . .”

173 See Grant, supra note 120, at 73; Lehner, supra note 169, at 450; Edwards, supra note 118, at 639-42.

174 See Grant, supra note 120, at 73.

175 See id.

176 See Edwards, supra note 118, at 639-40.

177 Lehner, supra note 169, at 448. Lehner analogizes the arguments that the steel industry articulated when it sought protection from foreign competition, with the justifications advanced in restriction of foreign ownership of airlines. “[E]ven if legitimate” from a defense posture “the national security argument is a weak one at best to explain the reluctance of states and industry . . . . The Chicago Convention itself contains provisions dealing with national security and emergencies.” Id. at 451.
believable concern with respect to international mergers, not unlike national mergers, goes to possible distortion of competition resulting from an acquisition rather than to the mere change of control. Further, safety of aircraft would not be affected, and neither maintenance requirements nor pilot licensing standards are at stake here. Second, air control and air space safety have improved considerably since the early age of aviation. Third, restrictions on ownership raise the cost of capital for U.S. airlines, which may affect the viability of American carriers. Potentially, this could mean fewer jobs, less competition and higher fares in the U.S. aviation industry.

4. Cabotage Restrictions

U.S. law provides that, although foreign civil aircraft are permitted to navigate in the U.S.,\footnote{178} they shall not take on, at any point within the U.S., persons, property, or mail destined for another point within the U.S.\footnote{179} In other words, cabotage in the U.S. is reserved for American carriers. U.S. airlines are not eager to relinquish this privilege of a captive market, the largest single aviation market in the world. Foreign ownership restrictions and cabotage restrictions are closely intertwined; no foreigner may own an American carrier, and only American carriers can exercise cabotage rights.

Cabotage is the bread and butter for most carriers in the U.S., and opening that market all at once could undoubtedly have far-reaching effects on the operations of domestic carriers. Most of the economical trimming, however, was achieved with deregulation, and it is quite unlikely that European carriers with higher average operating costs could compete efficiently in the domestic U.S. market. Therefore, the far-reaching effects are quite unlikely to be realized but, for the sake of caution, the risks, if any, can be readily controlled if access to cabotage is freed in stages. First, foreign ownership could be relaxed; second, cabotage could be limited to one inland leg of European carriers' flights. Assuming these benefits are traded for strict compliance with antitrust principles, a complete ban on state subsidies and similar rights for U.S. carriers in the E.U., two substantial benefits would be derived for American civil aviation: Europeans would gain a stake in the stability of U.S. aviation

\footnote{178} This is subject to a permit issued by DOT. See supra note 108 and accompanying text.

through increased ownership, and economically unsound European carriers would have to yield routes, access and slots to more competitive airlines, which would likely be American carriers. On a more level playing field, American companies, especially American airlines that survived the deregulation process, should stand to gain rather than to lose.

IV. EVALUATION AND CONCLUSION: FROM OPEN SKIES TO OPEN MARKETS

The liberalized European internal market is still functionally a relatively non-competitive market. New E.U. regulations, anticipated in late 1997, are expected to address ground-handling, air traffic management, and slot allocation. This third element is crucial to the economic benefits expected from Open Skies agreements, for without slots, there is no meaningful access to air rights. Only the Commission can legislate to create an official market for slots at European airports. An Open Skies agreement with the U.K. will change little in the market conditions for U.S. carriers if slots at Heathrow do not become negotiable commodities. The uncertainty surrounding the Commission's jurisdiction over international alliances further hampers progress. Similarly, any threat by the E.U. Commission to challenge, under the competition rules, the effects of Open Skies agreements creates unsettling conditions.

On the other hand, the European institutions' unwillingness (or inability) to eliminate, once and for all, subsidies and state aids to unprofitable carriers necessarily distorts competition on international routes. For the same reasons, the Commission's liberal grants of exemptions from E.U. competition rules favors European carriers competing with U.S. carriers for trans-Atlantic customers.

The Commission's mandate covers all the issues raised above, and the Commission has expressed a desire to discuss ownership restrictions. Such restrictions typify protectionism and protectionist mentalities which can hardly be justified in a globalized market. At a time when the U.S. airline industry has returned to profitability, ownership restrictions are even more difficult to justify other than by nationalism. Conversely, the profitability of U.S. airlines would put them at an advantage should ownership restrictions be lifted on both sides of the Atlantic.

For these reasons, the Department of Transportation should actively pursue negotiations with the European Commission with respect to soft rights and ownership restrictions. Increased
soft rights will enhance the economic value of existing and future Open Skies agreements and the privatization of European flag carriers in a subsidy-free market can only benefit the more efficient U.S. carriers. In addition, easing ownership restrictions in the U.S. should lower the cost of capital for domestic carriers. However, to prevent a repeat of the turmoil that followed the U.S. deregulation initiative, cabotage restrictions should not be lifted all at once in order to put a premium on existing carriers and existing American jobs. U.S. airlines with routes to Europe, international ambitions, or need for capital should come to the realization that their best ally is the European Commission enforcing sound competition rules in a scheme of multilateral Open Skies conditions.
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