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## Competition in the Air: European Union Regulation of Commercial Aviation

Paul Stephen Dempsey

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# **COMPETITION IN THE AIR: EUROPEAN UNION REGULATION OF COMMERCIAL AVIATION**

PAUL STEPHEN DEMPSEY<sup>1</sup>

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The real situation of Europe would, then, appear to be this: its long and splendid past has brought it to a new stage of existence where everything has increased; but at the same time, the institutions surviving from that past are dwarfed and have become an obstacle to expansion . . . Will she be able to shake off these survivals, or will she remain forever their prisoner?

—José Ortega y Gasset, *The Revolt of the Masses*

## I. INTRODUCTION

**T**HOUGH CREATION of a European common market has been a goal since the conclusion of the Treaty of Rome in

1957,<sup>2</sup> movement toward a single market in commercial air transport has consumed most of the ensuing half-century. While economic unification has come relatively easy in many sectors, creating a single market for air transport has proven to be a difficult challenge. The history of European commercial aviation is a colorful mix of national politics and economic policy. Although efforts to achieve regulatory liberalization were undertaken in the years leading up to the creation of the European Union (EU, or the Union), comparatively little liberalization occurred until the Union was achieved. While historically the airlines of Europe had been heavily regulated, owned, and/or subsidized by their governments,<sup>3</sup> by the 1980s the European Community (EC, or the Community) began to move toward liberalization.<sup>4</sup> National governments traditionally shielded their

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<sup>2</sup> In 1997, the European Union's Member States adopted the Treaty of Amsterdam. Aside from some slight changes in structure of the Union's governance, the Treaty of Amsterdam renumbered the articles of the Treaty of Rome. However, as the renumbering did not go into effect until 1999, virtually all regulations, decisions, and directives referred to in this paper use the original numbering system. To avoid confusion, the original numbering has been used throughout this paper; however, the reader should be aware of these changes. Below are the relevant articles of the Treaty of Rome mentioned in this paper, followed by their new numbers under the Treaty of Amsterdam. Please see the Treaty of Amsterdam for a comprehensive guide:

Article 2 = 2, Article 3 = 3, Article 5 = 10, Article 7 = 14, Article 48 = 39, Article 49 = 40, Article 50 = 41, Article 51 = 42, Article 74 = 70, Article 75 = 71, Article 84 = 80, Article 85 = 81, Article 86 = 82, Article 87 = 83, Article 88 = 84, Article 89 = 85, Article 90 = 86, Article 92 = 87, Article 93 = 88, Article 175 = 232, Article 198 = 262, Article 229 = 302, Article 234 = 307, and Article 235 = 308.

<sup>3</sup> Michael Feazel, *New GATT Negotiations Could Give Impetus to Airline Deregulation*, AV. WK. & SPACE TECH., Sept. 8, 1986, at 58. For an overview of early international negotiations for air rights, see Jeswald W. Salacuse, *The Little Prince and the Businessman: Conflicts and Tensions in Public International Air Law*, 45 J. AIR L. & COM. 807 (1980); PAUL STEPHEN DEMPSEY, LAW AND FOREIGN POLICY IN INTERNATIONAL AVIATION 7-22 (1987).

<sup>4</sup> American aviation was also heavily regulated prior to 1978. See PAUL STEPHEN DEMPSEY & WILLIAM E. THOMS, LAW AND ECONOMIC REGULATION IN TRANSPORTATION 26-29, 121-133 (1986).

Percentage of capital held in 1979 by States in the main European scheduled airlines was as follows:

Aer Lingus 100%, British Airways 100%, Sabena 100%, Air France 99%, Alitalia 99%, Lufthansa 82%, KLM 78%, Air Inter 50%, and Luxair 26%.

BULL. EUR. COMM. SUPP. 35 (May 1979) (cited in Comment, *Introducing Competition to the European Economic Community Airline Industry*, 15 CAL. W. INT'L L.J. 364, 365 n.7 (1985)). More recently, a number of European airlines have been partially or wholly privatized. For example, British Airways has been completely

airlines from the rigors of the marketplace, perceiving the industry to have public utility characteristics. Governments utilized air carriers to promote public policy objectives beyond allocative efficiency, such as increasing tourism and foreign exchange, augmenting international prestige, enhancing national security, reducing unemployment, and promoting domestic aircraft manufacturing.<sup>5</sup>

With the implementation of the EU Council's Third Package of liberalization in 1993, these positions began to change. National flag carriers now are forced to compete on equal terms, and are increasingly being run as competitive enterprises. Today, the EU commercial aviation market is well on its way to becoming a market without state-imposed anticompetitive restrictions.<sup>6</sup> Some experts predicted that liberalization would force unprofitable carriers out of business, into mergers, or into buyouts.<sup>7</sup> Airlines initially responded to liberalization by forming massive alliance structures.<sup>8</sup> It remains to be seen whether these cartels are beneficial for the consumer.<sup>9</sup>

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privatized, and the Dutch government today holds only an 11% interest in KLM. See KLM Royal Dutch Airlines ANNUAL REPORT 1997-98, at 86 (1998).

For historical reference, the following list indicates the levels of government ownership of the largest European major airlines in 1992:

Air France 100%, Iberia 100%, Olympic 100%, TAP-Air Portugal 100%, JAT-Yugoslav 100%, Aer Lingus 100%, Alitalia 83%, Austrian 76%, Finnair 70%, Sabena 53%, SAS 50%, Lufthansa 48%, KLM 39%, Swissair 23%, British Airways 0%, and Icelandair 0%.

D. Woerth, International Aviation: Cabotage, Foreign Ownership and International Marketing Alliances Appendix 1, Address at the University of Denver/Smithsonian Conference on Airlines, Airports and Aviation, Washington, D.C. (May 28, 1992).

<sup>5</sup> Frederik Sorensen, *Progress Towards the Development of a Community Air Transport Policy*, IATA MAG., June-July 1985, at 3, 7-8 [hereinafter SORESEN]; Paul Stephen Dempsey, *Turbulence in the "Open Skies": The Deregulation of International Air Transport*, 15 TRANSP. L.J. 305, 362-63 (1987) [hereinafter TURBULENCE].

<sup>6</sup> This new era is easily captured by the following industry statement: "[e]uropean airlines will face continuing upheaval over the next five years as they seek to lower costs and improve productivity, bowing to the inevitability of a more competitive environment where unit costs, employee productivity, good service and customer loyalty separate the winners from losers." Carole A. Shifrin, *Air Transport, Market Rigors Squeeze European Flag Carriers*, AV. WK. & SPACE TECH., Mar. 14, 1994, at 64.

<sup>7</sup> See, e.g., Carole A. Shifrin, *5 Year Outlook: Air Transport, European Airlines to Enter 21st Century with New Look*, AV. WK. & SPACE TECH., Mar. 15, 1993, at 67; *European Deregulation Expected To Lead to Airline Mergers*, AV. WK. & SPACE TECH., Mar. 9, 1987, at 203.

<sup>8</sup> See Pierre Sparaco, *European Deregulation Still Lacks Substance*, AV. WK. & SPACE TECH., Nov. 9, 1998, at 53 [hereinafter SUBSTANCE].

<sup>9</sup> See *id.*

In the short time since the establishment of the EU, true cabotage rights have become a reality.<sup>10</sup> Growth rates of mid-sized carriers have surpassed that of the larger, national flag carriers.<sup>11</sup> Due to increased competition, landing fees are decreasing, new carriers are entering the market, and carriers are being forced to improve on-time departures.<sup>12</sup> State aid (government subsidy) is increasingly becoming a historical concept.<sup>13</sup> While growing pains—particularly with respect to the *degree* of liberalization—have occurred,<sup>14</sup> commercial aviation on the Continent is drastically different today than it was even in the early 1980s.

Simply stated, the face of European commercial aviation *has already* transformed. As the EU moves ever closer to a seamless union—one without border crossings and tariffs and with a common currency—the issues confronting the European aviation community are rapidly changing. While cabotage has been a primary concern for the EU, the focus is increasingly shifting towards the representation of the EU commercial aviation community as a whole. As the British Airways/American Airlines alliance<sup>15</sup> and the Boeing/McDonnell Douglas merger case<sup>16</sup> both demonstrate, EU commercial aviation players are realizing the importance of banding together in an increasingly global aviation marketplace. Without a doubt, this arena is where the next

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<sup>10</sup> Implemented in 1997.

<sup>11</sup> SUBSTANCE, *supra* note 8, at 54 (“[M]id-size independents such as British Midland, KLM uk, Air Europa, Spanair and Norway’s Braathens are growing faster than national carriers.”).

<sup>12</sup> Pierre Sparaco, *Europe’s Regionals Hit Hardest by User Charges*, AV. WK. & SPACE TECH., Aug. 28, 1995, at 52.

<sup>13</sup> See, e.g., Pierre Sparaco, *Air Transport, Wise Men Reject State-Aid Rescue*, AV. WK. & SPACE TECH., Dec. 13, 1993, at 31.

<sup>14</sup> See SUBSTANCE, *supra* note 8, at 54. Sparaco notes, as is certainly true, that EU liberalization has much ground to cover before true success can be claimed. He notes that while EU officials claim such success, “airline fare structures are far from being revolutionized, dramatic service improvements have not materialized yet and no major consolidation initiatives are in sight.” *Id.* These are critical issues that the EU must address. This chapter will confront and assess such critiques and what the EU is doing to solve these problems.

<sup>15</sup> See generally G. Porter Elliott, *Learning to Fly: The European Commission Enters Unfamiliar Skies in Its Review of the British Airways-American Airlines Alliance*, 64 J. AIR L. & COM. 157 (1998) (examining the alliance in the context of Article 85 of the Treaty of Rome, the European Commission’s extraterritorial application of the EC Competition Rules, and the Merger Regulation of 1989).

<sup>16</sup> See generally Amy Ann Karpel, Comment, *The European Commission’s Decision on the Boeing-McDonnell Douglas Merger and the Need for Greater U.S.-EU Cooperation in the Merger Field*, 47 AM. U. L. REV. 1029 (1998) (delineating the European Commission’s actions and subsequent resolution of the Boeing/McDonnell Douglas merger).

great European commercial aviation debate will occur. As was noted in an industry publication, "[t]he EU's ultimate goal is to support European carriers' efforts to preserve a major role in the globalized market and allow effective competition against U.S. giants."<sup>17</sup> National flag carriers now are forced to compete on equal terms, and are increasingly being run as competitive enterprises. Today, the EU commercial aviation market is well on its way to becoming a market without anticompetitive restriction.

European aviation policy has always been the product of conflicting and competing legal, economic, and political interests.<sup>18</sup> The principal actors include scores of airlines (many still publicly owned or subsidized),<sup>19</sup> the European Union,<sup>20</sup> and a number of air transport associations including the Association of European Airlines (AEA), the International Air Transport Association (IATA), and the European Civil Aviation Conference (ECAC).<sup>21</sup> The achievement of any sort of cohesive policy is further complicated by a labyrinth of bilateral air transport agreements,<sup>22</sup> old European Community regulations and directives, and an increasingly competitive regional air transport market.<sup>23</sup>

After the United States deregulated its domestic air transport market<sup>24</sup> and began to export its ideology abroad, many observ-

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<sup>17</sup> Pierre Sparaco, *New Carrier Relationships Create Legal Complexities in Europe*, AV. WK. & SPACE TECH., Nov. 17, 1997, at 61, 62.

<sup>18</sup> See generally *Break It Up, but Not the American Way, Europe's Air Cartel*, ECONOMIST, Nov. 1, 1986, at 23, 93-107, 241-55 [hereinafter AIR CARTEL].

<sup>19</sup> *Id.* at 23. Many European nations are, however, moving toward privatization of their national airlines. For example, the Thatcher government privatized British Airways. Subsidies are also a major factor in the well being of governmentally owned airlines. In the early 1990s, the French government provided Air France with \$400 million, the Belgian government gave Sabena \$300 million, and the Italian government gave Alitalia \$300 million. *DOT Says "Hands Off" Best Approach to Helping Competition*, AVIATION DAILY, Mar. 6, 1992, at 427.

<sup>20</sup> The fifteen Member States are Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Netherlands, Luxembourg, Portugal, Spain, Sweden, and the United Kingdom.

<sup>21</sup> *EEC Deregulation Proposal Blocked While ECAC Plan Proceeds*, AV. WK. & SPACE TECH., July 7, 1986, at 33.

<sup>22</sup> See generally Dr. J. Naveau, *Bilateralism Revisited in Europe*, 10 AIR L. 85 (1985); DEMPSEY, *supra* note 3, at 47-75.

<sup>23</sup> Michael Feazel, *EEC Officials Draft New Directive to Ease Regional Airline Regulation*, AV. WK. & SPACE TECH., April 14, 1986, at 37. See also SUBSTANCE, *supra* note 8, at 53.

<sup>24</sup> See PAUL STEPHEN DEMPSEY, *THE SOCIAL AND ECONOMIC CONSEQUENCES OF DEREGULATION: THE TRANSPORTATION INDUSTRY IN TRANSITION* (Quorum Books ed., 1989).

ers argued that rigid regulation and pricefixing created inefficient markets and excessively high fares.<sup>25</sup> Capacity controls,<sup>26</sup> tariff coordination and pricefixing,<sup>27</sup> market access restrictions,<sup>28</sup> and revenue sharing (pooling) agreements<sup>29</sup> were targeted by liberalization proponents. In the 1980s, the United Kingdom and the Netherlands led the fight for liberalization, entering into a number of liberal bilateral transport agreements with other nations.<sup>30</sup> At the same time, the more conservative southern European nations, such as France and Greece, advocated a more modest relaxation of the regulatory reins.<sup>31</sup> New airlines, such as Ireland's Ryanair, entered the market to take

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<sup>25</sup> See, e.g., R. AMACHER, *PRINCIPLES OF MACROECONOMICS* 318-19 (2d ed. 1983). For an examination of U.S. domestic airline deregulation and its exportation abroad, see Paul Stephen Dempsey, *The Rise and Fall of the Civil Aeronautics Board—Opening Wide the Floodgates of Entry*, 11 *TRANSP. L.J.* 91 (1979), and Paul Stephen Dempsey, *The International Rate and Route Revolution in North Atlantic Passenger Transportation*, 17 *COLUM. J. TRANSNAT'L L.* 393 (1978).

<sup>26</sup> Capacity is defined as the total available aircraft seats on given air routes over a given period, usually expressed in terms of available-seat/kilometers. Capacity controls, which fix the number of seats that airlines from two different Member States will offer, are concluded in bilateral air transport agreements between nations. Analysis by the Council of Europe, Committee on Economic Affairs and Development of U.S. Deregulation of Air Transport and Its Inferences for a More Liberal Air Transport Policy in Europe, May 21, 1984, at 79; Commission of the European Communities, *CIVIL AVIATION MEMORANDUM NO. 2, PROGRESS TOWARDS THE DEVELOPMENT OF COMMUNITY AIR TRANSPORT POLICY* 32-33 (1984) [hereinafter *MEMORANDUM 2*].

<sup>27</sup> Governments impose price controls in an effort to guarantee revenues and enhance the viability and safety of airlines and ensure nondiscrimination among consumers.

<sup>28</sup> Market access restrictions determine which airlines will be granted particular air rights. See Dr. Z. Joseph Gertler, *Nationality of Airlines: A Hidden Force in the International Air Regulation Equation*, 48 *J. AIR L. & COM.* 51, 54 (1982).

<sup>29</sup> Pooling agreements between airlines equalize the revenue between airlines based on capacity offered. *MEMORANDUM 2*, *supra* note 26, at 33. Traditionally, before liberalization, 70 to 80% of the route-miles performed in Europe had been subject to pooling agreements. Michael Feazel, *ECAC Leaders Expected to Approve Liberalized Regulatory Proposals*, *AV. WK. & SPACE TECH.*, June 17, 1985, at 28, 29.

<sup>30</sup> Michael Feazel, *European Civil Aviation Leaders Commit to Increased Liberalization*, *AV. WK. & SPACE TECH.*, June 24, 1985, at 36 [hereinafter *INCREASED LIBERALIZATION*].

<sup>31</sup> *Id.* See also *British Caledonian Reduces AEA Activity in Deregulation Dispute*, *AV. WK. & SPACE TECH.*, Oct. 7, 1985, at 36 (discussing attitudes of European airlines toward deregulation) [hereinafter *BRITISH CALEDONIAN*].

advantage of areas that were amenable to competition.<sup>32</sup> Some established airlines also advocated increased liberalization.<sup>33</sup>

The EC itself—and then the EU—promulgated a series of comprehensive regulations mandating intra-Community air transport liberalization. This series, known individually as “packages,” culminated in the Third Package, put into effect in 1993. The Third Package brought the EU commercial aviation market ever closer to true cabotage rights. The Treaty of Rome established the EC in 1957 for the purpose of enhancing economic efficiency among the western European nations.<sup>34</sup> The EU was established by the Treaty of Maastricht in 1992.<sup>35</sup> On January 1, 1993, the EU began functional operation and the power embodied in the Treaty of Rome passed on to the EU.<sup>36</sup> The Treaty of Rome includes rules intended to promote competition in various economic sectors, including transportation.<sup>37</sup> Nevertheless, until the packages were promulgated, for nearly three decades the EC/EU left aviation outside the mainstream of European integration.<sup>38</sup>

The four governing bodies of the EU—the Council, the Commission, Parliament, and the European Court of Justice—share responsibility to interpret and implement the governing treaties.<sup>39</sup> The Council, whose members represent the Member States, is responsible for carrying out the objectives of the EU through legislative enactments.<sup>40</sup> The Commission, comprised of nonpartisan members chosen by common agreement by the Member States, gives recommendations and advisory opinions to the Council.<sup>41</sup> Parliament has the duty of advising the Council on issues relevant to the development of the EU.<sup>42</sup> The Court of Justice interprets the provisions of the Treaty of Rome

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<sup>32</sup> Sean D. Barrett, *Irish Airline's Model for Deregulation*, WALL ST. J., Dec. 10, 1986, at 35.

<sup>33</sup> BRITISH CALEDONIAN, *supra* note 31, at 36.

<sup>34</sup> Treaty Establishing the European Economic Community, Mar. 25, 1957, art. 2, 298 U.N.T.S. 11 [hereinafter TREATY OF ROME]. Salient provisions are set forth in DEMPSEY, *supra* note 4, at 451-59.

<sup>35</sup> TREATY ON EUROPEAN UNION, Feb. 7, 1992, O.J. (C 224) 1 (1992) [hereinafter TREATY OF MAASTRICHT].

<sup>36</sup> *Id.*

<sup>37</sup> TREATY OF ROME, *supra* note 34, at art. 3.

<sup>38</sup> M. Wouters, Some Aspects of E.C. Law in Relation to the Air Transport Industry 1 (unpublished address of April 1, 1992) [hereinafter WOUTERS].

<sup>39</sup> L. HENKEN ET AL., INTERNATIONAL LAW 1077 (1980) [hereinafter HENKEN].

<sup>40</sup> 3 Eur. Union L. Rep. (CCH) ¶¶ 4401, 4405 (1987).

<sup>41</sup> 3 Common Mkt. Rep. (CCH) ¶¶ 4472, 4481 (1987).

<sup>42</sup> 3 Common Mkt. Rep. (CCH) ¶ 4302 (1987).

and enforces its requirements.<sup>43</sup> Each of these governing bodies has its own conception of how the competition rules of the Treaty of Rome should be applied to air transport.

This paper examines the EC/EU's movement toward air transport liberalization. It begins by identifying the various commercial air transport organizations in the EU and discusses their respective positions—historical and current—on liberalization. It proceeds by examining the actions that the member European governments have taken on the subject, and reviews how these actions foreshadowed multilateral agreements. It discusses the Treaty of Rome's competition rules and their application to the field of air transport. The paper then focuses on the current structure of the EU. It also reveals how the Single European Act was the catalyst in not only the establishment of the EU, but also the acceleration towards air transport liberalization. The paper proceeds to review the important Court of Justice cases that circumscribed the zone of application in which the competition rules can regulate air transport. It next details how the EU institutions, early on, utilized the Treaty of Rome and the Court of Justice decisions to develop the foundation for a unified European transport policy. The paper then moves to a detailed discussion of what is commonly considered the contemporary environment for commercial air transport regulation—the sequence of 'packages.' The section breaks down the regulatory environment by sector area—for example, pricing, market access, state aid, etc. It also considers the relevance of the EU merger regulations to air transport. In addition, this section discusses EU regulations of non-economic air transport issues. Finally, this chapter looks into the future of EU air transport and examines the prospectus for further liberalization, paying particular attention to true cabotage and the EU acting for the European commercial aviation market as a whole.

Table 11.1 describes the primary events that were responsible for the contemporary regime. Our discussion in this paper also proceeds chronologically.

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<sup>43</sup> 3 Common Mkt. Rep. (CCH) ¶ 4600 (1981).



**Table 11.1 – European Community/Union Events Leading to Air Transport Liberalization<sup>1</sup>**

1944		The International Convention on Civil Aviation signed in Chicago.
1958		The Rome treaty becomes effective.
1962	February November	The anti-cartel Regulation (No. 17) becomes effective. Transport is withdrawn from the scope of application of Regulation No. 17.
1969	December	End of transition period.
1974		French merchant seamen's case decided. <sup>2</sup> Articles 48-51 applicable to sea transport.
1977-1984		Air Transport deregulation in the USA.
1978		Council establishes priority list of problems to be examined in air transport—Parliament votes resolution on competition in air transport.
1979	June July	First direct election to the European Parliament. First Memorandum of the Commission on aviation.
1980		Parliament emphasizes the need for a proper application of Articles 85 and 86 to the air transport industry. The Sterling Airways complaints against SAS investigated by the Commission under Article 89.
1981		First proposal of the Commission for the application of Article 85 and 86 to air transport. <sup>3</sup>
1982		Parliament endorses Commission's proposal – little progress in Council.
1983	January  July	The European Parliament brings action before the European Court of Justice against the Council for inactivity in the field of transport. <sup>4</sup> Directive on interregional services adopted by Council.
1984	March, 2 <sup>nd</sup>  March, 20 <sup>th</sup>  August	The Tribunal de Police de Paris decides to seize the Court of Justice with the question of the application of Art. 85 to air transport. <sup>5</sup> The Commission presents "Civil aviation Memorandum No. 2" including a proposal on the application of the competition rules to air transport. The Nouvelles Frontieres case is laid before the ECJ (applicability of Art. 85 to air transport).
1985	May June  September	The Parliament's transport case is decided. <sup>6</sup> Commission presents the European Council the White Paper on the completion of internal market by 1992. The Advocate General Lenz delivers his opinion in the Nouvelles Frontieres case. <sup>7</sup> Commission proceeds against Member States in the air transport sector.

<sup>43</sup> Otto Lenz, Address at the International Law Forum Conference at Krumbach, Austria (Sept. 3, 1999).

1986	January	The Saeed case is led before the ECJ (applicability of Articles 85, 86 and 90 to air transport), <sup>8</sup> referring to the opinion of Advocate General Lenz.
	February	The Single European Act, providing for majority voting on air transport matters, is signed.
	April	The ECJ decides the <i>Nouvelles Frontieres</i> case: applicability of Art. 85 to air transport. <sup>9</sup>
1987	June	The Council reaches agreement in principle on a package of measures [based on the Commission's proposals of 1984 and 1987] to increase competition in the civil aviation sector (so-called "first package").
	July 1 <sup>st</sup>	The Single European Act enters into force.
	December	The "First Package" is adopted by the Council.
1988	January	First Package becomes effective. <sup>10</sup>
1989	April	The Saeed case is decided. <sup>11</sup> The court confirms the <i>Nouvelles Frontieres</i> decision as to Art. 85, declares Art. 86 directly applicable and rules on the applicability of Art. 90.
	September	Commission adopts a package of proposals on the second stage of liberalization of air transport in the Community. <sup>12</sup>
1990	July/November	The "Second Package" of air transport regulations enters into force. <sup>13</sup>
1991	July	The Commission proposes the "Third Package" of air transport regulations. <sup>14</sup>
1993	January	The "Third Package" becomes effective. <sup>15</sup>

<sup>1</sup> Speech by Otto Lenz at the International Law Forum Conference at Krumbach, Austria (Sept. 3, 1999).

<sup>2</sup> ECR 74/359.

<sup>3</sup> OJ Nr. C 291 of 12/11/81, p.0004.

<sup>4</sup> ECR/85/1513 (*Parliament's transport case*).

<sup>5</sup> *Nouvelles Frontieres case*).

<sup>6</sup> ECR/85/1513.

<sup>7</sup> ECR/86/1425.

<sup>8</sup> ECR/89/803.

<sup>9</sup> ECR/86/1425.

<sup>10</sup> OJ Nr. L374/87 of 31.12.87.

<sup>11</sup> ECR/89/803.

<sup>12</sup> OJ C 258, 11/10/1989 p. 0003.

<sup>13</sup> OJ Nr. 217 of August 11, 1990.

<sup>14</sup> OJ C 258, 04/10/1991, p. 0002.

<sup>15</sup> OJ L 241, 24/08/1992 p. 0001.

## II. THE TREATY OF ROME

### A. OBJECTIVES OF THE ROME TREATY

The EC was established in 1957 by the Treaty of Rome.<sup>44</sup> By the mid-1980s it consisted of Belgium, Denmark, France, the Federal Republic of Germany, Ireland, Italy, Luxembourg, the Netherlands, Norway, and the United Kingdom. With the addition of Spain and Portugal on January 1, 1986, the EC grew to

<sup>44</sup> TREATY OF ROME, *supra* note 34. DEMPSEY, *supra* note 4, at 241-43.

twelve member nations.<sup>45</sup> In 1992 the Treaty of Maastricht was signed and the EC became the European Union at the end of that year.<sup>46</sup> By the dawn of the 21st century, the EU had grown to 15 members, having added Austria, Sweden, and Finland in January 1995.<sup>47</sup> It is widely anticipated that most of the remaining European states will join by 2012.<sup>48</sup> The twin goals of the Union/Community, as described by Peter Sutherland, former EC Commissioner for Competition, are "the completion of a genuine, barrier-free internal market and the restoration and enhancement of the competitiveness of European industry."<sup>49</sup>

The Treaty of Rome bound together the nations of Western Europe for the purpose of creating an economically efficient market in Europe and restricting anticompetitive behavior on the part of the Member States.<sup>50</sup> The objectives of the Treaty of Rome include harmonious development and expansion of economic activities, increased economic stability, an improved standard of living, and closer relations between the Member States.<sup>51</sup> To accomplish its goals, Article 3(e) of the Treaty of Rome directs the EC/EU to adopt, *inter alia*, a common transport policy.<sup>52</sup>

The Treaty of Rome has essentially become the Constitution of the European Union.<sup>53</sup> Consequently, community law, in-

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<sup>45</sup> H.A. Wassenbergh, *Regulatory Reform—A Challenge to Inter-Governmental Civil Aviation Conferences*, 11 AIR L. 31, 40 n.26 (1986). Originally, only six nations (France, West Germany, Italy, Belgium, the Netherlands, and Luxembourg) joined to form the European Economic Community (EEC), later renamed the European Community (EC). On January 1, 1973, the original six became nine, with the addition of Denmark, Ireland and the United Kingdom. Greece joined in 1981. West Germany annexed East Germany in 1990. Turkey, Austria, Malta and Cyprus all have applied for membership. However, attempts to integrate the EC within its 1992 target put expanded membership on hold.

<sup>46</sup> TREATY OF MAASTRICHT, *supra* note 35.

<sup>47</sup> THE WORLD ALMANAC 866 (Robert Famighetti ed., 1998).

<sup>48</sup> Projections for membership:

The Czech Republic, Hungary, and Poland may be admitted as early as 2003. By 2007: Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, and Slovenia. By 2012: Bulgaria and Romania. Probably after 2012: Croatia (which has not completed its application) and Turkey.

*Who Will Join Europe's Club – and When?*, ECONOMIST, April 8, 2000, at 53.

<sup>49</sup> Peter D. Sutherland, *The Competition Policy of the European Community*, 30 ST. LOUIS U.L.J. 149, 149 (1985) [hereinafter SUTHERLAND].

<sup>50</sup> TREATY OF ROME, *supra* note 34, at art. 3.

<sup>51</sup> *Id.* at art. 2.

<sup>52</sup> *Id.* at art. 3(e).

<sup>53</sup> See SUTHERLAND, *supra* note 49, at 149.

cluding competition law, takes precedence over the law of the individual Member States, and the governments of those states must bring their laws into conformity with the mandates and decisions of the EU ministers and the decisions of the Court of Justice.<sup>54</sup> The Treaty of Maastricht, in providing for a Union, also provided for a common currency, known as the Euro, which was inaugurated on January 1, 1999. In 1997, the EU took another step towards greater cohesion when its Member States signed the Treaty of Amsterdam.<sup>55</sup> The Treaty of Amsterdam expanded EU citizen rights, increased freedom of movement, and increased freedom of employment.<sup>56</sup> At the dawn of the 21st Century, the EU was embarking on Agenda 2000, which endeavored to enlarge and strengthen the Union by admitting countries from central and eastern Europe into the EU.<sup>57</sup>

## B. COMMON TRANSPORT POLICY

The Treaty of Rome was enacted with the presumption that "national economies can be unified only if there is an efficient system for moving people and goods."<sup>58</sup> The importance of transport in Europe is evidenced by the fact that the industry accounts for more than 7% of Europe's gross national product, (GNP) for approximately 7% of total employment, for 40% of Member States' investment, and 30% of Community energy consumption, and has shown almost continuous growth for the past

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<sup>54</sup> *Id.*; *Don't Take Europa to Brussels, They Cry*, ECONOMIST, Nov. 8, 1986. [herein after DON'T TAKE EUROPA]. National courts of Member States may be used to enforce the competition laws of the Treaty of Rome, and this route is being encouraged by the Commission to reduce its increasing workload. Only national courts may award damages in private litigation for injuries suffered through infringement of Articles 85 and 86. Compare TREATY OF ROME, *supra* note 34, at art. 177; 3 Common Mkt. Rep. (CCH) ¶ 4656 (preliminary rulings by Court of Justice), with TREATY OF ROME, *supra* note 34, at art. 183; 3 European L. Rep. (CCH) ¶ 4575 (jurisdiction of national courts).

<sup>55</sup> Treaty of Amsterdam Amending the Treaty on European Union, the Treaties Establishing the European Communities and Certain Related Acts, Oct. 2, 1997, O.J. (C 340) 1 (1997) [hereinafter TREATY OF AMSTERDAM].

<sup>56</sup> European Union, *The ABC of the European Union*, at <http://europa.eu.int/abc-en.htm> (last visited Feb. 28, 1999).

<sup>57</sup> European Union, *Agenda 2000 – For a Stronger and Wider Union*, at <http://europa.eu.int/comm/agenda2000/overview/en/agenda.htm> (last visited Feb. 28, 1999).

<sup>58</sup> Anastassopoulos, Report Drawn Up on Behalf of the Committee of Transport on the Judgment of the Court of Justice on the Common Transport Policy and the Council's Obligation in Relation Thereto, EUR. PARL. DOC. (A 2-84/85/B) 15 (1985) [hereinafter REPORT].

20 years.<sup>59</sup> The draftsmen of the Treaty of Rome were cognizant of the integrating function of transport as well as its unique problems. Thus, they gave special consideration to air transport under the Treaty of Rome. A major consideration was the coordination of sovereign rights both inside and outside the boundaries of the EC.<sup>60</sup>

The importance of transportation in the overall scheme of the European Community was underscored by separate provisions in the Treaty of Rome for a common transport policy.<sup>61</sup> Nevertheless, in 1962, when the Council adopted Regulation 17 (which implemented Articles 85 and 86 of the Treaty of Rome), it specifically exempted transportation from its application.<sup>62</sup> The solicitude for transportation arose, to a significant extent, because of longstanding bilateral and multilateral agreements among Member States. These agreements concerned international airline coordination that already existed at the adoption of the Treaty of Rome in 1957, such as the Chicago Convention on International Civil Aviation of 1944, and the multitude of bilateral air transport agreements between European nations.<sup>63</sup> The draftsmen of the Treaty of Rome were unable to design a policy to benefit the EC while maintaining the integrity of extra-EC treaties.<sup>64</sup> Consequently, air transport policy made little headway during the EC's first two decades, since most European governments were satisfied with the status quo.<sup>65</sup>

A common transport policy for rail, roads, and inland waterways was adopted in 1968.<sup>66</sup> Special consideration was given air transportation in Article 84(2), which provided: "The Council may, acting [unanimously,] decide whether, to what extent and by what procedure appropriate provisions may be laid down for

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<sup>59</sup> European Union, *Transport Services: Current Position and Outlook*, at <http://europa.eu.int/scadplus/leg/en/lvb/l24040.htm> (last visited February 2, 2000).

<sup>60</sup> EUR. PARL. DOC. (COM 469) 14 (1980).

<sup>61</sup> Common Transport Policy, 1 Common Mkt. Rep. (CCH) ¶ 1812 (1974).

<sup>62</sup> N. Argyris, *The EEC Rules of Competition and the Air Transport Sector*, 26 COMMON MKT. L. REV. 5, 6 (1989) [hereinafter ARGYRIS].

<sup>63</sup> See TURBULENCE, *supra* note 5, at 307-08, 314-18, 325-42.

<sup>64</sup> 1 Common Mkt. Rep. (CCH) ¶ 1945.05 (1974) ("[w]ith respect to transport by sea and air, Article 84(2) makes the applicability of the Title 'Transport' dependent upon a unanimous Council decision").

<sup>65</sup> SORENSEN, *supra* note 5, at 3.

<sup>66</sup> DEMPSEY, *supra* note 3, at 245; Council Regulation 1017/68, 1968 O.J. (L 241) 10.

sea and air transport."<sup>67</sup> A formal policy for sea transport was not adopted until 1986.<sup>68</sup>

In view of the widely perceived shortcomings in the EC's approach to air transport policies and procedures, it was to be expected that the debate would turn to the general Competition provisions of Articles 85 and 86 of the Treaty of Rome.<sup>69</sup> The applicability of these rules to air transport within the EC/EU has been a central issue since the mid-1970s.<sup>70</sup> While it was concluded that the competition rules would, indeed, be applied to air transport, the question was where, when, and how.<sup>71</sup> As we shall see later in this paper, even though the European Court of Justice declared in the 1986 *Nouvelles Frontières* case that the competition rules applied to air transport, significant questions remained unanswered.<sup>72</sup>

### C. COMPETITION RULES

Competition was intended to play an essential role in achieving the objectives of the EC.<sup>73</sup> In order to diminish barriers to the free flow of commerce, the draftsmen included Articles 85 and 86 in the Treaty of Rome, prohibiting anticompetitive activities.<sup>74</sup> The Commission declared that competition is the best motivator of economic activity and is essential for the improvement of living standards and employment prospects.<sup>75</sup> As a basic policy issue, Article 2 of the Treaty of Rome incorporates the goal of efficient economic integration of the Community.<sup>76</sup> Article 3(f) directs the implementation of a system assuring that competition will not be distorted within the Common Market.<sup>77</sup>

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<sup>67</sup> TREATY OF ROME, *supra* note 34, at art. 84(2).

<sup>68</sup> Council Regulation 4056/86, 1986 O.J. (L 378) 4.

<sup>69</sup> DEMPSEY, *supra* note 3, at 245.

<sup>70</sup> TREATY OF ROME, *supra* note 34, at arts. 85, 86.

<sup>71</sup> WOUTERS, *supra* note 38, at 55-56.

<sup>72</sup> *Id.* at 56.

<sup>73</sup> DEMPSEY, *supra* note 3, at 242.

<sup>74</sup> TREATY OF ROME, *supra* note 34, at arts. 85, 86.

<sup>75</sup> P. S. R. F. MATHIJSEN, A GUIDE TO EUROPEAN COMMUNITY LAW 167 (4th ed. 1985) [hereinafter MATHIJSEN].

<sup>76</sup> TREATY OF ROME, *supra* note 34, at art. 2.

<sup>77</sup> *Id.* at art. 3. Activities in Article 3 which are pertinent to competition include:

(e) the inauguration of a common transport policy;

(f) the establishment of a system ensuring the competition shall not be distorted in the Common Market;

The competition rules generally aim at preventing the introduction of obstacles to free trade. Still, this does not mean that Union policy on competition is basically restrictive. Indeed, cooperation among enterprises is permitted and even encouraged where the effect is to promote competition both inside and outside of the Union.<sup>78</sup> The primary thrust of the competition laws of the EU is to maintain a "beneficial, unified economy."<sup>79</sup> Unlike the United States, EU competition laws are aimed only at anticompetitive practices that produce abusive, harmful effects in the marketplace.<sup>80</sup>

The Commission may exercise considerable discretion in enforcing the competition rules of the Treaty of Rome.<sup>81</sup> Articles 85 and 86 are administered by the Commission as set forth in Regulation 17.<sup>82</sup> Under Regulation 17, the Commission may grant "negative clearances," declaring agreements not to be violative of Articles 85 and 86. Pursuant to Article 85(3), it may grant exemptions from the applicability of Article 85(1). Upon application of Member States, natural or legal persons, or upon its own motion, the Commission may take steps to put an end to violations, conduct investigations, and levy fines and penalties.<sup>83</sup>

### 1. Article 85

Article 85(1) prohibits as "incompatible with the common market; all agreements between undertakings, decisions by associations of undertakings and any concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market. . . ."<sup>84</sup> In order to fall

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(g) the application of procedures which shall make it possible to co-ordinate the economic policies of Member States and to remedy disequilibria in their balances of payments.

(h) the approximation of their respective municipal law to the extent necessary for the functioning of the Common Market.

*Id.*; see also MATHIJSEN, *supra* note 75, at 179.

<sup>78</sup> MATHIJSEN, *supra* note 75, at 168.

<sup>79</sup> DEMPSEY, *supra* note 3, at 241-55.

<sup>80</sup> *Id.*

<sup>81</sup> *Id.* at 242.

<sup>82</sup> MATHIJSEN, *supra* note 75, at 181.

<sup>83</sup> *Id.* at 182-83.

<sup>84</sup> TREATY OF ROME, *supra* note 34, at art. 85(1). Article 85 (1) "in particular" prohibits practices which, aside from satisfying the other criteria, consist of:

(a) the direct or indirect fixing of purchase or selling prices or of any other trading conditions;

within the prescriptions, agreements having proscribed objects need not be cast in the form of a legally binding contract.<sup>85</sup> Such an agreement within Article 85(1) may be written or oral, and may be inferred from the circumstances, and may consist merely of an informal and nonbinding combination to restrict competition.<sup>86</sup> If such a binding agreement exists, a violation has occurred even if it is not implemented. A violation of the Treaty of Rome may also be found if informal agreements are followed by certain practices. Impermissible binding agreements or practices may be inferred from circumstantial evidence, including behavior having an anticompetitive effect.<sup>87</sup> However, an anticompetitive effect alone, such as a parallel price increase, does not establish the existence of a prohibited agreement. Rather, such conduct may be the result of independent decisions or other factors not reflecting violations of the competition rules.<sup>88</sup>

The competition rules apply only to practices that affect trade among Member States.<sup>89</sup> In an agreement between a Member State and a non-EU nation, anticompetitive provisions would not be prohibited unless those provisions had an anticompetitive object or effect within the EU.<sup>90</sup> "An agreement 'may' affect trade when it 'is capable of constituting a threat, either direct or indirect, actual or potential, to freedom of trade between Member States in a manner which might harm the attainment of the objectives of a single market between States.'"<sup>91</sup> It should be

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(b) the limitation or control of production, markets, technical development or investment;

(c) Market-sharing or the sharing of sources supply;

(d) the application to parties to transactions of unequal terms in respect of equivalent supplies, thereby placing them at a competitive disadvantage; or

(e) the subjecting of the conclusion of a contract to the acceptance by a party of additional supplies, which, either by their nature or according to commercial usage, have no connection with the subject of such contract.

*Id.*

<sup>85</sup> CHRISTOPHER BELLAMY & GRAHAM D. CHILD, *COMMON MARKET LAW OF COMPETITION* 49 (3d ed. 1987).

<sup>86</sup> *Id.*

<sup>87</sup> MATHIJSEN, *supra* note 75, at 169-70.

<sup>88</sup> *Id.* at 170.

<sup>89</sup> *Id.* at 172.

<sup>90</sup> *Id.* at 172-74.

<sup>91</sup> *Id.* at 172 (quoting from Joined Cases 56 and 58/64, *Consten & Grundig v. Commission*, 1966 E.C.R. 299, at 341).



noted that, because the prohibitions extend to agreements that "affect" trade, even agreements that have the effect of increasing the volume of trade or which do not involve imports or exports may be prohibited.<sup>92</sup> The European Court of Justice has indicated that in order to constitute an impermissible "distorting," competition "must be prevented, restricted or distorted to an *appreciable* extent."<sup>93</sup> In summary, in order to fall within the prohibition of Article 85(1), an agreement must (1) consist of an agreement or concerted practice between undertakings, (2) distort, prevent or restrict competition, (3) within the European Union, (4) to an appreciable extent.<sup>94</sup>

Under Article 85(2), any agreements or decisions prohibited by the Treaty of Rome are automatically void.<sup>95</sup> With respect to entire agreements, however, only those clauses or provisions found to be in violation are void; the remainder of the agreements may remain in effect.<sup>96</sup>

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<sup>92</sup> MATHIJSEN, *supra* note 75, at 172 n.17, 174-75.

<sup>93</sup> *Id.* at 173 (emphasis in original). Case 56/65, *Societe Technique Miniere v. Maschinenbau Ulm* 1966 E.C.R. 235; Case 5/69, *Volk v. Vervaeke*, 1969 E.C.R. 295; Case 22/71, *Beguelin Import v. GL Import Export*, 1971 E.C.R. 949.

<sup>94</sup> The "appreciable extent" requirement was deemed of such importance that on May 27, 1970, the Commission issued a "Notice of Agreements of Minor Importance," known as the De Minimis Rule, which gives further guidance as to when the effect of an agreement on the European Community can be considered too weak for Article 85(1) to apply. However, the notice is only for guidance and is not binding on national courts of the European Court of Justice. In practice, the De Minimis Rule means that the Commission need not be notified of agreements where (1) the turnover of the participating undertakings does not exceed 200 million ECU, and (2) the goods or services which are the subject of the agreement together with their substitutable products or services, in that part of the market where the agreement has its effect, do not represent more than 5% of the total market. The Rule has since been updated, most recently on September 3, 1986. Oddly, the threshold requirements of the De Minimis Rule do not coincide with those of the Merger Regulations. In order to have Community dimension under the Merger Regulations, the parties (undertakings) to the merger must have (1) worldwide turnover of 5 billion ECUs, (2) they must have an European Community turnover of 250 million ECUs, or (3) they must obtain two-thirds of their turnover within a single member state. With the coming into force of the Merger Regulations, mergers need not proceed toward notification directly under Articles 85 and 86, but under the Merger Regulation itself.

<sup>95</sup> MATHIJSEN, *supra* note 75, at 175.

<sup>96</sup> *Id.* at 173. Exceptions of the "automatically void" provision exist for agreements executed before March 13, 1962, when Regulation 17, the first regulation implementing Articles 85 and 86, was enacted. *Id.* at 175. However, even the so-called "old" agreements may be voided if found to be in violation of the Treaty. *Id.* at 175-76.

The Commission may grant declarations of inapplicability of the operation of Article 85(1).<sup>97</sup> The Commission may grant negative clearances, declaring that the agreement does not distort, prevent or restrict competition, and therefore does not fall under the definition of Article 85(1). If negative clearance is not given because the Commission is of the opinion that the agreement *does* prevent, restrict or distort competition under the definition of Article 85(1), the Commission may still grant an exemption under Article 85(3), but only after the Commission has been notified and the four conditions specified in Article 85(3) are satisfied as follows:

- (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 of a substantial part of the products in question.<sup>98</sup>

## 2. Article 86

Article 86 addresses the abuse of market position within and affecting the internal market.<sup>99</sup> As the Commission and the Court have applied the foregoing rules, the following main types of agreements have been found likely to be prohibited: "(a) agreements relating to prices and conditions of sale; (b) limitations on markets and productions; (c) agreements whereby a vendor agrees not to compete within the market of the purchaser; (d) exclusive dealing agreements such as supply agreements; collective exclusive dealings; and (e) joint purchasing and joint selling agreements."<sup>100</sup>

Practices such as tariff agreements, pooling agreements, and capacity and territorial restrictions raise questions under Article

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<sup>97</sup> *Id.* at 176. The Council gave the Commission the power to look into agreements between companies with the promulgation of Regulation 17. The Commission can take agreements into consideration upon the request of the contracting parties, most commonly upon notification by them, or less commonly, upon notification by a competitor.

<sup>98</sup> See TREATY OF ROME, *supra* note 34, at art. 85(3).

<sup>99</sup> *Id.* at art. 86.

<sup>100</sup> MATHIJSEN, *supra* note 75, at 177-78; TREATY OF ROME, *supra* note 34, at art. 85(3). See generally ARGYRIS, *supra* note 62, at 9.

85 even under the most liberal of bilateral agreements. Both Council and Commission Regulations have been promulgated to define Article 85(3)'s application to aviation. Council Regulation 3976/87 gave the Commission the power to implement Article 85(3), which the Commission did in Commission Regulation 2671/88. The Council Regulation runs parallel to Council Regulation No. 17, in which the Commission received the power from the Council to issue exemptions under Article 85(3). However, since air transport was excluded from Council Regulation No. 17, Council Regulation 3976/87 gave no power to the Commission to exempt agreements under Article 85(3) for agreements regarding some aspects of air transport. For example, the Commission was given power only for regulation of air transportation between community airports. The Commission was only allowed to grant exemptions to certain agreements: those that have as their objective (1) joint planning of capacity to assure the spread of service at non-peak periods, (2) revenue sharing not to exceed one percent, (3) certain tariff consultations, (4) slot allocation and scheduling, (5) computer reservations systems, (6) ground handling, (7) interlining, or (8) catering, all within certain specific restrictions. The Commission Regulation permits "consultations" between airlines to prepare joint tariff proposals subject to the approval of the aeronautical authorities of the Member States, provided *inter alia* that participation in the consultations is (1) voluntary (2) open to any carrier that operates or proposes to operate on the route in question (3) the resulting tariff is not binding (thereby preserving the carriers' right of independent action), and (4) does not discriminate on the basis of the passengers' nationality or residence, and that discussions not include capacity or agent remuneration issues.<sup>101</sup>

Article 86, which complements Article 85, forbids abuse of a dominant position enjoyed individually or collectively by a group of undertakings.<sup>102</sup> The concept of "dominant position"

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<sup>101</sup> Commission Regulation 2671/88, 1988 O.J. (L 239) 9. Commission Regulation 2761/88 expired on January 31, 1991, and has been replaced by Commission Regulation 84/91, 1990 O.J. (L 10) 14.

<sup>102</sup> MATHIJSEN, *supra* note 75, at 179. Article 86 states that prohibitions are aimed at abuse of a dominant position "within the Common Market or within a substantial part of it" which affects trade between Member States. TREATY OF ROME, *supra* note 34, at art. 86; *see also* 2 European Union L. Rep. (CCH) ¶ 2101 (abuse of dominant position). The Article goes on to state:

Such improper practices may, in particular, consist in:

indicates a position of economic strength allowing the possessor to "behave to an appreciable extent independently of its competitors, customers and ultimately of the consumers."<sup>103</sup> Dominance is the power to hinder effective competition, to behave independently of the market.<sup>104</sup> Whether an undertaking or group of undertakings enjoys such a position must be established in view of relevant product and geographic markets, the market share possessed therein,<sup>105</sup> and the likelihood of actual or potential entry eroding the position of the dominant firm.<sup>106</sup> Although the dominant position must be over a substantial portion of the Common Market, the territory of a single Member State arguably could be sufficient for Article 86 to apply. Most European national airlines hold dominant positions in their own countries.<sup>107</sup> However, dominance is established not by size alone, but as noted above, by considering a number of factors.<sup>108</sup>

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(a) the direct or indirect imposition of any inequitable purchase or selling prices or of any other inequitable trading conditions;

(b) the limitation of production, markets or technical development to the prejudice of consumers;

(c) the application to parties to transactions of unequal terms in respect of equivalent supplies, thereby placing them at a competitive disadvantage; or

(d) the subjecting of the conclusion of a contract to the acceptance, by a party, of additional supplies which, either by their nature or according to commercial usage, have no connection with the subject of such contract.

TREATY OF ROME, *supra* note 34, at art. 86. Compare these latter "in particular" provisions with those in Article 85(1), *supra* note 84.

<sup>103</sup> Case 322/81, *Michelin v. Commission*, 1983 E.C.R. 3461; Case 85/76, *Hoffman La Roche v. Comm'n*, 1979 E.C.R. 461; Case 27/76, *United Brands v. Comm'n*, 1978 E.C.R. 207 (dominance consists of "a position of economic strength enjoyed by an undertaking which enables it to prevent competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors."); MATHIJSEN, *supra* note 75, at 179-80; DEMPSEY, *supra* note 3, at 248; C. BELLAMY & G. CHILD, *COMMON MARKET LAW OF COMPETITION* 8-004 (3d ed. 1987).

<sup>104</sup> BELLAMY & CHILD, *supra* note 103, at 8-004.

<sup>105</sup> "[T]he view may legitimately be taken that very large shares are in themselves, and save exceptional circumstances, evidence of the existence of a dominant position. An undertaking which has a very large market share and holds it for some time . . . is by virtue of that share in a position of strength." *Comm'n v. Hoffman-La Roche*, Case 95/76, 1970 E.C.R. 461, [1979] 3 CLMR 211.

<sup>106</sup> *Id.*; MATHIJSEN, *supra* note 75, at 180-81, DEMPSEY, *supra* note 3, at 248.

<sup>107</sup> DEMPSEY, *supra* note 3, at 248.

<sup>108</sup> MATHIJSEN, *supra* note 75, at 181.

The concept of "abuse" of a dominant position refers to an adverse impact on competition.<sup>109</sup> Any activity that "interferes with one of the basic freedoms or the free choice of purchasers or consumers or freedom of access to business, must be viewed as limiting competition and therefore as an 'abuse.'"<sup>110</sup> The methods employed to affect competition are irrelevant. Activities that are "detrimental to production or sales, to purchasers or consumers, and changes to the structure of an undertaking which lead to competition being seriously disturbed in a substantial part of the common market are prohibited by Article 86."<sup>111</sup> The mere existence of a monopoly does not establish a violation of Article 86; rather, only practices detrimental to consumers and the economy bring the proscriptions into play.<sup>112</sup>

### 3. *Distinguishing Articles 85 and 86*

In distinguishing Articles 85 and 86, it is important to note that unlike Article 85, Article 86 does not provide for exemptions.<sup>113</sup> Under Article 2 of Regulation 17, the Commission may grant a "negative clearance," which merely certifies that because it perceives no violation, the Commission sees no reason to proceed against the entities involved.<sup>114</sup> However, this does not confer "absolute immunity"; the Commission still reserves the power to determine subsequently that a violation exists and to proceed with enforcement.<sup>115</sup>

As noted above, while Article 86 prohibits abuse of monopoly power, the mere existence of the monopoly is not prohibited.<sup>116</sup> Rather, a violation consists of the use of monopoly power in a manner injurious to consumers—an abuse of market position. A national airline might be held to occupy a sufficiently dominant position over a large enough part of the Common Market (its own country) to bring the provisions of Article 86 into play.<sup>117</sup> Price-fixing and capacity-limitation agreements by firms in monopoly positions might be held to be violations of Article

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<sup>109</sup> *Id.*

<sup>110</sup> *Id.*

<sup>111</sup> *Id.* at 179.

<sup>112</sup> DEMPSEY, *supra* note 3, at 248.

<sup>113</sup> *Id.*

<sup>114</sup> *Id.* at 249, n.61.

<sup>115</sup> *Id.* at 249; *see also* Unlawful Practices by Dominant Concerns, Application of Article 86, 2 Common Mkt. Rep. (CCH) ¶ 2111 (1978) (CCH Explanation).

<sup>116</sup> DEMPSEY, *supra* note 3, at 248.

<sup>117</sup> *Id.*

86.<sup>118</sup> Therefore, an argument could be made that airline fare-setting and capacity limitations and other agreements and practices violate Article 85 absent a Commission regulation permitting such practices.

Direct application of the competition rules could have resulted in the prohibition of many European airline practices under both Articles 85 and 86. Indeed, the Commission threatened to (and subsequently did) take action on its own if the Council failed to act on a common air transport policy.<sup>119</sup> An understanding of the competition rules as they affect air transport requires further review of the governing institutions of the EU and the actions they have taken in response to air transport issues.

The drafters of the Treaty of Rome also recognized the market harm of state financial assistance to business otherwise known as "state aid" or government subsidies. Embodied within Article 92, the Treaty of Rome prohibits all state aid to firms unless such aid fits certain narrow provisions. These provisions generally focus upon social, humanitarian, disaster relief, or cultural aid.<sup>120</sup> In practice, the prohibition of state aid in commercial aviation has only really gained force since the late 1980s. Until that time, the Council ignored violations under the guise that it could not regulate air transport. Article 92 played a prominent role as liberalization emerged and the Council became more aggressive in enforcing Articles 85 and 86 with respect to air transport. Arguably, the turning point in the competitiveness of the European commercial aviation market turned on the Council's determined stance of reducing the influence of state-aid.<sup>121</sup>

### III. INSTITUTIONS OF THE EUROPEAN UNION AND THE DEVELOPMENT OF AIR TRANSPORT POLICY

#### A. INTRODUCTION

The institutions of the Treaty of Rome were created to ensure proper compliance and implementation of its provisions.<sup>122</sup>

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<sup>118</sup> *Id.*

<sup>119</sup> *Id.* at 250.

<sup>120</sup> TREATY OF ROME, *supra* note 34, at art. 92.

<sup>121</sup> See generally Carole Shifrin, *Air Transport Market Rigors Squeeze European Flag Carriers*, AV. WK. & SPACE TECH., Mar. 14, 1994.

<sup>122</sup> HENKEN, *supra* note 39, at 1077.

The four governing bodies of the EU—the Council, the Commission, Parliament, and the European Court of Justice—have devoted considerable attention to the question of how the Treaty of Rome should be applied to air transport. The Council consists essentially of representatives of the member governments. Most EU states originally owned or subsidized their airlines, and therefore, resisted liberalization. The Commission is essentially the secretariat or bureaucracy of the EU government. Its mission is to facilitate implementation of the Treaty of Rome, whose principal purpose is to create a unified economic union of free trade within Western Europe. The Commission sought liberalization, and proposed several texts to implement it (the so-called “Memoranda”). But the Commission only has the power to propose law to the Council, and may act only after the Council gives it power to act. At first, the Council resisted the proposals of the Commission. However, the Court of Justice issued several opinions that suggested the Council had a duty to act in the area of air transport, and that if it failed to do so, some of the competition provisions of the Treaty of Rome might essentially become self-executing. With this prodding, the Council did finally adopt several of the Commission’s proposals and made them law (the so-called “packages”). Let us examine the conflict and cooperation between these super-governmental units in greater detail.

#### B. FORMATION OF THE EUROPEAN UNION— THE SINGLE EUROPEAN ACT

An analysis of the functions and activities of the EU governing bodies would not be complete without an understanding of a major motivating force within the EU—the goal of a unified internal market, which was legislatively in place by 1992.<sup>123</sup> The Single European Act (SEA), which entered into force in July 1987, was intended to facilitate and compel the creation of the Union. As we shall see, the SEA provision allowing majority voting may have moved the Council to action on air transport. This provision replaced the previous requirement of unanimity in Council decisions.<sup>124</sup>

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<sup>123</sup> Creation of Internal Market, 1 Common Mkt. Rep. (CCH) ¶ 202.07 (1978) (CCH Explanation); *They’ve Designed the Future, and It Might Just Work*, ECONOMIST, Feb. 13, 1988, at 45-48; Thompson, *EC92*, NATION’S BUSINESS, June 1989, at 18.

<sup>124</sup> Single European Act, 1 Common Mkt. Rep. (CCH) ¶ 101.15 (1978) (CCH Explanation).

The attainment of a bona fide internal market in all economic sectors, including aviation, requires not only the removal of trade barriers, but also a "fusion of the members into a single economic area . . . extended to include freedom of movement of workers, the right of establishment, the free movement of services and capital, and a common transport policy."<sup>125</sup> The Commission assumed a prominent role in urging and planning for the eventuality of this economic and political unification.<sup>126</sup> In 1984, the Commission called attention to a marked slowdown in the progress toward the internal market throughout the 1970s. The Commission proposed the creation of a comprehensive program for the achievement of a genuine internal market.<sup>127</sup> The program included not only the simplification of procedures as intra-Community frontiers, but also the complete abolition of procedural formalities at the borders.<sup>128</sup> The Commission also stated that the internal market would be incomplete unless citizens of the European Community could reside in other Member States—even without economic justification.<sup>129</sup>

In June 1985, the Commission revealed a "White Paper," a major proposal for progress toward an internal market.<sup>130</sup> This set of specific, detailed proposals was submitted for consideration at the Council's Milan meeting. Reciting the Community's recognized need for an internal market, the Commission indicated that a definite target date and detailed plans had been missing and were needed. As a result of its deliberations, the Commission set the "bold target" of completion of the internal market by 1992.<sup>131</sup>

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<sup>125</sup> Creation of Internal Market, *supra* note 123, at ¶ 202.07.

<sup>126</sup> See Proposals Aim to Strengthen the Community's Internal Market, [1982-1985 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 10,415 (1982) (information memorandum from the Commission, June 1982); Commission Submits Program for the Consolidation of the Internal Market, [1982-1985 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 10,595 (1984) (information memorandum from the Commission, June 1984) [hereinafter COMMISSION SUBMITS PROGRAM].

<sup>127</sup> COMMISSION SUBMITS PROGRAM, *supra* note 126, ¶ 10,595.

<sup>128</sup> *Id.*

<sup>129</sup> *Id.*

<sup>130</sup> Completion of the Internal Market Sought by 1992, 4 Common Mkt. Rep. (CCH) ¶ 10,693 (1985) (information memorandum from the Commission, June 1985).

<sup>131</sup> *Id.* In the bulletin announcing the White Paper, the Commission recited the need for removal of barriers in numerous sectors of the Community and, among other matters, called for encouragement of industrial cooperation and the removal of disruptive taxation schemes as well as the free movement of goods and services. The Commission noted that removal of barriers to the flow of ser-



The Council meeting in Milan, for which the White Paper was prepared, was the juncture at which firm Community efforts commenced toward the creation and implementation of the Single European Act.<sup>132</sup> Ultimately, the signatories of the SEA agreed to the target date of December 31, 1992.<sup>133</sup>

The SEA grew out of efforts initiated by the European Council to advance the European Community toward a European Union.<sup>134</sup> In response to the European Council's Solemn Declaration at Stuttgart in June 1983, the first draft of the treaty was presented in February 1984. The Act was signed by representatives of the then twelve Member States on February 4, 1986, but did not take effect until July 1, 1987, after ratification by all Member States.<sup>135</sup> The majority of the SEA's provisions were amendments to the Treaty of Rome or new provisions to be added to it.<sup>136</sup> The SEA sought to create a genuine internal market in which the remaining barriers to free movement of goods, persons, services, and capital were removed.<sup>137</sup> To almost every extent, the Union has become successful in this regard. In signing the SEA, the Member States committed themselves to establish an internal market by December 31, 1992, although this was in reality only a statement of political intent at the time.<sup>138</sup>

The SEA made a number of institutional changes in the operation of the EC. The role of the European Parliament was expanded, and it was granted some degree of control over Council decisions. The role of the Commission was also expanded and

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vices had proceeded more slowly than for goods, but reaffirmed and explained the importance of service industries. Service industries included "traditional" areas such as "banking, insurance, and transport."

<sup>132</sup> Single European Act a Milestone on the Road Toward a European Union, 4 Common Mkt. Rep. (CCH) ¶ 10,812 (1986) (CCH Comment) [hereinafter MILESTONE].

<sup>133</sup> Single European Act, *supra* note 125, at ¶ 101.15.

<sup>134</sup> *Id.* The European Council grew out of previously unsuccessful meetings of Heads of State and Government, starting in 1972, intended to solve economic, social, and political problems. At the original meetings in 1972 it was decided to pursue the goal of attaining a European Union that would govern all relations between the Member States by 1980. This goal was confirmed at the Paris Summit in December 1974. At that time, it was formally decided to conduct such meetings three times a year and as otherwise necessary. These meetings were to constitute the European Council, and their purpose was to pursue solutions to the problems the ordinary Council could not solve. European Union, 1 Common Mkt. Rep. (CCH) ¶ 101.13 (1978) (CCH Explanation).

<sup>135</sup> Single European Act, *supra* note 124, at ¶ 101.15.

<sup>136</sup> MILESTONE, *supra* note 132, at ¶ 10,812.

<sup>137</sup> Single European Act, *supra* note 124, at ¶ 101.15.

<sup>138</sup> *Id.*; MILESTONE, *supra* note 132, at ¶ 10,812.

changed, particularly in regard to its interaction with the Parliament. The Council was allowed, at the request of the Court of Justice, to set up a court to hear, among other matters, appeals brought from Commission decisions on competition.<sup>139</sup>

A major barrier to the establishment of an internal market was the right of veto that every country maintained.<sup>140</sup> The right to veto (the so-called Luxembourg compromise) was extracted by the French in 1966 in order to terminate General De Gaulle's "empty-chair" period, a boycott maintained to defend French sovereignty.<sup>141</sup> The SEA made no provision for this right, under which, if a Member State declared a Council decision to be adverse to its vital national interests, and if enough other Members agreed (which they usually did), then the veto could not be outvoted.<sup>142</sup> Nonetheless, this opportunity was significantly diluted by the replacement of unanimous voting with qualified majority (54 votes out of 76) and weighted voting (the larger nations have 10 votes; the smallest has two) on a number of subjects, including development of a common transport policy.<sup>143</sup> Thus, the Council can now act by a qualified majority in deciding "whether, to what extent and by what procedure appropriate provisions may be laid down for sea and air transport."<sup>144</sup>

Two years after issuing the White Paper, the Commission stated that in a second annual report "[t]he Community must do better" in order to achieve an internal market by 1992. The Commission acknowledged numerous failures in itself, the Council, and Parliament to keep up with workloads, but looked with optimism to the improved decision making to be implemented through the Single European Act. The Commission stressed the importance of cooperative and expeditious involvement by officials of member governments and the necessity of not letting "national and sectorial interests take over."<sup>145</sup> In these movements toward an internal market, the Commission recognized the importance of a unified transport policy. Con-

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<sup>139</sup> MILESTONE, *supra* note 132, at ¶ 10,812.

<sup>140</sup> DON'T TAKE EUROPA, *supra* note 54, at 55; MILESTONE, *supra* note 132, at ¶ 10,812.

<sup>141</sup> DON'T TAKE EUROPA, *supra* note 54, at 55.

<sup>142</sup> *Id.* The article adds that "[t]he veto power is often abused." *Id.*; see also MILESTONE, *supra* note 132, at ¶ 10,812.

<sup>143</sup> *Id.*; Single European Act, *supra* note 124, at ¶ 101.15

<sup>144</sup> TREATY OF ROME, *supra* note 34, at art. 84; WOUTERS, *supra* note 38, at 2.

<sup>145</sup> Faster Rate of Progress in the Completion of the Internal Market Needed, 4 Common Mkt. Rep. (CCH) ¶ 10,882 (1987) (information memo from the Commission, May 1987).

sidering the significance of commercial aviation in the transportation infrastructure, initiatives directed toward liberalized competition and flexibility assumed critical importance and focus in the mid to late 1990s.

### C. PARLIAMENT

Meeting alternatively in Strasbourg, France, and Brussels, Belgium, the EU Parliament comprises more than 600 members<sup>146</sup> who are elected directly by the citizens of Member States.<sup>147</sup> Parliament's members are expected to act for the benefit of the entire European Union, rather than on behalf of their respective governments.<sup>148</sup> Parliament has the duty of advising the Council on issues of importance to the development of the EU.<sup>149</sup>

As a matter of procedure, the Commission issues recommendations to the Council that are subsequently referred to Parliament for further comment and recommendation. Parliament generally comments on the potential legal and political implications of the proposed regulation.<sup>150</sup> However, under the Treaty of Maastricht, Parliament gained more legislative power, and now shares "co-decision-making" powers with the Council in certain substantive areas.<sup>151</sup>

### D. THE EUROPEAN COURT OF JUSTICE

Sitting in Luxembourg, the European Court of Justice is composed of fifteen judges who are appointed for terms of six years by "common accord" of the Member States.<sup>152</sup> Also appointed by the Member States for similar terms are nine advocates general who in turn "deliver, in open court and with complete impartiality and independence, opinions on the cases brought before the Court."<sup>153</sup> As the highest court in the Union, the

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<sup>146</sup> The European Parliament, *European Parliament Overview – History*, available at [http://www.europarl.eu.int/presentation/default\\_en.html](http://www.europarl.eu.int/presentation/default_en.html) (last visited Feb. 2, 2001). In 1999, Parliament had 626 members.

<sup>147</sup> 3 Common Mkt. Rep. (CCH) ¶ 4306 (1987).

<sup>148</sup> 3 Common Mkt. Rep. (CCH) ¶ 4302 (1987).

<sup>149</sup> *Id.*

<sup>150</sup> *See generally id.*

<sup>151</sup> The European Parliament, *European Parliament Overview – History*, available at [http://www.europarl.eu.int/presentation/default\\_en.html](http://www.europarl.eu.int/presentation/default_en.html) (last visited Feb. 2, 2001).

<sup>152</sup> The European Court of Justice, *Composition and Organization*, available at <http://curia.eu.int/en/pres/co.htm> (last visited Feb. 28, 1999).

<sup>153</sup> *Id.*

Court of Justice renders decisions on the application to Member States. The Court interprets and enforces the provisions of the Treaty of Rome.<sup>154</sup>

Several problems arise when the Court interprets the Treaty of Rome and, in effect, changes Union policy in the absence of governing regulations promulgated by the Council. In such situations, Member States must administer competition laws without guidance of regulations. Consequently, in the past, laws have not always been applied with uniformity, because the individual states have been somewhat free to interpret them as they please. Furthermore, in the past, competition laws have been invoked only when convenient or acceptable to individual states, thereby only marginally stimulating competition.<sup>155</sup> The historically inconsistent application of the competition laws was certainly adverse to one purpose of the Treaty of Rome—to promote an economic and harmonious transport system.<sup>156</sup> Moreover, a decision applying the competition laws in the airline industry interfered with the Council's authority to adopt official policy for the economic harmonization of air transport.<sup>157</sup> The Court did, however, render decisions of great importance that held the competition laws of the Treaty of Rome applicable to air transport, and that the Council has a duty under the Treaty of Rome to formulate a coordinated transport policy for the EU. These decisions will be examined further on in this paper.

#### E. THE COMMISSION

Headquartered in Brussels, the EU Commission is a nonpartisan body comprising of 20 commissioners (two each from France, Germany, Italy, Spain and the United Kingdom, and one each from the other Member States) appointed for four-year terms by the common agreement of the Member States. The Commission works closely with the Council, but acts independently of the Council and Member States.<sup>158</sup> The Commission's duties are primarily executive in nature—to oversee EU development and to ensure that the development conforms to the Treaty of Rome. To fulfill its role, the Commission issues

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<sup>154</sup> 3 Common Mkt. Rep. (CCH) ¶ 4600 (1981).

<sup>155</sup> Letter from Knut Hammar skjold, Director-General of the IATA (source on file with author).

<sup>156</sup> See TREATY OF ROME, *supra* note 34, at arts. 74-84.

<sup>157</sup> *Id.* at art. 84(2).

<sup>158</sup> 3 Common Mkt. Rep. (CCH) ¶¶ 4472, 4482 (1987).

recommendations and advisory opinions to the Council for the consideration and adoption of regulations.<sup>159</sup> The Commission has specific and critically important jurisdiction over issues surrounding the infringement of the Treaty of Rome's competition laws.<sup>160</sup>

#### F. THE COUNCIL

The Council, which meets in Brussels and Luxembourg, includes one representative appointed from each of the Member States who directly represent their State's interests.<sup>161</sup> The Council has both legislative and executive powers<sup>162</sup> and is responsible for carrying out the objectives of the Union and coordinating the economic policies of Member States.<sup>163</sup> The Council can issue recommendations that are not binding on Member States,<sup>164</sup> or it can issue decisions, directives, and regulations that are binding.<sup>165</sup> The Council adopts regulations based upon recommendations and advisory opinions from the Commission or Parliament.<sup>166</sup>

### IV. JURISDICTION OF THE EUROPEAN UNION TO REGULATE AIR TRANSPORTATION: DECISIONS OF THE EUROPEAN COURT OF JUSTICE

#### A. INTRODUCTION

During the 1970s and 1980s, the European Court of Justice delivered a series of decisions that mapped out the fundamental legal underpinnings of EC/EU regulation of air transport. Until these cases clarified the law, it was unclear whether the Commission and Council had jurisdiction under the Treaty of Rome to regulate air transport. As the Court delineated, the Commission and Council did indeed have such power. Through these cases, the Court detailed the structural extent of air transport regulatory power, and constructed a framework in which the Commission and Council could proceed with liberalization.

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<sup>159</sup> 3 Common Mkt. Rep. (CCH) ¶ 4472 (1987).

<sup>160</sup> TREATY OF ROME, *supra* note 34, at art. 89. Article 89 gives the Commission investigatory powers.

<sup>161</sup> 3 Common Mkt. Rep. (CCH) ¶ 4406.02 (1978).

<sup>162</sup> HENKEN, *supra* note 39, at 1078.

<sup>163</sup> 3 Common Mkt. Rep. (CCH) ¶ 4402.04 (1978).

<sup>164</sup> 3 Common Mkt. Rep. (CCH) ¶ 4902.31 (1976).

<sup>165</sup> 3 Common Mkt. Rep. (CCH) ¶¶ 4902.15, 4902.25 (1976).

<sup>166</sup> 3 Common Mkt. Rep. (CCH) ¶ 4402 (1987).

### B. THE FRENCH SEAMEN'S CASE

Prior to the adoption of the SEA, Article 84(2) of the Treaty of Rome provided that "[t]he Council may, acting unanimously, decide whether, to what extent and by what procedure appropriate provisions may be laid down for sea and air transport." This provision is one of the few from the Treaty of Rome allowing the Council to act without a proposal from the Commission.

Before the Court's 1974 decision in the *French Seamen's Case*, it was unclear whether the failure of the Council to promulgate regulations under Article 84(2) shielded air transport from all the provisions of the Treaty of Rome, or only those provisions specifically dealing with transportation.<sup>167</sup>

In this decision, the Court pronounced that the general rules of the Treaty of Rome—such as nondiscrimination on national grounds, right of establishment, competition, mobility of labor, and equal pay—apply to transport, even though no regulation had been adopted to enforce those laws.<sup>168</sup> This holding, of course, violated the plain meaning of Article 84(2)—that the Treaty of Rome's provisions be applicable only after the Council has adopted rules making them so. Only Title IV was inapplicable to air transport by virtue of the Council's inaction.

### C. THE TRANSPORT POLICY DECISION (*EUROPEAN PARLIAMENT V. COMMISSION*)

Another important decision of the Court concerning European transportation was rendered in response to a complaint brought against the Council by Parliament.<sup>169</sup> In January of 1983, Parliament took the unusual step of bringing an action against the Council in the Court of Justice under Article 175, seeking a declaration that the Council had failed to act in the field of common transport policy.<sup>170</sup> Parliament also asked for a declaration that the Council breached the Treaty of Rome by

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<sup>167</sup> TREATY OF ROME, *supra* note 34, at arts. 74-84.

<sup>168</sup> SORENSEN, *supra* note 5, at 3; Case 167/73, *Comm'n v. Fr.*, 1974 E.C.R. 359; *see also* Case 156/77, *Comm'n v. Belg.*, 1978 E.C.R. 1881.

<sup>169</sup> European Parliament Committee on Transport, Notice to Members Concerning the Judgment of the Court of Justice of the European Communities of 22 May 1985 in Case 13/83, *European Parliament v. Council of the European Communities: Common Transport Policy—Obligations of the Council*, June 7, 1985, at 2 [hereinafter *OBLIGATIONS OF THE COUNCIL*].

<sup>170</sup> Bombardella, Analysis of the Judgment of the Court of Justice of 22 May 1985—Common Transport Policy—Council's Obligations, June 14, 1985, at 1 [hereinafter *BOMBARDELLA*].

failing to render a decision on sixteen specific proposals relating to surface transport submitted to it by the Commission.<sup>171</sup> Parliament insisted that the establishment of a common transport policy was a requirement flowing directly from the Treaty of Rome.<sup>172</sup>

In the *Transport Policy Decision*, the Court held that a complaint brought on grounds of failure to act was admissible.<sup>173</sup> This was the first time in the history of the EU that the Court had so held.<sup>174</sup> The Court concluded that the Council failed to act with regard to freedom to provide services in the field of international transport and the fixing of conditions under which nonresident carriers may operate transport services within a Member State, by not taking measures necessary for that purpose before the expiration of the transitional period (December 31, 1969), and that these failures constituted a breach of the Treaty of Rome.<sup>175</sup>

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<sup>171</sup> OBLIGATIONS OF THE COUNCIL, *supra* note 169, at 2.

<sup>172</sup> European Parliament Committee on Transport, Notice to Members: Proceedings Against the Council for Failure to Act, May 31, 1985, at 8 [hereinafter PROCEEDINGS]. Parliament argued that the Council's inaction violated articles 3(e) 61, 74, 75 and 84 of the TREATY OF ROME, *supra* note 34.

<sup>173</sup> Florus Wijsenbeek, European Parliament Committee on Legal Affairs and Citizens' Rights Opinion for the Committee on Transport on the Report on the Judgment of the Court of Justice on the Common Transport Policy and the Council's Obligation in Relation Thereto, June 28, 1985, at 3; Case 13/83, European Parliament v. Council, 1985 E.C.R. 519 at 1513.

<sup>174</sup> See REPORT, *supra* note 58, at 12 (first time Council found guilty of failure to act); see also Wijsenbeek, *supra* note 173, at 3 (Parliament strengthened by fact action for failure to act admissible). The Court reasoned that the institutional position of a body, as intended by the Treaty, particularly Article 4(1), would be prejudiced if it were restricted in the exercise of that power. The fact that the Parliament exercised political control over the Commission, and to a certain extent the Council, "does not affect the interpretation of the provisions of the Treaty governing the legal remedies available to the institutions." BOMBARDELLA, *supra* note 170, at 2. The Court found a close connection between freedom to provide services under Article 75(l)(a) and (b) and the adoption of a common transport policy. Furthermore, Articles 59 and 60 of the Treaty define the scope of the Council's obligation to introduce freedom to provide services. See OBLIGATIONS OF THE COUNCIL, *supra* note 169, at 6. The Court held that the Council does not have discretion in applying Articles 59 and 60. Articles 59, 60, and 61, in conjunction with 75(l)(a) and (b), clearly indicate that discretion may be exercised only with regard to the details of how the objective will be attained. *Id.* at 7. The Court's decision confirmed that there was not a coherent body of rules that could be described as a common transport policy within the meaning of Articles 74 and 75 of the Treaty, but that this does not in all aspects constitute a failure to act which is actionable under Article 175.

<sup>175</sup> OBLIGATIONS OF THE COUNCIL, *supra* note 169, at 7. The Court qualified its grant of review by holding that the failure to act must relate to measures that the

The Court held that the Council did, however, retain the right to determine the objectives and means of attaining a common transport policy in accordance with procedural rules laid down in the Treaty of Rome. The Court further held that the Council has wide discretion with regard to the substance and organization of the common transport policy, limited only by procedural requirements and specific time limits.<sup>176</sup>

The significance of this decision may best be described as an official acknowledgment that the Council failed in its duty to provide a common transport policy, and that the other bodies of the EU government had the right to obtain judicial review of the Council's activities. While the decision only explicitly addressed the Council's obligations to develop a surface transport policy, its implications for air transport are manifest.

#### D. OLYMPIC AIRWAYS

The Commission took a strong position on the question of whether the competition laws could be applied directly to sea and air transport<sup>177</sup> in the Association des Compagnies Aeriennes de la Communauté Européenne's (ACE's) complaint against Olympic Airlines.<sup>178</sup> Charges against Olympic followed

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Council has not adopted but are specific enough for the judgment to be executed under Article 176. In other words, Parliament must show that the Council has completely failed to act where there is a specific directive requiring action. Furthermore, the measures forming the subject matter of the dispute must be sufficiently defined to allow the Court to appraise the legality of their adoption or nonadoption. See BOMBARDELLA, *supra* note 170, at 2. But if the Parliament had specified which measures the Council should have adopted in the common transport policy, it would have risked having the case dismissed as an encroachment on the Council's discretion. PROCEEDINGS, *supra* note 172 at 6. As to the objective difficulties that, according to the Council, prevent progress from being made toward a common transport policy, the Court held that they are irrelevant in the context of disputes under Article 175. Article 175 makes no concessions to the degree of difficulty involved for the institution to fulfill its obligation. The Council is obligated to make a decision despite the difficulty it may encounter.

<sup>176</sup> PROCEEDINGS, *supra* note 172, at 9. Thus, as a procedural matter, if the Council is required to adopt a certain measure by a qualified majority, as in Article 75, it cannot justify its failure to act because of lack of unanimity. See BOMBARDELLA, *supra* note 170, at 3. The Council is also required to act on the measures specified by the Court within a "reasonable period." *Id.* The Court's determination that the Council must act with a "reasonable" time is not sufficiently clear. PROCEEDINGS, *supra* note 172, at 7. Nor has the Treaty set a time limit as to when action must occur. But a prolonged failure to act would presumably have been a further infringement of the Treaty. See BOMBARDELLA, *supra* note 170, at 3.

<sup>177</sup> TREATY OF ROME, *supra* note 34, at art. 84(2).

<sup>178</sup> DEMPSEY, *supra* note 3, at 246-49.



in the wake of charges against Sabena, which was accused of receiving illegal government loan guarantees and subsidization of depreciation charges and interest payments. The formal complaint against Olympic alleged that it received subsidies from the Greek government in the form of an exemption from paying landing fees at Greek airports, and it was abusing its "dominant position" in enjoyment of a monopoly in the provision of baggage handling at Greek airports. ACE claimed that allowing one airline to avoid paying fees "distorts or threatens to distort competition."<sup>179</sup> ACE's complaint charged that the market distortion created thereby violated Article 92(1), which mandates free and equal trading opportunities throughout the Common Market. ACE also alleged that the aid violated Article 7, which prohibits discrimination on the basis of nationality.<sup>180</sup> The Commission concluded that "[t]here is no legal basis for claiming, as Olympic Airways claims, that Articles 85 and 86 do not apply to air transport."<sup>181</sup> The European Court of Justice held that while air transport might be exempt from the direct applicability of Article 85, ancillary services (e.g., ground handling and computer reservations systems) were not.<sup>182</sup>

#### E. NOUVELLES FRONTIERES

Decided in April, 1986, the case of *Nouvelles Frontieres* involved the issue of whether Member States have the right to regulate the price of airline tickets sold within their borders, and the potential application of exemptions and sanctions of the competition provisions of the Treaty of Rome to air transport.<sup>183</sup> The Court answered certified questions from a French court concerning applicability of the competition rules of the Treaty of Rome to IATA price-fixing agreements made by French airlines.<sup>184</sup> *Nouvelles Frontieres*, a French travel agency, was sell-

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<sup>179</sup> *EEC Claims Greek Airline Received Illegal Subsidies*, AV. WK. & SPACE TECH., Jan. 17, 1983, at 34.

<sup>180</sup> *Id.*

<sup>181</sup> Commission Decision of Jan. 23, 1985, pmbl. 5.1, 1985 O.J. (L 46) 51, 52; DEMPSEY, *supra* note 3, at 104-06.

<sup>182</sup> Commission Decision of Jan. 23, 1985, pmbl. 5.1 (1985); Olympic Airways, 1985 O.J. (L 46/51), [1985] 1 C.M.L.R. 730; WOUTERS, *supra* note 38, at 21.

<sup>183</sup> Michael Feazel, *Liberalization Policies at Issue in Ruling in French Fare Case*, AV. WK. & SPACE TECH., July 15, 1985, at 28 [hereinafter LIBERALIZATION POLICIES].

<sup>184</sup> See generally Prof. Henri Wassenbergh, *The 'Nouvelles Frontieres' Case*, 11 AIR L. 161 (1986).

ing tickets at fares that had not been approved by the French Government under the French Civil Aviation Code.<sup>185</sup>

The *Nouvelles Frontières* case answered both a procedural and substantive question. As noted above, Council Regulation No. 17 implemented the competition rules of Articles 85 and 86 of the Treaty of Rome and gave the Commission power to look into cases of their infringement; by virtue of Regulation 17, the Commission may grant an exemption under Article 85 (but not Article 86).<sup>186</sup> However, air transport had been specifically excluded from the application of Regulation No. 17 in 1962.

In the absence of another Council regulation regarding implementation of the competition rules, the transitional regime contemplated under Articles 88 and 89 remains applicable. Article 88 gives Member States the power to rule on the lawfulness of agreements, decisions, or concerted practices and on abuses of dominant positions according to their national law, until the Council (acting on a proposal of the Commission) promulgates regulations implementing the competition rules.

Article 89 gives the Commission more limited power. The Commission may (in cooperation with Member States) investigate cases of suspected infringement of the competition rules, and—if it finds an infringement—shall propose measures to bring it to an end. If such conduct does not cease, the Commission shall issue a “reasoned decision” authorizing Member States to remedy the situation.

The Court first confirmed that, absent specific language within the Treaty of Rome, air transport was “subject to the general rules of the Treaty, including the competition rules.”<sup>187</sup> The Court then concluded that absent specific regulations governing air transport adopted by the Council under Article 87, it was, in effect, up to the competent “authorities in Member States” under Article 88 to apply the competition rules of the Treaty of Rome to agreements concerning the air transport industry, or, alternatively, the Commission could issue a “reasoned decision” under Article 89.<sup>188</sup> Either option could open a Pan-

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<sup>185</sup> Peter Haanappel, *Colloquium ‘Nouvelles Frontières,’* State University of Leyden, the Netherlands, 11 AIR L. 181 (1986).

<sup>186</sup> The four criteria for such an exemption under Article 85(3) are discussed above in [11.403].

<sup>187</sup> *Ministere Public v. Asjes (Nouvelles Frontières)*, 1986 E.C.R. 65, 72, [1985-86 Transfer Binder]; Common Mkt. Rep. (CCH) ¶ 14,287, at 16,772, 16,778 (1986).

<sup>188</sup> *Id.* at 16,778-80.

dora's box of litigation in the national courts of Member States.<sup>189</sup>

The substantive question addressed by *Nouvelles Frontières* involved the French law requiring approval of tariffs from public authorities. The Court held that the tariff-filing procedure was not contrary to the Treaty of Rome unless the tariffs themselves run afoul of the competition rules. Professor Peter Haanappel noted, "In essence, the Court ruled that it is contrary to . . . the Treaty to approve air tariffs where these tariffs are the result of an agreement, a decision of an association of undertakings [trade association] or a concerted practice itself contrary to Article 85."<sup>190</sup>

*Nouvelles Frontières* effectively expanded the power the Commission potentially could wield against anticompetitive practices among European airlines. But while a philosophical victory for those seeking greater liberalization, *Nouvelles Frontières* was in fact a partial defeat. Although the Court found that Articles 85 and 86 of the Treaty of Rome specifically apply to air transport, they created a right without a remedy until either the Council adopted regulations (under Article 87) or the Commission issued a reasoned decision (under Article 89), and Member States themselves acted to enforce the competition rules (under Articles 88 and 89)—something the Member States at the time appeared particularly reluctant to do. Thus, while in theory there was a remedy, in practice there was none.

Nonetheless, the decision intensified the pressure on the Council to promulgate regulations to keep the Pandora's box closed. The following year the Council did precisely that, although it limited their application to intra-European international air transportation between Community carriers.<sup>191</sup>

#### F. AHMED SAEED

In April 1989, the European Court of Justice handed down the important decision of *Ahmed Saeed*.<sup>192</sup> The case was brought before the German courts by the Association for the Protection Against Unfair Competition against two Frankfurt travel agencies that were selling airline tickets to German nationals for

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<sup>189</sup> See *id.* at 16,780; DEMPSEY, *supra* note 3, at 104-06, 252.

<sup>190</sup> Haanappel, *supra* note 185, at 181.

<sup>191</sup> Council Regulation 3975/87, art. 1, 1987 O.J. (L 374) 1.

<sup>192</sup> Case 66/86, Ahmed Saeed Fluereisen and Silver Line Reiseburo v. Zentrale zur Bekämpfung unlauteren Wettbewerbs EV, *reprinted in* 38 ZEITSCHRIFT FÜR LUFT-UND WELTRAUMRECHT [ZLW] 124 (1989).

flights ostensibly beginning in Lisbon, Portugal, via Frankfurt to points beyond. The passengers boarded in Frankfurt, discarding the Lisbon-Frankfurt ticket coupon, in violation of German law, to take advantage of airfares that were 60% less than those approved by the German government. The High Court of the Federal Republic of Germany submitted the case on certiorari to the European Court of Justice asking for a preliminary ruling as to whether: (i) airline tariff agreements are void as a violation of Article 85 of the Treaty of Rome, even if neither a Member State (under Article 88) nor the Commission (under Article 89(2)) had declared them incompatible with Article 85; (ii) such tariffs constitute an abuse of a dominant position within the meaning of Article 86; and (iii) the approval of such tariffs by a Member State are incompatible with Articles 5 and 90 of the Treaty of Rome, even where the Commission has not objected to such tariff approval (under Article 90(3)). After the initial hearing of the case, but before final judgment, the Council adopted its First Package of Liberalization and the Commission adopted its regulations in response thereto (discussed below). The Court re-opened the case so as to assess the impact of these developments.

The Court found that Article 85 was directly applicable to inter-Community tariff agreements, even in the absence of implementing legislation promulgated by the Member States (under Article 88) or the Commission (under Article 89), a conclusion that went beyond the holding in *Nouvelles Frontières*. While tariff "consultations" remain exempt, in order for the resulting agreements to be lawful, they must comply strictly with the requirements for individual exemptions specified in the Commission's regulations.<sup>193</sup> The Court also found that Article 86 was directly applicable to air transport even in the absence of implementing regulations, and infringement thereof could be invoked by any person.<sup>194</sup> Thus, the fixing of scheduled air tariffs on domestic flights, intra-Community flights, or flights to and from the EC (now EU) would be unlawful if they constituted an abuse of a dominant position and if trade between Member States might be affected. The Court thus affirmed its earlier holding in the *Wood Pulp* case,<sup>195</sup> which held the competition rules of the

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<sup>193</sup> Commission Regulation 2671/88, 1990 O.J. (L 10) 33; Council Regulation 3975/87, 1987 O.J. (L 374) 30.

<sup>194</sup> WOUTERS, *supra* note 38, at 20.

<sup>195</sup> Joined Cases 89, 104, 114, 116, 117 and 125 to 129/85, A. Ahlstrom Osakeyhtiö and Others v. Comm'n of the EC, 1988 E.C.J. CELEX LEXIS 2898.

Treaty of Rome applicable to agreements made outside the EC where they are put into effect within the EC.<sup>196</sup>

Moreover, the Court did not rule out the possibility that both Articles 85 and 86 can apply simultaneously. Thus, even if an airline qualifies for an individual exemption for a scheduled intra-Community tariff under Article 85(3), it may nevertheless run afoul of the law by abusing a dominant position under Article 86. The Court in *Ahmed Saeed* also addressed the role of Member States, reminding them of their obligation not to approve or encourage the consummation of tariff agreements contrary to Articles 85(1) or 86.<sup>197</sup>

## V. EARLY EUROPEAN COMMUNITY REGULATION OF AIR TRANSPORT: DECISIONS OF THE EUROPEAN PARLIAMENT, COMMISSION, AND COUNCIL

### A. INTRODUCTION

Until the late 1980s, the European Community had, at best, a disjointed and inconsistent approach to deregulation and liberalization. Flustered by the undermining presence of bilateral agreements and the stubborn "hands-off" approach taken by the Council, for many years the Commission appeared to be alone in its efforts to centrally liberalize air transport policy. As noted above, this disarray changed with the passage of the Single European Act. As we will see later, some argue that a degree of this disharmony still exists in direction of liberalization. This section will delineate the prelude to that debate—the early liberalization actions of the relevant institutions of the EU.

### B. PARLIAMENT

The EU Parliament devoted years of effort to bring about a comprehensive and coherent common transport policy.<sup>198</sup> Parliament's stated priorities are to bring the people of Europe closer together, boost intra-Union trade, encourage economic growth, reduce unemployment, open outlying regions, help bridge the gap between the prosperous and impoverished regions, and remove congestion from certain overcrowded urban centers. Parliament envisions achievement of its objectives by

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<sup>196</sup> L. Weber, Effect of EEC Air Transport Policy on International Cooperation (address before the International Congress on EEC Air Transport, Brussels, May 26, 1989).

<sup>197</sup> TREATY OF ROME, *supra* note 34, at arts. 5 and 90(1).

<sup>198</sup> REPORT, *supra* note 58, at 7.

the construction of new major routes and infrastructure and by the elimination of bottlenecks in existing route networks, to be paid for with taxpayer money.<sup>199</sup>

In 1985, Parliament approved a cautious approach to deregulation to be accomplished over a period of 14 years. Its advisory decisions would allow only limited exemptions to the competition rules for the first seven years. A parliamentary report stated that either nation served by a route in question should unilaterally be able to block new low fares on that route.<sup>200</sup> Since that time, however, the Parliament has largely assigned itself alternately the role of cheerleader or conscience of the Commission and Council. On such matters as noise limitations and most other environmental issues, the Parliament has been largely appreciative of the Commission and Council.<sup>201</sup> However, the Parliament has been extremely concerned that liberalization may somehow have a negative "social impact," and it has frequently called for studies showing what the effects of liberalization have been.<sup>202</sup> The 21st Century may see an expansion of the Parliament's involvement in air transport regulation, as the Treaty of Amsterdam, adopted in 1997, gives the Parliament much broader powers to shape regulation.<sup>203</sup> Yet so far the Parliament has not exerted its new powers in the field of aviation, content to follow the lead of the Commission and Council.

### C. THE COMMISSION

The Commission has been the most active and impatient body in the EU/EC government in pursuit of a unified transport policy and liberalization of airline regulations. While the Commission asserted that it did not believe the American style of deregulation would work in Europe, it advocated a gradual change from existing policy, referred to as the "go-slow" approach.<sup>204</sup> For instance, the Commission advocated increased

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<sup>199</sup> *Id.* at 21.

<sup>200</sup> *Europeans Advise Slow Deregulation Approach*, AV. WK. & SPACE TECH., Sept. 23, 1985, at 39.

<sup>201</sup> See *Towards an International Agreement on Aircraft Noise Level*, available at <http://www.europarl.eu.int/dg3/sdp/newsrp/en/n000127.htm#3> (last visited Aug. 14, 2000).

<sup>202</sup> See *Air Transport Liberalisation*, available at <http://www.europarl.eu.int/dg3/sdp/newsrp/en/1998/n980121.htm#3> (last visited Aug. 14, 2000).

<sup>203</sup> Roger J. Goebel, *Symposium: The European Union and the Treaty of Amsterdam*, 22 FORDHAM INT'L L. J. 7, at 28.

<sup>204</sup> SORENSEN, *supra* note 5, at 6.

flexibility<sup>205</sup> and proposed liberalization of capacity, airfares, and conditions of competition.<sup>206</sup> Nonetheless, it grew increasingly impatient with the Council's inability or unwillingness to promulgate regulations applying the Treaty of Rome's competition articles to air transport. Beginning in 1979, the Commission issued several memoranda that put forth possible objectives the Council could adopt.

### 1. *The First and Second Memoranda*

In 1979, the Commission issued *Memorandum 1*, which pointed out several problems of the current structure, including a tendency towards high tariffs due to governmental presence, limited fare flexibility for holidays, and limited possibilities for innovation.<sup>207</sup>

In March 1984, the Commission followed with *Memorandum 2*, entitled "Progress Towards the Development of a Community Air Transport Policy."<sup>208</sup> *Memorandum 2* expanded on the ideas promulgated in *Memorandum 1*.<sup>209</sup> The aims of *Memorandum 2* were to review the developments since *Memorandum 1*, to propose an overall framework for air transport in the Community, to put forth legislative measures for the Council's adoption, and to outline future work the Commission plans to pursue.<sup>210</sup>

The policies of *Memorandum 2* focused on air transport between Member States as an important part of the creation of a Common Market in aviation and the improvement of the Common Market in general.<sup>211</sup> However, the Commission was not oblivious to the impact and importance of international aviation outside of the Community. The memorandum recognized the effects of deregulation in the United States, under the Airline Deregulation Act of 1978, and the need to establish a unified Community posture toward international organizations and nonmember countries.<sup>212</sup> At the time, the Community's major scheduled airlines were earning 40% of their revenues in local Europe. The remainder of their revenue was earned on routes to other international destinations, especially on intercontinen-

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<sup>205</sup> *Id.*

<sup>206</sup> *Id.* at 7.

<sup>207</sup> *Id.* at 6.

<sup>208</sup> See generally MEMORANDUM 2, *supra* note 26; DEMPSEY, *supra* note 3, at 100-02.

<sup>209</sup> SORENSEN, *supra* note 5, at 5.

<sup>210</sup> *Id.* at 6.

<sup>211</sup> MEMORANDUM 2, *supra* note 26, at I.

<sup>212</sup> *Id.* at 12-13.

tal routes.<sup>213</sup> The Commissioners sought to maintain the existing system of regulation and agreement while introducing flexibility and the benefits of competition.<sup>214</sup>

*Memorandum 2* asked the Member States to consider proposals to increase competition by restricting the influence of governments on scheduled airline operations and by introducing greater flexibility in their air service arrangements, particularly in route access, designation, capacity, and fares.<sup>215</sup> The Commission asserted that all of the proposals in the memorandum were interdependent, and, therefore, must be adopted by both the Council and the Commission and implemented as a package.<sup>216</sup> While the Commission recognized the time necessary for discussion and implementation, it discouraged excessive delay and expressly reserved its right of direct action against airline practices that violated the competition articles.<sup>217</sup>

In *Memorandum 2*, the Commission addressed several specific areas for liberalization in Europe's highly regulated scheduled air transport industry. Capacity guarantees were to be reduced to no more than 25%,<sup>218</sup> although 50% had been the norm under typical bilateral agreements. The document addressed pooling agreements—where traffic and revenues are shared regardless of which carrier generates the traffic or earns the revenue.<sup>219</sup> The Commission also proposed guidelines designed to monitor state subsidies of airlines to ensure a fair, competitive environment.<sup>220</sup> Finally, in what has since become a major issue in liberalization, the Commission sought to apply the competition rules, specifically Articles 85 through 90 of the Treaty of Rome, to the scheduled air transport industry.<sup>221</sup> The Commission justified this assertion, two years before *Nouvelles Frontières*, on the basis of Court of Justice rulings in 1974 and 1978.<sup>222</sup> Opponents argued against adjustments to the European civil aviation regime on the ground that such changes would result in

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<sup>213</sup> *Id.* at 9.

<sup>214</sup> *Id.* at I.

<sup>215</sup> Colin Thaine, *The Way Ahead from Memo 2: the Need for More Competition, a Better Deal for Europe*, 10 AIR L. 90.

<sup>216</sup> MEMORANDUM 2, *supra* note 26, at III.

<sup>217</sup> *Id.*; TREATY OF ROME, *supra* note 34, at arts. 85-90.

<sup>218</sup> Thaine, *supra* note 215, at 93.

<sup>219</sup> *Id.* at 94.

<sup>220</sup> *Id.* at 95.

<sup>221</sup> *Id.* at 95-96.

<sup>222</sup> MEMORANDUM 2, *supra* note 26, at 17. *Nouvelles Frontières* was decided April 30, 1986.



unacceptable impacts on international aviation outside of the Community. The Commission rejected this rationale. Rather, the Commission insisted that such steps would contribute to a "Community market in aviation" and the "improvement of the internal market in its wider sense."<sup>223</sup> Nevertheless, it recognized the repercussions of its proposals on the non-Community states of Europe in formulating its proposals.<sup>224</sup> The Commission sought a qualified increase in competitiveness throughout European civil aviation:

[R]ecent years have made it clear that although the present regime has produced an extensive network of aviation services, the rigidities of the system . . . give rise to an increasing degree of public dissatisfaction. This criticism (not all of which is justified) has tended to center on the civil aviation services provided within Europe, and the Commission is confirmed in its view that within the Community there is scope for introducing more flexibility and competition into the existing system without destroying it or losing the benefits that it has brought about. Flexibility is not, however, an end in itself. It should be regarded rather as the means to improving the services to the consumer and the profitability of the efficient and enterprising airline.<sup>225</sup>

The Commission's qualifications on competition included a recognition of strong state interests in the survival of national airlines<sup>226</sup> and recognition of a history of competition in services within the industry, especially with respect to charter airlines.<sup>227</sup> In addition, the Commission explicitly acknowledged that the U.S.-style deregulation would not work in Europe<sup>228</sup> and that direct comparisons of costs and fares between European and similar U.S. routes were invalid. In particular, fuel, air traffic control, and airport charges presented significant cost elements that European airlines could not influence.<sup>229</sup> *Memorandum 2* concluded that airfares in Europe were not unreasonably related to costs, owing in large part to the fact that only 40% of total costs were controllable by the airlines. Nevertheless, the Commission believed that changes in procedures related to the

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<sup>223</sup> *Id.* at 21.

<sup>224</sup> *Id.* at 22.

<sup>225</sup> *Id.* at 21.

<sup>226</sup> *Id.* at 22.

<sup>227</sup> MEMORANDUM 2, *supra* note 26, at 23. Charter traffic within Europe accounts for 60% of all air travel. See AIR CARTEL, *supra* note 18, at 23, 26.

<sup>228</sup> MEMORANDUM 2, *supra* note 26, at 26-27.

<sup>229</sup> *Id.* at 24.

fixing of airfares would result in a "wider range of fares."<sup>230</sup> Moreover, the belief was expressed that competitive pressures would ultimately lead to lower airfares.<sup>231</sup>

*Memorandum 2* expressed a general preference for an "evolutionary approach"<sup>232</sup> to a more competitive air transport policy, rather than the more revolutionary policy adopted earlier by the United States.<sup>233</sup> While comprehensive deregulation arguably had merit in the large, unified market of the United States, conditions in Europe would not justify such an approach.<sup>234</sup> Additionally, at the time of deregulation, the United States had about 20 major air carriers, and the government could take "a relaxed view on the fate of any one of them," in contrast to the nationalized airlines and international character of European aviation.<sup>235</sup> The issue, therefore, was whether the system could be modified sufficiently to meet the needs of the European Community while at the same time bringing to bear sufficient competitive pressures for the airlines to "control costs, increase productivity and provide efficient and attractively priced services to the user; and to enable the efficient and enterprising airline to benefit . . ."<sup>236</sup> The Commission stated that the principal measures to be taken were: (a) Community rules on certain aspects of bilateral agreements between Member States; (b) changes in methods for settlement of air tariffs; and (c) action limiting the effect of commercial and tariff agreements between airlines.<sup>237</sup>

Regarding bilateral agreements, the Commission urged elimination of mandatory pooling arrangements between airlines. Also, it suggested rigid 50/50 traffic-sharing agreements should be relaxed to where no one party is guaranteed a traffic share of more than 25% in agreements between Member States.<sup>238</sup> "This would . . . permit a greater degree of competition and assure a Member State that its airline would have as a safety net a level of operation below which it could not fall without the consent of its own government."<sup>239</sup>

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<sup>230</sup> *Id.*

<sup>231</sup> *Id.*

<sup>232</sup> *Id.* at 27.

<sup>233</sup> MEMORANDUM 2, *supra* note 26, at 26.

<sup>234</sup> *Id.* at 26.

<sup>235</sup> *Id.* at 27.

<sup>236</sup> *Id.*

<sup>237</sup> *Id.* at 29.

<sup>238</sup> MEMORANDUM 2, *supra* note 26, at 30.

<sup>239</sup> *Id.*

The principal features of bilateral or multilateral agreements between airlines were identified as scheduling, capacity, revenue sharing, and tariff provisions. Even though the Commission, as explained above, wanted to prevent capacity agreements that were either mandatory or required a strict 50/50 sharing, it recognized that in some cases such agreements were desirable in order to assure service in thin markets. On the other hand, the Commission recognized that such agreements tended to inure to the detriment of the more efficient airline. Consequently, *Memorandum 2* indicated that capacity agreements should be permissible, but emphasized that any party should be able to withdraw from such an agreement upon giving reasonably short notice.<sup>240</sup>

As with capacity sharing, the Commission also recognized that pooling agreements could have desirable consequences in encouraging carriers to operate outside of profitable periods.<sup>241</sup> At the same time, such agreements may also restrict competition that otherwise might take place, contrary to Article 85(1).<sup>242</sup> Pooling agreements between airlines were of two basic types: open pools, which distributed revenue on the basis of the capacity offered by each airline (regardless of which carrier actually earned the revenue), and limited pools, which almost equalized revenue. The Commission was of the opinion that revenue pools should be permitted in certain limited circumstances,<sup>243</sup> but that open pools should be prohibited.<sup>244</sup> In order to be exempted from the competition rules under Article 85(3), such agreements must contribute to the improvement of air transportation with a minimum of anticompetitive effect.<sup>245</sup> However, the Commission's guideline in this area was more restrictive, limiting the transfer of revenue from one airline to another to one percent of poolable revenues. All other revenue-pooling arrangements would be subject to "specific scrutiny in each case in order to determine whether they would qualify for exemption under Article 85(3)."<sup>246</sup>

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<sup>240</sup> *Id.* at 32-33.

<sup>241</sup> *Id.* at 33.

<sup>242</sup> *Id.*; TREATY OF ROME, *supra* note 34, at art. 85(1).

<sup>243</sup> MEMORANDUM 2, *supra* note 26, at 33.

<sup>244</sup> *Id.* at 33-34; TREATY OF ROME, *supra* note 34, at art. 85(3).

<sup>245</sup> MEMORANDUM 2, *supra* note 26, at 33, 34; TREATY OF ROME, *supra* note 34, at art. 85(3).

<sup>246</sup> MEMORANDUM 2, *supra* note 26, at 34.

The Commission also recognized that airlines should be as free as possible to determine what tariffs best suited their commercial needs and should be able to set tariffs within certain predetermined "zones of reasonableness" without governmental approval.<sup>247</sup> In its "Amended Proposal for a Council Directive," the Commission indicated the minimum acceptable range to be covered within the zones.<sup>248</sup> This proposal reflected then-recent developments in the economic and regulatory environment, such as the agreements between the United States and certain ECAC countries for a given number of "reference tariffs," as well as "zones of reasonableness."<sup>249</sup> Within the zones, the following alternatives could be agreed upon: (1) airlines would be free to set fares without government interference; (2) proposed fares would take effect unless both countries disapproved ("double disapproval"); or (3) proposed fares would be subject to country-of-origin approval. While both governments in bilateral agreements would be expected to consult and agree in setting the zones of reasonableness, in case of a dispute between the two governments concerning fares outside of the zone, the country of origin would be able to determine the fare.<sup>250</sup>

The tariff-setting proposals of *Memorandum 2* also extended to agreements among airlines. The Commission observed that most of the nations that were members of the International Civil Aviation Organization (ICAO), which includes virtually the entire global aviation community, recognized such tariff consultations as an essential part of transport policy. These consultations restricted competition, but at the same time had resulted in a "system [which] allowed the provision of reliable, high quality services to the consumer."<sup>251</sup> Tariff-setting arrangements would be permissible if they "confer[red] an equivalent advantage to the consumer, [were] not unduly restrictive and . . . [from which] a reasonable degree of competition [was] ensured."<sup>252</sup> The Commission indicated that these conditions would be met if:

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<sup>247</sup> *Id.* at 31.

<sup>248</sup> The proposal called for two "zones of flexibility," each with a minimum range of 25%. The first zone was to "extend at least 15% on either side of the existing air fare for economy class," and the other was to "be situated below the first and cover restricted use air fares." *Id.* at Annex II, art. 6(4) & (5).

<sup>249</sup> *Id.* at 31.

<sup>250</sup> *Id.* at 32.

<sup>251</sup> MEMORANDUM 2, *supra* note 26, at 35.

<sup>252</sup> *Id.* at 35.

airlines had an effective right of independent action, both in terms of proposing tariffs independently of other airlines, and in terms of freedom to implement such tariffs, subject only to the [proposed] limited government control . . . .

The Member States concerned and the Commission were enabled to participate as observers in tariff consultations.<sup>253</sup>

Another major aspect of competition, market access, was given cursory treatment by the Commission.<sup>254</sup> While recognizing the dominance throughout the EC of large, national airlines, and that services to the consumer would be improved with a proliferation of smaller airlines, the Commission proposed only that the smaller airlines be allowed to operate on bilateral routes not presently utilized.<sup>255</sup> The Commission believed that such steps could be taken without "significant damage" to major airlines and without the detailed justification or reciprocity ordinarily required.<sup>256</sup> The Commission went further and suggested that if a Member State desired, such routes could be so utilized only after giving national airlines a right of first refusal.<sup>257</sup>

The Commission also proposed tight control of state aid and subsidies to encourage airlines to accept competition. Without guarantees that other airlines would compete on the same level, airlines would be reluctant to join an open market.<sup>258</sup> The Commission feared that unless state aids were adequately controlled, implementation of competition measures would result in a subsidy race—competition being financed by Member States. This was to be prevented by application of the Treaty of Rome's state aids rules in Articles 92 and 93, for which the Commission has responsibility.<sup>259</sup> Proper application of these rules would result in advance disclosure of all proposed state aids so that the Commission could take a position as to whether it opposed individual subsidies or other forms of governmental assistance.<sup>260</sup> The Commission recognized that state aids may be appropriate in certain circumstances in order to fulfill public service obliga-

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<sup>253</sup> *Id.*

<sup>254</sup> See Thaine, *supra* note 215, at 93; International Chamber of Commerce (ICC), *European Commission Civil Aviation Memorandum No. 2: A Response by the ICC*, 10 AIR L. 99, 103 (1985) (policy declaration and response adopted by the Executive Board of the ICC on Dec. 3, 1984).

<sup>255</sup> MEMORANDUM 2, *supra* note 26, at 43-44.

<sup>256</sup> *Id.*

<sup>257</sup> *Id.* at 44.

<sup>258</sup> SORENSEN, *supra* note 5, at 7.

<sup>259</sup> MEMORANDUM 2, *supra* note 26, at 36.

<sup>260</sup> *Id.* at 37.

tions, to compete with subsidized carriers from third countries, to overcome "particularly precarious" but temporary financial problems, or to assist economically underdeveloped regions.<sup>261</sup> Assistance in the form of "normal commercial transactions," such as loans, capital or guarantees, would also be acceptable, although cases would have to be examined individually to determine the presence of impermissible aid.<sup>262</sup>

As indicated previously, the primary concern and focus of the Commission in *Memorandum 2* was with the EC (now EU). Consequently, with regard to the international implications of its proposals, it reasserted the supremacy of Community law. Under Article 234,<sup>263</sup> Member States must take steps to eliminate conditions in agreements with third countries inconsistent with forthcoming Community/Union aviation provisions. Nevertheless, the Commission agreed that, given the legitimate priorities and programs in third countries, especially non-Community members of ECAC, some flexibility would be required.<sup>264</sup> Accordingly, the Commission entered into cooperation agreements under Article 229<sup>265</sup> with ECAC and EUROCONTROL.

In spite of its general adherence to a phased, evolutionary implementation of policies, *Memorandum 2* indicated some signs of the Commission's growing impatience with the situation. It suggested that any group exemptions from the competition provisions should be limited to seven years.<sup>266</sup> Additionally, even though the memorandum identified exceptions to the prohibitions in Article 85(1), if certain objectives were manifest, such exceptions would expire on December 31, 1991.<sup>267</sup> The Commission reminded the Council of the proposals it had submitted to the Council in 1981 calling for directives and regulations, upon which the Council still had not taken action.<sup>268</sup> Finally, the Commission repeatedly asserted its right to take direct action, in certain circumstances, against practices in violation of Treaty of Rome provisions.<sup>269</sup>

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<sup>261</sup> *Id.* at 37-38.

<sup>262</sup> *Id.* at 38.

<sup>263</sup> TREATY OF ROME, *supra* note 34, at art. 234.

<sup>264</sup> MEMORANDUM 2, *supra* 26, at 50.

<sup>265</sup> TREATY OF ROME, *supra* note 34, at art. 229.

<sup>266</sup> MEMORANDUM 2, *supra* note 26, at 35.

<sup>267</sup> *Id.* at Annex III C.

<sup>268</sup> *Id.* at 16-17.

<sup>269</sup> *Id.* at III, 36, Annex III C.2.

*Memorandum 2* also addressed a significant number of additional issues.<sup>270</sup> The memorandum attached six annexes, which included detailed proposals for Council action and guidelines related to the foregoing matters.<sup>271</sup> *Memorandum 2* was more than a general indication of the Commission's position and thoughts on European civil aviation. The memorandum was intended to provoke action by the Council and serve as a comprehensive guide to achieving the policy goals contained therein.

Reaction to *Memorandum 2* was mixed. IATA and AEA, while agreeing as to the necessity of reform, published their own proposals, which differed considerably from *Memorandum 2*.<sup>272</sup> Perceiving significant threats to their economic well-being, trade unions and airports opposed *Memorandum 2*. By contrast, charter airlines and consumer groups voiced strong support for the Commission proposals, particularly in areas approached most warily by scheduled carriers.<sup>273</sup> The European Parliament and the Economic and Social Committee conducted extensive hearings and published comprehensive reports that supported the overall thrust of *Memorandum 2*, but proposed significantly different approaches to many of the issues contained therein.<sup>274</sup> The Council instituted a high-level working group, which met eight times before the end of 1984. The efforts of the group culminated in a report that "can be said to build on Memorandum No. 2, taking into account the views that had been expressed in the interim."<sup>275</sup> On December 11, 1984, the Council endorsed the report as a guideline for further actions and arranged for additional study.<sup>276</sup>

## 2. Enforcement

The failure of the Council to adopt regulations implementing Articles 85 and 86 of the Treaty of Rome led the Commission in 1986 to send letters to ten European airlines<sup>277</sup> alleging that

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<sup>270</sup> See *id.* at 13, 48 (aircraft noise), 14 (search and rescue), 15 (accident investigation and interrogational air services), 42 (air freight transport), 43 (access to market), 45 (non-scheduled services), 47 (social matters as related to Community and aviation policies), 48 (research), 49 (general aviation).

<sup>271</sup> MEMORANDUM 2, *supra* note 26, at Annexes I-VI.

<sup>272</sup> WOUTERS, *supra* note 38, at 52-53.

<sup>273</sup> *Id.* at 53.

<sup>274</sup> *Id.* at 53-54.

<sup>275</sup> *Id.* at 54.

<sup>276</sup> *Id.* at 55.

<sup>277</sup> Air France, Aer Lingus, Alitalia, British Airways, British Caledonian, KLM, Lufthansa, Olympic, Sabena, and SAS.

they had violated the Treaty of Rome by engaging in price fixing, capacity limitation, revenue pooling, and restricted market entry.<sup>278</sup> The Commission threatened that failure of the airlines to cooperate to eliminate these anti-competitive practices would lead it to issue a "reasoned decision" under Article 89, an alternative which had been explicitly approved by the European Court of Justice earlier that year in *Nouvelles Frontières*. The issuance of such a "reasoned decision" by the Commission potentially would open a Pandora's box of litigation by private parties in the national courts of Member States.

Hence, the ten airlines had a strong incentive to comply. Although some of the southern European airlines initially resisted meeting with DG-4 (the Commission ministry responsible for competition),<sup>279</sup> a more strongly worded Commission letter in early 1987 advised recalcitrant carriers that the Commission believed an apparent infringement of the Treaty of Rome existed and that a "reasoned decision" would soon be forthcoming. This ultimately brought all the carriers to the bargaining table. During tense meetings in Brussels, Mr. Peter Sutherland warned representatives of Alitalia, Lufthansa, and Olympic that unless they agreed to join negotiations on pricing liberalization, he would bring an action against them in the European Court of Justice for operating an illegal cartel. The carriers capitulated.<sup>280</sup>

Yet, the informal understandings ultimately entered into between the Commission and the airlines were surprisingly modest in substance, allowing a great deal more anticompetitive activity than would be tolerated in, for example, the United States. With respect to pricing, the Commission allowed a continuation of carrier discussions regarding rates and permitted carriers to enter into voluntary rate agreements, so long as (1) such discussions were not conducted in secret, (2) the results of the discussions would not be binding upon any carrier participating in them, and (3) carriers retained the right of independent action to file a tariff deviating from the agreed rates. As to revenue and capacity-pooling agreements, they would continue to be tolerated so long as they were voluntary, they involved a sharing of

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<sup>278</sup> *EEC Commission Action Could Result in Suits Against 10 Large Carriers*, AV. WK. & SPACE TECH., July 14, 1986, at 35; ARGYRIS, *supra* note 62, at 10-11.

<sup>279</sup> *Alitalia Rejects EEC Request for Data on Operational Practices*, AV. WK. & SPACE TECH., Nov. 17, 1986, at 39.

<sup>280</sup> Merritt, *EC Deregulation at Crossroads*, INT'L HERALD TRIBUNE, June 15, 1987, at 9.



revenue of no more than one percent, and the transfer of revenue went to the carrier providing off-peak service. Slot allocation would be permitted so long as negotiated and concluded publicly. And, as to computer reservations systems, there would have to be equal and unbiased access to the systems.

Thus, the Commission effectively did an "end run" around the Council, defining the perimeters of lawful vis-à-vis unlawful carrier conduct when the Council had been rendered immobile by an inability to reach a consensus on regulations implementing Articles 85 and 86 of the Treaty of Rome. Yet, the Commission's modest constriction of anti-competitive behavior by air carriers surprised almost everyone because the Commission had previously done so much "chestbeating."

More recently, the Commission has been less reticent to use its enforcement power. In March of 1992, the Commission fined Aer Lingus 750,000 Euros for abuse of its dominant position on the Dublin-London Route because it broke an interlining agreement with British Midland Airways after it became a competitor on the route.<sup>281</sup> The Commission stated, "[r]efusing to interline is not normal competition on the merits. Interlining has for many years been accepted industry practice, with widely acknowledged benefits for both airlines and passengers. . . . A refusal to interline . . . is a highly unusual step and has up to now not been considered by the European airline industry as a normal competitive strategy."<sup>282</sup> This was the first time the Commission imposed a fine for breaking an interline agreement.

#### D. THE COUNCIL

In 1962, the Council adopted general competition rules, but specifically exempted air and sea transport. On June 30, 1968, the Council decided that competition laws should be made applicable to transport by rail, road, and inland waterway.<sup>283</sup> When the Treaty of Rome was adopted in 1957, air and sea transport were excluded because of the special attitude adopted toward these methods of transport.<sup>284</sup> Indeed, Council Regulation No. 141 states specifically that Council Regulation No. 17,

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<sup>281</sup> *Aer Lingus Fined by EC Commission for Breaking Interlining Agreement*, AVIATION EUROPE, Mar. 5, 1992, at 1; WOUTERS *supra* note 38, at 25.

<sup>282</sup> *British Midland v. Aer Lingus*, 4 C.M.L.R. 596 para. 25 (1993).

<sup>283</sup> 2 Common Mkt. Rep. (CCH) ¶ 2401-2634 (various dates) (Reg. No. 17).

<sup>284</sup> 1 Common Mkt. Rep. (CCH) ¶ 1945.05 (1974).

which gives the Council the direct means of investigating violations of Articles 85 and 86 in transport and imposes penalties for failure to comply,<sup>285</sup> does not apply to air transport and related activities.<sup>286</sup> The Council did not adopt maritime competition rules until December 1986.

Many in Europe, including northern European governments and the Commission, implored the Council to adopt regulations that would specify how the competition laws would be applied and enforced.<sup>287</sup> However, the major stumbling block in the adoption of competition regulations was the desire of each nation to guarantee the success of its own airline. Because the Council members represent the interests of their own States, they must follow the policies of their governments, many of which have been generally opposed to air transport liberalization.<sup>288</sup>

Article 74 of the Treaty of Rome states that "[t]he objectives of this Treaty shall . . . be pursued by the Member States within the framework of a common transport policy."<sup>289</sup> Article 75 directs the Council to create common rules applicable to international transport within the Member States.<sup>290</sup> Despite a strong push for liberalization by the Commission in 1979 and 1984, and an important decision by the EEC Court of Justice in 1986, the Council pled impossibility because of the complexity of the issues and dissent within the Council itself.<sup>291</sup>

By mid-1987, the Council appeared poised to conclude a comprehensive agreement on defining the application of relevant provisions of the Treaty of Rome to air transport. In particular, it would have laid down detailed rules for the application of the competition provisions—Articles 85 and 86. It would have also

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<sup>285</sup> MATHIJSEN, *supra* note 75, at 181-83.

<sup>286</sup> Association of European Airlines, European Air Transport Policy—AEA Proposals, Sept. 27, 1985, at 14 (paper adopted by President's Special Assembly at Brussels).

<sup>287</sup> DEMPSEY, *supra* note 3, at 246; TREATY OF ROME, *supra* note 34, at art. 84(2).

<sup>288</sup> DEMPSEY, *supra* note 3, at 98.

<sup>289</sup> TREATY OF ROME, *supra* note 34, at art. 74.

<sup>290</sup> *Id.* at art. 75.

<sup>291</sup> See BOMBARDELLA, *supra* note 170, at 3. PROCEEDINGS, *supra* note 172, at 12. In 1978, the Council established a priority program to address the problem of air transport. The Council's priorities include: control of nuisances, simplification of formalities, implementation of technical standards, implementation of provisions regarding aid and competition, and mutual recognition of licenses. Other items of Council concern include: working conditions, the right of establishment, improvements in inter-regional services, search, rescue and recovery operations, and accident inquiries. SORENSEN, *supra* note 5, at 3.

identified the group exemptions to be allowed thereunder and included directives on scheduled airline fares, capacity, and market access.

Specifically, the package would have eliminated secret pricefixing, but allowed public and voluntary agreements between carriers as to fares. As to entry, instead of being restricted to regional routes between provincial airports, the airlines would have been permitted to compete on feeder routes between regional and hub airports. The 50-50 capacity limitation agreements in many bilaterals would have been reduced to 45-55 for the first two years and 40-60 thereafter. Revenue pooling would have been limited to one percent and transferred to the carrier providing off-peak service. Computer reservation systems were to be open to all carriers without bias. The carriers would have been granted block exemptions from the competition rules to enable them to agree on certain joint operations, such as scheduling.<sup>292</sup>

But the entire package, accepted in principle by all Member States, foundered in mid-1987 on the question of the inclusion of Gibraltar in the proposed arrangements for route development.<sup>293</sup> Newly admitted Spain exercised its veto at the eleventh hour on an issue having virtually nothing to do with air transport. Spain contested British sovereignty over Gibraltar and apparently used this platform to reassert its position.

Although the Spanish veto scuttled the mid-1987 agreement, the ability of the Council to reach a majority resolution of such issues was greatly facilitated by the weighted voting of Member States permitted by the Single European Act, adopted on July 1, 1987. With implementation of the SEA and advent of the EU, no single nation can again unilaterally thwart the Council's ability to promulgate rules by casting a veto as Spain did in the Gibraltar debate. As noted above, the Single European Act may have prompted Council agreement on a conservative liberalization package (the so-called "First Package") in December 1987. The Council adopted a more liberal "Second Package," which entered into force on August 11, 1990<sup>294</sup> and a fully liberalized "Third Package," which became effective in January 1993.<sup>295</sup>

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<sup>292</sup> Merritt, *supra* note 280, at 9, 12.

<sup>293</sup> *Spain Blocks the Adoption of Air Deregulation in EC*, WALL ST. J., July 2, 1987, at 15; *Unfair Air Fares*, ECONOMIST, July 4, 1987, at 16; *Spain in Search of Europe*, ECONOMIST, July 18, 1987, at 43.

<sup>294</sup> 1990 O.J. Nr. 217.

<sup>295</sup> 1992 O.J. (L 241) 1.

Before proceeding, the difference between the types of actions that may be taken by the Council should be made clear. A "regulation" has general application, and is binding in its entirety and directly upon all Member States. A "directive" is binding as to its objective as to each Member State to which it is addressed, but leaves to the Member State the means by which it shall be implemented. A "decision" is binding in its entirety upon all to which it is addressed.<sup>296</sup>

## VI. CONTEMPORARY AIR TRANSPORT POLICY OF THE EUROPEAN UNION

### A. INTRODUCTION

The contemporary landscape of European regulation of air transport is one of growing competitiveness and government regulation designed to promote competition. This competitive environment was spawned in no small part by the historic movement of the European Council towards full liberalization. While the European Commission and industry organizations such as AEA and ECAC encouraged liberalization earlier than the Council actually undertook the task, true liberalization was not likely to occur until the Council became a liberalization actor. By the mid-1980s, the European Court of Justice made it clear that the regulation of air transport was well within the domain of the Council. With such impetus, the Council finally began to heed the advice of the Commission, and launched its voyage into liberalization—in a series of three packages. As the 1990s dawned, many commentators projected that the Council's liberalization plan would precipitate a competitive market—though at the same time producing a highly contentious climate full of merger activity and privatization difficulties. There was some hope that an intensely competitive merger climate would weed out poorer performing airlines<sup>297</sup> and provide economic benefits to the consumer.

The picture that emerged at the end of the 20th Century was somewhat different. While liberalization did make some aspects of the European air transport industry more competitive, alliances seemed to take the place of mergers. The anticipated consolidation thus occurred, but in a manner that might be even more potent than pure monopoly. These alliance struc-

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<sup>296</sup> TREATY OF ROME, *supra* note 34, at art. 189.

<sup>297</sup> Pierre Sparaco, *European Deregulation Still Lacks Substance*, AV. WK. & SPACE TECH., Nov. 9, 1998, at 53.

tures presented their own somewhat oblique uncompetitive challenges.

In terms of just the number of airlines, the industry appeared more competitive on its face. For example, in 1998, 164 scheduled air carriers operated in the EU, up from 132 in 1992. Of the carriers, twelve operated 70 to 100-seat regional jets, up from eight in 1995 and four in 1992.<sup>298</sup> However, there was argument that such numbers were inefficient, and that the "European airline industry restructuring [was] lagging, and the number of players [was] hardly evolving."<sup>299</sup>

Privatization was reasonably difficult; yet the greater regulatory challenge presented itself in the form of supranational conflict (i.e., air transport regulatory differences between the United States and the European Union). Prices had not fallen as drastically as was hoped, and new value-based entrants were not as successful as some commentators thought they would be. Ancillary services (ground handling) were also still relatively uncompetitive.

Regardless of the partial success of liberalization by the end of the 20th Century, the overall state of the air transport market was one of increasing competitiveness. Prices were falling and smaller, value-based airlines were gaining competitive ground. Restrictive bilateral agreements between nations were disappearing, and the European Union was beginning to assert its role as principal negotiator of air traffic rights by sweeping aside internal restrictions on air transportation. This section of the paper delineates the landscape of applicable European Union regulation of air transport—the Commission's proposals, the Council's packages, and other relevant legislation.

In December 1987, three decades after the signing of the Treaty of Rome, the EU Council adopted its long-awaited regulations on the application of the Treaty of Rome's competition rules to scheduled air transport,<sup>300</sup> group exemptions thereto,<sup>301</sup> a directive on scheduled airfares,<sup>302</sup> and a decision on capacity

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<sup>298</sup> *Id.*

<sup>299</sup> *Id.* (quoting Bernard Van Houtte, head of the Application of Community Law unit of the EC Transportation Directorate General).

<sup>300</sup> Council Regulation 3975/87, 1987 O.J. (L 374) 1.

<sup>301</sup> Council Regulation 3976/87 of 14 December 1987 Application of Article 85(3) of the Rome Treaty (Group Exemptions), 1987 O.J. (L 374) 9.

<sup>302</sup> Council Directive 87/601 of 14 December 1987 Scheduled Air Fares, 1987 O.J. (L 374) 12.

sharing and market access.<sup>303</sup> The regulations applied only to flights between EU Member States, and not to domestic flights or flights between Member States and third countries.

Why, after so many years of wrangling, had the Council finally achieved agreement? The political problems between Spain and the United Kingdom surrounding the UK's possession of Gibraltar, which had led Spain to veto the agreement earlier in the year, were resolved in December 1987.<sup>304</sup> Moreover, beginning on July 1, 1987, the implementation of weighted voting under the Single European Act had eliminated the possibility of a single state veto. Hence, no one nation could repeat the Spanish impasse of summer 1987. With weighted voting, consensus became more practical than intransigence.

Threats by the Commission to utilize the sanctions approved by the Court of Justice in *Nouvelles Frontieres* had abated considerably with the relatively conservative agreements it had entered into with offending airlines. The Commission itself began to appreciate the difficult political problems that international aviation posed for Member States, and was willing to opt for increased diplomacy over unilateral actions that might rip at the very threads of the fragile European alliance.<sup>305</sup>

Moreover, much of air transport had already been made more liberal, with the new bilateral air transport agreements in effect between Britain, the Netherlands, Ireland and many of their aviation partners.<sup>306</sup> ECAC had adopted modest liberalization proposals. Hence, there was already much for the European scheduled air transport industry to digest.

Charter services, which had largely been deregulated in the 1950s, dominated more than half of the air passenger market,<sup>307</sup> and inter-city rail services were also responsible for a sizable portion of the city-pair passenger market. With increased privatiza-

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<sup>303</sup> Council Decision 87/602 of 14 December 1987 Capacity Sharing and Market Access, 1987 O.J. (L 374). These regulations, directives, and decisions are set forth in Paul Dempsey, *Aerial Dogfights Over Europe: The Liberalization of EEC Air Transport*, 53 J. AIR L. & COM. 615, 687-736 (1988).

<sup>304</sup> *The Rock Stands Aside*, ECONOMIST, Dec. 5, 1987, at 55.

<sup>305</sup> As Peter Sutherland, EC Commissioner for Competition, noted, "it was better to move this way than by confrontation, which would have taken longer and involved protracted legal battles." Susan Carey & Julie Wolf, *EC Adopts Plan to Partly Deregulate Europe's Airline Industry Starting in '88*, WALL ST. J., Dec. 8, 1987, at 24.

<sup>306</sup> See DEMPSEY, *supra* note 3, at 102-04.

<sup>307</sup> *Id.* at 99.

tion of carriers such as British Airways and KLM,<sup>308</sup> and proposed mergers then in the offing (such as that between British Airways and British Caledonian), the market was already becoming increasingly competitive.

All of this made political consensus on a more conservative package, one more palatable to the southern European governments, easier to achieve. Effective January 1, 1988, the package provided for a three-year transition to a more liberalized air transport regime in areas of pricing, entry and capacity, ostensibly attempting to meet the Community's ambitious 1992 deadline for a unified internal market.<sup>309</sup>

As noted previously, original Council regulations excluded the transport sector from the application of the competition rules.<sup>310</sup> The 1987 *Regulation on the Application of the Competition Rules*<sup>311</sup> was the first to apply Articles 85 and 86 of the Treaty of Rome to air transport.<sup>312</sup> Under it, the Commission was explicitly conferred jurisdiction to hear complaints regarding violations of Articles 85(1) and 86 brought by member governments or by natural or legal persons having a legitimate interest.<sup>313</sup> It was given powers of investigation<sup>314</sup> and the authority to levy fines against enterprises found to have violated the Treaty of Rome.<sup>315</sup>

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<sup>308</sup> British Airways was completely privatized by the Thatcher government. KLM's government holdings have been reduced to 39%. P. Haanappel, A Decade of Deregulation, Address before the Aviation & Space Law Section of the Ass'n of American Law Schools 10 (Miami, Fla., Jan 9, 1988) [hereinafter P. HAANAPPEL].

<sup>309</sup> See *They've Designed the Future, and It Might Just Work*, *supra* note 123, at 45.

<sup>310</sup> Pursuant to Council Regulation 141, Regulation 17 was made inapplicable to transportation. Subsequently, the Council adopted Regulation 1017/68 to apply the competition rules to inland transport. And more recently, it adopted Regulation 4056/86, applying the rules to maritime services. See DEMPSEY, *supra* note 3, at 245; Council Regulation 4056/86, 1986 O.J. (L 378) 44.

<sup>311</sup> Council Regulation 3975/87, 1987 O.J. (L 374) 1.

<sup>312</sup> It was subsequently elucidated by Commission Regulation 4261/88, 1988 O.J. (L 376) 10, which identifies the due process rights of parties to participate in proceedings involving the application of competition rules to the transport sector, and amended by Council Regulation 1284/91, 1991 O.J. (L 122) 2, which allowed the Commission to take interim measures for up to nine months to deter the jeopardizing of existing air service.

<sup>313</sup> Council Regulation 3975/87, art. 3, 1987 O.J. (L 374) 2. Exceptions for technical agreements are set forth *id.* See also Council Regulation 4261/88, 1988 O.J. (L 376) 10, which establishes procedural rules for complaints.

<sup>314</sup> Council Regulation 3975/87, art. 11, 1987 O.J. (L 374) 4-5.

<sup>315</sup> *Id.* at 5.

Also, as noted above, Article 85(3) of the Treaty of Rome authorizes the establishment of group exemptions from the competition rules, and the Council adopted regulations implementing procedures for their creation.<sup>316</sup> Here again, the Commission was explicitly conferred significant powers to adopt regulations authorizing carriers to engage in, *inter alia*, capacity and revenue sharing, agreements regarding pricing, slot allocations, computer reservations systems, and ground handling.<sup>317</sup> Significantly, revenue pooling<sup>318</sup> was limited to one percent of the revenue earned on a route, with the transfer being made to the carrier suffering a loss because it was scheduling its flights at less busy times.<sup>319</sup> Hence, revenue pooling was substantially circumscribed. The Commission quickly promulgated three regulations that established the requirements for group exemptions for airlines under Article 85(3).<sup>320</sup>

On July 26, 1987, the Commission adopted regulations implementing the block exemptions on the application of Article 85(3) of the Treaty of Rome on agreements between airlines in three areas: (1) capacity, revenue pooling, tariff consultations and slot allocations (the airline agreements regulation)<sup>321</sup>; (2) computer reservations systems (the CRS regulation)<sup>322</sup>; and (3) ground handling services (the ground handling regulation).<sup>323</sup> These rules came into force on January 1, 1988.

The Council's First Package of liberalization, while revolutionary at the time, stopped quite short of true full cabotage. Likewise, in its Second Package, the Council rejected the Commission's proposals for the elimination of cabotage restrictions.<sup>324</sup> It also failed to extend antitrust exemptions to domes-

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<sup>316</sup> Council Regulation 3976/87, 1987 O.J. (L 374) 9.

<sup>317</sup> *Id.* at 2. These regulations were subsequently amended by Council Regulation 2344/90 of 24 July 24 1990, 1990 O.J. (L 217) 15, to include consultations on cargo rates.

<sup>318</sup> See DEMPSEY, *supra* note 3, at 64.

<sup>319</sup> Council Regulation 3975/87, art. 2, 1987 O.J. (L 374) 2.

<sup>320</sup> Commission Regulations 2671/88, 2672/88 and 2673/88. These regulations were effective until January 1, 1991.

<sup>321</sup> Commission Regulation 2671/88, 1988 O.J. (L 239) 9.

<sup>322</sup> Commission Regulation 2672/88, 1988 O.J. (L 239) 13, subsequently extended by Commission Regulation 83/91, 1991 O.J. (L 10) 9. See also Council Regulation 3976/87, 1987 O.J. (L 374) 9 (giving the Commission power to issue these block exemptions).

<sup>323</sup> Commission Regulation 2673/88, 1988 O.J. (L 239) 17.

<sup>324</sup> Werner F. Ebke & Georg W. Wenglorz, *Liberalizing Scheduled Air Transport Within the European Community: From the First Phase to the Second and Beyond*, 19 DEN. J. INT'L L. & POL'Y 493, 525 (1991). Cabotage restrictions prohibit foreign air-



tic flights and flights to third countries, despite the holding in *Ahmed Saeed* that the competition provisions of the Treaty of Rome are applicable to such operations.<sup>325</sup> The 1990 regulations did not apply to cargo services, for which a separate regulation has been adopted.<sup>326</sup> Neither did they apply to charter services.<sup>327</sup> However, the Third Package of liberalization addressed both charter and scheduled carriers.

While the early "packages" and proposals did much to change the competitive landscape of air transport, the largest impact by far was made by the last package of reforms put into effect by the Council. The First Package, while revolutionary in its approach, did little to practically affect the internal competitiveness of the European air transport market.<sup>328</sup> The Second Package effectively moved forward from this position, yet failed on major grounds to fully implement the desired level of liberalization.<sup>329</sup> In July 1991, the EC Commission proposed a three-part legislative package—the Third Package—designed to remedy these deficiencies and complete air transport liberalization within the EU by January 1, 1993. The Commission submitted it to the Council for approval, and with Council modification, the Third Package went into effect on January 1, 1993.<sup>330</sup>

This section focuses upon the regulatory constructs that currently affect the European air transport market—both EU-based constructs and those from private industry organizations. Particular areas of scope and interest are analyzed separately: pricing and tariffs, pooling of revenue, market access, (including licensing, capacity limits, traffic rights, slot allocation and bilateral agreements) computer reservation systems, ground handling,

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lines from serving domestic markets, or stated differently, providing service between two domestic points within a nation in which it is not registered. DEMPSEY, *supra* note 3, at 78-79, 112, 384.

<sup>325</sup> See Ebke & Wenglorz, *supra* note 324, at 526.

<sup>326</sup> Council Regulation 294/91, 1991 O.J. (L 36) 1; E. GIEMULLA & R. SCHMID, *EUROPEAN AIR LAW*, § 51 (1992).

<sup>327</sup> GIEMULLA & SCHMID, *supra* note 326, §§ 53-54.

<sup>328</sup> See Dennis A. Duchene, *The Third Package of Liberalization in the European Air Transport Sector: Shying Away from Full Liberalization*, 23 *TRANSP. L.J.* 119, 131 (1995) ("Although the First Package was intended to be the first step in a process of liberalization of the air transport industry, the reforms had little overall effect on the development of competition, especially in the area of air fares.").

<sup>329</sup> See *id.* at 137 ("The Second Package of liberalization considerably advanced the EC air transport system towards the goal of a more competitive market in the areas of air fare approval, route and slot access, and capacity growth. However, many obstacles remain[ed] to free competition, especially for new entrants.").

<sup>330</sup> 1992 O.J. (L 241) 1.

cargo services, merger regulations, stateaid, procedure, and the power of the EU to act on the commercial aviation world stage for Member States. Each area of analysis begins with an overview of the general regulatory environment for that area, followed by a detailed chronological delineation of relevant packages, proposals, resolutions, and regulations.

## B. PRICING AND TARIFFS

Country-based tariffs are highly limited under the current scheme of air transport regulation. The “tariff-as-weapon” concept has lost effective support as a greater number of old-line European state-owned/controlled airlines become privatized. As such, in addition to the relaxed regulatory environment, fewer nations have a vested interest in tariff consultations. Granted, such analysis leads one to a question of what came first—privatization or the relaxed regulatory climate? Actually, it was a bit of both. Regardless, tariff consultations between nations are becoming less important as the Third Package grows in maturity and the European air transport market moves towards an alliance structure crossing international boundaries.

### 1. *Directive and Regulations*

#### a. Directive on Scheduled Air Fares

Part of the First Package, the Council’s 1987 Directive on Scheduled Air Fares (Directive 87/601)<sup>331</sup> gave to the aeronautical authorities of Member States the jurisdiction to approve carrier rates.<sup>332</sup> Rates were to be approved if “they [were] reasonably related to the long-term fully allocated costs” of the carrier.<sup>333</sup> They were not be denied on grounds that the proposed rate “[was] lower than that offered by another air carrier operating on the route . . .”<sup>334</sup> Moreover, the Directive established two zones of pricing flexibility—a discount zone, extending from 90% to more than 65% of the referenced fare; and a deep-discount zone, running from 65% to 45% of the referenced fare.<sup>335</sup> Although the conditions attached to these fares

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<sup>331</sup> Council Directive 87/601, 1987 O.J. (L 374) 19.

<sup>332</sup> *Id.* at 14.

<sup>333</sup> *Id.* at 13-14.

<sup>334</sup> *Id.*

<sup>335</sup> *Id.* at 14. The “referenced fare” is the “normal economy air fare charged by a third- or fourth-freedom air carrier on the routes in question . . .” *Id.* at art. 2(c).

were rigid (e.g., advance purchase requirements, minimum and maximum lengths of stay, and age restrictions)<sup>336</sup> within these zones, carriers could set their prices freely without government restrictions.<sup>337</sup>

b. Regulation 2671/88

Following the implementation of the First Package, the Commission took action to assure that tariff consultations remained exempt from the normal operation of Article 85 of the Treaty of Rome. In July 1988, the Commission passed Regulation 2671/88, which addressed multiple aspects of the air transportation industry, including tariffs.<sup>338</sup> Regulation 2671/88 permitted consultations between airlines subject to seven conditions.<sup>339</sup> The first condition was that all such consultations had to be made with the purpose of setting tariffs within the parameters of Directive 87/601.<sup>340</sup> Next, the consultations could not concern tariffs that were not subject to approval by Member States, nor could they connect tariffs with the capacity level offered.<sup>341</sup> The first part of this condition was presumably designed to address American threats to bring antitrust actions against tariff fixing on flights into the US, while the second part seemed to prevent revenue fixing via harmonization of tariffs and capacity. The third condition required that agreed-upon tariffs could not discriminate against passengers based on passengers' nationalities or place of residence within the Community,<sup>342</sup> while the fourth obliged carriers to make such consultations voluntary and open.<sup>343</sup> Following that, it was required that any tariffs reached through such a consultation had to be voluntary.<sup>344</sup> The sixth condition prohibited the consultations from dealing with remuneration for ticketsellers.<sup>345</sup> Finally, the air carriers which participated in a tariff consultation had to notify the appropriate authorities in concerned Member States of any tariffs reached as

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<sup>336</sup> Council Directive 87/601, Annex II, 1987 O.J. (L 374) 17.

<sup>337</sup> *Id.* at 14.

<sup>338</sup> Commission Regulation 2671/88, 1988 O.J. (L 239) 9.

<sup>339</sup> *Id.* at 11.

<sup>340</sup> *Id.*

<sup>341</sup> *Id.*

<sup>342</sup> *Id.*

<sup>343</sup> Commission Regulation 2671/88, art. 4(1)(d), 1988 O.J. (L 239) 11.

<sup>344</sup> *Id.*

<sup>345</sup> *Id.*

part of a consultation arrangement.<sup>346</sup> The Commission set the regulation to expire on January 31, 1991.<sup>347</sup>

c. Regulations 2342/90 and 2343/90

In response to the Commission's proposals of September 1989 for liberalization of tariffs, capacity and market access,<sup>348</sup> in June 1990 the Council adopted new regulations governing scheduled intra-Community air transportation.<sup>349</sup> This primary focus of the Second Package for pricing regulations was simple—extension of liberalized pricing structures to “conditional Fifth Freedom rights under the condition that the Fifth Freedom air fares [fell] within the flexibility zones.”<sup>350</sup> Under the Second Package, regulations fares were still to be approved by the Member States concerned.<sup>351</sup> The EC, however, dealt with more than just pricing concerns. For the first time in history, with respect to tariff regulation, the EC embraced the double disapproval system (i.e., both nations must disapprove the proposed tariffs or they become effective) for tariffs that exceeded the referenced rate by at least five percent (i.e., the proposed rates go into effect unless both governments object), until January 1, 1993, when the double disapproval system was expanded to apply to all rates.<sup>352</sup>

Under the 1990 regulations, Member States had to approve the airfares of EC airlines if they were reasonably related to the carrier's long-term fully allocated costs. The fact that a proposed fare was lower than that offered by other airlines in the market was not a sufficient reason for disapproval.<sup>353</sup> Disagreements between Member States over applicable rates in their markets were to be submitted to arbitration.<sup>354</sup>

A “normal class economy ticket” could be established from 105% to 95% of the reference tariff. The reference fare was the average normal economy airfare on the route in question.<sup>355</sup> The discount zone was narrowed from 94% to 80% (from its

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<sup>346</sup> *Id.*

<sup>347</sup> *Id.* at 12.

<sup>348</sup> See COM(89) 417 final (source with author).

<sup>349</sup> Council Regulation 2342/90, 1990 O.J. (L 217) 1; Council Regulation 2343/90, 1990 O.J. (L 217) 8.

<sup>350</sup> Duchene, *supra* note 328, at 133.

<sup>351</sup> Council Regulation 2342/90 art. 4(1), 1990 O.J. (L 217) 3.

<sup>352</sup> *Id.*

<sup>353</sup> *Id.* at 2.

<sup>354</sup> *Id.* at 4.

<sup>355</sup> *Id.* at 2.

previous 90% to 65%), while the deep-discount zone was expanded from 79% to 30% (from its previous 65% to 45%) of the reference rate. Member States had to approve any rate within the zones.<sup>356</sup> On the whole, this allowed significantly more rate flexibility than was permitted under the First Package.<sup>357</sup> Restrictions, which under the First Package had limited the applicability of the discount zone to Saturday night stayovers and six-night excursions or off-peak travel, were eliminated, although they remained in effect for the deep-discount zone.

d. Regulation 84/91

In 1990, the Commission also promulgated a new regulation (Regulation 84/91) governing passenger and cargo tariff consultation,<sup>358</sup> although it was not to go into effect until the expiration of Regulation 2671/88.<sup>359</sup> Regulation 84/91 provided exemptions so long as, *inter alia*, participation was voluntary and not binding, tariffs were nondiscriminatory, such discussions were for purposes of facilitating interlining, they did not address agent compensation, and each participant informed the Commission.<sup>360</sup> The Commission and the Member States could send observers.<sup>361</sup> A Member State having a legitimate interest in the market could request that the Commission review a tariff outside the aforementioned flexibility zones and whether another State had satisfied its obligations under the Regulations. The Commission could review whether high tariffs were in the best interest of consumers, or whether carriers were "dumping" in order to drive other airlines from the market.<sup>362</sup> The new regulations (2342/90 and 84/91) also allowed airlines to introduce lower fares within the aforementioned zones not only in Third and Fourth Freedom markets, but also in Fifth Freedom markets.<sup>363</sup> Member States could also permit scheduled airlines

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<sup>356</sup> Council Regulation 2342/90, Annex II, 1990 O.J. (L 217) 6.

<sup>357</sup> See EBKE & WENGLORZ, *supra* note 324, at 519.

<sup>358</sup> Commission Regulation 84/91, 1991 O.J. (L 10) 14.

<sup>359</sup> *Id.* at 18.

<sup>360</sup> *Id.* at 16.

<sup>361</sup> *Id.*

<sup>362</sup> Council Regulation 2342/90, arts. 3(3), 5, 1990 O.J. (L 217) 2, 3.

<sup>363</sup> *Id.* at 3. Third Freedom movements involve transit from an airline's nation of registry to another nation. Fourth Freedom involves flights from another country to an airline's nation of registry. Fifth Freedom involves the right to carry traffic between two nations other than its nation of registry, so long as the flight originates or terminates in its own nation of registry. DEMPSEY, *supra* note 3, at 11, 49-50.

to meet the prices offered by competing charter airlines offering equivalent services. This accelerated the blurring of the distinction between the two classes of carriers.<sup>364</sup>

e. Regulation 2409/92

The Council's efforts at achieving a uniform regulation for pricing culminated in Regulation 2409/92, the third regulation of the Third Package.<sup>365</sup> Regulation 2409/92 is broad in scope, applying to all Union carriers and all routes except for those under a public service obligation.<sup>366</sup> However, it is still limited to flights that originate and terminate within the Union.<sup>367</sup> Charter fares and cargo rates are to be based on "free agreement" between the carrier and its clients.<sup>368</sup> Carriers are obligated to make all their fares and cargo rates available upon request.<sup>369</sup> This provision would appear to be designed to avoid the market capacity problems American consumers face when searching for fares.

The more substantive portion of Regulation 2409/92 commences in Article 5. The first paragraph of Article 5 establishes that the Union's default position will be to allow carriers to set prices at will.<sup>370</sup> Member States may (but are not obligated to) require carriers to file tariffs with them for review up to 24 hours before the tariffs are scheduled to go into effect, provided that the filing process is nondiscriminatory.<sup>371</sup> Until April 1, 1997, an exception existed for domestic routes that were served by only one carrier or multiple carriers jointly operating a single route.<sup>372</sup> In such an instance, the Member State concerned could require that tariffs be filed for such routes up to one month before they were scheduled to go into effect;<sup>373</sup> however, this provision has been allowed to lapse.

Despite the Council's seeming endorsement of free-market principles in pricing, the regulation also granted broad powers to the Member States to withdraw fares. Article 6 gives the

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<sup>364</sup> GIEMULLA & SCHMID, *supra* note 326, § 44.

<sup>365</sup> Council Regulation 2409/92, 1992 O.J. (L 240) 15.

<sup>366</sup> *Id.*

<sup>367</sup> *Id.*

<sup>368</sup> *Id.*

<sup>369</sup> *Id.*

<sup>370</sup> Council Regulation 2409/92, art. 5(1), 1992 O.J. (L 240) 15.

<sup>371</sup> *Id.*

<sup>372</sup> *Id.*

<sup>373</sup> *Id.*

Member States two situations in which their power can be exercised. The first is where a fare is so “excessively high” that it results in a “disadvantage [to] users.”<sup>374</sup> A fare is determined to be excessively high by examining the entire fare structure for the route and the “competitive market situation,” along with comparing the fare to the long-term, fully allocated costs of the carrier.<sup>375</sup> A fare might also be withdrawn when it represents part of a “sustained downward development” of fares that is not an ordinary seasonal phenomenon and is resulting in “widespread losses” among the carriers on the route.<sup>376</sup> As with excessively high fares, an excessively low fare is determined by considering the long-term, fully allocated costs of the carrier.<sup>377</sup>

A Member State invoking this power must notify the Commission, other Member States concerned, and the affected carriers to provide an explanation for its actions.<sup>378</sup> Other Member States have 14 days to object to the withdrawal of the fare; if none objects, the fare is automatically withdrawn.<sup>379</sup> Carriers and other parties do not have the right to contest the withdrawal of a fare, although any party with a “legitimate interest” may file a complaint asking the Commission to investigate whether a fare violates Article 6’s provisions.<sup>380</sup> If the Commission determines that a fare violates Article 6, the relevant Member State must withdraw the fare, barring a successful appeal to the Council to reverse the Commission’s decision.<sup>381</sup> The contested fare remains in effect pending the final decision of the Commission or the Council (in the event of an appeal), unless a similar or lower fare on the same route was found to be excessively high within the previous six months.<sup>382</sup> This entire process effectively terminates the double disapproval regime that had previously existed.

Regulation 2409/92 went into effect on January 1, 1993,<sup>383</sup> officially repealing Regulation 2342/90 in the process.<sup>384</sup> Regulation 2409/92 remains the pinnacle of direct tariff regulation, as

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<sup>374</sup> *Id.*

<sup>375</sup> Council Regulation 2409/92, art. 6(1)(a), 1992 O.J. (L 240) 15.

<sup>376</sup> *Id.* at 16.

<sup>377</sup> *Id.*

<sup>378</sup> *Id.*

<sup>379</sup> *Id.*

<sup>380</sup> Council Regulation 2409/92, art. 7(2), 1992 O.J. (L 240) 15, 17.

<sup>381</sup> *Id.* at 17.

<sup>382</sup> *Id.*

<sup>383</sup> *Id.*

<sup>384</sup> *Id.*

it has not been amended since its implementation, nor is there any proposed measure to amend or replace it.<sup>385</sup>

f. Regulation 1617/93

Although the EU's regulatory regime for pricing itself has remained unchanged since the implementation of Regulation 2409/92, the Commission has revisited the subject of tariff consultations several times. In 1993, the Commission adopted Regulation (EEC) 1617/93, which effectively replaced Regulation 84/91.<sup>386</sup> Regulation 1617/93 was substantially similar to Regulation 84/91, but it did have some noticeable changes. The new regulation broadened the exemption for tariff consultations concerning interlining by permitting consultations for the purpose of being able to provide users with a single travel document reflecting all stages of their journey<sup>387</sup> and by making it possible for a user to change their flight to a different air carrier.<sup>388</sup> Regulation 1617/93, however, imposed one notable restriction: when a carrier participates in a tariff consultation, it must individually file with the appropriate authorities of the Member States concerned all tariffs that were not the subject of the consultation.<sup>389</sup> Apparently this provision is intended to deter carriers from publicly consulting each other about a small number of tariffs and then using those consultations as the basis to covertly restructure the remainder of their tariffs. The regulation was scheduled to expire on June 30, 1998.<sup>390</sup>

g. Regulation 1523/96

Regulation 1617/93 has been amended twice since its implementation, first in 1996 and again in 1999. In July 1996, the Commission promulgated Regulation (EC) 1523/96,<sup>391</sup> which made a substantial change to the Union's policy toward tariff consultations. While earlier regulations concerning tariff consultations had governed all types of air carriage, Regulation 1523/96 specifically eliminated the exemption for consultations on cargo tariffs by removing all references to cargo or freight

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<sup>385</sup> As of July 15, 2000.

<sup>386</sup> Commission Regulation 1617/93, 1993 O.J. (L 155) 18.

<sup>387</sup> *Id.* at 20.

<sup>388</sup> *Id.* at 21.

<sup>389</sup> *Id.*

<sup>390</sup> *Id.* at 22.

<sup>391</sup> Commission Regulation 1523/96, 1996 O.J. (L 190) 11.



services from the text of Regulation 1617/93.<sup>392</sup> The Commission explained that the exemption for consultations had been granted to help carriers adjust to the introduction of competition and because it was believed that consultations were necessary for interlining agreements which would lower costs to users.<sup>393</sup> However, enough time had passed that carriers should have acclimated themselves to the more competitive environment.<sup>394</sup> Furthermore, evidence had shown that tariff consultations for the purpose of interlining did not actually result in lower costs.<sup>395</sup> Therefore, the Commission felt that cargo tariff consultations should no longer be protected from evaluation for anti-competitiveness<sup>396</sup> and gave carriers until June 30, 1997 to bring themselves into compliance with the regulation's dictates.<sup>397</sup> The Commission did not offer an explanation as to why consultations on passenger tariffs should be permitted to continue. The 1999 regulation, Regulation (EC) 1083/1999,<sup>398</sup> merely extended the conditions of Regulation 1523/96 to June 30, 2001.<sup>399</sup> At that time, the Commission will reconsider the exemption on passenger tariff consultations.<sup>400</sup>

## 2. ECAC Contributions

Outside the EU proper, ECAC has also contributed to the liberalization of pricing. On a quasi-diplomatic level, despite internal disagreement, ECAC has engaged in a modicum of airfare policy negotiations with the United States. In October 1984, the United States and ECAC signed a Memorandum of Understanding that liberalized regulation of North Atlantic fares. The pact set "zones of reasonableness" for North Atlantic fares through April 30, 1987.<sup>401</sup> A two-year memorandum with even more liberal provisions was signed in February 1987. The agreement established deep-discount fare zones of an average of ten percent,

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<sup>392</sup> *Id.* at 12.

<sup>393</sup> *Id.* at 11.

<sup>394</sup> *Id.*

<sup>395</sup> *Id.*

<sup>396</sup> Commission Regulation 1523/96, pmbl. (7), 1996 O.J. (L 190) 11, 12.

<sup>397</sup> *Id.* at 12.

<sup>398</sup> Commission Regulation 1083/1999, 1999 O.J. (L 131) 27.

<sup>399</sup> *Id.* at 28.

<sup>400</sup> *Id.* at 27.

<sup>401</sup> *U.S. European Carriers Extend Agreement on North Atlantic Fares*, AV. WK. & SPACE TECH., Apr. 8, 1985, at 31.

and allowed such fares to be offered with fewer restrictions.<sup>402</sup> Under this arrangement, airlines enjoyed freedom to set transatlantic fares without government intervention so long as they fell within an agreed-upon percentage above or below a reference price.<sup>403</sup>

Liberalization in the areas of rates and capacity took an important step forward in December 1986, when ECAC concluded two Memoranda of Understanding regarding intra-European scheduled air tariffs and capacity.<sup>404</sup> The former was the first effort by a significant number of European states to embrace a tariff scheme whereby rates falling within a specific range would be automatically approved by the involved governments. The tariff Memorandum of Understanding established a Discount Zone of 90% to 65% and a Deep-Discount Zone of 65% to 45% of the reference price, provided that the passengers using them satisfied certain conditions.<sup>405</sup> The Memorandum of Understanding on capacity sharing allowed either participating nation to provide up to 55% of the market's capacity, as opposed to the previous 50/50 sharing standard. Thus, for the then twenty-two ECAC member nations (which included all EU members at the time), liberalization in the areas of rates and capacity took an important first step forward in December 1986.<sup>406</sup>

### 3. *Commission Investigations*

Interestingly, since the implementation of the Third Package pricing regulation, the Commission has issued no decisions concerning tariff levels or tariff consultations.<sup>407</sup> In 1996, EasyJet, a value carrier operating on the London-Amsterdam route, filed a complaint against KLM, alleging predatory pricing.<sup>408</sup> The Commission spent over a year investigating the allegations, by

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<sup>402</sup> ECAC, *U.S. Renew North Atlantic Pact*, AV. WK. & SPACE TECH., Feb. 23, 1987, at 32. The agreement was effective for a two-year period, beginning April 1, 1987. The following 16 ECAC Member States are affected by it: Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom and Yugoslavia.

<sup>403</sup> U.S., *ECAC Sign Atlantic Fare Pact*, AV. WK. & SPACE TECH., Oct. 22, 1984, at 33.

<sup>404</sup> ECAC *Approves Liberalizing Fare, Capacity Regulations*, AV. WK. & SPACE TECH., Jan. 12, 1987, at 36.

<sup>405</sup> *Id.*

<sup>406</sup> *Id.*

<sup>407</sup> Lois Jones, *When the Going Gets Tough*, AIRLINE BUS., May 1998, at 26.

<sup>408</sup> John Dodgson & Jose Jorge, *Law of the Jungle?*, AIRLINE BUS., May 1997, at 70, 72-73.

the end of which EasyJet had withdrawn its complaint.<sup>409</sup> Another value carrier, World Airlines, filed a pricing complaint in 1996 against Air UK.<sup>410</sup> But World Airlines went bankrupt before the Commission could take action on its complaint.<sup>411</sup> Finally, VLM, a Flemish regional carrier, filed a pricing complaint against Cityflyer Express in 1996,<sup>412</sup> but it apparently also withdrew its complaint. Virgin Express has publicly expressed concern over the pricing policies of SAS, but it has not formally filed a complaint.<sup>413</sup> EU Competition Commissioner Karel Van Miert said in 1998, "[Predatory pricing] is a real problem but a very difficult problem to tackle. But if there is a good case then we eventually will rule on it."<sup>414</sup>

### C. POOLING OF REVENUE

Revenue pooling is a much smaller concern of the European Union now that full-scale liberalization of prices and cabotage has occurred. The EU last directly addressed revenue pooling as part of Regulation 2671/88, granting block exemptions for airline agreements from Article 85 regulations.<sup>415</sup> In order to avail themselves of the block exemption for revenue pooling, the economic transfer must go to the carrier offering the less favorable schedule (service at less busy times of day and less busy periods of the travel season), and must be determined prior to the offering of the service, on the basis of the schedule of the pool participants.<sup>416</sup> The regulation imposes a one-percent ceiling on the transfer of revenue (exclusive of shared costs).<sup>417</sup> Moreover, each carrier is guaranteed flexibility as to capacity offered.<sup>418</sup> Since the implementation of Regulation 2671/88, the Council and Commission have left the subject of revenue pooling undisturbed, either through further regulations or decisions.

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<sup>409</sup> Jones, *supra* note 407, at 31.

<sup>410</sup> Lois Jones, *96 at a Glance*, AIRLINE BUS., Mar. 1997, at 30 [hereinafter *96 AT A GLANCE*].

<sup>411</sup> Dodgson & Jorge, *supra* note 408, at 72.

<sup>412</sup> *96 AT A GLANCE*, *supra* note 410, at 30.

<sup>413</sup> Jackie Gallacher et al., *Holding the Pieces Together*, AIRLINE BUS., Jan. 1998, at 28.

<sup>414</sup> Jones, *supra* note 407, at 31.

<sup>415</sup> *Id.*

<sup>416</sup> *Id.*

<sup>417</sup> *Id.*

<sup>418</sup> *Id.*

## D. MARKET ACCESS

A keystone element of liberalization, market access provisions have been a primary focus of the Council and Commission for many years. Historically, market access was predicated on bilateral agreements ("bilaterals") between individual states<sup>419</sup> (i.e., nations would independently negotiate terms of market access for each other's air carriers).<sup>420</sup> But bilaterals go against one of the central purposes of the EC/EU: establishing uniform laws and regulations among Member States to advance commerce, including transportation.<sup>421</sup> Thus, the Council and Commission have worked to establish a body of regulations governing intra-Union market access<sup>422</sup> and have increasingly sought to replace the bilaterals that exist between Member States and non-members with EU-negotiated multilateral agreements.<sup>423</sup> The EC/EU's internal efforts at improving market access have been primarily directed at four areas: standardizing licensing of air carriers, eliminating capacity limits on routes, making full cabotage available, and regularizing slot allocation.

1. *Licensing of Air Carriers*

Processes for licensing for air carriers had been left undisturbed by the first two Packages, presumably because the Council was hesitant to touch a subject so closely bound to cherished notions of national identity. However, as part of the Second Package the Council ordered itself to adopt for implementation no later than July 1, 1992, a regulation governing the licensing of air carriers within the Community.<sup>424</sup> Although it missed its self-imposed deadline by six months, the Council did ultimately pass a regulation concerning the licensing of Community air carriers as part of the Third Package.<sup>425</sup> The Council may be forgiven for its tardiness, however, for its Regulation 2407/92 was of grand scope.

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<sup>419</sup> *EEC Transport Ministers Expected to Approve Compromise Liberalization*, AV. WK. & SPACE TECH., Oct. 20, 1986, at 45.

<sup>420</sup> Daniel C. Hedlund, *Toward Open Skies: Liberalizing Trade In International Airline Services*, 3 MINN. J. GLOBAL TRADE 259, 267-69 (1994).

<sup>421</sup> *Id.* at 288.

<sup>422</sup> Council Regulation 2408/92, pmbl., 1992 O.J. (L 240) 8, 9.

<sup>423</sup> Chris Thornton & Chris Lyle, *Freedom's Paths*, AIRLINE BUS., Mar. 2000, at 74.

<sup>424</sup> Council Regulation 2343/90, art. 3(2), 1990 O.J. (L 217) 8, 10.

<sup>425</sup> Council Regulation 2407/92, 1992 O.J. (L 240) 1.

## a. Regulation 2407/92

The regulation begins by stipulating that it does not cover the carriage of passengers, mail, or cargo by “non-power-driven” or ultra-light aircraft, nor does it cover flights take take-off from and land at a single airport.<sup>426</sup> These types of aviation will remain subject to relevant national laws.<sup>427</sup> Therefore, all commercial aviation (other than certain types of sightseeing flights) is placed under the EU’s jurisdiction. The regulation proceeds to establish that an air carrier meeting the requirements that follow is “entitled” to be granted an operating license, but licensing does not itself give an air carrier rights to specific routes or markets.<sup>428</sup> A Member State may confer an operating license when the undertaking applying has its principal place of business located in that Member State and its primary purpose is to conduct air transportation.<sup>429</sup> The air carrier must also be majority owned by Member States or their nationals, unless there is a preexisting agreement between a Member State and a non-EU member concerning ownership requirements.<sup>430</sup> A further exception to the general rule concerning the ownership requirement is that certain airlines are recognized as being grandfathered out of it,<sup>431</sup> although if their ownership shifts to another non-EU state or national, they will then become subject to the general rule.<sup>432</sup> Air carriers must be able to show on demand by a Member State that they are in compliance with the ownership requirements.<sup>433</sup>

The regulation also imposes a number of financial obligations on an air carrier seeking a license. The carrier must show that it can meet “at any time” its “actual and potential obligations” and both its fixed and operational costs, premised on realistic assumptions, for three months from its start of operations without any income from its operations.<sup>434</sup> To establish that it meets the previous requirements, the carrier has to provide a business plan for its first two years of operation to the appropriate licens-

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<sup>426</sup> *Id.* at 2.

<sup>427</sup> *Id.*

<sup>428</sup> *Id.*

<sup>429</sup> *Id.*

<sup>430</sup> Council Regulation 2407/92, art. 4(2), 1992 O.J. (L 240) 1, 2.

<sup>431</sup> *Id.* at 2. The excepted airlines are Scandinavian Airlines System, Britannia Airways, and Monarch Airlines.

<sup>432</sup> *Id.*

<sup>433</sup> *Id.* at 3.

<sup>434</sup> *Id.*

ing authority in the relevant Member State.<sup>435</sup> The carrier must give advance notice of any changes in its operations to the licensing authority, along with notice of planned mergers or acquisitions, or any change in ownership of a block of shares that represents ten percent or more of the company's total shareholding.<sup>436</sup> If the licensing authority decides that the above sort of activities have "a significant bearing on the finances" of the carrier, it can require that the carrier provide a new business plan covering at least the following twelve months.<sup>437</sup> Furthermore, if a licensing authority determines that "financial problems" exist with a carrier under license by it, the authority may examine the carrier's financial situation and suspend or revoke its license if it decides that the carrier cannot meet its actual and potential obligations for the next twelve months.<sup>438</sup> All air carriers must provide financial statements for each fiscal year to their licensing authorities and must also be able to provide such statements on demand by the licensing authorities.<sup>439</sup> Additionally, all air carriers must carry liability insurance.<sup>440</sup>

At their own discretion, Member States may require proof that the managers of the air carrier seeking a license are people of "good repute."<sup>441</sup> The managers may also be required to show that they have not declared bankruptcy, nor have they had a previous operating license suspended or revoked for "serious professional misconduct" or a criminal offense.<sup>442</sup>

An air carrier seeking a license need not own any aircraft, but it must have at least one aircraft under lease.<sup>443</sup> Other than in exceptional circumstances, all aircraft operated by a carrier must be registered in a Member State.<sup>444</sup> If a carrier wishes to register in one Member State an aircraft that was previously reg-

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<sup>435</sup> Council Regulation 2407/92, art. 5(2), 1992 O.J. (L 240) 1, 3.

<sup>436</sup> *Id.* at 3.

<sup>437</sup> *Id.*

<sup>438</sup> *Id.* However, none of these aforementioned provisions apply to air carriers that exclusively operate light aircraft, provided that they do not operate scheduled services or have a turnover greater than three million Euros per year. *Id.*

<sup>439</sup> *Id.*

<sup>440</sup> Council Regulation 2407/92, art. 7, 1992 O.J. (L 240) 1, 4.

<sup>441</sup> *Id.* at 7.

<sup>442</sup> *Id.* Proof of qualification can be made with appropriate official documents from the Member State or the manager's home Member State (if different from the Member State issuing the license), or may be made by swearing an oath or declaration before a competent notary, judge, or an equivalent administrative official. *Id.*

<sup>443</sup> *Id.*

<sup>444</sup> *Id.*

istered in another Member State, the State that will receive the new registration cannot apply any discriminatory fee to the registration and must process the registration without delay.<sup>445</sup> Interestingly, the regulation specifically prohibits only discriminatory fees and delays on the transfer of registration of aircraft within the Community. This would suggest that it is acceptable for a Member State to apply additional fees and to refuse to promptly handle transfers of registrations for aircraft belonging to non-Community carriers, perhaps indicating a protectionist impulse on the part of the Council.

The regulation also grants Member States broad powers to intervene in the operations of carriers after they have been licensed. Any carrier that wishes to lease an aircraft from or to another carrier must receive prior approval from the appropriate licensing authorities.<sup>446</sup> Member States may review a carrier's operating license one year after it is granted and every five years thereafter or if a carrier has ceased operations for six months.<sup>447</sup> If there is a change in "one or more elements affecting the legal situation" of a carrier, then the Member States that license it may, at their discretion, require the carrier to reapply for an operating license.<sup>448</sup> Furthermore, a carrier that applies for bankruptcy shall be stripped of its license if the appropriate licensing authorities believe that there is not a realistic possibility of the carrier recovering within a reasonable time.<sup>449</sup>

The remainder of the regulation is primarily procedural in nature. It requires that the Member States' processes for granting licenses be made public.<sup>450</sup> Member States must render decisions on whether to grant a license within three months of the carrier's application for one and, if the application has been refused, the Member State must provide an explanation for the refusal.<sup>451</sup> A carrier may appeal a license rejection to the Commission.<sup>452</sup> Failure by a licensed carrier to comply with the requirements of the regulation can result in its market-access rights being suspended until it brings itself into compliance.<sup>453</sup>

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<sup>445</sup> Council Regulation 2407/92, art. 8(4), 1992 O.J. (L 240) 1, 7.

<sup>446</sup> *Id.*

<sup>447</sup> *Id.* at 8.

<sup>448</sup> *Id.*

<sup>449</sup> *Id.*

<sup>450</sup> Council Regulation 2407/92, art. 13(1), 1992 O.J. (L 240) 1, 8.

<sup>451</sup> *Id.*

<sup>452</sup> *Id.*

<sup>453</sup> *Id.*

Finally, carriers that were already licensed at the time the regulation entered into effect had one year to bring themselves into compliance with the terms of the regulation unless otherwise provided for.<sup>454</sup>

b. The Savena Decision

Although licensing might appear to be a potentially contentious issue, most of the Commission's work on the subject has been without particular rancor. An exemplary decision concerned the ownership restructuring of the Belgian national air carrier Sabena.<sup>455</sup> In May 1995, the Belgian government notified the Commission of an agreement it had reached earlier that month to sell Swissair a considerable minority share in Sabena.<sup>456</sup> While Switzerland was a member of the European Free Trade Area, it was not a Union member, so Swissair was treated as a non-Union carrier, necessitating the review.<sup>457</sup> At the time the agreement was reached, the Belgian government or its national holding company owned a 61.6% share in Sabena, 37.49% was owned by a subsidiary of Air France, and the residual 0.9% was owned by other Belgian nationals (primarily institutional investors and Sabena employees).<sup>458</sup> The agreement gave Swissair a 49.5% share of Sabena by transferring all of Air France's shares to Swissair and by increasing Sabena's capitalization, with Swissair being given the opportunity to purchase the new issue first.<sup>459</sup> Swissair was also sold a block of "special participation certificates," which appear to be similar to preferred shares, in that they did not confer voting rights on the holders.<sup>460</sup>

Before the Commission began its analysis of the agreement, it laid out what it considered the four key elements of Regulation 2407/92: (i) the carrier's principal place of business must be located in the licensing Member State,<sup>461</sup> (ii) the carrier's main occupation has to be air transport or air transport in conjunc-

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<sup>454</sup> *Id.*

<sup>455</sup> Commission Decision 95/404/EC, 1995 O.J. (L 239) 19.

<sup>456</sup> *Id.* The Belgian government also submitted an addendum a month later, but the Commission treated the two documents as one for the purpose of its analysis.

<sup>457</sup> *Id.* at 23.

<sup>458</sup> *Id.* at 20.

<sup>459</sup> *Id.*

<sup>460</sup> Commission Decision 95/404/EC, 1995 O.J. (L 239) 19, 23.

<sup>461</sup> *Id.*



tion with some other aspect of aviation (maintenance, repair, etc.),<sup>462</sup> (iii)) the carrier must be majority owned by Member States and/or nationals of Member States,<sup>463</sup> and (iv) the carrier is required to be at all times "effectively controlled" by Member States and/or their nationals.<sup>464</sup>

The Commission first noted that the agreement would leave Sabena's headquarters in Belgium and Sabena's primary business would remain air transportation; so the agreement was in compliance with the first two elements of the regulation.<sup>465</sup> With respect to the third element, majority ownership, the Commission stated that it is satisfied if Member States or their nationals own even just 50% plus one share of the carrier's capital.<sup>466</sup> The Commission defined capital for these purposes as equity capital, (i.e., it confers voting rights on the holders and entitles the holders to dividends and a share of the corporation's assets if it is liquidated).<sup>467</sup> The issue of how capital is defined was relevant because of the "special participation certificates," which, if considered part of Sabena's capital, would have conferred a majority share to Swissair, thereby preventing Sabena from receiving a license as a Union carrier. However, since the certificates did not carry voting rights, Swissair would remain a minority shareholder under the Commission's definition.<sup>468</sup> Finally, while the agreement also contained a provision awarding Swissair warrants for the future purchase of additional Sabena shares, the agreement prohibited the warrants from being exercised without a change in EU regulation to permit majority ownership by non-EU states or nationals.<sup>469</sup> Thus, the Commission decided that the agreement was in compliance with the third element of Regulation 2407/92 as well.<sup>470</sup>

Finally, the Commission addressed the element of "effective control." The Commission stated that "effective control" means that Member States or their nationals must, either individually or jointly with other Member States or their nationals, have the "ultimate decision-making power" in the carrier's manage-

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<sup>462</sup> *Id.*

<sup>463</sup> *Id.*

<sup>464</sup> *Id.*

<sup>465</sup> Commission Decision 95/404/EC, VIII, 1995 O.J. (L 239) 19, 23.

<sup>466</sup> *Id.* at 24.

<sup>467</sup> *Id.*

<sup>468</sup> *Id.*

<sup>469</sup> *Id.* at 25.

<sup>470</sup> Commission Decision 95/404/EC, 1995 O.J. (L 239) 19, 25.

ment.<sup>471</sup> This means that they must be able to, directly or indirectly, make final determinations about the carrier's business plan, annual budget, or any major investments or cooperation projects.<sup>472</sup> However, the Commission claimed that there was no *per se* rule that could govern a determination about whether "effective control" exists; thus, each instance must be analyzed on the basis of its own merits.<sup>473</sup> In the case of the Sabena/Swissair agreement, the Commission noted that the structure of the company's board of directors, combined with Belgian majority ownership of voting shares, was such that the Belgian owners would retain the ability to effectively veto any unilateral action by Swissair.<sup>474</sup> Concluding its analysis of the effective control requirement, the Commission stated that, "Article 4(2) [of Regulation 2407/92] is not designed to prevent Community air carriers from cooperating with carriers from third countries . . . The provision must not be read as prohibiting a Community carrier from limiting its commercial freedom in the context of such long-term strategic cooperation."<sup>475</sup> The Commission concluded that the Sabena/Swissair agreement would not result in Sabena forfeiting its EU carrier status.<sup>476</sup>

## 2. *Capacity Limits*

Capacity issues were initially addressed under the Council's First Package, in its 1987 *Decision on Capacity Sharing and Market Access*.<sup>477</sup> Under this proposal, the traditional 50-50% split of capacity between European carriers was abandoned in favor of an immediate 55-45% rule (from January 1, 1988, to September 30, 1989), and then a 60-40% split (after October 1, 1989).<sup>478</sup> However, the Decision included an escape clause, enabling any Member State to petition the Commission to postpone or cancel the 60-40% rule on grounds that its flag carriers had suffered "serious financial damage."<sup>479</sup> The Decision also established

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<sup>471</sup> *Id.*

<sup>472</sup> *Id.*

<sup>473</sup> *Id.*

<sup>474</sup> *Id.* at 25-26. Swissair was also given veto powers but only in regards to amending Sabena's articles of incorporation, its capitalization, or whether to liquidate, merge, or split up the company. The Commission considered this to be ordinary protections for a minority shareholder.

<sup>475</sup> Commission Decision 95/404/EC, XII, art. 1, 1995 O.J. (L 239) 19, 27.

<sup>476</sup> *Id.* at 28.

<sup>477</sup> Council Decision 87/602, 1987 O.J. (L 374) 19.

<sup>478</sup> *Id.* at 21.

<sup>479</sup> *Id.*

new entry opportunities of multiple designation over routes having more than 250,000 passengers, with this threshold of passengers being reduced in the second and third year to 200,000 (or 1,200 return flights), and 180,000 (or 1,000 return flights), respectively.<sup>480</sup> Significant new opportunities for entry were created between hub and regional airports,<sup>481</sup> and for Fifth Freedom rights.

Under the Commission's airline-agreement block-exemption (from Article 85) regulations, capacity-limitation agreements between airlines had to have as their objective a satisfactory spread of regular and reliable service over less busy periods as opposed to anticompetitive market segmentation. Under the block exemption, airlines were also free to withdraw without penalty from such arrangements on short notice.<sup>482</sup>

Via the Second Package, in 1990, the Commission adopted another set of exemptions for the planning and coordination of capacity.<sup>483</sup> In order to qualify, any capacity agreements had to refrain from binding the carriers to the results, had to have as their purpose relief of airport congestion, and could not be designed to limit capacity.<sup>484</sup> The agreements also could not have the effect of preventing carriers from changing their allocated capacities and schedules,<sup>485</sup> nor could they be designed to influence the capacity or scheduling of a nonparticipating carrier.<sup>486</sup>

In conjunction with the revised Article 85 exemptions, the Council promulgated a new regulation governing capacity allocation, Council Regulation 2343/90.<sup>487</sup> The terms of the regulation only applied to scheduled air carriers<sup>488</sup> and Member States were left free to impose other restrictions on domestically licensed air carriers.<sup>489</sup> Member States were obliged to allow other Community airlines the use of Third and Fourth Freedom routes on a reciprocal basis.<sup>490</sup> With the approval of any other EC/EU nation concerned and the Commission, however, a Member State was allowed to impose capacity limitations on

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<sup>480</sup> *Id.* at 22.

<sup>481</sup> *Id.*

<sup>482</sup> ARGYRIS, *supra* note 62, at 24-25.

<sup>483</sup> Commission Regulation 84/91, 1990 O.J. (L 10) 14.

<sup>484</sup> *Id.* at 15.

<sup>485</sup> *Id.*

<sup>486</sup> *Id.*

<sup>487</sup> Council Regulation 2343/90, 1990 O.J. (L 217) 1, 8.

<sup>488</sup> *Id.* at 10.

<sup>489</sup> *Id.*

<sup>490</sup> *Id.*

routes that it had declared to be under a "public service obligation," provided that the route has 30,000 or fewer seats allocated to it already.<sup>491</sup> The 1990 regulations allowed multiple carrier designation on dense routes, defined as more than 140,000 (previously 180,000) passengers, or more than 800 (previously 1,000) round-trip flights during the preceding year.<sup>492</sup> On January 1, 1992, these thresholds were lowered to only 100,000 passengers or 600 round trip flights.<sup>493</sup> The 1990 regulations also permitted airlines to dedicate up to 50% of their seating capacity to Fifth Freedom routes (up from 30% allowed under Phase One).<sup>494</sup> The Member States were permitted to regulate, "without discrimination on grounds of nationality," the division of flights between the constituent airports of an airport system<sup>495</sup> (i.e., multiple airports that serve the same metropolitan area).

As to capacity limitations, the 60-40% ratio approved under the First Package (after October 1989) was extended beginning November 1, 1990, by 7.5%.<sup>496</sup> Thus, as of November 1, 1990, the capacity of a Member State's airlines could reach as high as 67.5%,<sup>497</sup> and the regulation specifically called for the Council to abolish capacity limitations by January 1, 1993.<sup>498</sup> But the Commission reserved the right to limit capacity growth for "a limited period" if it caused "serious financial damage" to an airline.<sup>499</sup> Member States were also granted the power to manipulate capacity limitations for the purpose of shielding certain new routes from competition.<sup>500</sup> This power is granted where a Member State has approved a new route for a carrier that will operate between regional airports using aircraft with 80 seats or less.<sup>501</sup> The Member State may prevent other carriers from operating on the route for up to two years unless they agree to limit their service to no more than 80 seats per flight (either by using aircraft with 80 seats or less, or by selling no more than 80 seats on a larger aircraft) between the two regional airports.<sup>502</sup>

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<sup>491</sup> *Id.* at 10-11.

<sup>492</sup> Council Regulation 2343, art. 6(2), 1990 O.J. (L 217) 1, 11.

<sup>493</sup> *Id.*

<sup>494</sup> *Id.* at 12.

<sup>495</sup> *Id.*

<sup>496</sup> *Id.*

<sup>497</sup> Council Regulation 2343/90, art. 11(1), 1990 O.J. (L 217) 8, 12.

<sup>498</sup> *Id.* at 12-13.

<sup>499</sup> *Id.* at 13.

<sup>500</sup> *Id.* at 11.

<sup>501</sup> *Id.*

<sup>502</sup> Council Regulation 2343/90, art. 5(4), 1990 O.J. (L 217) 8, 11.

### 3. *Traffic Rights*

The Third Package is broad in its scope and effect on the issue of traffic rights, its primary focus. On June 22, 1992, the Council adopted this third phase of regulations for scheduled and charter airlines.<sup>503</sup> The Third Package consists of three separate regulations, two of which directly address traffic rights: 1) licensing of Community air carriers (discussed above),<sup>504</sup> and 2) access to intra-Community routes for licensed Community air carriers.<sup>505</sup>

Key to understanding the current air transport market, and in turn, the EU's broader goal of full liberalization, is understanding the concept of Fifth Freedom rights. As defined by the Chicago Aviation Convention of 1944, a Fifth Freedom right is:

The right to transport passengers, cargo and mail between two other States as a continuation of, or a preliminary to, the operation of the 3rd or 4th freedom . . . .

3rd Freedom: The right to transport passengers, cargo and mail from the State of registration of the aircraft to another contracting State, and to set them down there.

4th Freedom: The right to take on board passengers, cargo and mail in another contracting State, and to transport them to the State of registration of the aircraft.<sup>506</sup>

The attainment of Fifth Freedom rights is the backbone of a competitive European air transport market. Prior to liberalization, full Fifth Freedom rights were the exception, rather than the norm, in the European air transport market. With Fifth Freedom rights come the practical ability to compete in a variety of national markets, an ability that in and of itself fosters competition. Around the concept of Fifth Freedom rights, the EU proceeded to build a superstructure of liberalization.

#### a. Regulation 2408/92

Regulation 2408/92 was designed to specifically address the issue of access to intra-Community routes for Community air carriers, particularly Fifth Freedom routes.<sup>507</sup> Unlike prior regulations, which had applied only to scheduled carriers, Regula-

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<sup>503</sup> See Carol A. Shiffrin, *EC Ministers Approve Liberalization, But 'Safeguards' May Slow Competition*, AV. WK. & SPACE TECH., June 29, 1992, at 21.

<sup>504</sup> Council Regulation 2407/92, 1992 O.J. (L 240) 1.

<sup>505</sup> Council Regulation 2408/92, 1992 O.J. (L 240) 8.

<sup>506</sup> GIEMULLA & SCHMID, *supra* note 326, at 5.

<sup>507</sup> Council Regulation 2408/92, pmbl., 1992 O.J. (L 240) 1, 8.

tion 2408/92 was directed at both scheduled and chartered carriers.<sup>508</sup> The central premise of the regulation is expressed in the first paragraph of Article 3, which reads, "Subject to this Regulation, Community air carriers shall be permitted by the Member State(s) concerned to exercise traffic rights on routes within the Community."<sup>509</sup> Thus, the Council established that the EC/EU's default position on internal air traffic would be to permit air carriers to exercise traffic routes.

Article 10(1) of Regulation 2408/92 abolished capacity limitations, with four notable exceptions.<sup>510</sup> The first exception, found in Article 6(1), was not noted in Article 10(1); but for Article 6(1) to have meaning, it must be considered an exception to Article 10(1)'s elimination of capacity restrictions. Article 6(1) is effectively a modification of the new route protection clause found in Regulation 2343/90, in that Member States may limit capacity on new routes between regional airports to 80 seats per flight for two years.<sup>511</sup> However, the regulation further circumscribes the application of this provision by limiting its applicability to routes with a capacity of 30,000 seats or less per year.<sup>512</sup> The second exception is found in Article 8(1), which states that the regulation does not affect the right of a Member State to control the distribution of traffic among the component parts of an airport system, provided it is done in a nondiscriminatory manner.<sup>513</sup> The regulation does not state what the relationship between traffic distribution and capacity limits are, but it can be inferred. Since many airports are incapable of handling all sizes of aircraft, the selection of which airport a carrier is permitted to use may effectively limit the maximum number of seats it can offer per flight. Article 9(1) provides the third exception, in that it permits Member States to "impose conditions on, limit or refuse" traffic rights because of serious environmental problems or congestion.<sup>514</sup> These conditions or limitations, however, must be nondiscriminatory (on the basis of nationality or identity of carriers), must not "unduly" affect competition among carriers, must not be more stringent than is required to alleviate the problem, and must not be imposed for a

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<sup>508</sup> *Id.* at 9.

<sup>509</sup> *Id.* at 10.

<sup>510</sup> *Id.* at 13.

<sup>511</sup> *Id.* at 11.

<sup>512</sup> Council Regulation 2408/92, art. 6(1), 1992 O.J. (L 240) 1, 11.

<sup>513</sup> *Id.*

<sup>514</sup> *Id.* at 12.

period of more than three years.<sup>515</sup> The Member State seeking to impose the conditions must notify other Member States and the Commission of its decision and provide a justification for its actions.<sup>516</sup> Finally, the fourth exception mirrors another provision of the earlier regulation. Article 10(2) permits the Commission to, after conducting a review of the circumstances, limit capacity in situations where a Community air carrier has suffered "serious financial damage."<sup>517</sup>

#### b. The Viva Air Decision

Regulation 2408/92 had been in effect for less than a month when the first traffic rights case came before the Commission.<sup>518</sup> On January 25, 1993, Viva Air, a value carrier based in Spain requested that the Commission investigate the decision of the French aviation authorities to deny it access to the Madrid-Paris (Charles De Gaulle) route.<sup>519</sup> Viva Air submitted an application to the French air authorities on October 28, 1992, asking to be granted traffic rights and slots to begin on January 2, 1993.<sup>520</sup> This application was followed by two messages from Spanish aviation authorities and another from Viva Air, none of which were acknowledged by the French authorities.<sup>521</sup> Finally, on December 18, following a third letter from Viva Air, the French authorities replied, denying Viva Air access on the grounds that it had not complied with a French regulation specifically governing the application process for non-French carriers.<sup>522</sup> Viva Air responded that Community regulations superseded such national regulations.<sup>523</sup> This led the French authorities to clarify their position by offering traffic rights to Paris (Orly) instead, based on Article 8(1) of Regulation 2408/92 which permits regulation of traffic distribution within an airport system.<sup>524</sup> Furthermore, the French authorities explained that they considered Viva Air to be a subdivision of Iberia, which already was operating on the Madrid-Paris (Orly) route, and duplication of routes was not

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<sup>515</sup> *Id.*

<sup>516</sup> *Id.*

<sup>517</sup> Council Regulation 2408/92, art. 10(2), 1992 O.J. (L 240) 1, 13.

<sup>518</sup> Commission Decision 93/347/EEC, 1993 O.J. (L 140) 51.

<sup>519</sup> *Id.* at 51.

<sup>520</sup> *Id.*

<sup>521</sup> *Id.*

<sup>522</sup> *Id.*

<sup>523</sup> Commission Decision 93/347/EEC, I(I), 1993 O.J. (L 140) 51, 51-52.

<sup>524</sup> *Id.* at 52.

permissible.<sup>525</sup> Following this response, Viva Air filed its complaint with the Commission.

In its complaint, Viva Air identified three principal areas for consideration by the Commission: (i) the conditions of the authorization procedure, (ii) the implementation of the traffic distribution rules under Article 8(1), and (iii) Viva Air's status as an independent carrier.<sup>526</sup> With respect to the first area, the Commission said that the "general principle [is] freedom of access for all Community air carriers to all intra-Community routes."<sup>527</sup> Member States still have the right to impose authorization procedures in conjunction with the conditions laid out in Article 3(2), 3(4) and/or Articles 4 through 10; although if none of those restrictions apply then traffic rights should be automatically granted.<sup>528</sup> However, even where the above restrictions apply, the authorization procedures "must be kept to the minimum necessary" and the Member State must respond to an application within a standard deadline.<sup>529</sup> Furthermore, "the right to exercise the freedom is now the rule and refusal the exception," so where a Member State does not reply by the mandated deadline, authorization of traffic rights is assumed.<sup>530</sup> Any refusal of traffic rights should clearly explain why the rights are being denied and what remedies are available to the carrier.<sup>531</sup>

Yet the Commission hastened to point out that this preference for granting traffic rights does not mean that carriers can rely on being able to immediately implement service. The process of slot allocation is considered to be separate from traffic rights, as reflected by it being governed by a different regulation.<sup>532</sup> Therefore, a carrier may receive traffic rights but not receive slots, or receive slots but not receive traffic rights.<sup>533</sup> Nevertheless, Member States may not deny traffic rights to a carrier merely because it lacks sufficient slots.<sup>534</sup>

Finally, in regard to authorization procedures, the Commission took the French authorities to task over the applicability of its traffic rights regulation. The Commission stated that Mem-

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<sup>525</sup> *Id.*

<sup>526</sup> *Id.* at 52-53.

<sup>527</sup> *Id.* at 54.

<sup>528</sup> Commission Decision 93/347/EEC, II(VI), 1993 O.J. (L 140) 51, 54-55.

<sup>529</sup> *Id.* at 55.

<sup>530</sup> *Id.*

<sup>531</sup> *Id.*

<sup>532</sup> *Id.* See next section for further analysis of Regulation 95/93.

<sup>533</sup> Commission Decision 93/347/EEC, II(VI), 1993 O.J. (L 140) 51, 55.

<sup>534</sup> *Id.*



ber States could not have different authorization procedures for domestic carriers than for carriers from other Member States.<sup>535</sup>

Next, the Commission examined the Paris traffic distribution rules in the light of Article 8(1) of Regulation 2408/92. The Commission admitted that Article 8(1) could produce restrictions on access to routes; so it is necessary to consider whether such restrictions are discriminatory or arbitrary.<sup>536</sup> The burden of proof is on the Member State under review to justify any restrictions that result from its traffic distribution rules.<sup>537</sup> Traffic distribution rules must be transparent and cannot have the effect of targeting individual carriers. Additionally, to be enforceable, any such rules must be published so carriers may have the opportunity to read them and make plans accordingly.<sup>538</sup> The traffic distribution rules for Paris were not published, so the Commission ruled they were inapplicable.<sup>539</sup>

Despite having determined that the traffic distribution rules for Paris were *per se* inapplicable because they were unpublished, the Commission still addressed the remainder of France's argument on the subject. French aviation authorities claimed that they had a rule that did not permit air carriers to run services on the same medium-haul international route from both Paris (Orly) and Paris (Charles De Gaulle).<sup>540</sup> As the French authorities considered Viva Air to be part of Iberia, which already operated on the Paris (Orly)-Madrid route, it would have contravened this rule to permit Viva Air to fly from Paris (Charles De Gaulle). The Commission viewed this argument with a strong degree of skepticism, stating, "[we] cannot accept at face value the explanations provided by the French authorities."<sup>541</sup> There was no clear rationale for why only medium-haul international routes should be subject to such a rule when, applying the French authorities' own criteria, there were other categories of routes which might justifiably be more subject to the rule.<sup>542</sup> Moreover, the Commission observed that Euralair, a subsidiary of Air France, was allowed to operate a Paris (Orly)-

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<sup>535</sup> *Id.*

<sup>536</sup> *Id.*

<sup>537</sup> *Id.*

<sup>538</sup> Commission Decision 93/347/EEC, II(VII), 1993 O.J. (L 140) 51, 56.

<sup>539</sup> *Id.* The Commission also noted that French law prohibits the enforcement of unpublished regulations, so the French aviation authorities violated national law as well as Community law.

<sup>540</sup> *Id.* at 56.

<sup>541</sup> *Id.*

<sup>542</sup> *Id.*

Madrid route while Air France was operating a Paris (Charles De Gaulle)-Madrid route, which clearly violated the supposed traffic distribution rule.<sup>543</sup> Thus, while this discussion was not essential to its decision, the Commission clearly established that it would take a sharply critical view of traffic distribution rules that appear capricious.

While the Commission had found by this point that Viva Air was wrongfully denied traffic rights for the Madrid-Paris (Charles De Gaulle) route, it chose to continue its analysis and address the final issue, whether Viva Air was part of Iberia. The Commission concluded that Viva Air should be considered a separate carrier from Iberia, noting that Article 2(b) of Regulation 2408/92 only defines a Community carrier as one that holds a valid operating license issued by a Member State, and imposes no other restrictions.<sup>544</sup> Viva Air held an operating license in its name and, furthermore, it had a separate staff, "commercial image," and air fleet.<sup>545</sup> Thus, the Commission determined that the French aviation authorities were obliged to withdraw their refusal of Viva Air's application.<sup>546</sup>

#### 4. Slot Allocation

##### a. Regulation 84/91

The Commission promulgated a new set of regulations in 1990 addressing slot allocation and airport scheduling.<sup>547</sup> The exemptions apply only if, *inter alia*, consultations on slot allocation and airport scheduling are open to all carriers, rules of priority are neutral and nondiscriminatory, new entrants receive not less than 50% of newly created or unused slots, and air carriers participating in the consultations have full information.<sup>548</sup>

##### b. Regulation 95/93

The Council next broached the subject of slot allocation in January 1993, with Regulation 95/93.<sup>549</sup> The regulation was enacted to remedy increasing levels of congestion at Community

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<sup>543</sup> Commission Decision 93/347/EEC, II(VII), 1993 O.J. (L 140) 51, 57.

<sup>544</sup> *Id.*

<sup>545</sup> *Id.*

<sup>546</sup> *Id.*

<sup>547</sup> Commission Regulation 84/91, 1990 O.J. (L 10) 14.

<sup>548</sup> *Id.* at 16.

<sup>549</sup> Council Regulation 95/93, 1993 O.J. (L 14) 1.

airports, while encouraging the entrance of new competitors.<sup>550</sup> It directly defined two categories of airports, and indirectly defined a third. The first category is that of "coordinated airports," those where a coordinator has been appointed to direct the operations of carriers in regards to slot availability.<sup>551</sup> The second category is that of "fully coordinated airports," those where a coordinator has been appointed to actively allocate slots to carriers desiring to land or take off.<sup>552</sup> The implied third category would be "uncoordinated" or "non-coordinated" airports, where there is no planning for slot allocation, presumably because demand for space is so low.

Under Article 3 of the regulation, Member States are not obligated to designate any airport as coordinated or fully coordinated unless specifically directed by the terms of the regulation.<sup>553</sup> A Member State must designate an airport as being coordinated in some manner when either: (i) the airport authority and carriers representing the majority of the traffic at the airport consider that capacity at the airport is inadequate,<sup>554</sup> or (ii) new entrants encounter "serious problems" in obtaining slots,<sup>555</sup> and, in either instance, a "thorough" capacity analysis determines there is a genuine lack of capacity.<sup>556</sup> If the analysis indicates that the lack of capacity cannot be quickly remedied by other measures, then the airport must be declared fully coordinated during those times when there is a shortage of capacity.<sup>557</sup>

Once it has been determined that an airport must be coordinated in some manner, the Member State shall appoint a party with "detailed knowledge of air carrier scheduling coordination" as the airport's coordinator.<sup>558</sup> The same party may be appointed as coordinator at multiple airports.<sup>559</sup> The coordinator must carry out its duties in an independent, neutral, nondiscriminatory, and transparent fashion, and make its information on slot history, requests, availability, and criteria for allocations available on request to interested parties.<sup>560</sup> The coordinator

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<sup>550</sup> *Id.* at 1.

<sup>551</sup> *Id.* at 2.

<sup>552</sup> *Id.*

<sup>553</sup> *Id.*

<sup>554</sup> Council Regulation 95/93, art. 3(3)(i), 1993 O.J. (L 14) 1, 2.

<sup>555</sup> *Id.* at 2.

<sup>556</sup> *Id.*

<sup>557</sup> *Id.* at 3.

<sup>558</sup> *Id.*

<sup>559</sup> Council Regulation 95/93, art. 4(1), 1993 O.J. (L 14) 1, 3.

<sup>560</sup> *Id.*

must be assisted in its duties by a "coordination committee," composed of air carriers (or a representative organization), the airport authorities, and air traffic control authorities concerned with the operation of the airport.<sup>561</sup> The coordinator, the coordination committee, and other concerned parties (including customs and immigration authorities) must reevaluate the capacity available for slot allocation twice a year, using objective criteria, and the feasibility of accommodating additional traffic.<sup>562</sup>

Articles 8 through 10 provide the means by which slots are to be allocated. A carrier that has used a particular slot previously should be allowed to obtain the same slot in the future,<sup>563</sup> provided that it has made use of that slot at least 80% of the time over the previous scheduling period.<sup>564</sup> In other words, the Council's regulation embraces the notion of "grandfather rights," whereby a carrier already holding and flying specified slots may continue to retain them, provided that they are not deemed dormant. Where all slot requests cannot be fulfilled, the coordinator should give preference to commercial carriers in general, and scheduled and "programmed non-scheduled" carriers in particular.<sup>565</sup> After following those criteria, the coordinator must also consider any other priority rules established by the airline industry and the coordination committee, provided those rules comply with EU law.<sup>566</sup> The coordinator must explain any refusals for slots and offer the nearest alternative slot in its place.<sup>567</sup> Carriers may exchange slots, subject to the coordinator's approval that the exchange would not violate any other parts of the regulation.<sup>568</sup> New entrants may not exchange their slots for service between two Member State airports for a period of two years.<sup>569</sup> Member States may reserve slots for carriers operating routes subject to public service obligations.<sup>570</sup> At fully coordinated airports, a slot pool must be formed from unused slots, forfeited slots, and newly created slots.<sup>571</sup> Slots are

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<sup>561</sup> *Id.*

<sup>562</sup> *Id.* at 3-4.

<sup>563</sup> *Id.* at 4.

<sup>564</sup> Council Regulation 95/93, art. 10(3), 1993 O.J. (L 14) 1, 5.

<sup>565</sup> *Id.* at 4.

<sup>566</sup> *Id.*

<sup>567</sup> Council Regulation 95/93, at art. 8(2), 4.

<sup>568</sup> *Id.*

<sup>569</sup> Council Regulation 95/93, art. 8(5), 1993 O.J. (L 14) 1, 4.

<sup>570</sup> *Id.* at 4, 5.

<sup>571</sup> *Id.* at 5.

forfeited when the carrier that had been assigned them fails to adequately use them and cannot offer evidence of mitigating circumstances.<sup>572</sup> As under the previous slot allocation regulation, 50% of slots in the slot pool must be reserved for new entrants, unless applications by new entrants total less than 50%.<sup>573</sup> If a new entrant refuses offers of reasonable alternative slots to those it has requested, it can be stripped of its new-entrant status.<sup>574</sup>

The regulation also contains a safeguard provision to prevent carriers in a dominant position from "running up the score" on weaker carriers.<sup>575</sup> If two or more carriers operate on the same route between EU airports, and at least one of those airports is fully coordinated, the carrier with a greater number of frequencies may not acquire additional slots at the fully coordinated airport if the carrier with fewer frequencies has been denied slots at the same airport.<sup>576</sup> In such a situation, the Member States concerned should make an effort to facilitate an agreement that would permit the parties to acquire the slots as they desire.<sup>577</sup> Finally, the regulation provides for reciprocity in regard to slot allocation at non-Member State airports: a non-Member State which does not provide equal access to slots at its airports will find its carriers subject to refusal for slots at Member State airports.<sup>578</sup>

### c. The Guernsey Transportation Board Case

Slot allocation has been the subject of a number of legal actions. One interesting case was litigated in a British national court,<sup>579</sup> rather than before the Commission; but it offers a clear example of the application of Regulation 95/93. In 1998, the States of Guernsey Transportation Board ("the Board") brought a suit against Airport Co-ordination Ltd. ("ACL"), the desig-

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<sup>572</sup> *Id.*

<sup>573</sup> *Id.*

<sup>574</sup> Council Regulation 95/93, art. 10(8), 1993 O.J. (L 14) 1, 5. Complaints about the allocation of slots should be directed first to the coordination committee, then to the Member State. *Id.* at 4.

<sup>575</sup> *Id.* at 5, 6.

<sup>576</sup> *Id.* at 5.

<sup>577</sup> *Id.* at 5, 6.

<sup>578</sup> *Id.* at 6.

<sup>579</sup> *R. v. Airport Co-ordination Ltd., ex parte States of Guernsey Transp. Board*, CO/0722/98 (Q.B. 1999).

nated airport coordinator for Heathrow Airport in London.<sup>580</sup> The Board filed suit in an effort to frustrate an exchange of slots at Heathrow between Air UK and British Airways.<sup>581</sup> The exchange of slots was the result of a decision by Air UK to terminate its London/Guernsey service, but which also had the secondary effect of depriving Guernsey of any access to Heathrow,<sup>582</sup> the preferred airport for London flights. Aside from providing Air UK with an equivalent number of other Heathrow slots, British Airways also gave Air UK a sum of money.<sup>583</sup> The Board alleged that this violated Articles 8 and 10 of Regulation 95/93, which permit only the “free exchange” or “transfer” of slots between carriers, and that ACL was obligated to block Air UK and British Airways from carrying out the exchange.<sup>584</sup> The Board also alleged that the decision of ACL to reallocate the same slots to Air UK during the following scheduling period was illegal.<sup>585</sup>

The Board raised four possible issues for consideration. The first was that the transactions between Air UK and British Airways “were not permissible exchanges” of slots.<sup>586</sup> The Board grounded its argument on the fact that the slots British Airways provided were unsuitable for Air UK’s use and that Air UK never used the slots, instead returning them to the Heathrow slot pool.<sup>587</sup> To support this argument, the Board cited an informal statement by a member of the Commission’s Directorate General VII (Transportation) that an exchange of money for slots, or an exchange of slots which results in only one party using its slots, is an illegal transfer of slots rather than an exchange.<sup>588</sup> The court rejected any such an interpretation, however, based on the plain meaning of the regulation. Article 8(4) of Regulation 95/93, the court observed, provides for the free exchange of slots, placing no limitations or restrictions on how slots may

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<sup>580</sup> *Id.* Air UK, British Airways, and IATA were also represented in the suit, although they were not joined as defendants.

<sup>581</sup> *Id.*

<sup>582</sup> *Id.*

<sup>583</sup> *Id.*

<sup>584</sup> *R. v. Airport Co-ordination Ltd., ex parte States of Guernsey Transp. Board*, CO/0722/98 (Q.B. 1999).

<sup>585</sup> *Id.*

<sup>586</sup> *Id.*

<sup>587</sup> *Id.*

<sup>588</sup> *Id.*

be exchanged.<sup>589</sup> The court also stated that the presence of an accompanying payment of money does not convert an exchange of slots into a sale.<sup>590</sup> Therefore, the initial exchange of slots was legal, despite Air UK's failure to use the slots it received and British Airways' payment of money. This decision on the first issue also obviated the need for a decision on the second issue, which concerned the question of whether Air UK and British Airways effected a "transfer" rather than an exchange.<sup>591</sup> The court noted that this was an odd linguistic issue, but it was founded on the opening sentence of Article 8(4), which states that slots may be "exchanged" or "transferred," without distinguishing between the two.<sup>592</sup> An explanation of the distinction between the two terms would be left for a court that had reason to define them.<sup>593</sup>

The third issue the Board presented was whether ACL, as airport coordinator, had a duty to investigate the circumstances surrounding exchanges of slots.<sup>594</sup> The Board based its argument on the second sentence of Article 8(4), which makes exchanges of slots "subject to confirmation" by the airport coordinator that they comply with the terms of the regulation.<sup>595</sup> The Board argued that it was "obvious" that Air UK had no intention to use the slots it obtained from British Airways and that ACL should have disallowed the transfer.<sup>596</sup> However, the court found that Regulation 95/93 did not grant airport coordinators investigative powers to examine slot exchanges in depth.<sup>597</sup> Indeed, as the court pointed out, such investigations would frustrate the quick, efficient slot allocation method that the regulation was intended to create.<sup>598</sup> Judicial review is available to correct abuses or serious oversights by coordinators.<sup>599</sup>

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<sup>589</sup> R. v. Airport Co-ordination Ltd., *ex parte* States of Guernsey Transp. Board, CO/0722/98 (Q.B. 1999).

<sup>590</sup> *Id.*

<sup>591</sup> *Id.*

<sup>592</sup> *Id.*

<sup>593</sup> *Id.*

<sup>594</sup> R. v. Airport Co-ordination Ltd., *ex parte* States of Guernsey Transp. Board, CO/0722/98 (Q.B. 1999).

<sup>595</sup> *Id.*

<sup>596</sup> *Id.*

<sup>597</sup> *Id.*

<sup>598</sup> *Id.*

<sup>599</sup> R. v. Airport Co-ordination Ltd., *ex parte* States of Guernsey Transp. Board, CO/0722/98 (Q.B. 1999).

Therefore, the court concluded that airport coordinators did not have a duty to investigate the terms of slot exchanges.<sup>600</sup>

The final issue was whether the decision of ACL to allocate the same slots to Air UK during the next scheduling period was legal. The Board argued that Regulation 95/93 was intended to assure that slots were allocated in a manner which would make the best possible use of them, and particularly that they would be allocated to air carriers which would use them.<sup>601</sup> The court rejected this argument, pointing out that Article 10 of the regulation specifically gave rights to the previous holders of slots, subject only to the condition that the holders had met the operating requirement for the previous scheduling period.<sup>602</sup> The regulation places no duty on the airport coordinator to determine what carriers will do with the slots they are given and, indeed, to impose such a duty "would be highly damaging to the scheduling process."<sup>603</sup> Thus, the court determined that there was no duty for coordinators to investigate the plans of recipients of "grandfathered" slots, and consequently ACL had not violated the regulation when it reallocated the slots despite Air UK and British Airways' agreement.<sup>604</sup>

The court's final determination was that ACL had not violated the plain meaning of the terms of Regulation 95/93.<sup>605</sup> Although the court did not specifically address the terms of the agreement between Air UK and British Airways in its final decision, its analysis clearly implied that the agreement was in compliance with the regulation. While the court's decision is obviously not binding on the whole EU, the fact that the Board could not present any Commission rulings to support its position strongly suggests that the court's decision was not too far removed from the official Union view on the subject. It would thus appear that the exchange of slots, provided it is done on a one-for-one basis, is permitted regardless of what the exchanging parties plan to do with the slots or if the exchange is "sweetened" with money or other benefits.

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<sup>600</sup> *Id.*

<sup>601</sup> *Id.*

<sup>602</sup> *Id.*

<sup>603</sup> *Id.*

<sup>604</sup> *R. v. Airport Co-ordination Ltd., ex parte States of Guernsey Transp. Board*, CO/0722/98 (Q.B. 1999).

<sup>605</sup> *Id.*



### 5. *Bilateral Agreements*

As noted above, transglobal aviation has historically been governed by bilateral agreements (bilaterals) between nations laying out the terms of market access for the respective states' air carriers.<sup>606</sup> The states of the European Union were no different and, by 1993, they had amassed over 800 separate bilaterals.<sup>607</sup> However, heady in the wake of the formation of the common aviation market by the Third Package, the Commission began a campaign to take over the negotiation and implementation of such agreements on behalf of the Member States.<sup>608</sup> Thus began a battle between the Commission and the Member States that has continued into the 21st Century without resolution.

#### a. Commission Efforts to Deal With Bilaterals

In March 1993, the Member States' transport ministers rejected a proposal to pool their bilaterals and vest negotiating powers for future agreements in the Commission.<sup>609</sup> One transport minister even went so far as to characterize bilaterals as "sacrosanct."<sup>610</sup> Although frustrated by the recalcitrance of the Member States, the Commission denied allegations that they would bring legal action against them.<sup>611</sup> However, the Commission's attitude would not always be so forgiving.

Eleven months later, the subject of bilaterals was once more brought to the fore of the Union's attention by the Comité des Sages (Comité)<sup>612</sup> in a report on many facets of the European aviation industry. The Comité stated that bilaterals "ignore the new realities" of the unified European aviation market and should be replaced by a multilateral regime directed by the EU rather than the member states.<sup>613</sup> The report recommended that the Commission be given such powers by mid-1995.<sup>614</sup>

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<sup>606</sup> David Mazzarella, *The Integration of Aviation Law in the EC: Teleological Jurisprudence and the European Court of Justice*, 20 TRANSP. L. J. 353, 354 (1992).

<sup>607</sup> Bruce Barnard, *EC Ministers Reject Pooling of Air Traffic Agreements*, J. COM., Mar. 16, 1993, at 3B.

<sup>608</sup> *Id.*

<sup>609</sup> *Id.*

<sup>610</sup> *Id.*

<sup>611</sup> *Id.*

<sup>612</sup> Popularly called the "Committee of Wise Men" in English-language sources.

<sup>613</sup> *Wise Men: Bilaterals Ignore "New Realities" of Single Market*, AVIATION EUR., Feb. 17, 1994.

<sup>614</sup> *Id.*

The Commission apparently took the recommendation to heart, as in March 1995 it issued a "strong . . . warning" that individual Member States would be haled before the European Court of Justice if they continued to negotiate bilaterals with other nations (particularly the United States).<sup>615</sup> The then-Transport Commissioner, Neil Kinnock, denounced bilaterals as "the most serious obstacle to competition,"<sup>616</sup> while a senior aide to the Commission stated that the Commission is "duty bound under European law to carry out infringement proceedings" against Member States engaging in such behavior.<sup>617</sup> However, most of the Member States did not share the Commission's concerns, or at least not to the same degree, and the assembled transport ministers rejected the Commission's proposals.<sup>618</sup>

Following that defeat in 1995, Kinnock and the Commission decided to apply some pressure to the Member States, filing a complaint against six Member States that had completed bilaterals with the United States after the implementation of the Third Package.<sup>619</sup> It was in this less-than-friendly atmosphere that the transport ministers met the following year, although Kinnock chose to present the situation more positively by claiming that there had been "considerable progress" on the subject of conferring negotiating powers to the Commission.<sup>620</sup> The transport ministers agreed to give negotiating powers to the Commission, but the powers were wrenched from them at high cost. The Member States required the Commission to conduct any such negotiations in two phases—the first phase was to give the Commission the power to negotiate "soft issues," such as computer reservation systems, slot allocation, ground handling, and air carrier ownership, while the second phase would give the rights to "hard issues," such as traffic rights and pricing.<sup>621</sup> The Commission would not receive the rights to negotiate agreements on

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<sup>615</sup> *EC Goal: All-Or-Nothing Bilaterals with U.S.*, AVIATION DAILY, Mar. 6, 1995, at 26.

<sup>616</sup> Julian Moxon, *EC Sets Open-Skies Schedule*, FLIGHT INT'L, June 14, 1995.

<sup>617</sup> *Id.*

<sup>618</sup> Bruce Barnard & Lisa Burgess, *Germany Faces EU Suit if it Signs US Air Pact*, J. COM., Feb. 16, 1996, at 1A.

<sup>619</sup> Bruce Barnard, *Kinnock Perseveres in Fight for EU-Wide Air Talks With US*, J. COM., June 20, 1995, at 2B. The targeted Member States were Austria, Belgium, Denmark, Finland, Luxembourg, and Sweden.

<sup>620</sup> *France Rejects Traffic Rights as Issue in Multilateral Talks*, AVIATION DAILY, Mar. 14, 1996, at 1, 2.

<sup>621</sup> *Commission's Multilateralism Mandate Comes in Phases, May be Too Late*, AVIATION DAILY, June 20, 1996, at 1.

the "hard issues," unless it could show that it had achieved "substantial results in the first phase."<sup>622</sup> Furthermore, the Member States retained the right to negotiate their own bilateral agreements with other nations.<sup>623</sup>

While the Commission declared that the transport ministers' concessions constituted a "true victory," the U.S. government said that it would refuse to participate in any sort of limited negotiations.<sup>624</sup> However, even with that rejection, Kinnock felt confident enough of his new powers to be generous with the Member States, stating there would be "no roll-back on any bilateral agreement in existence or under negotiation" and that the complaint against the Member States who had signed bilaterals would be dropped.<sup>625</sup>

By 1997 though, the Commission's patience with the Member States was wearing thin once more, as Member States continued their independent negotiations.<sup>626</sup> At the October meeting of transport ministers, Kinnock pledged that there would be a role for the Member States in any negotiations, but also floated the possibility of reinitiating legal action against Members who had already signed bilaterals.<sup>627</sup> Yet the transport ministers were moved by neither the velvet glove nor the iron fist of the Commission and once more rejected granting it full powers to negotiate agreements.<sup>628</sup> This prompted Kinnock to acknowledge that the Member States were "resistant" to turning over negotiations to the Commission, and to promise that he would "return to this issue" at the next transport ministers' meeting.<sup>629</sup>

Kinnock was not to have to carry on alone in the struggle to win negotiating authority for the Commission, however. Competition Commissioner Karel van Miert, long viewed as one of the most charismatic and influential members of the Commission,<sup>630</sup> increasingly brought the weight of his powerful office to bear against carriers whose parent governments had negotiated

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<sup>622</sup> *Id.*

<sup>623</sup> *Id.*

<sup>624</sup> *Id.*

<sup>625</sup> *Id.*

<sup>626</sup> Chris Johnstone, *Brussels Cajoles and Threatens in Bid for United EU Air Front*, J. COM., Oct. 8, 1997, at 20A.

<sup>627</sup> *Id.*

<sup>628</sup> *European Union Denies Kinnock Authority to Negotiate 'Hard Issues' With U.S.*, AVIATION DAILY, Oct. 10, 1997, at 63.

<sup>629</sup> *Id.*

<sup>630</sup> Karel van Miert, *When the Going Gets Tough . . .*, AIRLINE BUS., May 1, 1998, at 26, 26-27.

(or were in the process of negotiating) bilateral agreements.<sup>631</sup> Van Miert stated in February 1998, "I consider that bilateral open skies agreements do not constitute the right answer."<sup>632</sup> He continued by explaining "[I]f we want to establish fair competition conditions between European and North American [a]irlines, the best solution is to conclude a global agreement between the Community and the United States. We must develop a common policy giving Community carriers the possibility to compete on fair and equitable terms . . . ."<sup>633</sup>

But even testimony from such a powerful member of the Commission was insufficient to convince the Member States to desist from their activities, so in March the Commission announced that it had reopened legal proceedings against Member States that had signed bilateral agreements with the United States.<sup>634</sup> In its announcement, the Commission said that it was "not motivated simply by the legal breach of EU rules," but because the bilaterals "do not safeguard the long-term interests of the European air transport industry."<sup>635</sup> By giving access to national markets on different terms, the Commission concluded that bilaterals "not only distort the competition between airlines but also between airports."<sup>636</sup> In spite of the Commission's careful couching of its language, its frustration with the Member States still showed through: "Member States are not only failing to comply with EU law, but are also not co-operating to adopt, within a reasonable time, an EU approach making it possible to remedy the legal infringements and ensure equivalent regulatory conditions . . . ."<sup>637</sup> A spokesperson for Kinnock's office was more blunt: "The cozy negotiations are over and the gloves have

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<sup>631</sup> G. Porter Elliott, *Antitrust at 35,000 Feet: The Extraterritorial Application of United States and European Community Competition Law in the Air Transport Sector*, 31 GEO. WASH. J. INT'L L. & ECON. 185, 208-09 (1997).

<sup>632</sup> Commissioner Karel van Miert, *The Transatlantic and Global Implications of European Competition Policy*, Address to North Atlantic Assembly Meeting (Feb. 16, 1998).

<sup>633</sup> *Id.*

<sup>634</sup> *Commission Takes Further Legal Action against Member States' "Open Skies" Agreements with the United States*, available at <http://www.europa.eu.int/en/comm/dg07/press/ip98231en.htm> (last visited Mar. 7, 2001). The Members named were Austria, Belgium, Denmark, Finland, Germany, Luxembourg, and the UK, which had signed a preliminary agreement with the US in 1995.

<sup>635</sup> *Id.*

<sup>636</sup> *Id.*

<sup>637</sup> *Id.*

now been taken off. . . . If this does rattle some governments—so be it.”<sup>638</sup>

The Member States reacted poorly to the Commission’s threats, with Britain and France declaring the following day that they would continue their negotiations regardless.<sup>639</sup> The German transport minister called the threat “unacceptable” and warned that it would “endanger European jobs,” while others referred to it as “counterproductive.”<sup>640</sup> Portugal and Italy announced their plans to proceed with their talks with the United States,<sup>641</sup> seemingly undeterred by Kinnock’s statement that such behavior was “a shortsighted policy based on nationality.”<sup>642</sup> But even following the Member States’ virtual dismissal of Kinnock’s increasingly heavy-handed tactics, the Transport Commissioner still offered that they had a “final chance” at the October 1998 transport ministers’ meeting to give the Commission full negotiating powers.<sup>643</sup>

The transport ministers, however, were not impressed by Kinnock’s pleas or threats, and again rejected the Commission’s bid.<sup>644</sup> This led the Commission to take its legal action to the next level by filing a full complaint with the Court of Justice.<sup>645</sup> In a speech announcing the move, Kinnock admitted that the Member States had given the Commission negotiating powers, “but its scope is not broad enough to make meaningful negotiation possible and until that changes the Commission . . . has no option but to pursue legal action.”<sup>646</sup> He continued to explain that the Commission “sees no other option but to pursue the procedure under [the Treaty of Rome] to the finish.”<sup>647</sup> Yet even as Kinnock delivered this blow to the Member States, he continued to hold out the hand of partnership, stating that the

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<sup>638</sup> Chris Johnstone, *Kinnock Challenges Open-Skies Pact; EU Transport Chief Files Court Actions Against Member States that have Forged Deals with U.S.*, J. COM., Mar. 12, 1998, at 12A.

<sup>639</sup> *Id.*

<sup>640</sup> Kevin O’Toole, *The EC Wants Individual US Open Skies Deals to be Torn Up*, FLIGHT INT’L, Mar. 25, 1998, at 28, 29.

<sup>641</sup> *Id.*

<sup>642</sup> Pierre Sparaco, *European Deregulation Still Lacks Substance*, AV. WK. & SPACE TECH., Nov. 9, 1998, at 53.

<sup>643</sup> Bruce Barnard, *Virgin Set to Challenge US Carriers in US Skies*, J. COM., Sept. 24, 1998, at 11A.

<sup>644</sup> Chris Kjelgaard, *Commission Takes Eight EU Nations to Court Over US Bilaterals*, AIR TRANSP. INTELLIGENCE, Oct. 30, 1998.

<sup>645</sup> *Id.*

<sup>646</sup> *Id.*

<sup>647</sup> *Id.*

Commission was "willing and available to constructively build a common approach as regards air transport relations . . . and hopes that substantial progress . . . will be made in the coming months."<sup>648</sup>

While the Commission may have been willing to construct a "common approach" towards external European aviation policy, the Member States still were not. The UK continued its negotiations with the United States, albeit at a significantly reduced rate,<sup>649</sup> while just weeks after the Commission announced its complaint against eight Member States, Italy declared that it had completed a bilateral with the United States that would phase in Italian "open skies."<sup>650</sup> The Commission retaliated by commencing legal proceedings against the Netherlands over its bilateral with the United States.<sup>651</sup> This came as a particular shock to the Union's membership, as the Commission had previously indicated that the Netherlands/U.S. bilateral would be allowed to stand since it predated the Third Package.<sup>652</sup>

Ironically, throughout the recriminations and complaints, most Member States voiced support for giving the Commission negotiating powers for external aviation agreements. As early as 1993, the Danish ambassador to the EU stated, "We can get better results by negotiating in common. . . ."<sup>653</sup> In 1996, the transport minister of Germany expressed hope for "a U.S.-European agreement in the long term."<sup>654</sup> That same year, at the transport ministers' meeting, the Italian minister said that no one in the EU needed to be convinced of the value of multilateral negotiations, while the representative from the Netherlands was characterized as being "enthusiastic" about the prospects for the Commission being given full negotiating powers.<sup>655</sup> Portugal has also stated that it "firmly supports" the Commission's posi-

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<sup>648</sup> *Id.*

<sup>649</sup> John D. Morrocco, *Open Skies Impasse Shifts Alliance Plans*, AV. WK. & SPACE TECH., Nov. 9, 1998, at 45.

<sup>650</sup> U.S., *Italy Agree to Open Skies, Pending Alitalia-Northwest Immunity*, AVIATION DAILY, Nov. 13, 1998 at 275.

<sup>651</sup> *Netherlands/US Bilateral Agreement Focus of EC Proceedings*, AIRLINE INDUSTRY INFO., Feb. 8, 1999.

<sup>652</sup> *Id.*

<sup>653</sup> BARNARD, *supra* note 619, at 3B.

<sup>654</sup> *Germany - U.S. Open Skies 'Megadeal' May Boost Multilateral Negotiations*, AVIATION DAILY, Feb. 8, 1996, at 1.

<sup>655</sup> *France Rejects Traffic Rights as Issues in Multilateral Talks*, AVIATION DAILY, Mar. 14, 1996, at 1.

tion on the subject.<sup>656</sup> Indeed, the only Member States that have been particularly intransigent about the possibility of giving the Commission full negotiating powers have been the unlikely duo of France and the UK,<sup>657</sup> which have managed to repeatedly sway enough of the Member States at any given time to prevent a full transfer of powers. However, in 1999 the Commission introduced a new approach to the matter—the Common Transatlantic Aviation Area—which appears calculated to finally end the nearly decade-long struggle between itself and the Member States.

b. Proposed common Transatlantic Aviation Area

On May 12, 1999, Neil Kinnock gave a speech to the European Aviation Club entitled *European Air Transport Policy: All Our Tomorrows or "All Our Yesterdays" Replayed?*<sup>658</sup> Kinnock admitted air transportation in Europe "is shaping up to the future," but he warned "that restructuring in [the] industry will only be truly successful if it is accompanied and strengthened by an effective and proactive external strategy."<sup>659</sup> He then proceeded to lambaste the Member States that had insisted on continuing to pursue bilaterals, referring to the "magical attraction" of bilaterals and stating, "nostalgia . . . still has a big future."<sup>660</sup> However, what initially seemed to have been little more than an occasion for Kinnock to criticize his opponents quickly became something more substantial. Kinnock raised the concept of a Common Transatlantic Aviation Area (CTAA, alternatively referred to as the Transatlantic Common Aviation Area, TCAA, or simply the Common Aviation Area, CAA), a plan that he had initially floated shortly after becoming Transport Commissioner but that had been put aside during the lengthy struggles with the Member States.<sup>661</sup> The CTAA would not merely be an EU-wide bilat-

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<sup>656</sup> Frances Fiorino, *More Open Skies*, AV. WK. & SPACE TECH., June 12, 2000, at 19.

<sup>657</sup> *Commission's Multilateralism Mandate Comes in Phases, May be Too Late*, AVIATION DAILY, June 20, 1996, at 1. Spain, Ireland, and Germany have also been among the Member States to resist the Commission, but their positions have been more flexible.

<sup>658</sup> Commissioner Neil Kinnock, *European Air Transport Policy: All Our Tomorrows or "All Our Yesterdays" Replayed*, Address at the European Aviation Club (May 12, 1999). The title is a reference to a line in Shakespeare's *Macbeth*, which Kinnock quoted from at some points.

<sup>659</sup> *Id.*

<sup>660</sup> *Id.*

<sup>661</sup> *Id.*

eral, but would be qualitatively different, encompassing many subjects normally outside the scope of bilaterals, such as consumer rights and environmental protection, as well as traditional subjects like traffic rights and code-sharing.<sup>662</sup> Whether the CTAA is truly something other than a "mega-bilateral" is open to debate, but the Commission apparently felt strongly enough about its potential to circumvent the deadlock on the grant of negotiating powers that the legal proceedings against Member States were put on indefinite hold.<sup>663</sup>

Paradoxically, once Kinnock and the Commission had finally devised a seemingly feasible method of achieving their goals in the arena of external aviation policy, the entire Commission was reorganized and Kinnock was removed from the office of Transport Commissioner.<sup>664</sup> The new Transport Commissioner, Loyola de Palacio, has since shown much less interest in the subject of bilaterals and the CTAA,<sup>665</sup> with leadership on the subject of the CTAA passing largely into the hands of the AEA and its member companies.<sup>666</sup> Thus, at a U.S.-sponsored 1999 meeting of 90 transport ministers, while de Palacio presented the concept of the CTAA, it was the heads of several European air carriers who spoke most forcefully on its behalf.<sup>667</sup> The chairman of British Midland Airways expressed dismay that the U.S. and the UK, both of which had been long-time champions of deregulation, were now so opposed to even the idea of the CTAA.<sup>668</sup> Lufthansa's CEO stated that the CTAA was "the only way to make some progress" on the subject of international aviation.<sup>669</sup> The president of KLM declared that bilateralism was dead and that the air transport industry was doomed to follow in the path of the silent movies if the CTAA, or at least some form of multilateralism, were not adopted.<sup>670</sup> While the latter address may

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<sup>662</sup> *Id.*

<sup>663</sup> Simon Warburton, *Kinnock Calls Again for Common Transatlantic Pact*, AIR TRANSP. INTELLIGENCE, May 13, 1999.

<sup>664</sup> *De Palacio is Proposed to Take Over As European Transport Commissioner*, ATC MKT. REP., July 22, 1999 at 8.

<sup>665</sup> De Palacio's focus is centered on internal European air transportation issues, particularly air traffic control. *New EU Transport Commissioner Pledges to Fight for 'Single Sky'*, AVIATION DAILY, Aug. 31, 1999, at 1.

<sup>666</sup> James Ott, *Aviation Summit Yields EU Plan for Open Market: European CEOs Endorse a Transatlantic Common Aviation Area as a Trailblazing Alternative to Bilateral Agreements*, AV. WK. & SPACE TECH., Dec. 13, 1999, at 43, 44.

<sup>667</sup> *Id.*

<sup>668</sup> *Id.*

<sup>669</sup> *Id.*

<sup>670</sup> *Id.*



have been hyperbolic, it did serve to illustrate the increasing desire of the air carriers themselves to move beyond the bilateral system.

Despite these strong testimonials, the CTAA did not gain many supporters from among the world transport ministers and no reference to it was included in the final statement released by the conference.<sup>671</sup> Furthermore, while de Palacio suggested at the conference that the EU and the U.S. could meet every six months thereafter to lay the groundwork for an initial conference on the CTAA,<sup>672</sup> the first period for such discussions passed without action on either side of the Atlantic. By mid-2000 there were still no plans to even schedule discussions on the subject, making it unlikely that de Palacio's stated goal of a CTAA conference by 2002 would be met.<sup>673</sup> Indeed, on approximately the date the first discussion session would have met, it was announced that Portugal had signed a new bilateral with the U.S., giving the U.S. enhanced "open skies" access to the Portuguese market.<sup>674</sup> Thus, it appears that the final word on the Commission's long struggle has yet to be said.

## E. COMPUTER RESERVATION SYSTEMS

### 1. Regulation 2672/88

The Commission's first foray into Computer Reservations System (CRS) regulation was made in July 1988. They required that the CRS neutrally display the flights of all airlines seeking access, make available their services to all participating airlines, and not discriminate in the fees charged or services provided (including display bias).<sup>675</sup> Unlike U.S. computer reservations systems, European CRSs may not penalize travel agents who terminate their contracts. Travel agents may freely end their contracts on short notice, and may subscribe to more than a single CRS.<sup>676</sup> Commissions paid to them may not be linked to the volume of bookings made in the system in which the airline has

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<sup>671</sup> Chris Thornton & Chris Lyle, *Freedom's Paths*, AIRLINE BUS., Mar. 2000, at 74, 75.

<sup>672</sup> Graeme Osborn & Karen Walker-Was, *Sans Frontiers?*, AIRLINE BUS., Feb. 1, 2000, at 34, 35.

<sup>673</sup> *Id.*

<sup>674</sup> Frances Fiorino, *More Open Skies*, AV. WK. & SPACE TECH., June 12, 2000, at 19.

<sup>675</sup> Commission Regulation 2672/88, arts. 3, 4, 1988 O.J. (L 239) 13.

<sup>676</sup> *Id.* at 13.

an economic interest.<sup>677</sup> No CRS may engage in practices designed to partition the market.<sup>678</sup>

## 2. CRS Code of Conduct

The following year, the Council promulgated regulations providing for a Code of Conduct for Computerized Reservations Systems (CRS Code of Conduct).<sup>679</sup> The CRS Code of Conduct requires that a CRS vendor offering facilities for scheduled air passenger services allow all carriers “the opportunity to participate, on an equal and non-discriminatory basis” in the computer reservations system, subject to capacity and technical limitations.<sup>680</sup> A CRS vendor cannot require a carrier to accept “supplementary conditions which . . . have no connection with participation in its CRS.”<sup>681</sup> This would suggest that a vendor could not, for example, require a carrier to purchase its own line of office productivity software as part of an agreement for access to the vendor’s CRS. Data displayed therein shall be provided “in a clear and comprehensive manner and without discrimination or bias . . . ,” particularly with regard to carrier identity.<sup>682</sup> A CRS vendor may not require travel agents to accept an exclusive contract,<sup>683</sup> and agents may terminate their contract on three months notice.<sup>684</sup> Fees charged shall be “non-discriminatory and reasonable related to the cost of the service provided . . . ”<sup>685</sup> Carriers may belong to more than one system, and shall be free to leave a system upon six months prior notice.<sup>686</sup>

The CRS Code of Conduct also places specific limitations on the manner in which a vendor can provide information, statistical or otherwise, to parties using its system.<sup>687</sup> Information concerning individual bookings must be made available on an equal basis to each carrier involved in the booking.<sup>688</sup> Aggregate statis-

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<sup>677</sup> *Id.* at 14.

<sup>678</sup> ARCYRIS, *supra* note 62, at 29-31; Commission Regulation 2672/88, art. 10, 1998 O.J. (L 239) 13.

<sup>679</sup> Council Regulation 2299/89, 1989 O.J. (L 220) 1.

<sup>680</sup> *Id.* at 2.

<sup>681</sup> *Id.* at 2.

<sup>682</sup> *Id.* at 3.

<sup>683</sup> *Id.* at 4.

<sup>684</sup> Council Regulation 2299/89, art. 9(4), 1989 O.J. (L 220) 1, 4.

<sup>685</sup> *Id.* at 4.

<sup>686</sup> *Id.* at 2.

<sup>687</sup> *Id.* at 3.

<sup>688</sup> *Id.*

tics requested by one carrier must be offered to all participating carriers,<sup>689</sup> while statistics regarding a particular carrier can only be released to a requesting party with the permission of the carrier concerned.<sup>690</sup> Personal information regarding a particular consumer generated by a travel agent may only be made available to parties not involved in the transaction with the consent of the consumer.<sup>691</sup> Interestingly, given that the CRS Code of Conduct explicitly placed restrictions only on the dissemination of personal information about consumers as input by travel agents, the CRS was free to distribute a consumer's personal information if it had been input by another party.

Aggrieved persons, natural or legal, or Member States may file a complaint with the Commission seeking relief,<sup>692</sup> or the Commission may act on its own motion.<sup>693</sup> The Commission may conduct investigations and hearings, make findings, and impose fines on vendors, parent carriers, participating carriers, and/or subscribers.<sup>694</sup> Fines may be reviewed on appeal to the European Court of Justice.<sup>695</sup> In 1990, the Commission promulgated implementing regulations.<sup>696</sup>

The rights and obligations under the Commission's block exemptions and the Council's Code of Conduct are essentially the same. It is only the sanction that differs. If parties infringe the Commission's Regulation, the Commission may withdraw the benefit of the block exemption, thereby making transactions otherwise shielded from the competition rules of the Treaty of Rome effectively illegal.<sup>697</sup> Computer reservations systems could not exist since they are co-owned by air carriers and/or other service providers and need the block exemption to shield them from the application from Articles 85(1) and (2). In contrast, the punishment contemplated for violation of the Code of Conduct is the less draconian alternative to a fine.<sup>698</sup>

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<sup>689</sup> Council Regulation 2299/89, art. 6(b), 1989 O.J. (L 220) 1, 3.

<sup>690</sup> *Id.* at 3.

<sup>691</sup> *Id.*

<sup>692</sup> *Id.* at 4.

<sup>693</sup> *Id.*

<sup>694</sup> Council Regulation 2299/89, arts. 13, 16, 19, 1989 O.J. (L 220) 1, 5.

<sup>695</sup> *Id.*

<sup>696</sup> Commission Regulation 83/91, 1991 O.J. (L 10) 9. By their own terms, these regulations expired on December 31, 1992.

<sup>697</sup> Commission Regulation 2672/88, 1988 O.J. (L 239) 13.

<sup>698</sup> Commission Regulation 2299/89, art. 16 (1),(2), 1989 O.J. (L 220) 1.

In 1993, the Council amended its existing regulations significantly, described above,<sup>699</sup> involving a code of conduct for computer reservations systems.<sup>700</sup> The new regulations recognize that “competitive neutrality of computer reservation systems for air carriers must be ensured in respect to equal functionality and data security, in particular through equal access to functions, information/data and interfaces and a clear separation between private airline facilities and distribution facilities.”<sup>701</sup> The revisions to the CRS Code of Conduct were also made with an eye toward developments in the U.S. CRS regulatory environment.<sup>702</sup> The Council made this effort at harmonization of the Code of Conduct as part of an attempt to lay the foundation for uniform worldwide regulation of CRSs.<sup>703</sup>

### 3. *Goals of the Regulations*

The regulations have five principal goals—nondiscrimination, accuracy, contractual freedom, system separation, and privacy.

#### a. *Nondiscrimination*

Nondiscrimination is a dominant theme of the regulations. For example, booking and sales data shall be made available to participating carriers on a non-discriminatory basis with equal timeliness.<sup>704</sup> A system vendor<sup>705</sup> must allow air carriers to participate “on an equal and non-discriminatory basis” in its CRS.<sup>706</sup> No discrimination is allowed in CRS displays on the basis of flight schedules, fare types,<sup>707</sup> seat availability of participating carriers,<sup>708</sup> or on the basis of airports serving the same city.<sup>709</sup>

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<sup>699</sup> *Id.* at 1.

<sup>700</sup> Commission Regulation 3089/93, 1993 O.J. (L 278) 1. These regulations had to be revised by December 31, 1997, by a Commission proposal submitted by March 31, 1997. *Id.* at 18.

<sup>701</sup> *Id.* at 2.

<sup>702</sup> Competition Commissioner Karel van Miert, EU Competition Policy, The USA and the Air Transport Sector, Address at the SABRE World Conference '95 (July 9, 1995).

<sup>703</sup> *Id.*

<sup>704</sup> Commission Regulation 3089/93, pmbl., art. 6(1)(a)(b), 1993 O.J. (L 278) 1.

<sup>705</sup> System vendors are defined as those firms responsible for operating or marketing a CRS. *Id.* at 3.

<sup>706</sup> *Id.* (“... within the available capacity of the system concerned and subject to any technical constraints outside the control of the system vendor.”).

<sup>707</sup> *Id.* at 5.

<sup>708</sup> *Id.* Information on bundled products shall not be included in the principal display. *Id.*

Fees charged must be “nondiscriminatory, reasonably structured and reasonably related to the cost of the service provided and used and shall, in particular, be the same for the same level of service.”<sup>710</sup> However, these nondiscrimination provisions apply unconditionally only to Member State air carriers. If a non-Member State carrier operates a CRS outside of the EU, it must provide treatment to Member State carriers in the nondiscriminatory manner prescribed by the Code of Conduct in order to reciprocally receive nondiscriminatory treatment by CRSs within the EU.<sup>711</sup> If a CRS outside of the EU provides information biased against Member State carriers, then the parent carrier of the alien CRS will be considered to have forfeited its privilege to receive equitable treatment in Union-based CRSs.<sup>712</sup>

Parent carriers of CRSs must provide information to other CRSs “with equal timeliness, with the same information on schedules, fares and availability relating to its own air carriers as that which it provides to its own CRS . . . ”<sup>713</sup> The parent carriers also cannot refuse the distribution of their “air transport products” through a rival CRS, nor can they refuse to confirm or accept a reservation for their “air transport products” made through a rival CRS, provided that it complies with the parent carrier’s stipulated fares and conditions.<sup>714</sup>

#### b. Accuracy

Accuracy is also an important goal of the regulations. All carriers must ensure that the data they provide to CRSs are accurate and not misleading.<sup>715</sup> Presumably this might prohibit “bait-and-switch” advertising of a promotional fare for which there were insufficient seats to meet market demand. System vendors are also obliged not to manipulate the information received, nor to negligently or intentionally disseminate “inaccurate, misleading or discriminatory information.”<sup>716</sup> They must also load data received from carriers into their CRSs with “equal care and timeliness.”<sup>717</sup> System vendors must include data pro-

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<sup>709</sup> Commission Regulation 3089/93, art. 5(2)(c), 1993 O.J. (L 278) 1.

<sup>710</sup> *Id.* at 7.

<sup>711</sup> *Id.* at 6.

<sup>712</sup> *Id.*

<sup>713</sup> *Id.* at 4.

<sup>714</sup> Commission Regulation 3089/93, art. 3a(1)(a), 1993 O.J. (L 278) 1.

<sup>715</sup> *Id.* at 4.

<sup>716</sup> *Id.* at 4, 5.

<sup>717</sup> *Id.* at 4.

vided involving “flight schedules, fare types and seat availability in a clear and comprehensive manner and without discrimination or bias, in particular as regards the order in which information is presented.”<sup>718</sup> The specific order in which they are to display flights are (1) nonstop flights between the city-pairs involved, (2) direct single-plane flights, and (3) connecting flights.<sup>719</sup>

### c. Contractual Freedom

Certain restrictions imposed upon the contractual freedom of system vendors are designed to enhance the contractual freedom of participating airlines and subscribers. Vendors may not attach “unreasonable conditions” to their contracts with air carriers, require them to accept conditions which are irrelevant to CRS services,<sup>720</sup> or require carriers to abstain from participating in other CRSs.<sup>721</sup> After the end of the first year, carriers are free to terminate their contracts with system vendors on not more than six months notice, with the vendor limited to damages directly related to the costs of termination.<sup>722</sup> In regard to subscribers, no system vendor may attach unreasonable conditions to its subscribers’ contracts and, after the first year, such subscribers may terminate their contracts with three months notice.<sup>723</sup> A parent carrier also may not “link the use of any specific CRS by a subscriber with the receipt of any commission or other incentive or disincentive for the sale of air transport products . . . ”<sup>724</sup>

### d. System Separation

One interesting provision requires that CRSs be separated from a carrier’s “private inventory and management and marketing facilities.”<sup>725</sup> This separation may be accomplished either by means of distinct software systems or by physically partition-

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<sup>718</sup> *Id.* at 5.

<sup>719</sup> Commission Regulation 3089/93, Annex 1, 1993 O.J. (L 278) 1. Unless otherwise requested by a consumer, nonstop flights shall be listed on the basis of departure time, while the second two categories shall be listed on the basis of elapsed journey time. *Id.* at 2.

<sup>720</sup> *Id.* at 3, 4.

<sup>721</sup> *Id.* at 4.

<sup>722</sup> *Id.*

<sup>723</sup> *Id.* at 6.

<sup>724</sup> Commission Regulation 3089/93, art. 8(1), 1993 O.J. (L 278) 1.

<sup>725</sup> *Id.* at 5.

ing the respective components of the business.<sup>726</sup> This provision apparently affects only one CRS—American Airlines' SABRE—which complained vigorously of the enormous cost of technical and legal dehosting required to separate its internal database from its CRS.<sup>727</sup>

e. Right of Privacy

Several provisions of the new regulations ensure the right of privacy of passengers. The regulations set as a goal that "identification or personal information on a passenger or a corporate user must remain private. . . ."<sup>728</sup> Data provided shall not identify passengers without their consent.<sup>729</sup> This closed the "travel agents only" loophole that the Code of Conduct originally created.

4. *Broadening the Codes Applicability*

Aside from the five principal goals, the 1993 amendments to the Code of Conduct also greatly broadened the application of the Code of Conduct. As initially written, the Code of Conduct applied only to matters involving scheduled air carriers.<sup>730</sup> Yet, charter carriers transport 50 to 55% of all passengers in Europe<sup>731</sup> and make up approximately 80% of all licensed air carriers.<sup>732</sup> The Council rectified this considerable omission, noting that "non-scheduled air services are of major importance in the territory of the Community,"<sup>733</sup> by removing the term "scheduled" from the Code of Conduct's definition of air transport products.<sup>734</sup>

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<sup>726</sup> *Id.*

<sup>727</sup> AMR persuaded U.S. Secretary of Transportation Federico Pena to intervene with the EEC Commission on its behalf, to no avail.

<sup>728</sup> *Id.* at 2.

<sup>729</sup> Commission Regulation 3089/93, arts. 6(1)(b)(ii), 6(2), 1993 O.J. (L 278) 1.

<sup>730</sup> Council Regulation 2299/89, pmbl., 1989 O.J. (L 220) 1.

<sup>731</sup> *EC Finds Progress under Liberalisation But Weighs Probe of 'Excessive' Fares*, 6 AVIATION EUROPE 41, OCT. 24, 1996, at 1.

<sup>732</sup> Michael Niejahr & Giuseppe Abbamonte, *Liberalization Policy and State Aid in the Air Transport Sector*, 2 EC COMPETITION POLICY NEWSLETTER 2, Summer 1996, at 4.

<sup>733</sup> Council Regulation 3089/93, pmbl., 1993 O.L. (L 278) 1.

<sup>734</sup> *Id.* at 2.

## a. 1999 Amendments

In 1999, the Council again amended the CRS Code of Conduct.<sup>735</sup> Its purpose in doing so was twofold: first, to broaden the Code of Conduct to include rail carriers and second, to improve consumer protections. In regard to the first purpose, the Council stated, that “the integration of rail services into the CRS principal display can improve the quality of information available to consumers and provide consumers with the best options for their travel arrangements.”<sup>736</sup> The inclusion of rail carriers in the Code of Conduct resulted in few significant structural changes, primarily the changes were linguistic.<sup>737</sup> However, one of the few structural changes points to a deeper motive on the Council’s part. The system vendors must adjust the ranking principles for the main display screen “in order to take due account of the needs of consumers to be adequately informed of rail services that represent a competitive alternative to the air services.”<sup>738</sup> The Council goes on to provide the example that rail services with a few brief stops can be ranked with nonstop air services.<sup>739</sup> This would seem to suggest that the Council is hoping to offset the consolidation occurring among air carriers by promoting rail services as a substitute means of transportation, with CRSs as the means by which to do so unobtrusively.

The Council’s second purpose, improving consumer protections, required more changes to the regulation’s structure. The first major change was made in Article 6 of the Code of Conduct.<sup>740</sup> The change required that information concerning individual bookings be archived offline within seventy-two hours of the completion of the last element in the book and ultimately be destroyed within three years.<sup>741</sup> Furthermore, access to the information after it is taken offline will be permitted only for the resolution of billing disputes.<sup>742</sup> The amendment also adds a new article, Article 9a, which provides, among other things, that the subscriber must inform the consumer of en route changes of equipment, the actual identity of the air carrier operating the flight (presumably to guard against misleading code-sharing),

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<sup>735</sup> Council Regulation 323/1999, 1999 O.J. (L 040) 1.

<sup>736</sup> *Id.* at 2.

<sup>737</sup> *Id.* at 2, 5.

<sup>738</sup> *Id.* at 5.

<sup>739</sup> *Id.*

<sup>740</sup> Council Regulation 323/1999, art. 1(6), 1999 O.J. (L 040) 1.

<sup>741</sup> *Id.* at 3.

<sup>742</sup> *Id.*



and which airports the flight will pass through.<sup>743</sup> The subscriber must also tell the consumer the name and address of the system vendor, the duration his/her individual information will be retained, and the means of exercising his/her access rights.<sup>744</sup> The consumer also is given the right to receive a printout of the CRS display or to be provided with access to a parallel CRS display that shows the same information as displayed on the subscriber's terminal.<sup>745</sup> Finally, the consumer must be given access to his/her own information free of charge<sup>746</sup> and is also entitled to receive, at no cost, details of the CRS's current procedures, fees, system facilities, and information on interfaces and display criteria.<sup>747</sup>

b. The SABRE-Lufthansa Dispute

Since the implementation of the 1993 amendments to the CRS Code of Conduct, there appears to have been only one major Commission decision regarding it. In January 1997, the system vendor SABRE Travel Information Network (SABRE) filed a complaint against Deutsche Lufthansa AG (Lufthansa) for an alleged infringement of the Code of Conduct.<sup>748</sup> SABRE claimed that Lufthansa had offered incentives to corporate clients using electronic ticketing for its flights, but that electronic ticketing for Lufthansa was only available through the START Amadeus CRS, which was partly owned by Lufthansa.<sup>749</sup> SABRE also alleged that Lufthansa had refused to provide it with the means to issue electronic tickets, thereby subverting SABRE's market position in Germany.<sup>750</sup>

Lufthansa replied to SABRE's allegations with three different theories as to why it was not in violation of the Code of Conduct. The first theory Lufthansa offered was that the purpose of the incentive was to encourage consumers and subscribers to make use of the new electronic tickets, rather than to encourage them to use a particular CRS.<sup>751</sup> Lufthansa's second theory was premised on the grounds that there is a certain amount of lag time

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<sup>743</sup> *Id.* at 3-4.

<sup>744</sup> *Id.*

<sup>745</sup> Council Regulation 323/1999, art. 1(9), 1999 O.J. (L 040) 1.

<sup>746</sup> *Id.*

<sup>747</sup> *Id.* at 4.

<sup>748</sup> Commission Decision 99/618/EC, comp. (1), 1999 O.J. (L 244) 56.

<sup>749</sup> *Id.*

<sup>750</sup> *Id.* at 56.

<sup>751</sup> *Id.*

in the introduction of any new technology, and that it had a plan for eventually making electronic ticketing available to all CRSs.<sup>752</sup> Finally, Lufthansa attempted to play on the semantics of the Code of Conduct by arguing that a ticket was not an "air transport product" under Article 8(1).<sup>753</sup>

The Commission first replied to Lufthansa's semantic argument. While the Commission agreed that the Code of Conduct did not specifically use the term "ticket," it pointed out that Article 8(1) made reference to the sale of an air transport product, i.e., a contract is formed between the carrier and the customer.<sup>754</sup> The Commission observed that the conclusion of such a contract is usually manifested by the issuance of a ticket, regardless of its format.<sup>755</sup> This led the Commission to determine that the issuance of a ticket is "an integral part of the act of selling [air] transport service" and thus Article 8(1) was applicable.<sup>756</sup> The Commission also found that if the term "air transport product" were not understood to include tickets, it would contravene the spirit, if not the letter, of the Code of Conduct.<sup>757</sup>

Next, the Commission rejected Lufthansa's first theory. The Commission stated that "Lufthansa was fully aware that its announcement to offer incentives to subscribers to issue electronic tickets could only have been taken up by subscribers to the system of which it was a parent carrier."<sup>758</sup> It then proceeded to note that not all CRSs could have benefited from the incentive program and, therefore, the program was improper.<sup>759</sup>

The Commission did not directly address Lufthansa's claim that it had a plan to phase in electronic ticketing among other CRSs. However, the Commission determined that the period of the infringement of the Code of Conduct extended from January 1, 1997, (when the incentives were first offered) to June 30, 1998, (when Lufthansa first made electronic tickets available to a CRS besides START Amadeus).<sup>760</sup> This would seem to indicate that phased development of CRS technology is not permit-

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<sup>752</sup> *Id.* at 57.

<sup>753</sup> Commission Decision 99/618/EC, comp. (3), 1999 O.J. (L 244) 56.

<sup>754</sup> *Id.*

<sup>755</sup> *Id.*

<sup>756</sup> *Id.*

<sup>757</sup> *Id.*

<sup>758</sup> Commission Decision 99/618/EC, legal assessment (49), 1999 O.J. (L 244) 56.

<sup>759</sup> *Id.*

<sup>760</sup> *Id.*

ted if it would have the effect of favoring one CRS above others. Therefore, a carrier planning on starting new procedures or services would probably do well to make such a procedure or service universally available at the time it is introduced. Ultimately, Lufthansa was obliged to pay a fine of 10,000 euros.<sup>761</sup>

### 5. Industry Responses

In addition to EU actions, the private industry organization ECAC plays a direct role in the regulation of computer reservation systems. In 1994, ECAC passed the *Revised ECAC Code of Conduct for Computer Reservation Systems*.<sup>762</sup> As ECAC noted, the Code "[d]eveloped in close co-operation with the European Commission . . . and EU legislation (Council Regulations 2299/89 and 3089/93) . . . to provide a common European code of conduct [for the use of CRSs]."<sup>763</sup> Substantively, the Code mandated clear and nondiscriminatory displays, fees, and carrier links/agreements in the operation of CRSs.<sup>764</sup> In its regulation of code sharing, ECAC in essence broadened the application of the Code. In 1996, ECAC passed a recommendation to its Member States on the regulation of code sharing. The *Recommendation on Consumer Information/Protection Needs in Connection with Code-Shared Air Services*<sup>765</sup> set out to insure full disclosure of code-share information at every stage of the air travel process, particularly with respect to CRSs. The recommendation noted ECAC's concern that "[t]he display of code-shared flights in CRSs does not in all cases comply with the criteria set down in the ECAC and EU codes of conduct . . ."<sup>766</sup> In 1997 the ECAC Task Force on Code-Sharing issued a report detailing the code-sharing environment a year after the implementation of the recommendation. In particular, the report noted that consumer complaints with respect to adequacy of code-share information had decreased since the passage of the recommendation. The Task Force concluded that while significant improvements had been

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<sup>761</sup> *Id.* at art. 2.

<sup>762</sup> EUROPEAN CIVIL AVIATION CONFERENCE, REVISED ECAC CODE OF CONDUCT FOR COMPUTERIZED RESERVATION SYSTEMS, ECAC/16 (1994) [hereinafter EUROPEAN CIVIL AVIATION CONFERENCE].

<sup>763</sup> ECAC, *activities-economic*, available at <http://www.eac-ceac.org/uk/activities/activities-economic.htm> (last visited Feb. 27, 1999).

<sup>764</sup> EUROPEAN CIVIL AVIATION CONFERENCE, *supra* note 762.

<sup>765</sup> Report of the 21st ECAC Plenary Meeting (ECAC/21), Attachment to Appendix 10, Report from the task force on Code-Sharing, Implementation of Recommendation ECAC/19-1.

<sup>766</sup> *Id.*

made in the disclosure of code-share information, continued monitoring would be integral to the further success of the recommendation.<sup>767</sup>

## F. GROUND HANDLING

### 1. *Regulation 2673/88*

The Commission's initial ground handling regulation, Regulation 2673/88, ensured that a purchaser of such services may switch to another supplier on short notice and is free to deal with more than a single supplier.<sup>768</sup> The regulation also ensured the absence of discrimination between airlines.<sup>769</sup> Prices charged were to be reasonable and bear a reasonable relationship to the cost of services provided.<sup>770</sup>

### 2. *Regulation 82/91*

In 1990, the Commission adopted a second regulation on ground handling (Commission Regulation 82/91), providing an exemption so long (i) as the ground handler imposes no exclusivity requirements, (ii) the agreement is not tied to the requirement for the purchase of other goods and services, (iii) prices reflect costs, (iv) conditions are nondiscriminatory, and (v) the carrier is free to withdraw from the agreement upon three months notice.<sup>771</sup>

### 3. *Post-82/91 Discussion of Ground Handling Regulation*

After the expiration of Commission Regulation 82/91 on December 31, 1992, the EC's governing bodies entered into a period of reflection on the subject of ground handling. The Commission did not take any further action on the matter until December 14, 1993, when it adopted a Consultation Paper prepared by the Competition and Transportation Directorates General.<sup>772</sup> It subsequently submitted the Consultation Paper to the Economic and Social Committee (ESC) under Article 198 of the

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<sup>767</sup> *Id.*

<sup>768</sup> ARGYRIS, *supra* note 62, at 31-32; Commission Regulation 2673/88 of July 26, 1988, at arts. 3(3), 16.

<sup>769</sup> Smeathers, *European Liberalization—Turbulence En Route*, IATA REV. (Jan.-Mar. 1989) at 3, 4.

<sup>770</sup> Commission Regulation 2673/88 of July 26, 1988, at art. 3(4).

<sup>771</sup> Commission Regulation 82/91 of December 5, 1990, art. 3.

<sup>772</sup> Opinion of the Economic & Social Committee on the Commission Consultation Paper on Ground Handling Services, 94/C 393/21, 1994 O.J. (C 393) 110.

Treaty of Rome.<sup>773</sup> The ESC discussed the Consultation Paper and ultimately issued an Opinion Paper on September 14, 1994. Although the Commission had declared its intention to "take an initiative before the end of 1994 in order to achieve market access for ground handling [sic] services at Community airports," it did not issue a proposal on new ground handling regulations until April 10, 1995.<sup>774</sup> Shortly after issuing the new proposal, the Commission decided to submit it to the ESC, which released its opinion on the proposal on September 13, 1995.<sup>775</sup> Ultimately, the Council enacted new regulations governing ground handling in October 1996.<sup>776</sup>

#### 4. Directive 96/67/EC

Council Directive 96/67/EC is one of the less liberal air transport regulations introduced in the wake of the Third Package. Its divided nature is reflected in its own Preamble, which states that "it is essential that access to the ground handling [sic] market should take place within a Community framework, while allowing Member States the possibility of taking into consideration the specific nature of the sector."<sup>777</sup> Although its purpose was to create conforming Union-wide ground handling regulations, its net effect was simply to "normalize" ground handling procedures within a certain range.

The greatest degree of liberalization took place in the area of self-handling. Article 1 of the directive permits air carriers, as of January 1, 1998, to self-handle passengers, aircraft maintenance, surface transportation if necessary, and catering services.<sup>778</sup> Carriers are also allowed, as of January 1, 1998, to self-handle baggage, ramp services (i.e., docking the aircraft, loading and unloading the aircraft), refueling, and freight and mail transport provided that the airport meets certain minimum traffic volume requirements.<sup>779</sup> The volume requirements are not less than one million passenger movements or 25,000 tonnes (met-

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<sup>773</sup> *Id.*

<sup>774</sup> Opinion of the Economic & Social Committee on the Proposal for a Council Directive on Access to the Groundhandling Market at Community Airports, 95/C 142/09, 1995 O.J. (C 142) 7.

<sup>775</sup> Opinion on the Proposal for a Council Directive on Access to the Ground Handling Market at Community Airports, 95/C 301/10, 1995 O.J. (C 301) 28.

<sup>776</sup> Council Directive 96/67/EC, 1996 O.J. (L 272) 36.

<sup>777</sup> *Id.* at 36.

<sup>778</sup> *Id.* at 37.

<sup>779</sup> *Id.*

ric) of freight annually, although if an airport reaches the freight threshold without meeting the passenger threshold then only freight services will be subject to self-handling.<sup>780</sup> The directive only stipulates what will happen if the freight threshold is met while the passenger threshold is not, and not the reverse. Presumably, if the passenger threshold is met then both passenger and freight traffic will be subject to self-handling.

Article 1 also permits third-party ground handling (i.e., ground handlers who are employed by a company other than the airport itself or the carriers) from January 1, 1999, at airports with at least three million passenger movements or 75,000 tonnes (metric) of freight traffic annually.<sup>781</sup> Alternatively, it is also permitted at airports that have had not less than two million passenger movements or 50,000 tonnes of freight traffic during the six-month period prior to April 1 or October 1 of the preceding year.<sup>782</sup> This second provision would appear to be designed to address the issue of certain airports that are subject to high seasonal fluctuations in traffic, such as Mediterranean resort areas.<sup>783</sup>

Article 4 of the directive requires that any party that provides ground handling services and also provides some other variety of service must keep separate accounts of their ground handling and other services.<sup>784</sup> The separation of accounts is to be checked by an independent auditor that has been appointed by the Member State where the airport is located.<sup>785</sup> This separation and auditing process are, at least in the case of Airport Managing Bodies (AMBs), intended to prevent cross-subsidization of ground handling operations by other services.<sup>786</sup> Interestingly, Article 4 explicitly mentions the prohibition of cross-subsidization only in regard to AMBs, although it specifically states that the separation of accounts applies to AMBs, carriers, and third-party providers.<sup>787</sup> This seems to suggest that cross-

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<sup>780</sup> *Id.*

<sup>781</sup> Council Directive 96/67/EC, art. 1(1)(c), 1996 O.J. (L 272) 36, 37.

<sup>782</sup> *Id.* at 37.

<sup>783</sup> It should be noted that Article 1(2) states that the provisions of the directive apply to all commercial EU airports with at least two million passenger movements or 50,000 tonnes (metric) of freight traffic annually if the Article 1(1) requirements do not otherwise apply to them.

<sup>784</sup> *Id.* at 39.

<sup>785</sup> *Id.*

<sup>786</sup> See Council Directive 96/67/EC, 1996 O.J. (L 272) 36, 39.

<sup>787</sup> *Id.* at 39.

subsidization would be permissible for carriers and third-party providers if they openly report it.

The directive in Article 5 also requires the creation of "Airport Users' Committees" (Users' Committee) within 12 months of the time the directive enters into force.<sup>788</sup> The Users' Committee is formed from all carriers who fly to a particular airport. Carriers may, if they so desire, appoint an organization to represent some, or all, of their interests jointly.<sup>789</sup> The Users' Committees do not hold great power under the directive, but they are given a consultative role in determining which third-party providers are allowed to render ground handling services if the airport is subject to limitations on the number of providers who may have access to it.<sup>790</sup> Logically, the Users' Committees could serve as the basis for further liberalization in the future.

The remainder of the directive is largely a ratification of state power over ground handling. Article 6 gives Member States the right to bar non-EU-based ground handling providers from competing for access.<sup>791</sup> Member States may also limit the number of providers authorized to supply baggage handling, ramp services, refueling, and freight and mail transport, although they must permit at least two providers to offer these services.<sup>792</sup> As of January 1, 2001, at least one of the providers cannot be controlled either directly or indirectly by (i) the AMB, (ii) a carrier that has transported more than 25% of the airport's passenger or freight traffic in the preceding year, or (iii) a holding company that controls the AMB or such a carrier.<sup>793</sup> However, on July 1, 2000, a Member State may request from the Commission a delay until December 31, 2002, in meeting the two provider minimum.<sup>794</sup> Article 7 permits Member States to restrict the number of carriers who may self-handle items in the constrained categories (baggage handling, ramp services, refueling, freight and mail transport) to as few as two, provided that the Member States do so on the basis of relevant, objective, transparent, and nondiscriminatory criteria.<sup>795</sup> Article 8 allows Member States to

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<sup>788</sup> *Id.*

<sup>789</sup> *See id.*

<sup>790</sup> *See id.* at 41.

<sup>791</sup> Council Directive 96/67/EC, art. 6(1), 1996 O.J. (L 272) 36, 39.

<sup>792</sup> *Id.*

<sup>793</sup> *Id.*

<sup>794</sup> *Id.*

<sup>795</sup> *Id.*

reserve for the AMB, or “another body,” the “centralized infrastructures used for the supply of ground handling [sic] services whose complexity, cost or environmental impact does not allow of division or duplication.”<sup>796</sup> Member States may also make it compulsory that self-handling carriers and third-party providers use central infrastructures.<sup>797</sup> The only limitation on Member States’ powers in this area is that management of the central infrastructures must be “transparent, objective and non-discriminatory” and must not “hinder the access” of self-handling carriers or third-party providers “within the limits provided for in this Directive.”<sup>798</sup>

Article 9 provides Member States further means by which to restrict liberalization of the ground handling services at their airports. If it is “impossible to open up the market” due to “specific constraints of available space or capacity,” the Member State may (i) limit the number of third-party providers to as few as one or ban self-handling altogether or restrict it to as few as one carrier, either in general or in particular categories of ground handling.<sup>799</sup> If a Member State chooses to impose these restrictions, it must specify the categories of services that are subject to these restrictions along with an explanation of the limitations that justify it and a plan for measures to overcome the limitations.<sup>800</sup> The restrictions also should not “unduly prejudice the aims of this Directive,” create inequities between self-handlers and/or third-party providers, or “extend further than necessary.”<sup>801</sup> A Member State must submit a proposal for such restrictions to the Commission, which will make a determination about whether or not to permit the restrictions, or if it should be amended.<sup>802</sup> The Commission may permit a duration of up to three years for most restrictions, the exception being a decision to only allow one third-party provider to render services in the constrained service categories, which can only be granted for two years.<sup>803</sup> A Member State may also request a single extension of two years.<sup>804</sup>

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<sup>796</sup> Council Directive 96/67/EC, art. 8(1), 1996 O.J. (L 272) 36, 40.

<sup>797</sup> *Id.*

<sup>798</sup> *Id.*

<sup>799</sup> *Id.*

<sup>800</sup> *Id.*

<sup>801</sup> Council Directive 96/67/EC, art. 9(2)(b)(i)-(iii), 1996 O.J. (L 272) 36, 40.

<sup>802</sup> *Id.*

<sup>803</sup> *Id.*

<sup>804</sup> *Id.*



Member States are also permitted, under Article 11, to establish a selection procedure for third-party providers if their numbers are to be limited under the terms of Article 6(2) or Article 9.<sup>805</sup> Where a Member State has decided to establish such a selection procedure, it must consult with the Users' Committee at the relevant airport to establish "objective, transparent and non-discriminatory" criteria.<sup>806</sup> The AMB and the Users' Committee will select the third-party provider from the pool established under the selection criteria, provided that the AMB has no connection to the providing of ground handling services.<sup>807</sup> If the AMB does have a connection to the providing of ground handling service, then the "competent authorities" of the Member State, in consultation with the Users' Committee, will select the third-party provider.<sup>808</sup> A third-party provider will be selected for a period of no more than seven years.<sup>809</sup> An AMB that also provides ground handling services may automatically provide those services, even if the airport in question is subject to restrictions under Article 6(2) or Article 9.<sup>810</sup>

The directive goes on to state that Member States may "extend the obligation of public service" to an airport if it is located on an island, has 100,000 or more passenger movements annually, and the Commission approves the extension.<sup>811</sup> The Member States must also organize a mandatory annual meeting between each airport's AMB, carriers, and any third-party providers of ground handling services.<sup>812</sup> A Member State can also make the ground handling activity of third-party providers or self-handlers contingent upon receiving the approval of a public authority independent of the AMB.<sup>813</sup> This approval may be contingent on the financial condition or insurance coverage of the party seeking to render such services.<sup>814</sup> The Member State may also apply such conditions as relate to the safety of installations, aircraft, equipment, or personnel, along with environmental protection and "compliance with relevant social

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<sup>805</sup> *Id.* at 41.

<sup>806</sup> Council Directive 96/67/EC, art. 11(1)(a), 1996 O.J. (L 272) 36, 41.

<sup>807</sup> *Id.*

<sup>808</sup> *Id.*

<sup>809</sup> *Id.*

<sup>810</sup> *Id.*

<sup>811</sup> Council Directive 96/67/EC, art. 12, 1996 O.J. (L 272) 36, 41.

<sup>812</sup> *Id.*

<sup>813</sup> *Id.* at 42.

<sup>814</sup> *See id.*

legislation,”<sup>815</sup> provided that the criteria are applied in a “non-discriminatory manner,”<sup>816</sup> “relate to the intended objective,”<sup>817</sup> and do not have the effect of reducing market access below the level provided for in the directive.<sup>818</sup> The directive also reserves to the Member States the power to prohibit a third-party provider or carrier from operating ground handling services based on the recommendation of the AMB if they have failed to comply with the operational rules imposed by the AMB.<sup>819</sup>

Article 16 requires that Member States take necessary measures to ensure that self-handling carriers and third-party providers have access to airport installations as necessary to carry out their activities.<sup>820</sup> However, this and other provisions of the directive “in no way affect the rights and obligations of Member States in respect of law and order, safety and security in airports.”<sup>821</sup> Furthermore, Member States can use “necessary measures” to assure “protection of the rights of workers and respect for the environment,”<sup>822</sup> as well as requiring suppliers of ground handling service to conform with national laws which are “compatible” with EU law.<sup>823</sup>

Finally, the principle of reciprocity is codified by the directive.<sup>824</sup> A Member State may suspend its obligations under the directive in respect to suppliers of ground handling services from non-EU states if it “appears” that non-EU state does not grant Member State suppliers of ground handling services the same rights that suppliers from that country are granted at the Member State’s airports,<sup>825</sup> or does not grant Member State suppliers the same rights as its national suppliers are granted,<sup>826</sup> or grants suppliers from other nations more favorable treatment than Member State suppliers.<sup>827</sup> However, this article is “[w]ithout prejudice to the international commitments of the

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<sup>815</sup> *Id.*

<sup>816</sup> Council Directive 96/67/EC, art. 14(1)(a), 1996 O.J. (L 272) 36, 42.

<sup>817</sup> *Id.*

<sup>818</sup> *Id.*

<sup>819</sup> *Id.*

<sup>820</sup> *Id.*

<sup>821</sup> Council Directive 96/67/EC, art. 17, 1996 O.J. (L 272) 36, 42.

<sup>822</sup> *Id.*

<sup>823</sup> *Id.* at 43.

<sup>824</sup> *Id.*

<sup>825</sup> *Id.*

<sup>826</sup> Council Directive 96/67/EC, art. 20(1)(b), 1996 O.J. (L 272) 36, 43.

<sup>827</sup> *Id.*

Community,"<sup>828</sup> which suggests that it does not supersede existing bilateral agreements between Member States and non-EU states that may allow for a different level of access for ground handling suppliers.

### 5. *The Charles de Gaulle Airport Decision*

There have been a number of Commission decisions pertaining to ground handling since the implementation of Directive 96/67/EC, but a particularly representative decision was reached in April 1999.<sup>829</sup> The decision was issued in response to a request by French authorities in January of that year for the Commission to grant three exemptions for ground handling at the Roissy-Charles De Gaulle airport. The first exemption sought was for the Charles De Gaulle 2 (CDG 2) terminal to ban self-handling and permit the AMB to control the use of third-party providers concerning ramp services, particularly the transportation of passengers and baggage between aircraft and the terminal.<sup>830</sup> The proposed exemption was to be in effect until December 31, 2000.<sup>831</sup> The second exemption was for the AMB to control the use of third-party providers at the T9 terminal and concerned all ramp services other than catering and baggage handling inside the terminal itself.<sup>832</sup> The AMB would also have been granted the right to permit only two parties (either self-handlers or third-party providers) to engage in passenger handling<sup>833</sup> (i.e., any kind of assistance to passengers, including check-in for tickets and baggage).<sup>834</sup> This exemption was to be in effect until April 1, 2000.<sup>835</sup> The last exemption was to restrict, indefinitely, self-handling at all terminals (CDG 1, CDG 2, and T9) to three self-handlers in the categories of baggage handling, freight and mail handling, and most ramp services.<sup>836</sup>

The request for the exemption cited five factors that necessitated the restrictions for CDG 2: (i) the organization of the fleet of buses used to transport passengers between satellite terminals

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<sup>828</sup> *Id.*

<sup>829</sup> Commission Decision 1999/326/EC, 1999 O.J. (L 124) 14.

<sup>830</sup> *Id.* at 14.

<sup>831</sup> *Id.*

<sup>832</sup> *Id.*

<sup>833</sup> *Id.*

<sup>834</sup> Council Directive 96/67/EC, Annex (2), 1996 O.J. (L 272) 36, 44.

<sup>835</sup> Commission Decision 1999/326/EC, I(1)(1), 1999 O.J. (L 124) 14.

<sup>836</sup> *Id.* at 15.

and the main terminal building,<sup>837</sup> (ii) lack of adequate parking for the bus fleet,<sup>838</sup> (iii) the current structure of the terminal and its "halls" (i.e., concourses),<sup>839</sup> (iv) saturation of the aprons,<sup>840</sup> and (v) congestion on the service roads around the terminal.<sup>841</sup> For T9, the request only offered one justification, namely the lack of sufficient space in the terminal and on the "air-side" to "meet all the needs of the operators."<sup>842</sup>

In response to the request for the exemption, the Commission performed a study of the conditions at CDG, with particular emphasis on the CDG 2 and T9 terminals. Traffic at CDG 2 rose from 28.4 million passengers in 1995 to 38.5 million in 1998.<sup>843</sup> CDG 2 has five halls (A, B, C, D, and F1) and was originally designed to handle 24.5 million passengers annually.<sup>844</sup> Because CDG 2 is obliged to handle considerably more passenger traffic than it was built to, satellite terminals have been built some distance from the main terminal. It was the transport of passengers between these satellite terminals and the main terminal that was the primary focus of the proposed exemption for CDG 2.<sup>845</sup> Two different types of buses are used for this type of operation, conventional buses and specially designed "aerobuses."<sup>846</sup> The aerobuses must be operated by personnel particularly trained in their use.<sup>847</sup> Because of the number and variety of buses in use, there was too little space (a 1665 square meters shortfall) for the buses to be parked at the terminal and they were instead forced to park some distance away.<sup>848</sup> The Commission took particular note that because of the design of hall C, only aerobuses could serve that part of the terminal.<sup>849</sup>

The conditions at T9 were somewhat different, for T9 was especially designed to handle charter flights.<sup>850</sup> This results in the terminal having an uneven traffic distribution, with one-third of

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<sup>837</sup> *Id.* at 16.

<sup>838</sup> *Id.*

<sup>839</sup> *Id.*

<sup>840</sup> Commission Decision 1999/326/EC, II(14), 1999 O.J. (L 124) 14, 16.

<sup>841</sup> *Id.*

<sup>842</sup> *Id.*

<sup>843</sup> *Id.*

<sup>844</sup> *Id.* at 17.

<sup>845</sup> See Commission Decision 1999/326/EC, II(A)(15), 1999 O.J. (L 124) 14, 17.

<sup>846</sup> *Id.*

<sup>847</sup> *Id.*

<sup>848</sup> *Id.* at 18.

<sup>849</sup> *Id.*

<sup>850</sup> Commission Decision 1999/326/EC, II(B)(36), 1999 O.J. (L 124) 14, 19.

its annual traffic passing through in July and August, and half the weekly traffic volume coming on weekends.<sup>851</sup> The terminal has also seen a surge in traffic, with annual flow increasing from 1.2 million passengers in 1995 to 1.9 million in 1998.<sup>852</sup> Because of its unusual traffic distribution, the terminal was partially constructed of prefabricated building units.<sup>853</sup> Ground handling at T9 was provided by several third-party providers and one air carrier was self-handling for purposes of ramp services and refueling at the time the exemption was proposed.<sup>854</sup> Due to these factors, the terminal would reach "saturation" during peak periods, resulting in flights having to be diverted to other terminals with available space.<sup>855</sup> The AMB requested the exemption for T9 so it could expand the terminal to accommodate the additional traffic and continue to allow competition for ground handling.<sup>856</sup> The exemption was intended to permit the AMB to close part of the terminal for the expansion project.<sup>857</sup>

The Commission first addressed the third exemption requested, the limitation to three self-handlers. It was found by the Commission that it did not even need to grant an exemption for this action, as Article 7(2) of the ground handling directive permitted such an action without Commission approval provided that it was done nondiscriminatorily.<sup>858</sup> In regard to the other exemptions, the Commission stated that "where specific space or capacity constraints . . . make it impossible to admit a new supplier and/or authorise selfhandling . . . , the Member State in question may . . . restrict or even reserve the provision of services . . . and/or ban or limit self-handling . . . ."<sup>859</sup> However, the Commission also noted that "the main purpose of the Directive is to liberalise ground handling [sic] services . . . , measures which are liable to exclude or prohibit the activities of [parties wishing to ground handle] must 'be such as to guarantee the achievement of the intended aim and must not go beyond that which is necessary in order to achieve

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<sup>851</sup> *Id.*

<sup>852</sup> *Id.* at 16.

<sup>853</sup> *Id.* at 19.

<sup>854</sup> *Id.*

<sup>855</sup> Commission Decision 1999/326/EC, II(B.1)(41),(42), 1999 O.J. (L 124) 14, 19.

<sup>856</sup> *Id.* at 20.

<sup>857</sup> *Id.*

<sup>858</sup> *Id.* at 15.

<sup>859</sup> *Id.* at 20.

that objective.’”<sup>860</sup> The Commission therefore determined that its standard of judgment would be whether the exemptions contained “restrictions on freedom to provide services and, if so, whether those restrictions are justified by overriding reasons relating to the public interest.”<sup>861</sup> The Commission proceeded to state a three-part test for evaluating ground handling exemptions:

- The existence and extent of the space and capacity constraints used to justify the exemption and the impossibility of opening up the market to the degree provided for in the Directive; only the space an/or capacity constraints can be taken into account,
- The plan of appropriate measures to overcome the constraints; this plan must be credible and unconditional and have a timetable for the implementation of those measures,
- Conformity with the principles referred to [in] Article 9(2) [of Directive 96/67/EC] concerning compliance with the objective of the Directive, no distortion of competition and the extent of the measure.<sup>862</sup>

Furthermore, exemptions must be strictly interpreted and the scope of an exemption must be determined in relation to the aims of the proposed measures.<sup>863</sup>

Addressing the planned exemption for CDG 2, the Commission noted that while ground handling equipment “ideally” should be located near the terminals, that was “only as a matter of priority.”<sup>864</sup> The Commission explained that the Directive required a petitioning party to “demonstrate that it is *impossible*” (emphasis added) to liberalize its ground handling operations to the extent required.<sup>865</sup> Thus, in this instance French authorities would have had to show there was no manner in which they could accommodate additional buses. It was stated by the Commission that Member States could not use self-defined quality criteria to demonstrate such “impossibilities.”<sup>866</sup> Specifically focusing on CDG 2 itself, the Commission stated that, other than at hall C, it was physically possible to permit more buses to operate from the halls because the AMB was planning on phasing

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<sup>860</sup> Commission Decision 1999/326/EC, IV(1.1)(56), 1999 O.J. (L 124) 14, 21 (quoting Commission Decisions 98/387/EC and 98/388/EC, 1998 O.J. (L 173) 32 & 45).

<sup>861</sup> *Id.* at 21.

<sup>862</sup> *Id.*

<sup>863</sup> *Id.*

<sup>864</sup> *Id.* at 22.

<sup>865</sup> Commission Decision 1999/326/EC, IV(2)(63), 1999 O.J. (L 124) 14, 22.

<sup>866</sup> *Id.*

out the aerobuses, which required significantly more space than conventional buses.<sup>867</sup> The Commission conceded that there was inadequate parking at the terminals, but argued that the buses could be parked farther away from the terminals, such as on the open space reserved for future terminal construction.<sup>868</sup> However, the Commission admitted that it would not be possible to allow parties other than the AMB to serve hall C, because hall C's design could only accommodate aerobuses which, for a variety of reasons, are solely operated by the AMB's staff.<sup>869</sup> The Commission therefore refused the requested exemption for all the CDG 2 halls other than hall C, pending a demonstration that there were other constraints on ground handling operations.<sup>870</sup> The Commission granted the exemption for hall C, because of the circumstances at the hall and because the AMB complied with Article 9(2) of the Directive by providing a plan to remedy the factors restricting operations.<sup>871</sup> The plan was to redesign hall C to eliminate the need for aerobuses by adding stairways and/or escalators at the gates to permit conventional buses to load/unload passengers and baggage at them.<sup>872</sup>

Turning to the T9 terminal, the Commission observed that while there were significant constraints on ground handling operations, the proposed exemption was too broad in scope.<sup>873</sup> The space limitations previously identified concerned baggage handling and passenger services within the terminal, but the exemption would have encompassed many aspects of ramp services where there was no demonstrable shortage of space.<sup>874</sup> The Commission may have been particularly skeptical about the requested exemption for ramp services because the AMB submitted a compliance plan that would have addressed only the space problems within the terminal.<sup>875</sup> Therefore, the Commission permitted only that part of the exemption that concerned the ground handling services within the terminal, while denying the part concerning ramp services.<sup>876</sup>

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<sup>867</sup> *Id.*

<sup>868</sup> *Id.* at 23.

<sup>869</sup> *Id.* at 22.

<sup>870</sup> Commission Decision 1999/326/EC, IV(3)(81), 1999 O.J. (L 124) 14, 25.

<sup>871</sup> *Id.*

<sup>872</sup> *Id.*

<sup>873</sup> *Id.* at 26.

<sup>874</sup> *Id.*

<sup>875</sup> Commission Decision 1999/326/EC, IV(3)(82), 1999 O.J. (L 124) 14, 25-26.

<sup>876</sup> *Id.* at 27.

Reflecting upon Directive 96/67/EC, the Commission remarked that while its primary purpose was to improve market access, such access "should be real."<sup>877</sup> The Commission explained that this means access provisions that will improve the quality of service and reduce costs to the consumer.<sup>878</sup> Thus, the Commission appears to be attempting to balance the generous powers the Council granted to the Member States and their AMBs to restrict competition in the ground handling market. This is the logical conclusion to be drawn from the Commission's statement about "real" market access and its earlier declaration above that it must be physically impossible for additional parties to be admitted to the ground handling market for an exemption to be granted. Given the apparent antagonism between the Council's writing and the Commission's interpretation, Directive 96/67/EC may not be the final piece of EU legislation on the subject of ground handling.

#### G. CARGO SERVICES

Council Regulations 294/91 applied to combined scheduled and charter services, but cargo services were unaffected.<sup>879</sup> The Council met in December 1990 to consider regulations on the intra-Community operation of air cargo carriers. Two months later, the Council passed Regulation (EEC) 294/91, which came into force on February 4, 1991.<sup>880</sup> The Council announced its intention to adopt rules for licensing and routes for such carriers by July 1, 1992.<sup>881</sup> Third, Fourth, and Fifth Freedom rights were conferred.<sup>882</sup> Capacity limitation provisions were similar to those adopted in the Second Phase of Liberalization, discussed above, providing that, except for safety reasons, "there shall be no restrictions on frequency of service, aircraft type and/or the amount of cargo and mail which may be carried."<sup>883</sup> Cargo rates were deregulated.<sup>884</sup>

Ultimately, Regulation 294/91 was not long lived, being in effect less than two years. Article 15 of Regulation 2408/92 repealed all the provisions of Regulation 294/91 except for Article

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<sup>877</sup> *Id.* at 26.

<sup>878</sup> *Id.*

<sup>879</sup> GIEMULLA & SCHMID, *supra* note 326, at § 57.

<sup>880</sup> Council Regulation 294/91, 1991 O.J. (L 36) 1.

<sup>881</sup> *Id.* at arts. 3(2) 2.

<sup>882</sup> *Id.* at arts. 4, 5, 2-3.

<sup>883</sup> *Id.* at arts. 6, 3.

<sup>884</sup> *Id.* at art. 9(1); *see* GIEMULLA & SCHMID, *supra* note 326, at § 58.



2(b) and the regulation's annex.<sup>885</sup> Article 2(b) of 294/91 merely defines the term "Community air cargo carrier," which is an air cargo carrier whose principal place of business is located in a Member State and where Member States or their nationals own a majority of its shares.<sup>886</sup> The annex identified carriers that, while not in compliance with the definition of Article 2(b), were to be considered Community air cargo carriers on a "grandfather" basis.<sup>887</sup> Since January 1993, for the purposes of tariffs and licensing, cargo services have been treated the same as passenger services.

## H. THE COMPETITION RULES AND MERGER REGULATION

### 1. Introduction

Competitiveness in the EU's air transportation sector is governed by two principal mechanisms, the competition rules (Regulations 3975/87 and 3976/87), which arise from Articles 85 and 86 of the Treaty of Rome, and the merger regulation (Regulation 4064/89), which is derived from Articles 87 and 235 of the Treaty of Rome.<sup>888</sup> The competition rules are also supplemented by Articles 88 and 89 of the Treaty of Rome when a competition infraction lies beyond their scope.<sup>889</sup> The competition rules were promulgated in the wake of the *Nouvelles Frontières* case to forestall the Member States from seizing authority over air transportation regulation, while the merger regulation was created in the late 1980s as part of a surge in Community regulatory powers in anticipation of the coming formation of the EU. Unlike the antitrust regulations of the United States, these various regulations and treaty provisions are intended not so much to prevent the formation, or force the dissolution, of monopolies, but rather to prevent an undertaking, or group of undertakings, from achieving a market position

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<sup>885</sup> Council Regulation 2408/92, art. 15, 1992 O.J. (L 240) 8.

<sup>886</sup> Council Regulation 294/91, art. 2(b)(i), 1991 O.J. (L 36) 1.

<sup>887</sup> *Id.* at Annex 4. (The "grandfathered" carriers are SAS, Britannia Airways, and Monarch Airlines.).

<sup>888</sup> *Air Transport: Procedure for Application of Competition Rules*, available at <http://www.europa.eu.int/scadplus/leg/en/lvb/124079.htm> (last visited 7/13/2000); *Air Transport: Application of Competition Rules*, available at <http://www.europa.eu.int/scadplus/leg/en/lvb/124077.htm> (last visited 6/13/2001).

<sup>889</sup> Director of DG IV (Competition) Humbert Drabbe, Address to European Air Law Association 10th Annual Conference (Nov. 6, 1998).

that makes competition impossible or injures the consumer.<sup>890</sup> As detailed below, both categories of competitive measures have played key roles in the shaping of the EU air transport industry. Before proceeding with the analysis of the competition rules and the merger regulation, however, there is a broader issue, which includes both of them and is especially noteworthy in the realm of international air transportation.

In 1991, the EU and the U.S. reached an understanding in regard to the implementation of their respective competition laws.<sup>891</sup> Called an *Agreement Between the Government of the United States of America and the Commission of the European Communities Regarding the Application of Their Competition Laws* (the Agreement), the unimaginative title cloaked a radical step forward in international cooperation. The Agreement was intended to promote coordination between the EU and U.S. (referred to as the "parties" in the document) to reduce the danger of differences in their respective competition rulings concerning transatlantic mergers and acquisitions.<sup>892</sup> The "competition laws" included in the Agreement were Articles 85, 86, 89, and 90 of the Treaty of Rome, Regulations 3975/87 and 3976/87 as "implementing regulations," and the merger regulation (Regulation 4064/89), along with the U.S. Sherman Act, Clayton Act, Wilson Tariff Act, and the Federal Trade Commission Act.<sup>893</sup>

The basic premise of the Agreement was that each party should notify the other whenever its competition authorities (the Commission for the EU, the Department of Justice and the Federal Trade Commission for the U.S.) realize their enforcement activities may affect "important interests" of the other party.<sup>894</sup> This notice must be given in a timely manner so that the other party has an opportunity to voice its opinions on the matter.<sup>895</sup> Beyond this principle, the parties must also provide each other with "any significant information" their respective

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<sup>890</sup> See generally G. Porter Elliott, *Antitrust at 35,000 Feet: The Extraterritorial Application of United States and European Community Competition Law in the Air Transport Sector*, 31 GEO. WASH. J. INT'L L. & ECON. 185 (1998).

<sup>891</sup> Agreement Between the Government of the United States of America and the Commission of the European Communities Regarding the Application of Their Competition Laws, 1995 O.J. (L 95) 47 (publication was delayed for four years as the Court of Justice initially blocked its implementation) [hereinafter AGREEMENT].

<sup>892</sup> *Id.* at art. I(1).

<sup>893</sup> *Id.* at art. I(2)(A)(i) - (ii).

<sup>894</sup> *Id.*

<sup>895</sup> *Id.*

competition authorities uncover which may be relevant to the enforcement activities of the other party.<sup>896</sup> Under the Agreement, the parties also affirm their intentions to cooperate with each other in investigating anticompetitive activities that take place in the territory of one party, but whose effects are felt in the other.<sup>897</sup> However, the Agreement does not limit the discretion of the party in whose territory the anticompetitive activities are transpiring to decide not to intervene.<sup>898</sup>

The parties undertake "at all stages in [their] enforcement activities, to take into account the important interests of the other Party . . ."<sup>899</sup> If it appears that a party's enforcement activities would have a negative impact on the other party's "important interests," the enforcing party must consider several factors before proceeding with enforcement.<sup>900</sup> Among these factors are the relative significance of the anticompetitive activities, the purpose behind the anticompetitive activities, and the extent to which enforcement activities by the other party with respect to the undertaking may be affected.<sup>901</sup> Neither party is obligated to provide information to the other if such disclosure is forbidden by the law of the party holding the information, nor is a party required to provide information if doing so would be incompatible with its "important interests."<sup>902</sup> Furthermore, the parties must maintain, "to the fullest extent possible," the confidentiality of any information provided by the other in confidence.<sup>903</sup> Finally, no terms of the Agreement may be interpreted in a manner inconsistent with the existing laws of the parties.<sup>904</sup>

In 1998, the EU and U.S. entered into a supplemental arrangement on the subject of their competition laws.<sup>905</sup> Entitled an *Agreement Between the European Communities and the Government*

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<sup>896</sup> AGREEMENT, *supra* 891, at 48.

<sup>897</sup> *Id.* at 48-49.

<sup>898</sup> *Id.* at 49.

<sup>899</sup> *Id.*

<sup>900</sup> *Id.*

<sup>901</sup> AGREEMENT, *supra* note 891, at 49.

<sup>902</sup> *Id.* at 50.

<sup>903</sup> *Id.*

<sup>904</sup> *Id.* There is a brief reference to the Agreement in the context of the Boeing - MDC decision, *see* Commission Decision 97/816/EC, 1997 O.J. (L 336) 16, at art. VI(11)-(12), 17-18.

<sup>905</sup> Agreement Between the European Communities and the Government of the United States of America on the Application of Positive Comity Principles in the Enforcement of their Competition Laws, 1998 O.J. (L 173) 28.

of the United States of America on the Application of Positive Comity Principles in the Enforcement of Their Competition Laws (the Comity Agreement), it was intended to further clarify the principles under which the parties cooperate to eliminate anticompetitive activities in each other's respective territories.<sup>906</sup> As such, the Comity Agreement covers little new ground, and it is explicitly designed to refine the Agreement, rather than supersede it.<sup>907</sup> There is one significant change, however, in that the Comity Agreement specifically removes proceedings under the merger regulation, Regulation 4064/89, from the scope of the Agreement.<sup>908</sup> The rationale for removing such an important piece of EU regulatory work from the Agreement is uncertain. It may have been a further response by the EU to its difficulties dealing with the Boeing/McDonnell-Douglas merger discussed below.

## 2. Competition Rules

The EU competition rules are a complex mélange of Articles of the Treaty of Rome and their enforcing regulations. The relevant treaty provisions are discussed in Sections IV.C and VI.E and F above, along with Regulation 3976/87 discussed in Section IV.C; therefore, this analysis will be principally focused on the substantive portions of Regulation 3975/87.<sup>909</sup>

### a. Regulation 3975/87

Regulation 3975/87 was intended to provide detailed rules for the application of Articles 85 and 86 to the air transport industry, encompassing all air transport between Union airports.<sup>910</sup> The prohibitions prescribed by Article 85(1) of the Treaty of Rome are held not to apply to certain agreements and concerted practices provided that their sole object or effect was to achieve technical improvements or cooperation.<sup>911</sup> The investigative procedures established by the regulation may be started by the Commission on its own initiative, or in response

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<sup>906</sup> *Id.* at 28

<sup>907</sup> *Id.* at 30.

<sup>908</sup> *Id.* at 29.

<sup>909</sup> Council Regulation 3975/87, 1987 O.J. (L 374) 1. Regulation 3975/87 has been twice amended, first by Council Regulation 1284/91, 1991 O.J. (L 122) 2, and again by Council Regulation 2410/92, 1992 O.J. (L 240) 18. As both amendments predate the Third Package and did not radically alter the character of the regulation, the regulation as discussed here is its final amended form.

<sup>910</sup> Council Regulation 3975/87, art. 1(1) - (2), 1987 O.J. (L 374) 1, 2.

<sup>911</sup> *Id.* at 2.

to a complaint from either a Member State or a person, natural or legal, who claims a legitimate interest in the matter.<sup>912</sup>

Once the Commission has completed its investigation, and has determined that there is an infringement of Articles 85(1) or 86 of the Treaty of Rome, it may issue a decision requiring the undertaking(s) to cease such activities.<sup>913</sup> However, at its discretion the Commission may issue recommendations for actions that would bring the undertaking(s) into compliance with the terms of the treaty provisions.<sup>914</sup> If the activities of the undertaking(s) are in compliance with the terms of Article 85(1) and 86, or if an exemption under Article 85(3) is applicable, the Commission shall issue a decision declaring the activity to be within the bounds of the Treaty of Rome.<sup>915</sup> Where the Commission has reason to believe that certain activities are imminently threatening the existence of air service or an air carrier, it may issue an order halting the activities until such time as it is able to render a final decision, although the order may not be for an initial period greater than six months.<sup>916</sup>

Undertakings that desire to have the Article 85(3) exemptions applied to their activities may submit an application to the Commission for such approval rather than wait for a complaint to be brought against them.<sup>917</sup> Once such an application has been made and the Commission has taken comments from interested parties, it may issue a decision granting or denying the exemption, alternatively, it may simply let the matter pass, in which case after 90 days the exemption becomes effective for a period of six years.<sup>918</sup> Any decision granting an Article 85(3) exemption must state the length of time for which it is valid, although normally it would not be for a period less than six years.<sup>919</sup> The exemption may be extended if the undertaking(s) involved still comply with the necessary terms of the decision and the Treaty of Rome.<sup>920</sup> Equally, the exemption may be terminated earlier if there has been a change in the basic facts of the matter, or if the undertaking(s) violated the conditions of the decision or en-

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<sup>912</sup> *Id.*

<sup>913</sup> *Id.*

<sup>914</sup> *Id.*

<sup>915</sup> Council Regulation 3975/87, art. 4(2) - (3), 1987 O.J. (L 374) 1, 2.

<sup>916</sup> *Id.* at 2.

<sup>917</sup> *Id.* at 3.

<sup>918</sup> *Id.*

<sup>919</sup> *Id.*

<sup>920</sup> Council Regulation 3975/87, art. 6(2), 1987 O.J. (L 374) 1, 3.

gaged in other malfeasance.<sup>921</sup> The Member States have the power to apply Articles 85(1) and 86, provided that the Commission has not initiated an investigation, but only the Commission may grant the Article 85(3) exemptions, subject to review by the Court of Justice.<sup>922</sup>

Regulation 3975/87 grants the Commission the power to conduct "all necessary investigations" into undertakings that are being examined.<sup>923</sup> Alternatively, the Commission may request the Member State in whose territory the investigation is being conducted to use its resources to carry out the investigation.<sup>924</sup> An obligation of professional secrecy exists for examinations under the regulation.<sup>925</sup> Where an undertaking fails to provide requested information to the Commission, or otherwise does not cooperate with an investigation, the Commission may impose fines up to 5,000 Euros.<sup>926</sup> If an undertaking is found to have breached the terms of Articles 85(1) or 86 and/or failed to comply with a condition the Commission imposed in an earlier decision, the Commission may impose a fine from 1,000 to 1,000,000 Euros, or a fine in excess of 1,000,000 Euros but not exceeding 10% of the preceding year's turnover.<sup>927</sup> The implications of Regulation 3975/87 are particularly relevant to alliances between air carriers, as most such agreements include provisions that would violate Article 85(1)'s ban on anticompetitive activities. Thus, the air transport industry watched the first application of the regulation to an alliance with particular interest.

#### b. The Lufthansa - SAS Decision

On May 11, 1995, Deutsche Lufthansa AG (Lufthansa) and Scandinavian Airlines System (SAS) notified the Commission of a newly concluded cooperation agreement that would lead to the formation of "an integrated air transport system," (i.e., an alliance).<sup>928</sup> The carriers contacted the Commission about their proposed alliance in an effort to obtain an exemption under Article 85(3).<sup>929</sup> However, the Commission did not respond

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<sup>921</sup> *Id.*

<sup>922</sup> *Id.*

<sup>923</sup> *Id.* at 4.

<sup>924</sup> *Id.* at 5.

<sup>925</sup> Council Regulation 3975/87, art. 17(1)-(2), 1987 O.J. (L 374) 1, 6.

<sup>926</sup> *Id.* at 5.

<sup>927</sup> *Id.*

<sup>928</sup> Commission Decision 96/180/EC, I(A)(1), 1996 O.J. (L 54) 28, 28.

<sup>929</sup> *Id.*

positively to the initial application, stating that there were "serious doubts" about the compatibility of the agreement with the Treaty of Rome, thus necessitating a full investigation.<sup>930</sup>

In 1994, Lufthansa had the second largest amount of passenger-kilometers in Europe and the second largest amount of passenger-kilometers in worldwide traffic of any European air carrier.<sup>931</sup> Lufthansa also had the second largest fleet among European air carriers and it was the leading European cargo carrier.<sup>932</sup> SAS, on the other hand, was third in passenger-kilometers within Europe, but was the seventh-ranked European carrier in worldwide traffic.<sup>933</sup> SAS was the eighth largest European carrier in cargo traffic, both within Europe and worldwide, and had the third largest fleet of European carriers.<sup>934</sup> The agreement would establish a regional joint venture to handle all of their traffic between Germany and the Scandinavian nations.<sup>935</sup> The joint venture would be equally owned by the two carriers and its management would have the authority to determine such items as capacity, frequencies, and fares, but it would not constitute an independent company.<sup>936</sup> On a global level, the parties would pool their sales and marketing efforts, establish joint network and price planning, offer reciprocal access to their frequent-flyer programs, and integrate their cargo transport activities as much as possible.<sup>937</sup> Lufthansa and SAS would also establish a joint hub system, although each party would still handle its own domestic traffic independently.<sup>938</sup>

*i. The Relevant Market*

The Commission began its analysis by determining the relevant market, which in this instance would be the market for scheduled air transport of passengers and cargo on each of the routes joining Germany and Scandinavia.<sup>939</sup> The Commission concluded that chartered air transport could not be a viable alternative, as the principal part of traffic on the routes was com-

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<sup>930</sup> *Id.*

<sup>931</sup> *Id.* at 29.

<sup>932</sup> *Id.*

<sup>933</sup> Commission Decision 96/180/EC, I(B)(19), 1996 O.J. (L 54) 28, 30.

<sup>934</sup> *Id.* at 29-30.

<sup>935</sup> *Id.* at 30.

<sup>936</sup> *Id.*

<sup>937</sup> *Id.* at 30-31.

<sup>938</sup> Commission Decision 96/180/EC, I(C)(26) - (27), 1996 O.J. (L 54) 28, 30 - 31.

<sup>939</sup> *Id.* at 31.

posed of business travelers, who generally prefer to travel on scheduled flights.<sup>940</sup> High-speed trains may serve as an alternative to passenger air travel but, due to geography, that was not an option. Cargo transport by rail would not be a feasible alternative either.<sup>941</sup> Furthermore, the geography of the region would make it difficult for travelers to take alternatives to the direct Germany-to-Scandinavia routes because of the considerable extra time such routing would add to the trip.<sup>942</sup>

*ii. Potential Anticompetitive Effects*

Having established the nature of the relevant market, the Commission next turned to considering the potential anticompetitive effects of the agreement. Lufthansa and SAS claimed that there was significant competition between their proposed hubs (Copenhagen, Stockholm, Oslo, Frankfurt, and Munich) and other major European airports.<sup>943</sup> The Commission conceded that this was true, but it also pointed out that the “hub competition” was more important to intercontinental travelers than intra-European travelers.<sup>944</sup> Therefore, the anticompetitive effects needed to be determined on a route-by-route basis.<sup>945</sup> There were 25 routes between Germany and Scandinavia, eight of which were operated exclusively by the two parties (with the exception of one daily frequency by Singapore Airlines).<sup>946</sup> These eight routes alone accounted for 66% of all traffic between Scandinavia and Germany, and at least one of the parties operated on 12 of the other routes.<sup>947</sup> Thus, the proposed joint venture would “appreciably restrict actual and potential competition” in regards to those routes.<sup>948</sup> The carriers’ economic power would also be substantially increased as a result of their operational consolidation on the German-Scandinavian routes, while their pooled frequent-flyer programs would serve to attract even more traffic.<sup>949</sup> The combined integrated cargo service the parties planned to create also had “the object and effect

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<sup>940</sup> *Id.*

<sup>941</sup> *Id.*

<sup>942</sup> *Id.* at 32.

<sup>943</sup> Commission Decision 96/180/EC, II(C.1)(44), 1996 O.J. (L 54) 28, 32.

<sup>944</sup> *Id.* at 33.

<sup>945</sup> *Id.*

<sup>946</sup> *Id.*

<sup>947</sup> *Id.*

<sup>948</sup> Commission Decision 96/180/EC, II(C.1)(50), 1996 O.J. (L 54) 28, 33.

<sup>949</sup> *Id.* at 34.



of restricting competition" in the European air cargo market.<sup>950</sup> Turning its attention to the global implications of the alliance, the Commission was less concerned than it had been about the effects of the joint venture. It was admitted that the agreement would lead to competitive restrictions, but the effect of these restrictions would be significantly weaker given the level of competition both Lufthansa and SAS face on the world market.<sup>951</sup>

*iii. Grounds for an Exemption*

For the reasons above, the Commission concluded that the agreement did in fact violate the terms of Article 85(1) of the Treaty of Rome.<sup>952</sup> This conclusion was reached with little fanfare, however, for Lufthansa and SAS had clearly anticipated such a finding; hence their filing for an Article 85(3) exemption. The Commission therefore moved briskly to discuss possible grounds for an exemption. As part of its analysis, the Commission identified four major considerations for granting an exemption: (i) the agreement must contribute to the economic progress of the Union, (ii) the agreement must benefit consumers, (iii) the restrictions must be indispensable in nature, and (iv) there must not be an elimination of competition.<sup>953</sup>

With respect to the agreement's contribution to the economic progress of the EU, the Commission considered two factors: the effects of the agreement on the European air transportation network, and its effects on the costs of the two parties. The Commission observed that SAS's network was predominantly regional, while Lufthansa's was more balanced between regional and pan-European routes.<sup>954</sup> The alliance would therefore have a beneficial effect on the overall European air transportation network, particularly by improving service to Scandinavia, whose geographically peripheral location has left its populations feeling marginalized in the EU.<sup>955</sup> The Commission also stated that the reduction of European air carriers' costs is "an important factor" to consider in granting such an exemption given the considerably higher costs associated with European aviation.<sup>956</sup>

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<sup>950</sup> *Id.*

<sup>951</sup> *Id.*

<sup>952</sup> *Id.* at 35.

<sup>953</sup> Commission Decision 96/180/EC, II(E)(a), 1996 O.J. (L 54) 28, 35 - 37.

<sup>954</sup> *Id.* at 35.

<sup>955</sup> *Id.* at 36.

<sup>956</sup> *Id.*

The precise savings that the agreement was estimated to produce were excised from the decision; however, the Commission did appear to be impressed with the carriers' cost reduction plan.<sup>957</sup> The Commission therefore concluded that the alliance would "likely . . . contribute to economic progress."<sup>958</sup>

The Commission briefly addressed the other three considerations for exemption. First, it determined that consumers would benefit from improved access to the European air network and the lower fares the cost reductions were likely to generate.<sup>959</sup> The restrictions imposed by the agreement on the parties were indispensable, as neither Lufthansa nor SAS could achieve the same level of service operating independently.<sup>960</sup> Finally, although competition would initially be reduced on the German-Scandinavian routes, there were other carriers operating in the market which could expand their service, particularly once all the Third Package measures came into effect.<sup>961</sup> Despite this streamlined analysis, the Commission repeatedly expressed its opinion that restrictions on the parties would be necessary to bring the agreement into full compliance with Article 85(3).<sup>962</sup>

The Commission approved a ten-year exemption to the Article 85(1) prohibitions for the Lufthansa-SAS alliance, but approval came with a heavy price.<sup>963</sup> Eight routes exclusively operated by Lufthansa and SAS were singled out for the Commission's conditions under the decision (hereinafter the "Article 2(2) routes").<sup>964</sup> To describe the conditions, the Commission coined the phrase "Lufthansa/SAS entity." The Lufthansa/SAS entity would be composed of Lufthansa, SAS, any carrier in which either of the parties held more than 10 percent of the shares, any carrier with which either of the parties had completed a structural agreement, and any carrier with which the parties had concluded a code-sharing agreement on routes between Germany and Scandinavia.<sup>965</sup> Through October 31, 2002, on the Article 2(2) routes, if a carrier established in

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<sup>957</sup> *Id.*

<sup>958</sup> Commission Decision 96/180/EC, II(E)(a.2)(73), 1996 O.J. (L 54) 28, 36.

<sup>959</sup> *Id.*

<sup>960</sup> *Id.* at (76)-(78).

<sup>961</sup> *Id.*

<sup>962</sup> *Id.* at 36-7.

<sup>963</sup> Commission Decision 96/180/EC, art. 1, 1996 O.J. (L 54) 28, 40.

<sup>964</sup> *Id.* The eight routes were Dusseldorf-Copenhagen, Dusseldorf-Stockholm, Frankfurt-Copenhagen, Frankfurt-Gothenburg, Frankfurt-Oslo, Frankfurt-Stockholm, Hamburg-Stockholm, and Munich-Copenhagen.

<sup>965</sup> *Id.*

the EEA<sup>966</sup> provides three months notice to the Lufthansa/SAS entity of its intention to start service, the Lufthansa/SAS entity must freeze its daily frequencies on the affected routes until the new entrant starts its service.<sup>967</sup> The Lufthansa/SAS entity may subsequently increase its number of daily frequencies by one or by as many as is necessary to equal the new entrant's frequencies if it chooses to operate more than the Lufthansa/SAS entity already does.<sup>968</sup> If an EEA-based carrier wishes to enter into an interlining agreement with the Lufthansa/SAS entity, the entity must permit it to do so on terms comparable to the industry's norms for a period of seven years or until December 31, 2005, whichever comes first.<sup>969</sup> Furthermore, the Lufthansa/SAS entity must admit any EEA-based carrier into its frequent-flyer program if the new entrant is not already part of a frequent-flyer program and it plans on operating a service on an Article 2(2) route.<sup>970</sup>

The Commission also expressed concern about the fact that Lufthansa and SAS already participated in frequent-flyer programs with other carriers. To resolve that issue, the Commission obligated both parties to terminate those arrangements by January 1, 1997.<sup>971</sup> As noted above, the shortage of slots at most European airports is a chronic problem, so the Commission imposed elaborate slot allocation conditions on the Lufthansa/SAS entity.<sup>972</sup> Basically, the entity was obligated to give up a limited number of slots on demand to a new entrant on the Article 2(2) routes, provided that the new entrant had not otherwise been able to obtain the slots. Through October 31, 2002, the Lufthansa/SAS entity must provide annual reports to the Commission, detailing its number of frequencies on the Article 2(2) routes, any agreements on interlining or frequent-flyer programs, and a list of slots rendered to other carriers.<sup>973</sup> Finally, through December 31, 2005, the entity must provide the Com-

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<sup>966</sup> The EEA is the European Economic Area. It is composed of the Member States of the EU and the members of the European Free Trade Association (EFTA), which are Norway, Iceland, Liechtenstein, and Switzerland. There is a close relationship between the EU and the EFTA. See *European Free Trade Association, EFTA*, available at <http://secretariat.efta.int/euroeco>.

<sup>967</sup> Commission Decision 96/180/EC, art. 3(1)(a), 1996 O.J. (L 54) 28, 40.

<sup>968</sup> *Id.*

<sup>969</sup> *Id.*

<sup>970</sup> *Id.*

<sup>971</sup> *Id.* at 41.

<sup>972</sup> Commission Decision 96/180/EC, art. 3(8)(a), 1996 O.J. (L 54) 28, 41.

<sup>973</sup> *Id.* at 42.

mission with annual reports on ticket prices, total monthly capacity supplied, and data regarding the extent of cost-reduction achieved.<sup>974</sup>

c. Weakness of Regulation 3975/87

While the Commission's decision in the Lufthansa/SAS case has been hailed as a model for examining air-carrier alliances,<sup>975</sup> it also served to illustrate an inherent weakness of Regulation 3975/87. As written, Regulation 3975/87 (along with Regulation 3976/87) is limited in its applicability, pertaining only to air traffic within the EU.<sup>976</sup> Therefore, agreements between EU-based carriers and carriers from other countries must be assessed by the individual Member States under Articles 88 and 89 of the Treaty of Rome, thus creating a danger of different national competition authorities reaching divergent opinions about the compatibility of such an agreement with the Treaty of Rome.<sup>977</sup> This situation is particularly anomalous because it exists for no other industry and because the merger regulation does not differentiate between intra-EU and extra-EU agreements.<sup>978</sup> To resolve this potential minefield of jurisdictional controls, in 1997 the Commission proposed an amendment to Regulation 3975/87 and 3976/87 that would extend the EU's authority to extra-EU agreements.<sup>979</sup> Despite Parliament approval of the proposal, by mid-2000 no further progress on the implementation of the amendments had been made.<sup>980</sup> So for now, the competition rules remain bound to the borders of the EU.

3. *Merger Regulation*

a. Regulation 4064/89

Shortly after the implementation of the regulations for the competition rules, it became apparent to the EC's governing

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<sup>974</sup> *Id.*

<sup>975</sup> Deputy Head of Unit DG Competition Joos Straiger, Presentation to the 11th Annual Conference of the European Air Law Association (Nov. 5, 1999).

<sup>976</sup> Director of DG IV (Competition) Humbert Drabbe, Presentation to the 10th Annual Conference of the European Air Law Association (Nov. 6, 1998).

<sup>977</sup> *Id.*

<sup>978</sup> *Id.*

<sup>979</sup> *Application of the Competition Rules in Certain Sectors: 1997 Proposal*, available at <http://www.europa.eu.int/scadplus/leg/en/lvb/l24078b.htm> (last visited Aug. 21, 2000).

<sup>980</sup> *Id.*

bodies that the regulations were not sufficient to cover all possible exigencies.<sup>981</sup> It was therefore determined that a new regulation permitting effective monitoring of all concentrations, with an eye toward determining their impact on the structure of competition within the EC, was necessary.<sup>982</sup> To that end, in December 1989, the Council passed Regulation 4064/89, commonly referred to as the "merger regulation." Much of the merger regulation is purely procedural. For example, it explains the process for empanelling an advisory committee in regard to certain Commission actions;<sup>983</sup> however, several portions are highly relevant to the substantive subject of air transportation.

The regulation applies to all concentrations, i.e., where two undertakings merge or where an undertaking acquires partial or whole ownership of another undertaking,<sup>984</sup> thus creating a "Community dimension".<sup>985</sup> A concentration has a "Community dimension" when the aggregate worldwide turnover<sup>986</sup> of all the undertakings concerned is more than 5 billion Euros and the aggregate Union-wide turnover of each of at least two of the undertakings is more than 250 million Euros, unless more than two-thirds of each undertaking's Union-wide turnover takes place in one Member State.<sup>987</sup> Obviously, a merger between two or more major air carriers would almost certainly meet the worldwide turnover requirement, and if a European-based carrier were involved the Union-wide requirement would be fulfilled as well.

When the Commission examines such a concentration it must take into account a number of disparate factors. It must consider the necessity of preserving or developing effective competition within the Union in light of the relevant markets involved and the existence of actual or potential competitors.<sup>988</sup> The Commission should also consider the economic and financial power of the undertakings, access to supplies or markets, barri-

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<sup>981</sup> Council Regulation 4064/89, pmbL., 1989 O.J. (L 395) 1, 1 - 3.

<sup>982</sup> *Id.*

<sup>983</sup> *Id.* at 10 - 11.

<sup>984</sup> *Id.* at 4.

<sup>985</sup> *Id.* at 3.

<sup>986</sup> "Turnover" is a peculiar financial concept much beloved by the EU. It is the amount derived by an undertaking in the preceding fiscal year from the sale of products and the provision of services falling within the undertaking's ordinary activities after deduction of sales rebates, value-added tax, and other taxes directly related to turnover.

<sup>987</sup> Council Regulation 4064/89, art. 1(2), 1989 O.J. (L 395) 1, 3.

<sup>988</sup> *Id.*

ers to entry and trends in supply and demand for the relevant good or service.<sup>989</sup> Furthermore, the interests of all concerned consumers, and the effect that the concentration may have on technical and economic advancement must also be assessed.<sup>990</sup> If, after making these determinations, the Commission finds that the concentration does not create or strengthen a dominant position that would otherwise imperil competition, the concentration should be approved.<sup>991</sup> However, if the concentration would endanger competition, it should be declared incompatible with the nature of the common market,<sup>992</sup> even though satisfactory concessions by the undertakings may subsequently bring the concentration into compliance.

Given the current wave of air-carrier alliances, the merger regulation is of particular significance to the air transport industry. It explicitly permits actions—including joint ventures—that have as their object or effect the coordination of competitive behavior among undertakings, provided the undertakings remain independent.<sup>993</sup> As noted above, however, such an operation or joint venture might be in violation of the competition rules. But if the joint venture functions on a lasting basis as an “autonomous economic entity,” then it does constitute a concentration within the terms of the regulation.<sup>994</sup>

If the Commission determines that a concentration strengthens or gives rise to an undertaking’s dominant position, the regulation requires the Commission to issue a decision declaring the concentration incompatible with the common market.<sup>995</sup> As part of such a decision, the Commission may order the undertakings separated, their joint control terminated, or any other appropriate measures to “restore conditions of effective competition.”<sup>996</sup> Alternatively, the Commission may place conditions on an incompatible concentration to bring it into conformity with the terms of the regulation.<sup>997</sup> The undertakings would then be free to choose whether to comply with the conditions

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<sup>989</sup> *Id.*

<sup>990</sup> *Id.*

<sup>991</sup> *Id.*

<sup>992</sup> Council Regulation 4064/89, art. 2(3), 1989 O.J. (L 395) 1, 4.

<sup>993</sup> *Id.*

<sup>994</sup> *Id.*

<sup>995</sup> *Id.* at 6.

<sup>996</sup> *Id.* at 6-7.

<sup>997</sup> Council Regulation 4064/89, art. 8(2), 1989 O.J. (L 395) 1, 6.

and proceed with the concentration or to dissolve the concentration rather than accept the Commission's conditions.

The merger regulation also gives the Commission broad powers to impose fines, both as punishment for failure to cooperate with it procedurally and substantively. The Commission may fine an undertaking up to 50,000 Euros for failure to provide prompt notice of a concentration, negligently or deliberately providing inaccurate or incomplete information, or otherwise refusing to submit to an investigation of its business practices.<sup>998</sup> For the more severe action of defying the terms of a decision, the Commission may impose a fine up to ten percent of the undertaking's aggregate turnover.<sup>999</sup> Such a penalty would clearly be disastrous for an air carrier, because the value of the fine could run into the hundreds of millions, or even billions, of Euros. Given the high aggregate turnover and the slim profit margins that characterize the industry, the severe nature of the fines that could be imposed thus makes the aviation industry extremely susceptible to intimidation by the Commission via merger regulation.

The Court of Justice enjoys "unlimited jurisdiction" to review the decisions of the Commission within the context of the merger regulation.<sup>1000</sup> It may cancel, reduce, or increase the level of any fine imposed by the Commission.<sup>1001</sup> The regulation does not explicitly give the Court of Justice the power to alter the conditions imposed by the Commission, but that would appear to be a logical extension of its "unlimited jurisdiction."

The regulation also imposes an obligation of professional secrecy on the Commission and any other parties involved in the investigation of a concentration.<sup>1002</sup> Therefore, since the Commission may not disclose any information that would fall under the "professional secrecy" standard, decisions under the merger regulation often take on a cryptic tone. For example, "[a]ccording to Boeing only . . . of its production capacity is in use which leaves spare capacity of . . . ." <sup>1003</sup>

Finally, of particular importance for international aviation, the merger regulation introduces the concept of reciprocity for

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<sup>998</sup> *Id.* at 9.

<sup>999</sup> *Id.*

<sup>1000</sup> *Id.* at 10.

<sup>1001</sup> *Id.*

<sup>1002</sup> Council Regulation 4064/89, art. 17(1)-(3), 1989 O.J. (L 395) 1, 10.

<sup>1003</sup> Commission Decision 97/816/EC, (65), 1997 O.J. (L 336) 16, 26. (ellipses in the original).

investigations of concentrations. When it appears that a non-Member State is not granting Union undertakings the same standard of treatment as the Union grants undertakings from that nation, the Commission may submit a request for negotiating powers to the Council.<sup>1004</sup> These negotiating powers would be used to obtain comparable treatment for Union undertakings.<sup>1005</sup>

b. The Boeing-McDonnell Douglas Merger

Although the merger regulation has been applied numerous times since its introduction, there are few decisions as monumental in nature as the Commission's decision concerning the Boeing Company's (Boeing) takeover of McDonnell Douglas Corporation (MDC). While not directly involving air transportation, much of the Commission's analysis in the case would have equal applicability for air carriers.

In December 1996, Boeing and MDC concluded a purchase agreement under which MDC would become a subsidiary of Boeing, thus meeting the basic definition of a concentration within the terms of the merger regulation.<sup>1006</sup> The two undertakings had worldwide turnover considerably in excess of 5 billion Euros, along with Union-wide turnover greater than 250 million Euros. Neither undertaking achieved more than two-thirds of their Union-wide turnover within one Member State and, as a result, the merger had a Union dimension.<sup>1007</sup> Having established that the Boeing-MDC agreement fell within its purview under the merger regulation, the Commission began its analysis of the likely effects of the agreement.

The Commission identified the relevant product market for the two undertakings as being the market for new, large commercial aircraft (i.e., those that carried more than 100 passengers and had ranges in excess of 1,700 nautical miles), since those were the sole products that Boeing and MDC manufactured that were relevant to the Commission's investigation.<sup>1008</sup> The relevant geographic market was the entire world, given the ease with which the products are distributed.<sup>1009</sup> In the global

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<sup>1004</sup> Council Regulation 4064/89, art. 24(3), 1989 O.J. (L 395) 1, 12.

<sup>1005</sup> *Id.*

<sup>1006</sup> Commission Decision 97/816/EC, (5) - (6), 1997 O.J. (L 336) 16, 17.

<sup>1007</sup> *Id.*

<sup>1008</sup> *Id.* at 18. Because of U.S. security concerns, the Commission did not directly investigate the military aircraft divisions of the undertakings.

<sup>1009</sup> *Id.* at 19.



market for new, large commercial aircraft, there were only three manufacturers: Boeing, which was first with approximately 64% of the market, Airbus, which was second with approximately 27%, and MDC, which was third with approximately six percent.<sup>1010</sup>

The customers for the product were predominantly air carriers and leasing companies.<sup>1011</sup> While there were 561 air carriers operating the various manufacturers' aircraft, the 12 largest carriers accounted for half of all such aircraft in operation, while leasing companies held another 20%.<sup>1012</sup> This skew among customers is particularly important, as carriers prefer to purchase all their aircraft from a single supplier to streamline maintenance.<sup>1013</sup> Boeing was uniquely poised to exploit this preference, as it was the only undertaking capable of supplying aircraft in all size-ranges within the product type, given that Airbus' models were all of intermediate size and MDC's were of small to intermediate size.<sup>1014</sup> Furthermore, there was already evidence of Boeing moving to take advantage of the carriers' preference, as it had recently concluded exclusive dealing contracts with American Airlines, Delta Airlines, and Continental Airlines.<sup>1015</sup> In each instance, the carriers received aircraft or purchase options on aircraft at reduced prices in exchange for an agreement to use Boeing as their exclusive supplier for the next twenty years.<sup>1016</sup> These agreements effectively gave Boeing a guaranteed 13% of the estimated sales of large commercial jet aircraft for the next twenty years.<sup>1017</sup> All of these factors, combined with the extremely high costs of starting an aerospace company, served to ensure that no new competitors would enter the market in the foreseeable future.<sup>1018</sup>

The Commission concluded that Boeing already held a dominant position in the market for large commercial jet aircraft.<sup>1019</sup> Particularly significant, Boeing's market share had increased continuously over the previous seven years (primarily at the ex-

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<sup>1010</sup> *Id.* at 19-21. The remaining three percent was composed of aircraft whose manufacturers had discontinued production, such as Lockheed and Convair.

<sup>1011</sup> Commission Decision 97/816/EC, (25), 1997 O.J. (L 336) 16, 20.

<sup>1012</sup> *Id.*

<sup>1013</sup> *Id.* at 21-22.

<sup>1014</sup> *Id.*

<sup>1015</sup> *Id.* at 23.

<sup>1016</sup> Commission Decision 97/816/EC, (43) - (44), 1997 O.J. (L 336) 16, 23.

<sup>1017</sup> *Id.* at 24.

<sup>1018</sup> *Id.*

<sup>1019</sup> *Id.*

pense of MDC), while Airbus' market share had remained mostly unchanged over the same period.<sup>1020</sup> The Commission explained that this demonstrated that Boeing was able to act "to an appreciable extent independently of its competitors," which constitutes "an illustration of dominance."<sup>1021</sup> Having found that Boeing enjoyed a dominant position, the Commission was then obliged to assess whether the acquisition of MDC would further strengthen Boeing's dominance.

The immediate effects of the merger would be to increase Boeing's market share to 70% and give it a monopoly on the smallest size of large commercial jet aircraft (100–120 passengers), complementing its existing monopoly on the largest size.<sup>1022</sup> This could permit Boeing to sell its intermediate size aircraft below cost, relying on higher prices on the other sizes to compensate for the loss, thereby undermining Airbus' market position.<sup>1023</sup> Even more perniciously, the elimination of MDC would likely result in an increase in prices. The Commission determined this by comparing purchase agreements where MDC was a competitor for the sale with those purchase agreements where it did not participate. It was found that final prices were seven percent lower in those cases where MDC was a competitor, regardless of which undertaking finally received the purchase order.<sup>1024</sup> Boeing would also benefit in the long run from access to MDC manufacturing facilities and staff. Once all remaining new aircraft are delivered by the MDC plants, Boeing would be able to begin turning these resources to production of its own aircraft models.<sup>1025</sup> Given that the aircraft manufacturing industry is characterized by large production backlogs,<sup>1026</sup> this added capacity would eventually be of great benefit to Boeing.

Boeing's subsuming of MDC would also sharply increase its ability to negotiate exclusive dealing contracts—not merely due to the elimination of a competitor, but also because Boeing would be able to manipulate any pre-existing orders for MDC aircraft and parts.<sup>1027</sup> Moreover, Boeing had already suggested to

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<sup>1020</sup> *Id.* at 21.

<sup>1021</sup> Commission Decision 97/816/EC, (37), 1997 O.J. (L 336) 16, 21.

<sup>1022</sup> *Id.* at 24-25.

<sup>1023</sup> *Id.* at 29-30.

<sup>1024</sup> *Id.* at 25.

<sup>1025</sup> *Id.* at 26-27.

<sup>1026</sup> Commission Decision 97/816/EC, (28), 1997 O.J. (L 336) 16, 20.

<sup>1027</sup> *Id.* at 27.

carriers that it could take back newly delivered MDC aircraft, cancel existing orders for MDC aircraft, and substitute new Boeing aircraft in their place.<sup>1028</sup> Boeing's newfound monopoly in the small-size large commercial jet market would also enhance the attractiveness of any exclusive dealing contract it might offer a carrier.<sup>1029</sup> The Commission estimated that Boeing could secure as much as 40% of the world's market through such contracts.<sup>1030</sup>

While the Commission withheld judgment on the direct effects of the combination of Boeing and MDC's military aviation divisions, it expressed consternation at the possible indirect effects the combination might have on Boeing's civil aviation division. The concentration would triple the size of Boeing's military and space activities, thereby giving the undertaking access to a considerable stream of revenue which would be largely unaffected by economic fluctuations.<sup>1031</sup> Acquisition of MDC would also give Boeing access to the sizeable amounts of U.S. government-sponsored research and development (R&D) funds of which MDC was a beneficiary.<sup>1032</sup> Despite Boeing's protests that its civil and military divisions were discrete entities, the Commission pointed out that Boeing already had a history of diverting military research to civilian applications.<sup>1033</sup> Furthermore, even if it were to keep its military and civilian divisions clearly separate, Boeing still would obtain a greatly increased number of patents as a by-product of its government-sponsored R&D, which could serve to obstruct other manufacturers from developing the same technologies for civilian applications.<sup>1034</sup>

Finally, the Commission expressed reservations about the amount of influence Boeing would be able to wield over its suppliers in the wake of the concentration. The actual breakdown of sales was excised under the professional secrecy obligation of Article 17 of Regulation 4064/89. However, it may be inferred from the decision that a considerable percentage of suppliers of aerospace materials rely on Boeing and MDC for the majority of their sales.<sup>1035</sup> Boeing would have a significant ability to pres-

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<sup>1028</sup> *Id.*

<sup>1029</sup> *Id.* at 28.

<sup>1030</sup> *Id.*

<sup>1031</sup> Commission Decision 97/816/EC, (73), 1997 O.J. (L 336) 16, 28.

<sup>1032</sup> *Id.* at 30.

<sup>1033</sup> *Id.* at 32.

<sup>1034</sup> *Id.* at 34-35.

<sup>1035</sup> *Id.* at 35.

sure these suppliers for favorable prices or preferred access to products.<sup>1036</sup> The Commission cited a case from earlier in 1997, where Northrop Grumman dropped out of a development project with Airbus, seemingly in response to efforts by Boeing to dissuade it from cooperating with Airbus.<sup>1037</sup> For this reason, and the others cited above, the Commission determined that the merger of Boeing and MDC would “lead to a strengthening of a dominant position through which effective competition would be significantly impeded . . . ”<sup>1038</sup>

Nevertheless, the Commission agreed to grant permission for the merger under a series of stringent conditions. Boeing was obliged to maintain the civilian aircraft division of MDC as a separate legal entity for ten years, subject to review by an independent auditor.<sup>1039</sup> Boeing was also required to support the existing MDC product lines, providing the same level of service as it did to users of Boeing’s product lines.<sup>1040</sup> Additionally, Boeing had to give guarantees that it would not coerce any MDC users into purchasing Boeing’s products, or deter them from purchasing another manufacturer’s products.<sup>1041</sup> Until August 1, 2007, Boeing would be barred from entering into any exclusive dealing contracts unless another manufacturer had already offered such a contract to the carrier in question.<sup>1042</sup> Furthermore, the existing exclusive dealing contracts that Boeing had completed were voided.<sup>1043</sup>

The Commission also imposed an elaborate series of restrictions on Boeing’s R&D and patents. Upon request by another commercial aircraft manufacturer, Boeing must provide “a non-exclusive, reasonable royalty-bearing” license for any government-funded patent that could be applied to commercial jet aircraft.<sup>1044</sup> Under the same conditions, Boeing must license any “blocking patent” to any other aircraft manufacturer that agrees to cross-license its blocking patents to Boeing.<sup>1045</sup> To aid in verification of this, for a ten-year period Boeing must supply the

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<sup>1036</sup> Commission Decision 97/816/EC, (106), 1997 O.J. (L 336) 16, 35.

<sup>1037</sup> *Id.*

<sup>1038</sup> *Id.* at 36.

<sup>1039</sup> *Id.* at 36-37.

<sup>1040</sup> *Id.*

<sup>1041</sup> Commission Decision 97/816/EC, (115), 1997 O.J. (L 336) 16, 36-37.

<sup>1042</sup> *Id.* at 37.

<sup>1043</sup> *Id.*

<sup>1044</sup> *Id.* (“government-funded” means any patent obtained by Boeing in the process of performing its duties under a contract with the US government).

<sup>1045</sup> *Id.*

Commission with an annual report of its unexpired government-funded patents.<sup>1046</sup> Also for the next ten years, Boeing must give an annual report to the Commission detailing all of its nonclassified government-sponsored R&D, including a description of any patents or technologies generated by the research that could have commercial applications.<sup>1047</sup>

To make certain that Boeing did not exploit its dominant position vis-à-vis suppliers, it had to assure the Commission that it would "not exert or attempt to exert undue or improper influence . . . by promising an increase in supplies or subcontracted R&D activities, threatening to decrease supplies or subcontracted R&D activities, or leveraging in any other way its own supply relationships . . ." <sup>1048</sup> However, the Commission did permit Boeing to retain its ability to choose its own suppliers and to enforce its contracts with those suppliers.<sup>1049</sup>

In its final conclusion, the Commission effectively admitted that it would have liked to have seen MDC remain a competitor or, failing that, be purchased by somebody other than Boeing.<sup>1050</sup> However, as that was not possible, the Commission felt that the conditions it imposed were a satisfactory alternative in that "they adequately address[ed] the competition problems identified . . ." <sup>1051</sup> Thus, the Commission approved the concentration, subject to the above conditions and with the requirement that Boeing allow a Commission-appointed expert investigator to examine the undertaking periodically to verify compliance with all the terms of the decision.<sup>1052</sup>

### c. Regulation 1310/97

As the Boeing-MDC decision was winding its way through the Commission's decision process, the Council was preparing to make several significant changes to the merger regulation. The Council had determined that the minimum turnover required to trigger the Commission's investigative authority under Regulation 4064/89 was too high; many concentrations which would have best been handled by the Commission were instead being left at the mercy of multiple Member States' competition au-

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<sup>1046</sup> Commission Decision 97/816/EC, (117), 1997 O.J. (L 336) 16, 37.

<sup>1047</sup> *Id.*

<sup>1048</sup> *Id.* at 38.

<sup>1049</sup> *Id.*

<sup>1050</sup> *Id.* at 39.

<sup>1051</sup> Commission Decision 97/816/EC, (123), 1997 O.J. (L 336) 16, 39.

<sup>1052</sup> *Id.*

thorities.<sup>1053</sup> To rectify this and several other problems, the Council passed Regulation 1310/97 in July 1997, although the changes did not go into effect until the following March.<sup>1054</sup>

The most significant change for the air transportation industry came in a supplement to the standards for assessing whether a concentration was sufficiently large to come under the Commission's purview. Under Regulation 1310/97, concentrations that have a minimum aggregate worldwide turnover of 2.5 billion Euros, and where there is at least 100 million Euros turnover in at least three Member States, now are considered to possess a Union dimension provided that they meet certain additional criteria.<sup>1055</sup> Additional criteria require that in each of at least three Member States, the turnover of each of at least two of the undertakings concerned must be more than 25 million Euros and the aggregate Union-wide turnover of each of at least two of the undertakings concerned must be greater than 100 million Euros.<sup>1056</sup> These reduced levels clearly bring the majority of possible air carrier concentrations within the Commission's jurisdiction, with only concentrations between value carriers likely being small enough to remain outside of it.

With respect to joint ventures, Regulation 1310/97 made clear what Regulation 4064/89 had merely implied—joint ventures where the parties remain independent are still subject to review under the competition rules.<sup>1057</sup> The regulation also provided guidelines for such an analysis, stating that the Commission should particularly consider whether the parent undertakings would remain in competition with the joint venture, either in the same market or related markets, and whether the joint venture would have the possibility of “eliminating competition in respect of a substantial part of the products or services in question.”<sup>1058</sup>

The remainder of the Regulation 1310/97 amendments have few direct consequences for air transportation, as they concern other industries (such as the formula for calculating turnover for financial institutions)<sup>1059</sup> or are clarifications that do not oth-

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<sup>1053</sup> Council Regulation 1310/97, pmbl. (1), 1997 O.J. (L 180) 1, 1.

<sup>1054</sup> *Id.* at 6.

<sup>1055</sup> *Id.* at 2-3.

<sup>1056</sup> *Id.*

<sup>1057</sup> *Id.* at 3.

<sup>1058</sup> Council Regulation 1310/97, art. 1(2) - (3), 1997 O.J. (L 180) 1, 3.

<sup>1059</sup> *Id.*

erwise alter the substantive nature of the regulation.<sup>1060</sup> However, there is one procedural change of note, which likely resulted from the Boeing-MDC case. Under Article 7(1) of Regulation 4064/89, a concentration could not be put into effect before notification was given to the Commission or for three weeks thereafter. Regulation 1310/97 has changed this so that now a concentration cannot be effected until the Commission renders a decision on its compatibility with the common market.<sup>1061</sup> The only exception to this is where the Commission specifically grants a "presumption" of compatibility, which will allow the concentration to be put into effect until such time as the Commission gives its final decision.<sup>1062</sup> This change would appear to be at least partially a byproduct of the EU's disgust with Boeing's manipulation of MDC's customers during the time the Commission was investigating the concentration.

## I. STATE AID

The subsidization of the European transportation sector long predates the aviation industry,<sup>1063</sup> but few industries have received such vast quantities of state support relative to their share of national GDP.<sup>1064</sup> Thus, the governing bodies of the EC/EU were reluctant to formally address the issue, despite already having the authority under the Treaty of Rome to do so.<sup>1065</sup> It was not until after the passage of the Third Package that the Commission finally decided to take up the subject of state aid, on the grounds that state aid was more of a danger to the market now that it had been liberalized.<sup>1066</sup>

### 1. *Comité Recommendations*

In the summer of 1993, the Commission directed the Comité des Sages to analyze the condition of the EU's air transportation industry and to make recommendations on future Union pol-

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<sup>1060</sup> *Id.* at 5.

<sup>1061</sup> *Id.* at 4.

<sup>1062</sup> *Id.*

<sup>1063</sup> FREDERIC BASTIAT, *ECONOMIC SOPHISMS* 189-92 (Arthur Goddard trans., The Foundation for Economic Education 1996) (1848).

<sup>1064</sup> Carole A. Shifrin, *Market Rigors Squeeze European Flag Carriers*, *Av. Wk. & SPACE TECH.*, Mar. 14, 1994, at 64.

<sup>1065</sup> TREATY OF ROME, *supra* note 34, at arts. 92, 93.

<sup>1066</sup> Commission Paper, 350/07, I.1(1), 1994 O.J. (C 350) 5 [hereinafter COMMISSION PAPER].

icy.<sup>1067</sup> The Comité completed its report in February 1994, offering three principal recommendations.<sup>1068</sup> The first was that state aid to air carriers or ground handling services should be disapproved if it would be “incompatible with normal commercial practices.”<sup>1069</sup> Second, the Commission should “strictly enforce” those parts of the Treaty of Rome that govern state aid and it should release guidelines for evaluating any exceptional state aid.<sup>1070</sup> Finally, the Comité recommended that for “a brief period,” the Commission should consider approving state aid where the aid “serves the Community’s interest” in restructuring a carrier so it can be commercially viable.<sup>1071</sup>

The Comité also provided seven suggested conditions for such reorganizational aid: (i) the aid must be made on a “one time, last time” basis,<sup>1072</sup> (ii) the carrier and Member State must submit a restructuring plan designed to lead to commercial viability within a specified time frame and must ultimately lead to privatization,<sup>1073</sup> (iii) the feasibility of the restructuring plan must be determined by independent examiners selected by the Commission,<sup>1074</sup> (iv) the Member State concerned must refrain from interfering with the carrier’s operations,<sup>1075</sup> (v) the carrier may not use state aid to increase its total capacity,<sup>1076</sup> (vi) there must be “acceptable proof” that other carriers’ commercial interests are not damaged by the aid,<sup>1077</sup> and (vii) the restructuring plan must be monitored, preferably by independent experts, to verify that it complies with the above terms.<sup>1078</sup>

The Commission agreed with most of the Comité’s recommendations, but it did reject two key provisions. It was the Commission’s opinion that it could not, under the Treaty of Rome, absolutely refuse a Member State the right to grant aid to a carrier multiple times.<sup>1079</sup> Furthermore, the Treaty of Rome would also prohibit the Commission from compelling a Member State

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<sup>1067</sup> *Id.* at 6.

<sup>1068</sup> *Id.*

<sup>1069</sup> *Id.*

<sup>1070</sup> *Id.*

<sup>1071</sup> COMMISSION PAPER, *supra* note 1066, at 6.

<sup>1072</sup> *Id.*

<sup>1073</sup> *Id.*

<sup>1074</sup> *Id.*

<sup>1075</sup> *Id.*

<sup>1076</sup> COMMISSION PAPER, *supra* note 1066, at 6.

<sup>1077</sup> *Id.*

<sup>1078</sup> *Id.*

<sup>1079</sup> *Id.* at 6-7.



to privatize a carrier.<sup>1080</sup> However, the Commission stated that it would take such factors into consideration in deciding whether to permit state aid to carriers.<sup>1081</sup>

## 2. *Commission Paper on State Aid*

Having reviewed the Comité's recommendations, the Commission then turned to laying out its own guidelines on the subject of state aid. Aside from carriers themselves, the guidelines apply to any operations that are "accessory to air transport," such as flight schools, duty free shops, and airport facilities, and will apply to either direct or indirect subsidization.<sup>1082</sup> Aircraft manufacturing is beyond the scope of the guidelines, but aid granted for the purchase of aircraft is included.<sup>1083</sup> The guidelines also only apply to Member States, but if a third country is heavily subsidizing a carrier, it may be dealt with under the EU's "anti-dumping" regulations.<sup>1084</sup> The construction or enlargement of infrastructure like airports is beyond the scope of the guidelines,<sup>1085</sup> but granting preferential access to infrastructures for particular carriers could be considered aid.<sup>1086</sup> Aid defined as "social aid" may or may not be covered by the guidelines, depending on the effect of the aid.<sup>1087</sup> If the social aid gives a carrier a competitive advantage, for example by lowering its costs, then it would fall within the scope of the guidelines.<sup>1088</sup>

### a. Direct Operational Subsidies

The Commission strongly opposed direct operational subsidization of air routes, stating that such aid is "not compatible with the common market."<sup>1089</sup> Although subsidization may be necessary to encourage development of "disadvantaged areas," the Commission was concerned that the subsidies given for operation of such routes would be covertly used to subsidize other competitive routes.<sup>1090</sup> Accordingly, the Commission deter-

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<sup>1080</sup> *Id.*

<sup>1081</sup> COMMISSION PAPER, *supra* note 1066, at 6-7.

<sup>1082</sup> *Id.* at 8.

<sup>1083</sup> *Id.*

<sup>1084</sup> *Id.*

<sup>1085</sup> *Id.*

<sup>1086</sup> COMMISSION PAPER, *supra* note 1066, at 8.

<sup>1087</sup> *Id.*

<sup>1088</sup> *Id.*

<sup>1089</sup> *Id.* at 9.

<sup>1090</sup> *Id.*

mined that direct operational subsidies would only be acceptable in two circumstances.

The first is where a public service obligation has been imposed on a carrier.<sup>1091</sup> In such a case, a Member State may reimburse the carrier for any loss sustained in the process of operating the route.<sup>1092</sup> However, the carrier must clearly account for its costs in the operation of the route and the Member State may not overcompensate the carrier.<sup>1093</sup> To be considered a true public service obligation route, the right to operate the route has to have been made open to public bids.<sup>1094</sup> The recipient of the route should ordinarily be the lowest bidder, and if not, the Member State should be prepared to explain its selection to the Commission.<sup>1095</sup>

The other case where direct operational subsidies would be permitted is where they are used for "social aid," particularly for the benefit of individual consumers rather than suppliers, as provided for by Article 92(2)(a) of the Treaty of Rome.<sup>1096</sup> As applied to air travel, "social aid" would most likely mean aid intended to assist certain categories of passengers in obtaining flights.<sup>1097</sup> The aid must be granted without discrimination as to the origin of the service, so the aid would have to be granted to all Community carriers and European Economic Area (EEA) carriers transporting those varieties of passengers.<sup>1098</sup>

#### b. Evaluating Other Forms of State Aid

The Commission next established the method by which it would evaluate various types of state aid other than direct operational subsidies. A two-tier test is to be used for such evaluations. The first tier is generally known as the "Market Economy Investor Principle" (MEIP), meaning that the aid will be examined to determine if a private investor would make the same sort investment in the carrier.<sup>1099</sup> If the aid fails this first tier, then it will be examined under the second tier, which will consider whether the aid is "compatible with the common market"

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<sup>1091</sup> COMMISSION PAPER, *supra* note 1066, at 9.

<sup>1092</sup> *Id.* at 9-10.

<sup>1093</sup> *Id.* at 10.

<sup>1094</sup> *Id.*

<sup>1095</sup> *Id.* at 10-11.

<sup>1096</sup> COMMISSION PAPER, *supra* note 1066, at 11.

<sup>1097</sup> *Id.*

<sup>1098</sup> *Id.*

<sup>1099</sup> *Id.* at 12.

under the derogations of Article 92(3) of the Treaty of Rome.<sup>1100</sup> With respect to the MEIP, the Commission observed that it did not require the restructuring plan to assure profitability "beyond all reasonable doubt;" it need only be "reasonably certain" that a private investor would find the plan satisfactory.<sup>1101</sup>

There are three major types of possible state aid other than direct operational subsidies identified by the Commission. The first is capital injection. Capital injections are not considered state aid when the public holding in a company is increased, provided that the capital injection is proportional to the share of capital owned by the Member State and that it is done in conjunction with a capital injection from a private shareholder of "real economic significance."<sup>1102</sup> The MEIP will be satisfied if the future prospects for the company are such that the cost of the injection would be recouped through dividends or capital appreciation within a "reasonable period."<sup>1103</sup> The Commission noted that a private investor would normally provide financing if the present value of future returns exceeded the present outlay.<sup>1104</sup> Therefore, to determine whether the circumstances are appropriate, the Commission will examine, among other factors, a carrier's debt/equity ratio, cash flow, operating costs, labor productivity, fleet condition, and commercial strategy along with the "general economic environment of the airline industry."<sup>1105</sup> Where a carrier is actively losing money, a coherent restructuring program to restore profitability must be offered.<sup>1106</sup>

The second possible type of state aid other than direct subsidization is loan financing. The MEIP will be applied to assess whether the loan is being made on regular commercial terms and whether such a loan could have been procured from a private bank.<sup>1107</sup> The Commission will consider both the level of the interest rate and what collateral is required, as well as the financial position of the company at the time the loan is made.<sup>1108</sup> The difference between the terms of the State-pro-

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<sup>1100</sup> *Id.*

<sup>1101</sup> COMMISSION PAPER, *supra* note 1066, at 12.

<sup>1102</sup> *Id.*

<sup>1103</sup> *Id.* at 12-13.

<sup>1104</sup> *Id.*

<sup>1105</sup> *Id.* at 13-14.

<sup>1106</sup> COMMISSION PAPER, *supra* note 1066, at 14.

<sup>1107</sup> *Id.*

<sup>1108</sup> *Id.*

vided loan and a private loan will be deemed aid.<sup>1109</sup> If no collateral is required by the Member State in a situation where a private investor would have demanded it, then the entire value of the loan is considered equivalent to a grant.<sup>1110</sup>

Finally, there are loan guarantees. The Commission will permit such guarantees only where they are contractually bound to specific conditions for the carrier's operation.<sup>1111</sup> The aid element of a guarantee is the difference between the rate the carrier would have had to pay to obtain such a loan independently and the rate the carrier must pay for the guaranteed loan.<sup>1112</sup> If a carrier's legal status is such that it cannot go bankrupt, or where the Member State that owns it has taken on the burden of unlimited liability for its losses, then the carrier is considered to be permanently under a loan guarantee for these purposes.<sup>1113</sup>

### c. Exemptions

Where it has been determined that a carrier is receiving state aid through one of the above methods, the Commission will examine whether an exemption may exist under Article 92(3) of the Treaty of Rome.<sup>1114</sup> The first exemption is for regional aid, under Article 92(3)(a) and (c), which permits state aid to undertakings investing in "disadvantaged areas," as defined by Commission Communication O.J. No. C 212 of August 12, 1988.<sup>1115</sup> The second exemption under Article 92(3)(c) is for aid which "facilitates the development of certain economic activities . . . of particular interest."<sup>1116</sup> In the context of the aviation industry, this usually will mean aid for corporate reorganization or for social purposes such as "facilitating the adaptation of the work force to a higher level of productivity."<sup>1117</sup> However, such aid must be accompanied by a comprehensive restructuring plan to restore the carrier's commercial viability,<sup>1118</sup> and it must be "self-contained" (i.e., a one-time delivery of aid without expectation of future assistance).<sup>1119</sup> The Commission will only

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<sup>1109</sup> *Id.*

<sup>1110</sup> *Id.*

<sup>1111</sup> COMMISSION PAPER, *supra* note 1066, at 14.

<sup>1112</sup> *Id.*

<sup>1113</sup> *Id.*

<sup>1114</sup> *Id.* at 15.

<sup>1115</sup> *Id.*

<sup>1116</sup> COMMISSION PAPER, *supra* note 1066, at 15.

<sup>1117</sup> *Id.* at 15-17.

<sup>1118</sup> *Id.* at 15-16.

<sup>1119</sup> *Id.* at 16.

permit additional aid “under exceptional circumstances, unforeseeable and external to the company.”<sup>1120</sup> The progress of the restructuring plan will be subject to verification by the Commission, particularly those parts of it that the Commission demanded be included as conditions for its approval.<sup>1121</sup>

#### d. Privatization

The guidelines also address the role of state aid in the context of privatization. Aid is not considered to exist if the undertaking is disposed by way of “an unconditional public invitation” to bid on transparent and nondiscriminatory terms, the undertaking is sold to the highest bidder, and the bidders were given a “sufficient period” in which to prepare their offer.<sup>1122</sup> However, there is a presumption that a sale includes aid if the sale is made in a restricted manner or directly to a buyer, if the undertaking’s debts are cancelled or capitalized, and/or if the conditions of the sale would not be acceptable under the MEIP.<sup>1123</sup> If the sale is made in a manner that presumes aid, the undertaking must be valued by an independent expert, and the amount of aid will be the difference between the undertaking’s market value and what it would be sold for, although the Article 92(3) exemptions may apply.<sup>1124</sup>

#### e. Exclusive Rights

According to the guidelines, the granting of exclusive rights for activities that are accessory to air transport can also be a form of aid. If a Member State grants an exclusive concession to a carrier at a price below what that concession would have cost on the open market, then that difference is considered to be state aid.<sup>1125</sup> Furthermore, if the concession is put up for open bid and a carrier other than the lowest bidder is selected by the Member State, that choice may be subject to review by the Commission.<sup>1126</sup>

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<sup>1120</sup> *Id.*

<sup>1121</sup> COMMISSION PAPER, *supra* note 1066, at 17.

<sup>1122</sup> *Id.* at 17-18.

<sup>1123</sup> *Id.* at 18.

<sup>1124</sup> *Id.*

<sup>1125</sup> *Id.*

<sup>1126</sup> COMMISSION PAPER, *supra* note 1066, at 18.

f. Reporting State Aid

The Commission was also concerned that prior to the implementation of the guidelines, many forms of state aid were not properly reported. Consequently, the guidelines provide a list of actions that should be reported to the Commission.<sup>1127</sup> Funds that are provided through publicly owned undertakings or financial institutions should be reported in the same manner as funds provided directly by the Member State.<sup>1128</sup>

g. Accelerated Clearance

Finally, recognizing that a detailed examination of all transactions falling within the scope of the guidelines was not feasible, the Commission provided for an accelerated clearance procedure in certain instances.<sup>1129</sup> Where the amount of aid given to an undertaking is one million Euros or less over a three-year period, and the aid is tied to "specific investment objectives," other than operating expenses, the Commission will render a decision within 20 working days.<sup>1130</sup> As the Commission noted, the sum is so small it does not represent a meaningful amount of aid in so costly a field as aviation, but rather is intended to help with regional development not otherwise covered by public service obligations.<sup>1131</sup>

The Commission concluded the guidelines by noting that it would periodically update them.<sup>1132</sup> But since the implementation of the guidelines in 1994, they have remained unchanged<sup>1133</sup> and their vitality continues, subject only to the interpretations of the Commission in its application of them.

3. *The Olympic Airways Decision*

Soon after the announcement of the guidelines, the Commission was confronted with a particularly grisly state aid case.<sup>1134</sup> The Greek national carrier Olympic Airways (Olympic) had

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<sup>1127</sup> *Id.* at 19-20. The types of actions that should be reported include: set-offs for operational losses, the provision of capital, nonrefundable grants or loans, forgoing profits or the recovery of sums due, forgoing the return of public funds, and compensation for state-imposed financial burdens.

<sup>1128</sup> *Id.*

<sup>1129</sup> *Id.* at 20.

<sup>1130</sup> *Id.*

<sup>1131</sup> COMMISSION PAPER, *supra* note 1066, at 20.

<sup>1132</sup> *Id.* at 20.

<sup>1133</sup> As of August 17, 2000.

<sup>1134</sup> Commission Decision 94/696/EC, 1994 O.J. (L 273) 22.

been in deteriorating financial condition for years.<sup>1135</sup> Despite holding a government-granted monopoly on all domestic scheduled air travel, along with ground handling and aircraft maintenance at all Greek airports, by 1992 Olympic's total debt load exceeded its assets by a ratio of almost three-to-one.<sup>1136</sup> The carrier had no realistic possibility of recovery on its own, as its expenditures on debt maintenance alone consumed 67% of its annual revenue by 1993, while its passenger loads had fallen continuously since 1988.<sup>1137</sup> Even factoring out the cost of maintaining its debts, Olympic was suffering losses as high as 16.7% annually on its operations account.<sup>1138</sup> The Commission itself stated, "This financial structure is the worst of all comparable Community airlines."<sup>1139</sup> The only way Olympic was still able to operate was because the Greek government would guarantee unlimited borrowing.<sup>1140</sup>

a. The Commission Inquiry

The full scope of this situation first came to the Commission's attention in July 1992 when the Greek government, in response to an inquiry by the Commission, notified it of the loan guarantees it had extended to Olympic for the previous six years.<sup>1141</sup> For reasons that are at best unclear, no further action on the subject occurred for an entire year, at which time the Greek government sent a letter to the Commission requesting recognition of a restructuring plan for Olympic which would involve further state aid.<sup>1142</sup> The request claimed that the aid should be permitted under Article 92(3)(b) of the Treaty of Rome, which permits state aid to remedy a "serious disturbance" in a nation's economy.<sup>1143</sup> The Commission felt that the plan, as submitted, was too vague and sent two letters to the Greek government in August 1993 asking for further clarification.<sup>1144</sup>

As the Greek government failed to respond to the letters by March of the following year, the Commission published a notice

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<sup>1135</sup> *Id.* at 23.

<sup>1136</sup> *Id.*

<sup>1137</sup> *Id.*

<sup>1138</sup> *Id.*

<sup>1139</sup> Commission Decision 94/696/EC, Sect. I, 1994 O.J. (L 273) 22, 23.

<sup>1140</sup> *Id.* at 31.

<sup>1141</sup> *Id.* at 24.

<sup>1142</sup> *Id.*

<sup>1143</sup> *Id.*

<sup>1144</sup> Commission Decision 94/696/EC, Sect. II, 1994 O.J. (L 273) 22, 25.

in the Official Journal of the European Communities of its intent to investigate Greek state aid practices and the restructuring plan and it invited other parties to submit their comments.<sup>1145</sup> Four Member States (Finland, Norway, Sweden and the UK) and numerous other private parties responded to the Commission's notice before the Greek government did.<sup>1146</sup> The private parties almost universally condemned the restructuring plan,<sup>1147</sup> while the Member States demanded that stringent conditions be placed on any aid.<sup>1148</sup> Ultimately, these comments, combined with a further two-month delay by the Greek government in responding to the Commission's notice, probably did little to predispose the Commission to be sympathetic to the restructuring plan when it was finally presented.

b. The State Aid Analysis

The Commission began its analysis of the restructuring plan by noting that, under Article 92(1) of the Treaty of Rome, any assistance given by a Member State or assistance given at the behest of a Member State "which distorts or threatens to distort competition" is incompatible with the common market to the extent it affects trade between Member States and/or contracting parties.<sup>1149</sup> However, as the Treaty of Rome does not prejudice the rights of publicly owned undertakings, the Commission noted that it was obligated to assess any possible case of state aid on its own merits, rather than having a *per se* rule against such aid.<sup>1150</sup> Instead, the Commission must apply the logic of the Treaty of Rome and the MEIP in each instance, although "the conduct of a private investor . . . need not be the conduct of an investor laying out capital. . . [for] a profit in the relatively short term,"<sup>1151</sup> but rather the conduct of an investor "guided by prospects of profitability in the longer term."<sup>1152</sup>

The restructuring plan contained four provisions that could be state aid: (i) loan guarantees, (ii) debt relief, (iii) conversion

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<sup>1145</sup> *Id.*

<sup>1146</sup> *Id.* at 26.

<sup>1147</sup> *Id.* Only one party supported the restructuring plan, the bank Crédit Lyonnais, which admitted in its comments it was concerned that its loans to Olympic would not be repaid if the Commission refused the restructuring plan.

<sup>1148</sup> *Id.* at 26. Norway and the UK took particularly strident positions on the subject.

<sup>1149</sup> Commission Decision 94/696/EC, Sect. VI, 1994 O.J. (L 273) 22, 30.

<sup>1150</sup> *Id.*

<sup>1151</sup> *Id.*

<sup>1152</sup> *Id.* at 31.



of the debt to equity, and (iv) capital injections. The Commission stated that it considered all loan guarantees extended by a Member State to be within the terms of Article 92(1) of the Treaty of Rome and that it had to be notified of all such guarantees under Article 92(3).<sup>1153</sup> The Greek government had failed to notify the Commission in a timely manner of any of the loan guarantees it had made previously; therefore, those guarantees were provided illegally.<sup>1154</sup> Future loan guarantees, because the Greek government would guarantee them "indiscriminately," would be considered aid equal to the amount of the loan itself, as they would be "disguised subsidies."<sup>1155</sup> The Greek government's plan to assume 427 billion Drachmas worth of Olympic's debt (over 90% of the carrier's total debt load), without Olympic providing anything in return, would also be considered an equal amount of aid.<sup>1156</sup> While under the MEIP, it could be possible for a conversion of debt to equity to not be considered state aid, the complete "absence of any prospect of a return, at any point in time, on the capital invested" meant that in the case of Olympic this too would constitute state aid.<sup>1157</sup> Finally, the capital injections as well would be labeled state aid under the MEIP as well, once more because there was no reasonable possibility of Olympic becoming profitable.<sup>1158</sup>

### c. Exemptions

Having established that all of the proposed assistance to Olympic would fall under the rubric of state aid, the Commission next turned to the possible exemptions that would permit state aid. The Commission quickly disposed of the Article 92(2) exemptions, noting that the aid was not of a "social character," was not for the repair of damage caused by a natural disaster or "exceptional occurrences," nor were the other exemptions in that paragraph relevant.<sup>1159</sup>

Next, the Commission turned to the three Article 92(3) exemptions, which were the ones the Greek government actually

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<sup>1153</sup> *Id.*

<sup>1154</sup> Commission Decision 94/696/EC, Sect. VI, 1994 O.J. (L 273) 22, 31.

<sup>1155</sup> *Id.*

<sup>1156</sup> *Id.*

<sup>1157</sup> *Id.*

<sup>1158</sup> *Id.* at 32.

<sup>1159</sup> Commission Decision 94/696/EC, Sect. VII, 1994 O.J. (L 273) 22, 32. The remaining exemptions in Article 92(2) concerned aid for the former East Germany.

raised in its proposal. The Commission explained that aid under those exemptions must be compatible with the common market as a whole, rather than merely the domestic economy of the Member State.<sup>1160</sup> Furthermore, the exemptions may only be applied where the Commission determines "market forces would not have sufficed to persuade the future aid recipient" to act in the desired manner.<sup>1161</sup> Article 92(3)(a), which permits aid for development purposes, did not apply as the Greek government was solely offering aid to Olympic, rather than to all carriers serving an underdeveloped area.<sup>1162</sup> The Commission also rejected the Greek government's request for an Article 92(3)(b) exemption because that provision allows aid to rectify "a serious disturbance" in the Member State's economy, rather than merely assisting one undertaking.<sup>1163</sup> Finally the Commission turned to Article 92(3)(c), which permits aid for the restructuring of an undertaking. There are three criteria that must be met to exempt aid under the Article 92(3)(c) exemption. First, the aid must be part of a Commission-approved restructuring plan that will help the undertaking become profitable within a reasonable period of time.<sup>1164</sup> Second, the delivery of aid must be transparent and verifiable.<sup>1165</sup> Lastly, the aid may not "shift the Member State's problems onto the rest of the Community."<sup>1166</sup>

As Article 92(3)(c) was obviously the only possible basis for granting an exemption, the Commission focused its attention on whether the Greek government's restructuring plan met the necessary criteria. To ascertain whether a restructuring plan could restore an undertaking's profitability, the Commission stated it must be determined that the aid component is sufficient to meet the undertaking's needs under the plan, and that the assumptions of the plan are reasonable.<sup>1167</sup> In the case of Olympic, the debt relief and debt conversion, combined with the capital injections, would, within three years, reduce the carrier's debt load to less than a third of what it was in 1994.<sup>1168</sup>

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<sup>1160</sup> *Id.*

<sup>1161</sup> *Id.*

<sup>1162</sup> *Id.*

<sup>1163</sup> *Id.*

<sup>1164</sup> Commission Decision 94/696/EC, Sect. VII, 1994 O.J. (L 273) 22, 33.

<sup>1165</sup> *Id.*

<sup>1166</sup> *Id.*

<sup>1167</sup> *Id.*

<sup>1168</sup> *Id.*

Theoretically this would produce a sharp enough decline in Olympic's finance costs to allow the carrier to break out of the debt spiral in which it had found itself.<sup>1169</sup> Furthermore, the traffic projections used in the plan were more conservative than the projections of AEA and IATA for the same period,<sup>1170</sup> so the Commission did not consider them to be unreasonably optimistic.<sup>1171</sup> Olympic also had already initiated measures that would significantly lower its operating costs over the following years,<sup>1172</sup> and, combined with the debt restructuring, would "create an operation of lasting viability within three years without receiving further aid."<sup>1173</sup>

The Commission quickly determined that the restructuring plan and aid met the requirement of transparency and verifiability. Since that May, the Greek government had supplied all requested information and offered to provide follow-up reports on the progress of the restructuring.<sup>1174</sup> Additionally, the Greek government agreed to permit the Commission to appoint an independent investigator to verify compliance with the terms of the restructuring plan.<sup>1175</sup> Finally, the Commission concluded that the restructuring plan would not shift the burdens of the Greek government and Olympic to the rest of the Community. The plan would not lead to an "over-capitalization" of the carrier that would "give it privileged access to the capital market," nor would the plan increase Olympic's overall capacity, and Olympic guaranteed that it would not acquire any holdings in other carriers.<sup>1176</sup>

#### d. Conditions Imposed on the Restructuring Plan

Having established to its satisfaction that the criteria for granting an Article 92(3)(c) exemption existed, the Commission approved the Greek government's restructuring plan and all of the aid components within it.<sup>1177</sup> However, approval was not without its costs, for the Commission attached twenty-one distinct conditions for granting its acceptance to the restructuring

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<sup>1169</sup> Commission Decision 94/696/EC, Sect. VII, 1994 O.J. (L 273) 22, 33.

<sup>1170</sup> *Id.* at 27.

<sup>1171</sup> *Id.* at 34.

<sup>1172</sup> *Id.*

<sup>1173</sup> *Id.*

<sup>1174</sup> Commission Decision 94/696/EC, Sect. VII, 1994 O.J. (L 273) 22, 34.

<sup>1175</sup> *Id.*

<sup>1176</sup> *Id.*

<sup>1177</sup> *Id.* at 35.

plan.<sup>1178</sup> Many of the conditions were relatively specific to the terms of the plan (such as the need to submit progress reports),<sup>1179</sup> but several major concessions were also among them. The Commission demanded that the Greek government repeal by December 31, 1994 the law that permitted it to guarantee unlimited quantities of borrowing to Olympic.<sup>1180</sup> Olympic's legal status had to be made equivalent to any other Greek undertaking, except for specific tax exemptions related to the restructuring plan.<sup>1181</sup> Most importantly, Greek aviation law was to be brought into compliance with the terms of the Third Package by December 31, 1994, as well.<sup>1182</sup>

This last condition, combined with many of the Commission's own comments and displays of logic in its decision, betrays its real interests in the application of the state aid sections of the Treaty of Rome. For example, there is a peculiar discrepancy in the Commission's analysis of the proposed aid for Olympic. The Commission observed that there was "no doubt . . . about the absence of any prospect of a return, at any point in time, on the capital invested," and therefore under the MEIP no private investor would choose to provide Olympic with funding.<sup>1183</sup> However, the Commission later stated that under the restructuring plan Olympic would achieve "lasting viability within three years without receiving any further aid."<sup>1184</sup> Given that the Commission explicitly stated that the MEIP is not predicated on purely short-term profitability, but extends to the long-term as well,<sup>1185</sup> it seems peculiar that the restructuring program would not have qualified under it. The most plausible explanation for this discrepancy is that the Commission wished to be able to sculpt Greek transportation policy. But if the restructuring plan fulfilled the MEIP, then the Greek government would have been able to implement it without the Commission's oversight.

This theory of the Commission's motivation in treating the restructuring plan as state aid, yet still approving it, is further supported by many of the Commission's statements during its

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<sup>1178</sup> *Id.* at 36-37.

<sup>1179</sup> Commission Decision 94/696/EC, Sect. VIII, art. 1(h), 1994 O.J. (L 273) 22, 36.

<sup>1180</sup> *Id.*

<sup>1181</sup> *Id.*

<sup>1182</sup> *Id.*

<sup>1183</sup> *Id.* at 31.

<sup>1184</sup> Commission Decision 94/696/EC, Sect. VII, 1994 O.J. (L 273) 22, 34.

<sup>1185</sup> *Id.* at 31.

discussion of the criteria for granting an Article 92(3)(c) exemption. The Commission observed that the Greek government's offer to implement the provisions of the Third Package (particularly 2408/92) showed the government's "desire to place [Olympic] in a truly competitive environment."<sup>1186</sup> While this may have been commendable, none of the criteria the Commission had articulated required such an action.<sup>1187</sup> The same was true of the Greek government's proposal to repeal its loan guarantee law and to liberalize ground handling.<sup>1188</sup> Finally, while the Commission's statement that all such aid must be evaluated on an individual basis<sup>1189</sup> appears to be the height of fairness, it also effectively permits the Commission to invent new terms and criteria for permitting aid.<sup>1190</sup> This all seems to support the theory that the Commission considers the state aid provisions to be a tool for promoting liberalization, rather than as an end in themselves, a theory born out by later state aid cases.<sup>1191</sup> Indeed, in 1998, nine air carriers brought a suit in the European Court of Justice against the Commission for failing properly to apply the state aid provisions in assessing a proposed capital increase for Air France.<sup>1192</sup> The Court concluded that the Commission used "insufficient reasoning" in permitting some actions on Air France's behalf and therefore annulled the Commission's decision.<sup>1193</sup> Whether the Court's ruling will lead the Commission to a more strict interpretation and application of the state aid provisions is yet to be clear.<sup>1194</sup>

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<sup>1186</sup> *Id.* at 34.

<sup>1187</sup> *Id.*

<sup>1188</sup> *Id.*

<sup>1189</sup> Commission Decision 94/696/EC, Sect. VI, 1994 O.J. (L 273) 22, 30.

<sup>1190</sup> It should be noted that in its decision the Commission made only one specific reference to the state aid guidelines it had just articulated, in the context of defining the MEIP in Sect. VI.

<sup>1191</sup> See Commission Decision 94/698/EC, 1994 O.J. (L 279) 29 (permitting Portuguese state aid conditional on application of 2408/92); Commission Decision 97/789/EC, 1997 O.J. (L 322) 44 (permitting Italian state aid conditional on cessation of preferential traffic rights, slot allocation, and ground handling for Alitalia).

<sup>1192</sup> Joined Cases T-371 & T-394/94, *British Airways PLC and Others v. Comm'n of the EC*, 1998 E.C.J. CELEX LEXIS 5043 (1998).

<sup>1193</sup> *Id.*

<sup>1194</sup> As a postscript to the Olympic case, it was later found that the Greek government failed to comply with many of the conditions of the initial decision, leading to another Commission decision that largely reiterated the original terms. See Commission Decision 1999/332/EC, 1999 O.J. (L 128) 1.

## J. REGULATION OF NON-ECONOMIC ISSUES

As the Commission and Council have progressively eliminated the major obstacles to air transport in the EU, they have increasingly turned their attention to other related areas, ranging from the congested state of airports in the Union to the compensation of passengers who are refused seats on overbooked flights. Most of these reforms are targeted at improving the condition of air passengers.

### 1. *Air Traffic Congestion*

Historically, air traffic control has been the strict province of national governments.<sup>1195</sup> However, given the congested nature of European airspace, it became apparent by the late 1950s that some sort of transnational air traffic system had to be arranged. This consensus led to the formation of EUROCONTROL in 1961, which, while independent of the EU, includes all of the Member States and membership in it is mandatory for admission to the EU.<sup>1196</sup> The purpose of EUROCONTROL was to organize cooperation between its members' respective air traffic control systems.<sup>1197</sup>

While EUROCONTROL was initially hailed as a triumph of international cooperation, by the 1990s its performance was less than satisfactory. One-third of all flights experienced delays, with an average delay of 20 minutes, and delays of several hours being not uncommon during peak traffic periods.<sup>1198</sup> Half of these delays were directly attributable to air traffic congestion, causing an estimated loss of five billion euros annually.<sup>1199</sup>

This less than satisfactory situation prompted the Council, in June 1999, to request that the Commission investigate the condition of air traffic congestion in the Union and present a communication on what steps were being taken to improve the situation.<sup>1200</sup> The Commission reported back six months later, stating that although EUROCONTROL had formulated a 15-year plan for reducing congestion, "it is doubtful whether this initiative . . . is the right response if major structural reforms are

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<sup>1195</sup> Communication from the Commission to the Council and the European Parliament, EUR. PARL. DOC. COM(99) (614 final 2), Introduction (4) [hereinafter COMMUNICATION FROM COMMISSION].

<sup>1196</sup> *Id.*

<sup>1197</sup> *Id.*

<sup>1198</sup> *Id.* at Introduction (1).

<sup>1199</sup> *Id.*

<sup>1200</sup> COMMUNICATION FROM COMMISSION, *supra* note 1195, at Introduction (6).

not made both at national and at European levels.”<sup>1201</sup> The Commission hastened to point out that the recommendations it made were not intended to undermine EUROCONTROL, but should be viewed as part of “the will of the Commission to highlight the complementarity of the Community’s political goals and the specific responsibilities of EUROCONTROL.”<sup>1202</sup>

The Commission brought forward several proposals for improving air traffic flow. It suggested that in the short-term EUROCONTROL should devise contingency plans to deal with “crises due to unforeseen events,” such as strikes or severe weather, and make provisions for rerouting traffic around the affected area.<sup>1203</sup> For the long term, the Commission advocated the adoption of a “Single Sky policy,” which would dissociate air traffic control from national governments and vest more authority in a European-wide system.<sup>1204</sup> Under the aegis of the Single Sky policy, traffic corridors and sectors would be established without regard to national boundaries, while civil and military traffic zones would be reorganized as well.<sup>1205</sup> New regulations standardizing air traffic control systems and procedures in Member States would also be used to further promote uniformity among the EUROCONTROL members.<sup>1206</sup>

Since the Commission’s report there has been little advancement in the development of a true Single Sky.<sup>1207</sup> However, Transport Commissioner Loyola de Palacio appears determined to make the subject the focus of her term in office, calling the present air traffic situation “catastrophic.”<sup>1208</sup> De Palacio has gone so far as to personally meet with striking air traffic controllers to assure them that the Single Sky policy would not cost them their jobs.<sup>1209</sup> Yet Europe’s air traffic control unions remain tropismatically suspicious that the Single Sky policy is a covert attempt to privatize air traffic control, despite de Palacio’s repeated assurances that it is not.<sup>1210</sup> If de Palacio is able to

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<sup>1201</sup> *Id.*

<sup>1202</sup> *Id.* at II(11).

<sup>1203</sup> *Id.* at I(8).

<sup>1204</sup> *Id.* at II(12) - (13).

<sup>1205</sup> COMMUNICATION FROM COMMISSION, *supra* note 1195, at II(13).

<sup>1206</sup> *Id.* at II(16).

<sup>1207</sup> *Ministers Welcome Single Sky Initiative*, ATC MKT. REP. 1, at 1 (Feb. 3, 2000).

<sup>1208</sup> Simon Warburton, *De Palacio Offers to Meet French Controllers*, AIR TRANSP. INTELLIGENCE, July 12, 2000.

<sup>1209</sup> *Id.*

<sup>1210</sup> *De Palacio Slams ‘Disinformation, Manipulation’ by French ATC Strikers*, AVIATION DAILY, Jun. 27, 2000, at 1.

overcome this opposition, the future looks bright for the Single Sky, as the Member States almost unanimously support such a change.<sup>1211</sup>

## 2. Noise Limitations

Unlike North America, where airports are normally constructed on the periphery of urban areas, European airports are usually surrounded by dense population concentrations.<sup>1212</sup> It comes as no surprise then that the EC/EU has been among the world's leaders in efforts to restrict noise emissions from aviation.<sup>1213</sup> However this leadership has often drawn criticism from nations outside the Union, which view the noise limitations as being used to restrict market access for non-Union carriers and to protect European aircraft manufacturers. Yet the EC/EU has soldiered on with its attempts to reduce noise pollution. The Council's most recent action on the subject has proven to be its most controversial yet, prompting a series of threats from the United States, whose carriers, aircraft manufacturers, and aircraft reconditioning firms stand to lose considerable sums of money.<sup>1214</sup>

The regulation in question is Regulation 925/1999, which establishes significantly more stringent standards for noise emissions than the current ICAO convention demands.<sup>1215</sup> A full understanding of the regulation would require an elaborate explanation of the technical aspects of ICAO noise emission standards.<sup>1216</sup> Suffice it to say that aircraft are divided into four categories termed Chapters 1, 2, 3 and 4, after the relevant chapters of Volume I, Part II of Annex 16 to the Convention on International Civil Aviation, third edition.<sup>1217</sup> Chapters 3 and 4 set considerably higher standards for reducing aircraft noise than Chapters 1 and 2.<sup>1218</sup> Most Member States independently

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<sup>1211</sup> Simon Warburton, *EC Ministers to Discuss Worsening ATC Delays*, AIR TRANSP. INTELLIGENCE, Jan. 4, 2000.

<sup>1212</sup> Benedicte A. Claes, *Aircraft Noise Regulation in the European Union: The Hushkit Problem*, 65 J. AIR L. & COM. 329, 341 (2000).

<sup>1213</sup> *Id.* at 342.

<sup>1214</sup> *Id.* at 346-47. It has been estimated that within a year of the regulation's enactment US firms lost \$2.1 billion in cancelled orders for hushkits, spare parts, accelerated air fleet depreciation, etc.

<sup>1215</sup> Council Regulation 925/1999, 1999 O.J. (L 115) 1.

<sup>1216</sup> See Claes, *supra* note 1212, at 329 for a detailed discussion of how aircraft noise is measured and classified under the ICAO's standards.

<sup>1217</sup> Council Regulation 925/1999, pmbl. 5, 1999 O.J. (L 115) 1, 1.

<sup>1218</sup> Claes, *supra* note 1212, at 339-40.



banned Chapter 1 aircraft in 1988,<sup>1219</sup> while the Council banned Chapter 2 aircraft in 1990.<sup>1220</sup> However, nothing in these earlier efforts at limiting aircraft noise prevented a carrier from reconditioning its aircraft or changing their operating profile and then having them "recertificated" as meeting the standards of Chapters 3 or 4.<sup>1221</sup> As a result, many carriers took these less expensive options rather than scraping their noncompliant aircraft.

The EU was displeased by these less-than-absolute measures, for while the reconditioned aircraft did meet the Chapter 3 standards, they were still not as quiet as newer aircraft specifically manufactured to meet those standards.<sup>1222</sup> Therefore, Regulation 925/1999 was drafted with a particular eye towards closing this loophole. The regulation sets a baseline for evaluating aircraft by defining a "civil subsonic jet aeroplane" as one with a maximum take-off weight of 34,000 Kilograms or with 19 or more passenger seats, and with an engine "bypass ratio" of more than three-to-one.<sup>1223</sup> The bypass ratio is the volume of air drawn into the engine compared to the volume of air actually used in the fuel burning process.<sup>1224</sup> (This technical detail has become the focus of the EU-U.S. dispute.) The regulation defines "recertificated civil subsonic jet aeroplane" as those meeting the size requirements laid out above, but which were initially designed to meet Chapters 1 or 2 noise restrictions and have subsequently been reconditioned or placed under operational restrictions in order to comply with Chapter 3 limits.<sup>1225</sup> However, if an aircraft has been "re-engined" and its new engines

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<sup>1219</sup> *Id.* at 339. Chapter 1 includes such aircraft as the Boeing 707, the Hawker Siddeley Trident, and the Aérospatiale Caravelle.

<sup>1220</sup> Council Directive 89/629/EEC, 1989 O.J. (L 363) 27. Chapter 2 includes the Boeing 727, early models of the Boeing 737, and early models of the McDonnell Douglas DC-9.

<sup>1221</sup> Reconditioning is done in one of two ways. The aircraft's existing engines may be modified through the use of a "hushkit," or, in a process called "re-engining" the engines may be entirely stripped and replaced with engines having a higher rating. Changing an aircraft's operating profile means altering the way the aircraft is operated, such as not loading it to full capacity, flying only to airports at particular elevations, flying only during certain times of day, etc.

<sup>1222</sup> Council Regulation 925/1999, pmbl. (5), 1999 O.J. (L 115) 1, 1.

<sup>1223</sup> *Id.* at 2. Please note that there is an error in the text of the regulation as published, which states that the aircraft must have a bypass ratio of *less* than three, however a full reading of the regulation and other relevant sources makes clear that it must be *greater* than three.

<sup>1224</sup> Claes, *supra* note 1212, at 331.

<sup>1225</sup> Council Regulation 925/1999, art. 2(2), 1999 O.J. (L 115) 1, 2.

meet the three-to-one bypass ratio it will not be considered as being recertificated, but will instead be treated like an aircraft that was initially designed to meet Chapter 3 standards.<sup>1226</sup>

The regulation barred Member States from registering recertificated aircraft after April 1, 1999, although recertificated aircraft registered as of that date would not be stripped of their registration provided that they have remained continuously registered in a Member State.<sup>1227</sup> Recertificated aircraft that are registered in a Member State may not be operated within the Union as of April 1, 2002, unless it has operated in the Union prior to April 1, 1999.<sup>1228</sup> Furthermore, as of April 1, 2002, recertificated aircraft registered outside the EU would not be permitted to fly to airports in the Union unless they had been on the register of their home country as of April 1, 1999, and had operated in the Union between April 1, 1995, and April 1, 1999.<sup>1229</sup> There are certain exemptions, however, which Member States may grant, including for emergencies and other conditions of "an exceptional nature," as well as for aircraft that operate exclusively outside of the Union's territory.<sup>1230</sup> The regulation also does not apply to the overseas possessions of the Member States.<sup>1231</sup>

The dispute between the EU and the U.S. arises principally from Regulation 925/1999's use of an aircraft's engine bypass ratio to evaluate its noise emission status rather than directly imposing a standard of how much noise an aircraft can emit. The EU has argued that the engine bypass ratio is a good measure of how noisy an aircraft is and that it is less subjective than setting a specific decibel level, as decibel levels can vary according to environmental conditions.<sup>1232</sup> The U.S. has countered by pointing out that there are aircraft models with bypass ratios less than that prescribed by the regulation which have lower noise emissions than aircraft that are capable of meeting the regulation's standards.<sup>1233</sup> The issue of protectionism for European manu-

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<sup>1226</sup> *Id.*

<sup>1227</sup> *Id.* at 3.

<sup>1228</sup> *Id.*

<sup>1229</sup> *Id.* The date requirements in Article 3(3) appear to be designed to prevent carriers whose home territories are far from the Union from transferring older short-range aircraft, which would not have been able to reach the Union ordinarily, to carriers based on the Union's periphery.

<sup>1230</sup> Council Regulation 925/1999, art. 4(1)-(2), 1999 O.J. (L 115) 1, 3.

<sup>1231</sup> *Id.*

<sup>1232</sup> Tom Gill, *Europe Breaks Rank on Noise*, AIRLINE BUS., Apr. 1999, at 32.

<sup>1233</sup> Claes, *supra* note 1212, at 369.

facturers has also been raised by the U.S., as U.S.-based corporations are the sole suppliers of hushkits and many of the engine models produced by American manufacturer Pratt & Whitney do not meet the bypass ratio requirement.<sup>1234</sup>

The EU agreed to delay implementation of Regulation 925/1999 by one year to permit U.S. carriers an opportunity to eliminate more of their noncompliant aircraft through attrition or advanced re-engining rather than scrapping them.<sup>1235</sup> Yet this will likely not forestall the U.S. government from taking some form of retaliatory action, either unilaterally or multilaterally through the ICAO and/or the WTO. The United States has chosen to resist the Union over such a seemingly minor issue because it is widely believed in the aviation community that Regulation 925/1999 represents a first step towards banning all Chapter 3 aircraft,<sup>1236</sup> which would encompass a majority of the fleets of U.S. carriers. The EU has done nothing to assuage the fears of U.S. carriers or manufacturers, but rather has been pressing for revising the Convention on International Civil Aviation to increase the stringency of noise limitation standards.<sup>1237</sup> Thus, it appears likely that the subject of noise limitations will remain a bone of contention between the EU and The U.S. for a number of years to come.

### 3. *Air Carrier Liability*

Another area where the EU has recently shown dissatisfaction with the global aviation community's standards is in the realm of air carriers' liability for accidents. The Warsaw Convention of 1929 governs the policies concerning liability for accidents in international air travel absent any countervailing national laws.<sup>1238</sup> The Warsaw Convention was to bring uniformity to air carrier liability; but as its last fully ratified amendment was made in 1961 a preponderance of national laws and regulations has sprung up to replace it.<sup>1239</sup> The EU recognized that it was desirable, both for passengers and carriers, to have consistent liability

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<sup>1234</sup> Gill, *supra* note 1232, at 32.

<sup>1235</sup> Colin Baker, *The Next Chapter*, AIRLINE BUS., Mar. 2000, at 54.

<sup>1236</sup> *Id.* at 55-56.

<sup>1237</sup> *Id.*

<sup>1238</sup> Council Regulation 2027/97, pmbl., 1997 O.J. (L 285) 1.

<sup>1239</sup> *Id.* In May 1999 the Warsaw Convention was finally amended to increase the liability ceilings on carriers to levels more in line with current price levels, however this amendment has not been ratified by all nations, so in many countries the 1961 liability ceilings still apply.

policies throughout the union, and to that end the Council adopted Regulation 2027/97 in October 1997.<sup>1240</sup>

Regulation 2027/97, which applies whenever a passenger is killed or injured on board an aircraft while it is in flight, embarking, or disembarking,<sup>1241</sup> is a peculiar mix of pro-plaintiff and pro-defendant policies. Article 3 of the regulation provides that the liability of a carrier is not subject to any limit defined by law, convention, or contract.<sup>1242</sup> Furthermore, up to a level of 100,000 SDRs (Special Drawing Rights, the "currency" of the International Monetary Fund which is used in IATA calculations), a strict-liability regime applies.<sup>1243</sup> In other words, a carrier cannot defend itself by showing that it has taken all necessary safety precautions, nor can it claim that it was impossible to have done anything to avoid the loss. However, despite the strict liability regime, contributory negligence still applies, so if the injured or deceased passenger caused, or contributed to, the damage, the carrier may be partly or wholly exempted from liability.<sup>1244</sup>

The regulation also describes the assistance the carrier must render in the event of an accident. Within fifteen days of identifying the dead or injured passenger, the carrier has to provide such money "as may be required to meet immediate economic needs," proportional to the damage suffered.<sup>1245</sup> Yet in the event of death, the advance payment cannot be less than 15,000 SDRs per passenger.<sup>1246</sup> Any advance payments cannot be considered admissions of liability and they may be deducted from any future settlement or judgment against the carrier.<sup>1247</sup> Ordinarily, the carrier cannot demand the return of advance payments, unless it is proved that the passenger contributed to the damage or was otherwise not entitled to compensation.<sup>1248</sup>

Finally, it is stipulated what carriers must do to notify passengers of the terms of the regulation. Carriers licensed by the Member States are required to include the provisions of the regulation in their conditions of carriage,<sup>1249</sup> and they must make "adequate information" in "plain and intelligible language" on

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<sup>1240</sup> *Id.*

<sup>1241</sup> *Id.* at 2.

<sup>1242</sup> *Id.*

<sup>1243</sup> Council Regulation 2027/97, art. 3(2), 1997 O.J. (L 285) 1, 2.

<sup>1244</sup> *Id.* at 3.

<sup>1245</sup> *Id.*

<sup>1246</sup> *Id.*

<sup>1247</sup> *Id.*

<sup>1248</sup> Council Regulation 2027/97, art. 5(3), 1997 O.J. (L 285) 1, 3.

<sup>1249</sup> *Id.*

the regulation available to passengers at travel agencies, check-in counters, company offices, and at other points of sale.<sup>1250</sup> Carriers from outside the Union may choose to not apply the provisions of the regulation, but they must “expressly and clearly” notify passengers of that at the time of sale of the ticket.<sup>1251</sup>

Regulation 2027/97 has appeared to be relatively unconten- tious. However, the Council provided as part of the regulation that the Commission should prepare a report on the effective- ness of it.<sup>1252</sup> The Commission’s report should be available by the end of 2000.

#### 4. *Civil Aviation Accident/Incident Investigations*

Within the EC/EU, the procedures and mechanisms for inves- tigating civil aviation accidents had long been governed by the Chicago Convention, which gave exclusive control of the pro- cess to the Member State in which such an accident occurred and, where different, the home state of the carrier that suffered the accident.<sup>1253</sup> But with the passage of the Third Package, it would be increasingly difficult to neatly identify which Member States had an interest in such an investigation. Therefore, the Council determined that it was necessary to provide guidance on harmonizing investigation processes in the Member States.

To this end, in 1994 the Council issued Directive 94/56 with the goal of “facilitating the expeditious holding of investigations . . . ”<sup>1254</sup> The terms of the directive apply to all investigations of accidents or incidents within the territory of the Union, along with accidents or “serious incidents” outside of the territory of the Union if the aircraft concerned are registered in a Member State or owned by an undertaking established in a Member State, and the state where the event took place does not conduct such an investigation.<sup>1255</sup> For the purpose of the directive, an “accident” is defined as an event that occurs while passengers are on board the aircraft and where the event results in the death of, or serious injury to, a person, where the aircraft is seri- ously damaged, or where the aircraft “is missing or is completely

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<sup>1250</sup> *Id.*

<sup>1251</sup> *Id.*

<sup>1252</sup> *Id.*

<sup>1253</sup> Council Directive 94/56/EC, pmbl., 1994 O.J. (L 319) 14.

<sup>1254</sup> *Id.* at 15.

<sup>1255</sup> *Id.*

inaccessible.”<sup>1256</sup> An “incident” is an event, other than an accident, which affects or would affect the safety of the aircraft, while a “serious incident” is an event that involves circumstances suggesting an accident nearly occurred.<sup>1257</sup>

Every accident and serious incident must be the subject of an investigation, while lesser incidents may be investigated at the discretion of concerned Member States.<sup>1258</sup> The scope and nature of the investigation is to be determined by the appropriate investigating bodies, but the investigation is not to assign blame or liability for the event.<sup>1259</sup> A Member State may use whatever procedures are appropriate within its legislative system for establishing or defining an investigating body.<sup>1260</sup> However, the investigating body must have free access to all relevant materials and evidence related to the event, such as manufacturers’ design information and the site of the incident.<sup>1261</sup> The investigating body must also be “functionally independent” from other national aviation authorities, particularly those charged with certification of airworthiness, air traffic control, aircraft maintenance, or any other duty which might conflict with the duties of the investigating body.<sup>1262</sup> The investigating body must have sufficient resources to be able to conduct its duties normally. However, it may request assistance from other national agencies for the supply of installations and equipment for certain aspects of the investigation process.<sup>1263</sup> This would include everything from hangars to store crash debris to specialized lab facilities for examination of flight data recorders. This assistance should be supplied at no cost where possible.<sup>1264</sup> A Member State may choose instead to delegate its investigatory duties to another Member State.<sup>1265</sup>

Any investigation into an accident must be the subject of an accident report summarizing the investigating body’s findings and its safety recommendations if any.<sup>1266</sup> The report must be

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<sup>1256</sup> *Id.*

<sup>1257</sup> *Id.* at 16. See the Annex to the Directive for a list of possible events which would constitute a “serious incident.”

<sup>1258</sup> Council Directive 94/56/EC, art. 4(1), 1994 O.J. (L 319) 14, 16.

<sup>1259</sup> *Id.*

<sup>1260</sup> *Id.*

<sup>1261</sup> *Id.*

<sup>1262</sup> *Id.* at 16-17.

<sup>1263</sup> Council Directive 94/56/EC, art. 6(3) - (4)(a), 1994 O.J. (L 319) 14, 17.

<sup>1264</sup> *Id.*

<sup>1265</sup> *Id.*

<sup>1266</sup> *Id.*

made public, preferably within 12 months of the accident.<sup>1267</sup> The conditions attached to an incident report are significantly more stringent, presumably because the less severe nature of the event militates against the release of superfluous information. While an incident report must be generated, including safety recommendations where appropriate, it should guard the anonymity of any persons involved in the incident.<sup>1268</sup> Furthermore, unlike the accident report, which is to be publicly distributed, an incident report need only be provided to “the parties likely to benefit” from its determinations.<sup>1269</sup> Any safety recommendations included in either type of report must be provided to all of the concerned parties and to the Commission.<sup>1270</sup> Such recommendations shall not give rise to a presumption of blame or liability for the event being investigated.<sup>1271</sup>

Since it was adopted in November 1994, Directive 94/56 has proven to be uncontroversial. Almost six years after its enactment, no Commission decisions have even cited it, let alone turned on it, nor has it been cited in a ruling by the Court of Justice.<sup>1272</sup>

### 5. *Denied-Boarding Compensation*

As part of an effort to stem the “constant stream of complaints” about customer service received by the EU’s governing bodies and the Member States’ air authorities,<sup>1273</sup> the Council took action in 1991 to address the particularly trying subject of denied boardings.<sup>1274</sup> (A denied boarding is when a carrier refuses to permit a passenger on a flight despite the passenger holding a valid ticket, having a confirmed reservation, and having presented himself for check-in within the required time.)<sup>1275</sup>

Regulation 295/91 encompasses all instances of denied boarding due to overbooking for scheduled flights within the Union’s territory, regardless of the nationality of the passenger

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<sup>1267</sup> *Id.*

<sup>1268</sup> Council Directive 94/56/EC, art. (8)(1), 1994 O.J. (L 319) 14, 17.

<sup>1269</sup> *Id.*

<sup>1270</sup> *Id.*

<sup>1271</sup> *Id.*

<sup>1272</sup> As of August 16, 2000.

<sup>1273</sup> *Air Passenger Rights in the European Union: A Consultation Document on Consumer Protection in Air Transport*, available at [http://www.europa.eu.int/en/comm/dg07/pass\\_prot\\_cons/passprotcons.pdf](http://www.europa.eu.int/en/comm/dg07/pass_prot_cons/passprotcons.pdf) (last visited Aug. 10, 2000).

<sup>1274</sup> Council Regulation 295/91, 1991 O.J. (L 36) 5.

<sup>1275</sup> *Id.* at 5.

or carrier.<sup>1276</sup> Carriers must devise their own rules for how passengers will be loaded in the event of overbooking, which should include a procedure for requesting volunteers to remain behind<sup>1277</sup> and also address the needs of passengers who should have boarding priority, such as handicapped persons or unaccompanied children.<sup>1278</sup> Carriers are required to make the terms of their boarding policies available to the public and to notify the Commission and interested Member States as well.<sup>1279</sup> Regardless of the carrier's boarding rules, if a passenger is denied boarding due to overbooking he or she must be given a choice between a full refund of the unused portion of the ticket, re-routing to their final destination at the earliest opportunity, or re-routing at a later date at the passenger's convenience.<sup>1280</sup>

The regulation also provides for compensation that the passenger must receive in the event of such a denied boarding in addition to the refund or re-routing laid out above. If the final destination was 3,500 Kilometers or less from the point where boarding was denied, the carrier must pay the passenger 150 Euros, or 300 Euros if the final destination was more than 3,500 Kilometers from where boarding was denied.<sup>1281</sup> The payment must be made in cash, unless the passenger agrees to accept it in some other form, such as a discount voucher,<sup>1282</sup> although the payment may be reduced by 50% if the carrier is able to re-route the passenger in a manner that allows him or her to reach the destination within a brief length of time after they were originally scheduled to arrive.<sup>1283</sup> Furthermore, the payment "need not" exceed the original cost of the ticket.<sup>1284</sup> If the passenger agrees to accept a seat in a class lower than that paid for, the carrier must reimburse the difference in price between the two seats.<sup>1285</sup>

Regardless of what form or amount of compensation a passenger receives under these provisions, the carrier must also provide, free of charge, a telephone call or fax to the passenger's final destination, meals and refreshments "in a reasonable rela-

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<sup>1276</sup> *Id.*

<sup>1277</sup> *Id.* at 6.

<sup>1278</sup> *Id.*

<sup>1279</sup> Council Regulation 295/91, art. 3(1), (2), 1991 O.J. (L 36) 5, 6.

<sup>1280</sup> *Id.*

<sup>1281</sup> *Id.*

<sup>1282</sup> *Id.*

<sup>1283</sup> *Id.*

<sup>1284</sup> Council Regulation 295/91, art. 4(4), 1991 O.J. (L 36) 5, 6.

<sup>1285</sup> *Id.*



tion" to the wait time, and hotel accommodations if the passenger will be delayed overnight.<sup>1286</sup> In the case of a metropolitan area served by multiple airports, if a passenger agrees to travel to a different airport than he was originally destined for, the carrier must pay for the cost of travel between the respective airports or to another nearby location.<sup>1287</sup> If the passenger obtained his or her ticket through a package tour, the tour operator is to be the point of contact for matters relating to the denied boarding.<sup>1288</sup> Carriers must provide a passenger who has been denied boarding a document enumerating all their rights under Regulation 295/91.<sup>1289</sup> Interestingly, the regulation specifically states that it is without prejudice to any subsequent determination by courts that further compensation is appropriate.<sup>1290</sup>

The Union practices governing denied-boarding compensation have remained unchanged since the implementation of Regulation 295/91. However, there was some movement, beginning in late 1999, to amend and expand the terms of the regulation. The proposals before the Commission were to increase the level of compensation and possibly extend compensation to those passengers whose flights are delayed longer than is deemed acceptable.<sup>1291</sup> By mid-2000 though, they had still not been enacted.

## VII. CONCLUSION

Since the genesis of international aviation, all nations have jealously guarded their sovereignty over aviation, allowing airlines owned by foreign nationals to enter their own markets only on a reciprocal basis, carefully negotiated in a series of bilateral air transport agreements. But truly open markets require that traditional notions of air sovereignty, and the complex matrix of bilateral air transport agreements which codify the concept, must be superseded by a regime that treats all of the EU as a domestic cabotage market.

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<sup>1286</sup> *Id.*

<sup>1287</sup> *Id.* at 6-7.

<sup>1288</sup> *Id.* at 6.

<sup>1289</sup> Council Regulation 295/91, art. 8, 1991 O.J. (L 36) 5, 7.

<sup>1290</sup> *Id.*

<sup>1291</sup> *Air Passenger Rights in the European Union: A Consultation Document on Consumer Protection in Air Transport*, available at [http://www.europa.eu.int/en/comm/dg07/pass\\_prot\\_cons/passprotcons.pdf](http://www.europa.eu.int/en/comm/dg07/pass_prot_cons/passprotcons.pdf) (last visited Aug. 10, 2000).

Another traditional concept that already appears to be crumbling is the notion of "effective ownership and control" of a flag-carrier by citizens of its nation. For example, where the Ireland-Portugal bilateral air transport agreement allowed a carrier flying the flag of each nation to serve the Dublin-Lisbon market, it was required that each nation's carrier be effectively owned and controlled by citizens of the nation whose flag the airline flew. Thus, more than 50% of Aer Lingus is owned by Irish nationals, and more than 50% of TAP, the national airline of Portugal, is owned by Portuguese. "Effective ownership and control" is a concept that has long dominated the air transport relations of most nations, although a few multinational carriers existed here and there, the most notable among them being the Scandinavian Airline System (SAS), a consortium of Scandinavian nations. Under the regulations proposed by the Commission in 1991, an airline registered in any Member State would have virtually unhindered freedom to transport passengers in any intra-Community cabotage or Fifth Freedom market. Hence, entry would largely be deregulated. Carriers like British Airways or Swissair have already expressed interests in acquiring carriers like KLM and Sabena. Hence, multinational European airlines are likely eventually to be the norm, rather than the exception.

With their eyes on the U.S. "megacarriers" that have emerged from American deregulation (where fewer than a half-dozen airlines control more than 80% of the U.S. domestic market), privatization and merger discussions between carriers have become increasingly popular in Europe. The five largest EC airlines (i.e., British Airways, Air France, Lufthansa, KLM, and Iberia) account for nearly 70% of scheduled European traffic.<sup>1292</sup> Jan Carlzon, former president of SAS, predicted that ultimately only five airlines will survive liberalization.<sup>1293</sup> The global impact of deregulation is predicted to result in a consolidation of the industry into 15 to 20 multinational airlines, competing in markets around the world.<sup>1294</sup>

If the U.S. experience is any indication of what will occur in a liberalized regulatory environment in Europe, bankruptcies, consolidations, and mergers will result in a highly concentrated

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<sup>1292</sup> *European Deregulation Expected to Lead to Airline Mergers*, AV. WK. & SPACE TECH., Mar. 9, 1987, at 203. British Airways alone accounts for 22% of all EEC revenue passenger miles, even without its acquisition of British Caledonian. *Id.*

<sup>1293</sup> Carey, *European Airlines Discuss Joining Forces*, WALL ST. J., June 10, 1987, at 16, col. 3.

<sup>1294</sup> Kasper, *Toward Open Skies World-Wide*, WALL ST. J., Aug. 3, 1987, at 17.

group of multinational European megacarriers, all utilizing hub-and-spoke operations and linked to only a few sophisticated computer reservations systems.<sup>1295</sup> In the short run, passengers will enjoy lower ticket prices, as carriers become hotly competitive, because their profit margins will be severely squeezed by new entrants.<sup>1296</sup> Many smaller carriers and most new entrants will fall into bankruptcy, unless they can align themselves as feeders for the megacarriers.<sup>1297</sup> The charter airline industry will shrink radically or disappear. And once the remaining airlines have achieved consolidation into a handful of megacarriers, ticket prices will likely rise.<sup>1298</sup>

The increasing number of liberal bilateral agreements is evidence that the European nations are creating a more free-market-oriented air transport system. Individual airlines are also taking direct action against restraints to air transport. Nations and airlines opposed to deregulation are being increasingly subjected to market forces to which they must respond or risk losing ground to the more flexible, less-regulated States and increasingly privatized carriers. Industry organizations have tre-

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<sup>1295</sup> The emergence of European computer reservations systems (CRS) has already begun, with British Airways, KLM, and Swissair linking themselves in a joint venture with United Airlines, and its Covia reservations system. Rose, *Allegis Aims for More Profit, Passengers with European Reservations Venture*, WALL ST. J., July 13, 1987, at 2, col. 2. Recently, Allegis announced its intention to sell 35% of its Covia system to British Airways, Swissair, KLM and Alitalia. *Allegis Discloses More on 50% Sale of Its Covia Unit*, WALL ST. J., Feb. 19, 1988, at 36, col. 2. Meanwhile, Air France, Lufthansa, Iberia and SAS have teamed with Texas Air's System One CRS to form the Amadeus computer reservations system.

<sup>1296</sup> Paul Stephen Dempsey, *The Experience of Deregulation: Erosion of the Common Carrier System*, 13 TRANSP. L. INST. 121, 172-75 (1980).

<sup>1297</sup> See Paul Stephen Dempsey, *Antitrust Law & Policy in Transportation: Concentration is the Name of the Game*, 21 GA. L. REV. 505 (1987); Paul Stephen Dempsey, *Birth of the Monster Airlines*, TRAFFIC WORLD, Dec. 1, 1986, at 77; Rose, *Major U.S. Airlines Rapidly Gain Control Over Flying Low*, ROCKY MTN. NEWS, Aug. 9, 1987, at 73; Paul Stephen Dempsey, *The Carnage of Airline Deregulation*, HOUS. CHRON., July 30, 1987, at 27; Paul Stephen Dempsey, *Consolidation, a Destructive Trend*, DENV. POST, Dec. 6, 1986, at 4B, col. 1; Paul Stephen Dempsey, *Deregulation's Toll Is Rising*, DENV. POST, Sept. 4, 1986, at 5B, col. 4; Paul Stephen Dempsey, *Deregulated Skies Unfriendly to Small Airlines*, ROCKY MTN. NEWS, May 25, 1986, at 77, col. 1; Paul Stephen Dempsey, *Airline Deregulation's Hostile Skies*, DENV. POST, Oct. 17, 1983, at 3B, col. 1; Paul Stephen Dempsey, *Affordability, Safety of Airlines May Suffer*, L.A. TIMES, Oct. 11, 1983, at 7, col. 1; Rowen, *Airline Deregulation: A Bankrupt Policy*, WASH. POST, Sept. 29, 1983, at A21; see also DEMPSEY & THOMS, *supra* note 4, at 245-51.

<sup>1298</sup> PAUL STEPHEN DEMPSEY, *FLYING BLIND: THE FAILURE OF AIRLINE DEREGULATION* (1990); PAUL STEPHEN DEMPSEY, *THE SOCIAL AND ECONOMIC CONSEQUENCES OF DEREGULATION* (1989).

mendous influence in the European air transport industry. ECAC has made significant strides toward liberalization with its recent Memoranda of Understanding on tariffs and capacity. Although the interests and objectives of each organization are different, there is growing support for modest liberalization from these bodies, as well.

The European Community was established to promote a free market among Member States. Actions by the EC/EU were delayed by political considerations and by the reluctance of a few nations that own or subsidize their national airlines.<sup>1299</sup> While unable to accomplish immediate deregulation, the EC/EU helped generate public support that pressured governments towards more bilateral agreements to ease regulation. Through its governing bodies, the EC/EU contributed to the creation of a governmental climate favoring partial liberalization. Much progress has been achieved toward that objective with the Council's promulgation of its long-awaited regulations, group exemptions, directive and decision.

Although it is far from clear what the final result of these forces favoring liberalization of air transport regulations will be, it is obvious that significant liberalization in the regulatory environment of European air transport is occurring and that this trend will likely continue. Whether it will ultimately mirror U.S.-style deregulation or some more modest form of regulatory liberalization, as many EC officials insist it should, is as yet unclear.

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<sup>1299</sup> LIBERALIZATION POLICIES, *supra* note 183, at 28.

