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Aerial Dogfights over Europe: The Liberalization of EEC Air Transport

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AERIAL DOGFIGHTS OVER EUROPE: THE LIBERALIZATION OF EEC AIR TRANSPORT*

PAUL STEPHEN DEMPSEY**

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I. INTRODUCTION

AS AMERICA'S GRAND experiment with airline deregulation nears the end of its first decade, European carriers and their governments are examining it closely, pondering their own form of liberalization. Whatever its final design, the European plan will require consideration of a wider and more complex spectrum of variables than its American counterpart.

Airline liberalization in Europe involves a plethora of

competing legal, economic and political interests.¹ The principal actors include scores of privately and publicly owned or subsidized airlines,² the twelve nation European Economic Community (EEC), 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).³ The issue is further complicated by a host of bilateral agreements⁴ and a growing regional air transport market.⁵

European nations, particularly those belonging to the European Economic Community, are entering a new era in air transport. While this industry has traditionally been heavily regulated,⁶ many of the EEC states are reexamining their positions and moving toward liberalization of the regulatory environment.

The EEC was established by the Treaty of Rome in 1957 for the purpose of enhancing economic efficiency among the European states.⁷ The Treaty includes rules intended to promote competition in various economic sectors, including transportation.⁸ The four governing bodies of the EEC — the Council, the Commission, Parliament, and the European Court of Justice — share re-

¹ See generally *Europe's Air Cartel*, ECONOMIST, Nov. 1, 1986, at 23 [hereinafter *Air Cartel*]; P. DEMPSEY, LAW & FOREIGN POLICY IN INTERNATIONAL AVIATION 93-107, 241-55 (1987).

² *Air Cartel*, *supra* note 1, at 23.

³ *EEC Deregulation Proposal Blocked While ECAC Plan Proceeds*, AV. WK. & SPACE TECH., July 7, 1986, at 33.

⁴ See generally Naveau, *Bilateralism Revisited in Europe*, 10 AIR L. 85 (1985); P. DEMPSEY, *supra* note 1, at 47-75.

⁵ Feazel, *EEC Officials Draft New Directive to Ease Regional Airline Regulation*, AV. WK. & SPACE TECH., April 14, 1986, at 37.

⁶ 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 Salacuse, *The Little Prince and the Businessman: Conflicts and Tensions in Public International Air Law*, 45 J. AIR L. & COM. 807 (1980); P. DEMPSEY, *supra* note 1, at 7-22.

⁷ 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 P. DEMPSEY, *supra* note 1, at 451-59.

⁸ *Treaty of Rome*, *supra* note 7, art. 3.

sponsibility to interpret and implement these rules.⁹

The Council, whose members represent the Member States, is responsible for carrying out the objectives of the EEC through legislative enactments.¹⁰ The Commission, comprised of nonpartisan members chosen by common agreement by the Member States, gives recommendations and advisory opinions to the Council.¹¹ Parliament works for the benefit of the EEC as a whole and has the duty of advising the Council on issues relevant to the development of the EEC.¹² The Court of Justice interprets the provisions of the Treaty of Rome and enforces its requirements.¹³ 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.

Significantly, in December 1987, the EEC Council issued its long-awaited regulations applying the Treaty of Rome's competition rules to scheduled air transport, group exemptions thereto, a directive on scheduled air fares, and a decision on capacity sharing and market access. These are set forth as Appendices A - D, respectively, to this article. With 1992 established as the target for European economic unification, the heat is on to liberalize air transport.

The principal air transport organizations involved in the liberalization process are the International Air Transport Association, the European Civil Aviation Conference, and the Association of European Airlines. The IATA represents more than 100 airline companies and is one of the most influential airline organizations in the world.¹⁴ The ECAC includes the directors general of

⁹ L. HENKEN, R. PUCH, O. SCHACHTER & H. SMIT, *INTERNATIONAL LAW* 1077 (1980) [hereinafter L. HENKEN].

¹⁰ 3 Common Mkt. Rep. (CCH) ¶¶ 4401, 4405 (1987).

¹¹ 3 Common Mkt. Rep. (CCH) ¶¶ 4472, 4481 (1987).

¹² 3 Common Mkt. Rep. (CCH) ¶ 4302 (1987).

¹³ 3 Common Mkt. Rep. (CCH) ¶ 4600 (1981).

¹⁴ Letter from Knut Hammarskjold, Office of the Director General, IATA to G. Contogeorgis, Commissioner, European Economic Communities, Attachment A, at 6 (Dec. 28, 1981) [hereinafter Letter from Knut Hammarskjold]; P. DEMPSEY, *supra* note 1, at 269.

twenty-two European countries and strongly influences the European air transport policy.¹⁵ It issued two important Memoranda of Understanding liberalizing intra-European tariffs and capacity in December 1986. The AEA, representing the thirteen largest scheduled airlines in Europe, promotes the interests of its members in the EEC and in conferences concerning air transport policy.¹⁶ While these organizations tend to favor more modest forms of liberalization, their interests and objectives vary greatly.

Britain and the Netherlands have led the fight for liberalization, concluding a number of liberal bilateral transport agreements with other nations,¹⁷ while the more conservative southern European nations, such as France and Greece, have argued for a more modest relaxation of the regulatory reins.¹⁸ New airlines, such as Ireland's Ryanair, are entering the market to take advantage of areas which are amenable to competition.¹⁹ Established airlines, including British Caledonian and British Airways, advocate increased liberalization.²⁰ Although there has been a strong movement toward privatization in recent years, many European airlines are still state-owned or subsidized, complicating the ability of free market principles to work effectively.

This article will examine the contemporary status of competition in the European air transport industry and the efforts by the EEC, air transport organizations, and individual states and airlines to encourage liberalization.

¹⁵ *Liberal Regulatory Environment Alters IATA's Fare-setting Role*, AV. WK. & SPACE TECH., Nov. 11, 1985, at 102, 105 [hereinafter *Liberal Regulatory Environment*].

¹⁶ *European Airline Balance Shifts Toward Deregulation*, AV. WK. & SPACE TECH., Nov. 4, 1985, at 29 [hereinafter *European Airlines*].

¹⁷ Feazel, *European Civil Aviation Leaders Commit to Increased Liberalization*, AV. WK. & SPACE TECH., June 24, 1985, at 36 [hereinafter *Increased Liberalization*].

¹⁸ *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*].

¹⁹ Barrett, *Irish Airline's Model for Deregulation*, WALL ST. J., Dec. 10, 1986, at 35, col. 4.

²⁰ *British Caledonian*, *supra* note 18, at 36.

The political, legal, and economic winds unleashed by the debate over liberalization are creating increased turbulence in the skies over Europe.

II. CONTEMPORARY PRACTICES IN EUROPEAN AIR TRANSPORT

European airlines have traditionally been heavily regulated by their governments.²¹ Many European governments either fully own or subsidize their carriers.²² National governments have traditionally shielded their 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 earnings, augmenting international prestige, and enhancing national security, as well as reducing domestic unemployment and promoting domestic aircraft manufacturing industries.²³

But after the United States deregulated its domestic air

²¹ See *supra* note 6. American aviation was also heavily regulated prior to 1978. See P. DEMPSEY & W. THOMS, *LAW & ECONOMIC REGULATION IN TRANSPORTATION* 26-29, 121-133 (1986).

²² Percentage of capital held in 1979 by States in the main EEC scheduled airlines was as follows:

Air France	98.80
Air Inter	49.90
Alitalia	99.00
British Airways	100.00
KLM	78.00
Aer Lingus	100.00
Lufthansa	82.16
Luxair	25.57
Sabena	100.00

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 privatized and the Dutch government today holds only a 39% interest in KLM. See P. DEMPSEY, *supra* note 1, at 83.

²³ Sørensen, *Progress Towards the Development of a Community Air Transport Policy*, IATA MAG., June-July 1985, at 3, 7-8; Dempsey, *Turbulence in the "Open Skies": The Deregulation of International Air Transport*, 15 TRANSP. L.J. 305, 362-63 (1987) [hereinafter *Turbulence*].

transport market and began to export its ideology abroad, many observers argued that rigid regulation and price-fixing created inefficient markets and excessively high fares.²⁴ In 1983, unit operating costs of scheduled airlines in Europe were 70% higher than those in the United States.²⁵ The International Civil Aviation Organization published figures which showed Europe as having the most unfavorable revenue-cost ratio of twelve regions in the world.²⁶ Many fares in Europe remain substantially above fares for comparable distances in other parts of the world: "[I]t cost 166 [Pounds Sterling] to fly economy single for 585 miles from London to Milan compared with 110 [Pounds] to travel a similar distance between Jakarta and Singapore or 105 [Pounds] between Brisbane and Canberra."²⁷ When reduced fares were available on European flights, they were usually encumbered by restrictions and penalties.²⁸ Capacity controls,²⁹ tariff coordination and price-fixing,³⁰ market access restrictions,³¹ and reve-

²⁴ 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 Dempsey, *The Rise and Fall of the Civil Aeronautics Board — Opening Wide the Floodgates of Entry*, 11 *TRANSP. L.J.* 91 (1979), and Dempsey, *The International Rate and Route Revolution in North Atlantic Passenger Transportation*, 17 *COLUM. J. TRANSNAT'L L.* 393 (1978).

²⁵ COOR, *International Air Fares in Europe*, IATA MAG., Jan.-Mar. 1985, at 11 [hereinafter *International Air Fares*].

²⁶ Commission of the European Communities, *SCHEDULED PASSENGER AIR FARES IN THE EEC* (No. 398) 13 (Final 1981).

²⁷ Thaine, *The Way Ahead from Memo 2: The Need for More Competition and a Better Deal for Europe*, 10 *AIR L.* 90 (1985).

²⁸ *Id.*

²⁹ 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. The capacity controls are concluded in agreements between airlines which fix the number of seats that aircraft from two different Member States will offer. *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*].

³⁰ Price controls are prices imposed by governments in an effort to guarantee revenues and enhance the viability of airlines.

³¹ Market access restrictions are agreements to determine which airlines will be

nue sharing (pooling) agreements³² allegedly contributed to this disparity.³³

III. AIR TRANSPORT ORGANIZATIONS

Air transport organizations wield tremendous influence in the European air transport industry.³⁴ Although the interests and objectives of each organization differ, growing support exists for liberalization of European air transport.

The IATA perceives a relaxation of regulatory controls as inevitable³⁵ and has recently shifted toward partial support of liberalization.³⁶ In response to the pressure to liberalize, the IATA has already adopted some structural changes within its Tariff Conferences that make it easier to experiment with new fares and services.³⁷ The IATA's absolute power has diminished, but it still serves an important function in coordinating carrier tariffs.

The ECAC, representing 22 European States, makes recommendations and resolutions which are considered and often implemented as regulations by its members.³⁸ The ECAC unanimously issued a policy statement committing member governments to increasingly liberal regulatory schemes throughout the continent.³⁹ The proposed policy includes more flexibility in fare-setting, market entrance, and pooling agreements.⁴⁰ In the early

granted particular air rights. See Gertler, *Nationality of Airlines: A Hidden Force in the International Air Regulation Equation*, 48 J. AIR L. & COM. 51, 54 (1982).

³² Pooling agreements between airlines equalize the revenue between airlines based on capacity offered. MEMORANDUM 2, *supra* note 29, at 33. Traditionally, 70-80% of the route-miles performed in Europe have been subject to pooling agreements. Feazel, *ECAC Leaders Expected to Approve Liberalized Regulatory Proposals*, AV. WK. & SPACE TECH., June 17, 1985, at 28, 29.

³³ Barrett, *supra* note 19, at 35 (not discussing pooling agreements).

³⁴ See Dempsey, *The Role of the International Civil Aviation Organization on Deregulation, Discrimination, and Dispute Resolution*, 52 J. AIR L. & COM. 529 (1987).

³⁵ Fink, *Transport's Long Haul to Profits*, AV. WK. & SPACE TECH., Nov. 11, 1985, at 11.

³⁶ *Liberal Regulatory Environment*, *supra* note 15, at 105.

³⁷ *New Agreements Spur European Liberalization*, AV. WK. & SPACE TECH., Nov. 12, 1984, at 71 [hereinafter *New Agreements*].

³⁸ P. DEMPSEY, *supra* note 1, at 99-100.

³⁹ *Increased Liberalization*, *supra* note 17, at 36.

⁴⁰ *Id.*

1980s, the ECAC and the United States signed a Memorandum of Understanding that liberalizes regulation of North Atlantic fares.⁴¹ And late in 1986, ECAC approved two Memoranda of Understanding involving liberalization of intra-European tariffs and capacity.

The AEA, which promotes the interests of the airlines in the EEC and at air transport conferences, has approved a policy calling for only limited liberalization.⁴² This policy includes proposals providing for flexibility in capacity, tariffs, market access, and state aid.⁴³

A. *International Air Transport Association*

The International Air Transport Association (IATA) is composed of more than 100 air carriers, including airlines from all EEC Member States except Luxembourg.⁴⁴ More than 70% of IATA member routes involve Europe.⁴⁵ As one of the most influential airline organizations in the world,⁴⁶ the IATA organizes conferences for the coordination of tariffs.⁴⁷ After the conferences, airlines file the proposed tariffs with their respective governments.⁴⁸

The IATA sees liberalization as inevitable⁴⁹ and has recently shifted toward partial support of deregulation.⁵⁰ But by no means does it support total deregulation.⁵¹ The deregulation of U.S. airlines eliminated IATA's tariff-

⁴¹ This pact was signed by the United States and by Italy, Belgium, France, West Germany, Greece, the United Kingdom, Norway, Denmark, Finland, Ireland, Yugoslavia, Switzerland, the Netherlands, Portugal, Spain, and Sweden. *U.S., ECAC Sign Atlantic Fare Pact*, *AV. WK. & SPACE TECH.*, Oct. 22, 1984, at 33; see *Turbulence*, *supra* note 23, at 353.

⁴² *European Airlines*, *supra* note 16, at 31.

⁴³ *Cf.* Barrett, *supra* note 19, at 35 (criticizing restraints on these areas).

⁴⁴ P. DEMPSEY, *supra* note 1, at 269.

⁴⁵ Barnabo, *Regulatory Reform in Europe*, *IATA REV.*, Oct.-Dec. 1985, at 11.

⁴⁶ P. DEMPSEY, *supra* note 1, at 269.

⁴⁷ *Id.* at 38-45.

⁴⁸ *Turbulence*, *supra* note 23, at 313-15.

⁴⁹ Fink, *supra* note 35, at 11.

⁵⁰ *Liberal Regulatory Environment*, *supra* note 15, at 105.

⁵¹ *Deregulation Drive Stalls Out at IATA Annual General Meeting*, *TRAFFIC WORLD*, Nov. 12, 1984, at 44 [hereinafter *Deregulation Stall*].

setting role in the world's largest airline market.⁵² On May 6, 1981, the U.S. Civil Aeronautics Board (CAB) issued a final order prohibiting U.S. carriers from participating in IATA Tariff Coordinating Conferences.⁵³ The CAB found that the rate-fixing portion of the Conference agreements substantially reduced competition.⁵⁴ But the CAB was "sunset" on December 31, 1984, before it issued a final decision in the IATA proceeding. The Department of Transportation, which inherited the CAB's jurisdiction over international aviation, terminated this controversial proceeding in 1985.⁵⁵

The deregulation of the United States air transport industry created a new problem for the IATA — the potential loss of U.S. antitrust immunity.⁵⁶ IATA responded with plans to establish U.S. corporations to overcome antitrust exposure in the United States.⁵⁷

The IATA has been accused of violating the competition laws of the Treaty of Rome with its tariff coordination activities.⁵⁸ IATA price-fixing potentially violates Article 85, which prohibits the direct or indirect "fixing of purchase or selling prices or of any other trading conditions."⁵⁹ Furthermore, since consumers receive no benefit from the price-fixing, Article 85(3) does not apply.⁶⁰ This provision creates a potential exception to the competition laws for agreements which "contribute to the improvement of the production or distribution of goods . . . while reserving to users an equitable share in the profits resulting therefrom"⁶¹

⁵² *Liberal Regulatory Environment*, *supra* note 15, at 103.

⁵³ Tompkins, *The North Atlantic — Competition or Confrontation*, 7 AIR L. 48, 49 (1982); P. DEMPSEY, *supra* note 1, at 40-45.

⁵⁴ Order No. 81-5-27, 89 C.A.B. 468, 498 (1981).

⁵⁵ *Turbulence*, *supra* note 23, at 353-54.

⁵⁶ *Deregulation Stall*, *supra* note 51, at 45.

⁵⁷ Feazel, *New IATA Director General Plans to Stress Service to Airlines*, AV. WK. & SPACE TECH., Feb. 11, 1985, at 35, 37.

⁵⁸ Letter from Knut Hammar skjold, *supra* note 14.

⁵⁹ Treaty of Rome, *supra* note 7, art. 85(1).

⁶⁰ Dagtoglou, *Air Transport and the European Community*, 6 EUR. L. REV. 335, 352 (1981).

⁶¹ Treaty of Rome, *supra* note 7, art. 85(3).

In response to the pressure for liberalization, the IATA has already implemented some formal changes. In the early 1980's, the IATA suspended compulsory participation in tariff negotiations by IATA members, and discontinued imposition of conditions of in-flight service in agreements.⁶² The IATA has also begun formal meetings with nonmembers.⁶³

Structural changes within the IATA Tariff Conferences are making it easier to experiment with new fares and services.⁶⁴ An important factor added to the IATA procedures is that the burden of proof rests on airlines blocking new fares rather than on the carrier proposing them. Furthermore, only the airlines involved in the route may participate, whereas previously any carrier could object to a fare.⁶⁵

While IATA still serves important functions in tariff-setting, its absolute power has been diminished. In a practical sense, the IATA has been transformed from an international quasi-regulatory agency to an influential trade association.⁶⁶

B. *European Civil Aviation Conference*

The European Civil Aviation Conference (ECAC), which includes the directors general of twenty-two European countries, does not have direct regulatory power, but strongly influences European air transport policies.⁶⁷ The ECAC makes recommendations and resolutions which are considered by its members and often implemented by them as regulations.⁶⁸ The ECAC was responsible for Europe's first step toward deregulation, the 1956 multilateral agreement on non-scheduled services. To-

⁶² *International Air Fares*, *supra* note 25, at 11.

⁶³ *Liberal Regulatory Environment*, *supra* note 15, at 102.

⁶⁴ *New Agreements*, *supra* note 37, at 71.

⁶⁵ *Id.* at 76.

⁶⁶ *Liberal Regulatory Environment*, *supra* note 15, at 102.

⁶⁷ *Id.* at 105.

⁶⁸ P. DEMPSEY, *supra* note 1, at 99-100.

day, chartered carriers account for more than 50% of Europe's passenger air transport, with minimal regulation.

The top aviation officials of the ECAC unanimously issued a policy statement committing their governments to increasingly liberal regulatory schemes throughout the continent.⁶⁹ Commitment to liberalization by the ECAC is endorsed by senior aviation officials of all twenty-two member countries.⁷⁰ The policy statement lays a foundation for further agreements. It includes more flexibility in fare-setting, increased opportunity to enter new markets, and reduced emphasis on pooling agreements. Nearly every nation involved was dissatisfied with some portion of the policy statement. The principal disagreement concerned whether airlines should be protected by governments.⁷¹

In spite of disagreement, the ECAC has engaged in policy negotiations with the United States. In October 1984, the United States and ECAC signed a Memorandum of Understanding (MOU) that liberalizes regulation of North Atlantic fares. The pact set "zones of reasonableness" for North Atlantic fares through April 30, 1987.⁷² A new, two-year memorandum with even more liberal provisions was signed in February 1987. Under the new agreement, deep-discount fare zones have been dropped an average of 10%, and such fares may be offered with fewer restrictions.⁷³ With this system, airlines have freedom to set transatlantic fares without government intervention so long as they fall within an agreed-upon percentage above

⁶⁹ *Increased Liberalization*, *supra* note 17, at 36.

⁷⁰ *Liberal Regulatory Environment*, *supra* note 15, at 105.

⁷¹ *Increased Liberalization*, *supra* note 17, at 36.

⁷² U.S., *European Carriers Extend Agreement on North Atlantic Fares*, AV. WK. & SPACE TECH., Apr. 8, 1985, at 31 [hereinafter U.S., *European Carriers*].

⁷³ ECAC, *U.S. Renew North Atlantic Pact*, AV. WK. & SPACE TECH., Feb. 23, 1987, at 32. The agreement is 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.

or below a reference price.⁷⁴ Thus far, the agreement has been found to have increased stability in transatlantic air transport.⁷⁵

In December of 1986, ECAC concluded two Memoranda of Understanding regarding intra-European scheduled air tariffs and capacity. The former is the first effort by a significant number of European states to embrace a tariff scheme whereby rates falling within a specific range are automatically approved by the involved governments. The tariff MOU establishes a Discount Zone of 90 to 65 percent and a Deep Discount Zone of 65 to 45 percent of the reference price, provided that the passengers using them satisfy certain conditions. The MOU on capacity sharing allows either participating nation to provide up to 55 percent of the market's capacity as opposed to the previous 50/50 sharing standard. Thus, for the twenty-two ECAC member nations (which include all twelve EEC members), liberalization in the areas of rates and capacity took an important first step forward in December of 1986.⁷⁶

C. *Association of European Airlines*

The Association of European Airlines (AEA) represents the thirteen largest scheduled airlines in Europe. It is more conservative on the liberalization issue than most organizations. The AEA acts as a trade association to promote the interests of the airlines in the EEC and at air transport conferences. It has approved a policy calling for only limited liberalization. Aer Lingus, British Airways, British Caledonian, Iberia, KLM, and UTA would have preferred a more liberal position. Air France led the opposition, advocating a more heavily regulated environment.⁷⁷

⁷⁴ U.S., *ECAC Sign Atlantic Fare Pact*, AV. WK. & SPACE TECH., Oct. 22, 1984, at 33.

⁷⁵ U.S., *European Carriers*, *supra* note 72, at 31.

⁷⁶ *ECAC Approves Liberalizing Fare, Capacity Regulations*, AV. WK. & SPACE TECH., Jan. 12, 1987, at 36.

⁷⁷ *European Airlines*, *supra* note 16, at 29.

The AEA recommendations are generally based on its view concerning the best way to provide an economically sound and stable air transport industry. In its proposals, the AEA has consistently considered the special relationship between airlines and their governments and the potential dangers of putting European airlines at a competitive disadvantage. The AEA prefers a pragmatic approach for gradual change which would ensure orderly competition, maintain benefits of "inter-airline" coordination, and avoid additional regulatory controls.⁷⁸

The AEA proposals provide for flexibility in capacity, tariffs, market access, state aid, and competition rules, subject to certain limitations on geographical scope and exemptions.⁷⁹ The proposals lay down detailed rules for applying Articles 85 and 86 of the Treaty of Rome to air transport, stating that the rules should apply only to international air transport between Community airports, should not apply to technical standards of improvement, and should not interfere with relations and agreements with nonmember states.⁸⁰

The AEA also advocates capacity agreements which would provide that airline facilities used by the traveling public be proportional to the public's requirements, that fair and equal opportunity be granted airlines of any two states to use any route between the two states, and that each state must consider the other state's requirements and services.⁸¹ The suggested time limit for AEA proposals is 4 years, with review before the proposals' expiration.⁸²

The EEC Commission has criticized the AEA's proposals on grounds that the suggested changes in capacity

⁷⁸ President's Special Assembly of the Ass'n of European Airlines, *European Air Transport Policy — AEA Proposals*, Sept. 27, 1985, at 1 [hereinafter *European Air Transport Policy*].

⁷⁹ *Id.* at 1-21; cf. Barrett, *supra* note 19, at 35 (criticizing restraints on competition in capacity, market access and fares).

⁸⁰ *European Air Transport Policy*, *supra* note 78, at 14, 17-18.

⁸¹ *Id.* at 7.

⁸² *Id.* at 9.

agreements would add no new freedom and fares would still be fixed. An additional concern is that the AEA has called for exemptions for all existing practices, rendering any new proposals useless.⁸³

The AEA is a major supporter of the Tariff Reform Action Package of 1985. This package includes streamlined conference procedures, revamped Traffic Conference Bulletins with a special European edition circulated to all European governments and regulatory institutions, and improved consumer contacts.⁸⁴ The AEA also supports a tariff reduction package that would set up new zones for discount fares.⁸⁵ While the AEA failed to speak with a common voice, it does appear to be promoting a degree of liberalization.

IV. ACTIONS TAKEN BY INDIVIDUAL STATES: LIBERAL BILATERALS

While free competition may develop more easily in a large, unified market such as that found in the United States, it is much more difficult to obtain where the market consists of a large number of independent nations. State sovereignty is the most formidable obstacle to free competition in international aviation.⁸⁶ Bilateral agreements have been the preferred instrument of nations seeking to protect their own state interests and those of their airlines and consumers from the effects of unrestrained competition.⁸⁷ Recently, bilateral agreements between some of Europe's more liberal governments aimed at encouraging competition in certain markets have offered a glimpse of what fares and services might resemble throughout Europe were a multilateral agreement to be reached.⁸⁸

⁸³ *Community: Airlines' Proposals Disappoint Commission*, Common Mkt. Rep. (CCH), at 1-2 (Nov. 7, 1985).

⁸⁴ See generally Barnabo, *supra* note 45.

⁸⁵ *European Airlines*, *supra* note 16, at 29.

⁸⁶ Thaine, *supra* note 27, at 91.

⁸⁷ *Id.*

⁸⁸ Two years after Britain and Holland deregulated air transport between the

The key to liberalization of the European airline industry ultimately rests with the individual nations of Europe. As a practical matter, without the consent of the Member States, the Council of the EEC is powerless to enact rules by which the Treaty of Rome would apply to air transport. Nor could the recommendations of the individual groups promoting liberalization be implemented without state action.

Regulation or deregulation of European airlines begins not with action over privately owned carriers by a single regulatory agency as in the United States, but through member nations' and community regulations over state-owned or subsidized airlines. Bilateral agreements are often employed as a means by which the respective governments avoid actions by competitors deemed to be harmful to their airlines.⁸⁹ The bilaterals which have evolved establish conditions necessary to the exchange of air rights.⁹⁰ Such bilaterals frequently restrict capacity and market access and provide for revenue sharing (pooling).⁹¹ The shift away from bilateral agreements that serve to protect state sovereignty toward a community policy of free competition is emerging only gradually.

Individual states are recognizing that some liberalization is inevitable. Deregulation of U.S. airlines has increased pressure on North Atlantic routes and spurred competition with European airlines.⁹² That the tide of pervasive regulation is turning can be seen in the efforts of individual European states which have grown impatient with lack of progress toward liberalization.

The United Kingdom and the Netherlands have led the

two countries, the Amsterdam-London route has become the busiest in Europe with 210 weekly flights by seven scheduled airlines. *Airline Observer*, Av. Wk. & SPACE TECH., Nov. 17, 1986, at 33; see also *More and Merrier*, *ECONOMIST*, Nov. 8, 1986, at 90; P. DEMPSEY, *supra* note 1, at 102-04.

⁸⁹ Sørensen, *supra* note 23, at 4.

⁹⁰ Comment, *Introducing Competition to the European Economic Community Airline Industry*, 15 CAL. W. INT'L L.J. 364, 376 (1985).

⁹¹ *Id.* at 377.

⁹² *Liberal Regulatory Environment*, *supra* note 15, at 103.

fight for liberalization, insisting that both consumers and airlines benefit from the pressures of the marketplace.⁹³ The British government, which has been aggressively pushing for lower fares in Europe, has been the common denominator in most of the new liberal fare agreements in Europe.⁹⁴ The efforts of Britain and other nations have been reflected to a large extent in bilateral agreements which, it was hoped, would ultimately result in a Europe-wide system of deregulated aviation.⁹⁵ It has been suggested that the recent series of liberalized bilaterals has done more than anything else to create a climate conducive to reform.⁹⁶

The U.K. agreement with Luxembourg, which was entered into in March of 1985, was the first to liberalize route access, capacity controls and tariff approvals.⁹⁷ The agreement provided for unrestricted market entry and capacity. Fares may be rejected only by the agreement of both governments (this is referred to as a "double disapproval" pricing provision),⁹⁸ although the country of origin may unilaterally reject a fare which it considers predatory or excessive in relation to costs.⁹⁹ The language of this agreement was used as a model for subsequent bilaterals,¹⁰⁰ and this is the type of agreement which the British would like to see instituted throughout the EEC.¹⁰¹

In June 1984, Britain joined forces with the Netherlands in a major agreement which went far beyond any EEC proposals.¹⁰² This agreement was followed by an-

⁹³ *Increased Liberalization*, *supra* note 17, at 36.

⁹⁴ *New Agreements*, *supra* note 37, at 75.

⁹⁵ S. WHEATCROFT & G. LIPMAN, *AIR TRANSPORT IN A COMPETITIVE EUROPEAN MARKET* 65 (1986) [hereinafter *AIR TRANSPORT*].

⁹⁶ *Air Cartel*, *supra* note 1, at 23, 31.

⁹⁷ *AIR TRANSPORT*, *supra* note 95, at 66.

⁹⁸ Brown, *Britain Urges Deregulation Effort in 1986*, *AV. WK. & SPACE TECH.*, Dec. 2, 1985, at 36.

⁹⁹ *AIR TRANSPORT*, *supra* note 95, at 213.

¹⁰⁰ *Id.* at 66.

¹⁰¹ Brown, *supra* note 98, at 36.

¹⁰² *New Agreements*, *supra* note 37, at 76.

other in June 1985 which went further, including several of the provisions of the Luxembourg agreement while maintaining the 1984 provisions requiring the matching of fares on fifth freedom routes.¹⁰³ The agreement gives carriers between the two countries almost unlimited opportunity to offer additional capacity and discount fares.¹⁰⁴ Any certified airline may fly to any point in either country and thereafter to a second point within the country or on to a third country. Schedules and capacity are not controlled, and fares are controlled by the country of origin.¹⁰⁵ The Dutch-British bilateral spurred other, less sweeping agreements between Britain and West Germany, Switzerland, France, Finland, Greece, Spain, Italy and Portugal.¹⁰⁶

Renegotiation of the agreement with the Federal Republic of Germany met with limited success, although it was somewhat similar to the Dutch-British bilateral.¹⁰⁷ The agreement provided some liberalization of route access, but improved tariff approval procedures only minimally.¹⁰⁸

The agreement between the United Kingdom and France, concluded in September 1985, incorporated only a relaxation of the capacity sharing requirements from a rigid 50/50 split to allowing one nation to carry up to 55 percent of the traffic.¹⁰⁹ This agreement also changed destination restrictions.¹¹⁰ Even though the bilateral was the most restrictive entered into with Britain, its achievement was significant, considering France's strong opposition to any kind of liberalization.¹¹¹

The bilateral with France was followed, in October

¹⁰³ AIR TRANSPORT, *supra* note 95, at 65, 66.

¹⁰⁴ *New Agreements*, *supra* note 37, at 71.

¹⁰⁵ Brown, *supra* note 98, at 36.

¹⁰⁶ *New Agreements*, *supra* note 37, at 72-73.

¹⁰⁷ AIR TRANSPORT, *supra* note 95, at 65.

¹⁰⁸ Brown, *supra* note 98, at 36.

¹⁰⁹ AIR TRANSPORT, *supra* note 95, at 66.

¹¹⁰ *Britain and France Agree to Liberalized Air Services*, AV. WK. & SPACE TECH., Oct. 14, 1985, at 41.

¹¹¹ P. DEMPSEY, *supra* note 1, at 103.

1985, by an agreement with Belgium which incorporated the most liberal provisions of the Luxembourg and Netherlands agreements.¹¹² In this agreement, access and capacity are unrestricted. As in the Luxembourg bilateral, tariffs may be rejected only by the agreement of both governments. It also contains provisions for rejecting fares which are predatory or excessive in relation to costs.¹¹³

In December 1985, Britain and Switzerland signed two new service agreements liberalizing airline regulation between Switzerland and Britain or Hong Kong.¹¹⁴ The Swiss agreement liberalized route access and capacity control, but resembled the German agreement in its tariff-setting provisions. The sole change in tariff provisions was to require only country of origin approval with respect to special fares.¹¹⁵

The efforts of the U.K. to create a European common market in aviation, as reflected in the agreements with the Benelux countries, revolve around route access, capacity control and tariff approval.¹¹⁶ As set forth in the agreement with Luxembourg, route access provisions would basically allow free entry to all airports by airlines subject only to limitations on services available at airports. The policy regarding capacity would allow airlines the freedom unilaterally to decide the appropriate level, so long as the objective was to provide adequate capacity at reasonable load factors. Either country may call for consultations if it feels that its interests are being damaged.¹¹⁷ With respect to tariff approval, agreements would preferably not require the airlines to consult together beforehand. Tariffs would be subject to the principle of "double disapproval," wherein tariffs automatically become effective unless disapproved within thirty days by both govern-

¹¹² AIR TRANSPORT, *supra* note 95, at 66.

¹¹³ Brown, *supra* note 98, at 36.

¹¹⁴ *British, Swiss Sign New Air Services Pacts*, AV. WK. & SPACE TECH., Dec. 16, 1985, at 42.

¹¹⁵ AIR TRANSPORT, *supra* note 95, at 66.

¹¹⁶ *Id.* at 66, 67.

¹¹⁷ *Id.* at 66.

ments. The country of origin would be able to act unilaterally to disapprove tariffs considered predatory or excessive, and countries would otherwise be required to consult together to resolve perceived abuses.¹¹⁸

As a result of initiatives of the Irish minister for communications and an Irish airline, additional movement toward deregulation has begun in that country. These initiatives were pursued in order to take back routes lost to British Airways after Britain's liberalization of the Belfast-London route. Ryanair, a new Irish airline, reduced round-trip fares on the Dublin-London route from 208 to 95 British pounds. The new airline established under deregulation has sparked a dramatic surge in Irish travel and induced British Airways and Aer Lingus to reduce fares. In September through November 1986, traffic increases of 35%, 38%, and 40% over the same months of 1985 occurred. Other nations are expected to follow Ireland's lead.¹¹⁹

Ulrich Meir, Lufthansa's deputy general manager responsible for international relations, argues the Dutch-British agreement and subsequent bilateral agreements have taken the deregulation initiative away from the EEC.¹²⁰ Indeed, Rodney Muddle, British Airways' general manager for pricing, suggested, "The EEC is a benchmark. It forces people to think about these issues and keep them in the public attention. But I think the main changes are going to be on a bilateral basis."¹²¹ Airline officials believe that progress being made on the bilateral front may indicate there is minimal need for EEC-mandated action.¹²²

On the other hand, authors Wheatcroft and Lipman argue that bilateral agreements maintain their momentum only as long as willing partners can be found, and that

¹¹⁸ *Id.* at 67; P. DEMPSEY, *supra* note 1, at 58-62.

¹¹⁹ Barrett, *supra* note 19, at 35.

¹²⁰ *New Agreements*, *supra* note 37, at 75.

¹²¹ *Id.*

¹²² *Id.* at 76.

indications are that the "UK liberal bilateral experiment is running out of steam. . . ." They base this conclusion on limited U.S. success in negotiating bilateral agreements in the early 1970s and again in the late 1970s, and on the differing "competitive capabilities and national interests" of European states under which they will only agree to provisions which they perceive to be in their own best interests. Moreover, considering that aviation constitutes only one of many factors making up the European economy, individual nations can bring various economic and political influences to bear to scuttle disfavored aviation bilaterals.¹²³

In spite of British initiatives, many scheduled carriers have declined to offer competitive rates.¹²⁴ Furthermore, with the privatization of British Airways, Britain retreated somewhat to a more conservative position than that evidenced by the liberal bilaterals.¹²⁵ At this point, the prospectus for additional liberal bilaterals in Europe appears dim.¹²⁶

It must be kept in mind that although European nations favor liberalization, no consensus exists as to the degree of liberalization or the appropriate methods that should be employed. Perhaps the most difficult obstacles to overcome are the perceptions held by members of the European community.

Sovereignty is the most formidable obstacle to a free market and free competition.¹²⁷ Nations refuse to create a regime which might cause their state airlines to fail. IATA Director George R. Besse notes that airlines are "tools of prestige, of privilege. There is a social and political order connected with running an airline, and like it or not, that's the way it is."¹²⁸

Another problem is the immediate desire to create a

¹²³ AIR TRANSPORT, *supra* note 95, at 68-69.

¹²⁴ P. DEMPSEY, *supra* note 1, at 103.

¹²⁵ *Air Cartel*, *supra* note 1, at 23, 31.

¹²⁶ P. DEMPSEY, *supra* note 1, at 103-04.

¹²⁷ Thaine, *supra* note 27, at 91.

¹²⁸ *Deregulation Stall*, *supra* note 51, at 44.

rule to fix every problem, whether it truly needs fixing or not. "Whenever there was a problem we used to write a rule for it," said one airline employee, speaking of how the airline handled passenger service difficulties. "But regulations tended to stifle employees."¹²⁹

The general distrust of the free market in Europe also creates an environment hostile to liberalization. Karl-Heinz Neumeister, Secretary General of the AEA, said concerning increased profits of European airlines, "It is odd to note that when comparable net profits are announced in America, Wall Street considers the airline concerned to have done well and their share prices react accordingly. On this side of the Atlantic, such a performance is usually greeted with cries of profiteering and cartelism."¹³⁰

Finally, the perception that air transit is in the nature of a public utility allows governments to justify their pervasive interference. For example, Austria and the AEA have taken the position that while some liberalization is in order, airlines are essentially public utilities.¹³¹ Karl-Heinz Neumeister observed:

It remains a fact that scheduled air transport is a form of public utility. That means the airline has certain responsibilities, one of which is to provide a service according to a published schedule, irrespective of whether there is sufficient demand for a given flight. With such obligations, it is quite normal to receive compensation in return. This is usually expressed by limiting the number of airlines on a route.¹³²

In spite of the obstacles to liberalization, the increasing number of liberal bilateral agreements is evidence that the European nations are heading toward a more free market-oriented air transport system. Moreover, the EEC's au-

¹²⁹ *Competition Leads to Better Passenger Service*, AV. WK. & SPACE TECH., NOV. 11, 1985, at 185.

¹³⁰ *European Airline Profits Expected to Reach \$1 Billion This Year*, AV. WK. & SPACE TECH., Jan. 6, 1986, at 48.

¹³¹ *Increased Liberalization*, *supra* note 17, at 36.

¹³² *Id.*

thority under the Treaty of Rome supersedes that of its members' national governments in a number of areas, including farm prices, rules for fishing in the seas around member countries, competition policy, and GATT negotiations. Community law, beginning with the Treaty of Rome, takes precedence over the national laws of member nations.¹³³ Sovereignty is slowly eroding. "In the long run," as EEC Commissioner Peter Sutherland writes, "Europeans, to have a chance of survival, must unite."¹³⁴

V. ACTIONS TAKEN BY INDIVIDUAL AIRLINES

Individual airlines are joining the effort for a free market for air transport. Modifications are appearing in the activities of European nations and individual airlines to accommodate the changes in the air transport market. In general, because airlines have been prohibited from engaging in price competition, they have instead competed in areas of service, such as frequency of flights and quality of on-board service.¹³⁵

Several individual airlines are also taking direct action against the restraints on air transport. In October 1985, British Caledonian withdrew from further participation in the political committee of the AEA after the leaders of the twenty member airlines refused to agree to liberalization measures. British Caledonian proposed the institution of a more simple and flexible fare system that would allow competition, an end to pooling agreements, greater freedom of market access, and the abolition of all subsidies to state-owned airlines.¹³⁶

British Caledonian's position has been supported by British Airways, Aer Lingus, and KLM.¹³⁷ Those in oppo-

¹³³ *Don't Take Europa to Brussels, They Cry*, ECONOMIST, Nov. 8, 1986, at 55 [hereinafter *Don't Take Europa*].

¹³⁴ Sutherland, *The Competition Policy of the European Community*, 30 ST. LOUIS U.L.J. 149, 154 (1985).

¹³⁵ *Carriers Plan Increased Capacity on Atlantic Following Boom Year*, AV. WK. & SPACE TECH., Mar. 18, 1985, at 227, 228.

¹³⁶ *British Caledonian*, *supra* note 18, at 36.

¹³⁷ *Id.*

sition include Air France, Alitalia, Scandinavian Airlines System, and Olympic, all owned or subsidized by governments which have generally opposed liberalization.¹³⁸ It appears that several individual airlines recognize that liberalization is inevitable and are attempting to adapt to the new environment.

VI. THE EUROPEAN ECONOMIC COMMUNITY

A. *The Treaty of Rome*

The EEC was established in 1957 by the Treaty of Rome¹³⁹ and, with the addition of Spain and Portugal on January 1, 1986, has grown to twelve member nations.¹⁴⁰ The treaty is essentially the constitution of the EEC.¹⁴¹ The twin goals of the community, as described by Peter Sutherland, EEC Commissioner for Competition, are "the completion of a genuine, barrier-free internal market and the restoration and enhancement of the competitiveness of European industry. Free competition, within the limits set by law, provides the best way of achieving these goals."¹⁴²

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 nations.¹⁴³ The goals of the Treaty include harmonious development and expansion of economic activities, increased economic stability, an improved standard of living, and closer relations between the Member States.¹⁴⁴ To accomplish its goals, the Treaty directed the EEC to adopt, *inter alia*, a common transport policy.¹⁴⁵

¹³⁸ *Id.*

¹³⁹ Treaty of Rome, *supra* note 7.

¹⁴⁰ Wassenbergh, *Regulatory Reform — A Challenge to Inter-Governmental Civil Aviation Conferences*, 11 AIR L. 31, 40 n.26 (1986).

¹⁴¹ Sutherland, *supra* note 134, at 149.

¹⁴² *Id.*

¹⁴³ Treaty of Rome, *supra* note 7, art. 3.

¹⁴⁴ *Id.* art. 2.

¹⁴⁵ *Id.* art. 3(e).

The Treaty was enacted with the presumption that "national economies can be unified only if there is an efficient system for moving people and goods."¹⁴⁶ The importance of transport in Europe is evidenced by the fact that the industry accounts for more than 7 percent of Europe's Gross National Product, for employment of between 5.4 percent and 7.3 percent of the working population, and for 11 percent and 40 percent of private and public investment, respectively.¹⁴⁷ 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. A major consideration was the coordination of sovereign rights both inside and outside the boundaries of the EEC.¹⁴⁸

The solicitude for transportation arose, to a significant extent, because of longstanding bilateral and multilateral treaties among Member States concerning international airline coordination that already existed at the adoption of the Treaty in 1957, such as the Chicago Convention on International Civil Aviation of 1944 and the numerous bilateral air transport agreements between European nations.¹⁴⁹ The draftsmen of the Treaty were unable to design a policy to benefit the EEC while maintaining the integrity of extra-EEC treaties.¹⁵⁰ Consequently, air transport policy made little headway during the EEC's first two decades, since Member States' governments were satisfied with the status quo.¹⁵¹

However, the importance of transportation in the over-

¹⁴⁶ 1 Common Mkt. Rep. (CCH) ¶ 1802 (1974).

¹⁴⁷ 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*, 1985-1986 EUR. PARL. DOC. (A 2-84/85/B) 15 (1985) [hereinafter *Report*].

¹⁴⁸ 1980-1981 EUR. PARL. DOC. (No. 469) 14 (1980).

¹⁴⁹ See *Turbulence*, *supra* note 23, at 307-08, 314-18, 325-42.

¹⁵⁰ 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").

¹⁵¹ Sørensen, *supra* note 23, at 3.

all scheme of the European Economic Community was underscored by separate provisions in the Treaty of Rome for a common transport policy.¹⁵² A common transport policy for rail, roads, and inland waterways was adopted in 1968.¹⁵³ Special solicitude was shown for sea and air transport in Article 84(2), which provided: "The Council, acting by means of a unanimous vote, may decide whether, to what extent and by what procedure appropriate provisions may be adopted for sea and air transport."¹⁵⁴ A formal policy for sea transport was adopted in 1986. But the Council has failed to enact regulations under Article 84(2) for air transport.¹⁵⁵

In view of the widely perceived shortcomings in the EEC's approach to air transport policies and procedures, it was to be expected that the debate should turn to the general competition provisions of Articles 85 and 86 of the Treaty of Rome.¹⁵⁶ The applicability of these rules to air transport within the EEC has been a central issue since the mid-1970s.¹⁵⁷ While it was concluded that the competition rules would, indeed, be applied to air transport, the question was where, when, and how.¹⁵⁸ Even though the European Court of Justice declared in the 1986 *Nouvelles Frontières* case that the competition rules applied to air transport, significant questions nevertheless remained unanswered.¹⁵⁹ Before proceeding to a more in-depth analysis of actions taken in response to the competition rules, the following general discussion of the rules should serve as a helpful background.

Competition was intended to play an essential role in achieving the objectives of the EEC.¹⁶⁰ In order to dimin-

¹⁵² Common Transport Policy, 1 Common Mkt. Rep. (CCH) ¶ 1812 (1974).

¹⁵³ P. DEMPSEY, *supra* note 1, at 245.

¹⁵⁴ Treaty of Rome, *supra* note 7, art. 84(2).

¹⁵⁵ P. DEMPSEY, *supra* note 1, at 245.

¹⁵⁶ Treaty of Rome, *supra* note 7, arts. 85, 86.

¹⁵⁷ AIR TRANSPORT, *supra* note 95, at 55-56.

¹⁵⁸ *Id.* at 56.

¹⁵⁹ *Id.*; see also *infra* notes 248-253 and accompanying text.

¹⁶⁰ P. DEMPSEY, *supra* note 1, at 242.

ish barriers to the free flow of commerce, the draftsmen included Articles 85 and 86 in the Treaty, prohibiting anticompetitive activities.¹⁶¹ The Commission has declared that competition is the best motivator of economic activity and is essential for the improvement of living standards and employment prospects.¹⁶² As a basic policy issue, Article 2 of the Treaty incorporates the goal of efficient economic integration of the Community.¹⁶³ Article 3(f) directs the implementation of a system assuring that competition will not be distorted within the Common Market.¹⁶⁴ The competition rules generally aim at preventing the introduction of obstacles to free trade, but this does not mean that the Community 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 Community.¹⁶⁵ The primary thrust of the competition laws of the EEC is to maintain a "beneficial, unified economy."¹⁶⁶ Unlike the United States, the EEC competition laws are aimed only at anticompetitive practices which produce abusive, harmful effects in the marketplace.¹⁶⁷

The Treaty of Rome is basically the Constitution of the European Economic Community.¹⁶⁸ Consequently, Community law, including competition law, takes precedence over the law of the individual Member States, and the

¹⁶¹ Treaty of Rome, *supra* note 7, arts. 85, 86.

¹⁶² P. MATHIJSEN, A GUIDE TO EUROPEAN COMMUNITY LAW 167 (4th ed. 1985)

¹⁶³ Treaty of Rome, *supra* note 7, art. 2.

¹⁶⁴ *Id.* 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 that competition shall not be distorted in the Common Market;

(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 P. MATHIJSEN, *supra* note 162, at 179.

¹⁶⁵ P. MATHIJSEN, *supra* note 162, at 168.

¹⁶⁶ P. DEMPSEY, *supra* note 1, at 241-55.

¹⁶⁷ *Id.*

¹⁶⁸ *Id.* at 242.

governments of those states must bring their laws into conformity with the mandates and decisions of the EEC ministers and the decisions of the Court of Justice.¹⁶⁹

The Commission may exercise considerable jurisdiction in enforcing the competition rules of the Treaty.¹⁷⁰ Articles 85 and 86 are administered by the Commission as set forth in Regulation 17.¹⁷¹ 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, it may take steps to put an end to violations, conduct investigations, and levy fines and penalties.¹⁷²

Article 85(1) prohibits as "incompatible with the Common Market . . . any agreements between enterprises, any decisions by associations of enterprises and any concerted practices which are likely to affect trade between the Member States and which have as their object or result the prevention, restriction or distortion of competition within the Common Market"¹⁷³ In order to fall within

¹⁶⁹ *Id.*; *Don't Take Europa*, *supra* note 133, at 55. 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 7, art. 177; 3 Common Mkt. Rep. (CCH) ¶ 4656 (1978) (preliminary rulings by Court of Justice); *with* Treaty of Rome, *supra* note 7, art. 183; 3 Common Mkt. Rep. (CCH) ¶ 4685 (1978) (jurisdiction of national courts).

¹⁷⁰ P. DEMPSEY, *supra* note 1, at 242.

¹⁷¹ P. MATHIJSEN, *supra* note 162, at 181.

¹⁷² *Id.* at 182-83.

¹⁷³ Treaty of Rome, *supra* note 7, 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;
- (b) the limitation or control of production, markets, technical development or investment;
- (c) market-sharing or the sharing of sources of 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

the proscriptions, agreements having proscribed objects must be cast in the form of a legally binding contract. If such an agreement can be found, a violation exists even if it is not implemented. Alternatively, a violation of the Treaty may be found if informal agreements are followed by certain practices, or impermissible binding agreements or practices may be inferred from circumstantial evidence, including behavior having an anticompetitive effect.¹⁷⁴ However, it is important to note that 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.¹⁷⁵

The competition rules apply only to practices which affect trade among Member States.¹⁷⁶ In an agreement between a Member State and a non-EEC nation, anticompetitive provisions would not be prohibited unless those provisions had an anticompetitive object or effect within the EEC.¹⁷⁷ "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.'"¹⁷⁸ It should be noted that, because the prohibitions extend to agreements which "affect" trade, even agreements which have the effect of increasing the volume of trade or which do not involve imports or exports may be prohibited.¹⁷⁹ The European Court of Justice has indi-

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.

¹⁷⁴ P. MATHIJSEN, *supra* note 162, at 169-70.

¹⁷⁵ *Id.* at 170.

¹⁷⁶ *Id.* at 172.

¹⁷⁷ *Id.* at 172-74.

¹⁷⁸ *Id.* at 172 (quoting from *Consten and Grundig v. Commission*, 1966 Eur. Comm. Ct. J. Rep. 299, 341).

¹⁷⁹ P. MATHIJSEN, *supra* note 162, at 172 n.17, 174-75.

cated that in order to constitute an impermissible "distortion," competition "must be prevented, restricted or distorted to an *appreciable* extent."¹⁸⁰

Under Article 85(2), any agreements or decisions prohibited by the treaty are automatically void.¹⁸¹ However, with respect to entire agreements, only the clauses or provisions found to be in violation are void; the remainder of the agreements may remain in effect.¹⁸² Exceptions to 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.¹⁸³ However, even the so-called "old" agreements may be voided if found to be in violation of the Treaty.¹⁸⁴

Only the Commission may grant declarations of inapplicability of the operation of Article 85(1).¹⁸⁵ Such exemptions may be granted only after the Commission has been notified and the four conditions specified in Article 85(3) are satisfied:

(1) The agreement must contribute to improving the production or distribution of goods or to promoting technical and economic progress;

(2) consumers must get a fair share of the resulting benefit;

(3) the agreement may not impose restrictions which are not indispensable for the objectives under (1) and (2); and

(4) the agreement may not afford the parties the possibility of eliminating competition in respect of a substantial part of the products in question.¹⁸⁶

The exemptions may not take effect earlier than the date the Commission is notified. The Commission must set time limits on the duration of the exemptions and may

¹⁸⁰ *Id.* at 173 (emphasis in original).

¹⁸¹ *Id.* at 175.

¹⁸² *Id.* at 173.

¹⁸³ *Id.* at 175.

¹⁸⁴ *Id.* at 175-76.

¹⁸⁵ *Id.* at 176.

¹⁸⁶ See Treaty of Rome, *supra* note 7, art. 85(3).

attach conditions and obligations. Exemptions may be renewed or revoked, even retroactively.¹⁸⁷

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 production; 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.¹⁸⁸

Current practices such as tariff agreements, pooling agreements, and capacity and territorial restrictions, raise a strong argument that European airlines are in violation of Article 85 even under the most liberal bilateral agreements. However, to date, carriers have avoided the direct application of Article 85(1). The reason appears to be grounded in the unique nature of European civil aviation, including the strong impact of national sovereignty and public policy embedded in the current system. No doubt, avoiding the proscriptions of Article 85(1) can also, to some extent, be justified by analogy to the principles set forth in Article 85(3).

Article 86, which complements Article 85, forbids abuse of a dominant position enjoyed individually or collectively by a group of undertakings.¹⁸⁹ "Dominant position" indi-

¹⁸⁷ P. MATHIJSEN, *supra* note 162, at 177.

¹⁸⁸ *Id.* at 177-78; Treaty of Rome, *supra* note 7, art. 85(3).

¹⁸⁹ P. MATHIJSEN, *supra* note 162, at 179. Article 86 states that the 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 7, art. 86 (emphasis added); see also 2 Common Mkt. Rep. (CCH) ¶ 2101 (1978) (abuse of dominant position). The Article goes on to state:

Such improper practices may, in particular, consist in:

- (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

cates a position of economic strength allowing the possessor to "behave to an appreciable extent independently of its competitors, customers and ultimately of the consumers."¹⁹⁰ Whether an undertaking or group of undertakings enjoys such a position must be established in view of relevant product and geographical markets and the market share possessed.¹⁹¹ Although the dominant position must be over a substantial portion of the Common Market, the territory of a single member state may be sufficient for Article 86 to apply. Most European national airlines, therefore, hold dominant positions in their own countries.¹⁹² However, dominance is established not by size alone, but rather by considering a number of factors.¹⁹³

The concept of "abuse" of a dominant position refers to an adverse impact on competition.¹⁹⁴ Any activity which "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.'"¹⁹⁵ The methods used to affect competition are irrelevant. Activities which 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."¹⁹⁶ 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

(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 7, art. 86. Compare these latter "in particular" provisions with those in Article 85(1), *supra* note 173.

¹⁹⁰ P. MATHIJSEN, *supra* note 162, at 179-80; P. DEMPSEY, *supra* note 1, at 248.

¹⁹¹ P. MATHIJSEN, *supra* note 162, at 180-81; P. DEMPSEY, *supra* note 1, at 248.

¹⁹² P. DEMPSEY, *supra* note 1, at 248.

¹⁹³ P. MATHIJSEN, *supra* note 162, at 181.

¹⁹⁴ *Id.*

¹⁹⁵ *Id.*

¹⁹⁶ *Id.* at 179.

proscriptions into play.¹⁹⁷

In distinguishing Articles 85 and 86, it is important to note that unlike Article 85, Article 86 does not provide for exemptions.¹⁹⁸ 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.¹⁹⁹ However, this does not confer "absolute immunity;" the Commission still has power to determine that a violation exists and to proceed with enforcement.²⁰⁰

Article 86 prohibits abuse of monopoly power, but the mere existence of the monopoly is not prohibited.²⁰¹ Rather, a violation consists of the use of monopoly power in a manner injurious to consumers. A national airline would likely 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.²⁰² Price-fixing and capacity-limitation agreements by firms in monopoly positions might be held to be violations of Article 86.²⁰³ Therefore, a substantial argument could be made that airline fare-setting and capacity limitations and other agreements and practices violate Article 86.

Direct application of the competition rules could result in the prohibition of many current European airline practices under both Articles 85 and 86. Indeed, the Commission threatened to take action on its own if the Council failed to act on a common air transport policy.²⁰⁴ An understanding of the stalemate regarding the competition rules necessarily requires further understanding of the

¹⁹⁷ P. DEMPSEY, *supra* note 1, at 248.

¹⁹⁸ *Id.*

¹⁹⁹ *Id.* at 249 n.61.

²⁰⁰ *Id.* at 249; Unlawful Practices by Dominant Concerns, Application of Article 86, 2 Common Mkt. Rep. (CCH) ¶ 2111 (1978) (CCH Explanation).

²⁰¹ P. DEMPSEY, *supra* note 1, at 248.

²⁰² *Id.*

²⁰³ *Id.*

²⁰⁴ *Id.* at 250.

governing institutions of the EEC and the actions they have taken in response to air transport issues.

The governing institutions of the Treaty of Rome were created to ensure proper compliance and implementation of its provisions.²⁰⁵ These four governing bodies of the EEC, the Council, the Commission, Parliament, and the European Court of Justice, are in the process of determining how the Treaty of Rome should be applied to air transport.

B. *Institutions of the EEC*

1. *Parliament*

The EEC Parliament is comprised of members who are elected directly by the citizens of the twelve Member States.²⁰⁶ Parliament's members are expected to act for the benefit of the entire European Community, rather than on behalf of their respective governments.²⁰⁷ Parliament has the duty of advising the Council on issues of importance to the development of the EEC.²⁰⁸

As a matter of procedure, the Commission issues recommendations to the Council, which are subsequently referred to Parliament for further comment and recommendation. Parliament generally comments on the potential legal and political implications of the proposed regulation.²⁰⁹

Parliament has expended years of effort to bring about a comprehensive and coherent common transport policy.²¹⁰ Parliament's stated priorities are to bring the people of Europe closer together, boost inter-Community trade, encourage economic growth, reduce unemployment, open outlying regions, help bridge the gap between the prosperous and impoverished regions, and remove

²⁰⁵ L. HENKEN, *supra* note 9, at 1077.

²⁰⁶ 3 Common Mkt. Rep. (CCH) ¶ 4306 (1987).

²⁰⁷ 3 Common Mkt. Rep. (CCH) ¶ 4302 (1987).

²⁰⁸ *Id.*

²⁰⁹ *See generally id.*

²¹⁰ *Report, supra* note 147, at 7.

congestion from certain overcrowded urban centers. Parliament envisions achievement of its objectives by 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.²¹¹

Parliament has approved a very 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 recent parliamentary report has stated that either nation involved should be able to unilaterally block new low fares on a particular route.²¹²

2. *The European Court of Justice*

The European Court of Justice is comprised of eleven judges who are appointed for terms of six years by "common accord" of the Member States.²¹³ The Court of Justice renders decisions on the application to Member States of the Treaty of Rome. The Court interprets and enforces the provisions of the Treaty of Rome.²¹⁴ But the Court will not participate in the procedural adoption of competition laws.

There are several problems in using a Court of Justice holding to change policy. Member States would have to administer competition laws without guidance of regulations from the Council. Consequently, laws would not be applied with uniformity, because the individual states would be free to interpret them as they pleased. Furthermore, competition laws would be invoked only when convenient to individual states, so they would have little impact in increasing competition.²¹⁵ The inconsistent application of the competition laws would be adverse to one

²¹¹ *Id.* at 21.

²¹² *Europeans Advise Slow Deregulation Approach*, AV. WK. & SPACE TECH., Sept. 23, 1985, at 39.

²¹³ 3 Common Mkt. Rep. (CCH) ¶¶ 4606, 4611 (1981).

²¹⁴ 3 Common Mkt. Rep. (CCH) ¶ 4600 (1981).

²¹⁵ Letter from Knut Hammar skjold, *supra* note 14.

purpose of the Treaty — to promote an economic and harmonious transport system.²¹⁶ Moreover, a decision applying the competition laws in the airline industry would interfere with the Council's authority to adopt official policy for the economic harmonization of air transport.²¹⁷

The Court has, however, rendered decisions of great importance during the past decade which have held that the competition laws of the Treaty of Rome do apply to air transport, and that the Council has a duty under the Treaty to formulate a coordinated transport policy for the EEC. For example, in 1974 the Court pronounced that the general rules of the Treaty, such as nondiscrimination on national grounds, right of establishment, competition, mobility of labor, and equal pay, apply to air transport.²¹⁸

One important decision of the Court concerning European transportation was rendered in response to a complaint brought against the Council by Parliament.²¹⁹ On January 22, 1983, Parliament brought an action against the Council in the Court of Justice for a declaration that the Council had failed to act in the field of common transport policy.²²⁰ Parliament also asked for a declaration that the Council had breached the Treaty by failing to reach a decision on sixteen specific proposals relating to transport submitted to it by the Commission.²²¹ Parliament's position was that the establishment of a common transport policy is a requirement flowing directly from the Treaty.²²²

²¹⁶ See Treaty of Rome, *supra* note 7, arts. 74-84.

²¹⁷ *Id.* art. 84(2).

²¹⁸ Sprensen, *supra* note 23, at 3.

²¹⁹ 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*].

²²⁰ 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.

²²¹ *Obligations of the Council*, *supra* note 219, at 2.

²²² European Parliament Committee on Transport, *Notice to Members: Proceedings Against the Council for Failure to Act*, May 31, 1985, at 8 [hereinafter *Proceedings*].

The Council took the view that the Parliament could only supervise in a manner limited by Articles 137, 143, and 144 of the Treaty, which govern the means available to Parliament of influencing the activities of the Commission and the Council.²²³ If such were the case, Parliament could not use its supervisory powers to bring an action for failure to act. The Council also defended its lack of action on grounds of the absence of agreement and the complexity of the issue.²²⁴

The Court held that a complaint brought on grounds of failure to act is admissible.²²⁵ This was the first time in the history of the EEC that an action for failure to act has been declared admissible in the Court of Justice.²²⁶ 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."²²⁷

The Court found a close connection between freedom to provide services under Article 75(1)(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.²²⁸ 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(1)(a) and (b),

²²³ Bombardella, *supra* note 220, at 1.

²²⁴ See *id.* at 3.

²²⁵ 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.

²²⁶ See *Report*, *supra* note 147, at 12 (first time Council found guilty of failure to act); see also Wijsenbeek, *supra* note 225, at 3 (Parliament strengthened by fact action for failure to act admissible).

²²⁷ Bombardella, *supra* note 220, at 2.

²²⁸ *Obligations of the Council*, *supra* note 219, at 6.

clearly indicate that discretion may be exercised only with regard to the details of how the objective will be attained.²²⁹

The Court's decision confirmed that there was not a coherent body of rules which 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. The Court did conclude 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 this was in fact a breach of the Treaty.²³⁰

The Court qualified its grant of review by holding that the failure to act must relate to measures which the Council has not adopted and which 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.²³¹ 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.²³²

As to the objective difficulties which, 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. Ar-

²²⁹ *Id.* at 7.

²³⁰ *Id.*

²³¹ Bombardella, *supra* note 220, at 2.

²³² *Proceedings, supra* note 222, at 6.

ticle 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.²³³

The Council does, 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. 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.²³⁴ 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.²³⁵

The Council is also required to act on the measures specified by the Court within a "reasonable period."²³⁶ The Court's determination that the Council must act within a "reasonable" time is not sufficiently clear.²³⁷ Nor has the Treaty set a time limit as to when action must occur. But a prolonged failure to act would be a further infringement of the Treaty.²³⁸

The Parliament was given the task of investigating the legal consequences and developing definite views on the legal situation that would arise if the Council were to fail to act after being ordered to do so. If any legal measures adopted by the Council were contrary to the establishment of freedom to provide services required by the judgment, the Council would be under a duty to amend its legislation.²³⁹

While the Parliament's institutional position has been strengthened by the fact that such an action is admissi-

²³³ Bombardella, *supra* note 220, at 3.

²³⁴ *Proceedings*, *supra* note 222, at 9.

²³⁵ Bombardella, *supra* note 220, at 3.

²³⁶ *Id.*

²³⁷ *Proceedings*, *supra* note 222, at 7.

²³⁸ Bombardella, *supra* note 220, at 3.

²³⁹ Wijsenbeek, *supra* note 225, at 3.

ble,²⁴⁰ the Court cannot prescribe a transport policy and cannot therefore render a judgment capable of enforcement.²⁴¹ The significance of this decision may best be described as an official acknowledgment that the Council has failed in its duty to provide a common transport policy, and that the other bodies of the EEC government have the right to obtain judicial review of the Council's activities. While the decision explicitly addressed only the Council's obligations to develop a surface transport policy, its implications for air transport are manifest.

The Court of Justice has also recently ruled on other cases which are of import to the EEC's obligations vis-à-vis air transport. For example, in *Commission v. French Republic*, the Court held that all general provisions of the Treaty of Rome apply to sea and air transport, even though there are no regulations to enforce the laws.²⁴² This decision suggests that the Commission could apply the competition laws of the Treaty of Rome in those areas.²⁴³ Without specific action by the Council, however, there are no means whereby those competition laws may be applied directly to sea and air transport.²⁴⁴

The Commission has also taken a strong position on this question, in the *Association des Compagnies Aériennes de la Communauté Européenne* (ACE) complaint against Olympic Airlines. Charges against Olympic followed 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. ACE claimed that allowing one airline to avoid paying fees

²⁴⁰ *Id.*

²⁴¹ *Proceedings*, *supra* note 222, at 10.

²⁴² *Commission v. French Republic*, 1974 Eur. Comm. Ct. J. Rep. 359, [1974 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 8270 (1975).

²⁴³ Dagtoglou, *supra* note 60, at 349.

²⁴⁴ Treaty of Rome, *supra* note 7, art. 84(2).

"distorts or threatens to distort competition."²⁴⁵ ACE's complaint charged that the market distortion thereby created 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.²⁴⁶ The Commission held that, "There is no legal basis for claiming, as Olympic Airways claims, that Articles 85 and 86 do not apply to air transport."²⁴⁷

The most recent Court of Justice opinion of relevance, *Nouvelles Frontières*, involved the issue of whether member nations have the right to regulate the price of airline tickets sold within their borders.²⁴⁸ The European Court answered certified questions from a French court concerning applicability of the competition rules of the Treaty of Rome to price-fixing agreements by French airlines.²⁴⁹ *Nouvelles Frontières*, a French travel agency, was selling tickets at fares that had not been approved by the French Government under the French Civil Aviation Code.²⁵⁰ "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."²⁵¹

The Court first found that air transport, absent specific language within the Treaty, was "subject to the general rules of the Treaty, including the competition rules."²⁵²

²⁴⁵ *EEC Claims Greek Airline Received Illegal Subsidies*, AV. WK. & SPACE TECH., Jan. 17, 1983, at 34.

²⁴⁶ *Id.*

²⁴⁷ Commission Decision of Jan. 23, 1985, 28 O.J. EUR. COMM. (No. L46) 51, 52 (1985); P. DEMPSEY, *supra* note 1, at 104.

²⁴⁸ Feazel, *Liberalization Policies at Issue in Ruling in French Fare Case*, AV. WK. & SPACE TECH., July 15, 1985, at 28 [hereinafter *Liberalization Policies*].

²⁴⁹ See generally Wassenbergh, *The 'Nouvelles Frontières' Case*, 11 AIR L. 161 (1986).

²⁵⁰ Haanappel, *Colloquium 'Nouvelles Frontières'*, State University of Leyden, the Netherlands, 11 AIR L. 181 (1986).

²⁵¹ *Id.*

²⁵² *Ministere Public v. Asjes (Nouvelles Frontières)*, 1986 Eur. Comm. Ct. J. Rep. 65, 72, [1985-86 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 14,287, at 16,772, 16,778 (1986).

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 to agreements concerning the air transport industry, or, alternatively, the Commission could issue a "reasoned decision" under Article 89.²⁵³ But either option would open the Pandora's box of litigation in the national courts of Member States.²⁵⁴

Novelles Frontières represents the first "legal stick" available to the EEC Commission with which action may be taken against anticompetitive practices among European airlines. But *Nouvelles Frontières*, while a philosophical victory for those seeking greater liberalization, was in fact a practical defeat. Although the Court held that Articles 85 and 86 of the Treaty of Rome specifically apply to air transport, they create a right without a remedy until either the Council adopts regulations or the Commission issues a reasoned decision. Nonetheless, the decision intensified the pressure on the Council to promulgate regulations to keep Pandora's box closed.

These cases seem to indicate that the Member States of the EEC are bound to follow the Treaty of Rome competition rules in the area of air transport. The holdings also indicate the lack of enforcement power possessed by the Court. At best, the Court of Justice can be seen as a moral institution without any genuine power to force compliance with the Treaty.

3. *The Commission*

The Commission is a non-partisan body appointed by the common agreement of the Member States. The Commission functions closely with the Council, but acts independently of the Council and Member States.²⁵⁵ The Commission's duties are primarily executive in nature —

²⁵³ *Id.* at 16,778-80.

²⁵⁴ *See id.* at 16,780; P. DEMPSEY, *supra* note 1, at 104-06, 252.

²⁵⁵ 3 Common Mkt. Rep. (CCH) ¶¶ 4472, 4482 (1987).

to oversee EEC development and to ensure that the development conforms to the Treaty of Rome. To fulfill its role, the Commission issues recommendations and advisory opinions to the Council for the consideration and adoption of regulations.²⁵⁶ The Commission has specific authority over infringement of competition laws. Article 89 gives the Commission investigatory powers.²⁵⁷

The Commission has been the most active and impatient body in the EEC government in pursuit of a transport policy and liberalization of airline regulations. While the Commission asserts that it does not believe the American style of deregulation would work in Europe, it advocates a gradual change from existing policy, referred to as the "go slow" approach.²⁵⁸ Nonetheless, it has grown increasingly impatient with the Council's inability to promulgate regulations applying the Treaty of Rome's competition articles to air transport.

The Commission recognizes benefits derived from the traditional regulatory system, but believes that improvements are necessary. For instance, the Commission advocates increased flexibility²⁵⁹ and proposes liberalization of capacity, air fares, and conditions of competition.²⁶⁰

The Commission wants to establish an environment amenable to competition, recognizing that it cannot force companies to compete. However, the Commission does not feel that Article 85 should be fully implemented, because that would lead to total deregulation. In other words, the Commission desires "to tilt the bargaining power more to the advantage of innovation and market behaviour where the present system tends to block such action."²⁶¹

During the past decade, the Commission has issued several memoranda which have put forth possible objectives

²⁵⁶ 3 Common Mkt. Rep. (CCH) ¶ 4472 (1987).

²⁵⁷ Treaty of Rome, *supra* note 7, art. 89.

²⁵⁸ Sørensen, *supra* note 23, at 6.

²⁵⁹ *Id.*

²⁶⁰ *Id.* at 7.

²⁶¹ *Id.*

the Council could adopt. 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, most importantly, limited possibilities for innovation.²⁶²

In March 1984, the Commission followed with *Memorandum 2*, entitled "Progress Towards the Development of a Community Air Transport Policy."²⁶³ *Memorandum 2* expanded on the ideas promulgated in *Memorandum 1*.²⁶⁴ 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.²⁶⁵

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.²⁶⁶ However, the Commission was not oblivious to the impact and importance of international aviation outside of the Community. The memorandum recognized the impact 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.²⁶⁷ The Community's major scheduled airlines were earning 40 percent of their revenues in local Europe, with about 25 percent of the total earned in the Community. The remainder of their revenues were earned on routes to other international destinations, especially on intercontinental routes.²⁶⁸ Recognizing that

²⁶² *Id.* at 6.

²⁶³ See generally MEMORANDUM 2, *supra* note 29; P. DEMPSEY, *supra* note 1, at 100-02.

²⁶⁴ Sørensen, *supra* note 23, at 5.

²⁶⁵ *Id.* at 6.

²⁶⁶ MEMORANDUM 2, *supra* note 29, at I.

²⁶⁷ *Id.* at 12-13.

²⁶⁸ *Id.* at 9.

American-style deregulation would not work in the European context, the Commissioners sought to maintain the existing system of regulation and agreement while introducing flexibility and the benefits of competition.²⁶⁹

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.²⁷⁰ 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.²⁷¹ 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 in violation of the competition articles.²⁷²

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 percent,²⁷³ although 50 percent 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.²⁷⁴ The Commission also proposed guidelines designed to monitor state subsidies of airlines to ensure a fair, competitive environment.²⁷⁵ Finally, in what has since become a major issue in liberalization, the Commission sought to apply the competition rules, specifically Articles 85-90 of the Treaty of Rome, to the scheduled air

²⁶⁹ *Id.* at I.

²⁷⁰ Thaine, *supra* note 27, at 90.

²⁷¹ MEMORANDUM 2, *supra* note 29, at III.

²⁷² *Id.*; Treaty of Rome, *supra* note 7, arts. 85-90.

²⁷³ Thaine, *supra* note 27, at 93.

²⁷⁴ *Id.* at 94.

²⁷⁵ *Id.* at 95.

transport industry.²⁷⁶ The Commission justified this assertion, two years before *Nouvelles Frontières*, on the basis of Court of Justice rulings in 1974 and 1978.²⁷⁷ Opponents argued against adjustments to the European civil aviation regime on the grounds that such changes would result in unacceptable impacts on international aviation outside of the Community, but this rationale was rejected by the Commission. 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."²⁷⁸ Nevertheless, the Commission recognized the repercussions of its proposals on the non-Community states of Europe in formulating its proposals.²⁷⁹ 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 centre 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.²⁸⁰

The Commission's qualifications on competition included a recognition of strong state interests in the survival of national airlines²⁸¹ and recognition of a history of

²⁷⁶ *Id.* at 95-96.

²⁷⁷ MEMORANDUM 2, *supra* note 29, at 17. *Nouvelles Frontières* was decided April 30, 1986. See *supra* notes 248-254 and accompanying text.

²⁷⁸ MEMORANDUM 2, *supra* note 29, at 21.

²⁷⁹ *Id.* at 22.

²⁸⁰ *Id.* at 21.

²⁸¹ *Id.* at 22.

competition in services within the industry, especially with respect to charter airlines.²⁸² In addition, the Commission explicitly acknowledged that the U.S.-style deregulation would not work in Europe²⁸³ 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 which European airlines could not influence.²⁸⁴ *Memorandum 2* concluded that air fares in Europe were not unreasonably related to costs, owing in large part to the fact that only 40 percent of total costs are controllable by the airlines. Nevertheless, the Commission believed that changes in procedures related to the fixing of airfares would result in a "wider range of fares."²⁸⁵ Moreover, the belief was expressed that competitive pressures would ultimately lead to lower airfares.²⁸⁶

Memorandum 2 expressed a general preference for an "evolutionary approach"²⁸⁷ to a more competitive air transport policy, rather than the more revolutionary policy adopted earlier by the United States.²⁸⁸ While comprehensive deregulation arguably had merit in the large, unified market of the United States, conditions in Europe would not justify such an approach.²⁸⁹ Additionally, 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.²⁹⁰ 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 competi-

²⁸² *Id.* at 23. Charter traffic within Europe accounts for 60% of all air travel. See *Europe's Air Cartel*, *ECONOMIST*, Nov. 1, 1986, at 23, 26.

²⁸³ *MEMORANDUM 2*, *supra* note 29, at 26-27.

²⁸⁴ *Id.* at 24.

²⁸⁵ *Id.*

²⁸⁶ *Id.*

²⁸⁷ *Id.* at 27.

²⁸⁸ *Id.* at 26.

²⁸⁹ *Id.*

²⁹⁰ *Id.* at 27.

tive 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" ²⁹¹ 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. ²⁹²

Regarding bilateral agreements, the Commission urged elimination of mandatory pooling arrangements between airlines. Also, they suggested rigid 50/50 traffic-sharing agreements should be relaxed to where no one party is guaranteed a traffic share of more than 25 percent in agreements between Member States. ²⁹³ "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." ²⁹⁴

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 which 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. ²⁹⁵

²⁹¹ *Id.*

²⁹² *Id.* at 29.

²⁹³ *Id.* at 30.

²⁹⁴ *Id.*

²⁹⁵ *Id.* at 32-33.

As with capacity sharing, the Commission also recognized that pooling agreements could have desirable consequences in encouraging carriers to operate outside of profitable periods.²⁹⁶ At the same time, such agreements may also restrict competition that otherwise might take place, contrary to Article 85(1).²⁹⁷ Pooling agreements between airlines were of two basic types: open pools aimed at equalizing revenues (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.²⁹⁸ Open pools which distributed revenues on the basis of capacity offered by the airlines would be impermissible in any case.²⁹⁹ 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.³⁰⁰ However, the Commission's guideline in this area was quite 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)."³⁰¹

In what was probably its most noteworthy proposal, the Commission 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.³⁰² In its "Amended Proposal for a Council Directive," the Commission indicated the mini-

²⁹⁶ *Id.* at 33.

²⁹⁷ *Id.*; Treaty of Rome, *supra* note 7, art. 85(1).

²⁹⁸ MEMORANDUM 2, *supra* note 29, at 33.

²⁹⁹ *Id.*; Treaty of Rome, *supra* note 7, art. 85(3).

³⁰⁰ MEMORANDUM 2, *supra* note 29, at 33, 34; Treaty of Rome, *supra* note 7, art. 85(3).

³⁰¹ MEMORANDUM 2, *supra* note 29, at 34.

³⁰² *Id.* at 31.

imum acceptable range to be covered within the zones.³⁰³ This proposal reflected 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."³⁰⁴ Within the zones, the following alternatives could be agreed upon: airlines would be free to set fares without government interference; or proposed fares would take effect unless both countries disapproved ("double disapproval"); or 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.³⁰⁵

The tariff-setting proposals of *Memorandum 2* also extended to agreements among airlines. The Commission observed that most ICAO Member States recognized such tariff consultations as an essential part of transport policy. Such 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."³⁰⁶ Tariff-setting arrangements would be permissible if they "confer[red] an equivalent advantage to the consumer, [were] not unduly restrictive and . . . a reasonable degree of competition [was] ensured."³⁰⁷ The Commission indicated that these conditions would be met if:

- i) airlines had an effective right of independent action, both in terms of proposing tariffs independently of other

³⁰³ The proposal called for two "zones of flexibility," each with a minimum range of 25 percent. 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.* Annex II, art. 6 (4) & (5).

³⁰⁴ *Id.* at 31.

³⁰⁵ *Id.* at 32.

³⁰⁶ *Id.* at 35.

³⁰⁷ *Id.*

airlines, and in terms of freedom to implement such tariffs, subject only to the [proposed] limited government control

ii) The Member States concerned and the Commission were enabled to participate as observers in tariff consultations.³⁰⁸

Another major aspect of competition, market access, was given inadequate and cursory treatment by the Commission.³⁰⁹ While recognizing the dominance throughout the EEC 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.³¹⁰ The Commission believed that such steps could be taken without "significant damage" to major airlines and without the detailed justification or reciprocity ordinarily required.³¹¹ The Commission went further and suggested that if the Member State desired, such routes could be so utilized only after giving national airlines rights of first refusal.³¹²

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.³¹³ 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 would be prevented by application of the Treaty's state aids rules in Articles 92 and 93, for which the Commission

³⁰⁸ *Id.*

³⁰⁹ See Thaine, *supra* note 27, at 93; International Chamber of Commerce (ICC), *European Commission Civil Aviation Memorandum No. 2*, 10 AIR L. 99, 103 (1985) (policy declaration and response adopted by the Executive Board of the ICC on Dec. 3, 1984).

³¹⁰ MEMORANDUM 2, *supra* note 29, at 43-44.

³¹¹ *Id.*

³¹² *Id.* at 44.

³¹³ Sørensen, *supra* note 23, at 7.

has responsibility.³¹⁴ Proper application of these rules would result in advance disclosure of all proposed state aids so that the Commission could take a position.³¹⁵ The Commission recognized that state aids may be appropriate in certain circumstances in order to fulfill public service obligations, compete with subsidized carriers from third countries, overcome "particularly precarious" but temporary financial problems, or to assist economically underdeveloped regions.³¹⁶ 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 if there was an impermissible aid element.³¹⁷

As indicated previously, the primary concern and focus of the Commission in *Memorandum 2* was with the EEC. Consequently, with regard to the international implications of its proposals, it reasserted the supremacy of Community law. Under Article 234,³¹⁸ Member States must take steps to eliminate provisions in agreements with third countries inconsistent with forthcoming Community 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.³¹⁹ Accordingly, the Commission had entered into cooperation agreements under Article 229³²⁰ 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

³¹⁴ MEMORANDUM 2, *supra* note 29, at 36.

³¹⁵ *Id.* at 37.

³¹⁶ *Id.* at 37, 38.

³¹⁷ *Id.* at 38.

³¹⁸ Treaty of Rome, *supra* note 7, art. 234.

³¹⁹ MEMORANDUM 2, *supra* note 29, at 50.

³²⁰ Treaty of Rome, *supra* note 7, art. 229.

seven years.³²¹ Additionally, even though the memorandum identified exceptions to the prohibitions in Article 85(1) if certain objectives were manifest, such exceptions would expire in a little less than eight years on December 31, 1991.³²² The Commission called attention to proposals made to the Council in 1981 calling for directives and regulations, upon which the Council still had not taken action.³²³ Finally, the Commission repeatedly reasserted its right to take direct action, in certain circumstances, against practices in violation of Treaty provisions.³²⁴

In addition to the above matters, *Memorandum 2* discussed a significant number of additional issues.³²⁵ The memorandum also attached six annexes which included detailed proposals for Council action and guidelines related to the foregoing matters.³²⁶ *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 and inconclusive. IATA and AEA, while agreeing as to the necessity of reform, published their own proposals which differed considerably from *Memorandum 2*.³²⁷ 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.³²⁸ The European Par-

³²¹ MEMORANDUM 2, *supra* note 29, at 35.

³²² *Id.* Annex III C.

³²³ *Id.* at 16-17.

³²⁴ *Id.* at III, 36, Annex III C.2.

³²⁵ See *id.* at 13, 48 (aircraft noise), 14 (search and rescue), 15 (accident investigation and interregional air services), 19, 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).

³²⁶ *Id.* Annexes I - VI.

³²⁷ AIR TRANSPORT, *supra* note 95, at 52-53.

³²⁸ *Id.* at 53.

liament and the Economic and Social Committee conducted extensive hearings and published comprehensive reports which supported the overall thrust of *Memorandum 2*, but which proposed significantly different approaches to many of the issues.³²⁹ 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 which "can be said to build on *Memorandum No. 2*, taking into account the views that had been expressed in the interim."³³⁰ On December 11, 1984, the Council endorsed the report as a guideline for further actions and arranged for additional study.³³¹

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 alleging that they had violated the Treaty by engaging in price-fixing, capacity limitation, revenue pooling, and restricted market entry.³³² The Commission threatened that failure of the airlines to cooperate to eliminate these anticompetitive 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 a "reasoned decision" by the Commission would open a Pandora's box of litigation by private parties in the national courts of Member States.

Hence, the ten airlines (*i.e.*, Air France, Aer Lingus, Alitalia, British Airways, British Caledonian, KLM, Lufthansa, Olympic, Sabena and SAS) 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),³³³ a more

³²⁹ *Id.* at 53-54.

³³⁰ *Id.* at 54.

³³¹ *Id.* at 55.

³³² *EEC Commission Action Could Result in Suits Against 10 Large Carriers*, AV. WK. & SPACE TECH., July 14, 1986, at 35.

³³³ *Alitalia Rejects EEC Request for Data on Operational Practices*, AV. WK. & SPACE TECH., Nov. 17, 1986, at 39.

strongly worded Commission letter in early 1987 advised recalcitrant carriers that the Commission believed an apparent infringement of the Treaty 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.³³⁴

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. As to pricing, the informal agreements allowed a continuation of carrier discussions regarding rates and permitted carriers to enter into voluntary rate agreements, so long as such discussions were not conducted in secret, the results of the discussions would not be binding upon any carrier participating in them, and carriers retained the right of independent action to file a tariff deviating from the rates agreed to. As to revenue and capacity-pooling agreements, they would continue to be tolerated so long as they were voluntary, they involved a sharing of 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 concluded publicly. And, as to computer reservations systems, there would have to be equal access to the systems, and they could not be biased.

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

³³⁴ Merritt, *EC Deregulation at Crossroads*, Int'l Herald Tribune, June 15, 1987, at 9, col. 5.

of Rome. Yet, the Commission's modest constriction of anticompetitive behavior by air carriers surprised almost everyone, because the Commission had previously done so much "chest-beating."

4. *The Council*

The Council is comprised of representatives appointed from each Member State who directly represent their States' interests.³³⁵ The Council has both legislative and executive powers³³⁶ and is responsible for carrying out the objectives of the Community and coordinating the economic policies of Member States.³³⁷ The Council can give recommendations which are not binding on Member States.³³⁸ It can also issue decisions, directives, and regulations which are binding.³³⁹ The Council adopts regulations based upon recommendations and advisory opinions from the Commission or Parliament.³⁴⁰

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.³⁴¹ Air and sea transport were excluded because of the special attitude adopted toward these methods of transport when the Treaty of Rome was adopted in 1957.³⁴² Indeed, Council Regulation No. 141 states specifically that Council Regulation No. 17, which gives the Council the direct means of investigating violations of Articles 85 and 86 in transport and imposes penalties for failure to comply,³⁴³ does not apply to air transport and related activities.³⁴⁴ Maritime competition

³³⁵ 3 Common Mkt. Rep. (CCH) ¶ 4406.02 (1978).

³³⁶ L. HENKEN, *supra* note 9, at 1078.

³³⁷ 3 Common Mkt. Rep. (CCH) ¶ 4402.04 (1978).

³³⁸ 3 Common Mkt. Rep. (CCH) ¶ 4902.31 (1976).

³³⁹ 3 Common Mkt. Rep. (CCH) ¶¶ 4902.15, 4902.25 (1976).

³⁴⁰ 3 Common Mkt. Rep. (CCH) ¶ 4402 (1987).

³⁴¹ 2 Common Mkt. Rep. (CCH) ¶¶ 2401-2634 (various dates) (Reg. No. 17).

³⁴² 1 Common Mkt. Rep. (CCH) ¶ 1945.05 (1974).

³⁴³ P. MATHIJSEN, *supra* note 162, at 181-83.

³⁴⁴ Association of European Airlines, *European Air Transport Policy — AEA Propos-*

rules were not adopted by the Council until December of 1986.

Many in Europe have implored the Council to adopt regulations which would specify how the competition laws would be applied and enforced.³⁴⁵ However, the major stumbling block in the adoption of competition regulations for the airlines has been the desire of each nation to guarantee the success of its own airlines. 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.³⁴⁶

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."³⁴⁷ Furthermore, Article 75 of the Treaty directs the Council to create common rules applicable to international transport within the Member States.³⁴⁸ 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 has pleaded impossibility because of the complexity of the issues and dissent within the Council itself.³⁴⁹ The Council, according to the Court of Justice, must pursue the objective of establishing freedom to provide services in the field of transport.³⁵⁰

By mid-1987, the Council appeared poised to conclude

als, Sept. 27, 1985, at 14 (paper adopted by President's Special Assembly at Brussels).

³⁴⁵ P. DEMPSEY, *supra* note 1, at 246; Treaty of Rome, *supra* note 7, art. 84(2).

³⁴⁶ P. DEMPSEY, *supra* note 1, at 98.

³⁴⁷ Treaty of Rome, *supra* note 7, art. 74.

³⁴⁸ *Id.* art. 75.

³⁴⁹ See Bombardella, *supra* note 220, at 3.

³⁵⁰ *Proceedings*, *supra* note 222, 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. Sørensen, *supra* note 23, at 3.

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 also have 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 price-fixing, 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 be limited to 1%, and be 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.³⁵¹

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.³⁵² Newly admitted Spain exercised its veto at the eleventh hour on an issue having virtually nothing to do with air transport; Spain continues to contest British sovereignty over Gibraltar and apparently used this platform to reassert its position.

Although the mid-1987 agreement was scuttled by the Spanish veto, the ability of the Council to reach a majority resolution of such issues will henceforth be greatly facilitated by the weighted voting of Member States recently

³⁵¹ Merritt, *supra* note 334, at 9, 12, col. 4.

³⁵² *Spain Blocks the Adoption of Air Deregulation in EC*, Wall St. J., July 2, 1987, at 15, col. 6; *Unfair Air Fares*, *ECONOMIST*, July 4, 1987, at 16; *Spain in Search of Europe*, *ECONOMIST*, July 18, 1987, at 43.

permitted by the Single European Act. Thus, no single nation can again unilaterally thwart the Council's ability to promulgate rules by casting a veto as Spain did here. As we will see below, the Single European Act may have prompted Council agreement on a conservative liberalization package in December 1987.

C. *Goal of an Internal Market by 1992 and the Single European Act*

The foregoing analysis of the functions and activities of the EEC governing bodies would not be complete without an understanding of a major motivating force within the EEC — the goal of a unified internal market, a European Union, by 1992.³⁵³ The Single European Act (SEA), which took effect in July 1987, is intended to facilitate and compel the creation of a European Union by this target date. As we shall see, the SEA provision allowing majority voting recently may have moved the Council to action on air transport. This provision replaces the previous requirement of unanimity in Council decisions.³⁵⁴

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."³⁵⁵ The Commission has assumed a prominent role in urging and planning for the eventuality of this economic and political unification.³⁵⁶

³⁵³ Creation of Internal Market, 1 Common Mkt. Rep. (CCH) ¶ 202.07 (1978) (CCH Explanation) [hereinafter Internal Market]; see *They've Designed the Future, and It Might Just Work*, ECONOMIST, Feb. 13, 1988, at 45-48 [hereinafter *They've Designed the Future*].

³⁵⁴ Single European Act, 1 Common Mkt. Rep. (CCH) ¶ 101.15 (1978) (CCH Explanation) [hereinafter Single European Act].

³⁵⁵ Internal Market, *supra* note 353, ¶ 202.07.

³⁵⁶ 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] Com-

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.³⁵⁷ The program would include not just the simplification of procedures at intra-Community frontiers, but rather the complete abolition of procedural formalities at the borders.³⁵⁸ 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.³⁵⁹

In June 1985, the Commission revealed the "White Paper," a major proposal for progress toward an internal market.³⁶⁰ This set of specific, detailed proposals was submitted for consideration at the Council's Milan meeting at the end of June. Reciting the Community's recognized need for an internal market, the Commission indicated that a definite target date and detailed plans had been missing. As a result of its deliberations, the Commission had set the "bold target" of completion of the internal market by 1992.³⁶¹ 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 services had proceeded more slowly than for goods, but reaffirmed and explained the importance of service industries. Service industries included "tradi-

mon Mkt. Rep. (CCH) ¶ 10,595 (1984) (information memorandum from the Commission, June 1984) [hereinafter *Commission Submits Program*].

³⁵⁷ *Commission Submits Program*, *supra* note 356, ¶ 10,595.

³⁵⁸ *Id.*

³⁵⁹ *Id.*

³⁶⁰ *Completion of the Internal Market Sought by 1992*, 4 Common Mkt. Rep. (CCH) ¶ 10,693 (1985) (information memorandum from the Commission, June 1985).

³⁶¹ *Id.*

tional" areas such as "banking, insurance, and transport."³⁶²

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.³⁶³ Ultimately, the signatories of the SEA agreed to the target date of December 31, 1992.³⁶⁴

The SEA is a treaty that grew out of efforts, initiated by the European Council, to advance the European Communities toward a European Union.³⁶⁵ 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 twelve Member States on February 4, 1986, but it did not take effect until July 1, 1987, after ratification by all Member States.³⁶⁶ The majority of the Act's provisions are amendments to the Treaty of Rome or new provisions to be added to the Treaty.³⁶⁷ The Act seeks to create a genuine internal market in which the remaining barriers to free movement of goods, persons, services and capital are removed.³⁶⁸ In signing the Act, the Member States have committed themselves to establish an internal market by December 31, 1992, although this is in reality only

³⁶² *Id.*

³⁶³ Single European Act a Milestone on the Road Toward A European Union, 4 Common Mkt. Rep. (CCH) ¶ 10,812 (1986) (CCH Comment) [hereinafter Milestone].

³⁶⁴ Single European Act, *supra* note 354, ¶ 101.15.

³⁶⁵ *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, by 1980, a European Union which would govern all relations between the Member States. 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).

³⁶⁶ Single European Act, *supra* note 354, ¶ 101.15.

³⁶⁷ Milestone, *supra* note 363, ¶ 10,812.

³⁶⁸ Single European Act, *supra* note 354, ¶ 101.15.

a statement of political intent.³⁶⁹

The SEA makes a number of institutional changes in the operation of the EEC. The role of the European Parliament will be expanded, and it will be granted some degree of control over Council decisions. The role of the Commission will also be expanded and changed, particularly in regard to its interaction with the Parliament. The Council will be 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.³⁷⁰ A major barrier to the establishment of an internal market has been removed by the replacement of unanimous voting with qualified majority voting on a number of subjects, including development of a common transport policy.³⁷¹ However, a significant obstacle to the efficacy of majority voting remains in the right of veto which each country maintains.³⁷² The right of veto, the so-called Luxembourg compromise, was extracted by the French in 1966 in order to terminate General DeGaulle's "empty-chair" period, a boycott maintained to defend French sovereignty.³⁷³ The SEA makes no provision for this right, under which, if a Member State declares a Council decision to be adverse to its vital national interests, and if enough other Members agree (which usually happens), then the veto cannot be outvoted.³⁷⁴

Two years after issuing the White Paper, in a second annual report, the Commission stated that "[t]he Community must do better" in order to achieve an internal market by 1992. The Commission recited 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 Eu-

³⁶⁹ *Id.*; Milestone, *supra* note 363, ¶ 10,812.

³⁷⁰ Milestone, *supra* note 363, ¶ 10,812.

³⁷¹ *Id.*; Single European Act, *supra* note 354, ¶ 101.15.

³⁷² *Don't Take Europa*, *supra* note 133, at 55; Milestone, *supra* note 363, ¶ 10,812.

³⁷³ *Don't Take Europa*, *supra* note 133, at 55.

³⁷⁴ *Id.* The article adds that "[t]he veto power is often abused." *Id.*; see also Milestone, *supra* note 363, ¶ 10,812.

ropean Act. The Commission stressed the importance of cooperative and expeditious involvement by officials of Member governments and the necessity of not letting "national and sectoral interests take over."³⁷⁵ In these movements toward an internal market, the Commission has recognized the importance of a unified transport policy. Considering the importance of commercial aviation in the transportation infrastructure, initiatives directed toward liberalized competition and flexibility will assume critical importance.

D. *The Transition to Liberalization of European Air Transport: 1988-1992*

In December 1987, the EEC Council adopted its long awaited regulations on the application of the Treaty of Rome's competition rules to scheduled air transport,³⁷⁶ group exemptions thereto,³⁷⁷ a directive on scheduled air fares,³⁷⁸ and a decision on capacity sharing and market access.³⁷⁹

So why, after so many years of wrangling, had the Council finally achieved agreement? The political problems between Spain and the United Kingdom surrounding the U.K.'s possession of Gibraltar, which had led Spain to veto the agreement earlier in the year, were resolved in December 1987.³⁸⁰ Moreover, the prospect of weighted voting under the Single European Act had alleviated the possibility of a single state veto. Hence, no one

³⁷⁵ 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).

³⁷⁶ Council Regulation on the Application of the Competition Rules (Procedural Provisions), Council Regulation (EEC) No. 3975/87 of 14 Dec. 1987, *infra* Appendix A.

³⁷⁷ Council Regulation on the Application of Article 85(3) of the Rome Treaty (Group Exemptions), Council Regulation (EEC) No. 3976/87 of 14 Dec. 1987, *infra* Appendix B.

³⁷⁸ Council Directive on Scheduled Air Fares of 14 Dec. 1987, *infra* Appendix C.

³⁷⁹ Council Decision on Capacity Sharing and Market Access of 14 Dec. 1987, *infra* Appendix D.

³⁸⁰ *The Rock Stands Aside*, *ECONOMIST*, Dec. 5, 1987, at 55.

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 Frontières* had abated considerably with the relatively conservative agreements it had entered into with offending airlines. And 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 which might rip at the very threads of the fragile European alliance.³⁸¹

Across the Atlantic, the American experiment in deregulation was beginning to turn sour. This was dampening enthusiasm for radical liberalization in Europe. Even the most liberal of the EEC members, Britain and the Netherlands, appeared to back off of their effort to accomplish American-style deregulation.

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.³⁸² ECAC itself 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,³⁸³ and intercity rail services were also responsible for a sizable portion of the market. And with increased privatization of carriers such as British Airways and KLM,³⁸⁴ and proposed mergers in the offing (such as that

³⁸¹ 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." Carey & Wolf, *EC Adopts Plan to Partly Deregulate Europe's Airline Industry Starting in '88*, Wall St. J., Dec. 8, 1987, at 24, col. 2.

³⁸² See P. DEMPSEY, *supra* note 1, at 102-04.

³⁸³ *Id.* at 99.

³⁸⁴ British Airways was completely privatized by the Thatcher government. KLM's government holdings have been reduced to 39%. P. Haanappel, *A Decade*

announced between British Airways and British Caledonian), the market was already increasingly competitive.

All of this made political consensus on a more conservative package, one more palatable to southern European governments, easier to achieve. The package itself, effective January 1, 1988, provides for a three year transition, ostensibly attempting to meet the Community's ambitious 1992 deadline for a unified internal market.³⁸⁵ Yet, for reasons expressed below, even the date for elimination of all internal barriers to aviation may be unrealistic.

The original Council regulations excluded the transport sector from the application of the competition rules.³⁸⁶ Hence, the *Regulation on the Application of the Competition Rules*³⁸⁷ is the first to apply Articles 85 and 86 of the Treaty of Rome to air transport. Under it, the Commission is 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.³⁸⁸ It is given powers of investigation,³⁸⁹ and the authority to levy fines against enterprises found to have violated the Treaty.³⁹⁰

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.³⁹¹ Here again, the Commission is explicitly conferred significant powers to adopt

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].

³⁸⁵ See *They've Designed the Future*, *supra* note 353, at 45.

³⁸⁶ Pursuant to Council Regulation No. 141, Regulation No. 17 was made inapplicable to transportation. Subsequently, the Council adopted Regulation No. 1017/68 to apply the competition rules to inland transport. And more recently, it adopted Regulation No. 4056/86, applying the rules to maritime services. See P. DEMPSEY, *supra* note 1, at 245; *Council Regulation (EEC) No. 4056/86 of 22 December 1986*, 29 O.J. EUR. COMM. (No. L 378) 4 (1986).

³⁸⁷ See *infra* app. A.

³⁸⁸ *Id.* art. 3. Exceptions for technical agreements are set forth at *id.* art. 2.

³⁸⁹ *Id.* art. 11.

³⁹⁰ *Id.* art. 12(2).

³⁹¹ See *infra* app. B.

regulations authorizing carriers to engage in, *inter alia*, capacity and revenue sharing, agreements regarding pricing, slot allocations, computer reservations systems, and ground handling.³⁹² Significantly, revenue pooling³⁹³ is limited to one percent of the revenue earned on a route, with the transfer being made to the carrier suffering a loss because it is scheduling its flights at less busy times.³⁹⁴ Hence, revenue pooling has been substantially circumscribed.

The Council's *Directive on Scheduled Air Fares*³⁹⁵ gives to the aeronautical authorities of Member States the jurisdiction to approve carrier rates.³⁹⁶ Rates shall be approved if "they are reasonably related to the long-term fully allocated costs" of the carrier.³⁹⁷ They shall not be disapproved on grounds that the proposed rate "is lower than that offered by another air carrier operating on the route"³⁹⁸ Moreover, the Directive establishes 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.³⁹⁹ Although the conditions attached to these fares are rigid (e.g., advance purchase requirements, minimum and maximum lengths of stay, and age restrictions)⁴⁰⁰ within these zones, carriers may set their prices freely without government restrictions.⁴⁰¹

And finally, in the Council *Decision on Capacity Sharing and Market Access*,⁴⁰² the traditional 50-50% split of capacity between European carriers is abandoned in favor of an

³⁹² *Id.* art. 2.

³⁹³ See P. DEMPSEY, *supra* note 1, at 64.

³⁹⁴ See *infra* app. B, art. 2.

³⁹⁵ See *infra* app. C.

³⁹⁶ *Id.* art. 4.

³⁹⁷ *Id.* art. 3.

³⁹⁸ *Id.*

³⁹⁹ *Id.* art. 5. The "referenced fare" is the "normal economy air fare charged by a third- or fourth-freedom air carrier on the routes in question" *Id.* art. 2(c).

⁴⁰⁰ *Id.* Annex II.

⁴⁰¹ *Id.* art. 5.

⁴⁰² See *infra* app. D.

immediate 55-45% rule (from January 1, 1988, to September 30, 1989), and then a 60-40% split (after October 1, 1989).⁴⁰³ However, the Decision includes 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 have suffered "serious financial damage."⁴⁰⁴

The Decision also established 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.⁴⁰⁵ And significant new opportunities for entry have been created between hub and regional airports.⁴⁰⁶

The package has been characterized as "a watered down version of earlier pro-deregulation proposals [*e.g.*, *Memorandum 2*] made by the EEC Commission."⁴⁰⁷ Others described the new rules as "extremely modest."⁴⁰⁸ Modest perhaps, from an American perspective. But these new rules, coupled with the new liberal European bilateral air transport agreements, the competition engendered by U.S. — flag carriers traversing the Atlantic, the new ECAC rules, the rash of privatization and mergers, and the significant competition provided by European charter carriers, suggests that the environment is hardly the protectionist, cartel atmosphere of the 1970s. While falling short of the ambitious proposals of *Memorandum 2*, tremendous progress has been made.

And that the Europeans want to take a gradual approach to liberalization, rather than the hog wild, comprehensive lightning speed deregulation of the United

⁴⁰³ *Id.* art. 3.

⁴⁰⁴ *Id.* art. 4.

⁴⁰⁵ *Id.* art. 5.

⁴⁰⁶ *Id.* art. 6.

⁴⁰⁷ P. Haanappel, *supra* note 384, at 11.

⁴⁰⁸ Carey & Wolf, *supra* note 381, at 24, col. 1.

States,⁴⁰⁹ suggests that EEC leaders are more prudent than their brash American cousins, and more willing to learn from the failures of a blind adherence to the ideology of *laissez faire*.⁴¹⁰

There are, by the way, some interesting paradoxes in the perspectives on both sides of the ocean. A recent poll revealed that Europeans, who have not yet experienced airline deregulation, favor it by a margin of four to one. In contrast, Americans, who have had about a decade of it, favor it by a margin of only 1.6 to one.⁴¹¹ Apparently, the grass is greener on the other side of the Atlantic.

VII. GAZING INTO THE CRYSTAL BALL: THE PROSPECTUS FOR EUROPEAN COMMERCIAL AVIATION

The year 1992 may well be too ambitious a target for comprehensive European unification of the nature intended by the SEA. Nonetheless, since unification may be achieved eventually, the relevant question here is what this will mean for air transport. All nations have traditionally 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.

Today Phillips, the Dutch electronics firm, can build a manufacturing facility in Barcelona with relative ease. But if KLM Royal Dutch Airlines sought to establish hub-and-spoke operations centered in Barcelona, the Spanish Air Force would likely be scrambled to escort the KLM jets out of sovereign Spanish airspace. Nevertheless, if Europe is to achieve a unified economy, shouldn't KLM have the freedom to enter and exit markets that Phillips enjoys? If so, then the traditional notion of air sovereignty, and the complex matrix of bilateral air transport agreements which codify the concept, must be superseded by a

⁴⁰⁹ See Dempsey, *The Rise and Fall of The Civil Aeronautics Board — Opening Wide the Floodgates of Entry*, 11 TRANSP. L.J. 91 (1979).

⁴¹⁰ See *infra* notes 418-420 and accompanying text.

⁴¹¹ P. Haanappel, *supra* note 384, at 12.

regime which treats all of the EEC as a domestic cabotage market. If this occurs, Lufthansa will be able to make a hub of Lyon, and Air France a hub of Munich, as they choose, without governmental interference.

Another traditional concept which 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 is owned by Portuguese. This was a concept which had 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.

With their eyes on the U.S. megacarriers which 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. Already, SAS has announced (and subsequently abandoned) plans to merge with Sabena, and recently privatized British Airways has announced its intention to acquire British Caledonian, also a target of SAS.⁴¹² Alitalia has also expressed an interest in securing a merger partner.

Today, the five largest EEC airlines (*i.e.*, British Airways, Air France, Lufthansa, KLM, and Iberia) account for

⁴¹² Hemp, *British Airways Wins Caledonian By Increasing Bid to \$457.9 Million*, Wall St. J., Dec. 22, 1987, at 18, col. 1; Hemp, *SAS Bids for Part of British Caledonian, Which Favors the Offer Over British Air's*, Wall St. J., Dec. 10, 1987, at 18, col. 1; Marcom, *U.K. to Review British Air Plan for a Takeover*, Wall St. J., Aug. 7, 1987, at 20, col. 1; Merritt, *For EC 'Flag Carriers,' Partnerships May Be a Necessity*, Int'l Herald Tribune, June 15, 1987, at 9, col. 2.

nearly 70% of scheduled European traffic.⁴¹³ Jan Carlzon, president of SAS, predicts that ultimately only five airlines will survive liberalization and wants SAS to be among them.⁴¹⁴ 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.⁴¹⁵

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 group of multinational European megacarriers, all utilizing hub-and-spoke operations and linked to only a few sophisticated computer reservations systems.⁴¹⁶ In the short run, passengers will enjoy lower ticket prices, as carriers become hotly competitive, more efficient, and economical, because their profit margins will be severely squeezed by new entrants.⁴¹⁷ Those benefits will be enjoyed at the cost of deterioration in labor-management relations, the margin of safety, small community access, and an overall decline in the quality of airline service.⁴¹⁸ Many smaller carriers and most new entrants will

⁴¹³ *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.*

⁴¹⁴ Carey, *European Airlines Discuss Joining Forces*, Wall St. J., June 10, 1987, at 16, col. 3.

⁴¹⁵ Kasper, *Toward Open Skies World-Wide*, Wall St. J., Aug. 3, 1987, at 17.

⁴¹⁶ 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.

⁴¹⁷ Dempsey, *The Experience of Deregulation: Erosion of the Common Carrier System*, 13 TRANSP. L. INST. 121, 172-75 (1980) [hereinafter *Experience of Deregulation*].

⁴¹⁸ Dempsey, *The Dark Side of Deregulation: Its Impact on Small Communities*, 39 ADMIN. L. REV. 445 (1987); *Turbulence*, *supra* note 23, at 387-88; Dempsey, *Transportation Deregulation — On a Collision Course?*, 13 TRANSP. L.J. 329, 342-64 (1984); Dempsey, *With Deregulation, Big Get Bigger*, Philadelphia Inquirer, Dec. 19, 1987, at 9A; Dempsey, *Deregulation's First Decade*, J. of Commerce, Dec. 18, 1987, at 8A;

fall into bankruptcy, unless they can align themselves as feeders for the megacarriers.⁴¹⁹ 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 soar.⁴²⁰

VIII. CONCLUSION

The enthusiasm for liberalization has waned somewhat as Europeans have observed the massive shakeout occurring across the Atlantic in the decade-old American experiment in deregulation. Nevertheless, nations such as Britain and the Netherlands, which believe both consumers and airlines will ultimately benefit from the forces of the marketplace, have continued to exert considerable pressure for liberalization.⁴²¹ 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

Dempsey, *Punishing Smallness*, Cleveland Plain Dealer, Dec. 12, 1987, at 15A; Rowen, *Airline Service Has Gone to Hell*, Washington Post, July 23, 1987, at A21, col. 1; Dempsey, *Consumers Pay More to Receive a Lot Less*, USA Today, July 16, 1987, at 8A.

⁴¹⁹ Dempsey, *Antitrust Law & Policy in Transportation: Concentration Is the Name of the Game*, 21 GA. L. REV. 505 (1987); Dempsey, *Birth of the Monster Airlines*, TRAFFIC WORLD, Dec. 1, 1986, at 77; Rose, *Major U.S. Airlines Rapidly Gain Control Over Regional Lines*, Wall St. J., Feb. 17, 1988, at 1, col. 6; Dempsey, *Deregulation Brings Flying Low*, Rocky Mountain News, Aug. 9, 1987, at 73; Dempsey, *The Carnage of Airline Deregulation*, Houston Chronicle, July 30, 1987, at 27; Dempsey, *Consolidation a Destructive Trend*, Denver Post, Dec. 6, 1986, at 4B, col. 1; Dempsey, *Deregulation's Toll Is Rising*, Denver Post, Sept. 4, 1986, at 5B, col. 4; Dempsey, *Deregulated Skies Unfriendly to Small Airlines*, Rocky Mountain News, May 25, 1986, at 77, col. 1; Dempsey, *Airline Deregulation's Hostile Skies*, Denver Post, Oct. 17, 1983, at 3B, col. 3; Dempsey, *Stormy Skies of Deregulation*, Chicago Tribune, Oct. 14, 1983, at 19, col. 1; Dempsey, *Affordability, Safety of Airlines May Suffer*, Los Angeles Times, Oct. 11, 1983, at 7, col. 1; Rowen, *Airline Deregulation: A Bankrupt Policy*, Washington Post, Sept. 29, 1983, at A21; see P. DEMPSEY & W. THOMS, *supra* note 21, at 245-51.

⁴²⁰ *Experience of Deregulation*, *supra* note 417, at 174.

⁴²¹ *Increased Liberalization*, *supra* note 17, at 36.

States and increasingly privatized carriers. Industry organizations have tremendous influence in the European air transport industry, and 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 Economic Community was designed to promote a free market among Member States. Actions by the EEC have been delayed by political considerations and by the reluctance of a few nations that own or subsidize their national airlines.⁴²² While unable to accomplish immediate deregulation, the EEC has helped generate public support that is pressuring governments towards more bilateral agreements to ease regulation.⁴²³ Through its governing bodies, the EEC is contributing to the creation of a governmental climate favoring at least partial deregulation. Much progress has been achieved toward that objective with the Council's promulgation of its long-awaited regulations, group exemptions, directive and decision, reproduced in the ensuing pages of this article.

Although it is far from clear what the final result of these forces favoring liberalization of air transport regulation will be, and whether deregulation can be achieved by 1992, it is obvious that a significant liberalization in the regulatory environment of European air transport is occurring and that this trend is likely to continue. Let us only hope that Europe learns from the American experience with deregulation and does a better job of it than we have on this side of the Atlantic.⁴²⁴

⁴²² *Liberalization Policies*, *supra* note 248, at 28.

⁴²³ *New Agreements*, *supra* note 37, at 76.

⁴²⁴ See *supra* notes 416-420 and accompanying text for a discussion of possible consequences.

APPENDIX A

COUNCIL REGULATION ON THE APPLICATION OF THE
COMPETITION RULES
(PROCEDURAL PROVISIONS)COUNCIL REGULATION (EEC) No 3975/87
of 14 December 1987

laying down the procedure for the application of the rules on competition to undertakings in the air transport sector*

THE COUNCIL OF THE EUROPEAN COMMUNITIES,
Having regard to the Treaty establishing the European Economic Community, and in particular Article 87 thereof,

Having regard to the proposal from the Commission¹,
Having regard to the Opinions of the European Parliament²,

Having regard to the Opinion of the Economic and Social Committee³,

Whereas the rules on competition form part of the Treaty's general provisions which also apply to air transport; whereas the rules for applying these provisions are either specified in the Chapter on competition or fall to be determined by the procedures laid down therein;

Whereas, according to Council Regulation No 141⁴, Council Regulation No 17⁵ does not apply to transport services; whereas Council Regulation (EEC) No 1017/68⁶

* [Ed. - Throughout Appendices A - D, the editors have duplicated, with minor variations in spacing, the citation form used in the footnotes to the original Council documents. Therefore, citations throughout these Appendices will not conform with A UNIFORM SYSTEM OF CITATION (14th ed. 1986). Whereas the Council documents began with footnote number one on each new page which contained a footnote, the editors have renumbered the footnotes to make them consecutive.]

¹ OJ No C 182, 9.7.1984, p. 2.

² OJ No C 182, 19.7.1982, p. 120 and OJ No C 345, 21.12.1987.

³ OJ No C 77, 21.3.1983, p. 20.

⁴ OJ No 124, 28.11.1962, p. 2751/62.

⁵ OJ No 13, 21.2.1962, p. 204/62.

⁶ OJ No L 175, 23.7.1968, p. 1.

applies only to inland transport; whereas Council Regulation (EEC) No 4056/86⁷ applies only to maritime transport; whereas consequently the Commission has no means at present of investigating directly cases of suspected infringement of Articles 85 and 86 of the Treaty in air transport; whereas moreover the Commission lacks such powers of its own to take decisions or impose penalties as are necessary for it to bring to an end infringements established by it;

Whereas air transport is characterized by features which are specific to this sector; whereas, furthermore, international air transport is regulated by a network of bilateral agreements between States which define the conditions under which air carriers designated by the parties to the agreements may operate routes between their territories; Whereas practices which affect competition relating to air transport between Member States may have a substantial effect on trade between Member States; whereas it is therefore desirable that rules should be laid down under which the Commission, acting in close and constant liaison with the competent authorities of the Member States, may take the requisite measures for the application of Articles 85 and 86 of the Treaty to international air transport between Community airports;

Whereas such a regulation should provide for appropriate procedures, decision-making powers and penalties to ensure compliance with the prohibitions laid down in Articles 85(1) and 86 of the Treaty; whereas account should be taken in this respect of the procedural provisions of Regulation (EEC) No 1017/68 applicable to inland transport operations, which takes account of certain distinctive features of transport operations viewed as a whole;

Whereas undertakings concerned must be accorded the right to be heard by the Commission, third parties whose interests may be affected by a decision must be given the opportunity of submitting their comments beforehand

⁷ OJ No L 378, 31.12.1986, p. 4.

and it must be ensured that wide publicity is given to decisions taken;

Whereas all decisions taken by the Commission under this Regulation are subject to review by the Court of Justice under the conditions specified in the Treaty; whereas it is moreover desirable, pursuant to Article 172 of the Treaty, to confer upon the Court of Justice unlimited jurisdiction in respect of decisions under which the Commission imposes fines or periodic penalty payments;

Whereas it is appropriate to except certain agreements, decisions and concerted practices from the prohibition laid down in Article 85(1) of the Treaty, insofar as their sole object and effect is to achieve technical improvements or co-operation;

Whereas, given the specific features of air transport, it will in the first instance be for undertakings themselves to see that their agreements, decisions and concerted practices conform to the competition rules, and notification to the Commission need not be compulsory;

Whereas undertakings may wish to apply to the Commission in certain cases for confirmation that their agreements, decisions and concerted practices conform to the law, and a simplified procedure should be laid down for such cases;

Whereas this Regulation does not prejudice the application of Article 90 of the Treaty,

HAS ADOPTED THIS REGULATION:

Article 1

Scope

1. This Regulation lays down detailed rules for the application of Articles 85 and 86 of the Treaty to air transport services.
2. This Regulation shall apply only to international air transport between Community airports.

*Article 2**Exceptions for certain technical agreements*

1. The prohibition laid down in Article 85(1) of the Treaty shall not apply to the agreements, decisions and concerted practices listed in the Annex, insofar as their sole object and effect is to achieve technical improvements or co-operation. This list is not exhaustive.
2. If necessary, the Commission shall submit proposals to the Council for the amendment of the list in the Annex.

*Article 3**Procedures on complaint or on the Commission's own initiative*

1. Acting on receipt of a complaint or on its own initiative, the Commission shall initiate procedures to terminate any infringement of the provisions of Articles 85(1) or 86 of the Treaty.

Complaints may be submitted by:

- (a) Member States;
- (b) natural or legal persons who claim a legitimate interest.

2. Upon application by the undertakings or associations of undertakings concerned, the Commission may certify that, on the basis of the facts in its possession, there are no grounds under Article 85(1) or Article 86 of the Treaty for action on its part in respect of an agreement, decision or concerted practice.

*Article 4**Result of procedures on complaint or on the Commission's own initiative*

1. Where the Commission finds that there has been an infringement of Articles 85(1) or 86 of the Treaty, it may by decision require the undertakings or associations of undertakings concerned to bring such an infringement to an end.

Without prejudice to the other provisions of this Regulation, the Commission may address recommendations for

termination of the infringement to the undertakings or associations of undertakings concerned before taking a decision under the preceding subparagraph.

2. If the Commission, acting on a complaint received, concludes that, on the evidence before it, there are no grounds for intervention under Articles 85(1) or 86 of the Treaty in respect of any agreement, decision or concerted practice, it shall take a decision rejecting the complaint as unfounded.

3. If the Commission, whether acting on a complaint received or on its own initiative, concludes that an agreement, decision or concerted practice satisfies the provisions of both Article 85(1) and 85(3) of the Treaty, it shall take a decision applying paragraph 3 of the said Article. Such a decision shall indicate the date from which it is to take effect. This date may be prior to that of the decision.

Article 5

Application of Article 85(3) of the Treaty Objections

1. Undertakings and associations of undertakings which wish to seek application of Article 85(3) of the Treaty in respect of agreements, decisions and concerted practices falling within the provisions of paragraph 1 of the said Article to which they are parties shall submit applications to the Commission.

2. If the Commission judges an application admissible and is in possession of all the available evidence and no action under Article 3 has been taken against the agreement, decision or concerted practice in question, then it shall publish as soon as possible in the *Official Journal of the European Communities* a summary of the application and invite all interested third parties and the Member States to submit their comments to the Commission within 30 days. Such publications shall have regard to the legitimate interest of undertakings in the protection of their business secrets.

3. Unless the Commission notifies applicants, within 90 days of the date of such publication in the *Official Journal of*

the European Communities, that there are serious doubts as to the applicability of Article 85(3) of the Treaty, the agreement, decision or concerted practice shall be deemed exempt, insofar as it conforms with the description given in the application, from the prohibition for the time already elapsed and for a maximum of six years from the date of publication in the Official Journal of the European Communities.

If the Commission finds, after expiry of the 90 day time limit, but before expiry of the six-year period, that the conditions for applying Article 85(3) of the Treaty are not satisfied, it shall issue a decision declaring that the prohibition in Article 85(1) applies. Such decision may be retroactive where the parties concerned have given inaccurate information or where they abuse an exemption from the provisions of Article 85(1) or have contravened Article 86.

4. The Commission may notify applicants as referred to in the first subparagraph of paragraph 3; it shall do so if requested by a Member State within 45 days of the forwarding to the Member State of the application in accordance with Article 8(2). This request must be justified on the basis of considerations relating to the competition rules of the Treaty.

If it finds that the conditions of Article 85(1) and (3) of the Treaty are satisfied, the Commission shall issue a decision applying Article 85(3). The decision shall indicate the date from which it is to take effect. This date may be prior to that of the application.

Article 6

Duration and revocation of decisions applying

Article 85(3)

1. Any decision applying Article 85(3) of the Treaty adopted under Articles 4 or 5 of this Regulation shall indicate the period for which it is to be valid; normally such period shall not be less than six years. Conditions and obligations may be attached to the decision.

2. The decision may be renewed if the conditions for applying Article 85(3) of the Treaty continue to be satisfied.

3. The Commission may revoke or amend its decision or prohibit specific acts by the parties:

- (a) where there has been a change in any of the facts which were basic to the making of the decision; or
- (b) where the parties commit a breach of any obligation attached to the decision; or
- (c) where the decision is based on incorrect information or was induced by deceit; or
- (d) where the parties abuse the exemption from the provisions of Article 85(1) of the Treaty granted to them by the decision.

In cases falling under subparagraphs (b), (c) or (d), the decision may be revoked with retroactive effect.

Article 7

Powers

Subject to review of its decision by the Court of Justice, the Commission shall have sole power to issue decisions pursuant to Article 85(3) of the Treaty.

The authorities of the Member States shall retain the power to decide whether any case falls under the provisions of Article 85(1) or Article 86 of the Treaty, until such time as the Commission has initiated a procedure with a view to formulating a decision on the case in question or has sent notification as provided by the first subparagraph of Article 5(3) of this Regulation.

Article 8

Liaison with the authorities of the Member States

1. The Commission shall carry out the procedures provided for in this Regulation in close and constant liaison with the competent authorities of the Member States; these authorities shall have the right to express their views on such procedures.

2. The Commission shall immediately forward to the competent authorities of the Member States copies of the

complaints and applications and of the most important documents sent to it or which it sends out in the course of such procedures.

3. An Advisory Committee on Agreements and Dominant Positions in Air Transport shall be consulted prior to the taking of any decision following upon a procedure under Article 3 or of any decision under the second subparagraph of Article 5(3), or under the second subparagraph of paragraph 4 of the same Article or under Article 6. The Advisory Committee shall also be consulted prior to adoption of the implementing provisions provided for in Article 19.

4. The Advisory Committee shall be composed of officials competent in the sphere of air transport and agreements and dominant positions. Each Member State shall nominate two officials to represent it, each of whom may be replaced, in the event of his being prevented from attending, by another official.

5. Consultation shall take place at a joint meeting convened by the Commission; such a meeting shall be held not earlier than fourteen days after dispatch of the notice convening it. In respect of each case to be examined, this notice shall be accompanied by a summary of the case, together with an indication of the most important documents, and a preliminary draft decision.

6. The Advisory Committee may deliver an opinion notwithstanding that some of its members or their alternates are not present. A report of the outcome of the consultative proceedings shall be annexed to the draft decision. It shall not be made public.

Article 9 *Requests for information*

1. In carrying out the duties assigned to it by this Regulation, the Commission may obtain all necessary information from the Governments and competent authorities of the Member States and from undertakings and associations of undertakings.

2. When sending a request for information to an undertaking or association of undertakings, the Commission shall forward a copy of the request at the same time to the competent authority of the Member State in whose territory the head office of the undertaking or association of undertakings is situated.

3. In its request, the Commission shall state the legal basis and purpose of the request and also the penalties for supplying incorrect information provided for in Article 12(1)(b).

4. The owners of the undertakings or their representatives and, in the case of legal persons or of companies, firms or associations having no legal personality, the person authorized to represent them by law or by their rules shall be bound to supply the information requested.

5. When an undertaking or association of undertakings does not supply the information requested within the time limit fixed by the Commission, or supplies incomplete information, the Commission shall by decision require the information to be supplied. The decision shall specify what information is required, fix an appropriate time limit within which it is to be supplied and indicate the penalties provided for in Article 12(1)(b) and Article 13(1)(c), as well as the right to have the decision reviewed by the Court of Justice.

6. At the same time the Commission shall send a copy of its decision to the competent authority of the Member State in whose territory the head office of the undertaking or association of undertakings is situated.

Article 10

Investigations by the authorities of the Member States

1. At the request of the Commission, the competent authorities of the Member States shall undertake the investigations which the Commission considers to be necessary under Article 11(1) or which it has ordered by decision adopted pursuant to Article 11(3). The officials of the competent authorities of the Member States responsible

for conducting these investigations shall exercise their powers upon production of an authorization in writing issued by the competent authority of the Member State in whose territory the investigation is to be made. Such an authorization shall specify the subject matter and purpose of the investigation.

2. If so requested by the Commission or by the competent authority of the Member State in whose territory the investigation is to be made, Commission officials may assist the officials of the competent authority in carrying out their duties.

Article 11
Investigating powers of the Commission

1. In carrying out the duties assigned to it by this Regulation, the Commission may undertake all necessary investigations into undertakings and associations of undertakings. To this end the officials authorized by the Commission shall be empowered:

- (a) to examine the books and other business records;
- (b) to take copies of, or extracts from, the books and business records;
- (c) to ask for oral explanations on the spot;
- (d) to enter any premises, land and vehicles used by undertakings or associations of undertakings.

2. The authorized officials of the Commission shall exercise their powers upon production of an authorization in writing specifying the subject matter and purpose of the investigation and the penalties provided for in Article 12(1)(c) in cases where production of the required books or other business records is incomplete. In good time before the investigation, the Commission shall inform the competent authority of the Member State in whose territory the same is to be made of the investigation and the identity of the authorized officials.

3. Undertakings and associations of undertakings shall submit to investigations ordered by decision of the Commission. The decision shall specify the subject matter and

purpose of the investigation, appoint the date on which it is to begin and indicate the penalties provided for in Articles 12(1)(c) and 13(1)(d) and the right to have the decision reviewed by the Court of Justice.

4. The Commission shall take the decisions mentioned in paragraph 3 after consultation with the competent authority of the Member State in whose territory the investigation is to be made.

5. Officials of the competent authority of the Member State in whose territory the investigation is to be made may assist the Commission officials in carrying out their duties, at the request of such authority or of the Commission.

6. Where an undertaking opposes an investigation ordered pursuant to this Article, the Member State concerned shall afford the necessary assistance to the officials authorized by the Commission to enable them to make their investigation. To this end, Member States shall take the necessary measures after consultation of the Commission by 31 July 1989.

Article 12

Fines

1. The Commission may, by decision, impose fines on undertakings or associations of undertakings of from 100 to 5000 ECU where, intentionally or negligently:

- (a) they supply incorrect or misleading information in connection with an application pursuant to Article 3(2) or Article 5; or
- (b) they supply incorrect information in response to a request made pursuant to Article 9(3) or (5), or do not supply information within the time limit fixed by a decision adopted under Article 9(5); or
- (c) they produce the required books or other business records in incomplete form during investigations under Article 10 or Article 11, or refuse to submit to an investigation ordered by decision taken pursuant to Article 11(3).

2. The Commission may, by decision, impose fines on undertakings or associations of undertakings of from 1000 to 1,000,000 ECU, or a sum in excess thereof but not exceeding 10% of the turnover in the preceding business year of the undertakings participating in the infringement, where either intentionally or negligently they:

- (a) infringe Article 85(1) or Article 86 of the Treaty; or
- (b) commit a breach of any obligation imposed pursuant to Article 6(1) of this Regulation.

In fixing the amount of the fine, regard shall be had both to the gravity and to the duration of the infringement.

3. Article 8 shall apply.

4. Decisions taken pursuant to paragraphs 1 and 2 shall not be of a penal nature.

5. The fines provided for in paragraph 2(a) shall not be imposed in respect of acts taking place after notification to the Commission and before its decision in application of Article 85(3) of the Treaty, provided they fall within the limits of the activity described in the notification.

However, this provision shall not have effect where the Commission has informed the undertakings or associations of undertakings concerned that, after preliminary examination, it is of the opinion that Article 85(1) of the Treaty applies and that application of Article 85(3) is not justified.

Article 13

Periodic penalty payments

1. By decision, the Commission may impose periodic penalty payments on undertakings or associations of undertakings of from 50 to 1000 ECU per day, calculated from the date appointed by the decision, in order to compel them:

- (a) to put an end to an infringement of Article 85(1) or Article 86 of the Treaty the termination of which has been ordered pursuant to Article 4 of this Regulation;
- (b) to refrain from any act prohibited under Article 6(3);

- (c) to supply complete and correct information which has been requested by decision taken pursuant to Article 9(5);
 - (d) to submit to an investigation which has been ordered by decision taken pursuant to Article 11(3).
2. When the undertakings or associations of undertakings have satisfied the obligation which it was the purpose of the periodic penalty payment to enforce, the Commission may fix the total amount of the periodic penalty payment at a lower figure than that which would result from the original decision.
3. Article 8 shall apply.

Article 14

Review by the Court of Justice

The Court of Justice shall have unlimited jurisdiction within the meaning of Article 172 of the Treaty to review decisions whereby the Commission has fixed a fine or periodic penalty payment; it may cancel, reduce or increase the fine or periodic penalty payment imposed.

Article 15

Unit of account

For the purpose of applying Articles 12 to 14, the ECU shall be [that] adopted in drawing up the budget of the Community in accordance with Articles 207 and 209 of the Treaty.

Article 16

Hearing of the parties and of third persons

1. Before refusing the certificate mentioned in Article 3(2), or taking decisions as provided for in Articles 4, 5(3) second subparagraph and 5(4), 6(3), 12 and 13, the Commission shall give the undertakings or associations of undertakings concerned the opportunity of being heard on the matters to which the Commission takes, or has taken, objection.
2. If the Commission or the competent authorities of the

Member States consider it necessary, they may also hear other natural or legal persons. Applications by such persons to be heard shall be granted when they show a sufficient interest.

3. When the Commission intends to take a decision pursuant to Article 85(3) of the Treaty, it shall publish a summary of the relevant agreement, decision or concerted practice in the *Official Journal of the European Communities* and invite all interested third parties to submit their observations within a period, not being less than one month, which it shall fix. Publication shall have regard to the legitimate interest of undertakings in the protection of their business secrets.

Article 17
Professional secrecy

1. Information acquired as a result of the application of Articles 9 to 11 shall be used only for the purpose of the relevant request or investigation.

2. Without prejudice to the provisions of Articles 16 and 18, the Commission and the competent authorities of the Member States, their officials and other servants shall not disclose information of a kind covered by the obligation of professional secrecy and which has been acquired by them as a result of the application of this Regulation.

3. The provisions of paragraphs 1 and 2 shall not prevent publication of general information or of surveys which do not contain information relating to particular undertakings or associations of undertakings.

Article 18
Publication of decisions

1. The Commission shall publish the decisions which it adopts pursuant to Articles 3(2), 4, 5(3) second subparagraph, 5(4) and 6(3).

2. The publication shall state the names of the parties and the main contents of the decision; it shall have regard

to the legitimate interest of undertakings in the protection of their business secrets.

Article 19
Implementing provisions

The Commission shall have the power to adopt implementing provisions concerning the form, content and other details of complaints pursuant to Article 3, applications pursuant to Articles 3(2) and 5 and the hearings provided for in Article 16(1) and (2).

Article 20
Entry into force

This Regulation shall enter into force on 1 January 1988. This Regulation shall be binding in its entirety and directly applicable in all Member States.
Done at Brussels, 14 December 1987.

For the Council
The President
U. ELLEMANN-JENSEN

List Referred to in Article 2

- (a) the introduction or uniform application of mandatory or recommended technical standards for aircraft, aircraft parts, equipment and aircraft supplies, where such standards are set by an organisation normally accorded international recognition, or by an aircraft or equipment manufacturer;
- (b) the introduction or uniform application of technical standards for fixed installations for aircraft, where such standards are set by an organisation normally accorded international recognition;

- (c) the exchange, leasing, pooling, or maintenance of aircraft, aircraft parts, equipment or fixed installations for the purpose of operating air services and the joint purchase of aircraft parts, provided that such arrangements are made on a non-discriminatory basis;
- (d) the introduction, operation and maintenance of technical communication networks, provided that such arrangements are made on a non-discriminatory basis;
- (e) the exchange, pooling or training of personnel for technical or operational purposes;
- (f) the organisation and execution of substitute transport operations for passengers, mail and baggage, in the event of breakdown/delay of aircraft, either under charter or by provision of substitute aircraft under contractual arrangements;
- (g) the organisation and execution of successive or supplementary air transport operations, and the fixing and application of inclusive rates and conditions for such operations;
- (h) the consolidation of individual consignments;
- (i) the establishment or application of uniform rules concerning the structure and the conditions governing the application of transport tariffs, provided that such rules do not directly or indirectly fix transport fares and conditions;
- (j) arrangements as to the sale, endorsement and acceptance of tickets between air carriers (interlining) as well as the refund, prorating and accounting schemes established for such purposes;
- (k) the clearing and settling of accounts between air carriers by means of a clearing house, including such services as may be necessary or incidental thereto; the clearing and settling of accounts between air carriers and their appointed agents by means of a centralised and automated settlement plan or system, including such services as may be necessary or incidental thereto.

APPENDIX B

COUNCIL REGULATION ON THE APPLICATION OF
ARTICLE 85(3) OF THE ROME TREATY
(GROUP EXEMPTIONS)

COUNCIL REGULATION (EEC) No 3976/87 of
14 December 1987 on the application of
Article 85(3) of the Treaty to certain
categories of agreements and
concerted practices in the air transport sector

THE COUNCIL OF THE EUROPEAN COMMUNITIES,
Having regard to the Treaty establishing the European
Economic Community and in particular Article 87
thereof,

Having regard to the proposal from the Commission¹,
Having regard to the Opinions of the European
Parliament²,

Having regard to the Opinions of the Economic and So-
cial Committee³,

Whereas Council Regulation (EEC) No 3975/87⁴ lays
down the procedure for the application of the rules on
competition to undertakings in the air transport sector;
whereas Regulation No 17 of the Council⁵ lays down the
procedure for the application of these rules to agree-
ments, decisions and concerted practices other than those
directly relating to the provision of air transport services;
Whereas Article 85(1) of the Treaty may be declared inap-
plicable to certain categories of agreements, decisions and
concerted practices which fulfil the conditions contained
in Article 85(3);

Whereas common provisions for the application of Article
85(3) should be adopted by way of Regulation pursuant to

¹ OJ No C 182, 9.7.1984, p. 3.

² OJ No C 262, 14.10.1985, p. 44; OJ No C 190, 20.7.1987, p. 182 and OJ No C 345, 21.12.1987.

³ OJ No C 303, 25.11.1985, p. 31 and OJ No C 333, 29.12.1986, p. 27.

⁴ See page 1 of this Official Journal.

⁵ OJ No 13, 21.2.1962, p. 204/62.

Article 87; whereas, according to Article 87(2)(b), such a Regulation must lay down detailed rules for the application of Article 85(3), taking into account the need to ensure effective supervision, on the one hand, and to simplify administration to the greatest possible extent, on the other; whereas, according to Article 87(2)(d), such a Regulation is required to define the respective functions of the Commission and of the Court of Justice;

Whereas the air transport sector has to date been governed by a network of international agreements, bilateral agreements between States and bilateral and multilateral agreements between air carriers; whereas the changes required to this international regulatory system to ensure increased competition should be effected gradually so as to provide time for the air transport sector to adapt;

Whereas the Commission should be enabled for this reason to declare by way of Regulation that the provisions of Article 85(1) do not apply to certain categories of agreements between undertakings, decisions by associations of undertakings and concerted practices;

Whereas it should be laid down under what specific conditions and in what circumstances the Commission may exercise such powers in close and constant liaison with the competent authorities of the Member States;

Whereas it is desirable, in particular, that block exemptions be granted for certain categories of agreements, decisions and concerted practices; whereas these exemptions should be granted for a limited period during which air carriers can adapt to a more competitive environment; whereas the Commission, in close liaison with the Member States, should be able to define precisely the scope of these exemptions and the conditions attached to them;

Whereas there can be no exemption if the conditions set out in Article 85(3) are not satisfied; whereas the Commission should therefore have power to take the appropriate measures where an agreement proves to have effects incompatible with Article 85(3); whereas the Commission

should consequently be able first to address recommendations to the parties and then to take decisions;

Whereas this Regulation does not prejudge the application of Article 90 of the Treaty;

Whereas the Heads of State and Government, at their meeting in June 1986, agreed that the internal market in air transport should be completed by 1992 in pursuance of Community actions leading to the strengthening of its economic and social cohesion; whereas the provisions of this Regulation, together with those of Council Directive 87/601/EEC of 14 December 1987 on fares for scheduled air services between Member States⁶ and those of Council Decision 87/602/EEC of 14 December 1987 on the sharing of passenger capacity between air carriers on scheduled air services between Member States and on access for air carriers to scheduled air service routes between Member States⁷, are a first step in this direction and the Council will therefore, in order to meet the objective set by the Heads of State and Government, adopt further measures of liberalization at the end of a three year initial period,

HAS ADOPTED THIS REGULATION:

Article 1

This Regulation shall apply to international air transport between Community airports.

Article 2

1. Without prejudice to the application of Regulation (EEC) No 3975/87 and in accordance with Article 85(3) of the Treaty, the Commission may by regulation declare that Article 85(1) shall not apply to certain categories of agreements between undertakings, decisions of associations of undertakings and concerted practices.

2. The Commission may, in particular adopt such regu-

⁶ See p. 12 of this Official Journal.

⁷ See p. 19 of this Official Journal.

lations in respect of agreements, decisions or concerted practices which have as their object any of the following:

- joint planning and co-ordination of the capacity to be provided on scheduled air services, insofar as it helps to ensure a spread of services at the less busy times of the day or during less busy periods or on less busy routes, so long as any partner may withdraw without penalty from such agreements, decisions or concerted practices, and is not required to give more than three months' notice of its intention not to participate in such joint planning and co-ordination for future seasons;
- sharing of revenue from scheduled air services, so long as the transfer does not exceed 1% of the poolable revenue earned on a particular route by the transferring partner, no costs are shared or accepted by the transferring partner and the transfer is made in compensation for the loss incurred by the receiving partner in scheduling flights at less busy times of the day or during less busy periods;
- consultations for common preparation of proposals on tariffs, fares and conditions for the carriage of passengers and baggage on scheduled services, on condition that consultations on this matter are voluntary, that air carriers will not be bound by their results and that the Commission and the Member States whose air carriers are concerned may participate as observers in any such consultations;
- slot allocation at airports and airport scheduling, on condition that the air carriers concerned shall be entitled to participate in such arrangements, that the national and multilateral procedures for such arrangements are transparent and that they take into account any constraints and distribution rules defined by national or international authorities and any rights which air carriers may have historically acquired;
- common purchase, development and operation of computer reservation systems relating to timetabling, reservations and ticketing by air transport undertakings, on condition that air carriers of Member States have access to such systems on equal terms, that participating carriers have their services listed on a non-discriminatory basis

and also that any participant may withdraw from the system on giving reasonable notice;

— technical and operational ground handling at airports, such as aircraft push back, refuelling, cleaning and security;

— handling of passengers, mail, freight and baggage at airports;

— services for the provision of in-flight catering.

3. Without prejudice to paragraph 2, such Commission regulations shall define the categories of agreements, decisions or concerted practices to which they apply and shall specify in particular:

(a) the restrictions or clauses which may, or may not, appear in the agreements, decisions and concerted practices;

(b) the clauses which must be contained in the agreements, decisions and concerted practices, or any other conditions which must be satisfied.

Article 3

Any regulation adopted by the Commission pursuant to Article 2 shall expire on 31 January 1991.

Article 4

Regulations adopted pursuant to Article 2 shall include a provision that they apply with retroactive effect to agreements, decisions and concerted practices which were in existence at the date of the entry into force of such Regulations.

Article 5

Before adopting a regulation, the Commission shall publish a draft thereof and invite all persons and organizations concerned to submit their comments within such reasonable time limit, being not less than one month, as the Commission shall fix.

Article 6

The Commission shall consult the Advisory Committee on Agreements and Dominant Positions in Air Transport established by Article 8(3) of Regulation (EEC) No 3975/87 before publishing a draft regulation and before adopting a regulation.

Article 7

1. Where the persons concerned are in breach of a condition or obligation which attaches to an exemption granted by a regulation adopted pursuant to Article 2, the Commission may, in order to put an end to such a breach:

— address recommendations to the persons concerned;
and

— in the event of failure by such persons to observe those recommendations, and depending on the gravity of the breach concerned, adopt a decision that either prohibits them from carrying out, or requires them to perform, specific acts or, while withdrawing the benefit of the block exemption which they enjoyed, grants them an individual exemption in accordance with Article 4(2) of Regulation (EEC) No 3975/87 or withdraws the benefit of the block exemption which they enjoyed.

2. Where the Commission, either on its own initiative or at the request of a Member State or of natural or legal persons claiming a legitimate interest, finds that in any particular case an agreement, decision or concerted practice to which a block exemption granted by a regulation adopted pursuant to Article 2(2) applies nevertheless has effects which are incompatible with Article 85(3) or are prohibited by Article 86, it may withdraw the benefit of the block exemption from those agreements, decisions or concerted practices and take, pursuant to Article 13 of Regulation (EEC) No 3975/87, all appropriate measures for the purpose of bringing these infringements to an end.

3. Before taking a decision under paragraph 2, the Commission may address recommendations for termination of the infringement to the persons concerned.

Article 8

The Council shall decide on the revision of this Regulation by 30 June 1990 on the basis of a Commission proposal to be submitted by 1 November 1989.

Article 9

This Regulation shall enter into force on 1 January 1988. This Regulation shall be binding in its entirety and directly applicable in all Member States,
Done at Brussels, 14 December 1987.

For the Council

The President

U. ELLEMANN-JENSEN

APPENDIX C

COUNCIL DIRECTIVE ON SCHEDULED AIR FARES

COUNCIL DIRECTIVE of 14 December 1987
on fares for scheduled air services between
Member States
(87/601/87)

THE COUNCIL OF THE EUROPEAN COMMUNITIES,
Having regard to the Treaty establishing the European
Economic Community, and in particular Articles 84(2)
and 227(2) thereof,

Having regard to the proposal from the Commission¹,
Having regard to the Opinions of the European
Parliament²,

Having regard to the Opinion of the Economic and Social
Committee³,

Whereas more flexible procedures for approving sched-
uled passenger air fares for air services between Member
States will give air carriers greater scope to develop mar-
kets and better meet consumer needs;

Whereas air carriers should be encouraged to control
their costs, increase productivity and provide efficient and
attractively priced air services;

Whereas common rules should be established laying
down criteria for the approval of air fares;

Whereas, by virtue of Article 189 of the Treaty, Member
States may choose the most appropriate means of imple-
menting the provisions of the Directive, and in particular
may apply the criteria laid down in Article 3 more
precisely;

Whereas procedures should be established for the sub-
mission by air carriers of proposed air fares and their ex-
press or automatic approval by the Member States
concerned; whereas air carriers should be free to propose

¹ OJ No C 78, 30.3.1982, p. 6

² OJ No C 322, 28.11.1983, p. 10 and OJ No C 345, 21.12.1987.

³ OJ No C 77, 21.3.1983, p. 26.

air fares individually or after consultation with other air carriers for the purpose, in particular, of fixing the terms of interlining agreements, given the important benefits which they confer;

Whereas provision should be made for rapid consultation between Member States in the case of any disagreement and for procedures for settling such disagreements regarding approval of fares as are not resolved by consultations;

Whereas provision should be made for the regular consultation of consumer groups on matters relating to air fares; Whereas the Heads of State and Government, at their meeting in June 1986, agreed that the internal market in air transport should be completed by 1992 in pursuance of Community actions leading to the strengthening of its economic and social cohesion; whereas the provisions of this Directive on fares are a first step in this direction and the Council will therefore, in order to meet the objective set by the Heads of State and Government, adopt further measures of liberalization in respect of air fares at the end of a three year initial period,

HAS ADOPTED THIS DIRECTIVE:

SCOPE AND DEFINITIONS

Article 1

This Directive shall apply to criteria and procedures to be applied with respect to the establishment of scheduled air fares charged on any route between an airport in one Member State and an airport in another Member State. This Directive shall not apply to the overseas departments referred to in Article 227(2) of the Treaty.

Article 2

For the purposes of this Directive:

- (a) scheduled air fares means the prices to be paid in the applicable national currency for the carriage of passengers and baggage on scheduled air services and

the conditions under which those prices apply, including remuneration and conditions offered to agency and other auxiliary services;

- (b) zone of flexibility means a pricing zone as referred to in Article 5, within which air fares meeting the conditions in Annex II qualify for automatic approval by the aeronautical authorities of the Member States. The limits of a zone are expressed as percentages of the reference fare;
- (c) reference fare means the normal economy air fare charged by a third- or fourth-freedom air carrier on the routes in question; if more than one such fare exists, the average level shall be taken unless otherwise bilaterally agreed; where there is no normal economy fare, the lowest fully flexible fare shall be taken;
- (d) air carrier means an air transport enterprise with a valid operating licence to operate scheduled air services;
- (e) a third-freedom air carrier means an air carrier having the right to put down, in the territory of another State, passengers, freight and mail taken up in the State in which it is registered;
a fourth-freedom air carrier means an air carrier having the right to take on, in another State, passengers, freight and mail for off-loading in its State of registration;
a fifth-freedom air carrier means an air carrier having the right to undertake the commercial air transport of passengers, freight and mail between two States other than its State of registration;
- (f) Community air carrier means:
 - (i) an air carrier which has its central administration and principal place of business in the Community, the majority of whose shares are owned by nationals of Member States and/or Member States and which is effectively controlled by such persons or States, or
 - (ii) an air carrier which, although it does not meet

the definition set out in (i), at the time of adoption of this Directive:

- A. either has its central administration and principal place of business in the Community and has been providing scheduled or non-scheduled air services in the Community during the 12 months prior to adoption of this Directive,
- B. or has been providing scheduled services between Member States on the basis of the third- and fourth-freedoms of the air during the 12 months prior to adoption of this Directive.

The enterprises which meet the above criteria are listed in Annex I;

- (g) States concerned mean the Member States between which the scheduled air service in question is operated;
- (h) scheduled air service means a series of flights each possessing all the following characteristics:
 - (i) it passes through the air space over the territory of more than one Member State;
 - (ii) it is performed by aircraft for the transport of passengers or passengers and cargo and/or mail for remuneration, in such a manner that on each flight seats are available for purchase by members of the public (either directly from the air carrier or from its authorized agents);
 - (iii) it is operated so as to serve traffic between the same two or more points, either
 - 1) according to a published timetable, or
 - 2) with flights so regular or frequent that they constitute a recognisably systematic series;
- (i) flight means a departure from a specified airport towards a specified destination.

*CRITERIA**Article 3*

Without prejudice to Article 5(2), Member States shall approve air fares if they are reasonably related to the long-term fully allocated costs of the applicant air carrier, while taking into account other relevant factors. In this connection, they shall consider the needs of consumers, the need for a satisfactory return on capital, the competitive market situation, including the fares of the other air carriers operating on the route, and the need to prevent dumping. However, the fact that a proposed air fare is lower than that offered by another air carrier operating on the route shall not be sufficient reason for withholding approval.

*PROCEDURES**Article 4*

1. Air fares shall be subject to approval by the aeronautical authorities of the States concerned. To this end, an air carrier shall submit its fares in the forms prescribed by those authorities.

This shall be done either:

- (a) individually, or
- (b) following consultations with other air carriers, provided that such consultations comply with the requirements of regulations issued pursuant to Council Regulation (EEC) No 3976/87 of 14 December 1987 on the application of Article 85(3) of the Treaty to certain categories of agreements and concerted practices in the air transport sector.⁴

Aeronautical authorities shall not require air carriers to submit their fares for approval more than 60 days before they come into effect.

2. Subject to Article 5, and without prejudice to Article 6, fares shall require approval by both the States concerned. If neither of the aeronautical authorities has ex-

⁴ See p. 9 of this Official Journal.

pressed disapproval within 30 days of the date of submission of a fare, it shall be considered as approved.

3. An air fare, once approved, shall remain in force until it expires or is replaced. It may however be prolonged after its original date of expiry for a period not exceeding 12 months.

4. A Member State shall permit an air carrier of another Member State operating a direct or indirect scheduled air service, on giving due notice, to match an air fare already approved between the same city pairs. This provision shall not apply to indirect services which exceed the length of the shortest direct service by more than 20%.

5. Only third- and fourth-freedom air carriers shall be permitted to act as price leaders.

Article 5

1. There shall be two zones of flexibility on any scheduled air service as follows:

- a discount zone which shall extend from 90% to more than 65% of the reference fare;
- a deep-discount zone which shall extend from 65% to 45% of the reference fare;

2. Within zones of flexibility, the States concerned shall permit third- or fourth-freedom air carriers to charge discount and deep-discount air fares of their own choice subject to the respective conditions set out in Annex II and provided those air fares have been filed with the States concerned at least 21 days prior to the proposed date for their entry into force.

3. If a fare which has been, or is, approved under the bilateral approval regime and which, as far as its conditions are concerned, qualifies for automatic approval in the deep-discount zone, is below the floor of that zone, there shall be additional flexibility as to the level of that fare. Such additional flexibility shall extend from 10% below the bilaterally approved level of that fare to the ceiling of the deep-discount zone.

A fare which is entitled to additional flexibility in accord-

ance with this paragraph shall be renewed in successive fare seasons at the request of the air carrier concerned at a level not lower than the percentage of the reference fare at which it stood at the end of the previous fare season, any change in level of the reference fare being duly taken into account. For the purpose of this paragraph, summer and winter fare seasons shall be treated separately.

Article 6

This Directive shall not prevent Member States from concluding arrangements which are more flexible than the provisions of Articles 4 and 5 or from maintaining such arrangements in force.

Article 7

1. When a State concerned (the first State) decides, in conformity with the above Articles, not to approve a scheduled air fare, it shall inform the other State concerned (the second State) in writing within 21 days of the fare being filed, stating its reasons.

2. If the second State disagrees with the decision of the first State, it shall so notify the first State within seven days of being informed, providing the information on which its decision is based, and request consultations. Each State shall supply all relevant information requested by the other. Either of the States concerned may request that the Commission be represented at the consultations.

3. If the first State has insufficient information to reach a decision on the fare, it may request the second State to enter into consultations before the expiry of the 21-day period prescribed in paragraph 1.

4. Consultations shall be completed within 21 days of being requested. If disagreement still persists at the end of this period, the matter shall be put to arbitration at the request of either of the States concerned. The two States concerned may agree to prolong the consultations or to proceed directly to arbitration without consultations.

5. Arbitration shall be carried out by a panel of three

arbitrators unless the States concerned agree on a single arbitrator. The States concerned shall each nominate one member of the panel and seek to agree on the third member (who shall be a national of a third Member State and act as panel chairman). Alternatively they may nominate a single arbitrator. The appointment of the panel shall be completed within seven days. A panel's decisions shall be reached by a majority of votes.

6. In the event of failure by either State concerned to nominate a member of the panel or to agree on the appointment of a third member, the Council shall be informed forthwith and its President shall complete the panel within three days. In the event of the Presidency being held by a Member State which is party to the dispute, the President of the Council shall invite the Government of the next Member State due to hold the Presidency and not party to the dispute to complete the panel.

7. The arbitration shall be completed within a period of 21 days of completion of the panel or nomination of the single arbitrator. The States concerned may, however, agree to extend this period. The Commission shall have the right to attend as an observer. The arbitrators shall make clear the extent to which the award is based on the criteria in Article 3.

8. The arbitration award shall be notified immediately to the Commission.

Within a period of 10 days, the Commission shall confirm the award, unless the arbitrators have not respected the criteria set out in Article 3 or the procedure laid down by the Directive or the award does not comply with Community law in other respects.

In the absence of any decision within this period, the award shall be regarded as confirmed by the Commission. An award confirmed by the Commission shall become binding on the States concerned.

9. During the consultation and arbitration procedure, the relevant existing air fares shall be continued in force

until the procedure has expired and any new fare has entered into force.

GENERAL PROVISIONS

Article 8

At least once a year, the Commission shall consult on air fares and related matters with representatives of air transport user organizations in the Community, for which purpose the Commission shall supply appropriate information to the participants.

Article 9

1. By 1 November 1989, the Commission shall publish a report on the application of this Directive, which shall include statistical information on the cases in which Article 7 has been invoked.
2. Member States and the Commission shall co-operate in the application of this Directive, particularly as regards the collection of the information referred to in paragraph 1.
3. Confidential information obtained in application of this Directive shall be covered by professional secrecy.

Article 10

Where a Member State has concluded an agreement with one or more non-member countries which gives fifth-free-dome rights for a route between Member States to an air carrier of a non-member country, and in this respect contains provisions which are incompatible with this Directive, the Member State shall, at the first opportunity, take all appropriate steps to eliminate such incompatibilities. Until such time as the incompatibilities have been eliminated, this Directive shall not affect the rights and obligations vis-à-vis non-member countries arising from such an agreement.

Article 11

1. After consultation with the Commission, the Member

States shall take the necessary steps to comply with this Directive by 31 December 1987.

2. Member States shall communicate to the Commission all the laws, regulations and administrative provisions which they adopt for the application of this Directive.

Article 12

The Council shall decide on the revision of this Directive by 30 June 1990, on the basis of a Commission proposal to be submitted by 1 November 1989.

Article 13

This Directive is addressed to the Member States.

Done at Brussels, 14 December 1987

For the Council

The President

U. ELLEMANN-JENSEN

ANNEX I

AIRLINES REFERRED TO IN ARTICLE (2)(f)(ii)

The following airlines meet the criteria referred to in Article 2(f)(ii) as long as they are recognized as a national carrier by the Member State which so recognizes them at the time of the adoption of this Directive:

- Scandinavian Airlines System
 - Britannia Airways
 - Monarch Airlines
-

*ANNEX II**CONDITIONS FOR DISCOUNT AND DEEP-DISCOUNT
FARES**DISCOUNT ZONE*

1. To qualify for the discount zone all of the following conditions must be met:

- (a) round or circle trip;
- (b) maximum stay of six months; and either
- (c) minimum stay of not less than Saturday night or six nights or
- (d) if off-peak (as defined in the Appendix) advance purchase of not fewer than 14 days; reservation for the entire trip, ticketing and payment to be made at the same time; cancellation or change of reservation only available prior to departure of outbound travel and at a fee of at least 20% of the price of the ticket.

DEEP-DISCOUNT ZONE

2. To qualify for the deep-discount zone, a fare must meet:

— either conditions 1(a), (b) and (c) and one of the following conditions:

- (a) reservation for the entire trip, ticketing and payment to be made at the same time; cancellation or change of reservation only available prior to departure of outbound travel and at a fee of at least 20% of the price of the ticket;
- (b) mandatory advance purchase of not fewer than 14 days; reservation for the entire trip, ticketing and payment to be made at the same time; cancellation or change of reservation only available prior to departure of outbound travel and at a fee of at least 20% of the price of the ticket;
- (c) purchase of the ticket only permitted on the day prior to departure of outbound travel; reservation

to be made separately for both the outbound and inbound journeys and only in the country of departure on the day prior to travel on the respective journeys;

- (d) passenger to be aged not more than 25 years or not less than 60 years;
- or, if off-peak (as defined in the Appendix), conditions 1(a) and (b) together with:
- either condition 2(b) and one of the following conditions:
 - (e) passenger to be aged not more than 25 years or not less than 60 years;
 - (f) father and/or mother with children aged not more than 25 years travelling together (minimum 3 persons);
 - (g) 6 or more persons travelling together with cross-referenced tickets;
- or
- (h) mandatory advance purchase of not fewer than 28 days; reservation for the entire trip, ticketing and payment to be made at the same time; cancellation or change of reservation only available:
 - if more than 28 days before outbound travel, at a fee of at least 20% of the price of the ticket, or
 - if fewer than 28 days before outbound travel, at a fee of at least 50% of the price of the ticket.

APPENDIX

Definition of "off-peak"

An air carrier may designate certain flights as "off-peak" on the basis of commercial considerations.

When an air carrier wishes to use condition 1(d) or any of conditions 2(e) to (h), identification of the off-peak flights for each route shall be agreed between the aeronautical

authorities of the Member States concerned on the basis of the proposal made by that air carrier.

On each route where the total activity of third- and fourth-freedom air carriers reaches a weekly average of 18 return flights, the air carriers concerned shall be allowed as a minimum to apply conditions 1(d) or 2(e) to (h) on up to 50% of its total daily flights, provided that the flights to which these conditions may be applied depart between 10.00 and 16.00 or between 21.00 and 06.00.

APPENDIX D

COUNCIL DECISION ON CAPACITY SHARING AND
MARKET ACCESSCOUNCIL DECISION
of 14 December 1987

on the sharing of passenger capacity between
air carriers on scheduled air services
between Member States and access
for air carriers to scheduled service routes
between Member States
(87/602/87)

THE COUNCIL OF THE EUROPEAN COMMUNITIES,
Having regard to the Treaty establishing the European
Economic Community, and in particular Articles 84(2)
and 227(2) thereof,

Having regard to the proposal from the Commission,¹

Having regard to the Opinions of the European
Parliament,²

Having regard to the Opinion of the Economic and Social
Committee,³

Whereas flexibility and competition in the Community air
transport system should be increased;

Whereas the artificial constraints imposed on the capacity
which air carriers may provide and on their access to the
market should therefore be relaxed;

Whereas, taking into account the competitive market situ-
ation, provision should be made to prevent unjustifiable
economic effects on air carriers; whereas Member States
should accordingly be able to intervene if the capacity
share of their carriers in a bilateral relationship would
otherwise fall below a given percentage;

Whereas increased market access will stimulate the devel-
opment of the Community air transport sector and give

¹ OJ No C 182, 9.7.1984, p. 1.

² OJ No C 262, 14.10.1985, p. 44, and OJ No C 345, 21.12.1987.

³ OJ No C 303, 25.11.1985, p. 31.

rise to improved services for users; whereas, however, in order to prevent undue disturbance of existing air traffic systems and to allow time for adaptation, it is appropriate to provide for some limitations on market access;

Whereas it is necessary to ensure that such limitations do not give an unfair advantage to any one air carrier;

Whereas it is necessary, in order to achieve a balanced set of opportunities, and taking account of the provisions of the measures as a whole, to redress the economic disadvantages of air carriers established in the peripheral Member States of the Community;

Whereas it is necessary, in particular, not to apply the opening of routes between hub airports of one State and regional airports of another State to a certain number of airports for reasons relating to airport infrastructure and in order to secure a gradual development of the Community policy of liberalization avoiding negative effects on the Community air transport system;

Whereas arrangements for greater cooperation over the use of Gibraltar airport were agreed in London on 2 December 1987 by the Kingdom of Spain and the United Kingdom in a joint declaration by the Ministers of Foreign Affairs of the two countries, and such arrangements have yet to come into operation;

Whereas air carriers should be free from any State obligation to enter into agreements with other air carriers in respects of capacity and market access;

Whereas the Heads of State and Government, at their meeting in June 1986, agreed that the internal market in air transport should be completed by 1992 in pursuance of Community actions leading to the strengthening of its economic and social cohesion; whereas the provisions of this Decision on capacity sharing and market access are a first step in this direction and the Council will therefore, in order to meet the objective set by the Heads of State and Government, adopt further measures of liberalization in respect of capacity sharing and market access including

new fifth-freedom traffic rights between Community airports at the end of a three year initial period,

HAS ADOPTED THIS DECISION :

SCOPE AND DEFINITIONS

Article 1

1. This Decision concerns:
 - (a) the sharing of passenger capacity between the air carrier(s) of one Member State and the air carrier(s) of another Member State on scheduled air services between these States;
 - (b) access for Community air carrier(s) to certain routes between Member States which they do not already operate.
2. This Decision shall not affect the relationship between a Member State and its own air carriers respecting capacity sharing and market access.
3. This Decision shall not apply to the overseas departments referred to in Article 227(2) of the Treaty.
4. Articles 3 and 4 shall not apply to those services subject to Council Directive 83/416/EEC of 25 July 1983 concerning the authorization of scheduled inter-regional air services for the transport of passengers, mail and cargo between Member States,⁴ as amended by Directive 86/216/EEC.⁵
5. The application of this Decision to the airport of Gibraltar is understood to be without prejudice to the respective legal positions of the Kingdom of Spain and the United Kingdom with regard to the dispute over sovereignty over the territory in which the airport is situated.
6. Application of the provisions of this Decision to Gibraltar airport shall be suspended until the arrangements in the joint declaration made by the Foreign Ministers of the Kingdom of Spain and the United Kingdom on 2 De-

⁴ OJ No L 237, 26.8.1983, p. 19.

⁵ OJ No L 152, 6.6.1986, p. 47.

cember 1987 have come into operation. The Governments of Spain and the United Kingdom will so inform the Council on that date.

Article 2

For the Purpose of this Decision:

- (a) capacity shall be expressed as the number of seats offered to the general public on a scheduled air service over a given period;
- (b) capacity share means the share of the air carrier(s) of a Member State expressed as a percentage of the total capacity in a bilateral relationship with another Member State, excluding any capacity provided under the provisions of Article 6(3) or under the terms of Directive 83/416/EEC and also any capacity provided by a fifth-freedom air carrier;
- (c) air carrier means an air transport enterprise with a valid operating license to operate scheduled air services;
- (d) a third-freedom air carrier means an air carrier having the right to put down, in the territory of another State, passengers, freight and mail taken up in the State in which it is registered;
a fourth-freedom air carrier means an air carrier having the right to take on, in another State, passengers, freight and mail, for off-loading in its State of registration;
a fifth-freedom air carrier means an air carrier having the right to undertake the commercial air transport of passengers, freight and mail between two States other than its State of registration;
- (e) States concerned mean the Member States between which the scheduled air service in question is operated;
- (f) Community air carrier means
 - (i) an air carrier which has its central administration and principal place of business in the Community, the majority of whose shares are

- owned by nationals of Member States and/or Member States and which is effectively controlled by such persons or States, or
- (ii) an air carrier which, although it does not meet the definition set out in (i) at the time of adoption of this Decision:
 - A. either has its central administration and principal place of business in the Community and has been providing scheduled or non-scheduled air services in the Community during the 12 months prior to adoption of this Decision;
 - B. or has been providing scheduled services between Member States on the basis of the third and fourth freedoms of the air during the 12 months prior to adoption of this Decision.

The enterprises which meet the above criteria are listed in Annex I.

- (g) scheduled air service means a series of flights each possessing all the following characteristics:
 - (i) it passes through the air space over the territory of more than one Member State;
 - (ii) it is performed by aircraft for the transport of passengers or passengers and cargo and/or mail for remuneration, in such a manner that on each flight seats are available for purchase by members of the public (either directly from the air carrier or from its authorized agents);
 - (iii) it is operated so as to serve traffic between the same two or more points, either
 - (1) according to a published time-table, or
 - (2) with flights so regular or frequent that they constitute a recognizably systematic series;
- (h) flight means a departure from a specified airport towards a specified destination;
- (i) multiple designation on a country-pair basis means

the designation by one Member State of two or more of its air carriers to operate scheduled air services between its territory and that of another Member State;

- (j) multiple designation on a city-pair basis means the designation by one Member State of two or more of its air carriers to operate a scheduled air service between an airport or airport system in its territory and an airport or airport system in the territory of another Member State;
- (k) hub airport means an airport included in the list in Annex II as a category 1 airport; regional airport means a category 2 or 3 airport as listed in Annex II;
- (l) airport system means two or more airports grouped together as serving the same city.

SHARES OF CAPACITY

Article 3

1. In the period between 1 January 1988 and 30 September 1989, a Member State shall allow any third- and fourth-freedom air carriers(s) authorized by the States concerned under the arrangements in force between them to operate routes between their territories to adjust capacity provided that the resulting capacity shares are not outside the range 55%:45%.

2. Unless a different decision is taken under Article 4, the range within which a Member State shall allow the air carrier(s) of another Member State to increase its (their) capacity share shall be extended to 60:40% from 1 October 1989.

3. In applying the provisions of paragraphs 1 and 2, unilateral cut-backs in capacity shall not be taken into account. In such cases, the basis for the calculation of capacity shares shall be the capacity offered in the previous corresponding seasons by the air carrier(s) of the Member State which has (have) reduced its (their) capacity.

4. Adjustments within the 55%:45% range or the

60%:40% range, as appropriate, shall be permissible in any given season, under the following conditions:

- (a) after the first automatic approval, the air carrier(s) of the Member State offering less capacity shall be authorized to increase its (their) own capacity up to the limit of the capacity approved for the air carrier(s) of the Member State offering the larger capacity;
- (b) if the latter air carrier(s) choose(s) to react to the above mentioned increase, it (they) shall receive automatic approval for one further increase, up the level of its (their) first capacity filing(s) for that season, within the applicable range;
- (c) the carrier(s) of the Member State offering less capacity will then receive automatic approval for one increase up to the matching level;
- (d) any further increases during that season shall be subject to the applicable bilateral provisions between the two Member States concerned.

Article 4

1. At the request of any Member State for which the application of Article 3(1) has led to serious financial damage for its air carrier(s), the Commission will carry out a review before 1 August 1989 and, on the basis of all relevant factors, including the market situation, the financial position of the carrier(s) and the capacity utilisation achieved, will take a decision on whether the provisions of Article 3(2) should be applied in full or not.

2. The Commission shall communicate its decision to the Council which, acting by unanimity, may take a different decision within a period of two months of this communication.

MULTIPLE DESIGNATION

Article 5

1. A Member State shall accept multiple designation on a country-pair basis by another Member State but, subject

to paragraph 2, shall not be obliged to accept the designation of more than one air carrier on any one route.

2. A Member State shall also accept multiple designation on a city-pair basis by another Member State:

— in the first year after the notification of this Decision, on routes on which more than 250,000 passengers were carried in the preceding year;

— in the second year, on routes on which more than 200,000 passengers were carried in the preceding year or on which there are more than 1200 return flights per annum;

— in the third year, on routes on which more than 180,000 passengers were carried in the preceding year or on which there are more than 1000 return flights per annum.

3. The provisions of this Article are subject to those in Articles 3 and 4.

ROUTES BETWEEN HUB AND REGIONAL AIRPORTS

Article 6

1. Subject to the provisions of Articles 3, 4 and 5, Community air carriers shall be permitted to introduce third or fourth freedom scheduled air services between category 1 airports or airport systems in the territory of one Member State and regional airports in the territory of another Member State. Airport categories are listed in Annex II.

2. (i) The provisions of paragraph 1 shall not apply:

- (a) to regional airports exempted from the provisions of Directive 83/416/EEC;
- (b) for the duration of this Decision to:
 - the following airports which, at the time of notification of this Decision, handle fewer than 100,000 passengers per annum on international scheduled air services:

Aalborg,	Seville,
Bergamo,	Skrydstrup,
Billund,	Sønderborg,
Bologna,	Stauning,
Esbjerg,	Thisted,
Karup,	Tirstrup,
Odense,	

- the following airports or airport systems which at the time of the notification of this Decision meet the criteria set out in Article 9:

Barcelona,
Malaga,
Milan-Linate/Malpensa.

- (ii) In addition, in order to prevent major disturbance of existing air traffic systems and to allow time for adaptation, the following airports shall also be excluded from the provisions of paragraph 1 for the duration of this Decision:

Alicante,	Salonica-Micra,
Athens,	Turin,
Bilbao,	Valencia,
Genoa,	Venice.

3. Articles 3 and 4 shall not apply to services between an airport in category 1 and a regional airport which are provided by aircraft with not more than 70 passenger seats.

4. Where an air carrier of one Member State has been authorized in accordance with this Article to operate a scheduled air service, the State of registration of that air carrier shall raise no objection to an application for the introduction of a scheduled air service on the same route by an air carrier of the other State concerned.

5. The provisions of this Article shall not affect a Member State's right to regulate the distribution of traffic between the airports within an airport system.

*COMBINATION OF POINTS**Article 7*

1. In operating scheduled air services to or from two or more points in another Member State or States, a third- or fourth- freedom Community air carrier shall, subject to the provisions of Articles 3, 4 and 5, be permitted to combine scheduled air services, provided that no traffic rights are exercised between the combined points.
2. The provisions of paragraph 1 shall not apply within Spanish territory during the period of validity of this decision. Similarly, air carriers registered in Spain may not avail themselves of those provisions during that period.

*FIFTH-FREEDOM RIGHTS**Article 8*

1. Without prejudice to Article 6(2), a Community air carrier shall be permitted to operate a fifth-freedom scheduled air service where third- or fourth-freedom traffic rights exist, provided that the service meets the following conditions:
 - (a) it is authorized by the State of registration of the Community air carrier concerned;
 - (b) it is operated as an extension of a service from, or as a preliminary of a service to, its State of registration;
 - (c) without prejudice to paragraph 2, it is operated between two airports at least one of which is not a category 1 airport; and
 - (d) not more than 30% of the carrier's annual capacity on the route concerned may be used for the carriage of fifth-freedom passengers.
2. Subject to paragraphs 1(a), (b) and (d), Ireland and Portugal may each select one category 1 airport in each of the other Member States and may each designate an air carrier to carry fifth-freedom traffic on services between those airports, provided that neither of the air carriers so designated may exercise such rights at any one airport on more than one such route. The Member States concerned

need not designate the same carrier for all routes but may for this purpose designate only one carrier to each other Member State.

3. This Article shall not apply during the period of validity of this Decision to routes to or from Spanish territory. Similarly, during the same period air carriers registered in Spain may not claim fifth-freedom rights on the basis of the provisions in this Article.

GENERAL PROVISIONS

Article 9

Notwithstanding Articles 5 to 8, a Member State shall not be obliged to authorize a scheduled air service in cases where:

- (a) the airport concerned in that State has insufficient facilities to accommodate the service;
- (b) navigational aids are insufficient to accommodate the service.

Article 10

1. This Decision shall not prevent Member States from concluding arrangements which are more flexible than the provisions of this Decision or from maintaining such arrangements in force.

2. The provisions of this Decision shall not be used to make existing capacity or market access arrangements more restrictive.

Article 11

Member States shall not require air carriers to enter into agreements or arrangements with other air carriers relating to any of the provisions of this Decision, nor shall they forbid them to do so.

Article 12

1. After consultation with the Commission, Member

States shall take the necessary steps to comply with this Decision not later than 31 December 1987.

2. Member States shall communicate to the Commission all the laws, regulations and administrative provisions which they adopt for the application of this Decision.

Article 13

1. Before 1 November 1989, and every two years thereafter, the Commission shall publish a report on the implementation of this Decision.

2. Member States and the Commission shall cooperate in implementing this Decision, particularly as regards collection of information for the report referred to in paragraph 1.

3. Confidential information obtained within the framework of the implementation of this Decision shall be covered by professional secrecy.

Article 14

The Council shall decide on the revision of this Decision by 30 June 1990 at the latest, on the basis of a Commission proposal to be submitted by 1 November 1989.

Article 15

This Decision is addressed to the Member States.

Done at Brussels, 14 December 1987

For the Council

The President

U. ELLEMANN-JENSEN

ANNEX I

AIR CARRIERS REFERRED TO IN ARTICLE 2(f)(ii)

The following air carriers meet the criteria referred to in Article 2(f)(ii) as long as they are recognized as national carriers by the Member State which so recognizes them at the time of the adoption of this Decision:

- Scandinavian Airlines System,
- Britannia Airways,
- Monarch Airlines.

ANNEX II

LIST OF AIRPORT CATEGORIES

<i>Category 1</i>	BELGIUM:	Brussels-Zaventem
	DENMARK:	Copenhagen-Kastrup/Roskilde
	GERMANY:	Frankfurt/Rhein-Main, Düsseldorf-Lohausen Munich-Riem
	SPAIN:	Palma-Mallorca, Madrid-Barajas Malaga, Las Palmas
	GREECE:	Athens-Hellinikon, Salonika-Micra
	FRANCE:	Paris-Charles de Gaulle/Orly
	IRELAND:	Dublin
	ITALY:	Rome-Fiumicino/Ciampino, Milan-Linate/Malpensa
	NETHERLANDS:	Amsterdam-Schiphol
	PORTUGAL:	Lisbon, Faro
	UNITED KINGDOM:	London-Heathrow/ Gatwick/Stansted, Luton
<i>Category 2</i>	GERMANY:	Hamburg-Fuhlsbüttel, Stuttgart-Echterdingen, Cologne/Bonn
	SPAIN:	Tenerife-Sur, Barcelona, Ibiza, Alicante,

	Gerona
FRANCE:	Marseilles-Marignane, Nice-Côte d'Azur, Lyon-Satolas, Basle-Mulhouse
IRELAND:	Shannon
ITALY:	Naples-Capodichino, Venice-Tessera, Catania-Fontanarossa
LUXEMBURG:	Luxemburg-Findel
PORTUGAL:	Funchal, Oporto
UNITED KINGDOM:	Manchester-Ringway, Birmingham-Elmdon, Glasgow-Abbotsinch
Category 3	All other airports officially open to international scheduled services.;