Competition in Air Transport — The Need for a Shift in Focus

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I. INTRODUCTION

A preeminent regulatory challenge confronting air transport is the need to update policies, guidelines, and other regulatory instruments to address global changes in the aviation environment. Recent pressures on commercial aviation require that the industry shift its focus to encourage free competition. The industry must either enact measures that enable airlines to fully maximize market potential, or risk falling apart.

Traditionally, competition in commercial aviation was not truly "free." From the beginning of regulated civil aviation in 1944, marked by the signing of the Chicago convention,[1] competition remained, until recently, rigidly regulated. Competition in commercial aviation was based on predetermined capacities, which limited opportunities for a carrier to enter a market, stunting the growth of the global air transportation sys-

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1. Chicago Convention on International Civil Aviation, Dec. 7, 1944, 61 Stat. 1180, T.I.A.S. 1591, 15 U.N.T.S. 295 [hereinafter Chicago Convention].

tem.[2] The air transport industry thus became comfortable and languid, with established legacy carriers dominating a vastly untapped market.[3]

However counterintuitive this system may seem in today's economy, the air transport system of the past had its advantages when considered in light of the technological limitations of the times. For instance, even then, a consumer in almost any corner of the globe could fly seamlessly to almost any other part of the world through a single transaction. Complex, but reasonably efficient, sets of working relationships between hundreds of individual air carriers facilitated this relatively smooth network. Transaction costs were low; a single call to a travel agent could finalize a transcontinental flight. This was possible because individual airlines themselves ensured the provision of their services, infrastructure and procedures to connect passengers and freight both within their own networks and to those of connecting carriers

Today, the story is somewhat different. Changing market conditions and a growing demand for air transportation, roughly equal to double the rate of the growth in the general economy, has naturally led the industry towards sophistication and technological improvements. The exponential infusion of capacity to meet growing demand has required costly systems and infrastructure. A primary result is that air transport has become more expensive.

The industry has recently faced other challenges, *e.g.*, terrorism and environmental regulations. The airline industry suffered a tremendous blow in September of 2001. The threat of terror brought such problems as more expensive aviation insurance and the need to cancel flights on an emergency basis.[4] The initial setback suffered due to the events of 11 September 2001, combined with the impact of an economic downturn and an initial precipitous decline in air travel, portended an inevitable gloom for the air transport industry. This became a reality when air traffic suffered an abrupt downfall globally during 2001.[5] Subsequent retaliation by the world community against terrorism further increased passengers' fear and reluctance to use air transport.[6]

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2. WTO, *International Trade in Air Transport: Recent Developments and Policy Issues*, *in* WORLD TRADE REPORT 2005: EXPLORING THE LINKS BETWEEN TRADE, STANDARDS AND THE WTO 213, 224 (2005), *available at* www.wto.org/English/res_e/booksp_e/anrep_e/world_trade_report05_e.pdf (last visited Mar. 10, 2006) [hereinafter WORLD TRADE REPORT 2005].

3. *Id.*

4. *2001 Annual Civil Aviation Report*, ICAO J., Sept.-Oct. 2002, at 6, 12.

5. *Id.* at 12,13.

6. *See, e.g.*, Mariel Garza, *Travel Fears Alters Southern Californians' Travel Plans, Experts Say*, LOS ANGELES DAILY NEWS, Nov. 21, 2001. The International Civil Aviation Organization, in its annual report for the year 2001, recorded that following the events of 11 September 2001, total passenger traffic decreased by 3.9 percent over the previous year and international freight tonnes kilometers by 5 percent. *2001 Annual Civil Aviation Report*, *supra* note 4, at 12.

In the years that followed, several events compounded the setbacks initiated by 9/11. The build up to the war in Iraq in 2002, followed by the beginning of the war in 2003, and the outbreak of Severe Acute Respiratory Syndrome (SARS), the failing global economy and the continuing terrorism threat, all had negative effects on the industry.[7] These unfortunate historical landmarks proved to be the industry's "four horsemen of the Apocalypse," each holding serious ramifications for air carriers.[8] The ill-effects stemming from these events were seen in rising security and insurance costs, massive employee lay-offs, drastic reduction of unprofitable routes, closure of facilities, and cessation of airline operations.[9] Increasing costs of security enforcement and insurance, in combination with falling traffic volume, prompted air carriers to cancel or postpone new aircraft requisition orders.[10] Many carriers, particularly in developing countries, had to revisit their cost structures and downsize their human resource bases.[11] The manufacturing industry experienced a colossal loss in 2002 as aircraft orders were deferred, resulting in significant cutbacks in employment.[12] Airports and air navigation service providers suffered a similar fate, losing income from user charges and non-aeronautical revenues, while at the same time facing enhanced insurance and security costs.[13]

Other consequences of the proliferation of air travel were emerging environmental concerns, including aircraft noise and engine emissions, as well as airport congestion and slot allocation.[14] The explosion in air travel also facilitated the free movement of diseases.[15] Further, the industry's focus on safety began to decline as competition between carriers led some carriers to expand at any cost, ignoring potential adverse consequences. Critical services required for aviation safety, such as efficient ground handling and precise engineering, were outsourced, with no guarantee of

7. Speech by Giovanni Bisignani, President, Int'l Air Transp. Ass'n, State of the Industry (June 7, 2004), http://www.iata.org/pressroom/speeches/2003-06-02-01.htm (last visited Mar. 14, 2006).

8. *Id.*

9. Peter Morrell & Fariba Alamdari, *The Impact of 11 September on the Aviation Industry: Traffic, Capacity, Employment and Restructuring* 6 (Int'l Labour Office Working Paper No. 181, 2001), *available at* www.ilo.org/public/english/dialogue/sector/techmeet/tmica02/tmica-wp181.pdf (last visited Mar. 14, 2006).

10. *See* Yann Cochennec, *What goes up . . . Aircraft orders and deliveries slid dramatically in 2002, but 2003 will be even tougher*, INTERAVIA BUS. & TECH., Jan. 1, 2003.

11. *See* Morell, *supra* note 9, at 7.

12. *Id.* at 7-8; Cochennec, *supra* note 10.

13. *2001 Annual Civil Aviation Report*, *supra* note 4, at 24.

14. *See* WORLD TRADE REPORT 2005, *supra* note 2, at 223-24.

15. For a general discussion of the legal and regulatory implications of SARS and the airline industry, see Ruwantissa I.R. Abeyratne, *International Responsibility in Preventing the Spread of Communicable Diseases through Air Carriage - The SARS Crisis*, 30 TRANSP. L.J. 53 (2002).

maintaining previously demanded levels of flight safety.[16]

Despite the industry's troubles, international airline services have survived because neither a single nation nor the global aviation community has ever deregulated airline safety and security. Governments have continued to bear the responsibility of providing additional capacity, funding safety and security inspectors, and ensuring that carriers operate air services with full insurance coverage, however expensive. In this way, the world economy has not run aground for lack of international air services.

Additionally, all 188 signatories to the 1944 Convention on International Civil Aviation (Chicago Convention) have been able to rely on the ICAO for regulatory solutions that have kept the airline industry from descending into unmanageable crisis. In the recent past, ICAO has passed regulations on safety and security, established and conducted safety and security audits, adopted much needed principles of guidance on facilitation, assisted in preventing the spread of disease by air carriage, and even developed a global aviation insurance program to support in the insurance industry in the case of future emergencies of a similar scale to 11 September 2001.[17]

Notwithstanding the setbacks of 9/11 and a subsequent slowdown in economic growth, current trends suggest that the world economy will remain moderately stable and healthy in the near future.[18] The airline industry has generally experienced long-term marginal profitability through cyclical fiscal growth, with profitable periods intermixed by less successful periods.[19] One of the reasons for this fluctuating pattern is that the industry is driven by multiple variable factors, such as passenger demand, operational and technological changes, and regulatory control.[20]

Demand for air travel has several determinants. Primarily, the amount of air travel is determined by income levels, demographics and the cost of air travel.[21] With regard to the cost of air travel, world energy prices are one of the key factors driving both the profitability of the air carrier industry and the costs passed down by the carrier to the consumer.[22] The continuing upward trend in fuel prices will increase airline fixed costs, meaning that to remain competitive, airlines will increasingly

16. *See Layers of Maintenance Outsourcing, Use of Subcontractors Difficult to Track*, AIR SAFETY WK., Jan. 30, 2006.

17. *Annual Review of Civil Aviation 2003*, ICAO J., Sept. 2004, at 4, 5-6.

18. *Id.* at 4.

19. RIGAS DOGANIS, AIRLINE BUSINESS IN THE 21ST CENTURY xi (2001).

20. *Id.*

21. PAT HANLON, GLOBAL AIRLINES: COMPETITION IN A TRANSNATIONAL INDUSTRY 12 (1996).

22. *Id.* at 22.

be defined in trade terms with a firm focus on services.[23] This will lead to further global alliances and partnerships between carriers, based on 'core' groups of airlines providing direction and focus as a key element in industry strategic development. Improved coordination will provide integration and stability to the air transport industry. Moreover, the continuing outsourcing of non-core activities will encourage fledgling carriers to emerge in a liberalized market. Also, larger airlines will seek to maximize franchising opportunities and code sharing agreements with other airlines. They will also seek to create low cost subsidiaries wherever possible, while at the same time looking to consolidate their services with other carriers. In the process, existing distinctions between scheduled and non-scheduled (charter) carriers will be minimized. In terms of service distribution, airlines will invest in e-commerce, concentrating as much as possible on selling their services directly on-line.

The preeminent regulatory challenge confronting the air transport industry is to update policies, guidelines and other regulatory instruments to address recent changes in the aviation environment. Competition, when coupled with the international liberalization of air services, will require a more open regulatory approach.

However, it is not prudent to consider air transport services as a typical economic activity. The overarching objective of the ICAO, as contained in Article 44 of the Convention on International Civil Aviation, is for the ICAO to foster the planning and development of international air transport so as to "meet the needs of the peoples [of the world] for safe, regular, efficient and economical air transport."[24] This fundamental declaration not only draws the inference that air transport is a public utility, but also challenges the ICAO, its contracting states, and their carriers to ensure the provision of a safe service that satisfies fixed standards of continuity, regularity, capacity and pricing.[25]

As air transport is at the same time both a public utility and a free commercial enterprise, there must be a delicate balance between untrammelled competition and overly restrictive regulation. While the first approach may give rise to the predictable free-market inhibitors such as airport, airway and runway congestion, the other may hinder air transport services to such a degree that demand cannot be met.

The challenge to reach such a balance is highlighted in two areas: insufficient airport capacity and revenue management. First, the growth in commercial air services has continued to outstrip the available capacity

23. *Id.*; *see* WORLD TRADE REPORT 2005, *supra* note 2, at 221.

24. Chicago Convention, *supra* note 1, art. 44.

25. Int'l Civil Aviation Org. [ICAO], *Policy and Guidance Material on the Economic Regulation of International Air Transport*, at 1-18, ICAO Doc. 9857 (2nd ed.1999) [hereinafter *ICAO Economic Policy Guidance Material*].

at more and more airports. Although many airports with congestion problems are located in Europe, a growing number of airports in other regions are reaching capacity limits.[26] Moreover, because of the interconnected operations of the international air transport system, capacity constraints at some airports adversely impact other airports.[27] Airport congestion is a challenge to the continued growth of air transport and also impacts further industry liberalization with respect to market access.[28] For instance, some airports may be required to enter into alliances with other airports just to survive.[29]

Governments, airlines and airports have each developed measures to overcome or ameliorate situations of insufficient airport capacity. Many states have expanded existing runways or terminals or built new airports.[30] At least one inter-governmental body and a regional body have taken action to improve air traffic control systems designed to increase the airport capacity.[31] Despite increased security requirements after the events of 11 September 2001, airports and air carriers have been able to enhance airport capacity by improved facilitation at existing facilities.[32] However, environmental, economic, political and physical constraints have, in some instances, prevented physical expansions to increase airport capacity.[33]

In the wake of trends in privatization of airports and air navigation services, such issues as liability, appropriate cost pricing, revenue allocation and investment management are becoming more important.[34]

In order to improve international cooperation and achieve a well-meshed and competitive policy, states must first eliminate anti-competi-

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26. *See* WORLD TRADE REPORT 2005, *supra* note 2, at 223.

27. *See* HANLON, *supra* note 21, at 140-41.

28. *Id.* at 141.

29. *See* Aaron Karp, *Growth in airport alliances predicted*, AIR TRANSP. INTELLIGENCE, Sept. 10, 2001.

30. As was noted by the WTO:

> A number of high growth international ports, such as Hong Kong, China (1998), Osaka (1994), Kuala Lumpur (1998) and Shanghai (2002) have built new airports to deal with the [capacity] problem . . . London's Heathrow airport is particularly notable for the capacity constraint problem. After decades of struggling to deal with congestion, the authorities have decided to build a new terminal and a short runway.

WORLD TRADE REPORT 2005, *supra* note 2, at 222.

31. For example, in April 2001, the Federal Aviation Administration (FAA) announced a set of initiatives in its Operational Evolution Plan, which is designed to increase capacity within the United States national air space. *See* GOV'T ACCOUNTING OFFICE, GAO-01-725, AIR TRAFFIC CONTROL: ROLE OF FAA'S MODERNIZATION PROGRAM IN REDUCING DELAYS AND CONGESTION 5 (2001).

32. *Annual Review of Civil Aviation 2003*, *supra* note 17, at 10.

33. *See* WORLD TRADE REPORT 2005, *supra* note 2, at 222.

34. Gunnar Finnsson, *Move to Privatization of Airports Requires Careful Consideration of Numerous Factors*, ICAO J., Jan.-Feb. 1993, at 18.

tive practices. One way of ensuring collective state action in this regard might be for states to enter into agreements toward combating restrictive trade practices, either bilaterally or plurilaterally. This can only be achieved with a robust and effective international legislative structure.

As for liberalization of air transport, there has so far been no indication that any state favours a total opening of its domestic market.[35] Strategic alliances between airlines, whether through mergers or other arrangements, are viewed cautiously by individual airlines and states so as to preclude the total overrunning of local interests.[36]

The question of fundamental importance to international civil aviation is whether the global community should consider the operation of air transport services as a trading activity or as a public utility.[37]

The two integral areas that will carry the sustainability of air carriers and assurance of air services in the years to come will be regulatory control and economic strategy.[38] It seems likely that competition will be increasingly between airline alliances rather than individual carriers. Markets will be unstable, and only the individual airlines that go "back to basics" to offer the consumer a service as "value for money" will survive.

Both states and carriers must share responsibility to ensure continuity of air transport services. The uniqueness of the operation of air transport services lies in the symbiosis between states and carriers. Although air transport may be heavily privatized in some instances, particularly in the developed world,[39] it does not take away the overall regulatory supervisory role of the state and its obligation to support its carriers.[40]

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35. *See* HANLON, *supra* note 21, at 48.

36. ORG. FOR ECON. CO-OPERATION & DEV. [OECD], THE FUTURE OF INTERNATIONAL AIR TRANSPORT POLICY: RESPONDING TO GLOBAL CHANGE 12 (1997) [hereinafter GLOBAL CHANGE].

37. HANLON, *supra* note 21, at 29-30.

38. *See* Ruwantissa I.R. Abeyratne, *Sustainability of Air Carriers and Assurances of Services*, 68 J. AIR L. & COM. 3, 7 (2003).

39. *E.g.*, Belgium's Sabena airlines in 1997 was forty-nine per cent foreign owned, Australia's Qantas airlines was forty-nine per cent foreign owned, and the United State's Northwest Airlines was twenty-four per cent foreign owned. GLOBAL CHANGE, *supra* note 36, at 77 tbl 3.5.

40. This is particularly true in the area of airline safety. As Hanlon has noted:

> In the discussion of airlines as quasi public utilities, the question of safety is often raised. Air transport is a fail-dangerous activity, a fail-extremely dangerous one. It has always been regarded as having unique safety problems because of the nature of its vehicle. There is a widely held view that market forces alone cannot be expected to elicit from all airlines and consistent degree of attention to safety standards. . ..[However], [t]he need for technical regulation of safety is one of the few things on which governments have reached unanimous agreement. Under the aegis of the International Civil Aviation Organization, governments have agreed on [various] operational requirements [related to safety].

HANLON, *supra* note 21, at 31-32.

From a regulatory perspective, the challenges are to update and promote ICAO policies and guidelines to meet the demands of a changing environment and to seek a balance between promoting economic growth in the industry and strengthening security measures and facilitation. In order to address these challenges, all players involved need to seek a balance between a liberalized economic regulatory framework and proper safety, security, social and labor standards.

II. Competition in Air Transport

Competition is defined by the market conditions that allow buyers and sellers to interact and establish prices and the system by which goods and services are exchanged.[41] Competition in the air transport industry is a complex process, not yet precisely defined by airline economists.[42] In the case of the airline passenger, there is segmentation in travel between the business traveler, who does not usually pay for the travel himself, and leisure travelers, who pay their own way.[43] The leisure market competition is therefore primarily based on the fare, whereas in business travel other considerations, such as facilities on board, play a more considerable role.[44]

From a legal perspective, competition is associated with the rights of the competitor as well as the consumer, whereby the former is precluded from exercising dominance over others by trying to eliminate, restrict or deter competition[45] (an action termed "predation"[46]).

Unfair competition, which occurs when one competitor is being a dishonest or fraudulent rival, usually refers to the misrepresentation of one's product through deceptive packaging, labeling, pricing of goods and services offered.[47] In a broad sense, unfair competition refers to any activity that unfairly creates an advantage.[48] Competition law *de lege fer-*

41. *See* Michael E. Porter, On Competition 21 (1998). Mr. Porter has identified five key market conditions determining competition levels and type within a given industry. These are entry, threat of substitution, bargaining power of buyers, and rivalry amongst current competitors. *Id.* at 22 fig1.1.

42. *See* Hanlon, *supra* note 21, at 28-45 (discussing various economic descriptions of the global airline industry as either giving rise to a natural oligopoly, or, more recently, to a contestable market).

43. OECD, Deregulation and Airline Competition 20 (1988).

44. *Id.* at 21.

45. Pat Hanlon, *Discriminatory Fares: Identifying Predatory Behavior*, 1 J. Air Transp. Mgmt. 89, 91-96 (1994).

46. Hugo B. Roos & Niels W. Sneek, *Some Remarks on Predatory Pricing and Monopolistic Competition in Air Transport*, 22 Air & Space L. 154, 154 (1997).

47. Black's Law Dictionary 69 (8th ed. 2004).

48. *Id.*

enda[49] would dictate that in a state of "perfect competition" there would be a benchmark for evaluating the performance of individual participants in actual markets.[50] Under conditions of perfect competition, goods and services would be produced as efficiently as possible and consumers would get the maximum amount of the goods and services.[51]

Unfortunately, the economic variants in air transport are far too complex to be analyzed on the basis of "perfect competition".[52] The air transport industry thus looks to a "workable competition" model. Introduced by American economist John M. Clark in 1940,[53] the notion of workable competition rests on two premises. First, in most industries the number of business firms is not so great as to preclude an individual firm from having some power to influence market prices and conditions.[54] Second, participants rarely have complete knowledge of market conditions.[55]

Mr. Clark theorized, however, that departures from perfect competition are often not great enough to warrant government intervention into the market (through antitrust action or direct regulation),[56] since the results achieved could be approximately comparable to the outcome of the perfect competition.[57] The main difficulty of the workable competition concept is that no precise criteria have been developed to determine when it actually exists.[58] This is certainly true of competition in the air transport industry.

The airline industry has always been in the throes of a dichotomy. On the one hand, while it has been international in terms of operations, the industry has been national with regard to matters of ownership and control of airlines and interests relating to market access.[59] The latter, brought to bear by regulatory inhibition prohibiting airlines from freely accessing markets through remote routes, and prevailing restrictions as to

49. "'From law to be passed.' A proposed principle that might be applied to a given situation instead or in the absence of a legal principle that is in force." Id. at 32.

50. OECD, *Glossary of Industrial Organization, Economics and Competition Law*, 66, Dec. 1999, *available at* http://www.oecd.org/dataoecd/8/61/2376087.pdf (last visited Mar. 13, 2006) [hereinafter *Glossary*].

51. *Id.*

52. GLOBAL CHANGE, *supra* note 36, at 11-12.

53. *See generally* J.M. Clark, *Toward a Concept of Workable Competition*, 30 AM. ECON. REV. 241 (1940).

54. *Id.* at 243.

55. *Id.* at 244-45.

56. *Id.* at 256.

57. *Id.* at 241-42.

58. For a thorough critique of the concept, see George W. Stocking, *The Rule of Reason, Workable Competition, and Monopoly*, 64 YALE L. J. 1107, 1109 (1955) and *Glossary*, *supra* note 50, at 86.

59. DOGANIS, *supra* note 19, at 19.

who owns and controls an airline that bears the nationality of a state, has been increasingly viewed as overtly restrictive in an expanding air transport market. [60] This has led to a gradual liberalization of market access as well as ownership and control in many parts of the world.[61]

A. Current Trends in Competition

Current competition in global air transport presents unique strategic issues. Global industries, such as multinational air carrier alliances, are characterized by the presence of competitors operating worldwide from home bases in different countries.[62] Host governments may have deeply rooted interests and objectives relating to airline employment and the balance of payments, along with other concerns that may not be strictly economic.[63] Therefore, airlines will be increasingly examining the relationships between individual air carriers and their governments.[64] The home country's industrial policy must be well understood, particularly in terms of the political considerations that may relate to such issues as purchases of aircraft and the exchange of market rights.[65]

As a global industry, commercial entities in air transport develop global competitive strategies,[66] which involve a coordinated world-wide pattern of market positions, facilities and investments.[67] Factors considered include the overlap between competitors, geographic location of carriers, and defensive investments in particular markets and locations that stop competitors from gaining advantages.[68]

Those supporting the retention of regulation argue that the very nature of air transport, being either naturally monopolistic or interdependently oligopolistic, calls for regulation in order that fares remain competitive and are not arbitrarily raised.[69] Another theory in support of regulation is that some form of control should be exercised over "mushroom" airlines that may sprout up to exploit a liberalized market, thus disturbing the existing balance of an integrated network.[70]

The main consideration of efforts by the international aviation community to achieve a deregulated global airline industry is evaluating

60. *Id.*
61. *Id.* at 6.
62. Michael E. Porter, Competitive Strategy 275 (1980).
63. *Id.* at 286.
64. *See* Global Change, *supra* note 36, at 13-15.
65. *Id.* at 16.
66. *See* Porter, *supra* note 62, at 276.
67. *Id.* at 277.
68. *Id.* at 291-98.
69. Hanlon, *supra* note 21, at 33.
70. *Id.* at 35-37.

whether free market principles can be applied globally to air transport.[71] Specifically, whether the industry is ready to accept the consequences of free market competition in air transport, particularly the loss of national prestige projected by flag carriers.[72]

Following industry deregulation, companies switch from operative performance to competitive performance.[73] Indeed, the deregulation of domestic air transport industry of the United States, introduced in 1978, has led to a more efficient airline system.[74]

Access to facilities is essential toward attaining fluidity of market forces.[75] In the air transport industry, this specifically addresses the supply of complementary facilities, namely, airport access, computer reservation systems and airport and air regulation services.[76]

In a policy statement, the International Chamber of Commerce (ICC) expressed the view that the efficiency of air transport would be enhanced by creating more open markets and more flexibility with regard to foreign ownership.[77] The ICC is in favor of more freedom in the exchange of air services throughout the world and is convinced that it is time to move beyond the existing bilateral system toward a genuine multilateral liberalization of air transport.[78]

Liberalization and the ensuing competition would impel airlines to pool their resources (such as code sharing and airport slots) in order to maximize assets.[79] However, alliances do not necessarily mean lack of competition between partners. Airlines within alliances need to gain market access, which in turn requires that both private enterprises and the states in which these enterprises are entrenched be equally competitive.[80]

Any agreement to liberalize trade is generally a proactive measure and depends on the willingness and ability of the governments to face

71. GLOBAL CHANGE, *supra* note 36, at 14, 18-19.

72. *See id.* at 18-19 (outlining the necessary changes that nations must be willing to make).

73. RUWANTISSA I.R. ABEYRATNE, AVIATION IN CRISIS 74 (2004).

74. *See* GLOBAL CHANGE, *supra* note 36, at 82. For a comprehensive analysis of the United States deregulation experience, see generally, TRANSP. RESEARCH BD., SPECIAL PUBLICATION 270, WINDS OF CHANGE: DOMESTIC AIR TRANSPORT SINCE DEREGULATION (1991).

75. *See* GLOBAL CHANGE, *supra* note 36, at 68.

76. *Id.* at 68-69.

77. INT'L CHAMBER OF COMMERCE [ICC], COMMITTEE ON AIR TRANSPORT, DOC. NO. 304-2/23 REV. 3, THE NEED FOR GREATER LIBERALIZATION OF INTERNATIONAL AIR TRANSPORT 1 (2005), *available at* http://www.iccwbo.com/uploadedFiles/ICC/policy/transport/Statements/304-2-23-Rev3-EN-1-12-05.pdf (last visited Mar. 16, 2006).

78. *Id.* at 7.

79. *See* RUWANTISSA I.R. ABEYRATNE, AVIATION TRENDS IN THE NEW MILLENIUM 4 (2001).

80. HANLON, *supra* note 21, at 212-13.

trading issues squarely.[81] Any agreement on trading benefits would be ineffective without competition between both the enterprises and the states.[82] A free trade agreement is merely the catalyst in the process.[83]

B. Antitrust Regulation in Europe, the United States and the ICAO

The regulation of competition within the European Community is governed by the EC Treaty.[84] The goals of the Treaty are to promote the free movement of services, goods, persons and capital while effectively obviating barriers to trade within the community.[85] Two provisions in particular, Articles 81 and 82, contain principles which outlaw anti-competitive conduct.[86] While the former essentially contains provisions for agreements, decisions or practices with anti-competitive effects, the latter concerns itself with abuses of a dominant market position.[87] Both these provisions relate generally to all sectors of transport unless explicitly excluded by the Treaty provisions.[88]

Article 81 prohibits agreements that:

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81. Abeyratne, *supra* note 73, at 74.

82. *Id.*

83. *Id.*

84. Treaty Establishing the European Community, Nov. 10, 1997, 1997 O.J. (C340), *amended by* Treaty of Nice, 2001 O.J. (C 80) 1 [hereinafter EC Treaty] *reprinted in* Barry E. Carter, Phillip R. Trimble & Curtis A. Bradley, International Law: Selected Documents 230 (2003-2004 ed., Aspen Publishers 2003) ("The Treaty Establishing the European Community (or Treaty of Rome) was signed on March 25, 1957, and entered into force on January 1, 1958. The Single European Act was signed in February 1986, and came into force on July 1, 1987. The Treaty on European Union was signed at Maastricht on February 7, 1992, and came into force on November 1, 1993. The Treaty Establishing the European Community created the European Economic Community, what was initially one of the three European Communities and then an integral part of the European Community . . . . The whole entity came to be known as the European Union after the Maastricht Treaty came into Force in 1993. The Treaty Establishing the European Community was amended on January 1, 1995, by the instruments concerning the accession of Austria, Finland and Sweden to the European Union. The Treaty of Amsterdam, which was signed on October 2, 1997 and entered into force on May 1, 1999, further amended the Treaty Establishing the European Community and renumbered the articles. The Treaty of Nice, which was signed on February 26, 2001, and entered into force on February 1, 2003, once again amended the Treaty, with a view to easing the Union's expansion to a membership of 25 states, planned for 2004. Incorporating the changes made by the Treaty of Amsterdam and the Treaty of Nice, the new version of the treaty is known as the Consolidated Version of the Treaty Establishing the European Community. It includes the Protocol on the Enlargement of the European Union, adopted at Nice in 2000.").

85. *See id.*

86. EC Treaty arts. 81-82.

87. *Id.* art. 82.

88. Case 167/73, Comm'n of the European Cmtys v. French Republic, 1974 E.C.R. 359; Bernardine Adkins, Air Transport and E.C. Competition Law 2 (1994).

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; and

e) make the conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of those contracts.[89]

These conditions are imposed on agreements between undertakings, which are defined as independent entities performing some economic or commercial activity.[90]

Article 82 provides that "any abuse by one or more undertakings of a dominant position within the Common Market, or in a substantial part of it, shall be prohibited as incompatible with the Common Market in so far as it may affect trade between member states."[91] Similar to Article 81, this Article prohibits direct or indirect imposition of unfair purchase or selling prices or unfair trading conditions; limitation of production, markets or technical development to the prejudice of consumers; application of dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; and conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.[92]

In implementing these two provisions, air carriers have to exercise caution not to assume that a related practice would be exempt from the prohibitions contained in Articles 81 and 82 purely in view of a bloc exemption on air transport in the Treaty that may pertain to a particular issue. In the air transport section of the Treaty, it is abundantly clear that block exemptions may apply only if abuse of a dominant position is not evident in a given transaction.[93] Articles 81 and 82 are independent and complementary provisions and any exemption under Article 81 will not necessarily render the provisions of Article 82 nugatory.[94]

"Dominant position" was defined in the 1979 decision of *Hoffman-La Roche* v. *Commission* as "a position of economic strength enjoyed by

89. EC Treaty art. 81.
90. *Id.*
91. *Id.* art. 82.
92. *Id.*
93. *See* ADKINS, *supra* note 88, at 81.
94. Case T-51/89, Tera Pak Rausing SA v. E.C. Comm'n, 1991 C.M.L.R. 334.

an undertaking which enables the prevention of effective competition in the relevant market by affording the business the power to behave independently of its competitors, its customers and ultimately its consumers.[95] Such a position may preclude some competition except in monopoly or quasi-monopoly situations.[96] There is every indication, from existing jurisprudence and EC practice, that an assessment of an abuse of dominant position would not be predicated upon one factor or a single characteristic but would rather be anchored on numerous factors such as market structure, barriers to entry and conduct of the business enterprise concerned.[97]

In the United States, the term "antitrust laws" encompasses federal and state legislation that regulate competition and outlaw unfair trade practices.[98] Antitrust laws apply equally to international air services and preclude both conduct and structural changes in business enterprises.[99] A typical example of conduct falling under antitrust laws in the United States is a merger between competitors that would unduly limit competition.[100] These laws are also meant to prevent producers or purchasers of goods from exercising a monopoly in imposing prices which significantly deviate from expected free-market norms.[101]

Antitrust legislation in the United States goes back to 1890 and the enactment of the Sherman Act, which makes it criminally illegal to form any contract, combination or conspiracy in restraint of trade.[102] This all-encompassing provision prohibits price fixing, anti-discounting agreements, divisions of markets by pooling agreements, and capacity agreements and exchanges of information that can be considered as competitively sensitive.[103] The Act also prohibits monopolies and conspiracy to monopolize.[104] In 1914, the United States Congress legislated

95. Case 85/76, Hoffman La Roche & Co. AG v. Comm'n of the European Cmtys, 1979 E.C.R. 461.

96. *Id.*

97. *See id.*

98. *See* Sherman Antitrust Act, 15 U.S.C. §§ 1-7 (2000); U.S. CONST. art. 1, § 8, cl. 2.

99. *See* Elenor M. Fox, *Antitrust Regulation Across National Borders*, 16 BROOKINGS REV. 30, 30-32 (1998) (discussing examples of US antitrust regulations governing international air services).

100. See COMPETITION COMM., OECD., DAF/COMP(2005)13, UNITED STATES REPORT ON COMPETITION LAW AND INSTITUTIONS 3 (2004), http://www.oecd.org/dataoecd/45/24/34343090.pdf.

101. *See* Sherman Act, ch. 647 § 1, 26 Stat. 209 (1890) (current version at 15 U.S.C. § 1 (2000)).

102. 15 U.S.C. §§ 1-7.

103. *Id.*

104. *Id.* § 2.

the Clayton Act,[105] primarily as a supplement to the Sherman Act. The Clayton Act outlaws certain types of "exclusive dealing" and "tied sales" and prescribes standards for determining the legality of mergers and acquisitions.[106]

Both Acts provide for compensation to persons injured in their trade or business up to three times the amount of their loss, plus attorney fees.[107] Along with the protections offered by these Acts, courts have also permitted consumer class actions as an antitrust activity, leading to significant recovery of damages.[108]

In its role as the sole international regulatory body in the field of air transport, the International Civil Aviation Organization has issued clear policy and guidance material on the avoidance or reduction of conflicts over the application of competition laws to international air transport.[109] The ICAO has issued these guidelines to address the conflicts that may arise between states that adopt policies, practices and laws relating to the promotion of competition and restraint of unfair competition within their territories.[110] The ICAO urges states to ensure that their competition laws, policies and practices, and any application thereof to international air transport, are compatible with their obligations under relevant international agreements.[111] Within this guideline, there is a strong recommendation for close consultation between all interested parties in order to achieve maximum uniformity in practice across borders.[112] Accordingly, when a state is adopting laws pertaining to competition, it is expected to give full consideration to views expressed by any other state or states whose interests in international air transport may be affected.[113] States are urged to have full regard to principles of international comity, moderation and restraint.[114] The guidelines also provide direction on dispute resolution and problem solving.[115]

The regulation of air transport services lies within the purview of

105. *See* Clayton Act, ch. 323 § 7, 38 Stat. 730 (1914) (current version at 15 U.S.C. § 12 et seq. (2000)).

106. 15 U.S.C. §§ 13, 18.

107. *Id.* § 15.

108. *See, e.g., In re* Delta Airlines, 310 F.3d 953, 953 (6th Cir. 2002) (holding that class action alleging violations of the Sherman act was allowed to proceed); FED. R. CIV. P. 23 (governing class action lawsuits in the United States).

109. ICAO, *Manual on the Regulation of International Air Transport*, ¶ 4.1-1, ICAO Doc. 9626 (1st ed.1996) [hereinafter *ICAO Regulation Manual*].

110. *ICAO Economic Policy Guidance Material, supra* note 25, ¶ A2-1.

111. *Id.* ¶ A2-2.

112. *Id.*

113. *Id.*

114. *Id.*

115. *Id.* ¶ A2-5.

ICAO member states.[116] The ICAO retains in its Legal Bureau a register of all bilateral air transport agreements.[117] Bilateral air transport agreements usually include a reciprocal agreement between states allowing their carriers to have fair and equal opportunity in operating air services between their territories without unduly affecting the air services operated by each.[118] Under a bilateral agreement, capacity offered by carriers must bear close relationship to the needs of the people using air transport.[119] These regulatory provisions have so far succeeded in protecting carriers of lesser developed states by securing them fair and equal opportunity to operate air services in routes that are shared by more established carriers of wealthier nations.[120]

Since the World Trade Association (WTO) cannot sustain air transport services within a bilateral framework,[121] it remains to be seen whether the aviation community would move towards placing air traffic rights in a multilateral or plurilateral system.[122] Such a General Agree-

116. *See* Chicago Convention, *supra* note 1, arts. 44-49; ICAO Air Navigation Bureau, *Making an ICAO Standard*, http://www.icao.int/anb/mais (last visited Mar. . 23, 2006).

117. For ICAO's searchable Database of Aeronautical Agreements and Arrangements (DAGMAR) see http://www.icao.int/cgi/goto_m_leb.pl?applications/dagmar/main.cfm.

118. These bilateral agreements grew out of the principle of national sovereignty over airspace that forms the basis of the Chicago Convention. *See* Chicago Convention, *supra* note 1, arts. 1, 3, 6; Paul S. Dempsey, *Flights Of Fancy And Fights Of Fury: Arbitration And Adjudication Of Commercial And Political Disputes In International Aviation* 2 GA. J. INT'L & COMP. L. 231, 231(2003). The first of these bilateral agreements, the Bermuda Agreement, was completed in 1946 between the United Kingdom and the United States and set an example for the many bilateral air agreements to come. *See* RAMON DE MURIAS, THE ECONOMIC REGULATION OF INTERNATIONAL AIR TRANSPORT 52-72 (1989) (summarizing the Agreement and its implications); Air Services Agreement with the United Kingdom, Feb. 11, 1946, U.S.-U.K. 60 Stat. 1499 [hereinafter Bermuda I].

119. DE MURIAS, *supra* note 118, at 52.

120. This principle of "fair and equal opportunity" is ensconced in the Chicago Convention. Chicago Convention, *supra* note 1, art. 44; *see also* Ruwantissa I.R. Abeyratne: *The Air Traffic Rights Debate – A Legal Study*, 18 AIR & SPACE L. 3, 13 (1993).

121. The WTO, created in 1994, had, as a founding mandate , the purpose of providing a multilateral framework of principles and rules for trade in services, analogous to the trading regime in goods that has existed since 1947 under the General Agreement on Tariffs and Trade (GATT). *See* General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194 [hereinafter GATT 1947]. This new system for promoting trade in services is set out in the General Agreement on Trade in Services (GATS). *See* General Agreement on Trade in Services, Apr. 15, 1994, WTO Agreement, Annex 1B, Legal Instruments—Results of the Uruguay Round, 33 I.L.M. 1167 (1994) [hereinafter GATS].

122. In general, there has been resistance from the airline industry to the suggestion that the WTO take a more active regulatory role. *See, e.g.,* Frances Williams, *WTO seeks to spread its wings over air services*, FIN. TIMES, Sept. 29, 2000, at 13 ("But there is little support among members for giving the organization a role in passenger traffic."); *see also* Int'l Air Transp. Ass'n [IATA], *Liberalization Of Air Transport And The GATS*, IATA DISCUSSION PAPER, Oct. 1999, at 12, *available at* www.wto.org/english/tratop_e/serv_e/iacposit41.pdf (last visited Mar. 17, 2006) [hereinafter IATA] ("IATA Members remain to be convinced that the GATS can add value to

ment on Trade in Services (GATS)[123] would rejuvenate the WTO's efforts to include air transport services within its purview in order to liberalize market access and impose the Most Favored Nations Treatment Clause (MFN)[124] of the General Agreement on Tariffs and Trade (GATT).[125] Under the MFN clause, a GATS member could be required, immediately and unconditionally, to accord to the services and service suppliers of any other member treatment no less favorable than it accords to like services and service suppliers of any other country.[126] However, this is not practical as the application of the MFN principle to international air transport would adversely affect the ongoing process of liberalization between like minded states.[127]

In this context, the role played by ICAO (that of the guardian and mentor of international civil aviation) becomes of primary importance. The ICAO believes that it is important to draw to the attention of GATS and its member states certain critical features of international air transport which are relevant to any present or future consideration of how air transport should be treated.[128] The ICAO steadfastly maintains its posi-

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the existing liberalization process. Indeed, with few exceptions, they hold to the view that the GATS is not the vehicle for fundamental reform of the air transport sector at this time.").

123. *See* GATS, *supra* note 121.

124. *See* GATT 1947, *supra* note 121, at art. I. The WTO has described MFN status as denoting a type of equality between trading partners. "Each member treats all the other members equally as 'most-favoured' trading partners. If a country improves the benefits that it gives to one trading partner, it has to give the same "best" treatment to all the other WTO members so that they all remain 'most-favoured.'" WORLD TRADE ORGANIZATION, UNDERSTANDING THE WTO 11 (3d ed. 2005), *available at* www.wto.org/english/thewto_e/whatis_e/tif_e/understanding_e.pdf (last visited Mar. 17, 2006).

125. *See* GATS, *supra* note 121.

126. Marrakesh Agreement Establishing the World Trade Organization art. II, Apr. 15, 1994, Legal Instruments - Results of the Uruguay Round, 33 I.L.M. 1144 (1994) [hereinafter WTO Agreement].

127. *See* IATA, *supra* note 122, at 12 ("They are also concerned that the unconditional application of the MFN principle would hold back liberalization. Furthermore, bilateral air service agreements continue to offer a practical means of ensuring sector-specific reciprocity.").

128. At its Fifth Worldwide Air Transport Conference, held in March 2003, ICAO Contracting States adopted Recommendation 4.1.4 stating that ICAO's future economic regulatory role should focus on the development of policy guidance for economic liberalization, which will permit States to choose their own path and pace but also ensure the safety and security of international air transport. *See* The ICAO Fifth Worldwide Air Transport Conference: Challenges and Opportunities of Liberalization, Mar. 24-29, 2003, *Consolidated Conclusions, Model Clauses, Recommendations, and Declarations*, ¶ 2.2, ATConf/5 (Mar. 31, 2003) (*presented by* the ICAO secretariat) [hereinafter *2003 Liberalization Conference Conclusions*]. This role should also include facilitation, promotion and provision of assistance to States in harnessing liberalization for their broader benefit. *Id.* The Conference also recommended that in its relations with WTO-OMC, ICAO should continue to draw attention to the Organization's policy on trade in services, as currently reflected in Assembly Resolution A35-18, while emphasizing the interrelationship between safety, security and economic regulation and the Organization's focus on facilitating, promoting and assisting States in the liberalization process. *Id.* See generally R.I.R.

tion as the guiding force behind air transport services because it feels that bilateralism at the operating level has, over the decades, proved to be a flexible system which has allowed states to pursue their objectives, whether these be regimes of a more open and competitive, or more protective and restrictive nature.[129] The ICAO maintains that any external multilateral framework which seeks general or limited application must recognize, and be compatible with, this existing structure of air transport.[130]

Multilateralism, in the form of a broad-based consensus on principles and guidance to states in the conduct of their air transport activities, has enjoyed renewed interest in the ICAO in recent years.[131] While seeking to progressively develop positions and guidance to assist states in their regulatory and economic activities, the ICAO recognizes the sovereignty of states in pursuing their own national air transport policies and objectives.[132] In this regard, the ICAO's role is limited to providing consulting services and recommendations, and to avoiding incompatibilities with liberalization.[133] The ICAO has also expressed its resolve to continue to cooperate with GATS in order that ICAO's views and concerns, along with the particular features of the international air transport sector, are properly considered.[134]

The ICAO first dealt with multilateralism in 1953, when it formally adopted a position on the regulation of air transport services. At its 7th Assembly held in June and July, 1953, the ICAO enacted Assembly Resolution A 7-15, which stated that there was no prospect of achieving a universal multilateral agreement at that time, but acknowledged that the achievement of multilateralism in commercial rights remained an objective of the organization.[135] This Resolution is still in force today.[136]

Abeyratne, *The Worldwide Air Transport Conference of ICAO and Its Regulatory Economic Impact*, 28 AIR & SPACE L. 218, 229 (2003) for the author's previous account of the Conference's accomplishments.

129. *See* Abeyratne, *supra* note 128, at 229-33.

130. *Id.* at 229.

131. *See, e.g.*, James Ott, *ICAO Backs Liberalization*,158 AVIATION WK. & SPACE TECH. 62 (2003); The ICAO Fifth Worldwide Air Transport Conference: Challenges and Opportunities of Liberalization, *Working Paper: Liberalizing Air Carrier Ownership and Control*, at 2, ATConf/5-WP7 (Oct. 10, 2002) (*presented by* the ICAO Secretariat) [hereinafter *Liberalizing Air Carrier Ownership*].

132. *See ICAO Economic Policy Guidance Material*, *supra* note 25, ¶¶ 1-14 to -15.

133. *See* Taieb Cherif, *Wings of Change in International Air Transport*, UN CHRONICLE ONLINE, http://www.un.org/Pubs/chronicle/2003/issue4/0403p15.asp (last visited Mar. 21, 2006).

134. *See 2003 Liberalization Conference Conclusions*, *supra* note 128, ¶ 2.2.

135. ICAO, *Prospects and Methods for Further International Agreement on Commercial Rights in International Air Transport – Scheduled International Air Services*, Assemb. Res. A7-15 (1953), *compiled in Resolutions and Indexes to Documentation*, at 27, ICAO Doc. 7417 (July, 27, 1953).

At its 26th Session in September/October 1986, the ICAO Assembly adopted Resolution A 26-14, which reaffirmed the ICAO's position as the preeminent multilateral body within the United Nations for dealing with international air transport.[137] The Resolution urged contracting states participating in multilateral negotiations on trade in services where international air transport was included, to ensure that their representatives be fully aware of potential conflicts with the existing legal system for the regulation of international air transport.[138] The Resolution also requested that the ICAO Council actively promote, to international bodies involved with trade in services, a full understanding of the ICAO's role in international air transport, as well as the existing structure of international agreements regarding air transport.[139]

In light of the significant recent developments in the trade in service negotiations, the question arises as to whether this policy is adequate to continue to serve the interests of ICAO, and international air transport in general, over the next few years. The ICAO's philosophy may require reassessment and additional directives from the Assembly. While Assembly Resolution A26-14 gave guidance to states and the Council, and expressed certain concerns, it did not set out an organizational view on the inclusion of international air transport in a multilateral agreement on trade in services.[140] A future session of the Assembly may consider developing such a view for transmission to GATS and the GNS as well as to contracting states.

One possible view that the Assembly may consider is that air transport should not be included in services agreements. The adoption of such a position by the ICAO could be based on two concerns expressed in Resolution A26-14.[141] First, the Organization was concerned with its role as the United Nations' specialized agency responsible in air transport matters.[142] Second, the Organization was concerned for the integrity of the Chicago Convention principles and the widespread system of bilateral air transport agreements that resulted from those principles.[143]

Airlines are faced with the imminent prospect of commercial aviation being controlled by a group of air carriers serving global regions and

136. *See* ICAO, *Assembly Resolutions in Force (as of Oct. 8, 2004)*, ¶ A-13, ICAO Doc. 9848 (noting that A7-15 has since been superseded by A32-17).

137. *See* ICAO, *Air Transport Related Activities by Other International Bodies Interested in Trade in Services*, Assemb. Res. A26-14 (1986), *compiled in Resolutions Adopted by the Assembly and Index to Documentation*, at 74, ICAO Doc. 9495 A26-RES (Oct. 10, 1986).

138. *Id.*

139. *Id.*

140. *Id.*

141. *Id.*

142. *Id.*

143. *Id.*

operated by a network of commercial and trade agreements. Regional carriers will dominate, forcing out niche- and small national carriers who could not compete with the lower unit costs and joint ventures of a larger carrier. A perceived justification for "open skies" or unlimited liberalization might be seen in bilateral air services agreements between two countries, where *fair and equal opportunity to operate* air services is a *sine qua non* for both national carriers concerned.[144] This may be interpreted to mean *fair and equal opportunity to compete,* or even *fair and equal opportunity to effectively participate* in the international air transportation as agreed.[145]

While the "open skies" policy sounds economically expedient, its implementation would undoubtedly phase out smaller carriers who are now offering competition and a larger spectrum of air transport to the consumer.[146] Lower fares, different types of services and varied in-flight service profiles are some of the features of the present system.

C. Preferential Treatment for Carriers of Developing Countries

To achieve the desirable objective of a higher level of competitiveness in the air transport industry, preferential measures for carriers of developing countries may be required.[147] The ICAO has suggested the following preferential measures for the consideration of, and possible use by, air carriers of its member states who are at a competitive disadvantage in commercial aviation:

> (a) the asymmetric liberalization of market access in a bilateral air transport relationship to give an air carrier of a developing country: more cities to serve; fifth freedom traffic rights[148] on sectors which are otherwise not normally granted; flexibility to operate unilateral services on a given route for a certain period of time; and the right to serve greater capacity for an agreed period of time;
>
> (b) more flexibility for air carriers of developing countries (than their counterparts in developed countries) in changing capacity between routes in a bilateral agreement situation; code-sharing to markets of interest to them; and changing gauge (aircraft types) without restrictions;

144. Henri Wassenbergh, *De-Regulation of Competition in International Air Transport*, 21 Air & Space L. 80, 80 (1996).

145. *Id.*

146. *Id.* at 83.

147. *See generally*, Ruwantissa I.R. Abeyratne, *The Future of African Civil Aviation*, 3 J. Air Transp. World Wide 30, 30-49 (1998).

148. The right to uplift or discharge passengers, mail and cargo in a country other than the grantor state. World Trade Report 2005, *supra* note 2, at 225 (describing the eight "freedoms" countries may choose to grant in air service agreements).

(c) the allowance of trial periods for carriers of developing countries to operate on liberal air service arrangements for an agreed time;

(d) gradual introduction by developing countries in order to ensure participation by their carriers to more liberal market access agreements for longer periods of time than developed countries' air carriers;

(e) use of liberalized arrangements at a quick pace by developing countries' carriers;

(f) waiver of nationality requirement for ownership of carriers of developing countries on a subjective basis;

(g) allowance for carriers of developing countries to use more modern aircraft through the use of liberal leasing agreements;

(h) preferential treatment in regard to slot allocations at airports; and

(i) more liberal forms for carriers of developing countries in arrangements for ground handling at airports, conversion of currency at their foreign offices and employment of foreign personnel with specialized skills.[149]

Furthermore, two direct corollaries to the proposed measures include the benefits of improved market access and operational flexibility.[150] These proposed preferential measures are calculated to give air carriers of developing countries a "head start," effectively ensuring their continued participation in international air services.[151]

In addition to addressing the preferential measures proposed by the ICAO (which, if implemented, would be of immense assistance to carriers of developing countries), the international aviation and trading community should consider the larger issue of funding. Long term, low-interest loans could be made available to carriers of developing countries through such institutions as the World Bank and the International Monetary Fund.[152] Some consideration could also be given to a balanced distribution of aircraft throughout the world. Developing countries could then have access to aircraft that have been discarded by their more affluent counterparts.[153] An equitable system of leasing such aircraft should be considered.

Another useful tool that could be addressed under the umbrella of preferential measures is to exempt aircraft operated by carriers of developing countries from the certain technological standards (to the extent possible) of modern aircraft.[154] Aircraft engine emission standards and

149. *See ICAO Policy and Guidance Material, supra* note 25, ¶ A3-1.

150. Abeyratne, *supra* note 147, at 41.

151. *See generally*, Ruwantissa I.R. Abeyratne *Competition in the Air Transport Industry and Preferential Measures for Developing Countries*, 20 WORLD COMPETITION 39, 54 (1997).

152. Abeyratne, *supra* note 147, at 42.

153. *Id.*

154. *Id.*

noise regulations are two examples.[155]

Preferential measures may also be considered on a collective basis to allow a carrier of one country to use air traffic rights on behalf of a different carrier from another country. This would particularly help developing countries that are unable to launch their own airlines, or are unable to allocate a national carrier on a particular route, due to economic reasons. This principle could also be extended to cover instances where airlines from developing countries would combine their operations by using their air traffic rights collectively. For example, airlines of countries A and B, who have been granted air traffic rights to operate air services from their countries to countries C and D, respectively, would offer joint service to countries C and D in just one flight through their collective traffic rights.

Additionally, developing countries should be released from the obligation to own and control their air carriers or to have their carriers substantially owned and controlled by their nationals. It is only then that countries that cannot fully finance their carriers could maintain, and provide well-rounded competition in, the air transport industry.

D. National Ownership and Control and Airline Competition

The airline industry is unique in terms of trade and competition, giving states the prerogative to impose conditions on ownership and control of airlines.[156] Ever since the formal regulation of civil aviation, many countries have owned and controlled their national carriers, due partly to national prestige and symbolism, and partly to a traditional requirement in the standard bilateral air services agreement.[157] This requirement states that a designated carrier should be substantially owned and effectively controlled by nationals of a country which designated that carrier to operate air services under bilateral agreements.[158] A state may withhold permission for landing rights in its territories if substantial ownership and effective control of an airline is not vested in nationals of that state.[159] The International Air Services Transit Agreement (IASTA)[160] is the only international agreement that provides for conditions upon which

155. *Id.* For a detailed discussion of regulations on aircraft noise and engine emissions, see Ruwantissa I.R. Abeyratne, Legal and Regulatory Issues in International Aviation 271-313 (1996).

156. *See* International Air Services Transit Agreement, art. I, Dec. 7, 1944, 59 Stat. 1693, 84 U.N.T.S. 389. [hereinafter IASTA].

157. *See* Kirsten Bohmann, *The Ownership and Control Requirement in U.S. and European Union Air Law and U.S. Maritime Law – Policy; Consideration; Comparison*, 66 J. Air L. & Com. 689 (2001); *see supra* note 118, and accompanying text.

158. *See ICAO Regulation Manual, supra* note 109, ¶ 4.4-1.

159. *Id.*

160. IASTA, *supra* note 156.

ownership and control of airlines may be restricted.[161] Article 1, Section 5 provides:

> Each Contracting State reserves the right to withhold or revoke a certificate or permit to an air transport enterprise of another State in any case where it is not satisfied that substantial ownership and effective control are vested in nationals of a Contracting State, or in case of failure of such air transport enterprise to comply with the laws of the State over which it operates, or to perform its obligations under this agreement.[162]

Starting in the early fifties, states responded to the growth of civil aviation by increasingly availing themselves of the prerogative given by IASTA to withhold or revoke an airline's operational permit to enter into their territories for a commercial purpose.[163] States also restricted foreign investment in their own airlines or "flag carriers" by including a clause with specific conditions on nationality in the bilateral air services agreements they signed with other states in conformity with Article6 of the Chicago Convention.[164]

Both the United States and member states of the European Union have protected their domestic markets from external operators by preserving their markets for national flag carriers or, at the least, carriers that are owned by the state or state nationals.[165] In the European Union, according to Article 4 of Court Regulation 2407/92, national authorities are vested with this power.[166] States may grant operating licenses based on the criterion that the carrier's principal place of business be located in the licensing state.[167] There are additional requirements under the regulation: The carrier must be involved in air transportation as its main occupation, the holder of the license must be under direct or majority ownership by nationals of the European Union, and the licensee must be effectively controlled by such nationals.[168] One reason, at least from the perspective of the European Union, for retaining ownership and control within its territory is to safeguard the interests of the member states of

161. *Id.* art. I; *see 2003 Liberalization Conference Conclusions*, *supra* note 128, at 2 ("Air carrier ownership and control is a unique and complex issue, arising mainly from the particular way international air transport is regulated.").

162. IASTA, *supra* note 156, art. I, § 5.

163. Constantine G. Alexandrakis, *Foreign Investment in U.S. Airlines: Restrictive Law is Ripe for Change*, 4 U. MIAMI BUS. L.J. 71, 75 (1994); Bohman, *supra* note 157, at 693.

164. Chicago Convention, *supra* note 1, art. 6; Alexandrakis, *supra* note 163, at 75.

165. Bohman, *supra* note 157, at 692, 693-64.

166. *See* Council Regulation 2407/92, Licensing of Air Carriers, art. 2(g), 1992 O.J. (L 240) 1[hereinafter Licensing of E.U. Air Carriers].

167. *Id.*

168. Effective control essentially means the power and ability to exercise a decisive influence on an air transport undertaking, including but not limited to the use, enjoyment and alienation of movable and immovable property of that undertaking. *See* Licensing of E.U. Air Carriers, *supra* note 166, art. 2(g).

the European Union and to preclude carriers of non-European Union states from capitalizing on a liberalized European Union market.[169]

In contrast to Regulation 2407/92 of the European Union, which does not expressly address issues regarding nationality of management, the United States regulations contain requirements pertaining to the nationality of airline management.[170] Arguably, the European Union regulation addresses the external control of a company by stockholders, and not the management of the air transport enterprise, as envisaged by the United States law.[171] Be that as it may, both the United States and the European Union have shown, through legislation, that the issue of ownership and control remains a critical issue in the liberalization of, and competition in, air transport.[172]

Restrictive ownership and control criteria may have been tolerable in the first decades of commercial aviation because demand for capacity was manageable.[173] However, these requirements gradually evolved into a restrictive force in the provision of air transport services.[174] Many states were left with unprofitable state-owned airlines that required subsidization.[175] The circumscribing nature of this inflexible ownership and control requirement has prompted many states to permit privatization of air carriers, with a reduction in percentage of government held shares.[176] For example, British Airways and Lufthansa have been completely privatized, while Air France, Alitalia, Sabena and Iberia have been partially privatized.[177] The United States deregulated its domestic carriers in 1978.[178]

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169. Bohman, *supra* note 157, at 722.

170. *See id.* at 695-97.

171. *See id.* at 723.

172. See, for example, House Resolution 4542, introduced on December 15, 2005 by Rep. Oberstar, and currently in committee (*available at* http://thomas.loc.gov/cgi-bin/query/z?c109:H.R.+4542:) This resolution "direct[s] the Secretary of Transportation to report to Congress concerning proposed changes to long-standing policies that prohibit foreign interests from exercising actual control over the economic, competitive, safety, and security decisions of United States airlines, and for other purposes." *See also Commission White Paper on European Transport Policy for 2010*, at 92-93, COM (2001) 370 final (Sept. 12, 2001), *available at* http://www.eu.int/comm/energy_transport/library/lb_texte_complet_en.pdf (last visited Mar. 25, 2005) ("To hold their own, alongside the big world players, the major European airlines need to operate world wide. . .In other words, the objective is to give European airlines 'Community' nationality in relations with third countries.").

173. *See* WORLD TRADE REPORT 2005, *supra* note 2, at 222.

174. *See* Bohman, *supra* note 157, at 689.

175. *Id.*

176. *See* HANLON, *supra* note 21, at 196; Iain Carson, *The Sky's the Limit*, ECONOMIST, Mar. 8, 2001, at 45.

177. Bohman, *supra* note 157, at 689 n.1.

178. Airline Deregulation Act of 1978, Pub. L. No. 95-504, 92 Stat. 1705 (codified as amended in scattered sections of 49 U.S.C.); *see* Bohman, *supra* note 157, at 689-90.

Although liberalization of air transport is sweeping the globe, the bilateral air services agreement, through antiquated requirements of national ownership, still prevents proactive airlines from merging with each other and entering into other strategic alliances.[179]

Further, the bilateral requirement of substantial ownership and effective control, based on the fundamental postulate that a majority ownership provision would effectively preclude foreign ownership from taking major control of a national carrier, has not been easy to enforce or put into practice in all situations.[180] While a blanket provision might simply require majority national ownership and control, airlines have had to contend in many instances with complex requirements regarding the nationality of the members of a board of directors, the powers of a board, and the powers of directors of such boards.[181] Often states have attempted to circumvent these difficulties by establishing a safeguard to ensure a "golden share", which accords the owner government a greater voice in the carrier's decision making process.[182]

There is no documented definition of, or agreed meaning to the term "substantial ownership and effective control."[183] This is particularly troublesome when an airline is privatized and the government loses its majority share position, resulting in a lack of demonstrable evidence of

179. This criticism is fairly common. For a particularly well-written and scathing indictment of ownership and citizenship requirements, see Brian F. Havel, *White Paper: A New Approach To Foreign Ownership Of National Airlines* 1-8, www.law.depaul.edu/bhavel (last visted Apr. 2, 2006). *See also*, Bohman, *supra* note 157, at 690; WORLD TRADE REPORT 2005, *supra* note 2, at 227 ("Certainly, complete liberalization of foreign ownership regulations has not occurred; on the contrary, such regulations remain a barrier to a more competitive international airline industry."); *Liberalizing Air Carrier Ownership*, *supra* note 131, at 4 ("Liberalization experience, at the national and regional levels, seems to suggest that unless the constraint originating from the bilateral regime is overcome, there will be limited progress in advancing the cause [of creating an operating environment in which air carriers could operate efficiently and economically without compromising safety and security].").

180. *See, e.g.,* Pierre Sparaco, *Air France Now Owns KLM, But Full Union Will Take at Least Three Years*, AVIATION WK. & SPACE TECH., May 9, 2004, at 1, *available at* http://www.aviationnow.com/avnow/news/channel_awst_story.jsp?view=story&id=news/0 (last visited Mar. 25, 2006); Peter Van Fenema, *National Ownership and Control Provisions Remain Major Obstacle to Airline Mergers*, ICAO J., Nov.-Dec. 2002, at 7.

181. *See* Bohman, *supra* note 157, at 706-07.

182. G. Nicoletti & R. Gonenç, *Regulation, Market Structure and Performance in Air Passenger Transportation*, 31 (OECD Economics Department Working Paper No. 254, 2000); Robert W. Poole, Jr., *Guidelines for Airport Privatization*, HOW-TO GUIDE NO. 13 (Reason Foundation, Los Angels, C.A.), Oct. 1994, at 15, *available at* http://www.reason.org/htg.13.pdf (last visited Mar. 25, 2006).

183. ICAO Worldwide Air Transport Conference: Challenges and Opportunities of Liberalization, Mar. 24-29, 2003, *Working Paper: Airline Views on Liberalizing Ownership and Control*, at 2, ATConf/5-WP26 (Dec. 16, 2002) (*presented by* the IATA) [hereinafter *Airline Views on Liberalization*].

national ownership.[184] The international community has taken to the practice of identifying the ownership of an airline with its voting shares, often equating "substantial ownership" to greater than 50% of the voting shares.[185] However, this simplistic approach may no longer be sufficient due to the wave of privatization in the airline industry.[186] For example, 45% of voting shares held by a private entity in a national airline may arguably be termed "substantial ownership" even when 55% of the voting shares are held by nationals of the state.[187]

The issue of "effective control" is a more complex issue than ownership. Effective control relates to who actually controls the airline in question.[188] In broad terms, this may mean the individual body who directs airline policy and hires and fires personnel.[189] For example, the definition of "control" in the United States includes "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise."[190]

There is a distinct variance in the effect between "substantial ownership" and "effective control" regulation. The former may often be established through a presumption of nationality, while the latter may involve such complications as the nationality of members of a supervisory board or the nationality and rights of the directors of a board.[191] Furthermore, the nationality criterion with respect to ownership may be easily obviated. For example, the European Union introduced a 1997 legislation that admitted a "community air carrier" which could operate air services anywhere within the fifteen member states of the Union and Norway, Iceland and Liechtenstein.[192] Through this legislation, the European Union effectively replaced the "national carrier" requirement with a "Community air carrier" criteria.[193]

Other agreements have retained the "effective control" criteria. In November 2000, the United States, New Zealand, Chile and Singapore, under the auspices of the Asia-Pacific Economic Cooperation Group

184. *See* Nicoletti, *supra* note 182, at 15.

185. *See* Commission Decision 95/404/EC on a Procedure Relating to the Application of Council Regulation (EEC) No. 2407/92 (Swissair/Sabena), 1995 O.J. (L 239) 19, at 9.

186. *See Airline Views on Liberalization*, *supra* note 183, at 3.

187. *See* Bohman, *supra* note 157, at 723.

188. *Id.*

189. *See, e.g., id.* at 722 (discussing Council Regulation 2407/92 On Licensing of Air Carriers, art. 2(g), 1992 O.J. (L 240) 1).

190. 17 C.F.R. § 240.12b-2 (2005).

191. *See* Ruwantissa I.R. Abeyratne, *Crisis Management: Toward Restoring Confidence in Air Transport - Legal and Commercial Issues*, 67 J. AIR L. & COM. 595, 644 (2002).

192. *See* Council Regulation 2408/92 on Access for Community Air Carriers to Intra-Community Air Routes, art. 3, 1992 O.J. (L 240) 8 [hereinafter Council Regulation 2408/92].

193. *Id.*

(APEC), agreed on liberalizing air services between their territories on a multilateral "open skies" basis.[194] The agreement signed by the four state parties did away with the standard term "substantial ownership" but retained the "effective control" requirement.[195]

Airline alliances may offer a way around the market access constraints presented by bilateral air services agreements. However, such alliances are not usually effective against the inhibiting qualities of the traditional ownership and control requirements. This is particularly true in the context of facilitation of cross-border investment, which is essentially regulated by the bilateral air services agreement.[196] In order to find a practical and legitimate way out of this seemingly impossible situation, the ICAO has devised a proactive approach based on making the "principal place of business" and "permanent residence" of the carrier the operative criteria for purposes of devolution of control.[197]

In response to concerns for developing countries, the ICAO, at its 35th Assembly held in September and October of 2004, adopted Resolution A35-18.[198] This legislation recognizes that the strict application of the criterion of substantial ownership and effective control for the authorization of route and other air transport rights could deny many developing states a fair and equal opportunity to operate international air services.[199] The ICAO Assembly was apprehensive that continued insistence on the substantial ownership and effective control criterion could seriously jeopardize the opportunity for airlines of developing states to compete fairly and equally with the airlines of developed states.[200] Resolution A35-18 thus urges states to recognize community of interest within regional and sub-regional economic groupings as a valid basis for designating airlines.[201]

The notion that relaxation of the current ownership and control restrictions may increase competition is commonly accepted in the airline industry.[202] The restrictions came into being in the first place largely as a result of the stringent national interests that prevailed immediately after

194. *Multilateral Agreement on the Liberalization of International Air Transportation*, Nov. 15, 2000, http://www.maliat.govt.nz/ (last visited Mar. 28, 2006).

195. Council Regulation 2408/92, supra note 192, at art. 3.

196. *See* Ruwantissa I.R. Abeyratne, *Stategic Alliances of Airlines and their Consequences*, 5 J. AIR TRANSP. 55, 56 (2000).

197. *Liberalizing Air Carrier Ownership*, *supra* note 131, at 5.

198. ICAO, *Consolidated Statement of Continuing ICAO Policies in the Air Transport Field*, Assemb. Res. A35-18 (2004), *compiled in Assembly Resolutions in Force*, at III-1, ICAO Doc. 9848 (Oct. 8 2004).

199. *Id.* art. III-3.

200. *Id.*

201. *Id.*

202. *See 2003 Liberalization Conference Conclusions*, *supra* note 128, at 3.

World War II and continued until recent globalization and privatization.[203] The primary question then becomes whether states will continue to retain national interests in their airlines for reasons of national pride, prestige, and other considerations, or relax restrictions so as to allow foreign investment in airlines.[204]

States that retain restrictive practices to promote national interests may impede the emergence of new entrants and competitors in their market. This could lead to monopolistic national carriers with no reason or incentive to lower production costs and pass that savings on to the consumer.[205] Such a monopoly would be inefficient, producing an increasingly high priced air transport product.[206]

Withdrawal of current restrictions and liberalizing investment in national airlines may also result in a distinct advantage for the air transport market's ability to attract capital. This infusion of capital into the industry may increase competition in the international market.[207] Also, a natural corollary to the injection of capital in a domestic market is increased coverage, which could give a competitive edge to a national carrier in the international market.[208] Of course, it follows that the end result would be enhanced competition among airlines and also between states. This would enable developing States in particular to actively participate in market competition and allow their carriers to effectively compete with dominant carriers.[209]

Another consideration is that any air traffic rights that a state may obtain for its airline through the process of bilateral air services negotiations (made necessary by Article 6 of the Chicago Convention[210]) are a national asset.[211] This raises the question of whether such traffic rights are jeopardized by the removal of ownership and control restrictions.

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203. Alexandrakis, *supra* note 163, at 75.

204. For an illustration of how efforts by the European Union to liberalize air carriers have forced Member States to reduce their reliance on flag carriers as a means to enhance international prestige, see Paul S. Dempsey, *Competition in the Air: European Union Regulation of Commercial Aviation*, 66 J. AIR L. & COM. 979, 984 (2001).

205. *See* HANLON, *supra* note 21, at 33.

206. *See id.*

207. *See Airlines Views on Liberalization*, *supra* note 183, ¶ 1.2.

208. *See* ICAO Fifth Worldwide Air Transport Conference, Mar. 24-29, 2003, *Information Paper: The Need for Greater Liberalization of International Air Transport*, at 1.2, ATConf/5-WP/35 (Jan. 20, 2003) (*presented by* the ICC) [hereinafter *The Need for Greater Liberalization*].

209. *See* Abeyratne, *supra* note 147, at 41.

210. *See* Chicago Convention, *supra* note 1, art. 6.

211. For an informative account of the significant increase in the number of bilateral regional and subregional agreements concluded between 1995 and 2001, see ICAO Fifth Worldwide Air Transport Conference, Mar. 24-29, 2003, *Working Paper: Liberalization of Market Access*, ¶ 2.2, ATConf/5WP/8 (Oct. 17, 2002) (*presented by* the ICAO Secretariat) [hereinafter *Liberalization of Market Access*].

In the final analysis, the issue of ownership and control of airlines and its effect on competition has to be viewed in the context of the two operative principles contained in Article 6 of the Chicago Convention and Article 1 Section 5 of IASTA.[212] As long as airlines are required to obtain permission of states before flying into their territories for commercial purposes, and states continue to exercise the prerogative offered by IASTA by insisting that airlines are substantially owned and effectively controlled by an identified category of person, competition will be stifled. States enforcing such restrictions should ask themselves if this is what they want for their airline industry. And if so, they should ask themselves why.

If the answer to these questions comes from national pride and prestige, protectionism related to air traffic rights or even, as in some instances, a certain reluctance towards implementing change, such a stance is wholly understandable, albeit not economically judicious.[213] States should realize that retaining the status quo ante does not contribute toward providing needed services to consumers and promoting air transport in their territories. [214] States must consider the interests of their passengers and consumers.[215] For instance, would passengers really be concerned if their national airline was not available to carry them overseas, but the same services were available through foreign airlines? Or can the air transport industry be viewed the same way as the hotel and surface transport industry, where the particular name of a hotel or bus line is of secondary importance to the quality of the services provided?

Furthermore, the health of the industry as a whole must be considered in light of the stark reality that, at best, the profitability of the airline industry has been both marginal and cyclical.[216] The industry has never enjoyed sustained periods of profitability.[217] Even among the large carriers, short bouts of profitability have inevitably been followed by periods

212. IASTA, supra note 156, art. 1.

213. For an illustration of the economic benefits that flow from abandoning protectionism, see the summary given in Box 1in the WTO's WORLD TRADE REPORT 2005, *supra* note 2, at 225.

214. *See The Need for Greater Liberalization, supra* note 208, at 1.

215. ICAO Fifth Worldwide Air Transport Conference, Mar. 24-29, 2003, *Working Paper: Air Carrier Ownership and Control; Leasing; Slots; Consumer Interests*, at 1, ATConf/-WP/33 (Jan. 17, 2003) (presented by the Int'l Air Carrier Ass'n [IACA]) [hereinafter *Air Carrier Ownership & Consumer Interests*].

216. *Special Report: World Airlines Lining up for Profits*, ECONOMIST, Nov. 10, 2005, at 65 ("Mention the airline industry in polite company and a few truisms invariably come trundling out: airlines are loss-making, inefficient, prone to extreme cycles and vulnerable to fickle consumers.").

217. *See* DOGANIS, *supra* note 19, at ix ("Over the last three decades five to six years of reasonable profits have been followed by to four years of declining profits and, in the case of many airlines, of losses.").

of downturn in real income.[218] This fluctuation in fortune is simply a characteristic of air transport and a consequence of rigid regulation, competition and technological change.[219]

Although the flexibility given to states by IASTA regarding ownership and control of airlines may have been tolerable in the first decades of commercial aviation, when demand for capacity was manageable, it has gradually evolved into an inhibitor of air transport services. Many states have been left with unprofitable state-owned airlines that require subsidization.[220] The circumscribing nature of an inflexible ownership and control requirement has prompted many States to permit privatization of air carriers, with a reduction in percentage of government held shares.[221]

E. Extraterritoriality

One of the most significant, and contentious, commercial considerations with regard to transatlantic air transport has been the extraterritorial application of European Union and United States competition law.[222] Extraterritoriality is one way by which the application of a state's domestic trade policy could affect more than one jurisdiction.[223] The United States, the European Community and Germany are all proponents of extraterritoriality.[224] Both the European Union and the United States have policy pertaining to air transport that is carried out by legislation.[225] In these states, competition rules are applied to the commercial conduct of foreign enterprises in foreign markets that is intended to affect the state domestically.[226]

It is not surprising that the laws applicable to trans-national air trans-

218. For an overview of hardships endured by large carriers in the UNITED STATES, see George Williams, The Airline Industry and the Impact of Deregulation 143 (1994).

219. *See* Doganis, *supra* note 19, at ix.

220. Willie Walsh, *Chocks Away*, Global Agenda, Sept. 2006, at 142.

221. *See* Carson, *supra* note 176, at 45.

222. *See* G. Porter Elliott, *Antitrust At 35,000 Feet: The Extraterritorial Application Of United States And European Community Competition Law In The Air Transport Sector*, 31 Geo. Wash. J. Int'l L. & Econ. 185, 186 (1998).

223. *Id.* at 197-98.

224. As demonstrated by the UNITED STATES interpretation and enforcement of Sections 1 and 2 of the Sherman Antitrust Act, 15 U.S.C §§ 1, 2 (2000), Articles 81 and 82 of the E.C. Treaty and the German Act Against Restraints of Competition (GWB), Law of August 26, 1998 (BGBl. I S. 2546). For further discussion of Germany's approach to extraterritoriality see generally, David J. Gerber, *The Extraterritorial Application of the German Antitrust Laws*, 77 Am. J. Int'l L. 756 (1983).

225. *See* Elliot, *supra* note 222, at 197-98, 204-05. For further discussion of the roles and responsibilities of Department of Transport in enforcing UNITED STATES anti-trust provisions, see John. M. Nannes, *Antitrust Lessons from the Airline Industry*, 60 Antitrust L.J. 685, 685-86 (1991).

226. *See* Roger P. Alford, *The Extraterritorial Application of Antitrust Laws: The United States and European Community Approaches*, 33 Va. J. Int'l L. 1, 16 (1992).

port from both ends may be questioned by either side as extraterritorial. Such a contention does not necessarily reflect *mala fides* on the party against whom extraterritoriality is alleged. Usually, the question of extraterritorial application of national laws arises in instances where, in the absence of an international framework of competition rules, the extraterritorial application of national competition laws is perceived to be necessary to patch up loopholes emerging from the territorial reach of national jurisdiction.[227]

In the seminal 1945 case, *United States v. Alcoa,*[228] the United States courts established the "effects" doctrine whereby commercial conduct carried out overseas but intended or calculated to affect the United States is subject to United States antitrust laws.[229] This doctrine has been followed by the courts in the United States with an unfailing consistency, culminating in the United States Justice Department's 1995 guidelines on international commercial operations.[230] These guidelines give the United States wide extraterritorial jurisdiction with respect to the anti-competitive practices followed by foreign enterprises outside of the United States when those activities adversely affect the United States' market in a particular commercial activity.[231] One of the most compelling features of this legislation is its emphasis on "market access" for American businesses in foreign countries.[232] A number of hypothetical examples in the guidelines reflect the Department of Justice's desire to challenge the conduct of foreign enterprises in foreign countries if they would hinder American enterprises from exporting goods to, or investing in, a foreign country.[233]

European Union rules on extraterritoriality are not explicit and therefore are not incorporated in the competition provisions of Articles 81 and 82 of the European Community Treaty.[234] Although extraterritoriality may be imputed to the provisions through liberal interpretation,

227. *Id.* at 3-5.

228. United States v. Aluminum Co. of Am. [Alcoa], 148 F.2d 416, 443-44 (2d Cir. 1945).

229. Alford, *supra* note 226, at 5.

230. U.S. Department of Justice and Federal Trade Commission Antitrust Enforcement Guidelines for International Operations (1995), *reprinted in* FTC TODAY, Apr. 4, 1995 [hereinafter International Guidelines].

231. *See* Dean Brockbank, *The 1995 International Antitrust Guidelines: The Reach of U.S. Antitrust Law Continues to Expand*, 2 J. INT'L LEGAL STUDIES 1, 1 (1996).

232. *See* International Guidelines, *supra* note 230, at 9.

233. *See, e.g., id.* at 18.

234. *See* R. E. Falvey & P. J. Lloyd, *An Economic Analysis of Extraterritoriality* 5 (Centre For Research On Globalisation And Labour Markets, Research Paper 99/3, 1999), *available at* http://www.nottingham.ac.uk/economics/leverhulme/research_papers/99_3.pdf (last visited May 10, 2006).

the European Court of Justice in the 1988 *Wood Pulp* case[235] added further guidance. The court applied the principle of *lex situs* to jurisdiction and held that it is the place where the anti-competitive arrangements take effect that determines the jurisdiction of the Union in matters relating to competition.[236]

The logical interpretation of Article 85 (requiring that the Commission ensure the application of Articles 81 and 82) is that legislation is necessary to give effect to Articles 81 and 82 in the instance of issues arising from air transport in routes between the European Union and a third country or in routes entirely outside the community.[237]

However, a case in the German courts softened this requirement. In *Ahmed Saeed,* the German Federal Court of Justice sought the ruling of the European Court of Justice (ECJ) on a matter pertaining to the selling in Germany of air tickets to the public at prices below the approved level by the Federal Minister of Transport, in contravention of local German municipal law.[238] The issue was whether Article 82 of the EEC Treaty had overriding jurisdiction over local laws of Union states. The ECJ held that Article 82 is directly applicable in national courts even in the absence of implementing legislation.[239]

In the modern global economy, some degree of extraterritoriality in the enforcement of national competition rules is inevitable. States are justified in applying competition rules to the conduct of foreign enterprises when conduct abroad adversely affects their economy, particularly if the state in which the conduct takes place does not have competition rules or does not intend to prohibit such conduct. For instance, some transnational business entities engage in restrictive business practices in a type of "twilight zone" where no state can fully exercise jurisdiction over them and yet the harmful effects of their restrictive business practices can be felt in more than one country.[240] To say that extraterritoriality has no place in the application of competition rules would mean to give such transnational entities a free pass to engage in anti-competitive conducts with impunity.[241]

However, the extraterritorial application of competition rules is costly for both the enforcing agency and the foreign defendants. It is

235. Joined Cases 89, 104, 114, 116, 117, & 125 to 129/85, Ahlstrom Osakyhtio v. Comm'n, 1988 E.C.R. 5193, 4 C.L.M.R. 901 (1988) [hereinafter Woodpulp case].

236. This case established the European equivalent to the United States "effects test," the so-called "place of implementation test." *See* Elliot, *supra* note 222, at 204.

237. *Id.* at 204-09.

238. *See* Case 66/86, Ahmed Saeed Flugreisen v. Zentrale zur Bekämpfung unlauteren Wettebewerbs E.V., [1989] E.C.R. 803, [1990] 4 C.M.L.R. 102, ¶¶ 1, 3, 4, 6.

239. *Id.* ¶ 58.

240. *See* ABEYRATNE, *supra* note 79, at 382.

241. *Id.*

often a second-best solution to a problem that essentially boils down to a question of how best to cope with transnational anti-competitive conduct.[242] An extraterritorial application of competition rules is often not as effective as it would be if applied domestically.[243] A state attempting to apply its anti-competitive laws extraterritorially to a defendant enterprise located abroad will probably face difficulties in enforcing judgments and in establishing forum and jurisdiction.[244] Further, disabling legislation in a foreign state may effectively preclude extraterritoriality altogether.[245]

The *Watchmakers of Switzerland* case of 1955 illustrates the principle that the application of anti-trust laws on foreign enterprises may produce conflicts with the legislation of other states.[246] In this case, the Court found that a watch repair enterprise, conducted in the United States by two Swiss corporations, could be subjected to United States domestic laws.[247] The court held that, in order for a foreign corporation to be present within the jurisdiction of a court for purpose of service of process, there must be proof of continuous local activities and a showing that under all circumstances forum is not unfairly inconvenient.[248] Although the two Swiss entities did not own property in the United States and did not directly carry out their activities in the country, their American business activities were carried out by a domestic American corporation. Due to the control exerted by the Swiss corporations in determining the prices and terms of their American business affiliate, the court held that the Swiss corporations could be subjected to United States anti-trust statutes and tariff laws.[249]

In the 1984 case *Laker Airways Limited v. SABENA Belgian World Airlines*, the Court held that territoriality-based jurisdiction permitted a state to regulate the conduct or status of individuals or property physically situated within a foreign territory if the effects of that conduct are felt outside that territory.[250] *Laker* also holds that conduct that is calculated to have a substantial effect on a territory but takes place outside

242. *Id.*
243. *Id.*
244. *Id.*
245. *See, e.g.*, The Protection of Trading Interests Act, 1980, §§ 2, 5 (Eng.). This so-called blocking statute makes it difficult to depose witnesses, obtain documents, or enforce extraterritorially multiple liability judgments in the United Kingdom. *See id.* It also contains a "clawback" provision allowing parties with outstanding multiple liabilities in foreign jurisdictions (e.g., treble damages in the United States) to sue the successful plaintiff in a British court to recover the punitive element of such awards. *Id.* § 6 (Eng.).
246. United States v. Watchmakers of Switz. Info. Ctr. Inc., 133 F. Supp. 40, 42, 46, 49-50 (1955).
247. *Id.* at 42, 47, 48.
248. *Id.* at 43, 50.
249. *Id.* at 47, 50.
250. Laker Airways Ltd. v. Sabena, 731 F.2d 909, 921-22 (1984).

that territory may also be regulated.[251] The Court further held that a state has jurisdiction to prescribe law governing the conduct of its nationals whether such conduct takes place inside or outside its territory.[252] Accordingly, Laker Airways was deemed to be subject to United States anti-trust legislation because its activities gravely impaired the interests of the United States.[253] When considering the question of whether United Kingdom law should have applied, the Court compared the anti-trust legislation of the United Kingdom to that of the United States and held:

We find no indication in either the statutory scheme or prior judicial precedent that jurisdiction (by the United States) should not be exercised. Legitimate United States interests in protecting consumers, providing for vindicating creditors' rights, and regulating economic consequences of those doing substantial business in our country are all advanced under the congressionally prescribed scheme. These are more than sufficient jurisdictional contacts under *United States v. Aluminium Co. of America* and subsequent case law to support the exercise of prescriptive jurisdiction in this case.[254]

In the United States, the scope of antitrust legislation and protection thus extends to those persons who are either directly or indirectly adversely affected by third-party antitrust violations.[255] The adverse effect in question must have been contemplated within the applicable laws.[256] For example, in the *Uranium* antitrust litigation of 1979, a business entity that engaged in a "tying arrangement"[257] to sell its product was held to have violated antitrust legislation.[258]

F. The Low Cost Carrier Phenomenon

Due to current market conditions, air transportation is growing at a rate twice that of the general economy, with a correspondingly dramatic increase in the size of aggregate and individual aviation markets.[259] There has been a surge of energetic and robust competition among carriers in

251. *Id.* at 922.
252. *Id.*
253. *Id.* at 923-24.
254. *Id.* at 945-46.
255. *See In re* Uranium Antitrust Litigation, 473 F. Supp. 393, 401 (N.D. Ill. 1979).
256. *Id.*
257. *See id.* ("A tying arrangement is the sale of one item (the tying product) only on condition that the buyer would take the second item (the tied product) from the same source. Such arrangements are *per se* unreasonable and violative of antitrust laws if the tie-in involves two distinct products, and the party has sufficient economic power in the tying market to impose significant restraints in the tied product market.").
258. The tie-in resulted in a drop in demand for the product concerned, leading to a drop in prices and adversely affecting other market competitors. *Id.* at 403.
259. Michael W. Tretheway, *Distortions of Airline Revenues: Why the Network Airline Business Model is Broken*, 10 J. Air Transp. Mgmt. 3, 4 (2004).

the air transport industry in recent years, mostly due to the globalization of the industry and privatization of airlines and airports.[260] Regionally, market deregulation in Europe and Asia has added to this impetus, encouraging new enterprises to approach the air transport market with vigor and energy.[261] This has facilitated the emergence of a number of new price-based carriers and the restructuring of existing carriers striving to keep up with the competition.[262] The end result was the birth of a new breed of air carrier, called the low-cost carrier, offering a simple low-cost service intended for customers with simple itineraries.[263] The low-cost carrier has grown to such significant size that some now compete with the largest established carriers in the world.[264] Low-cost carriers have been quick to capture emergent growth opportunities, responding to demand for travel wherever opportunities arise.[265]

The low-cost carrier is a business model with imposing and permanent visibility in the market place.[266] The traditional business models of major network airlines have proven fundamentally flawed in the past few years, enabling emerging low cost carriers to establish themselves with robust business profiles.[267] These low-cost carriers have adopted sustained pricing policies consistent with the recovery of costs and profit making.[268] The success of the low-cost carrier lies mainly in lower cost structures, more efficient seat management policies and the absence of discrimination on price when compared to the practices of larger legacy carriers.[269] For instance, drastically reduced airfare has proven to more than compensate for the lack of luxuries of network connectivity and

260. Ruwantissa I.R. Abeyratne, *The Decision in the* Ryanair *Case - The Low Cost Carrier Phenomenon*, 39 EUROPEAN TRANSP. L. 585, 586 (2004); Bruce D. Nordwall, *Privatization May Speed ATC Systems Acquisitions*, AVIATION WK & SPACE TECHN., May 16, 1994, at 49.

261. THOMAS C. LAWTON, CLEARED FOR TAKE OFF: STRUCTURE AND STRATEGY IN THE LOW FARE AIRLINE BUSINESS, 1, 3 (2002). The low cost carrier phenomenon has also spread to the United States and Canada. The major Canadian low cost carriers, CanJet, Jetsgo and WestJet have shown an annual growth of 54 percent in the past five years and have been quicker than their US counterparts in infiltrating the trans-border market. LCCs compete with Air Canada in 13 of Air Canada's 61 U.S. Markets. Steve Lott, *Canadian LCCs Poised to Join Battle for Warmer Markets*, AVIATION DAILY, Nov. 17, 2004, at 5.

262. LAWTON, *supra* note 261, at 1.

263. Abeyratne, *supra* note 260, at 587.

264. *Id.*

265. *Id.*

266. *Id.*

267. Doganis observes that in 1999 a survey carried out on 19,000 leisure passengers had astonishing results where the majority had preferred low cost no-frills carriers to established scheduled airlines such as British Airways and other scheduled European air carriers. *See* DOGANIS, *supra* note 19, at 126 (2001).

268. The main difficulty faced by legacy carriers has been their inability to maintain a viable business model that could drive a revenue base to cover a traditional cost base while allowing for an adequate return on invested capital. *See* Tretheway, *supra* note 259, at 3.

269. Abeyratne, *supra* note 260, at 587.

other value-added services featured by legacy carriers.[270] This has resulted in a dwindling market share for legacy carriers, a share which could eventually drop to as low as forty per cent, even if producing a higher revenue share.[271]

The threat posed by low-cost carriers to legacy carriers was non-existent until the early 1970s, when charter carriers first started encroaching on the market.[272] This trend coincided with an increasing awareness that, particularly in Europe, controls on market access, monopoly of air services by legacy carriers who were receiving state aid, and restrictions on pricing and frequency of services were overwhelmingly anti-competitive and thus detrimental to the interests of the traveling public.[273] In the United States, the Airline Deregulation Act of 1978 paved the way for liberalization of the domestic air transport market.[274]

The surge of liberalization and the aviation industry's healthy growth rate of four to six per cent in the late 1970s, which continued for twenty years due to aggregate rises in the gross domestic product, spurned an increased demand for travel.[275] In particular, demand grew from business travelers who had deeper pockets than the average tourist.[276] In response, the major airlines launched a practice called "network management" using sophisticated computer technology and optimized business models.[277] They matched expected demand and offered capacity through advanced quantitative analyses that enabled them to build global networks using the famous "hub and spoke" model.[278] The trend encouraged network carriers to attract traffic to their designated hubs, even going so far as to create the multi-hub systems visible in the United States in the 1980s.[279] However, intense competition between 'hub and spoke' carriers created a standoff that forced them to match their competitors' destination profiles at the expense of productivity.[280] If carriers failed to create competitive destination portfolios, they would be devoured by

270. *Id.*

271. Tretheway, *supra* note 259, at 5.

272. *Id.* at 8.

273. Rigas Doganis, *The Impact of Liberalization on European Airline Strategies and Operations*, 1 J. AIR TRANSP. MGMT., 1, 15 (1994).

274. Tretheway, *supra* note 259, at 6 n.9; *see also* Airline Deregulation Act of 1978, Pub. L. No. 95-504, 92 Stat. 1705 (codified as amended in scattered sections of 49 U.S.C.).

275. *See* GLOBAL CHANGE, *supra* note 36, at 25-27.

276. *Id.* at 42.

277. Tretheway, *supra* note 259, at 8.

278. *Id.*; *see also*, MICHAEL W. TRETHEWAY & TAE H. OUM, AIRLINE ECONOMICS: FOUNDATIONS FOR STRATEGY AND POLICY 64-74 (1992) (giving a detailed statistical description of the hub and spoke system based as it relates to anticipated passenger traffic levels).

279. Markus Franke, *Competition Between Network Carriers and Low Cost Carriers—Retreat Battle or Breakthrough to a New Level of Efficiency?*, 10 J. AIR TRANSP. MGMT. 15, 17 (2004).

280. *Id.* at 17.

other carriers through computer reservation systems which penalized reductions in connectivity with reductions in bookings, resulting in revenue drops.[281]

This dilemma led large network carriers to build compensatory competition tools by forming partnerships and global alliances. These arrangements were immensely popular in the mid 1990s and continue to flourish today in certain instances. These alliances would have been absolutely successful had existing regulatory restrictions on ownership and control been liberalized. However, because liberalization this did not occur globally, airline alliances failed to attain the full cost-savings potential.[282]

The final nail in the coffin of the conventional legacy carrier was driven from late 2000 through 2001 as the demand for air travel rapidly decreased due to the economic downturn and the unfortunate events of 11September 2001.[283] As mentioned, more recently, the war in Iraq and the spread of Severe Acute Respiratory Syndrome contributed to the troubles of the conventionally priced legacy air carriers. These events were a tremendous opportunity for low cost carriers who found a niche market in price sensitive clients.[284]

One distinct advantage of the low-cost carrier service is its unwavering focus on efficient and punctual carriage by air.[285] Further, the fact that low-cost carriers fly to secondary airports is proving attractive to passengers who increasingly prefer to go through airports that offer connections with fewer interactions than congested mega airport complexes.[286] Low-cost air carriers also attract to air travel the passenger who would have otherwise used an alternative mode of transportation that was cheaper than the high priced fares of network carriers.[287] Large full-service network carriers are further confronted with the reality that low-cost carriers can drastically expand their own empires with their low-cost business models.[288] A primary example is Southwest Airlines, which has operated low-cost services for the past 30years and has now established its own network of low-cost destinations in the United States.

The point-to-point services offered by low-cost carriers such as Ryan Air, Easy Jet, and Southwest, feature operational efficiency and simplicity of service.[289] These carriers use simple services and processes which, in

281. *Id.* at 16.
282. *Id.*
283. *Id.*
284. *Id.; see supra* pp. 2-3 and accompanying notes.
285. Franke, *supra* note 279, at 16.
286. *Id.* at 17.
287. *Id.*
288. *Id.*
289. Tretheway, *supra* note 259, at 4.

turn, result in a simple, lean organization.[290] This approach has been called "sustainable competitive advantage."[291] Usually, airlines following this approach will offer one class of service with open seating and no meals.[292] This strategy has the dual advantage of cutting costs and simplifying cabin services. Additionally, the low-cost carriers standardized their aircraft, such as Southwest's exclusive use of the 737. This greatly reduces maintenance and crew training costs.[293] Subscribing to one aircraft type also endears the airline to the aircraft's manufacturer, leading to the potential for special discounts.[294]

From a cost-based perspective, the most strategic measure of the low-cost carrier is its focus on secondary airports in small cities.[295] The airline-airport relationship is an integral part of the "low-cost, legacy carrier" equation. Smaller, uncongested airports are appealing to passengers because they reduce landing and take-off queues and provide much shorter gate times than do congested airports in large cities.[296] Shorter walkways and less confusion at gate and check-in points are critical advantages offered to consumers.[297] Furthermore, smaller secondary airports eliminate the usually difficult transfer connections and delays in the delivery of baggage.[298]

All of these factors enable low-cost carriers to lower their costs per available seat mile compared to their competition.[299] In contrast, network carriers are unable to similarly reduce rates because of the vicious network cycles.[300] Network carriers would have to eliminate their networks in order to attain a sustainable competitive advantage in regards to cost. However, legacy carriers are unable to do so because their existence depends on their route networks.[301]

G. Regulation of Pricing

The most fundamental regulatory postulate applicable to the "low-cost, legacy carrier" phenomenon is enshrined in the Chicago Convention

290. *Id.*

291. David Gillen & Ashish Lall, *Competitive Advantage of Low-cost Carriers: Some Implications for Airports*, 10 J. Air Transp. Mgmt. 41, 42 (2004).

292. *See id.* at 45 (discussing Southwest Airlines as the archetypal example).

293. *Id.*

294. *Id.*

295. *Id.*

296. *See* Lawton, *supra* note 261, at 86-87 (discussing the Airline Quality Rating model as applied to Southwest and Ryanair from 1998-2000).

297. *Id.* at 76.

298. *Id.* at 77.

299. *See generally*, Lawton, *supra* note 261 (containing a very thorough and far-reaching analysis of the low-cost carrier phenomenon).

300. Franke, *supra* note 279, at 16.

301. *Id.*

of 1944, which provides that one of the objectives of the ICAO should be to prevent waste caused by undue competition.[302] To this end, at the ICAO's 5th Worldwide Air Transport Conference, contracting states declared that liberalization of air transport must be accompanied by appropriate safeguard measures to ensure fair competition and effective and sustained participation of all states.[303]

The primary question to be raised is whether low-cost carriers are indulging in unfair competition through pricing. The ICAO Air Transport Conference suggested a model clause that would consider charging fares and rates on routes at levels insufficient to cover the costs of providing the services would constitute unfair competitive practice.[304] If low-cost carriers price their product lower than their cost base, then, under the ICAO's model clause, they would be indulging in a practice inconsistent with fair competition.[305]

The Conference also identified practices involving the addition of excessive capacity or frequency of service as anti-competitive. This would be particularly true if such practices were regular and sustained, rather than sporadic or temporary; had a serious negative economic effect on, or cause significant damage to, another airline; reflected an apparent intent to, or had the probable effect of, crippling, excluding or driving another airline from the market; and, if the behavior indicated an abuse of a dominant position on the route.[306] The Conference recommended consultation between aeronautical authorities of state parties in the case of a conflict under this clause with subsequent resolution under the ICAO's provisions pertaining to dispute resolution.[307]

The Conference also recommended that states carefully consider whether consumer interests in service quality have been addressed by current commercial practices of airlines (and service providers, if applicable), and what elements should be handled by regulatory and/or Voluntary Commitment approaches.[308] Some of the services recognized by the Conference under this heading were: availability of lower fares, including fares on Web sites; reservation, ticketing and refund rules; check-in procedures; handling of compensation for flight delays, cancellation and denied boarding; baggage handling and liability; assistance regarding complaints; and assistance for disabled and special-needs passengers.[309]

302. *See* Chicago Convention, *supra* note 1, art. 44(e).
303. *2003 Liberalization Conference Conclusions*, *supra* note 128, at 9; *see supra* note 128.
304. *2003 Liberalization Conference Conclusions, supra* note 128, at 10.
305. *Id.*
306. *Id.*
307. *Id.* at 11.
308. *Id.*
309. *Id.* at 12-13.

With regard to fares and rates, the ICAO Assembly, at its 32nd Session, adopted Resolution A32-17.[310] This resolution recognized that fares and rates for international air transport must be fair and reasonable and designed to promote the satisfactory development of air services.[311] The Resolution also recognized that states or their governments have a responsibility in the matter of fares and rates and requested the ICAO Council to monitor the establishment of international tariffs along with any associated rules and conditions.[312]

Although Resolution A32-17 is no longer in force, its thrust and spirit is embodied in Resolution A35-18, the Consolidated Statement of Continuing ICAO Policies in the Air Transport Field, adopted at the ICAO's 35th Session.[313] This Resolution requests the Council to instruct the Secretary General to periodically issue a study on the regional differences in international air transport operating costs, analyzing how differences in operations and input prices affect the impact that changes in costs may have on air transport tariffs.[314]

To this end, the ICAO has published models of bilateral tariff clauses and identified determinative factors and mechanisms for developing tariffs both for passenger and cargo carriage.[315] The ICAO has also identified the following justifications for international tariffs: to ensure that national carriers have a fair opportunity to operate and compete in providing international air services; to respond to the needs of international air transport; and, to promote competition in international air transport.[316]

In Europe, entrenched European Union legislation controls predatory pricing, competition and fair trade. Article 82 of the European Communities Treaty prohibits abuse of dominant position by a carrier as determined through the comparison of a relevant market and the market share enjoyed by the carrier under evaluation.[317] The pricing practices of the carrier must not be lower than average cost.[318] The Competition Act of 1998 of the United Kingdom also links predatory pricing with domi-

310. ICAO, *Consolidated Statement of Continuing ICAO Policies in the Air Transport Field*, Assemb. Res. A32-17 (2001), *compiled in Resolutions Adopted at the 32nd Session of the Assembly—Provisional Edition* (2001).

311. *See id.* app.G.

312. *See id.*

313. ICAO, *Consolidated Statement of Continuing ICAO Policies in the Air Transport Field*, Assemb. Res. A35-18 (2004), *compiled in Assembly Resolutions in Force,* at III-1, ICAO Doc. 9848 (Oct. 8 2004); *see supra* notes 198-201 and accompanying text.

314. *See id.* at app.G.

315. *See ICAO Economic Policy Guidance Material, supra* note 25, ¶¶ 4.1 - 4.23.

316. *See ICAO Regulation Manual, supra* note 109, ¶ 4.2-1.

317. EC Treaty art. 82.

318. *Id.* art. 82(a).

nant position and uses a process similar to that of the European Union in assessing price-cost relationships.[319] Germany has similar legislation in the Gesetz gegen Wettbewerbsbeschrankungen (GWB), an Act Against the Restraint of Competition.[320] The GWB identifies predatory practices as an abuse of dominant position if the predator is dominant in the market, the conduct of predatory pricing is sustained and continuous, and pricing is below average costs without objective justification.[321]

As mentioned, the United States competition law has, at its genesis, the Sherman Act of 1890[322] and the Clayton Act of 1914[323] (amended in 1950).[324] These acts have been judicially interpreted as requiring two criteria: pricing below average variable costs and proof of recoupment of losses incurred during an alleged period of predatory pricing.[325] In the 2001 case of *United States v. AMR Corp.*,[326] the court held that an air carrier who matches prices and increases output to compete with low-cost carriers is not guilty of monopolization of the market, even if the carrier in question reverted to its original pricing after all low-cost carriers had left the market.[327] The court based its decision on the fact that the carrier had not priced its fare at an inappropriately low level.[328] The carrier in question was found to have met the competition fairly and there was no evidence that the carrier would recoup its losses through competitive pricing.[329]

Predation in Canada is brought within the purviews of both civil and criminal law. Section 50(1)(c) of the Canadian Competition Act recognizes selling at an unreasonably low price to be an act of predation when it is calculated to eliminate competition or lessen a competitor's ability to

319. *See* Competition Act, 1998, c. 41, § 18 (Eng.).

320. *See* 4-35 BUSINESS TRANSACTIONS IN GERMANY § 35.05 (2005) (containing an English translation of the act).

321. *See id.* at § 35.05[3][a].

322. *See* Sherman Act, ch. 647 § 1, 26 Stat. 209 (1890) (current version at 15 U.S.C. § 1 (1990)).

323. *See* Clayton Act, ch. 323 § 7, 38 Stat. 730 (1914) (current version at 15 U.S.C. § 12 (2000)).

324. 1950 Celler-Kefauver Amendments, Pub. L. No. 81-899, 64 Stat. 1125 (codified at 15 U.S.C. § 18 (2000)).

325. *See* Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 222, 224 (1993) (holding that in order to prove predatory pricing a plaintiff needs to demonstrate the defendant priced below average variable cost and that the defendant has a "reasonable prospect" or a "dangerous probability" of recouping its losses from its pricing scheme); *see* David J. Kates, Note: *Recouping the Losses of Brooke Group*, 73 WASH. U. L.Q. 609, 628-29 (1995).

326. United States v. AMR Corp., 140 F. Supp. 2d 1141 (D. Kan. 2001) *aff'd* 335 F.3d 1109 (10th Cir. 2003).

327. *Id.* at 1194.

328. *See id.* at 1207.

329. *See id.* at 1209.

compete.[330]

The Australian Trade Practices Act of 1974,[331] which is administered through the Australian Competition and Consumer Commission, provides that, when a firm takes control of dominant market power with an intent to lessen or eliminate its competition, the onus is on that party to prove that its actions are not tantamount to predatory practices.[332] Recoupment through pricing at competitive levels is seen as a *sine qua non* of predatory pricing.[333]

The above discussion leaves no room for doubt that there is strong regulatory control of fares and services offered to the consumer in air transport. The responsibility in this regard lies primarily in sovereign states acting through the ICAO (for global consensus) and through their own national legislation and policy.[334]

H. Liability Issues

The most compelling area for consideration, particularly from a legal perspective, is the level of services that should be required by low-cost carriers who do not provide the usual frills of international air transport. In point-to-point service, where support services at an airport are minimal and complaints from the passengers or consignors/consignees are difficult to channel to the carrier, the approach taken by courts to handle is of particular interest.

The United States Supreme Court ruled in the 2004 case *Olympic Airways* v. *Husain et. al.*[335] that the plaintiff was allowed recovery for the death of an asthma suffering passenger who was exposed to second hand smoke in flight.[336] The death was allegedly caused by the refusal of a flight attendant to relocate the passenger away from his assigned seat which was in close proximity to the aircraft's smoking section.[337] The Warsaw Convention of 1929, applicable to such liability issues, provides that a carrier is liable for damage sustained in the event of death, or any

330. Competition Act, R.S.C. 1985, c. C-34, sec. 50(1)(c) (Can.).

331. See Trade Practices Act 1974 No. 51 (Austl. 1974), *available at* http://www.comlaw.gov.au/ComLaw/Legislation/Act1.nsf/framelodgmentattachments/BDD38FC3EFBED13CCA256F71007743AD (last visited Apr. 12, 2006).

332. *See id.* §§ 46, 49(1), 49(3).

333. *See id.* § 48.

334. *See, e.g.*, Malcolm N. Shaw, QC, International Law 694-698 (Cambridge University Press 1997) (5th ed. 2003) (explaining that if a state commits an unlawful act towards another state the state committing the wrong owes reparation towards the other state under the law of state responsibility and *not* international law because it does not distinguish between contractual and tortious responsibility).

335. Olympic Airways v. Husain, 540 U.S. 644 (2004).

336. *Id.* at 657.

337. *See id.* at 648 (explaining that there was not a formal announcement of the cause of death because it was against religious practices to perform an autopsy).

other bodily injury suffered by a passenger, if the injury was sustained due to accident that took place on board, or in the course of any of the aircraft's operations.[338] The *Husain* decision endorses an earlier judicial view that failure on the part of an airline to render medical assistance or care for a passenger in need could constitute an injury under the Convention.[339] The Court clarified a prior ruling stating that an accident which did not bear upon the passenger's existing condition of health was deemed to be an outside and unexpected occurrence.[340] The *Husain* decision adds another dimension to the word "accident."[341]

More importantly, *Husain* introduces the possibility that airlines may be burdened with convincing courts that they took every measure possible to look after the interests of their passengers, even if they were not directly responsible for the cause of an accident.[342] Particular care has to be taken regarding passengers who might need special assistance, such as elderly and disabled persons. In a 2002 case, a plaintiff who requested and received wheelchair assistance from check-in to boarding fell on the escalator on her way to boarding, sustaining injury when her wheelchair fell backwards.[343] The primary issue was whether the carrier was liable under Article 17 of the Warsaw Convention for injury sustained during the course of operations of embarking.[344] The Court in that case considered various criteria, such as the plaintiff's location when the injury occurred, and concluded that, because the accident occurred while the plaintiff was on her way to enter the aircraft, and at a location where she was obliged to be, the situation did indeed fall under the "in the course of operations of embarking" clause.[345] The Court further observed that the airline's entire "departure routine," which passengers were obliged to follow, was included in the process of embarking and was not merely a "waiting" activity.[346]

Given the sensitivity of current jurisprudence to a carrier's liability, carriers should seriously review their exposure to the risk of law suits. As

338. *Id.* at 649.

339. Seguritan v. Nw. Airlines, Inc., 86 A.D.2d 658 (N.Y. App. Div. 1982).

340. *See Husain*, 540 U.S. at 656-57 (clarifying the definition of "accident" as given in Air France v. Saks, 470 U.S. 392, 405 (1985)).

341. *Id.*; *see* Lorraine B. Halloway, Mark J. Andrews, Kenneth E. Siegel, & Dean Saul, *International Legal Developments in Review: 2004*, 39 INT'L LAW 417, 420 (2005).

342. *See 2005 SMU Air Law Symposium Recent Developments in Aviation Law*, 70 J. AIR L. & COM. 171, 176-77 (2005) (explaining that knowledge that an event requires action or inaction in certain circumstances would require action on the part of the airline).

343. Case Law Digest, *Warsaw Convention – Article 17 – Injury during the course of embarkation – Article 29 – Limitation Period – Liability in negligence*, XXVIII AIR & SPACE L. 194 (2003) (summarizing *Philips v. Air New Zealand Ltd.*, (2002) 2 Lloyd's Rep. 408 (Q.B.D.)).

344. *Id.*

345. *Id.*

346. *Id.*

some courts have gone so far as to find a carrier responsible even for the conduct of a sexual predator, over whom the airline need not necessarily have any control, the situation remains delicate.[347]

III. Competition in Europe

A. European Community Legislation on Air Transport

Air transport in the European Community historically has been regulated by two treaties, the ECSC Treaty (which established the European Coal and Steel Community),[348] and the EEC Treaty (which established the European Economic Community).[349] The former, signed in Paris in 1951, addressed issues related to the carriage of coal and steel through the media of rail, road and inland waterways and as such was not directly relevant to aviation.[350] The latter dealt with issues relating to all modes of transport in the carriage of persons and goods and is thus of some relevance to aviation.[351]

The EEC Treaty, signed in Rome on March 25, 1957, had at its core a Common Transport Policy (CTP) concept.[352] The CTP was calculated to achieve the fundamental purposes of the European Community.[353] One of the most salient features of the EEC Treaty is that the tasks of the Community are set out succinctly in Article 2, which provides *inter alia* for the adoption of a Common Transport Policy as provided for in Article3(1).[354] This provision is linked to Article 84, which in turn provides that the objectives of the Treaty regarding issues of transportation would be pursued by state parties within the parameters of the CTP, which is established by the Council of Europe through secondary legislation.[355]

The rights and duties of the Council of Europe in establishing the CTP, particularly in the fields of air and maritime transport, can be attributed to a 1986 case[356] and Article 189 of the EEC Treaty. Article 189

347. *See* Wallace v. Korean Air, 214 F.3d 293, 299-300 (2d Cir. 2000) (holding that a sexual assault can be defined as an accident under Article 17 of the Warsaw Convention).

348. Treaty instituting the European Coal and Steel Community, Apr. 18, 1951, 261 U.N.T.S. 140. This treaty expired in 2002, although many of its substantive provisions were included in the superceding Treaty of Nice. *See Treaty of Nice sets stage for union's enlargement*, S. China Morning Post, May 14, 2001.

349. Treaty Establishing the European Economic Community, 25 Mar. 1957, 298 U.N.T.S. 3 [hereinafter Treaty of Rome].

350. *See* Paul. S. Dempsey, *Competition in the Air: European Union Regulation of Commercial Aviation*, 66 J. Air L. & Com. 979, 992 (2001).

351. *Id.* at 992; EC Treaty art. 3(e).

352. *See* EC Treaty art. 3(e); Dempsey, *supra* note 350, at 993.

353. *See* Dempsey, *supra* note 350, at 993-94.

354. *Id.* at 994; Council Regulation 1017/68, 1968 O.J. (L 241) 10.

355. *See* Dempsey, *supra* note 350, at 994.

356. Cases 209-213/84, Ministere Public v. Lucas Asjes, 1986 E.C.R. 1425 [1990]; EC Treaty art. 189.

enables the Council to adopt common rules attributable to international transport to or from the territory of a member state or passing across the territory of one or more member state, the conditions under which non-resident carriers may operate transport services within a member state, and any other appropriate provisions.[357]

Article 84(1) of the EEC Treaty applies the provisions of the Section relating to transport to railroad and inland waterway, with a qualifier in Article 84(2) giving discretion to the Council to decide whether, and to what extent and by what procedure, appropriate provisions may be laid down for sea and air transport.[358] Although air and maritime transport is explicitly mentioned in Article 84, implicit in the Treaty is the understanding that the transport title will not *ipso facto* apply to those two modes of transport.[359]

The applicability of the EEC Treaty to air and maritime transport was examined in some detail in the 1974 case, *Commission v. France*. The court observed:

> Whilst under Article 84(2), therefore, sea and air transport, so long as the Council has not decided otherwise, is excluded from the rules of Title IV Part Two of the Treaty relating to the CTP, it remains, on the same basis as other modes of transport, subject to the general rules of the Treaty.[360]

The court subsequently confirmed this view in a 1977 case.[361] Both decisions make it clear that the general rules of the Treaty apply *per force* to transportation in general, if the Council, acting under Article 84(2) does not decide to the contrary.[362] This essentially means that the Commission has a legal, as well as political, duty to ensure that the general provisions of the Treaty are applied to air and maritime transportation.[363]

The Treaty on European Union (TEU) is a supplemental treaty which embellishes the provisions of the EEC Treaty. In particular, the TEU added that the Council shall, in addition to its duties in Article

357. EC Treaty art. 189.

358. *Id.* art. 84 (current version at art. 80).

359. *See* Moritz F. Scharpenseel, *Perspective, Consequences of E.U. Airline Deregulation in the Context of the Global Aviation Market*, 22 NW. J. INT'L L. & BUS. 91, 95 (2001) ("Under Article 84(2) of the EEC Treaty the Council decides whether these provisions may be applied to sea and air transportation. This statute raised doubts as to whether shipping and aviation were covered by the EC Treaty at all.").

360. Case 167/73, Commission of the European Communities v. French Republic, 1974 E.C.R. 359 [1974] (holding that the obligation under Article 2 of the EC Treaty to establish a common market refers to the whole of the economic activities in the Community).

361. Case 156/77 Commission v. Kingdom of Belgium, 1978 E.C.R. 1881.

362. Scharpenseel, *supra* note 359, at 102; *see also* Ruwantissa Abeyratne, *The Decision of the European Court of Justice on Open Skies, How can we Take Liberalization to the Next Level?*, 68 J. AIR L. & COM. 485, 503 (2003).

363. *See* Abeyratne, *supra* note 362, at 503.

75(1), lay down measures to improve transport policy.[364] The TEU also established the principle that the Council is obligated in all instances to act on proposals from the Commission, consequent to obtaining the opinion of the European Parliament.[365] This procedure is laid out in Article 189c of the EEC Treaty; the TEU merely enforced the need for the Council to act according to the provision.[366] The TEU also requires the European Community to contribute to the establishment and development of trans-European networks, specifically telecommunications and energy infrastructures per Article 129b(1) of the TEU.[367]

In October 1997, the Joint European Council confirmed the creation of a European Common Aviation Area (ECAA) which would encompass the European Community States, member states of the European Economic Area (EEA), and the Associated States of Central Europe.[368] The EEA is based on the *Acquis Communautaire* in air transport and is founded in a multilateral agreement containing transitional provisions on market access and environmental protection, with a particular emphasis on noise.[369] European Community legislation is extended by the ECAA agreement in areas relating to market access and ancillary issues, competition rules, air traffic management, safety, environmental protection, social aspects, and consumer protection.[370]

The perceived dichotomy between the wide-ranging powers of the European Union in external relations in air transport and the inhibitions cast upon the Union by its enabling legislation, the European Communities Treaty (which does not explicitly grant the Union competence), has led to sustained examination by the adjudicatory process.[371] The European Court of Justice (ECJ) decided in 1971 that the Community has both external competence and internal competence on an intra-Europe basis.[372] This judgment gave implicit external competence to the European Union to take over control of negotiations on behalf of European member states in matters relating to international air transport agreements.[373] Although the Union has not utilized this right extensively, it

364. Treaty on European Union, art. 75(1)(c), Feb. 7, 1992, O.J.(C 224) 1 (1992) [hereinafter TEU] as amended by Treaty of Amsterdam, October 2, 1997 O.J. (C 340) 1 (1997).

365. *Id.* art. 198(a).

366. *Id.* art. 75.

367. *Id.* art 129(b)(1).

368. Abeyratne, *supra* note 362, at 504.

369. The so-called "third package." *See* Scharpenseel, *supra* note 359, at 95; *see infra* note 431.

370. Scharpenseel, *supra* note 359, at 98.

371. *Id.* at 102.

372. *See* Case 22/70 *Comm'n of the European Communities v. Council of the European Communities*, 1971 E.C.R. 236.

373. *See Civil Aviation Memorandum No. 1 and Civil Aviation Memorandum No. 2, Progress Towards the Development of Community Air Transport Policy*, COM(84)72 final (1994).

was used in the 1990s when the European Community adopted internal rules pertaining to CRS on an intra-Europe basis.[374] However, this right (until the recent European Court of Justice Transport cases discussed in Parts B and C *infra*) did not extend to trade in services per a 1994 ECJ judgment holding that trade in services, including trade relating to air transport services, is beyond the jurisdiction of the European Union.[375]

The Maastricht Treaty of 1992[376] provided that the European Community may decide to cooperate with third countries to promote projects of mutual interest. It thus became possible to encompass the countries of Central and Eastern Europe within the purview of the European Union, extending some flexibility to the rigid treaty law governing Europe, particularly in relation to trade in services and commercial competition in air transport.[377] The third and final phase, or "third package," of European Community air transportation liberalization took effect in January 1993, putting in place regulations covering areas such as market access, slot allocation and scheduling.[378]

The tightly-woven Pan-European legislation on competition reflects the desire of the European nations to band together as a collective force rather than compete individually with other nations or among themselves in the field of air transport.[379] However, although a combined Europe is more populated than North America, airlines of the European Union have not maximized the market's potential, primarily due to the airlines' high operating costs.[380] Several airlines have been successful, such as British Airways, KLM and Lufthansa (although only in the mid nineties), but most other European carriers, have operated at or below break-even

374. *See* Commission Regulation 1617/93, 1993 O.J. 1993 (L 155) 18; Council Regulation 95/93, 1993 O.J. (L 140) 1; Council Regulation 3089/93, 1993 O.J. (L 278) 1; Commission Regulation 3652/93, 1992 O.J. (L 333) 37. For a discussion of computer reservation systems, see generally Raffaele Cavani, *Computerized Reservation Systems for Air Transport: Remarks on the European Community Legislation*, 17 FORDHAM INT'L L.J. 441, 454-56 (1994).

375. *See* Benoit M.J. Swinnen, *An Opportunity for Trans-Atlantic Civil Aviation: From Open Skies to Open Markets?*, 63 J. AIR L. & COM. 249, 276 (1997); *European Union Denies Kinnock Authority to Negotiate 'Hard Issues' With U.S.*, AVIATION DAILY, Oct. 10, 1997, at 63.

376. Provisions amending the Treaty establishing the European Economic Community with a view to establishing the European Community, Feb. 7, 1992, 1 C.L.M.R. 719 [hereinafter Maastericht Treaty].

377. *See id.*; *see also* Dempsey, *supra* note 350, at 1070-72.

378. *See* Scharpenseel, *supra* note 359, at 104.

379. There has always been a mixed reaction amongst E.U. countries to the notion of giving the Commission sovereignty to negotiate all international aviation agreements. *See, e.g.*, Daniel Dombey, *Long Haul Ahead in Open Skies Struggle*, FINANCIAL TIMES, Nov. 5, 2002, at 11 (quoting E.U. Transport Commissioner Loyola de Palacio); *AUA Says Court Ruling Will Change Little in Practice*, AUSTRIA TODAY, Nov. 7, 2002, at 5 (quoting Austrian Airlines Group spokesman Johann Jurecka).

380. *See* LAWTON, *supra* note 261, at 69.

levels.[381] As a result of the rapidly evolving collectiveness of the European States, particularly in the liberalization of intra-European markets, European Union carriers have now entered more intra-European routes. Several airlines of European States have established subsidiaries in other Union Member States.[382]

The success of the European Union states in tightening air transport legislation and liberalizing air transport intra-Europe is a classic example of the "cluster" theory, a principle based on the competitive advantage of a cluster of nations which are geographically proximate to each other.[383] In this case, the air carriers of a cluster of European states, interconnected and linked by commonalities and complementariness, are given the opportunity to form alliances, sourcing their capital, goods and technology to locate their operations wherever within the European Continent it may be cost effective.[384]

The prevalence of clusters in economies brings to bear new concepts about national, municipal and international economies and opens a whole new dimension of competition centered around liberalization on an intra-continental legal structure.[385]

Clustering in European air transport in the areas of slot allocation and market access has created new management agendas for European carriers, giving them a tangible stake in key business areas such as taxation, utility cost sharing and wages.[386] The European Union states, in their macroeconomic vision, have created a driving force in the European air transport industry, not only by maximizing air transport potential within the continent, but also by creating new types of dialogues between air transport enterprises within Europe.

The theory of clustering is based on the economic potential of a group of enterprises. Clusters of European airlines operating within Europe would affect competition by increasing the productivity of constituent partners across the board. The partners' innovation and growth in productivity would increase through the stimulation of new business strategies that expand the dimensions of the cluster.[387] Clusters also effectively maximize economies of agglomeration by promoting proximity of operation to markets while minimizing costs.[388]

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381. *Id.* at 62.

382. *Id.* at 21.

383. *See generally*, PORTER, *supra* note 41, at 197-271 (analyzing the manifold forms "clusters" may take and their effects on competition within a market).

384. *Id.* at 199.

385. *Id.*

386. *Id.* at 172.

387. *Id.* at 241.

388. *Id.*

Together with the overall thrust of the cluster phenomenon brought about by tight legislation on liberalization, European nations also have the advantage of the immense capacity of their air transport industry to innovate and upgrade. Europe has retained competition advantage within the continent through a highly localized process.

For the European Union nations, the most important market is arguably the North Atlantic air transport market between the United States and Europe. A primary commercial tool which European carriers have used in participating in this market is the air carrier alliance.[389] The North Atlantic market was by far the largest in the world in the mid nineties, with 34 million passengers carried in 1993.[390] The largest country pair in this market is the United States and United Kingdom, which accommodated 43% of all United States-to-Europe traffic in 1997.[391]

Although post-Second World War trends produced by the Bermuda I and Bermuda II[392] models were perceived as inhibiting the hidden potential in air transport between the United States and Europe,[393] the United States' external aviation policy of liberalization, launched in 1978, paved the way for more competition.[394] The Netherlands, which blazed the trail with the first liberalized bilateral agreement with the United States in 1978,[395] was followed by Belgium[396] and Germany[397] in quick succession.

B. European Commission v. United Kingdom, Denmark, Sweden, Finland, Belgium, Luxembourg, Austria, Germany

In 1998, the European Commission applied to the European Court of Justice to review the actions of seven European Union member states who had concluded bilateral "open skies" agreements with the United

389. Abeyratne, *supra* note 79, at 431.

390. *U.S. Int'l Air Passenger & Freight Statistics 1993* (Dep't of Transp., Washington) Dec. 1994, at 21.

391. *U.S. Int'l Air Passenger & Freight Statistics 1998* (Dep't of Transp., Washington) Dec. 1998, at 32.

392. Jose A. Gomez-Ibanez & Ivor P. Morgan, *Deregulating International Markets: The Examples Of Aviation And Ocean Shipping*, 2 Yale J. on Reg. 107, 111, 112 (1984).

393. *Id.* at 113.

394. *Id.* at 115.

395. *See* Protocol Relating to the United States-Netherlands Air Transport Agreement of 1957, Mar. 31, 1978, 29 U.S.T. 3088. This agreement provided for unrestricted capacity and unrestricted fares. *Id.* art. 6.

396. Agreement on International Aviation, Oct. 24, 1977, and Nov. 16, 1977, U.S.-Belgium, T.I.A.S. No. 8923.

397. *See* P. C. Haanappel, *Bilateral Air Transport Agreements: 1913-1980*, 5 Int'l Trade L.J. 241, 261-62 (1980).

States in the field of air transport.[398] The Court held oral proceedings in May 2001 and subsequently considered the conclusions of the Advocate-General.[399]

The European Commission's complaint dated back to 1992 when the member states of the European Union jointly agreed to create a single European market in air transport.[400] Broadly, this meant that air carriers of the European Union member states could carry passengers and freight on an intra-EU basis territorially, using liberalized commercial rights.[401] This accorded European Community airlines with equal rights at law to operate air services from their home bases.[402] Furthermore, European Community airlines became *ipso facto* airlines of the European Union, with the same rights and on the same terms as local airlines in a given European Union territory.[403]

A natural corollary to this agreement was the belief on the part of the Commission that a broad based initiative to remove trade barriers in market access would encourage competition among European Union carriers within the Union, particularly as European carriers would benefit by operating services from their home base and establishing commercial operations anywhere in the European Union on an equal basis to any native carrier.[404] More importantly, the European Commission held a reasonable expectation that the agreements would apply European Union external policy to countries outside the Union.[405]

Further, the documents before the Court indicated that, in 1992, the United States had offered various European States the opportunity of concluding a bilateral "open skies" agreement.[406] Such agreements were

398. Case C-466/98, Comm'n of the Eur. Communities v. United Kingdom of Gr. Brit. and N. Ir.; Case C-467/98, Comm'n of the Eur. Communities v. Kingdom of Den.; Case 468/98, Comm'n of the Eur. Communities v. Kingdom of Swed.; Case C-469/98, Comm'n of the Eur. Communities v. Republic of Fin.; Case C-471/98, Comm'n of the Eur. Communities v. Kingdom of Belg.; Case C-472/98, Commission of the European Communities v. Grand Duchy of Luxembourg; Case C-475/98, Comm'n of the Eur. Communities v. Republic of Aus.; Case C-476/98, Comm'n of the Eur. Communities v. Federal Republic of Ger. [hereinafter the Transport Cases]. With the exception of the U.K. case, which does not discuss all of the major issues addressed in the other cases, all of the ECJ opinions are nearly identical.

399. *A Break in the Clouds: The European Court's "Open-Skies" Ruling Undermines the Protection of Europe's Flag Carriers*, THE ECONOMIST, Nov. 9, 2002, at 14.

400. Jacob A. Warden, Comment, *"Open Skies" at a Crossroads: How the United States and European Union Should Use the ECJ Transport Cases to Reconstruct the Trans-Atlantic Aviation Regime*, 24 Nw. J. INT'L L. & BUS. 227, 241 (2003).

401. *Id.* at 240.

402. *Id.*

403. *Id.*

404. *See Civil Aviation Memorandum No. 1 and Civil Aviation Memorandum No. 2, Progress Towards the Development of Community Air Transport Policy*, COM(84)72 final (1994).

405. *Id.*

406. *See* Warden, *supra* note 400, at 237.

intended to facilitate alliances between American and European carriers. They conformed to a number of criteria set out by the United States government, such as free access to all routes, the granting of unlimited route and traffic rights, the fixing of prices in accordance with a system of "mutual disapproval" for air routes between the parties to the agreement, and the possibility of sharing codes.[407] During 1993 and 1994, the United States intensified its efforts to conclude bilateral air transport agreements under the open skies policy with as many European States as possible.[408] In 1994, the United States issued an "International Aviation Policy Statement" advocating a global open aviation system, committing itself to an "open skies" approach.[409] The United States "open skies" policy is a liberalized bilateral, and multilateral, structure that enables carriers to continue service to a third country in a single flight (usually called "Fifth Freedom" rights).[410] In the context of United States and Europe, an example would be a carrier operating air services from New York to Paris and continuing onwards to London.

In accordance with its position against individual bilateral negotiations in favor of a European Union-based common approach, the Commission requested European Union member states to refrain from entering into any new agreements, specifically with the United States. In a letter sent to member states on November 17, 1994, the Commission highlighted the possible negative effects of such bilateral agreements on the Community and stated that, in its opinion, these types of agreements were likely to affect internal Community legislation.[411] The Commission added that only at the Community level could negotiation of bi-lateral agreements be carried out effectively and in a legal manner.[412]

Although the Commission requested European Union member states to desist from entering into bilateral agreements individually, seven of eight members signed an "open skies" agreement with the United States, the United Kingdom being the only exception.[413] For instance, the Kingdom of Belgium reached an agreement with the United States on a new amendment to the 1980 Agreement, subsequently confirmed by an exchange of diplomatic notes on March 1, 1995.[414] Several provisions

407. *Id.*

408. *Id.*

409. *See* In the Matter of "Open Skies", Dep't of Transp. Order No. 92-8-13 (August 5, 1992), *available at* 992 DOT Av. LEXIS 586 at 14-16.

410. *See* Warden, *supra* note 400, at 234.

411. *See* Dempsey, *supra* note 350, at 1071.

412. *Id.* at 1071-72.

413. *Id.* at 1073-74. Although it agreed to nationality principles in the US/UK bilateral agreement, the UK did not go so far as to conclude an open skies agreement with the US. *Id.* at 1073 n.634.

414. Case C-471/98, Comm'n v. Belg., 2002 E.C.R. I-09681 ¶ 31.

were amended or revoked so that the agreement complied with the American "open skies" model agreement.[415] In addition, Annexes I and II to the 1980 Agreement, containing schedules of routes and opportunities for their use, were amended to bring them into line with that model.[416] For example, changes were made in relation to routes, operational flexibility, and charter flights.

Under Article 3 of the 1980 Agreement, each contracting party may grant appropriate operating authorizations and necessary technical permissions to airlines designated by the other party, subject to the condition that a substantial part of the ownership and effective control of that airline is vested in the designating party nationals of that party.[417] According to Article4 of that agreement, those authorizations and permissions may be revoked, suspended or limited where the above condition is not fulfilled.[418]

i. The European Commission's Arguments

The Commission's major contention against the "open skies" agreements was that they eroded the fundamental premise of the European Union, namely that it is one large liberalized market (similar to the American market in so far as the United States is concerned).[419] Although the Commission conceded that "open skies" agreements may accord benefits to consumers, it believed that the "open skies" agreements between the United States and European Union member states would provide United States carriers with significant operational benefits in Europe without according reciprocal benefits to European carriers in the United States.[420]

Specifically, the Commission claimed that although United States carriers could operate air services from any point in the United States to any point in Europe, the European carriers were restricted to operating services to the United States only from their home bases.[421] Additionally, the Commission argued that nationality restrictions in the "open skies" agreements would hinder intra-European investment and rationali-

415. "The following amendments were made ('the 1995 amendments'). In the body of the text of the 1980 Agreement, Articles 1 (Definitions), 3 (Designation and Authorization), 6 (Safety), 7 (Aviation Security), 8 (Commercial Opportunities), 9 (Customs Duties and Taxes), 10 (User Charges), 11 (Fair Competition), 12 (Pricing), 13 (Surface Transportation/Intermodal Services), 14 (Commissions), 15 (Enforcement), 17 (Settlement of Disputes) and 20 (Multilateral Agreement)." *Id.*

416. *Id.*

417. *Id.* ¶ 32.

418. *Id.*

419. *Id.* ¶ 56.

420. *Id.* ¶¶ 27, 28.

421. *Id.* ¶¶ 59, 63.

zation.[422] It was the Commission's submission to the European Court that the only reasonable manner in which negotiations with the United States could be carried out was through bloc negotiations in which the leverage of European Union states could be pooled.[423] The Commission noted that the pooling approach was being used by European Union states in other areas of commercial interaction and that air transport should be no exception.[424]

Moreover, the Commission asserted that it was the only party that could effectively negotiate air transport agreements on behalf of all European Union states.[425] The Commission claimed that it had exclusive jurisdiction in air service negotiations based on the doctrine of implied powers, enshrined in Article80 of the European Communities Treaty.[426] The fundamental principle of the doctrine is that the existence of Community law on a particular issue supersedes the rights of individual states to make their own decisions on that issue.[427] Member states lose their right to assume obligations with non-member countries if and when common rules regarding or affecting those obligations are enacted.[428]

Article 84(1) of the European Communities Treaty (now, after amendment, Article 80 (1) EC) provides that the provisions of Title V, relating to transport, of Part Three of the Treaty are to apply only to transport by rail, road and inland waterway.[429] Paragraph2 of that article provides: "The Council may, acting by a qualified majority, decide whether, to what extent and by what procedure appropriate provisions may be laid down for sea and air transport. The procedural provisions of Article 75(l) and (3) shall apply."[430]

Pursuant to that provision, and with a view to the gradual establishment of the internal market in air transport, the Council adopted three 'packages' of measures, in 1987, 1990 and 1992 respectively, designed to ensure freedom in providing services in the air transport sector, and to apply the Community's competition rules in that sector.[431]

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422. *Id.* ¶ 107.

423. *Id.* ¶¶ 77-79.

424. *Id.* ¶ 55 (citing Case 22/70, Comm'n v. Council, 1971 E.C.R. 263 ¶ 17 (holding that a grant of internal competence in given subject matter implies power to make treaties externally concerning that subject)).

425. Comm'n v. Belg., 2002 E.C.R. I-09681 ¶¶ 77-79.

426. Case 22/70, Comm'n v. Council, 1971 E.C.R. 263 ¶ 17.

427. *Id.*

428. *Id.*

429. EC Treaty art. 84(1) (as in effect 1998) (now, after amendment, article 80(1) EC), *cited in* Comm'n v. Belg. ¶ 3.

430. EC Treaty art. 84(1) (as in effect 1998) (now, after amendment, article 80(1) EC) *cited in* Comm'n v. Belg. ¶ 3) (Article 75(1) and (3) are now Article 71 EC).

431. The "first package" consisted of Council Directive (EEC) 87/601, 1987 O.J. (L 374) 12 and Council Decision (EEC) 87/602, 1987 O.J. (L 374) 19; the "second package" consisted of

The third package, which came into effect in 1992, was essentially geared toward liberalizing and establishing an internal European market of air services by providing uniform standards for intra-European Union market access to European Union carriers.[432] The legislation comprises Regulation Nos. 2407/92, 2408/92 and 2409/92.[433] According to Article 1 of Regulation No 2407/92, that regulation concerns requirements for the granting and maintenance of operating licenses by member states in relation to air carriers established in the Community.[434] In that respect, Article 3(3) provides that no undertaking established in the Community is to be permitted within the territory of the Community to carry by air passengers, mail and/or cargo for remuneration and/or hire unless the undertaking has been granted the appropriate operating license.[435] Under Article 4 (l) and (2), a member state may grant that license only to undertakings which have their principal place of business and registered office, if any, in that member state and, without prejudice to agreements and conventions to which the Community is a contracting party, which are majority owned and effectively controlled by member states and/or their nationals.[436]

As stated in Article 1 (1) of Regulation No 2409/92, that regulation lays down the criteria and procedures to be applied for the establishment of fares and rates on air services for carriage wholly within the Community.[437] Article 1 (2) and (3) of that regulation provide:

> Without prejudice to paragraph 3, this Regulation shall not apply:
>
> a) to fares and rates charged by air carriers other than Community air carriers; and
>
> b) to fares and rates established by public service obligation, in accordance with Council Regulation (EEC) No 2408/92 of 23 July 1992 on access for Community air carriers to intra-Community air routes.
>
> Only Community air carriers shall be entitled to introduce new products or

Council Regulation (EEC) 2342/90, 1990 O.J. (L 217) 1 and Council Regulation (EEC) 2343/90, 1990 O.J. (L 217) 8; and the "third package" consisted of Council Regulation (EEC) 2407/92, 1992 O.J. (L 240) 1, Council Regulation (EEC) 2408/92, 1992 O.J. (L 240) 8, and Council Regulation (EEC) 2409/92, 1992 O.J. (L 240) 15 *cited in* Comm'n v. Belg. ¶ 3.

432. *See generally* Council Regulation (EEC) 2407/92, 1992 O.J. (L 240) 1, Council Regulation (EEC) 2408/92, 1992 O.J. (L 240) 8, and Council Regulation (EEC) 2409/92, 1992 O.J. (L 240) 15.

433. *Id.*

434. Council Regulation (EEC) 2407/92, 1992 O.J. (L 240) art. 1, *cited in* Comm'n v. Belg. ¶ 6.

435. Council Regulation (EEC) 2407/92, 1992 O.J. (L 240) art. 3(3), *cited in* Comm'n v. Belg. ¶ 6.

436. Council Regulation (EEC) 2407/92, 1992 O.J. (L 240) arts. 4(1)-(2), *cited in* Comm'n v. Belg. ¶ 6.

437. Council Regulation (EEC) 2409/92, 1992 O.J. (L 240) art. 1(1), *cited in* Comm'n v. Belg. ¶ 9.

lower fares than the ones existing for identical products.[438]

In addition to Regulations Nos. 2407/92, 2408/92 and 2409/92, the Community legislature adopted other measures in relation to air transport, in particular Regulations Nos. 2299/89 and 95/93.[439]

In accordance with Article 1, Regulation No. 2299/89 applies to Computer Reservation Systems (CRS) to the extent that they contain air transport products when offered for use or used in the territory of the Community. This was irrespective of the status or nationality of the system vendor, the source of the information used or the location of the relevant central data processing unit, or the geographical location of the airports between which air carriage takes place.[440]

However, Article 7 (1) and (2) of the same regulation provides:

> The obligations of a system vendor under Articles 3 and 4 to 6 shall not apply in respect of a parent carrier of a third country to the extent that its CRS outside the territory of the Community does not offer Community air carriers equivalent treatment to that provided under this Regulation and under Commission Regulation (EEC) No 83/91.
>
> The obligations of parent or participating carriers under Articles 3a, 4 and 8 shall not apply in respect of a CRS controlled by (an) air carrier(s) of one or more third country (countries) to the extent that outside the territory of the Community the parent or participating carrier(s) is (are) not accorded equivalent treatment to that provided under this Regulation and under Commission Regulation (EEC) No 83/91.[441]

Regulation No. 95/93 also applies to air carriers from non-member countries.[442] Article 12 of that regulation provides:

> Whenever it appears that a third country, with respect to the allocation of slots at airports:
>
> a) does not grant Community air carriers treatment comparable to that granted by member States to air carriers from that country; or
>
> b) does not grant Community air carriers de facto national treatment; or
>
> c) grants air carriers from other third countries more favorable treatment than Community air carriers, appropriate action may be taken to remedy the situation in respect of the airport or airports concerned, including the sus-

438. Council Regulation (EEC) 2409/92, 1992 O.J. (L 240) arts. 1(2)-(3), *cited in* Comm'n v. Belg. ¶ 10.

439. Council Regulation (EEC) 2299/89, 1989 O.J. (L 220) 1, *amended by* Council Regulation (EEC) 3089/93, 1993 O.J. (L 278) 1; Council Regulation (EEC) 95/93, 1993 O.J. (L 14) 1, *both cited in* Comm'n v. Belg. ¶11.

440. Council Regulation (EEC) 2299/89, 1989 O.J. (L 220) art. 1, *amended by* Council Regulation (EEC) 3089/93, 1993 O.J. (L 278) 1 *cited in* Comm'n v. Belg. ¶ 12.

441. Council Regulation (EEC) 2299/89, 1989 O.J. (L 220) arts. 7(1)-(2), *amended by* Council Regulation (EEC) 3089/93, 1993 O.J. (L 278) 1 *cited in* Comm'n v. Belg. ¶ 13.

442. *See* Council Regulation (EEC) 95/93, 1993 O.J. (L 14) 1 *cited in* Comm'n v. Belg. ¶ 14.

> pension wholly or partially of the obligations of this Regulation in respect of an air carrier of that third country, in accordance with Community law.
>
> Member States shall inform the Commission of any serious difficulties encountered, in law or in fact, by Community air carriers in obtaining slots at airports in third countries.[443]

Based on the doctrine of implied powers, the Commission contended that the negotiation of "open skies" agreements by European Union member states with the United States exceed the authority of those states and was contrary to the letter and spirit of the third package of liberalization.[444] The Commission added that the allocation of traffic rights by nationality effectively prevented competition between European Union airlines and unduly restricted aspirant European Union airlines from establishing bases in other European Union states.[445]

The Commission took the position that it would be inconsistent with the aims of the liberalization to allow member states to negotiate and finalize bilateral agreements pertaining to air transport services with countries outside the European Union.[446] The Commission reasoned that a concerted single market approach to bilateral negotiations by the European Union against non-Union countries would ensure the pristine equity of a single European market, effectively precluding unfair competition from non-Union carriers who might not have met the stringent criteria required of airlines before they are granted European Union carrier status.[447] The Commission argued that non-Union carriers should be granted market access to territories in the European Union only if such carriers satisfied criteria that were acceptable to the Union as a whole, and not on an individual state-by-state basis.[448]

In support of the principle that bilateral air services agreements with non-Union States should only be negotiated by the European Union and not by individual member states, the Commission further contended that if European Union states were to individually allocate air traffic rights to foreign destinations based on nationality, such an approach would result in discrimination against national flag carriers of separate European Union member states, violating treaty provisions that govern the European Union's liberalization initiative.[449] The Commission asserted that any negotiation based on individual nationality would hinder competition

443. Council Regulation (EEC) 95/93, 1993 O.J. (L 14) art. 12 *cited in* Comm'n v. Belg. ¶ 14.

444. *See* Comm'n v. Belg., 2002 E.C.R. I-09681 ¶¶ 55, 58-59, 76-78; *see also* Case 22/70, Comm'n v. Council, 1971 E.C.R. 263 ¶ 17.

445. *Id.*

446. *Id.*

447. *Id.* ¶ 78.

448. *Id.*

449. *See* Opinion 466/98, 2002 E.C.R. I-09427 ¶ 44.

between European Union airlines, which would react by safeguarding their national interests.[450] This reaction would have far reaching adverse consequences on the progress of the European economy.[451]

ii. The Decision of the European Court

The European Court enunciated similar principles in support of its individual judgments against all eight respondent states, and this discussion refers to the general observations and conclusions of the Court that are applicable to all eight states. However, for purposes of analysis, specific reference will be made to the Court's approach to the Kingdom of Belgium and its decision in that particular case.[452]

a. Abuse of Procedure

The Court noted that European Commission's action was for a declaration that the eight respondent states had failed to fulfill their obligations under Community law by separately forming bilateral agreements with the United States in the field of air transport. [453] The Court found that the Commission had properly applied the Treaty rules by bringing the action in accordance with Article 169 of the Treaty. The Commission had properly utilized the proceedings specifically envisaged by the Treaty for cases where a member state has failed to fulfil one of its obligations under Community law.[454]

The Court did not accept the Belgian Government's argument concerning the Commission's motives in choosing to bring the present action rather than taking action against the Council. The Belgian Government had asserted that the action infringed on its legitimate expectation that the failure to fulfill its obligations would not be pursued.[455] In its role as guardian of the Treaty of Rome, the Commission alone is competent to decide whether it is appropriate to bring proceedings against a member state for a declaration of its failure to fulfil obligations, and on which conduct or omission any such proceedings should be brought.[456] The Court held that this plea must therefore be rejected.[457]

450. *Id.*

451. *Id.*

452. *See* Transport Cases, *supra* note 398.

453. Comm'n v. Belg., 2002 E.C.R. I-09681 ¶ 47.

454. *Id.* ¶ 48.

455. Comm'n v. Belg., 2002 E.C.R. I-09681 ¶¶ 36, 39 (citing C-431/92, Commission v. Ger., 1995 E.C.R. I-2189, 22).

456. *Id.*

457. Comm'n v. Belg., 2002 E.C.R. I-09681 ¶ 40.

b. Internal Versus External Competency

The Court's primary ruling was that, in relation to air transport, Article 84 (2) of the Treaty merely provides the Community power to take action provided there has been a prior decision by the Council.[458] Accordingly, although that provision may be used by the Council as a legal basis for conferring on the Community the power to conclude an international agreement in the field of air transport in a given case, the Court was of the view that it could not be regarded as in itself establishing an external Community competence in that field.[459]

While the Court conceded that it had held that the Community's competence to enter into international commitments may arise not only by express conferment from the Treaty but also by implication from treaty provisions, such implied external competence existed only when the internal competence had already been used to adopt measures for implementing common policies on the occasion of the conclusion and implementation of international agreements.[460] Thus, the competence to bind the Community in relation to non-member countries may arise by implication from the Treaty provisions establishing internal competence, provided that participation of the Community in the international agreement is necessary for attaining one of the Community's objectives.[461]

In a subsequent opinion, the Court summarized Opinion 1/76 as holding that, where internal competence may be effectively exercised only at the same time as external competence,[462] the conclusion of international agreements is necessary in order to attain objectives of the Treaty that cannot be attained by establishing autonomous rules.[463] However, it was the opinion of the Court that this was not the case here.[464] There was nothing in the Treaty to prevent the institutions from arranging agreements with the United States, now was there any bar preventing institutions from approaching their external dealings in such a way as to mitigate any discrimination or distortions of competition resulting from the implementation of commitments from member states to the United States under "open skies" agreements.[465] It has therefore not been established that, by reason of discrimination or distortions of com-

458. EC Treaty art. 84(2) (as in effect 1998) (now, after amendment, article 80(2) EC), *cited in* Comm'n v. Belg. ¶ 65.

459. Comm'n v. Belg., 2002 E.C.R. I-09681 ¶ 66.

460. Comm'n v. Belg., 2002 E.C.R. I-09681 ¶ 67; *see also* Case 22/70, Comm'n v. Council, 1971 E.C.R. 263 ¶ 17; Opinion 1/76, 1977 E.C.R. 741 ¶¶ 1, 3-4.

461. *Id.*

462. *Id.* ¶ 68.

463. *Id.*

464. *Id.* ¶ 69.

465. *Id.* ¶ 70.

petition, the aims of the Treaty in the area of air transport cannot be achieved by establishing autonomous rules.[466]

The Court went on to observe that, in 1992, the Council had been able to adopt the third package, which, according to the Commission, achieved the internal market in air transport based on the freedom to provide services. It did not appear necessary at that time to resort to the conclusion by the Community of air transport agreement with the United States of America.[467] On the contrary, the documents before the Court showed that the Council, which the Treaty entrusts with the task of deciding appropriate action in the field of air transport and to define the extent of Community intervention, did not consider it necessary to conduct negotiations with the United States at the Community level.[468] It was not until June 1996, subsequent to the exercise of the internal competence, that the Council authorized the Commission to negotiate an air transport agreement with the United States. The Council granted the Commission a restricted mandate for that purpose, while taking care to make clear, in its joint declaration with the Commission of 1996, that the system of bilateral agreements with the United States would be maintained until the conclusion of a new agreement binding the Community.[469]

The Court therefore concluded that the above finding could not be called into question by the fact that the measures adopted by the Council in relation to the internal market in air transport contain a number of provisions concerning nationals of non-member countries.[470] In direct contrast to the Commission's argument, the Court found that the relatively limited character of those provisions precluded the inference that the freedom of nationals of member states to provide services in air transport is inextricably linked to the treatment accorded nationals of non-member countries (or, in non-member countries, to nationals of the member states).[471]

In the opinion of the Court, this case did not constitute a situation in which internal competence could only be exercised at the same time as external competence.[472] In the light of the foregoing considerations, it was the considered view of the Court that the Community's claim that exclusive external competence was required to conclude an air transport agreement with that country was not valid.[473]

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466. *Id.*
467. *Id.* ¶ 71.
468. *Id.*
469. *Id.*
470. *Id.* ¶ 72.
471. *Id.*
472. *Id.* ¶ 73.
473. *Id.* ¶ 74.

c. Clause on Ownership and Control of Airlines

The Court next took into consideration the Commission's assertion that the respondent states had, by individually negotiating and concluding "open skies" agreements with the United States in the field of transport, failed to fulfill their obligations under Articles 5 and 52 of the European Communities Treaty.[474] The Commission also claimed that the respondent states had, by not rescinding those provisions of the agreements which were incompatible with Article 52 of European Communities Treaty, or secondary law, failed to comply with their obligations under Article 5 of the Treaty and secondary law.[475] The Commission argued that the states had not accorded to the nationals of other member states the treatment reserved for the states' own nations. In particular, the clause in the case concerning the Kingdom of Belgium did not provide other airlines or undertakings of the relevant member states the same treatment reserved for Belgian nationals.[476]

The Belgian Government had submitted that the clause on the ownership and control of airlines did not fall within the scope of Article 52 of the Treaty.[477] It was Belgium's contention that as the clause regulated the exercise of traffic rights to points situated in non-member countries, it did not relate to the freedom of establishment but rather to the right of air carriers to offer services in non-member countries.[478]

All respondent states were of the view that, whereas Article 61 of the European Communities Treaty precluded Treaty provisions on the freedom to provide services from applying to transport services (being governed by the provisions of the title concerning transport), there was no article in the Treaty precluding provisions on freedom of establishment from applying to transport.[479]

Article 52 of the Treaty is in particular properly applicable to airline companies established in a member State and supplying air transport services between a member state and a non-member country.[480] All companies established in a member state (within the meaning of Article 52 of the Treaty) are covered by that provision, even if their business in that state consists of services directed to non-member countries.[481]

Regarding the question of whether the Kingdom of Belgium had infringed Article 52 of the Treaty, it should be noted that, under the article,

474. *Id.* ¶ 1.
475. *Id.*
476. *Id.* ¶ 127.
477. *Id.*
478. *Id.* ¶ 128.
479. *Id.* ¶ 132.
480. *Id.* ¶ 133.
481. *Id.*

freedom of establishment includes the right to pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms.[482] Articles 52 and 58 of the Treaty thus guarantee nationals of member states who have exercised their freedom of establishment, and companies or firms assimilated to them, the same treatment in a host member state as that accorded to nationals of that member state. This is both as to access to an occupational activity on first establishment and to the exercise of that activity by the person established in the host member state.[483]

The Court has previously held that the principle of national treatment requires a member state party to a bilateral international treaty with a non-member country for the purpose of avoiding double taxation to grant to permanent establishments of companies resident in another member state the same advantages provided for by that treaty. Those rights must be granted on the same conditions as those which apply to companies resident in the member state that is party to the treaty.[484]

In this case, the Court held that the clause on the ownership and control of airlines permits the United States to withdraw, suspend or limit the operating licenses or technical authorizations of an airline designated by a member of the European Union but with substantial ownership and effective control vested in another non-member state or individual.[485] The Court also held that airlines established in a European Union member state with substantial ownership and effective control vested in another member state or individual ("Community airlines") may be affected by that clause.[486] By contrast, the United States is, in principle, under an obligation to grant appropriate operating licenses and technical authorizations to airlines with a substantial ownership and effective control vested in European Union states.[487]

The Court thus concluded that Community airlines may always be excluded from the benefit of an air transport agreement between a European Union member state and the United States, even though that benefit is assured to airlines of that member state.[488] Consequently, Community airlines suffer discrimination by the prevention of similar treatment to that afforded the host member state and its own

482. *Id.* ¶ 134.

483. *Id.* ¶ 135 (citing Case C-307/97 Saint-Gobain v. Finanzamt Aachen-Innenstadt, 1999 E.C.R. I-6161).

484. *Id.* ¶ 136; *see* Saint-Gobain v. Finanzamt Aachen-Innenstadt, 1999 E.C.R. I-6161 ¶ 59; Case C-55/00 Gottardo v. INPS, 2002 E.C.R. I-413.

485. *Id.* ¶ 137.

486. *Id.* ¶ 138.

487. *Id.* ¶ 139.

488. *Id.* ¶ 140.

nationals.[489]

Contrary to the arguments of respondent member states, the Court found that the direct source of the discrimination was not possible conduct by the United States but the clause on the ownership and control of airlines, which specifically acknowledges the right of the United States to act in the manner described.[490]

iii. Conclusion

While the basic finding of the Court was that, having negotiated an "open skies" agreement with the United States, the European Union states concerned had failed to fulfill certain obligations imposed by the applicable European Communities Treaty, it is important to note, in order to remove any doubt or confusion, that the European Court did not render invalid the bilateral agreements in question.[491] Nor did the Court admonish the European Union states and prohibit them from conducting bilateral negotiations with the United States in the future.[492] In contrast to the Commission's claims, the Court did not have jurisdiction to confer authority on the Commission to conduct air transport negotiations with the United States, a right which only the European Union Council of Ministers could confer.[493] The Court simply held that certain provisions and areas covered in the "open skies" agreements were contrary to European Union law because they encroached internal European Union regulations pertaining to non-European Union nationals.[494] The provisions in question include:

a) those pertaining to the allocation of airport slots;[495]

b) those governing pricing, or fares and rates of intra-European air services;[496]

c) agreements on computer reservation systems (insofar as they appear as provisions in the "open skies" agreements in question);[497] and

d) those which reserve the right to grant permission only to those airlines which are substantially owned and effectively controlled by nationals of the European Union member states that were parties to a particular agreement.[498]

489. *Id.*
490. *Id.* ¶ 141.
491. Abeyratne, *supra* note 362, at 488-89.
492. *Id.* at 489.
493. *Id.*
494. *See* Warden, *supra* note 400, at 243.
495. *Id.*
496. *Id.* at 244.
497. *Id.*
498. *Id.* at 244.

The essential component of the European Court's decision is not its validity or reasoning, neither of which are in question, but its consequences. The Court ruled that certain areas of air transport are strictly within the overall competency of the European Commission or the Council as the case may be.[499] However, the Court also ruled that the national prerogative of a European Union member state to initiate, negotiate and finalize bilateral air services still remains. Issues of market access and air traffic rights could thus indeed be the subject of individual negotiation of a European Union State provided such did not discriminate against the equal rights enjoyed by other European carriers.[500] In this regard the decision of the Court was not unexpected and retains the status quo ante.[501]

The most interesting aspect to the decisions, particularly from a competition angle, is that the core element of the bilateral air services agreement, market access involving the award of air traffic rights, was untouched except for the Court's disapproval with European Union members who, in their agreements with the United States, would explicitly preclude another European Union member from operating air services from that member's territory.[502] For example, Belgium would not be permitted to reach an agreement with the United States in which Belgium agreed that Air France would not be allowed to operate services between Brussels and New York. The prohibition against such agreements is based on the Treaty of Rome, which forms the substance of the European Union's legislative legitimacy and incorporates the right of equal national treatment for all European Union member states. [503] Under the Treaty, such agreements would be tantamount to discrimination.[504]

The Court further held that where the allocation of airport slots is a consideration in a bilateral agreement, provisions pertaining to slot allocation would be contrary to European Union law and therefore invalid.[505] However, this holding was only academic because none of the eight bilateral agreements in question contained provisions pertaining to slot allocation.[506] The Court also held that provisions prescribing fares and rates for intra-European routes were inconsistent with European Union law.[507] The European Union alone has authority to price air services

499. *Id.* at 243.
500. *Id.*
501. *Id.* at 245.
502. Abeyratne, *supra* note 362, at 489.
503. *See* EC Treaty art. 6.
504. *Id.*
505. Comm'n v. Belg., 2002 E.C.R. I-09681 ¶ 5.
506. *Id.* ¶ 105.
507. *Id.* ¶¶ 96-97.

within the Union.[508] Similarly, when considering European Union laws on Computer Reservation Systems ("CRS"), the Court found that the CRS provisions in the bilateral agreements between the United States and European Union member states were unacceptable.[509]

IV. Competition in the United States

The United States has, through its courts, applied antitrust laws to commercial activities conducted outside the United States when such activities impinge upon the equilibrium of commercial activities within the United States by having a direct, substantial and reasonably foreseeable effect within the country.[510] The Foreign Trade Antitrust Improvement Act of 1982,[511] which grants the United States courts jurisdiction over certain aspects of foreign conduct, grants the United States Department of Transportation jurisdiction over air routes between the United States and a foreign country. This includes routes that are entirely outside the United States if competition on such routes is reasonably likely to have an adverse effect on the United States.[512] As a result of this legislative possibility, courts in the United States have jurisdiction over antitrust actions brought by private entities in a court in the United States even where such actions may concern foreign entities.[513]

In a laudable and fair attempt at balancing harmoniously the stringent application of United States law to foreign conduct with external cooperation, the United States has enacted the 1994 International Antitrust Enforcement Assistance Act[514] which broadly admits of arrangements with foreign authorities to investigate antitrust violations through the exchange of information and common and reciprocal retrieval of evidence.[515]

Unlike its neighbor Canada, who has a comparably restrictive foreign investment policy, the United States has a liberal "open door policy" on foreign direct investment and is one of the most open economies in this respect.[516] The United States International Investment Policy State-

508. *Id.*

509. *Id* ¶ 104.

510. *See, e.g., Aluminium Co. of Am.*, 148 F.2d at 443-44; Ludwig Weber, *Modern Trends in the Antitrust/Competition Law Governing the Aviation Industry* 20 Air & Space L. 101, 101 (1995).

511. Foreign Trade Antitrust Improvement Act of 1982, Pub. L. No. 97-290, 96 Stat. 1234 (1982) (codified at 15 U.S.C. §§ 6a and 45(a)(3)).

512. *See* 15 U.S.C. § 6a.

513. Weber, *supra* note 510, at 103.

514. International Antitrust Enforcement Assistance Act of 1994, Pub. L. No. 103-438, 108 Stat. 4597 (1994).

515. See International Guidelines, *supra* note 230, at 67.

516. Abeyratne, *supra* note 362, at 509-10.

ment of 1983 confirmed:

> The United States has consistently welcomed foreign direct investment in this country. Such investment provides substantial benefit to the United States. . .We provide foreign investors fair, equitable and non-discriminatory treatment under our laws and regulations. We maintain exceptions to such treatment only as are necessary to protect our security and related interests and which are consistent with our international legal obligations.[517]

The United States has adopted the approach that the absence of regulation encourages investment and is beneficial to the nation's economy.[518] It has therefore generally ensured non-discriminatory treatment for foreign investors.[519] A commentator adds:

> Foreign nationals and companies are treated as favorably as nationals or companies of the United States with respect to the establishment and operation of enterprises in this country. . . Further, on the basis of the national treatment principal investors from other countries can generally make investments in this country on the same legal terms as American investors.[520]

However, this "open door" policy and national treatment principal does not provide an accurate picture of the status of foreign investment in the United States.[521] In contrast to the policy's perception, there are numerous laws that effectively preclude it from taking full effect, impeding foreign investment in the country.[522] For example, the 1988 Exon-Florio Amendment[523] provided the President with broad powers to review investments of foreign investors on his own initiative for any reason including those which directly or indirectly affect national security.[524] The President may also review a foreign investment following the complaint of a third party.[525]

Foreign investors may, of their own volition, serve notice on the Committee on Foreign Investment in the United States (CFIUS).[526] In addition, the CFIUS can also decide to inquire into an investment by it-

517. International Investment Policy Statement 19 *Weekly Comp. Pres. Doc. 1214* (Sept. 1983), *cited in* Jean Raby, *The Investment Provisions of the Canada-United States Free Trade Agreement: A Canadian Perspective,* 84 AM. J. INT'L L. 395, 400 (1990).

518. *See* Weber, *supra* note 510, at 101.

519. *See* Harvey E. Bale Jr., *The United States Policy Towards Inward Foreign Direct Investment*, 18 VAND J. TRANSNAT'L. L. 199, 207 (1985).

520. *Id.*

521. *See* Raby, *supra* note 517, at 400.

522. *Id.* at 401-02.

523. Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, 102 Stat 1107 (1989).

524. *See id.* § 5021; *see also* J.A. Knee, *Limiting Abuse of Exon-Florio by Takeover Targets* 23 GEO. WASH. J. INT'L L & ECON. 475, 475 (1989).

525. *See* Knee, *supra* note 524, at 476.

526. *Id.* at 487.

self.[527] It then advises the President of its decision with regard to an investment and the President ultimately decides whether or not the investment is contrary to national security interests.[528] However, the notion of "national security" is ambiguous in this context, leaving the Executive with great discretion in the implementation of the Act.[529] The Act is used infrequently and each case is evaluated individually.[530]

In addition, many other sectors operate through a fixed maximum level of foreign participation and are thus excluded from foreign investor participation entirely or partially. At the federal level, these restrictions are seen in the fields of communications,[531] transportation,[532] aviation,[533]

527. *Id.* at 478.

528. *Id.* at 484.

529. *Id.* at 485.

530. For example, in 1990, President Bush issued an order based on the Exon-Florio Amendment, to the China National Technology Import and Export Corporation to divest its holdings in MAMCO, a United States manufacturer of aircraft components. *See* Stuart Auerbach, *President Tells China to Sell Seattle Firm*, WASH. POST, Feb. 8, 1990, at A1. MAMCO was a firm that fabricated custom made metal components for the use of manufacturing civilian aircraft and helicopters. *Id.*; *see also* J. Mendenhall, *Recent Developments: U.S. Executive Authority to Divest Acquisitions Under the Exon-Florio Amendment - the MAMCO Divestiture*, 32 HARV. INT'L L.J. 286, 294 (1991); David S. Nance & Jessica Wasserman, *Regulation of Imports and Foreign Investment in the United States on National Security Grounds*, 11 MICH. J. INT'L L. 926, 973 (1990) (discussing Presidential powers to regulate foreign investments on national security grounds).

531. The Federal Communications Commission considers national security, law enforcement, foreign policy, and trade policy concerns when analyzing a transfer of control or assignment application in which foreign ownership is an issue. *See* Telecommunications Act of 1996, Pub. L. No. 104-104, § 310, 110 Stat. 56 (codified as amended in scattered sections of 47 U.S.C.); 47 C.F.R. § 0.51 (2004); Foreign Participation in the U.S. Telecommunications Market, 62 Fed. Reg. 64,741 (Nov. 24, 1997) (codified at C.F.R. p. 43, 63, 64).

532. As Paul Dempsey has noted:

> The United States Congress has promulgated legislation specifically designed to prohibit or inhibit foreign investment in the field of transportation. Pursuant to the Jones Act, 1920, 46 U.S.C. §§ 861-889 (1970), the coastal and fresh water shipment of commodities or passengers between points in the United States or its territories must be accomplished in vessels which are constructed and registered in the United States, and which are owned by citizens of the United States. Before a corporation will be permitted to register a ship in the United States, the corporation's principal officer and chairman of the board must be U.S. citizens and 75% of its stock must be held by U.S. citizens.

Paul S. Dempsey, *The Law of Intermodal Transportation: What It Was, What It Is, What It Should Be*, 27 TRANSP. L.J. 367, 374 n.32 (2000) (citing 46 U.S.C. §§ 802, 833a, 888 (1970)).

533. *See* discussion *supra* Part D. As was discussed above, under current UNITED STATES law, in order to operate as a UNITED STATES airline, an entity must obtain a certificate of public convenience and necessity or an exemption from the certification requirement from DOT. *See* 49 U.S.C. § 10901 (2000); 49 C.F.R. pt. 1150 (2005). A prerequisite for obtaining such authority is United States "citizenship." 49 U.S.C. § 40102. Current United States law defines a "citizen of the United States" as an individual United States citizen, partnership whose members are United States citizens, or a corporation or association organized under United States law where at least seventy-five percent of the voting interest is owned and controlled by UNITED STATES citizens. *Id.* The law also specifies that the President, as well as at least two-thirds of the Board of Directors of the corporation, must be United States citizens. *Id.* § 40102(c). In prac-

energy and national resources,[534] banking,[535] and defense.[536] Federal laws such as antitrust regulations contained in the Clayton Act and the Sherman Act discussed *supra*, may also have limiting effects on the activities of foreign investors' in the United States.[537]

In 1995, the United States Department of Transportation (DOT) announced a new aviation policy, geared towards providing more access to international air transport and increasing the variety of price and service options available to the consumer.[538] The policy advocated providing carriers with untrammeled rights and opportunities to offer air services based on their own evaluations and positions in the markets.[539] Above all, there was a shift in approach towards liberalization. The policy was crafted to ensure that competition is fair and the playing field level, achieved through the elimination of market distortions such as government subsidies and restrictions placed upon carriers' business practices.[540] The policy's overall objective was to encourage the development of a cost effective and productive air transportation industry well equipped to compete in global aviation and to seek changes to airline foreign investment law so that air transport could be further liberalized.[541]

The United States "open skies" philosophy, which has given rise to numerous agreements with a wide range of countries, allows for an open-

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tice, DOT has interpreted control to mean that day-to-day management decisions must be made by United States citizens, even if there is substantial foreign investment in the airlines. *See* Bohman, *supra* note 157, at 698. That is, the law has been construed as requiring actual control of the enterprise to rest with United States citizens. *Id.*

534. *See, e.g.,* Atomic Energy Act of 1954, 42 U.S.C. §§ 2133, 2134 (2000) (requiring a license for any person in the United States to transfer, manufacture, produce, use or import any facilities that produce or use nuclear materials. Such a license may not be issued to any entity known or believed to be owned, controlled or dominated by an alien, a foreign corporation or a foreign government); *see also* Agricultural Foreign Investment Disclosure Act, 7 U.S.C. § 3501 (2000) (requiring that individuals who transfer title of agricultural land to a foreign individual submit a report to the Secretary of Agriculture within 90 days of the transaction).

535. *See, e.g.,* The National Bank Act, 12 U.S.C. § 72 (2000) (requiring that all directors of a national bank must be citizens of the United States, except in the case of a national bank affiliated with or owned by a foreign bank).

536. As discussed above, section 5021 of the Omnibus Trade and Competitiveness Act of 1988, which amended § 721 of the Defense Production Act of 1950, 50 U.S.C. app. § 2061, *et seq* , provides authority for the President to review the effect on national security of certain mergers, acquisitions, and takeovers of UNITED STATES companies by foreign interests. *See* U.S. GEN. ACCOUNTING OFFICE [GAO], GAO 02-736, DEFENSE TRADE: MITIGATING NATIONAL SECURITY CONCERNS UNDER EXON-FLORIO COULD BE IMPROVED 1 (2002).

537. See *supra* Part B and accompanying notes.

538. Statement of United States International Air Transportation Policy, 60 Fed. Reg. 21,841, 21,844 (May 3, 1995).

539. *Id.*

540. *Id.*

541. *Id.*

route schedule, open traffic rights and open capacity.[542] The policy's practical application was effected by inviting states to enter into open aviation agreements, either singly or as a group, in order to exchange unrestricted third and fourth freedom traffic.[543] The first multilateral open skies agreement signed was the 2001 Asia-Pacific Economic Cooperation (APEC) agreement between the United States, Brunei, Chile, New Zealand and Singapore.[544] This agreement allows carriers of the signatory states to operate unrestricted services to, from and beyond the others' territories, without any restrictions on where the carriers can fly.[545]

V. Competition Options

A. Transatlantic Common Aviation Areas

As to whether there should be absolute, untrammeled competition within the Americas and between the Americas and Europe is a critical issue for the coming years. One recent suggestion has been to crystallize a "convergence of regulatory principles" between Europe and the United States in competition by establishing a Transatlantic Common Aviation Area (TCAA).[546] This concept was suggested by the Association of European Airlines (AEA), which put forward a policy statement including detailed and realistic proposals on how to bring about an ideal regulatory convergence between the European region and the United States.[547] The policy addresses three areas:

a) matters in respect of which harmonization is necessary;

b) those in respect of which convergence could take the form of mutual recognition; and

c) those which could in principle be left at the discretion of each party.[548]

542. The United States has concluded more than seventy bilateral Open Skies agreements with countries from every region of the world and at every level of economic development. For an up-to-date list, see Bureau of Economic and Business Affairs, *Open Skies Partners*, http://www.state.gov/e/eb/rls/othr/2006/22281.htm (last visited Apr. 30, 2006).

543. Statement of United States International Air Transportation Policy, 60 Fed. Reg. at 21, 845.

544. *See* Press Release, The White House, President Clinton & APEC Partners Announce Multilateral "Open Skies" Aviation Agreement (Nov. 15, 2000), http://hongkong.usconsulate.gov/usinfo/ca/00111501.htm (last visited Apr. 31, 2006).

545. *Id.*

546. *See EU Transport Commissioner Offers Support to Trans-Atlantic Liberalization*, World Airline News, Oct. 29, 1999 (discussing the 1999 policy statement issued by the Association of European Airlines *Towards a Transatlantic Common Aviation Area*) [hereinafter *TCAA Policy*].

547. *Id.*

548. *Id.*

The TCAA concept advocates the freedom of parties to provide services, addresses issues pertaining to airline ownership and the right of establishment, provides recommendations with regard to competition policy, and offers guidelines on the leasing of aircraft.[549]

Since the TCAA aims at replacing traditional governmental regulatory control of such aspects of competition as market entry and pricing, the issues emerging from competition policy are by far the most complex and difficult to deal with within the TCAA's parameters.[550] Although the fundamental postulates of competition in Europe (stipulated by European Union regulations) and the United States are largely similar in purpose, both depending to a certain extent on the application of extra-territoriality in their regulations, there are obvious differences. For instance, there are dissimilar approaches to transatlantic airline alliances.[551] Also, the United States stringently relies on a principle of "public interest" in its air transportation policy,[552] while European competition rules are not as explicit in their policies.[553] The basic essence of a TCAA would therefore establish the principle that matters of route sharing, capacity, pricing and frequency of services should be driven by market forces rather than be determined by governmental intervention.[554] In this way a certain commonality could be established between the air transport of two regions.[555]

B. The World Trade Organization and General Agreement on Trade in Services

Along with TCAA, another option is to allow absolute open competition between Europe and North America. Although globalization of competition in trade is a reality, in the case of air transport it may be premature. The current bilateral air services negotiations structure still

549. *Id.*

550. *Id.* To the AEA's credit, they openly acknowledged that "convergence of competition policy is one of the most important, and difficult aspects of the TCAA." *Id.*

551. As Mr. Schulte-Strathaus, Secretary General of the AEA succinctly noted:

> Certain aspects of international aviation today are absurd. The EU has its Competition Rules and the U.S. its Sherman Act. Both are intended to stimulate market competition, but each arrives at a different conclusion. So the U.S. gave the green light to innovative strategic airline alliances with only minor undertakings for the applicants, whereas the Commission felt obliged to impose inhibiting conditions on the very same alliances between the very same airlines on the very same routes.

Ulrich Schulte-Strathaus, Op-Ed,. . .*And the Stalled 'Open Skies' One*, Wall St. J. (Europe), Aug. 19 2004, at A-17.

552. *See, e.g.*, 49 U.S.C. § 40101 (requiring that in carrying out economic regulation of air transport, the Secretary of Transportation shall consider among other things, whether a matter is in the public interest and consistent with public convenience and necessity).

553. *See* Schulte-Strathaus, *supra* note 551.

554. *See TCAA Policy*, *supra* note 546.

555. *Id.*

seems to work, and absolute globalization of air transport will depend on the level to which air transport is encompassed in the General Agreement on Trade in Services (GATS), which, as discussed previously,[556] contains the Most Favored Nations (MFN) treatment clause.

Neither the United States nor the European Union has, in the pursuit of liberalization, advocated the GATS umbrella.[557] The approach taken by the United States has been to hold on to its policy of "public interest" and of maximizing air transport as a service industry capable of confronting the challenges of the upcoming decades.[558] The GATS example served only to show a certain similarity of equal opportunity and competition under the MFN clause. This is reflective of the philosophy of an "open skies" regime, where all participating states would enjoy absolutely equal air traffic rights on a reciprocal basis.[559]

As to the question whether the GATS negotiating scheme should be adopted with regard to international competition policy, the main concern whether, if considered, it should be contemporaneous with the development of a scheme within the World Trade Organization (WTO) for negotiating international antitrust principles. Such negotiations could be made on a total harmonization or partial harmonization basis. This would have the advantage of allowing members to introduce a variety of international competition agreements out of which the most suitable might be selected. Also, if this approach is adopted, it would be important for members to have a firm commitment to promote competition law and policy, both internationally and domestically. Such commitment should be clearly declared. Also, it may be necessary to establish, as in GATS, a time schedule within which negotiations should be carried out. A declaration of fundamental principles of competition would also be necessary. This declaration should contain analogous provisions to most favoured nation treatment, national treatment and transparency. Consideration should also be given to prohibition in principle of cartels, resale price maintenance, boycotts and others. Given the wide variety of princi-

556. *See supra* notes 121-27 and accompanying text.

557. *See, e.g.*, IATA, *supra* note 122, at 5 ("With few exceptions, IATA's member airlines continue to hold to the policy agreed in 1994 that it is premature to view the GATS as a vehicle to liberalise traffic rights.").

558. *See* Martin Staniland, *Transatlantic Air Transport: Routes to Liberalization*, 20-21 (European Union Center, European Policy Paper No. 6, 1999), www.ucis.pitt.edu/cwes/EUC/Conferences/future_EU_US_avirel.pdf (last visited Apr. 30, 2006).

> Not surprisingly, the U.S. also has a lot to loose. In fact, the MFN principle, while providing an important instrument for ratcheting up the liberalization of international trade, also creates a serious risk of enabling "free-rider" protectionist states to enter large and lucrative markets (such as the US and EU markets) without any obligation to offer the same reciprocity as offered between liberal trading partners.

Id. at 20.

559. *Id.*

ples that are followed by members with regard to other areas such as mergers and acquisitions, vertical non-price restraint and predatory pricing, it may be feasible to simply declare general and abstract principles requiring members to promote competition policy in such areas.

The WTO is not the only forum in which a scheme of convergence of competition laws can be accommodated.[560] However, there is compelling reason for such a scheme to be considered under the WTO umbrella due to the volume of membership that WTO carries.[561] Many of the more than 125 states which participated in the Uruguay Round leading to the establishment of the WTO Agreement do not have competition laws and many are not yet ready for such laws.[562] When an international competition code is finally drafted, it is logical to expect a certain degree of universality in its principles. Such uniformity could be accomplished on a wider scale, given the WTO's membership.[563]

Professor Petersmann has recommended that an international competition code may be accommodated as an agreement of Annex IV of the WTO Agreement, which contains optional agreements.[564] Petersmann examines the idea of a smaller number of nations entering into such an agreement initially, *e.g.*, the United States, Japan and members of the European Community, Canada and Australia.[565] Petersmann believes that, at least in the initial stage, an international competition code among a smaller number of members may work more effectively.[566] Developing states might be granted a grace period to join the agreement.[567] Such an agreement may, according to Petersmann, address "market access" issues effectively.[568]

An international competition code in the WTO Agreement would have the advantage of coordination with other policies embodied in WTO

560. The OECD, for example is, to every purpose, an appropriate forum. *See* Randolph W. Tritell, Commentary, *International Antitrust Convergence: A Positive View*, ANTITRUST, Summer 2005, at 26 ("On a multilateral level, the Competition Committee of the OECD has been an important venue for developed country competition agencies to promote convergence.").

561. Joseph M. Moschella, Comment and Note, *The Necessity Of Active American Involvement In Global Competition Law*, 22 WIS. INT'L L.J. 187, 191-92 (2004).

562. *Id.* at 206-07.

563. *Id.* at 205.

564. Ernst-Ulrich Petersmann, *Legal, Economic and Political Objectives of National and International Competition Policies: Constitutional Functions of WTO "Linking Principles" for Trade and Competition*, 34 NEW ENG. L. REV. 145, 162 (1999).

565. *See* Ernst-Ulrich Petersmann, *The Transformation of the World Trading System through the 1994 Agreement Establishing the World Trade Organization*, 6 EUROPEAN J. INT'L L. 161, 170-71 (1995).

566. *Id.* at 171.

567. ERNST-ULRICH PETERSMANN, THE GATT/WTO DISPUTE SETTLEMENT SYSTEM: INTERNATIONAL LAW INTERNATIONAL ORGANIZATIONS AND DISPUTE SETTLEMENT, 202 (1997).

568. *Id.* at 202-09.

agreements, such as the Trade Related Intellectual Property Rights Agreement (TRIPS), the Safeguard Agreement and the Antidumping Agreement.[569] This co-ordination would be accomplished easier than if a competition code was established separately from the WTO. Another advantage is that the dispute settlement process incorporated in Annex II of the WTO Agreement could be utilized for disputes relating to the enforcement of competition laws.[570]

Perhaps the only similarity between the competition rules of the existing bilateral structure relating to the air services agreement and WTO competition rules is the insistence by both systems on the requirement of fair and equal opportunity.[571] The current bilateral structure of the air services negotiations will remain in force as long as states subjectively consider the potential that the air traffic of their carriers would have over others when others are excluded from given market segments.[572] The states are empowered to take this position, not only because of Article 6 of the Chicago Convention but also by virtue of the underlying principle of sovereignty which legally entitles a state to prohibit a carrier from flying into or out of its territory without that state's permission.[573] As the preceding discussion has revealed, the protectionist attitude that pervades commercial air transport is not limited to struggling carriers of developing nations but applies equally to mega carriers who "protect" what they believe to be a legitimate share of their market.[574] In this backdrop, the term "market access" can only be used with the word "reciprocity." The *status quo* in commercial aviation is therefore by no means consistent with the competition principles advocated by the WTO.[575]

If the concept of "market access" of commercial aviation is to be in consonance with WTO competition rules, the first step that the aviation

569. *See* Petersmann, *supra* note 564, at 160.

570. *Compare* Kenneth O. Rattray, *Air Carriers of Developing Countries Must Have Safeguards in a Liberalized Environment*, ICAO J., Nov.-Dec. 2002, at 13 ("At the very heart of [the Chicago Convention] is the recognition of the fact that the principles and arrangements for the safe and orderly development of air transport services must be established on the basis of equality.") *with* WTO, UNDERSTANDING THE WTO 11 (3rd ed. 2005), *available at* http://www.wto.org/english/thewto_e/whatis_e/tif_e/understanding_e.pdf (last visited Mar. 17, 2006) ("The WTO is sometimes described as a "free trade" institution, but that is not entirely accurate. The system does allow tariffs and, in limited circumstances, other forms of protection. More accurately, it is a system of rules dedicated to open, fair and undistorted competition."); *see supra* note 124 and accompanying text.

571. *See* United Nations Conference on Trade and Development, June 21-23, 1999 Geneva, Switz., *Air Transport Services: The Positive Agenda For Developing Countries*, ¶¶ 60, 63, 70, TD/B/COM.1/EM.9/2 (Apr. 16,1999) [hereinafter *UN Positive Air Transport Agenda*].

572. *Id.* ¶¶ 68, 69.

573. *See* Rattray, *supra* note 570, at 13.

574. *See UN Positive Air Transport Agenda*, *supra* note 571, ¶¶ 68, 69.

575. A sentiment that the IATA has repeatedly emphasized. *See* IATA, *supra* note 122, at 5.

community should take is to change its overall philosophy and consider all international air traffic as international rather than national property.[576] This calls for a radical change in international policy regarding air traffic rights. Individual states would have an overall duty to consider their citizens as units of an international community of nations, rather than units of that particular state.[577] In other words, states should represent citizens as nationals of an international society. The international traffic market would then be viewed as a whole and nations would adapt themselves to an extra national approach in sharing international air traffic. Once such an extra-national philosophy is in place, it would not be difficult to consider extra-territoriality in competition in a manner compatible with WTO competition rules, particularly in the context of the WTO's emphasis on uniformity.[578] The principles of transparency, most favored nation treatment and dispute resolution would then all fall into place.[579]

Although the above proposal may sound logical and workable in theory, in reality, it cannot be denied that states have jealously guarded their historical rights to air traffic over the past fifty five years and would therefore be reluctant to embrace a multilateral approach to open competition. As to whether this trend will continue between the member states of the European Union and the United States after the decision of the European Court is a matter for the future.

VI. CIS States

The Commonwealth of Independent States (CIS) is an emergent body of sovereign states with burgeoning economies and evolving communications systems.[580] These relatively newly-formed states must develop their telecommunications, information technology and air transport.[581] Of these, air transport development is arguably the most compelling item. In this regard, the air carriers of CIS states are faced with a problem typical of most carriers of the developing world, *i.e.*, sur-

576. *See* Petersmann, *supra* note 565, at 169.

577. *Id.*

578. *Id.*

579. *Id.*

580. At present the CIS includes Azerbaijan, Armenia, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Uzbekistan and Ukraine. *See* About Commonweath of Independent States, http://www.cisstat.com/eng/cis.htm (last visited May 2, 2006) [hereinafter About CIS].

581. *See BEEPS-at-a-Glance—Commonwealth of Independent States*, EBRD-World Bank Business Environment and Enterprise Performance Survey [BEEPS] (European Bank for Reconstruction & World Bank Joint Project, Washington, D.C.) Feb. 7, 2006, at 14, *available at* http://siteresources.worldbank.org/INTECAREGTOPANTCOR/Resources/BAAGREV2006 0208CIS.pdf (last visited May 3, 2006).

vival amidst a firmly entrenched system of alliances among more established international carriers. In order to meet the challenge of global competition, CIS carriers must modernize their fleets, maximize their route structures, develop market access, and forge alliances with established carriers.

At the time when the CIS states were formed, two trends were profoundly affecting the airline industry: country mergers and airline mergers.[582] Of these, the unification of Europe was the largest single influence on international airlines.[583]

A. Strategies for CIS Carriers

Regardless of the political stage of CIS states and the rest of the world, the foremost challenge faced by aviation in CIS states is competition among carriers.[584] The primary responses to this challenge lie in information technology and competitive strategy.[585] With the information revolution sweeping the world, business competition in the CIS states, and, in particular, airline competition, should focus on achieving dramatic reductions in the cost of obtaining, processing and transmitting information in order to radically maximize profit bases.

Most CIS carriers have already realized that information technology is more than just computers, but is relating not only to stored databases, but also to management of information through convergent and integrated technologies. With the current high-growth rate of CIS carriers, proper management of information would provide them with a competitive edge and ways to outperform rival competition, the opening out of new businesses within parent companies, and a radical change in industry structure.

The airline product has both a physical and an information dimension. In general, the information dimension represents a systematic spec-

582. The Commonwealth of Independent States (CIS) was created in December, 1991. About CIS, *supra* note 580. Germany's reunification formally concluded on October 3, 1990. *See* Serge Schmemann, *Evolution In Europe: Germans' Day of Exultation and Marlene Dietrich Too*, N.Y. Times, Oct. 4, 1990, at A16. In September 1993 the Heads of the CIS States signed an Agreement on the creation of Economic Union to form common economic space grounded on free movement of goods, services, labor force, capital; to elaborate coordinated monetary, tax, price, customs, external economic policy; to bring together methods of regulating economic activity and create favorable conditions for the development of direct production relations. About CIS, *supra* note 580.

583. *See* Dempsey, *supra* note 351, at 982-85.

584. *See* Mikhail Molchanov & Yuri Yevdokimov, Socio-Economic Efficiency and International Development Ethics of the Free Trade Agreement in Post-Soviet Eurasia 16 (2004) (unpublished paper presented at Eleventh World Congress for Social Economics, June 8-11, 2004), www.socialeconomics.org/uploads/Molchanov.pdf (last visited May 2, 2006).

585. *See* Porter, *supra* note 41, at 50.

trum of knowledge that the consumer can acquire and fully utilize.[586] Airline passengers have come to expect convenient, convincing and accessible information on the particular products they purchase.

The airline industry's structure in CIS states is composed of five competitive forces, all of which may impact profitability: the power of the purchaser of the product, the power of the provider (airline) of the product, threats caused by new entrants, threats caused by other modes of transportation, and the rivalry among existing competitors.[587] Information technology can play a role in all of these areas. For instance, information technology has led to automated tickets and airway bills, pop-up computer reservations information on the Internet, and direct communication between airline and passenger. In addition, airlines could develop differentiated travel services for corporate customers through the use of information technology, *e.g.*, to arrange travel and monitor incurred expenses.

Information technology can also enhance an airline's regional and global scope by facilitating business in international offices in coordination with a local head office. Above all, the use of information technology can give rise to derivative and generic business enterprises such as computer reservation systems and frequent-flyer clubs. Airlines that use information technology prudently could also sell excess capacity to other similar businesses.

The second tool which CIS airlines could use effectively is competitive strategy of 'being different'. The broad principle of strategic alliances between airlines is a sub-set of competitive strategy. Harvard Business School Professor Michael Porter states that competition strategy is composed of calculated business acts, which deliberately choose a different set of activities to deliver a unique mix of value.[588] Examples of present-day commercial strategies of airlines relating to their in-flight service include such tactics as the installation of a video system in every seat, or offering on-board gambling activities in aircraft. Other examples of airline competitive strategy include Singapore Airlines, which perpetuated the in-flight myth of the "Singapore Girl,"[589] and Emirates which became an aggressive competitor in Asia with its superior quality in-flight service.[590]

586. *Id.* at 80. For an account of how information on the internet is affecting airline ticketing see generally, Ruwantissa Abeyratne, *Electronic Ticketing—Current Legal Issues*, 70 J. AIR L. & COM. 141, 141-42 (2005).

587. PORTER, *supra* note 41, at 86-87.

588. *Id.* at 45.

589. *See* Martin Roll, *Profile: Singapore Airlines, Flying Tiger*, BRAND CHANNEL.COM, Dec. 6, 2004, http://www.brandchannel.com/features_profile.asp?pr_id=209 (last visited May 2, 2006).

590. *See Brand Strategies in Emerging Markets*, ISBINSIGHT, Mar. 2006, at 16, *available at* www.isb.edu/isbinsight/ISBInsight_March2006.pdf (last visited May 7, 2006).

Another compelling need in CIS aviation is attracting potential customers. It is imperative that airlines tap dormant markets instead of redistributing existing traffic.[591] One stratagem that airlines could adopt, particularly in regions of Asia which have untapped business and tourism potential, is to create excess demand in areas where tight oligopolies exist and attempt to cater to such demand by supplying capacity.

There are several strategic measures that CIS airlines could adopt for the future. First, they must continue to embrace globalization on the foundation of a unique competitive position. Airlines cannot effectively participate in a global market if they do not gain a competitive advantage over other carriers wherever possible. Airlines should globalize also in areas where they have the most unique advantages, such as computer reservation systems.

Second, airlines of CIS States must establish a consistent approach for penetrating international markets. Airlines must make a comprehensive assessment of market shares that can be tapped in foreign markets with or without the assistance of other carriers who have established presence in those markets. An airline would need to establish a clear home base from which to run its business, preferably located in the country with the most demand for the airline's business.

Another suggestion for CIS airlines to consider is the fact that alliances need not all be strategic and exclusively calculated to yield profits. Alliances might be formed that merely ensure an airline's global presence, which can be developed into a viable business prospect when foreign markets demand more capacity.

The basic challenge faced by CIS airlines, particularly those from rapidly developing countries, is to shift from the comparative advantage they may enjoy in certain areas to an overall competitive advantage. To achieve this, airlines must form alliances and build networks on a regional basis to the fullest extent possible, similar in scope and application to such entities as the single European aviation market created in 1997, or the MERCOSUR bloc of Argentina, Bolivia, Brazil, Chile and Paraguay.[592] If CIS carriers are considering "open skies" arrangements with

591. The success of the low fare competitors such as Ryanair and Southwest has, in fact, been attributed to their successful tapping of just such underserved markets. *See* LAWTON, *supra* note 261, at 35.

592. *See* Treaty Establishing a Common Market Between the Argentine Republic, the Federative Republic of Brazil, the Republic of Paraguay and the Eastern Republic of Uruguay, (MERCOSUR), Mar. 26, 1991, 30 I.L.M. 1041. In 1996, MERCOSUR countries signed the Fortaleza Agreement, establishing freedom of the air for subregional airlines for intra-zone traffic on routes not served by existing bilateral agreements. *UN Positive Air Transport Agenda*, *supra* note 571, ¶ 24. For further reading see José Tavares De Araujo, Jr. & Luis Tineo, *Harmonization of Competition Policies Among MERCOSUR Countries*, 24 BROOK. J. INT'L L. 441 (1998).

the United States and States of Europe, they should also pursue "open skies" agreements on an intra-European basis.

Another area in which CIS states should concentrate if their airlines are to succeed is national competitiveness. National competitiveness is the essential catalyst to trade, and a critical element of successful government and industry in every nation.[593] Yet for all the discussion, debate, and writing on the topic, there is still no persuasive theory to explain national competitiveness.[594] And there is yet no concrete formula identifying how nations can proactively provide a favorable home base for companies that compete internationally.[595] However, CIS countries can still consider what sort of home base they can provide. This base is where a company's strategy is set, where core product and process technology are created and maintained, and where the most productive jobs and advanced skills are located.[596] While the ownership of the company is often concentrated at the home base, the nationality of shareholders is secondary.[597]

CIS states should review their policies on the ownership and control of the airlines operating in their territories. Past experience of liberalization in ownership and control has demonstrated that it can take place without: (1) conflicting with the obligations of the parties under the Chicago Convention;[598] (2) without undermining the nature of international air transport;[599] and, (3) most importantly, whatever the form and pace of liberalization, conditions for air carrier designation and authorization can ensure that safety and security remain paramount, and that clear lines of responsibility and accountability for safety and security are established for the parties involved in liberalized arrangements.[600]

Moreover, at the Fifth ICAO Worldwide Air Transport Conference,[601] it was recognised that states may take a wide variety of approaches to liberalizing air carrier provisions, with no single approach being necessarily more appropriate or better than others.[602] Thus, CIS countries should feel they have wide freedom in choosing their liberalization approach. This could include broadening ownership and control provisions by gradually reducing specified proportions of national ownership, or by making limited and temporary changes regarding certain types of

593. PORTER, *supra* note 41, at 155, 158.
594. *Id.* at 158.
595. *Id.*
596. *Id.*
597. *Id.*
598. *See 2003 Liberalization Conference Conclusions*, *supra* note 128, ¶ 2.1(a).
599. *Id.*
600. *Id.* ¶ 1.2(b).
601. *See supra* discussion in Part D.
602. *2003 Liberalization Conference Conclusions*, *supra* note 128, ¶ 2.1(b).

operations (such as non-scheduled or cargo, application within certain geographic regions, or case-by-case consideration).[603]

The Conference also recommended that states may, at their discretion, take positive approaches, including coordinated action, to facilitate liberalization by accepting designated foreign air carriers that might not meet the traditional criteria of national ownership and control or the criteria of principle place of business and effective regulatory control.[604] States that wish to liberalize their conditions for designation could do so in one of three ways: issue individual statements of their policies for accepting designations of foreign air carriers; issue joint statements of common policy; and/or develop a binding legal instrument.[605] However, these measures must be made with an assurance that, whenever possible, any policies developed are in accordance with the principles of non-discrimination and non-exclusive participation.[606]

CIS countries should also be aware of the economic and social consequences of liberalization. These were also considered by the Conference at some length.[607] The Conference recommended that states should ensure that s economic and social impacts, including the concerns of labor, are properly addressed.[608] Moreover, CIS states should be aware of the potential risks associated with foreign investments (such as flight of capital, uncertainty for assurance of service) and take these into account.[609] The Conference also acknowledged that as a result of the diversity of approaches countries may take, there is a need for international regulatory bodies to continue to provide regulatory flexibility, so as to enable all states to follow the approach of their choosing at their own pace while also accommodating the approaches chosen by others.[610]

Although in regard to safety and security, state sovereignty and regulatory control are more important than ever, eventually, CIS states may have to alter their views of the air transport industry in response to progressive liberalization. Thus, although now they may view the air transport industry as a type of national property to be restricted under rigid sovereign parameters, this view may change to one viewing the industry as being a regular competitive industry simply in need of regulation. The resulting regional CIS networks accompanying this view shift should develop distinctive product varieties for which CIS airlines can become

603. *Id.*
604. *Id.* ¶ 2.1(f).
605. *Id.*
606. *Id.*
607. *Id.* ¶ 2.1(e).
608. *Id.*
609. *Id.*
610. *Id.* ¶¶ 2.1(b), 2.1(c).

known. With time, these airlines can build innovative capacity sufficient to enter more and more markets. It is then that most CIS airlines would gain the competitive advantage they are looking for.

VII. Conclusion

The most undeniable fact when addressing competition in today's world is that low-cost carriers are here to stay. Many of the 50 or so low-cost carriers are already in the pan-European air transport business, such as Ryanair and Easyjet.[611] There is no doubt that the low-cost carrier has been accepted by the consumer and will continue to flourish. If legacy carriers are to be protected, states, who have overall responsibility for setting policy, should consider eliminating needlessly complex business restrictions such as those applicable to ownership and control of air carriers, and release the network carriers to forge new and innovative alliances. Furthermore, both low-cost and legacy carriers have to work together to achieve a seamless and transparent process toward pricing and general airline practice. All parties concerned, including states, may need to adopt clear rules regarding cost bases of air carriers, particularly regarding available costs, product-specific fixed costs and sunken costs. A key consideration for both types of carriers is the manner in which future alliance models or cooperation arrangements, including mergers, could move towards optimal levels of efficiency. Airports play a critical role in this equation. The first measure that airports can adopt is to align their business models to those of airlines and consider ways and means of revenue sharing. Airports should review their bargaining power and strategic approaches to non-aviation revenue, with particular consideration to the low cost carrier customer.

In the context of both low-cost and legacy carriers, the fact remains that competition in air transport, like any other aspect of human discipline and conduct, is governed by public international law. A fundamental principle of international law that stultifies competition between air carriers is Article 6 of the Chicago Convention. It effectively precludes carriers from operating international air services over and into the territory of a contracting state, unless under that state's authorization, and in accordance with any attached conditions.[612] In order to circumvent this bottleneck, airlines have been forming strategic alliances.[613] The primary objective of strategic alliances is global reach. A 2000 survey indicated that 67 per cent of European and United States carriers had formed alli-

611. *See* Lawton, *supra* note 261, at 57.

612. Alexandrakis, *supra* note 163, at 75.

613. *See* Kostas Iatrou, *The Impact of Airline Alliances on Partner's Traffic*, 29 Air & Space L. 207, 210 (2004); Abeyratne, *supra* note 362, at 506.

ances to bypass restrictive legislation and legal principles in order to gain access to the trans-Atlantic market.[614] Once permission is obtained by a carrier under Article 6 of the Convention, Article 15 offers equal treatment, under uniform conditions, in accessing airports which a national carrier of a contracting state has been authorized to access.[615]

However, there are distinct legislative regimes operating in the United States and Europe acting against anti-competitive conduct. American anti-trust laws entail both civil and criminal sanctions. EEC competition law contains civil sanctions against anti competitive conduct that infringe Community laws.[616] Competition laws are calculated to achieve agreements that do not eliminate or restrict competition, eliminate the abuse of dominant positions of carriers, and discourage both predatory pricing and the dumping of capacity and monopolistic mergers.[617]

Broadly, competition in air transport should be viewed from the perspective of the benefits accruing to the people of the world through liberalized aviation. In the years to come, there will be an increase in population, an increase in aging populations with increased disposable income, and increased migration.[618] All these factors, together with expanding industries and trade, will undoubtedly stimulate the further growth of the air transport industry.

In the air transport field, geographic size of a country becomes a relevant consideration, both in terms of the volume of traffic generated by a particular country and the negotiation leverage it enjoys in bartering air traffic rights and points of departure and landing. European states, being relatively small, must band together in order to optimize their collective potential. Strict European Union legislation is therefore understandable, particularly in such areas as slot allocation, computer reservation systems and fares and rates in air transport services. However, any legislation should continue to promote a competitive advantage and stimulate and upgrade domestic demand in product performance, product safety and environmental impact. In particular, the last element, environmental impact, should be addressed in harmony with global regulations as promulgated through the International Civil Aviation Organi-

614. Abeyratne, *supra* note 362, at 506.

615. Chicago Convention, *supra* note 1, art. 15.

616. EC Treaty art. 83.

617. *Id.* arts. 81, 82.

618. In 2002, the scheduled air carriers of the world carried over 1.6 billion passengers and 30 million tons of air freightICAO records that in the year 2003, airlines of the world carried 1.657 billion passengers and 35 million tons of freight. During that year the world gross domestic product (GDP) grew approximately 3.9 per cent in real terms, almost one percentage higher than in the previous year. Department of Economic and Social Affairs, Population Division, *Population, Environment and Development - The Concise Report*, U.N.Doc. ST/EA/SER.A/ 2002, 1,5, 7-8 (2001).

zation. European states should also continue limiting direct co-operation among industry rivals in order to obviate anti-competitive conduct. Competition should be deregulated and state monopolies, which are already discouraged in the Union, should be eschewed. European airlines should also establish early warning systems that can detect changes in the air transport market. For instance, airlines could find and serve passengers and consignors whose needs are indicative of the market, study markets whose regulations foreshadow emerging regulations elsewhere, incorporate outside expertise into their management teams, and continually conduct research on market access.

In the quest for globalization, European airlines should tap selectively into other nations' airlines. However, airline alliances have to be used selectively: a poorly planned alliance could actually end up highlighting the mediocrity of the partnership. In general, the aviation industry should focus on the ripples of prosperity that air transport can generate. The ICAO has estimated that in 1998, the direct contribution of civil aviation, in terms of the consolidated output of air carriers, other commercial operators and their affiliates, was 370 billion US dollars.[619] Direct on-site employment at airports and by air navigation services providers generated 1.9 million jobs while aerospace and other manufacturing industries employed another 1.8 million people.[620] Overall, the aviation industry directly employed no less than 6 million persons in 1998.[621]

These direct economic activities have multiplier effects.[622] Every $100 US of output produced and every 100 jobs created by air transport trigger additional demand of $325 US and 610 jobs in other industries.[623] In 1998, the total economic contribution of air transport, considering both the direct economic activities and the multiplier effects, is estimated at $1360 billion US output produced and 27.7 million jobs world-wide.[624]

The strategic establishment of domestic airports in undeveloped areas could yield significant prosperity to the populace of those areas and the whole state. For example, a case study conducted recently on Frankfurt Airport quantified a contribution of the airport to Germany's na-

619. ICAO, *The Economic Contribution of Civil Aviation*, at 1, ICAO Circular 292-AT/124 (2004) [hereinafter *Economic Contribution*]; Economic Contribution of Civil Aviation: Ripples of Prosperity 1 (2005), *available at* http://www.icao.int/icao/en/atb/fep/EconContribution.pdf (last visited May 3, 2006).

620. *See Economic Contribution*, note 619, at 3.

621. *Id.*

622. *Id.*

623. *Id.*

624. *Id.* at 4. The year 1998 is taken as a bench mark to reflect current trends since the fluctuating fortunes of the air transport industry have not succeeded in radically changing the contribution of aviation over the past 6 years.

tional economy.[625] For every Deutsche Mark earned at the airport and for every airport based job, there were 2.01 DM earned and 1.77 jobs created throughout the national economy, including DM 1.26 earned and 1.29 jobs created in the regional economy.[626]

Economic activity in air transport, particularly in the movement of aircraft between states, must also be viewed in the context of sustainable development, where environmental protection will play a key role.[627] The economic aspects of environmental protection, particularly in the areas of noise charges and emissions trading as a market based option, is a challenge.[628]

It may be time to take a closer look at Article 6 of the Chicago Convention and revisit its meaning and purpose. The Article should project openness by contracting states to freely grant permission to qualified applicant states. If a state can present compelling reasons to allow its carriers market access, states should allow access in order to contribute to the overall objectives of aviation, rather than denying access to protect individual national interests.

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625. ICAO, *Second Meeting of the North American, Central American, and Caribbean Directors of Civil Aviation,* ¶¶ 9, 13, NACC/DCA/2 (Sept. 5, 2005).

626. *Id.* ¶ 13.

627. *See* Ruwantissa Abeyrante, *Air Transport and Politics of Sustainability*, 35/3 ENVTL. POL'Y & L. 114, 15 (2005).

628. *Id.;* Ruswantissa I.R. Abeyratne, *Emissions Trading as a Market-based Option in Air Transport – Contractual Issues*, 29/5 ENVTL. POLICY & L. 226, 232 (1999); see generally, International Energy Agency, *International Emission Trading From Concept to Reality*, (2001).