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Learning to Fly: The European Commission Enters Unfamiliar Skies in Its Review of the British Airways-American Airlines Alliance

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LEARNING TO FLY: THE EUROPEAN COMMISSION ENTERS UNFAMILIAR SKIES IN ITS REVIEW OF THE BRITISH AIRWAYS-AMERICAN AIRLINES ALLIANCE

G. Porter Elliott*

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I. INTRODUCTION

On June 11, 1996, British Airways' (BA) Chief Executive Robert Ayling and American Airlines' (AA) President Donald Carty stood side-by-side against the backdrop of London's Waldorf Hotel with British and American flags draped over their shoulders. As the media gathered, they unveiled the most significant airline alliance to date and boldly predicted prompt regulatory approval. Smiling coolly amidst the swarming onlookers of the West End theatre district, the two executives seemed unsuspecting of the long ordeal to follow, that the fate of their alliance would rest not just with the regulators in Washington and London, but with those in Brussels as well. They could not have anticipated that more than two years later, with billions of dollars of potential revenue lost, the alliance would remain grounded.

On July 30, 1998, twenty-five months after learning of the proposed alliance between British Airways and American Air-

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2 See id., supra note 1.
3 See id.
4 American Airlines predicted that the deal could generate as much as US $4 billion a year in new revenues. See id.
5 A writer with the Wall Street Journal Europe referred to the period of inactivity caused by the two-year review as "one of the longest and costliest airline delays in history." Id. The agreement between BA and AA was concluded on June 11, 1996, and notified to the European Commission (Commission) shortly thereafter. The Commission decided to initiate proceedings on July 3, 1996, and issued a notice inviting interested parties to comment on October 2, 1996. See Commis-
lines, the European Commission finally published a notice indicating conditions under which it would be willing to approve the partnership. Although negotiations are still continuing, the notice signaled a potential conclusion to one of the most intriguing cases in recent years, from both an antitrust and a constitutional law perspective. The Commission’s review of the BA-AA alliance set the stage for a battle of competences, the outcome of which will shape the future of competition in transatlantic air transport and of diplomatic relations in the area.

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6 The European Commission is the main executive body of the European Community (EC). The Council of Ministers (Council) consists of representatives from the Member States and is the Community’s main legislative body. For those readers wishing for a more general background on the Community and its institutions, there is an abundance of books on the subject. See, e.g., DERRICK WYATT & ALAN DASHWOOD, WYATT AND DASHWOOD’S EUROPEAN COMMUNITY LAW (3d ed. 1993).

7 See Commission Notice Concerning the Alliance Agreement Between British Airways and American Airlines, 1998 O.J. (C 239) 10. This notice expresses the “preliminary opinion of the Commission . . . that the Agreement in its entirety infringes Article 85 and, as far as the hub-to-hub routes are concerned, Article 86 if implemented without the measures envisaged by the Commission.” See id. The Commission’s decision, pending the parties’ acceptance of the conditions and any further negotiations between the parties and the Commission, is still forthcoming. Many newspapers and journals published general aspects of the Commission’s proposed conditions as soon as they were publicly announced on July 8, 1998, by the Commission’s press services. See, e.g., Laurence Zuckerman, Europeans Act to Clear Way for Air Pacts, Conditionally, N.Y. TIMES, July 9, 1998, at D1; Don Phillips, EU Sets Terms for Airline Deal, WASH. POST, July 9, 1998, at A9; EC Details American-BA, United-Lufthansa-SAS Conditions, AVIATION DAILY, July 9, 1998, at 53.

8 See infra Part II.C.3.

9 The commercial aviation sector is quickly consolidating, with four very large alliances emerging from the pack:
(1) British Airways-American Airlines (with members Cathay Pacific, Canadian, Qantas, and Iberia, this alliance will be known as “Oneworld.”);
(2) The Star Alliance (Lufthansa, United, Scandinavian Airline System (SAS), Air Canada, Thai Airlines, and Varig);
(3) Delta, Swissair, Sabena, and Austrian; and
(4) KLM, Northwest.
Despite having based its review of the BA-AA alliance on a virtually obsolete treaty provision,\textsuperscript{11} the Commission refused to acknowledge its relative legal impotence, remaining resolute amidst challenges to its competence from two of the world's premier commercial airlines\textsuperscript{12} and two of the most established anti-

\textsuperscript{10} As investigations of alliances involving third country routes such as BA-AA and the Star Alliance involve concurrent reviews by the Commission and the Member States involved, relations between the Commission and Member States are likely to be strained. In addition, the relations between the Community and the United States are also at stake. Transatlantic alliances being reviewed by the Commission and the Member States concerned are in most cases being reviewed concurrently by the United States Department of Transportation, whose philosophy on how best to ensure effective competition has frequently differed with that of the Commission. See, e.g., Michael Skapinker, \textit{US Defends Alliances' Rights to Air Routes}, \textit{FIN. TIMES}, May 4, 1998, at 1. Charles Hunnicutt, U.S. Assistant Secretary of Transportation for Aviation and International Affairs, criticized EC Competition Commissioner Karel Van Miert's proposal to require the BA-AA alliance to limit flights on certain routes where they would be dominant in order to allow other airlines to offer competing services. Mr. Hunnicutt was quoted as saying that "[i]mposing reductions and freezes on network carriers' capacity will exert upward pressure on fares . . . especially for business passengers." Michael Skapinker, \textit{Rival Regulators in EU and US Air Their Differences}, \textit{FIN. TIMES LTD. (LONDON)}, May 13, 1998, at 4. Mr. Hunnicutt also questioned the Commission's approach of focusing on single route markets where competition might be restricted instead of on the transatlantic market as a whole where competition may increase as a result of the alliance offering flights to more destinations. In a letter to Van Miert, Mr. Hunnicutt noted that approval of alliances by U.S. regulators "is based on the conclusion that the appropriate reference frame for evaluating their competitive impact is their overall effect on competition in the transatlantic market, not merely on traffic between any given city-pair." \textit{Hunnicutt Letter to Van Miert Details Market-Wide Competition Concerns}, \textit{AVIATION DAILY}, May 6, 1998, at 219. The United States historically has favored a "carrot-and-stick" approach, whereby antitrust immunity is offered to the airlines of countries who negotiate an "open skies" deal with the United States. See, e.g., Aviva Freudmann, \textit{Canada Backs Airlines' Request: US Antitrust Waiver Could Accelerate Bilateral Open Skies}, \textit{J. COM.}, Mar. 15, 1996, at 1A. Indeed, the United States has used the same approach in its review of the BA-AA alliance. See \textit{Europeans Dubious on British Air Alliance}, \textit{N.Y. TIMES}, Dec. 10, 1996, at D6. The approach has been very successful for the U.S. in gaining access for its carriers to foreign markets, and no market is more desirable than the U.S.-U.K. market. See Vance Fort, \textit{A U.S. Point of View, in Air Transport Law and Policy in the 1990s: Controlling the Boom} 101, 103 (Pablo Mendes de Leon ed., 1991). The U.S. tactic is not simply a case of diplomatic bullying, however. Indeed, an open skies regime promises greater access to markets for all carriers and as such is a well-reasoned approach to improving competition in such markets. For an interview with Mr. Van Miert concerning his take on airline alliances including BA-AA, see Louis Jones, \textit{When the Going Gets Tough . . .}, \textit{AIRLINE Bus.}, May 1998, at 26.


\textsuperscript{12} In 1996, British Airways led all European airlines in operating results ($1.053 billion), net profit ($865 million), and passenger kilometers (100.6 mil-
Rightly or wrongly, the Commission established itself as a regulatory body to be taken seriously on both sides of the Atlantic in a sector where its extraterritorial jurisdiction for so long had been unclear. As BA and AA look to further expand their network (the airlines recently announced plans to add Cathay Pacific, Canadian Airlines, Qantas Airways, and Iberia to their alliance), the role of the Commission will surely not be overlooked.

This Article examines the lessons to be learned from the European Commission's controversial role in reviewing the BA-AA alliance. It is intended to serve as a brief guide to EC antitrust review of airline alliances for U.S. and other non-Community airlines that are contemplating alliances with EC carriers. In consideration of the Journal's readership, the author has endeavored to provide a practical overview of the relevant substantive and procedural law relating to the review of such airline alliances. Where appropriate, the author has transcribed or summarized in detail the applicable legal rules.
The first part of this Article reviews the EC competition rules applicable to cooperative and concentrative arrangements generally, to airline alliances specifically, and problems inherent in enforcing these rules extraterritorially as illustrated by the BA- AA case. The main mechanisms for review of airline alliances under EC law are Article 85 of the EC Treaty, concerning agreements between companies, and the EC Merger Regulation. The Merger Regulation may be applied extraterritorially, i.e., to concentrations involving routes outside the EU, provided the relevant turnover thresholds are met. In practice, however, the Merger Regulation’s application to cross-border airline alliances is limited because equity partnerships are hindered by laws restricting foreign ownership of domestic airlines. Article 85 also has extraterritorial reach. But the Commission presently lacks a mandate from the EC Member States to apply Article 85 unilaterally to air transport involving routes outside the EC, and therefore must rely instead on Article 89, an obscure, transitional provision of the EC Treaty that remains in effect in the area of extra-Community air transport. Concurrently, Member States are entitled to review alliances involving third country routes under both Community law and na-


22 Foreign ownership of U.S. airlines is limited to 25%, while foreign ownership of airlines in the EC is limited to 49.9%. See Michael Skapinker, Boarding Business Class Now, FIN. TIMES, July 9, 1998, at 13. As American Airlines’ Donald Carty points out, “There are no flag chemical companies or flag hotel companies, but there are flag airlines and nations have historically protected them by limiting foreign ownership.” Id. “The concept of ‘substantial ownership and effective control’ is as old as bilateralism itself . . . . Whatever its origin or rationale, [the] nationality clause is, until today, the single most effective barrier to mergers or take-overs by airlines of different nationality.” H. Peter van Fenema, Ownership Restrictions: Consequences and Steps to be Taken, 23 AIR & SPACE LAW 63 (1998).


24 EC Treaty, supra note 11, art. 89.
tional law, based on Article 88 of the EC Treaty, a counterpart provision to Article 89. The possibility of concurrent reviews by the Commission and Member States has given rise to a battle of competences, which, based on its actions in the BA-AA case, it appears the Commission is winning by might, if not by right.

The author then presents a brief overview of the areas of cooperation envisaged in the BA-AA alliance and the conditions set forth by the Commission to eliminate the anti-competitive effects of this cooperation. The author submits that the Commission's review of the BA-AA alliance, while exceptional from a procedural perspective, at the same time offers legal certainty from a substantive point of view. A review of the conditions formulated by the Commission regarding the BA-AA alliance, investigated under Article 89, in relation to those conditions imposed on other alliances reviewed by the Commission under Article 85 and the Merger Regulation, reveals a common methodological approach to analyzing the effects of airline alliances on Community competition. This approach is discussed here.

Finally, the author examines proposed changes to EC legislation that would clarify the procedure for applying the EC competition rules to air transport involving third country routes.

II. AN OVERVIEW OF THE EC COMPETITION RULES AND DIVISION OF COMPETENCES APPLICABLE TO THE REVIEW OF AIRLINE ALLIANCES

Airline alliances may involve many forms of cooperation ranging from relatively limited agreements (such as joint frequent flyer programming) to the participation of one airline in another airline's equity. The potential competition concerns raised by an alliance depend upon the nature and extent of the relationship, which will also determine the legal mechanism.

25 Id. art. 88.
26 See infra Part II.C.3.
27 Specifically, the author will discuss two proposals: an amendment to Council Regulation 3975/87 and a new regulation complimenting Regulation 3976/87. See infra Part IV.
28 One author defines the difference as follows: “Alliances consist of two categories, equity alliances where airlines take equity or part ownership in other carriers, and joint venture alliances where the arrangements between airlines are limited to specific objectives. The former alliances are wide-ranging, while the latter have route specific [objectives].” Michael S. Simons, Aviation Alliances: Implications for the Qantas-BA Alliance in the Asia Pacific Region, 62 J. AIR L. & COM. 841, 843 (1997).
under which the alliance will be reviewed under Community law.

A. Article 85 of the EC Treaty: The Basic Provision on Agreements Between Companies

For airline alliances, just as with agreements between companies in general, the main mechanism of antitrust review under Community law is Article 85 of the EC Treaty, which states:

1. The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:

   (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
   (b) limit or control production, markets, technical development, or investment;
   (c) share markets or sources of supply;
   (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
   (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

2. Any agreements or decisions prohibited pursuant to this Article shall be automatically void.

3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:

   - any agreement or category of agreements between undertakings;
   - any decision or category of decisions by associations of undertakings;
   - any concerted practice or category of concerted practices, which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

      (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;

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29 EC Treaty, supra note 11, art. 85.
(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.\(^{30}\)

The first paragraph of Article 85 prohibits agreements between companies that may affect trade between Member States and are either intended to prevent, restrict, or distort competition or have the effect of doing so.\(^{31}\) Any agreement infringing Article 85(1) is automatically void under Article 85(2).\(^{32}\) However, there are several possibilities for exemption from Article 85(1), including individual exemption granted by the European Commission under Article 85(3) for agreements whose benefits for the consumer outweigh their anti-competitive effects,\(^{33}\) and a number of so-called “block” exemptions specifically in the area of air transport. These block exemptions remove certain categories of agreements from the scope of Article 85(1) altogether.\(^{34}\)

\(^{30}\) Id.

\(^{31}\) Id. art. 85(1).

\(^{32}\) Id. art. 85(2).

\(^{33}\) Id. art. 85(3).

B. THE APPLICATION OF ARTICLE 85(1) TO AIR TRANSPORT

1. Overview

Whether the EC competition rules, including but not limited to Article 85(1), are applicable to air transport was for many years a contentious issue between the Commission and the majority of Member States. Ultimately, the answer would be determined by the European Court of Justice based primarily on an interpretive reading of the EC Treaty.

Articles 74 to 84 of the EC Treaty set out the general rules governing Community transport, but the Articles only cover rail, road, and inland waterway transport. The Treaty expressly left the fate of air and sea transport to the initiative of the Council of Ministers, leading most Member States to believe that the Treaty provisions, including the competition rules, would not cover air transport until the Council adopted provisions in this area.

In 1962, the Council issued Regulation 1741 implementing generally Articles 85 and 86, the main competition rules of the Treaty. Shortly thereafter, however, the Council issued Regula-

35 Indeed, the EC competition rules are embodied in Articles 85 through 94 of the EC Treaty. The issue of whether the competition rules are applicable to air transport was significant not only for Article 85 but notably for Article 86 (concerning abuses of dominant position) and Articles 92-94 (on state aid) as well.

36 See infra note 46 and accompanying text, concerning the Nouvelles Frontières judgment.

37 EC TREATY, supra note 11, arts. 74-84.

38 Id. art. 84(1).

39 See id. art. 84(2). "The Council may, acting by qualified majority, decide whether, to what extent and by what procedure appropriate provisions may be laid down for sea and air transport." Id.


41 Article 86 reads:

Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States. Such abuse may, in particular, consist in: (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions; (b) limiting production, markets or technical development to the prejudice of consumers; (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; (d) making the conclusion of contracts subject to acceptance by the other parties of supplemen-
tion 141, retroactively removing transport from the scope of Regulation 17, although the Commission subsequently held Regulation 17 to apply still to several businesses ancillary to air transport, including ground handling and computerized reservation systems. Member States took Regulation 141 to mean that the EC competition rules in general were not applicable to air transport. After all, Article 84(2) allows the Council to decide "whether, to what extent and by what procedure appropriate provisions may be laid down for . . . air transport." Because the Council issued a regulation that retroactively removed air transport from the scope of the implementing regulation, many Member States concluded that the competition rules did not govern air transport.

The Court of Justice of the European Communities held otherwise in its 1986 Nouvelles Frontières judgment. In Nouvelles Frontières, executives of airlines and travel agencies were charged in France with having violated a French Civil Aviation Code requirement that all tariffs be approved by the French Minister of Civil Aviation. Answering a request for a preliminary ruling Answering a request for a preliminary ruling

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45 EC Treaty, supra note 11, art. 84(2).


47 Id.
by the *tribunal de police*, a French criminal court, the European Court of Justice held that France’s practice of approving tariffs served to enforce the anticompetitive effects of what amounted to a decision by an association of undertakings or a concerted practice that would likely infringe Article 85(1). The Court relied on the argument that no provision in the Treaty expressly excluded the application of the competition rules to transport, although there was, for example, such an exclusion for the Common Agricultural Policy. According to the Court, it could be inferred that any area not expressly exempted from the competition rules must be considered to be subject to them. Furthermore, the Court reasoned that the exclusion of air and sea transport from the Title of the EC Treaty covering transport does not exclude these sectors from the remaining general rules of the Treaty. These rules include Articles 85 and 86. The fact that the implementing regulation did not cover air transport meant only that the rules set out in the regulation for applying Articles 85 and 86 were not relevant to air transport.

Therefore, although previous decisions of the Court of Justice had so foretold, the *Nouvelles Frontières* judgment clearly established that air transport could not be considered immune from the Community competition rules. Subsequent Community

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48 According to Article 177 of the EC Treaty,

The Court of Justice shall have jurisdiction to give preliminary rulings concerning ... the interpretation of this Treaty ... Where such a question is raised before any court or tribunal of a Member State, that court or tribunal may, if it considers that a decision on the question is necessary to enable it to give judgment, request the Court of Justice to give a ruling thereon. Where any such question is raised in a case pending before a court or tribunal of a Member State against whose decisions there is no judicial remedy under national law, that court or tribunal shall bring the matter before the Court of Justice.

EC Treaty, supra note 11, art. 177.

49 See *Nouvelles Frontières*, 1986 E.C.R. at 1461.

50 See id. at 1465.

51 See id. at 1466.

52 See id. at 1464.

53 See, e.g., Case 167/73 Commission v. French Republic, 1974 E.C.R. 359 (otherwise known as the French Seamen’s Case). Here, the Court of Justice stated that Article 84(2) provides only that the specific rules in the Title of the EC Treaty dealing with transport shall not apply to air (and sea) transport, but that these areas remain subject to the general rules of the Treaty. See id. These general rules include Articles 85 and 86.

legislation implemented Articles 85 and 86 with regard to air transport between and within Member States and empowered the Commission to grant block exemptions for certain kinds of air transport agreements, decisions, and concerted practices that might otherwise infringe Article 85(1).

After determining that Article 85 applies to air transport, it became clear that most airline alliances, by virtue of constituting agreements between undertakings that have the effect of restricting competition (at least as between the alliance partners), would infringe Article 85(1). However, as mentioned above, an agreement that infringes Article 85(1) may nevertheless avoid the prohibition of Article 85(2) if it qualifies for an exemption. There are two types of exemptions: individual exemptions under Article 85(3) and block exemptions pursuant to Commission Regulations. Block exemptions allow agreements meeting certain criteria to escape scrutiny under Article 85(1) altogether, while individual exemptions may be sought for agreements that do not qualify for block exemptions and that are found to have infringed Article 85(1). Accordingly, when determining whether an agreement in the air transport sector is likely to infringe Article 85(1), one must first determine whether a block exemption applies.

55 Two proposals were adopted as part of the so-called “first package” of legislation concerning Community air transport: Council Regulation 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, 1987 O.J. (L 374) 1 (EEC) [hereinafter Council Regulation 3975/87] and Council Regulation 3976/87, supra note 34, at 9. Amendments to these Regulations to extend their scope to air transport between the Community and non-EC countries are discussed in Part IV of this article. The “second package,” adopted in 1990, included amendments to the block exemption regulations. See Council Regulation 2344/90, supra note 34 (amending Council Regulation 3976/87). The “third package” included a regulation extending the scope of the implementing regulation to domestic air transport within a Member State. See Council Regulation 2408/92 of 23 July 1992 on Access for Community Air Carriers to Intra-Community Air Routes, art. 3, 1992 O.J. (L 240) 8, 10 (EEC) [hereinafter Council Regulation 2408-92]. See FRANKY DE CONINCK, EUROPEAN AIR LAW: NEW SKIES FOR EUROPE 27-54, 65-84, 91-115 (1992) for more information on these three packages.

56 See Council Regulation 3976/87, supra note 34.

57 For more on block exemptions, see infra Part II.B.2.

58 Most general treatises on EC competition law discuss with some detail the various means of exemption. See, e.g., IVO VAN BAEL & JEAN-FRANCOIS BELLIS, COMPETITION LAW OF THE EUROPEAN COMMUNITY (1994); CHRISTOPHER BELLAMY & GRAHAM CHILD, COMMON MARKET LAW OF COMPETITION (1993); VALENTINE KORAH, AN INTRODUCTORY GUIDE TO EC COMPETITION LAW AND PRACTICE (1994). For a particularly useful guide on block exemptions, see ROSA GREAVES, EC BLOCK EXEMPTION REGULATIONS (1994).
2. Block Exemptions

Block exemptions provide that certain types of commercial agreements that are generally likely to meet the criteria of Article 85(3) will be held to fall outside the scope of Article 85(1) and therefore will not be prohibited, provided they meet the criteria of the block exemption. Agreements that fall within the ambit of a block exemption do not need to be notified to the Commission. The reasons for having such block exemptions are varied but certainly a significant consideration is economy. The Commission is simply not equipped to review all agreements that infringe Article 85(1) and therefore must exempt those that are less likely to pose significant problems in order to devote the necessary attention to the more serious infringements.

The Commission may adopt legislation exempting certain categories of agreements in a given sector once the Council has enabled it to do so. In the air transport sector, the enabling regulation is Council Regulation 3976/87, as amended by Council Regulation 2344/90 and Council Regulation 2411/92.

The Commission has issued two block exemptions of particular importance to airline alliances: Regulations 1617/93 and 3652/93. According to these block exemptions, Article 85(1) in general shall not apply to agreements concerning: joint planning and schedule coordination of intra-Community flights; joint operation of scheduled air service on new or low-density intra-Community routes; tariff consultations on intra-Community routes; slot allocation concerning intra-Community routes; and development and operation of computerized reservation systems (CRSs), including co-purchase or co-development of a CRS, creation of a system vendor to market and

59 Council Regulation 3976/87, supra note 34.
60 Council Regulation 2344/90, supra note 34.
61 Council Regulation 2411/92, supra note 34.
62 Commission Regulation 1617/93, supra note 34.
63 Commission Regulation 3652/93, supra note 34. Commission Regulation 82/91, 1991 O.J. (L 10) 7 (EEC) exempting certain agreements in the ground-handling sector is not discussed here as ground-handling services generally are not integral to airline alliances.
64 See Commission Regulation 1617/93, supra note 34, art. 2, at 19-20.
65 See id. art. 3, at 20.
66 See id. art. 4, at 20-21.
67 See id. art. 5, at 21-22.
68 See Commission Regulation 3652/93, supra note 34, art. 1(a), at 38.
operate the CRS, and regulation of the provision of distribution facilities by the CRS vendor or by distributors.

Again, the above restrictions on competition must meet the criteria of the relevant block exemption regulation in order to qualify for exemption. For example, although Regulation 1617/93 shields joint planning and schedule coordination from Article 85(1), it does not protect carriers that enter into agreements to set prices or share capacity. Also, the CRS exemptions in Regulation 3652/93 only apply to systems that are operated in an equal and non-discriminatory way. Because these criteria are rather technical, companies that consider that their agreement falls within the scope of one of these block exemptions would nevertheless be advised to consult an EC lawyer.

It is important to note that the Regulation 1617/93 exemption in particular, in addition to having a limited scope, refers expressly to intra-Community flights and does not cover agreements involving third-country routes. Therefore, an alliance between a European carrier and a U.S. carrier currently does not benefit from this block exemption. The proposed extension of the scope of the block exemptions to cover third-country routes is examined further in Part IV.

3. Individual Exemptions

If an agreement does not qualify for a block exemption and violates Article 85(1), it may still be exempted if it satisfies the requirements of Article 85(3). Article 85(3) provides that Article 85(1) may be declared inapplicable if the following conditions are met: the agreement leads to the improvement of the production or distribution of goods or promotion of technical or economic progress; the agreement allows consumers a fair share of the resulting benefit; the agreement only imposes restrictions that are indispensable to its objectives; and the agreement does not eliminate competition.

In practice, even where the above conditions are satisfied, individual exemptions under Article 85(3) are rarely issued. More commonly, the Commission will issue a so-called “comfort letter” to the parties concerned, announcing that it has no rea-

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69 See id. art. 1(b).
70 See id. art. 1(c).
71 Commission Regulation 1617/93, supra note 34, art. 3(e), at 20.
72 Commission Regulation 3652/93, supra note 34, art. 3(1), at 39.
73 EC TREATY, supra note 11, art. 85(3).
74 See VAN BAELE & BELLIS, supra note 58, at 777-79.
son to intervene in the agreement and that, unless there is a material change of circumstances, no further action will be taken. 75 Parties may request a formal exemption, but because it may take the Commission years to issue such an exemption, 76 in most cases companies are content to receive a comfort letter.

C. THE EXTRATERRITORIAL APPLICATION OF THE EC COMPETITION RULES TO AIR TRANSPORT INVOLVING THIRD COUNTRY ROUTES

1. Background

Based on the 1986 judgment of the European Court of Justice in Nouvelles Frontières 77 and subsequent legislation, 78 it is clear that the provisions of Article 85 apply to air transport between and within Member States of the Community. Furthermore, it is well established that EC competition law in general may be applied extraterritorially, so long as the place of implementation of the conduct at issue is within the Community. 79 As concerns air transport between the Community and third countries such as the United States, however, there is no implementing regulation in place to allow the Commission to apply Article 85(1) unilaterally or to grant exemptions under Article 85(3).

In 1989 the Court of Justice indicated in the Ahmed Saeed case 80 that the EC competition rules in principle apply to air transport between Member States and non-Member States. 81 Nevertheless, the Court stopped short of finding that the Commission had the external competence to apply Article 85 unilat-

75 See id.
76 See id.
81 See id. at 822.
erally to air transport to and from third countries absent a Council Regulation authorizing it to do so.\textsuperscript{82} Therefore, in terms of the extraterritorial application of Community competition law to air transport involving third country routes, it can be said that Article 85 applies; however, the Commission currently lacks the exclusive right to apply it.

2. Articles 88 and 89

This brings into play Articles 88 and 89 of the EC Treaty, which, other than in the field of air transport between Member States and third countries, have been rendered obsolete by the implementation of the competition rules by Regulation 17.\textsuperscript{83} The reason for the importance of these Articles is the absence of a mandate for the Commission to apply Article 85 unilaterally in air transport between Member States and third countries. Recall that Regulation 141\textsuperscript{84} retroactively removed air transport from the scope of the general implementation regulation\textsuperscript{85} and that the regulation implementing the competition rules in the area of air transport,\textsuperscript{86} along with subsequent legislation,\textsuperscript{87} only applies these rules to intra-Community routes.

The importance of Articles 88 and 89 to the review of transatlantic airline alliances such as BA-AA merits quoting these Articles in full.

Article 88 provides:

Until the entry into force of the provisions adopted in pursuance of Article 87, the authorities in [Member States] shall rule on the admissibility of agreements, decisions and concerted practices and on abuse of a dominant position in the common market in accordance with the law of their country and with the provisions of Article 85, in particular paragraph 3, and of Article 86.\textsuperscript{88}

Article 89 reads:

\textsuperscript{82} See id. at 823.

\textsuperscript{83} Articles 88 and 89 are not obsolete in the air transport sector because Council Regulation 141/62 removed air transport from the scope of the main implementing regulation (Council Regulation (EEC) 17/62) and because the implementing regulation in the field of air transport (Council Regulation (EEC) 3975/87) is limited to intra-Community air transport.

\textsuperscript{84} Council Regulation 141/62, \textit{supra} note 42.

\textsuperscript{85} See Council Regulation 17/62, \textit{supra} note 40.

\textsuperscript{86} See Council Regulation 3975/87, \textit{supra} note 55.

\textsuperscript{87} See Council Regulation 2408/92, \textit{supra} note 55.

\textsuperscript{88} EC TREATY, \textit{supra} note 11, art. 88.
1. Without prejudice to Article 88, the Commission shall, as soon as it takes up its duties, ensure the application of the principles laid down in Articles 85 and 86. On application by a [Member State] or on its own initiative, and in co-operation with the competent authorities in the [Member States], who shall give it their assistance, the Commission shall investigate cases of suspected infringement of these principles. If it finds that there has been an infringement, it shall propose appropriate measures to bring it to an end.

2. If the infringement is not brought to an end, the Commission shall record such infringement of the principles in a reasoned decision. The Commission may publish its decision and authorize [Member States] to take the measures, the conditions and details of which it shall determine, needed to remedy the situation.89

Article 88 is a transitional provision meant to allow national competition authorities to retain the right to rule on agreements and abuses of dominant position in areas where Articles 85 and 86 have not yet been implemented. Most significantly, Article 88 allows Member States to provide an exemption under Article 85(3) to alliances involving their own national carriers.90

Under Article 89, the Commission may act under Articles 85 and 86 but must rely on the cooperation of national competition authorities.91 This has created numerous conflicts between the Commission and Member State authorities, most notably the ongoing feud between the Commission and the United Kingdom over the proposed alliance between British Airways and American Airlines.92

Based on the Nouvelles Frontieres and Ahmed Saeed judgments and Community legislation to date, the following can be said regarding the application of the EC competition rules to air transport between Member States and third countries. First, the competition rules apply to the entire field of air transport, including routes between Member States,93 within Member States,94 and between Member States and third countries95 such

89 Id. art. 89.
90 Id. art. 88.
91 Id. art. 89(1).
92 See discussion infra Part III.C.3.
94 See Council Regulation 2408/92, supra note 55.
as the United States. However, in sectors where there is no implementing regulation (as is the case with air transport involving third country routes), the Commission may not act unilaterally under Article 85. In such cases, the national competition authorities and the Commission may act concurrently under Articles 88 and 89. Member States may apply national competition law in reviewing an alliance, even when the Commission is conducting its own investigation of the same alliance, but may not do so in a manner that undermines the application of Community law. The Commission may conduct an investigation under Article 89, but must do so in cooperation with national authorities. Under the transitional regime of Articles 88 and 89, the Member States alone may grant an Article 85(3) exemption. Finally, agreements in the air transport sector are void only when national competition authorities hold that they violate Article 85(1) and do not qualify for an exemption or, apparently, when the Commission has recorded an infringement pursuant to Article 89(2).

97 See id. at 1467-68.
98 This is a corollary to the well-established supremacy principle of Community law that national law may be applied even where it is inconsistent with Community law, but where there is an actual conflict between national law and Community law, Community law prevails. Member States shall take all appropriate measures, whether general or particular, to ensure fulfilment of the obligations arising out of this Treaty or resulting from action taken by the institutions of the Community. They shall facilitate the achievement of the Community's tasks. They shall refrain from any measure which could jeopardize the attainment of the objectives of this Treaty.

EC Treaty, supra note 11, art. 5.

By creating a Community of unlimited duration, having . . . powers stemming from a limitation of sovereignty or a transfer of powers from the States to the Community, the Member States have limited their sovereign rights, albeit within limited fields, and have thus created a body of law which binds both their nationals and themselves.

Case 6/64, Costa v. ENEL, 1964 E.C.R. 585, 593.; see also Case 106/77, Simmenthal, 1978 E.C.R. 629, 643 (provisions of the Treaty and directly applicable measures of the institutions "render automatically inapplicable any conflicting provision of . . . national law.").

100 See id.
101 See Re Ahmed Saeed Flugreisen, 1989 E.C.R. at 846-47. The fact that an agreement may be void based on the Commission having recorded an infringement runs counter to the wording in the Treaty. See infra note 106 and accompanying text.
3. Battle of Competences

The Commission's role should then be that of a good referee. In sports the best referees are those who blow their whistles with economy, limiting their intervention in the game to a minimum to avoid interrupting the play unnecessarily and destroying its natural flow and rhythm. In doing so they apply the rules and do not change them or invent new ones. We expect the same from the Commission, and we particularly want them to refrain from creating their own rules and interpretations as they go along. This, however, seems not to be the case.102

The lack of legal clarity in the application of Articles 88 and 89 has resulted in a heated constitutional battle between Member States and the Commission. In no case has the fervor reached a higher level than in the British Airways-American Airlines review. Simultaneous investigations of the BA-AA alliance have been conducted by the Commission, the U.K. Office of Fair Trading, and the U.S. Department of Transportation. Each regulatory body has taken a different approach to the alliance, each suggesting different conditions in exchange for clearance, creating a very difficult predicament for the two airlines. Although negotiations are still ongoing, the Commission appears to have won its battle of competences with the U.K., if by political might alone. Whether the Commission has acted legally is another question altogether.

A comparison of the powers conveyed to the Commission and the Member States through Articles 88 and 89 suggests that national authorities have the right to take the lead in such investigations, with the Commission limited to playing a supporting role. Article 89, after all, applies "[w]ithout prejudice to Article 88."103 Furthermore, under Articles 88 and 89, only Member States have the express right to rule on agreements and to grant exemptions under Article 85(3).104 Finally, the Commission is restricted in that it must act "in co-operation with the competent authorities in the [Member States]."105 A strict reading of the Treaty seems to weigh in the favor of the Member States.

102 Karl-Heinz Neumeister, Secretary General of the Association of European Airlines, Remarks at “Meeting the Global Challenge: The Outlook for Civil Aviation in the EU” (Jan. 27, 1998) (transcript on file with author).
103 EC Treaty, supra note 11, art. 89(1).
104 See Nouvelles Frontières, 1986 E.C.R. at 1467.
105 EC Treaty, supra note 11, art. 89(1). Article 89 provides that the Commission should act “in co-operation with the competent authorities in the Member States, who shall give it their assistance.” Id.
The Court of Justice, however, has taken a rather dubious stance, holding in *Ahmed Saeed* that an agreement may be prohibited and ruled void under Article 85 either if the national authorities have found that it falls within the prohibition of Article 85(1) and does not qualify for an exemption under Article 85(3), or alternatively, if the Commission has recorded an infringement pursuant to Article 89(2). It is difficult to see how this latter alternative has foundation in the wording of Article 89. On its face, Article 89 permits the Commission only to investigate with the assistance of the Member State, to propose measures to bring infringements to an end, to record infringements that are not brought to an end, and to authorize Member States to take measures to remedy the situation. While the Commission may investigate, propose, record, and authorize, under Article 88, Member States alone are entitled to rule on the admissibility of agreements.

The better view, it would seem, is that national authorities should play the more prominent role in reviewing alliances involving third country routes. In the case of BA-AA, this would mean that the United Kingdom, not the Commission, would be entitled to set out the conditions for approval of the alliance provided these conditions in no way jeopardize the effectiveness of Community law. But the judgment of the Court of Justice in *Ahmed Saeed* has complicated the situation and the Commission, intent on leaving no gaps in its enforcement of the EC competition rules, has acted boldly in reviewing the alliance. Indeed, the Commission has even threatened to sue the United Kingdom before the Court of Justice if the U.K. ruling undermines Community law. Considering the Court's judgment in *Ahmed Saeed*, this is not a case the U.K. would be likely to win.

**D. The Merger Regulation**

While Article 85(1) is the general provision applying to agreements between companies, it will not apply to mergers and other concentrations that are held to be of sufficient financial

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107 EC Treaty, supra note 11, art. 89(1).
108 See *id*.
109 See *id.* art. 89(2).
110 See *id*.
111 *Id.* art. 88.
importance to the Community.\textsuperscript{113} The legality of such concentrations will be reviewed instead under the EC Merger Regulation.\textsuperscript{114} In the field of air transport, the Merger Regulation may apply to alliances involving an equity participation. Such alliances are allowed, provided they do not create or strengthen a dominant market position of the airlines involved in the concentration.\textsuperscript{115}

The Merger Regulation applies to all concentrations having a Community dimension.\textsuperscript{116} A concentration is defined to include the following: mergers between two or more independent companies;\textsuperscript{117} the acquisition of control by one or more companies directly or indirectly of part or whole of another company;\textsuperscript{118} and certain joint ventures which perform as an autonomous economic entity on a lasting basis.\textsuperscript{119}

Community dimension is determined solely on whether the concentration has sufficient world-wide and Community-wide turnover. A concentration will be considered to have a Community dimension if: the combined aggregate world-wide turnover of all the companies concerned is more than ECU 5,000 million\textsuperscript{120} and each of at least two of the companies have an aggregate Community-wide turnover of more than ECU 250 million\textsuperscript{121} unless each of the companies concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State.\textsuperscript{122}

In addition, under the recent amendments to the Merger Regulation,\textsuperscript{123} a concentration that does not meet the above thresholds will still be considered to have a Community dimen-

\begin{itemize}
\item \textsuperscript{113} See, e.g., BARRY E. HAWK & HENRY L. HUSER, EUROPEAN COMMUNITY MERGER CONTROL: A PRACTITIONER'S GUIDE 338 (1996). Although somewhat outdated after the recent amendments to the Merger Regulation, the Hawk and Huser book remains one of the most valued treatises in the field. See also C.J. COOK & C.S. KERSE, E.C. MERGER CONTROL (1996).
\item \textsuperscript{114} See Council Regulation 4064/89 of 21 December 1989 on the Control of Concentrations Between Undertakings, 1990 O.J. (L 257) 14 (EEC) as amended by Merger Regulation, supra note 20 [hereinafter Council Regulation 4064/89].
\item \textsuperscript{115} See id.
\item \textsuperscript{116} See id.
\item \textsuperscript{117} See id. art. 3(1)(a).
\item \textsuperscript{118} See id. art. 3(1)(b).
\item \textsuperscript{119} See id. art. 3(2).
\item \textsuperscript{120} See id. art. 1(2)(a). At the rate of exchange on 31 July 1998 (ECU 1 = US $1.1073), this would equate to approximately US $ 5537 million.
\item \textsuperscript{121} See id. art. 1(2)(b). This would equate to approximately US $ 277 million.
\item \textsuperscript{122} See id. art. 1(2)(b).
\item \textsuperscript{123} Merger Regulation, supra note 20.
\end{itemize}
sion when: the combined aggregate global turnover of all the companies concerned exceeds ECU 2,500 million;\textsuperscript{124} in each of at least three Member States, the combined aggregate turnover of all of the companies concerned exceeds ECU 100 million;\textsuperscript{125} in each of at least three Member States for which the second criterion is satisfied, the aggregate turnover of each of at least two of the companies exceeds ECU 25 million;\textsuperscript{126} and the aggregate Community-wide turnover of each of at least two of the companies exceeds ECU 100 million,\textsuperscript{127} unless more than one such undertaking concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State.\textsuperscript{128}

Because much airline turnover is derived from cross-border flights, the Commission has had to consider how to determine the countries to which turnover for a given route should be attributed. The Commission has devised three main approaches: (1) attributing 100\% of ticket revenues to the country of destination, (2) attributing half of ticket revenues to the country of origin and half to the country of destination, and (3) attributing all revenues to the country where the sale of the ticket occurred.\textsuperscript{129} In the Swissair-Sabena merger,\textsuperscript{130} the Commission used the third approach,\textsuperscript{131} and indeed seems to be favoring a "country of sale" test over the other two alternatives. The application of this test could remove a significant number of cases from the scope of the Merger Regulation because Member State airlines are fairly likely to generate over two-thirds of their turnover from sales made within their home country.

Concentrations having a Community dimension will be reviewed under the Merger Regulation by the Merger Task Force,
a specialized unit within the Commission’s Directorate-General for competition, DG-IV. If the agreement does not constitute a concentration, but instead a cooperation, the Merger Regulation will not apply, and the agreement may be subject instead to Article 85(1). Where the agreement does constitute a concentration, but does not have a Community dimension, it may be subject to national merger control law and may need to be notified in a number of jurisdictions. An advantage of the Merger Regulation is that it allows for "one-stop shopping" for companies whose concentration has a Community dimension.

If an alliance falls within the scope of the Merger Regulation, the Merger Task Force will examine whether the alliance creates or strengthens a dominant market position of the carriers involved. If so, it will be prohibited under the Merger Regulation, unless the parties can offer commitments that would eliminate these problems.

Unlike the Commission’s limited external competence with respect to reviews under Article 85, the Commission’s competence in reviews under the Merger Regulation is not dependent on whether the alliance relates to intra-Community routes or third-country routes. The Commission has reviewed concentrations in many economic sectors under the Merger Regulation involving non-EU companies, perhaps most notably that between two American companies, Boeing and McDonnell-Douglas.

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132 See VAN BAEL & BELLIS, supra note 58, at 486-87. The Merger Task Force (MTF) has its own registry, internal organisation, management system and working methods. Id.

133 The Commission generally will not intervene under Article 85 or, more appropriately, Article 86, with respect to concentrations falling below the turnover thresholds. See HAWK & HUSER, supra note 113, at 338.

134 While there is no rule concerning how high market share must be to create a dominant position, the Commission has never found a dominant position to exist when the combined market shares of the parties were below 40%. Depending on other market factors such as potential competition and relative bargaining or buying power of customers, companies may have market shares exceeding 40% without having a dominant position.

LEARNING TO FLY

III. A COMPARISON OF THE COMMISSION'S REVIEW OF THE BA-AA ALLIANCE WITH ITS REVIEWS OF OTHER MAJOR AIRLINE ALLIANCES

"If this alliance is allowed to go ahead, it would be the equivalent of a merger between Coke and Pepsi, Nike and Reebok, or General Motors and Ford."136

In general, it can be said that the Commission, in its review of airline alliances, will consider whether sustainable competition from other airlines will remain or can develop once the alliance is in place. In order to determine whether such competition exists, the Commission may look at different aspects of the relevant market, such as the number of airlines operating on a given route, the frequency of flights on this route, and the availability of take-off and landing slots at the relevant airports. The Commission will also consider the specific provisions of the alliance agreement concerning, inter alia, interlining137 with other carriers and frequent flyer programming.

The legal mechanism used by the Commission to review an alliance depends on the form of the alliance. Alliances involving cooperation between airlines within the Community that fall short of equity sharing will most likely be evaluated under Article 85 of the EC Treaty. An example of such a review is the Commission's review of the SAS-Lufthansa alliance.138 Where such alliances involve routes outside of the Community, the Commission must act under Article 89 of the Treaty, with Member State authorities likely reviewing the alliance pursuant to Ar-

136 Carole A. Shifrin, American, BA Await Decision on Alliance, AVIATION WK. & SPACE TECH., Oct. 14, 1996, at 34 (quoting Richard Branson, Virgin Atlantic Airways Chairman). In his trademark understated manner, Branson has labeled the alliance "the merger from hell." Karen Walker, Two Bobs Stir the Immunity Debate, AIRLINE Bus., May 1998, at 90. For reasons that have already been discussed in this Article, see supra Part II.D, the BA-AA alliance does not, in a legal sense, constitute a merger.

137 Interlining is the practice whereby one airline accepts tickets issued in the name of another airline. See, e.g., Bernardine Adkins, AIR TRANSPORT AND E.C. COMPETITION LAW 30 (1994).

ticle 88. The British Airways-American Airlines\textsuperscript{139} alliance is the most significant example to date of an Article 89 review. Finally, when an alliance takes the form of a concentration and has Community-wide and global turnover sufficient to give it a Community dimension, it will be reviewed under the Merger Regulation. Although most cross-border airline alliances are cooperative, not concentrative, the Sabena-Swissair\textsuperscript{140} alliance is a good example of a review under the Merger Regulation of an equity alliance between a Community carrier and a non-Community carrier.

The following pages provide a summary of the Commission’s reviews of these airline alliances. As will become evident, while the procedural aspects of these reviews differ significantly, there is notably very little difference in the philosophical approach taken by the Commission in these cases, as reflected in the conditions imposed.

A. THE COMMISSION’S ASSESSMENT OF AN ALLIANCE INVOLVING THIRD COUNTRY ROUTES: BA-AA

In the past year, the Commission’s plate has been full, as it has investigated no less than four major airline alliances under Article 89 of the EC Treaty. In addition to its review of British Airways-American Airlines, indisputably the most significant of the bunch, the Commission has also suggested conditions for approval of Lufthansa, United, SAS\textsuperscript{141} and is expected to issue comments shortly on the KLM-Northwest and Delta, Sabena, Swissair, Austrian Airlines alliances.\textsuperscript{142} Although the specific aspects of these alliances vary, basic provisions include codesharing, joint advertising and selling, joint frequent flyer programming, flight and schedule coordination, co-operation of computerized reservation systems, co-marking, joint product development, and joint cargo services.

The proposed BA-AA alliance contemplates such an expansive collaboration between the parties that EC competition commis-

\textsuperscript{139} See Commission Notice Concerning the Alliance Between British Airways and American Airlines, 1998 O.J. (C 239) 10.


\textsuperscript{141} See Commission Notice Concerning the Alliance Between Lufthansa, SAS, and United Airlines, 1998 O.J. (C 239) 5.

\textsuperscript{142} See Jones, \textit{supra} note 10, at 28.
sioner Karel Van Miert has referred to the alliance as a "near merger." The BA-AA agreement provides for cooperation in the following areas:

**Codesharing:** BA and AA will codeshare on their North Atlantic services. Insofar as permitted by various competition authorities, they will also codeshare world-wide, with plans to include affiliate airlines in the codesharing scheme as well.\(^{144}\)

**Revenues:** BA and AA “will employ similar internal proration processes to distribute revenues... to the North Atlantic alliance services... and to all non-alliance segments for connecting itineraries involving services operated by [BA or AA]”.\(^{145}\)

**Pricing:** BA and AA will price common products in the same manner, with AA pricing alliance segments from the United States to Europe and BA pricing alliance segments from Europe to the United States.\(^{146}\)

**Joint Scheduling:** BA and AA will jointly schedule the alliance services for the North Atlantic routes and “will use reasonable efforts to coordinate the schedules of their North Atlantic alliance services with the schedules of their codeshared flights out of their respective homeland gateways”.\(^{147}\)

**Display in Computerized Reservation Systems (CRS):** BA and AA will use reasonable efforts to assure that both BA and AA services are displayed simultaneously on flights covered by the alliance;\(^{148}\)

**Co-marking:** BA and AA will use a mutually agreed mark to represent the alliance and frequent flyer linkage;\(^{149}\)

**Co-development of product:** BA and AA will coordinate product development.\(^{150}\)

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\(^{143}\) See id.

\(^{144}\) These include American Eagle and Brymon Airways, Deutsche BA, and TAT European Airlines. See Commission Notice Concerning the Alliance Agreement Between British Airways and American Airlines, 1996 O.J. (C 289) 4.

\(^{145}\) Id. at 4-5.

\(^{146}\) See id. at 5.

\(^{147}\) Id.

\(^{148}\) See id.

\(^{149}\) See id.

\(^{150}\) See id.
Frequent Flyer Programming (FFP): BA and AA will create a fully reciprocal FFP relationship which will offer points accrual and redemption;\textsuperscript{151}

\textit{Joint-selling}: BA and AA will coordinate the selling of their product in both Europe and the United States;\textsuperscript{152}

\textit{Shared facilities}: BA and AA will share airport facilities to the extent possible;\textsuperscript{153} and

\textit{Cargo}: BA and AA will create a cargo alliance which will include all of their current and future services between Europe and the United States, and between Europe, Latin America, and the Caribbean.\textsuperscript{154}

In order to make the BA-AA agreement compatible with the EC competition rules, the Commission has proposed the following measures:

\textit{Reduction in frequencies}: For the first six months after approval of the alliance,\textsuperscript{155} on the three hub-to-hub routes\textsuperscript{156} where the alliance would be dominant (London-Dallas, London-Miami and London-Chicago), BA and AA, if requested by a competitor, should “reduce their combined number of weekly frequencies so as to allow their competitors to operate up to 55\% of frequencies on [these routes].”\textsuperscript{157} Based on the current level of flights, this means that if a competitor wishes to expand its presence or to develop new services on these markets and so requests, BA and AA would need to reduce their frequencies by twelve on the London Heathrow-Chicago route, eight on the London Gatwick-Dallas route, and five on the London-Miami route.\textsuperscript{158} The alliance should relinquish, without compensation, the same number of slots as it previously used for the frequencies it gives up, unless there are already sufficient slots available at the relevant airports.\textsuperscript{159}

\textsuperscript{151} See id.
\textsuperscript{152} See id.
\textsuperscript{153} See id.
\textsuperscript{154} See id.
\textsuperscript{155} See Commission Notice Concerning the Alliance Between British Airways and American Airlines, 1998 O.J. (C 239) 10, 11.
\textsuperscript{156} BA has its hub in London, while AA has hubs in Dallas, Miami, and Chicago.
\textsuperscript{157} Commission Notice Concerning the Alliance Between British Airways and American Airlines, 1998 O.J. (C 239) 10, 10-11.
\textsuperscript{158} See id. at 11. The London-Miami route operates from both Heathrow and Gatwick. See id.
\textsuperscript{159} See id.
Relinquishment of take-off and landing slots: The airlines are expected to give up, without compensation, as many as 267 take-off and landing slots at London’s Heathrow and Gatwick airports in order to allow competitor airlines, so requesting, to launch a new service or to expand existing services on the London-U.S. routes. Specifically, the parties would need to give up as many as 200 slots at Heathrow for non-hub-to-hub services, seventeen slots at Gatwick for non-hub-to-hub services, and an additional fifty slots for hub-to-hub routes. In arriving at this number, the Commission used a formula designed to ensure that competitors would control 55% of these slots.

Interlining: BA and AA should allow other American and European airlines to enter into interlining agreements with them.

Frequent Flyer Programming: BA and AA either should refrain from operating joint frequent flyer programs between the United Kingdom and the United States and from allowing passengers to transfer points between the airlines, or should allow other airlines without comparable frequent flyer programs to join the BA-AA frequent flyer program.

Display in Computerized Reservation Systems (CRS): The Commission is still investigating whether concurrent listings on a CRS screen of BA and AA flights that are operated under a code-sharing arrangement is likely to have the effect of filling the first screen to the detriment of competitors, but suggests that CRS listings of such code-shared flights should be limited to one line.

Relations with Travel Agencies: BA and AA “should not include a system of remuneration that has the effect of securing the loyalty of travel agents to the members of the alliance on the relevant markets.”

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160 See id. at 12.
161 See id.
162 See id.
163 See id. at 14. These slots would be divided as follows: 24 slots for London-Chicago, 16 for London-Dallas and 10 for London-Miami.
164 See id. at 12. The slot formula is as follows: (the number of slots to be given up by BA-AA) = (the number of BA-AA slots used on London-U.S. routes in 1997 / 0.45) x 0.55 - (the number of competitors’ slots used on London-US routes in 1997). See id.
165 See id. at 15.
166 See id. at 14.
167 See id. at 15.
168 Id. BA has been accused by rival airlines in Europe of operating an incentive system whereby travel agents would be rewarded for selling above the sales
In addition, the Commission stated that it would expect an undertaking from the United Kingdom to “permit any Community carrier established in the EEA\textsuperscript{169} to operate direct and indirect services between any airport in its territory and the United States, setting its fares freely,”\textsuperscript{170} in other words to allow for multiple carrier designation.

**B. The Commission’s Assessment of an Alliance Under Article 85: SAS-Lufthansa**

A number of airline alliances have been evaluated under Article 85(1), but for reasons already explained, these alliances have involved Community routes flown by Community carriers only. The most significant alliance to date evaluated under Article 85 was the one between Lufthansa and SAS.\textsuperscript{171} After the parties requested the Commission to find that their agreement did not infringe Article 85(1) of the EC Treaty or, alternatively, that it qualified for an individual exemption under Article 85(3),\textsuperscript{172} the Commission sent Lufthansa and SAS a letter notifying them that there were “serious doubts” of the alliance’s compatibility with the common market.\textsuperscript{173} However, instead of prohibiting the agreement on the grounds that it prevented, restricted, or distorted competition under Article 85(1), the Commission concluded that if certain conditions were agreed, the benefits of the alliance would outweigh its possible anti-competitive effects.\textsuperscript{174} Ultimately, the Commission granted an individual exemption under Article 85(3),\textsuperscript{175} but only after insisting on numerous conditions applying to the eight largest routes\textsuperscript{176} where SAS and Lufthansa competed prior to their alliance,\textsuperscript{177} including: a freeze on the number of daily flights offered on routes where a

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\textsuperscript{169}The European Economic Area (EEA) includes the fifteen EC Member States plus Iceland, Norway, and Liechtenstein.

\textsuperscript{170}Commission Notice Concerning the Alliance Between British Airways and American Airlines, 1998 O.J. (C 239) 10, 15.

\textsuperscript{171}See Commission Decision IV/35.545, supra note 138.

\textsuperscript{172}See id.

\textsuperscript{173}Id.

\textsuperscript{174}See id. at 37-40.

\textsuperscript{175}Id. at 1.

\textsuperscript{176}These included the Düsseldorf-Copenhagen, Düsseldorf-Stockholm, Frankfurt-Copenhagen, Frankfurt-Göteborg, Frankfurt-Oslo, Frankfurt-Stockholm, Hamburg-Stockholm, and Munich-Copenhagen routes. See id. art. 2.2.

\textsuperscript{177}See id. at 37.
new entrant decides to compete;\textsuperscript{178} the relinquishment of a significant number of slots at the airports of Frankfurt, Düsseldorf, Stockholm and Oslo;\textsuperscript{179} an obligation to allow other airlines to enter into interlining agreements with Lufthansa and SAS;\textsuperscript{180} and an obligation to allow other airlines to participate in the frequent flyer program offered by Lufthansa and SAS.\textsuperscript{181}

C. THE COMMISSION'S ASSESSMENT OF AN ALLIANCE UNDER THE MERGER REGULATION: SWISSAIR-SABENA\textsuperscript{182}

The 1995 Swissair-Sabena alliance was one of the first involving two flag carriers to be reviewed under the Merger Regulation,\textsuperscript{183} and considering that it involved third-country routes (as Switzerland is not a member of the Community), it is particularly interesting for our present purposes.

As part of their alliance, Swissair took a 49.5\% stake in and partial control of Sabena,\textsuperscript{184} satisfying the conditions for a concentration.\textsuperscript{185} Furthermore, both the world-wide and Community-wide turnover sufficiently gave the alliance a Community dimension.\textsuperscript{186}

Upon review under the Merger Regulation, the Commission determined that the concentration, without modifications, would create a dominant position on some of the routes Swissair and Sabena would operate together and therefore was likely to significantly impede competition.\textsuperscript{187} However, Swissair and Sabena offered commitments which made the alliance acceptable to the Commission.\textsuperscript{188} These concessions included: a restriction from increasing the services on each of the routes

\textsuperscript{178} See id. art. 3.1(a), at 40.
\textsuperscript{179} See id. art. 3.8, at 41.
\textsuperscript{180} See id. art. 3.2, at 40.
\textsuperscript{181} See id. art. 3.3.
\textsuperscript{183} See id.
\textsuperscript{184} See id. ¶ 1.
\textsuperscript{185} See id. ¶ 12.
\textsuperscript{186} See id. ¶ 15.
\textsuperscript{187} See id. ¶ 42. "[T]he Commission has come to the conclusion that the proposed operation will raise serious doubts as to its compatibility with the common market, because it will lead to the creation of a dominant position as a result of which effective competition will be significantly impeded in the common market." Id.
\textsuperscript{188} See id.
concerned beyond 25% of the present level; the relinquishment of as many as twelve daily slots at Zürich and Geneva, and as many as eighteen daily slots at Brussels; an obligation to allow other airlines to enter into interlining agreements with Swissair and Sabena; and an obligation to allow other airlines to participate in the frequent flyer program offered by Swissair and Sabena.

The Swiss and Belgian governments also offered commitments, including the transition from a single designation regime to a multiple designation regime (to allow more than one carrier from each country to serve routes between Belgium and Switzerland), the abolition of capacity restrictions, and the grant of access to four other European carriers (on a “first come, first serve” basis) to the routes concerned for fifth freedom operations.

D. Conclusions

While the proposed BA-AA alliance has been reviewed by the Commission under Article 89, it is interesting to note that the same types of conditions being sought in this case were required when the Commission acted under Article 85 in its review of the Lufthansa-SAS alliance and under the Merger Regulation in its assessment of the Swissair-Sabena concentration. In each case, the Commission considered that ensuring continued competition on the relevant markets (defined in terms of city-pair routes) requires that the parties either limit or freeze capacities on routes where they are dominant. In the case of Lufthansa-SAS, the Commission deemed a freeze necessary, while for Swissair-Sabena, it prohibited the parties from increasing their frequencies by more than 25%. For BA-AA, the Commission

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189 See id. ¶ 46(iii).
190 See id. ¶ 46(i).
191 See id. ¶ 46(ii).
192 See id. ¶ 46(iv).
193 See id. ¶ 46(v).
194 See id. ¶ 43.
195 See id.
196 See id. The fifth “freedom of the air” is the right of an air carrier to transport passengers, freight, and mail between two states other than the one in which it is licensed. ANDREAS F. LOWENFELD & JAMES M. BURGER, AVIATION LAW § 1.12, at 2-7 (2d ed. 1981).
197 See Commission Decision IV/35.545, art. 3.1 (a).
198 See Commission Decision of 20 July 1995 Declaring a Concentration to be Compatible with the Common Market (Case No. IV/M.616–Swissair/Sabena.
has called for an actual reduction of frequencies on the main routes.\footnote{See Commission Notice Concerning the Alliance Between British Airways and American Airlines, 1998 O.J. (C 239) 10, 10-11.}

In addition, the Commission in each case requested that the parties relinquish take-off and landing slots to competitors at airports relevant to the markets, particularly at hubs. The Commission also required the parties to the alliances not to have exclusive interlining agreements and frequent flyer programs but instead to allow the participation of competing airlines in these arrangements. Finally, the Commission established that it will seek commitments on the part of the Member State(s) involved, including commitments to provide for multiple carrier designation.

It should be noted that the Commission also recognized that airline alliances can offer benefits to the consumer by expanding and improving the quality of the services offered and by passing the savings from the resulting synergies to the consumer. However, prior to the modification of the agreements, the Commission did not consider the benefits to outweigh the anti-competitive effects of the alliances discussed above.

While reaffirming the Commission’s past practice in reviewing airline alliances, the Commission’s notice on BA-AA at the same time reveals some new wrinkles in the Commission’s methodology. The slot allocation formula used in BA-AA to ensure that competitors have access to up to 55% of slots at the key airports is interesting, as it seems to suggest a 45% market share limit for alliances. The 55%-45% formula was also featured in the Lufthansa-SAS-United notice, which the Commission issued the same day as BA-AA.\footnote{See Commission Notice Concerning the Alliance Agreement Between British Airways and American Airlines, 1996 O.J. (C 289) 4.} It will be interesting to see whether the Commission retains this formula for future cases.

It is also interesting that the Commission made reference in its notice on BA-AA to a likely infringement of Article 86 “as far as the hub-to-hub routes are concerned.”\footnote{Commission Notice Concerning the Alliance between British Airways and American Airlines, 1998 O.J. (C 239) 10.} The Commission made no mention of Article 86 in its 1996 notice on the BA-AA alliance.\footnote{Commission Notice Concerning the Alliance Between Lufthansa, SAS and United Airlines, 1998 O.J. (C 239) 5.} Indeed, although the Court of First Instance has made it clear that Articles 85 and 86 are “independent and com-
neither the Court of Justice nor the Court of First Instance has ever held that the mere conclusion of an agreement between two independent companies constitutes an abuse of a dominant position under Article 86. The Commission’s claim that Article 86 applies to the BA-AA alliance in general, as opposed to subsequent oligopolistic behavior of the alliance, is of dubious merit. The alliance is, after all, an agreement between undertakings, and does not itself entail the kind of unilateral abuse with which Article 86 is typically concerned. One has to wonder if the Commission’s consideration of whether a dominant position is at issue is an indication of its belief that alliances such as BA-AA should be reviewed under similar rules as mergers, for which the creation or strengthening (but not abuse) of a dominant position is the relevant test. The Commission, clearly treading on thin ice, makes no attempt to justify its preliminary conclusion that the BA-AA agreement infringes Article 86. While it is doubtful that the Court of Justice would uphold such a conclusion, until the Court decides on the matter, the threat of finding an Article 86 infringement may play a more significant role in the Commission’s future reviews of airline alliances that do not fall within the Merger Regulation.

IV. PROPOSED CHANGES IN EC COMPETITION LAW WHICH WOULD AFFECT THE REVIEW OF FUTURE ALLIANCES INVOLVING THIRD COUNTRY ROUTES

The Commission has proposed an amendment to the regulation implementing the competition rules in the air transport sector that would allow the Commission unilaterally to apply the EC competition rules to airline alliances involving third country routes. Concurrently, the Commission has proposed a new regulation to enable it to grant block exemptions to air transport agreements involving third country routes. The Commis-

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Commission's proposal has already been approved by the European Parliament. If approved by the Council, these amendments would resolve the existing conundrum of dual competences under Articles 88 and 89. The Commission would gain exclusive authority to apply the EC competition rules to future alliances involving routes outside the Community.

The first proposed change is to Regulation 3975/87, which implements the EC competition rules in air transport. Currently, the competition rules have only been implemented in the area of air transport between and within Member States. The proposed amendment to Regulation 3975/87 would extend the application of the competition rules to air transport agreements involving third country routes. The Commission would, as a result, be empowered to apply Article 85 directly to airline alliances such as BA-AA, which involve third country routes, thereby eliminating the current need for the Commission to act in coordination with the national competition authorities under Article 89.

Council Regulation 3976/87 enables the Commission to grant block exemptions in the field of intra-Community air transport, i.e., air transport between and within Member States. The Commission has proposed a Regulation that would compliment Regulation 3976/87, extending the scope of the block exemptions in the sector to “international air transport between the Community and third countries.” The proposed regulation would allow air transport agreements involving third country routes, which fall within the scope of the block exemptions, to be shielded from Article 85 review.

See EUR. PARL. DOC. A4-0141/98 (1998) (the "Scarbonchi report").

See Council Regulation 3975/87, supra note 55 (implementing the competition rules to air transport between Member States); Council Regulation 2410/92, supra note 78 (extending the implementing regulation to domestic air transport).


Council Regulation 3976/87 initially applied only to air transport between Member States, but was amended to apply to air transport within a single Member State. Council Regulation EEC 3976/87, supra note 34; Council Regulation 2411/92, supra note 34.

The above-mentioned proposed changes to EC legislation ultimately may benefit U.S. and other non-EC airlines contemplating alliances with Community carriers. A carrier such as American Airlines would rather have its alliance with British Airways reviewed by British authorities who are sympathetic to BA's cause,\(^{212}\) than by the European Commission. However, considering the rather brazen manner with which the Commission has exerted its authority in this case, it might have been easier for the airlines had the British authorities not been involved. Indeed, considering that the parties already had to answer to both the Commission and the U.S. Department of Transportation (which has made the conclusion of a U.S.-U.K. open skies agreement a condition to approving the BA-AA alliance), things might have been easier had the parties been able to limit their negotiations to Washington and Brussels.

Moreover, placing exclusive authority in the hands of the Commission should bode well for the shortening of review procedures. By allowing the Commission to investigate without the assistance of Member State authorities, reviews should move at a quicker pace. Prompt regulatory review is essential in a rapidly consolidating industry where two-year delays in the implementation of an alliance can place the carriers involved at a significant disadvantage vis-à-vis their major competitors.

V. CONCLUSIONS: CLEARER SKIES AHEAD?

The Commission's reviews of the BA-AA, Lufthansa-SAS, and Swissair-Sabena alliances provide helpful case studies for non-EC airlines contemplating an alliance with an EC carrier because they indicate the types of concessions that the Commission is likely to demand in exchange for clearance. While it is now up to the Council to decide whether the Commission's authority to act under Article 85 extends to its consideration of alliances involving third country routes, such an extension likely would impact only the effectiveness with which the Commission can act on these alliances, not the kinds of concessions the Commission would require of them to ensure sufficient competition.

The Commission is unlikely to prohibit an alliance without attempting to seek concessions from the partners which would,\(^{212}\) The U.K. Office of Fair Trading has expressed willingness to approve the alliance upon the relinquishment of 168 take-off and landing slots. *See* Robert Rice & Emma Tucker, *UK Defiant on Transatlantic Alliance*, *FIN. TIMES*, Jan. 15, 1997, at 2.
in its opinion, make the deal compatible with the common market. Based on the Commission's practice to date, non-EC carriers entering into alliances should expect their alliance to be required to freeze or even reduce frequencies, relinquish take-off and landing slots to competitors at key airports, and to permit competing airlines to join their alliance's interlining and frequent flyer program agreements. The question faced by non-EC airlines contemplating such alliances is, therefore, how much they are willing to sacrifice and how much time they are willing to devote to negotiating a clearance before the deal becomes either impracticable or undesirable.