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Competition Law and the International Transport Sectors

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This article charts the evolving regulation of cooperation and coordination between international transport firms, in particular those operating within the liner shipping and international air transport sectors. There has been a long history of exemption of these sectors from the rules and regulations of antitrust or competition law. In the past three decades, regulatory reforms and privatization have, however, subjected these sectors to competitive forces that have transformed these industries. With the introduction of competition law in many jurisdictions, the justifications for their continued exemption have come under intense scrutiny. In the late 1970s, the US initiated deregulation of its domestic airline sector and introduced reforms in the regulation of liner shipping which resulted in greater competition and lower prices. In 2006, the EU adopted a tougher stance by becoming the first jurisdiction to remove exemption for IATA passenger tariff conferences from 2007 and for liner shipping conferences from 2008. While arguments for the benefits of competition can be generally made, the lack of harmonization of competition laws together with the international nature of these sectors (which are further complicated by high concentration, network characteristics, and government sanctioned barriers to entry) continue to present challenges for competition authorities.

1. INTRODUCTION

The international liner shipping and airline sectors are foundational pillars for global trade flows and passenger movements. Arising from their perceived strategic importance to a nation's trade and security, there has been a long history of exemption of these sectors from the rules and regulations of antitrust or competition law. In the past three decades, regulatory reforms and privatization have, however, subjected these sectors to competitive forces that have transformed the structure of these industries. With the introduction of competition law in many jurisdictions,¹ the justifications for their continued exemption have come under intense scrutiny. The international nature of these sectors and the dependence of countries on the services of foreign fleets and airlines have constrained national competition authorities from implementing policies that depart from the norm set by the major economic powers, in particular, the US and EU.

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¹ In 2008, the International Competition Network (ICN) has a membership of 102 competition agencies from 91 countries. The list of members can be found at the ICN website at: <<http://www.internationalcompetitionnetwork.org/>>.

This article presents the historical arguments both for as well as against the exemption of these sectors and the practices adopted. It then discusses the current state of competition policy in these two sectors, focusing, in particular, on the landmark change in EC policy for liner conferences from October 2008. While arguments for the benefits of competition can be generally made, the lack of harmonization of competition laws together with the international nature of these sectors (which are often further complicated by high concentration, network characteristics, and government sanctioned barriers to entry) continue to present challenges for competition authorities.

The subject matter of this article involves both law and economic policy and serves as a good reminder, once again, that competition law is best understood when viewed in its extralegal historical as well as economic contexts. This is especially important in the context of the international transport sectors where we find strong interaction between market developments and economic policies on the one hand and the gradual development of competition laws on the other.

Let us turn now to the first of these sectors, *viz.*, liner shipping.

2. LINER SHIPPING

2.1. 1875 – 1998: A Century of Antitrust Immunity

Liner shipping is distinct from tramp shipping in that liners publish a freight tariff, operate on scheduled routes and leave at scheduled times. The formal history of liner shipping cartels dates from 1875, the opening year of the Calcutta Conference² and thereafter the practice rapidly spread to most of the main world trade routes. These cartels have been variously known as liner conferences, shipping conferences, and ocean shipping conferences. A conference is essentially an association of shipping lines, all travelling the same route and in the same direction; members explicitly and formally agree to common prices, a set schedule, and renegotiation and dispute settlement procedures. An agreement establishing a conference may include pooling profits or revenues, managing capacity, allocating routes, and offering loyalty discounts.³

The beginnings of liner conferences in the nineteenth century have been attributed to the advent of fast steamships which brought a considerable amount of instability into the liner shipping sector which was then dominated by obsolescent sailing ships. Fast steamships also increased the predictability of sailing times, which made coordination possible. The over-supply of capacity resulted in sharp rate drops which motivated

² More detailed information relating to the historical origins of shipping conferences may be found in Morton, 'Entry and Predation: British Shipping Cartels 1879-1929' (1997) 6(4) *Journal of Economics and Management Strategy* 679. Morton studies a small sample of price wars initiated by shipping cartels at the turn of the 20th century and uses the characteristics of the entrants that are fought to evaluate several theories of predation. He finds support for the 'long purse' theory of predation as 'weaker' entrants are more likely to be fought.

³ See Sjostrom 'Ocean shipping cartels: a survey' (2004) 3(2) *Review of Network Economics* 107.

British shipping lines, the dominant players at that time, to opt for formal agreements amongst themselves to limit capacity and fix rates.⁴ These shipping conferences were subsequently given sanction by the British courts in 1889 (and the House of Lords in 1892) when they held in a predatory pricing case that the law did not prohibit cartel agreements.⁵

In the United States, with the passage of the Sherman Act in 1890, federal courts frequently found conference conduct illegal. A major government investigation at the turn of the 20th century recommended that conferences be tolerated but subject to government oversight.⁶ Shortly after, the US Congress passed the Shipping Act of 1916 which exempted the US international liner shipping industry from federal antitrust.⁷ However, the Act required conferences in the US foreign trades to be ‘open’ and not to restrict entry and exit of any shipping company.

In the rest of the world, conferences have historically gone completely unregulated. Despite Canada’s Competition Act of 1889 (the oldest antitrust statute in the world), it was not until 1970 that the *Shipping Conferences Exemption Act*, which followed a similar model to the US legislation, was passed.⁸ Conferences continued to enjoy immunity from competition regulations even as new competition regimes were established. According to a recent OECD report, there were around 150 liner conferences worldwide in 2002, with membership ranging from two to as many as 40 separate lines.⁹

Besides liner conferences, there exist other forms of operational cooperation between shipping lines. Consortia agreements began at the end of the 1960s with the start of container services. Consortia agreements are aimed primarily at sharing fixed costs on a maritime route through various technical, operational or commercial arrangements such as joint use of vessels, port installations, marketing organizations, etc. These cooperative agreements were motivated by the need for high levels of capital

⁴ See OECD, Competition Policy in Liner Shipping, Final Report, 16 April 2002, at Sections 2.4 and 2.5. The report is available at the OECD website: <<http://www.oecd.org>>.

⁵ In the seminal English decision of *Mogul Steamship Co v McGregor, Gow, and Co*, both the Court of Appeal (in (1889) 23 QBD 598) and the House of Lords (in (1892) AC 25) held that a number of shipowners who formed a cartel which offered artificially low charges for the carriage of tea from certain Chinese ports with the aim of driving out of business other shipowners who were competing with them were not liable to those other shipowners when they succeeded in their aim; see, generally McBride, ‘The Classification of Obligations and Legal Education’, in Birks (ed.), *The Classification of Obligations*, London, Society of Public Teachers of Law, Oxford University Press, 1997, at p 85.

⁶ See Report of the Committee on the Merchant Marine and Fisheries on Steamship Agreements and Affiliations in the American Foreign and Domestic Trade, H.R. Doc. No. 805, 63d Cong., 2d Sess., at 415 (1914), routinely referred to as the ‘Alexander Report’ after the chair of the committee, Rep Joshua Alexander.

⁷ See Sagers, ‘The Demise of Regulation in Ocean Shipping: A Study in the Evolution of Competition Policy and the Predictive Power of Microeconomics’ (2006) 39(3) *Vanderbilt Journal of Transnational Law* 779.

⁸ See Heaver, ‘The Shipping Conferences Exemption Act: Review and Suggestions of Positions Appropriate for the Panel’ (2001), paper commissioned by the Canada Transportation Act Review Panel.

⁹ See OECD, op cit, n 4, at p 19.

investment in new vessels, containers and port facilities. Unlike conferences, they do not contain price-fixing provisions and generally involve lower market shares than conferences. Members of a consortium may be independent lines or they may be members of the same conference. It is widely recognized that consortia agreements lead to cost reductions derived from risk sharing and economies of scale.¹⁰

Discussion or talking agreements emerged in the 1980s when conferences were unable to convince independent liners to join them. They facilitate exchange of information about freight rates, costs, capacity and conditions of service on a particular trade route, on non-binding terms. These agreements exist mainly in the US and Australia trade routes. In periods of scarce demand, competition may be limited by agreements between conference and non-conference liners such as Capacity Stabilization agreements (binding) and Discussion Agreements (which are non binding), by which liners attempt to control the supply capacity and the level of rates.¹¹

In the mid-1990s, the liner industry underwent another period of restructuring arising from the formation of global strategic alliances amongst leading container carriers. Unlike the route specific nature of previous agreements, these alliances represent a new level of cooperation over major route networks. Theoretically, members are not involved in price setting (as this takes place within conferences) but in the rationalization of their services on a global basis and optimization of each carrier's assets through schemes such as sharing of vessels, ports, charters, terminals, joint scheduling and where permitted, coordination of inland services.¹² The establishment of alliances was motivated by the rapid globalization of world trade and investments and the resulting unprecedented levels of demand for world-wide services, supply chain management and the provision of logistics value added services.¹³

The usual arguments for the long standing exemption of these collusive activities in the shipping sector are summarized below.¹⁴

- (i) The structure of the liner industry predisposes it to decreasing short run marginal costs. Consequently, a free market may result in destructive competition, which undermines the basic characteristics of the liner service, such as frequency and

¹⁰ See OECD, *op cit*, n 4, at Section 2.7.

¹¹ See Benacchio, Ferrari and Musso, 'The liner shipping industry and EU competition rules' (2007) 14 *Transport Policy* 1.

¹² 1996 witnessed the formation of four large strategic alliances: Global Alliance, Grand Alliance, Maersk/Sealand, and Hanjin/Tricon. Membership of alliances in the initial years was characterized by a high level of instability according to a study by Midoro and Pitto, 'A critical evaluation of strategic alliances in liner shipping' (2000) 27(1) *Maritime Policy and Management* 31.

¹³ A study of the changes in the container shipping industry as a result of strategic alliances is to be found in Slack, Comtois, and McCalla, 'Strategic alliances in the container shipping industry: a global perspective' (2002) 29 (1) *Maritime Policy and Management* 65.

¹⁴ Ryoo and Lee, 'The role of liner shipping co-operation in business strategy and the impact of the financial crisis on Korean liner shipping companies', in Grammenos (ed.), *The Handbook of Maritime Economics and Business*, London, LLP, 2002, provides a list of arguments often advanced by carriers to justify exemption of the sector.

reliability of schedules, and the certainty that services will be provided ahead of demand. This argument represents the economic foundation for rate fixing, yet it implies that in order to stabilize rates, conferences will charge rates in line with the average cost of their less efficient members.

- (ii) The standard investment for each ship has increased over time in order to exploit the economies of scale so that only large shipping lines can bear the financial burden of new ships.
- (iii) There are substantial imbalances in traffic flows on the different routes served by liners in nearly all markets, resulting in voyages made with part of the ship's capacity used to carry ballast.

Other arguments include:¹⁵

- (i) The theory of the empty core, that is, a natural market equilibrium does not exist. This is a characteristic of markets where few competitors generate supra-normal profits for the incumbents which then attracts entry and frenzied competition and results in losses for all the market participants. Consequently, exit and solidification of market shares by the remaining competitors once again attracts entry.
- (ii) Containerization and the development of the hub-and-spoke structure have encouraged further mergers and alliances. Conferences remain a sort of bulwark in defense of a certain degree of competition within the market.
- (iii) Inelastic demand in the short run.
- (iv) The important role of liner shipping in the development of international commerce and economic development.

Carriers were generally successful in pushing these arguments until the 1980s. In 1984, the US Shipping Act was passed to clarify the boundaries of antitrust immunity. The legislation subjected all liner agreements to oversight from the Federal Maritime Commission as to the agreement's conformity with the public interest.¹⁶ For the first time, ocean common carriers were permitted to enter into service contracts with shippers. The 1984 act allowed carriers to legally offer discounted rates so long as these were made public and communicated to other conference carriers. The effect was to make freight rates for service contracts transparent to all carriers as well as shippers. However, after passage of the Act, conferences either refused to allow their members to enter individually into service contracts, or they quickly withdrew that right after witnessing dramatic falls in freight rates. Not unexpectedly, independent carriers were aggressive in offering service contracts.¹⁷

¹⁵ As presented by Benacchio et al, *op cit*, n 11, and Sjostrom, *op cit*, n 3.

¹⁶ Reitzes and Sheran, 'Rolling seas in liner shipping' (2002) 20 *Review of Industrial Organization* 51.

¹⁷ *Ibid*.

2.2.1. 1986 and 1995 EU block exemptions

The EU in 1986 allowed liner conferences a block exemption from antitrust legislation. Council Regulation (EEC) 4056/86 which came into force on 1st July 1987 ended years of speculation and uncertainty about whether Articles 81 and 82 EC Treaty applied to the liner conferences. This block exemption has often been called the most generous exemption ever given as it covered traditional hard-core restrictions and furthermore did not contain a review clause and was to remain in force for an unlimited period of time.¹⁸

Unlike other competition regimes that do not distinguish between different types of liner shipping agreements in granting immunity from competition law, the EC makes a distinction between liner conferences and liner consortia. First adopted in 1995, the consortia exemption sunsets every five years.¹⁹ It was extended in 2000 in Regulation 823/2000 and again in 2005 and provides automatic exemption for joint service agreements that exclude price fixing.²⁰ It also sets a market share threshold of less than 30% (35% in the case of non-conference consortia) to qualify for exemption. The formation of consortia with market shares between 30% (35% in the case of non-conference consortia) and 50% must be notified to the Commission. Unlike the EU, the US does not distinguish between different types of agreements in its regulation of shipping. Canada requires conference agreements to be filed and does not regulate consortia agreements.²¹ Significant differences thus exist in liner shipping regulation and institutional mechanisms in different jurisdictions.²²

The adoption of the block exemptions in the EU was followed by a long period of conflicts over the interpretation of the regulations. During the 1990s, the Commission made a number of decisions that clarified the scope of the exemptions which were subsequently upheld by the Court of First Instance (CFI). The decisions include prohibiting: (i) inland haulage collective price fixing for the inland leg of multi-modal transport operations;²³ (ii) conference prohibitions on member companies entering into

¹⁸ OJ 1986 L378/4 Council Regulation (EEC) No. 4056/86 laid down detailed rules for the application of Articles 81 and 82 of the Treaty to maritime transport: see Benacchio, et al, op cit, n 11 and Pozdnakova, *Liner Shipping and Competition Law*, The Netherlands, Kluwer Law International, 2008, at Section 9.2.

¹⁹ Commission Regulation 870/95 on the application of Article 81(3) of the Treaty to certain categories of agreements, decisions and concerted practices between liner shipping companies (consortia), OJ 1995 L89/7: see OECD, op cit, n 4, at p 26 and Benacchio, et al, op cit, n 11.

²⁰ OJ 2000 L100/24 Commission Regulation (EC) No. 823/2000 expired on 25 April 2005 and was amended by OJ 2005 L101/10 Commission Regulation (EC) No. 611/2005.

²¹ Heaver, op cit, n 8, at p 12.

²² In Australia, Canada, Japan, New Zealand, and the United States, consortia agreements are entitled to immunity from anti-trust law, without reference to whether the agreement provides that ship operators should operate under uniform or common freight rates (OECD, op cit, n 4, at p 25).

²³ The Commission objected to inland haulage tariff fixing in two 1994 cases involving the Trans-Atlantic Agreement (TAA) and the Far East Freight Conference (FEFC) and in the 1998 Trans-Atlantic Conference Agreement (TACA): OJ 1994 L376/1, OJ 1994 L378/17, and OJ 1999 L95/1, respectively. The Commission's decisions were upheld by the Court of First Instance in three judgments issued on the same day 28.2.2002 (Case T86/95 *Campagnie Generale Maritime and others v Commission* [2002] ECR II-1011, better

individual contracts; (iii) restrictive clauses applied to individual service contracts; and, (iv) the fixing of ancillary charges such as freight forwarders commissions.²⁴ In November 2002, following the CFI confirmation of its earlier decisions, the Commission granted an individual exemption for the revised Trans-Atlantic Conference Agreement after it held that provisions in the agreement regarding service contracts and multi-carrier service contracts to be outside the scope of the block exemption.²⁵ The decision came after members agreed to make substantial concessions, and in the words of the then European Commissioner for Competition Policy, ‘only because of circumstances peculiar to the market on which the Revised TACA operates’.²⁶

2.2 1999 - 2008: The Gradual Demise of Liner Conferences

2.2.1. The US Ocean Shipping Reform Act

In 1998, the US passed the Ocean Shipping Reform Act (OSRA) which continued to grant immunity to all types of liner conference agreements but stipulated a list of permissions/conditions which served to undermine successful collusion, hence limiting the extent of anti-competitive behaviour. The list includes: (i) shippers and carriers may negotiate confidential service agreements and keep the terms of the contracts safe from other carriers and shippers; (ii) conference tariffs still had to be published; and, (iii) allowing independent rate action for carriers to cover multiple trade lanes, making it easier for larger shippers to do ‘one-stop shopping’. Allowing independent rate action across multiple trade lanes dealt a further blow to conferences organized on the basis of individual trade lanes. The OSRA by eliminating tariff filing requirements also effectively eliminated FMC’s role of enforcing tariff rates. In essence, the OSRA ‘transformed ocean shipping in the US from the concept of “common carriage” to “contract carriage” whereby tariff filing with federal authorities and strict enforcement of these tariffs have been replaced by confidential contracts between shippers and carriers’.²⁷

known as the *FEFC* case; Case T395/94 *Atlantic Container Line & others v Commission* [2002] ECR II-875, better known as the *TAA* case; and Case T18/97 *Atlantic Container Line & others v Commission* [2002] ECR II-1125, the *TACA Immunity* case).

²⁴ The 1998 Commission decision on *TACA*, *ibid*, was wide ranging in scope and dealt with fixing of freight forwarder commissions, conference restrictions on member companies entering into individual contracts, restrictive clauses applied to individual service contracts, and inducing competitors to join the conference (Benacchio, et al, *op cit*, n 11).

²⁵ The individual exemption, cleared in November 2003, replaced the agreement prohibited by the Commission in 1998: see Revised TACA, OJ 2003, L26/53. See also Marlow and Nair, ‘Service Contracts – An instrument of international logistics supply chain: Under United States and European Union regulatory frameworks’ (2008) 32 *Marine Policy* 489.

²⁶ Monti, ‘A time for change? – Maritime competition policy at the crossroads’, speech to the European Shipper’s Council by then European Commissioner for Competition Policy, Antwerp, 12 June 2003.

²⁷ As succinctly described in ‘Shipping Conferences Exemption Act, 1989, Consultation Paper’, July 1999, Transport Canada Policy Group, Canada.

By reducing the transparency of freight rates and giving conference members independent contracting rights, the Act increased cartel enforcement costs. The US shipping market was effectively freed, except for the fact that carriers are still not subject to antitrust – they may share price information, agree to non-binding guidelines for rates and terms of service, adopt common non-binding tariffs, and so on. There have been several efforts since 1999 to do away with US conference antitrust exemption entirely.²⁸

Since 1 May 1999, the day that OSRA became effective, the following impacts have been observed:

- (i) There has been ‘upheaval in liner conferences’ – several conferences operating US trade routes have disbanded. While 32 conference agreements were in effect in 1997, the number had dwindled to 22 by May 2000. Conferences that remained lost significant membership.²⁹
- (ii) There has been an increase in the number of discussion agreements involving conference carriers and independent carriers.
- (iii) The use of confidential service contracts increased dramatically. The FMC reported that between 1 May 1999 and 30 June 1999, 15,000 service contracts were signed in comparison with 3,400 in the same period of the prior year.³⁰
- (iv) Many conferences stopped issuing joint service contracts – only four conference service contracts remained in effect in May 2000, as compared with over 400 a year earlier.³¹
- (v) Price discrimination increased.
- (vi) There has been consolidation of shipping lines through mergers and acquisition.
- (vii) Data published on the website of Containerization International showed an increasing gap between westbound and eastbound freight rates in the transatlantic and transpacific routes from 1999. From approximate parity in 1999, average eastbound (US-Europe) freight rates were approximately 80% below average westbound (Europe-US) rates on the transatlantic route by 2005. Average westbound (US-Asia) rates were halved average eastbound (Asia-US) rates on the transpacific route by 2005. While a part of the rate imbalance is due to trade patterns, US exports/shippers have undoubtedly benefited from a large reduction in freight rates as a consequence of the OSRA.³²

²⁸ Sagers, *op cit*, n 7, reviews the US deregulation of the liner shipping sector and concludes that the experience suggests that liner markets can perform well under normal price competition, contrary to long-standing claims from the industry and some academics.

²⁹ Statistics from the Federal Maritime Commission as reported by Reitzes and Sheran, *op cit*, n 16.

³⁰ As reported by Reitzes and Sheran, *op cit*, n 16.

³¹ *Ibid.*

³² See Benacchia et al, *op cit*, n 11, for graphs of the trends in freight rates.

2.2.2. 2006 EU repeals block exemption for liner shipping conferences

The effects of the 1998 US reform of ocean shipping practices were closely monitored across the Atlantic. In March 2003, following an OECD report³³ which severely criticized the need for conferences to have antitrust exemption, the EU competition commission decided to re-examine Regulation 4056/86. The Commission adopted a three stage approach: the first being a consultation paper in March 2003,³⁴ followed by a White Paper published in October 2004,³⁵ and thereafter, a legislative proposal for a Council regulation to repeal the conference exemption on 14 December 2005.³⁶ The proposal to repeal the block exemption was thus the result of a thorough three year long process of consultation, review and studies. The Commission findings were that the exemption did not fulfil the four cumulative conditions of Article 81(3) which were necessary for it to continue, these being:³⁷

- (i) concrete benefits resulting from price fixing and capacity regulation are identified;
- (ii) a fair share of the proved benefits are passed on to consumers;
- (iii) the indispensability of price fixing and capacity regulation for the provision of reliable services; and
- (iv) competition is not eliminated on a substantial part of the market.

Instead, the Commission's review process found:³⁸

- (i) no causal link between price fixing and reliable liner services as conferences are not able to enforce the conference tariff nor do they manage the capacity available. However, the conference tariff still acts as the benchmark which impacts on the negotiation of individual contracts. Of greater concern was the joint fixing of charges and surcharges (on average 30% of the price of transport) where there is no competition between conference members as well as non-conference members.

³³ See OECD, *op cit*, n 4. The OECD report recommended that member countries seriously consider removing antitrust exemptions for price fixing and rate discussions. Exemptions for other operational arrangements may be retained so long as these do not result in excessive market power.

³⁴ See Commission, 'Consultation Paper on the review of Council Regulation (EEC) No 4056/86 laying down detailed rules for the application of Articles 81 and 82 of the Treaty to maritime transport', 27 March 2003. Available at DG Competition website, section Maritime Transport under 'Antitrust – Legislation': <<http://ec.europa.eu/competition/antitrust/legislation/maritime/>>.

³⁵ See Commission, 'White Paper on the review of Regulation 4056/86, applying the EC competition rules to maritime transport', COM (2004) 675 final. Available at DG Competition website, *ibid*.

³⁶ See Commission, 'Proposal for a Council Regulation repealing Regulation (EEC) No 4056/86 laying down detailed rules for the application of Articles 85 and 86 to maritime transport, and amending Regulation (EC) No 1/2003 as regards the extension of its scope to include cabotage and international tramp services', COM (2005) 651 final. Available at DG Competition website, *ibid*.

³⁷ See "Impact Assessment", Annex to the Commission Proposal, *ibid*. Also Evans, 'The future regulatory framework for liner shipping', speech at 8th Global Liner Shipping Conference, London, 27th April 2006; and Benacchia et al, *op cit*, n 11.

³⁸ *Ibid*.

- (ii) transport users have opposed the conference system which they do not consider to deliver adequate services.
- (iii) reliable scheduled liner services are provided in several ways.
- (iv) given the extent of relationships between carriers in conferences, consortia, alliances and vessel sharing agreements, determining the extent to which a conference is subject to outside competition is a complex analysis that must be carried out on a case by case basis. However, the Commission noted that all carriers operating on the same trade tend to apply the same charges and surcharges.

The Commission also assessed the expected impact of the repeal on the basis of independent consultancy reports and concluded that it would lead to a moderate drop in ocean transport prices and considerable reductions in charges and surcharges. It also expected service quality and innovation to be improved.³⁹

The European Parliament subsequently issued a report in July 2006 and on 25 September 2006, the Competitiveness Council agreed to repeal Council Regulation 4056/86. The repeal of the block exemption makes the EU the first jurisdiction to put an end to the possibility for liner carriers to meet in conferences, fix prices and regulate capacities with effect from October 2008 (Council Regulation 1419/2006 of 25 September 2006 repealing Regulation (EEC) 4056/86).⁴⁰ In July 2008, the Commission published guidelines on the application of Article 81 of the EC Treaty to maritime transport services.⁴¹ Regulation 823/2000 on maritime consortia which has been extended until 2010 is not affected by the repeal and liner carriers will continue to be allowed to offer joint services.

2.3 THE FUTURE: EFFECTS OF THE EU REPEAL FROM OCTOBER 2008

With the EU repeal of the block exemption for liner conferences from October 2008, two questions are raised here with regard to the future: (i) the likely market effects, and (ii) expected changes in regulatory regimes in other jurisdictions.

2.3.1. What will be the market effects of the EU repeal?

The commission has predicted that with newfound competition, prices will decline and 'service quality will either be unaffected or will improve'.⁴² Professor Haralambides of Erasmus University has, however, continued to push the traditional argument that the liner conference system produces much-needed certainty and predicted that rates would

³⁹ Ibid.

⁴⁰ OJ 2006 L269/1. The documents relating to the review process are available in the DG COMP website: <<http://ec.europa.eu/comm/competition/antitrust/legislation/maritime/>>.

⁴¹ Commission of the European Communities, 'Guidelines on the application of Article 81 of the EC Treaty to maritime transport services', published on 1 July 2008, may be accessed at: <http://ec.europa.eu/comm/competition/antitrust/legislation/maritime/guidelines_en.pdf>.

⁴² EUROPA Press Release, 'Competition: repeal of block exemption for liner shipping conferences – frequently asked questions' (25 September 2006) MEMO/06/344 Brussels.

instead rise as carriers consolidate further. Logistics costs would also rise, he said, while carriers may consider a return to the use of smaller vessels as capacity sharing declines. 'The European officials are making a big blunder -- they are looking inside themselves when their competitors are thinking globally'.⁴³ However, contrary to the views expressed by Haralambides, studies on the effects of the US OSRA have shown clearly that competition in the liner shipping sector can work and can bring prices down.

With the repeal of the block exemption, the market conduct of shipping companies will be subject to the full application of the EC Treaty competition provisions. Given the industry's privileged position historically and the existing complex links among competitors, interpreting and applying the competition rules of the EC Treaty present legal problems in their own right.⁴⁴ Many issues remain to be clarified while in some cases existing interpretation of competition law may not be appropriate in the specific context of liner shipping. Without doubt, the shipping industry will continue to consolidate and most existing conferences will be transformed into consortia. The EU Competition Commission will necessarily need to study the net economic benefits of proposed mergers and individual applications for exemptions. In concentrated markets, the market conduct of dominant firm(s) becomes potentially subject to prohibition of abuse of dominance laid down in Article 82 EC. The Commission will have to devote substantial resources to investigating alleged abuses of dominance as well as gathering evidence of price fixing activities which are likely to go underground.

2.3.2. Which is a preferred way to regulate the maritime transport sector?

Other jurisdictions including Australia, Japan and Brazil have also been reviewing exemptions for liner shipping agreements. In 2006, the newly formed Competition Commission of Singapore decided to grant a five year block exemption to all liner shipping agreements, subject to a list of conditions.⁴⁵ The decision was made a few months prior to the EU announcement of the repeal of block exemption for liner shipping. As a major transshipment hub competing for transshipment cargo with other regional ports, a non-exempt decision could have risked the diversion of cargo to nearby ports without a competition law regime or with antitrust exemption for the sector. These considerations also weighed in Canada's 1999 review of its Shipping Conferences Exemption Act where the following views were expressed: 'For Canada to remove the exemption while others, particularly the U.S. do not, would in all likelihood result in a shift of some cargo being moved through U.S. ports rather than Canadian ports due to the imbalance in antitrust protection. Significant economic harm to

⁴³ International Herald Tribune, 22 Nov 2006. 'Free Flow: A maritime cartel nears its end'.

⁴⁴ Pozdnakova, op cit, n 18, is a recent book based on the author's doctoral thesis that analyzes the application of Articles 81 and 82 EC Treaty to the market conduct of liner shipping companies.

⁴⁵ On 14 July 2006, the Singapore Minister for Trade and Industry issued the Competition (Block Exemption for Liner Shipping Agreements) Order 2006, exempting a category of liner shipping agreements from the section 34 prohibition of Singapore's Competition Act. The order is available online at the Competition Commission of Singapore's website at: <www.ccs.gov.sg/Legislation/Block+Exemption+Order/>.

Canadian shippers, railway and trucking firms, and ports could result if the Act were to be abolished at this time.⁴⁶

With the EU repeal, existing competition authorities will need to consider the following: Is the US likely to follow the EU in removing antitrust exemption for liner shipping conferences? Is the US present maritime regulatory model of conditional antitrust exemption sufficiently competitive and efficient in its outcome, or should the EU strict repeal of liner conferences be followed? Nascent competition authorities would also have to consider whether to make distinctions between the different liner shipping agreements when granting exemptions. International competition policy for the maritime sector now stands at the crossroads, with future developments dependent on whether the US chooses to align its policy with the EU.

We now turn to a discussion of competition issues in the international aviation sector.

3. INTERNATIONAL AIRLINES

3.1. The Past: The Arcane Web of Aviation Regulation

The aviation industry has been shaped largely by government policy for most of its history. Within the US domestic interstate market, the Civil Aeronautics Board (CAB) regulated entry, exit, and fares of privately owned airlines as well as undertook merger reviews and other antitrust functions from 1938-1978.⁴⁷ The result was relatively high fares, inefficient operations, and airline earnings volatility as rents were dissipated through competition on service quality.

In the area of international aviation, the 1944 Chicago Convention⁴⁸ established the framework for market behaviour that discouraged competition as it was based on bilateral agreements between governments from which airlines derive the right to operate international air services. It led to the general adoption of a one country one airline policy. State ownership and subsidies for flag carriers became the norm in the international aviation sector. Restrictions on foreign ownership of domestic air carriers were universal. International services were tightly controlled by bilateral Air Services Agreements (ASAs)⁴⁹ and prices generally established jointly by airlines themselves under the ASAs or International Air Transport Association (IATA) conferences (IATA

⁴⁶ 'Shipping Conferences Exemption Act, 1989, Consultation Paper', op cit, n 27.

⁴⁷ Civil Aeronautic Act of 1938, 52 Stat. 973. For a historical overview of US regulation and deregulation of the domestic aviation sector, see Borenstein and Rose, 'How airline markets work, or do they? Regulatory reform in the airline industry' in Rose (ed.), *Economic Regulation and Its Reform: What Have We Learned?*, Chicago, The University of Chicago Press, 2006; and Bailey, 'Aviation policy: past and present' (2002) 69 (1) *Southern Economic Journal* 12.

⁴⁸ International Civil Aviation Organization (ICAO), Convention on International Civil Aviation, Doc 7300/9, 9th edition, Montreal, 2007. This and all earlier editions are available at the ICAO website at: <<http://www.icao.int/icaoet/dcs/7300.html>>.

⁴⁹ The first bilateral agreement was signed between the US and UK at Bermuda on 11 February 1946 (known as Bermuda I): 'Agreement between the United Kingdom and the United States', 11 February 1946, 60 Stat. 1499.

is a trade association representing some 260 airlines worldwide). The bilateral agreements often did not permit fifth freedom which enables airlines to carry passengers to one country, and then fly on to another country rather than back to their own.⁵⁰

The US became the first country to deregulate its domestic airline industry in 1978 when the US Congress passed the Airline Deregulation Act.⁵¹ The Act provided for a phase out of the CAB by January 1983 its elimination by 1985. Under the CAB Sunset Act of 1984,⁵² CAB's antitrust authority was transferred to the Department of Transportation (DOT). However, DOT's antitrust powers with respect to domestic air transportation expired on 1 January 1989 and this was transferred to the Department of Justice (DOJ) Antitrust Division. For international intercarrier arrangements, both DOT and the DOJ are empowered.

The result of airline deregulation has been tremendous growth in capacity, lower fares and more efficient operations – all of which have benefited the majority of consumers. Competition has resulted in innovations in the form of hub-and-spoke networks, complex yield management systems, price discrimination among travellers, as well as the development of computer reservation systems initially and internet sales in recent years. The initial entry of about one hundred new low cost carriers was followed by a wave of airline mergers, insolvencies and consolidation of the industry. Volatility in industry earnings has continued and average earnings have declined.⁵³ The industry continues to contain a complex mix of competitive, cooperative and regulated elements with airport slot allocations and international route allocations still not competitively determined.

The US experience with deregulation was followed with much interest around the world. New Zealand abolished the government control of fares and entry barriers in 1983 with subsequent privatization of Air New Zealand in 1989. Canada moved to partially liberalize its airline sector in 1984 and 1988; deregulation in Australia was introduced through the passage of the Airline Agreement (Termination) Act of 1990.⁵⁴

Deregulation in the EU was implemented in phases starting from 1988.⁵⁵ The first phase allowed multiple designations, fifth freedom rights and automatic approval of

⁵⁰ Jennings has described the resulting framework as the 'insane world of international aviation regulation'. Jennings, 'The insane world of bilateral international aviation regulation' (2003); available at: <<http://www.samizdata.net/blog/archives/005229.html>>.

⁵¹ The Airline Deregulation Act of 1978, 92 Stat. 1744.

⁵² The Civil Aeronautic Board Sunset Act of 1984, 98 Stat. 1703. See Lu, *International Airline Alliances: EC Competition Law, US Antitrust Law and International Air Transport*, The Hague, Kluwer Law International, 2003, at p 26.

⁵³ See Borenstein and Rose, op cit, n 47.

⁵⁴ See Sinha, *Deregulation and Liberalisation of the Airline Industry: Asia, Europe, North America and Oceania*, England, Ashgate, Aldershot, 2001, for the experiences with domestic airline deregulation in New Zealand, Australia, Canada, Europe and India.

⁵⁵ See Lu, op cit, n 52, at Section 2.2.1; and Gil-Molto and Piga, 'Entry and exit in a liberalised market', Discussion Paper Series, Department of Economics, Loughborough University, UK, 2006.

discount fares.⁵⁶ This package, and the second in 1990, loosened the constraints of bilateral agreements by freeing capacity limitations, allowing additional airlines to be designated and creating additional route rights.⁵⁷ The third and most significant package implemented from 1993 to 1997 replaced the bilateral system with a multilateral system of air transport regulation.⁵⁸ Most significantly, there was to be no restrictions on pricing, no regulatory distinction between scheduled and charter airlines, and movement away from the requirement of national ownership. From 1997, full cabotage (occasionally referred to as the ninth freedom) granted permission to European carriers to operate domestic flights in member countries other than their home market.⁵⁹

The first package also contained three block exemptions for the air transport sector for joint planning, coordination of schedules, joint operations, and consultation on tariffs and slot allocation agreements; categories of agreements between undertakings relating to computer reservation systems; and ground handling services.⁶⁰ The majority of the exemptions had been allowed to expire with the exception the block exemption for IATA tariff conferences, and IATA slots and scheduling conferences which was renewed in 1993.⁶¹

3.2. The Present: The Age of Budget Airlines and Alliances

The past decade has seen increased liberalization which has resulted in worldwide growth in the volume of air passengers, the proliferation of low cost carriers worldwide and the increased cooperation between airlines in the form of global alliances and code-sharing arrangements. Increased liberalization has also been accompanied by the greater frequency in the application of competition law to a variety of issues within the airline sector.

⁵⁶ The first package contains four pieces of legislation: Council Regulation 3975/87, OJ 1987 L374/1; Council Regulation 3976/87, OJ 1987 L374/9; Council Directive 87/601, OJ 1987 L374/12; and Council Decision 87/602, OJ 1987 L374/19.

⁵⁷ The second liberalization package contains five regulations: Council Regulation 2342/90 revoking Council Directive 87/601, Council Regulation 2343/90 revoking Council Decision 87/602, Council Regulation 2344/90, Commission Regulations 83/91 and 84/91. See OJ 1990, L217/15 and OJ 1991, L10/14.

⁵⁸ Council Regulation 2407/92, OJ 1992, L240/1. See Morrell, 'Air transport liberalization in Europe: the progress so far' (1998) 3(1) *Journal of Air Transportation World Wide* 42.

⁵⁹ Chang and Williams investigate how European major airlines responded to the liberalized policy. They conclude that British Airways and the SAirGroup have pursued a policy of acquiring airlines in EU countries, with the former finding it an expensive and questionable strategy and the latter disastrous: see Chang and Williams, 'European major airlines' strategic reactions to the Third Package' (2002) 9 *Transport Policy* 129.

⁶⁰ See *supra*, n 56. The air transport sector had enjoyed special exemption from EC competition law dating back to 1962 under Council Regulation 141/62, OJ 124, 28.11.62, p 2751; English Special Edition 1959-62, p 291.

⁶¹ Commission Regulation 1617/93 (IATA Tariff and Slot Conferences), OJ 1993 L155/18. See *infra*, text accompanying n 75 and n 77.

3.2.1. Low cost carriers (LCCs) take off worldwide

In the aftermath of deregulation, low cost carriers have carved a sizeable niche of the industry for themselves. In the US, Southwest Airlines, America's most profitable airline, and JetBlue have shown that the low cost segment can be very lucrative.⁶² In Europe, low cost air carriers such as Ireland's Ryanair and UK's EasyJet have been very successful as well.⁶³ The success of LCCs in the US and Europe helped to break down resistance to aviation liberalization globally. In the past five years in the Asia Pacific, the growth of LCCs has been the single most important factor shaping the airline industry in the region. In the Asian Pacific region, LCCs have emerged in India, Japan, Malaysia, New Zealand, Philippines, Thailand, Australia and Singapore.⁶⁴ The growth of LCCs internationally however continues to be constrained by regulations on foreign participation in ownership and management and bilateral agreements between governments.

3.2.2. Alliances and other forms of cooperation

Increased competition in the aviation sector has been paralleled by increased cooperation between airlines in the form of both domestic and global alliances and code-share agreements. Since the formation of the Star Alliance global network in 1997, other major global alliance groups have been formed. At present the three major global alliances are Star Alliance, oneworld and SkyTeam, each involving major carriers from at least ten different nationalities. Alliances may represent different levels of cooperation from joint marketing to integration of businesses. Alliance cooperation can include code-sharing agreements which allow airlines to market seats on flights operated by partner airlines where the flight carries both airline identifiers and airline specific flight numbers. However, non-alliance airlines also make use of code-share agreements which allows partner airlines to jointly set fares.⁶⁵

The most important reason for the prevalence of alliances is that generally, cross-border mergers and acquisitions of airlines in order to expand route networks are not possible. The obstacle derives from bilateral air services agreements (ASAs) between pairs of states which provide that a state may refuse to allow an airline from the other state to operate if it is not substantially owned and effectively controlled by that other state or its nationals. Given that a change of ownership could result in the withdrawal

⁶² Ito and Lee, 'Low Cost Carrier Growth in the U.S. Airline Industry: Past, Present, and Future' (2003) Brown University Department of Economics Paper No. 2003-12.

⁶³ Gil Moto and Piga, *op cit*, n 27; Paul and Hartmann, 'The World Airline Industry: A European Perspective' (2003), Case 303-073-1, European Case Clearing House Collection.

⁶⁴ Findlay and Goldstein, 'Liberalization and Foreign Direct Investment in Asian Transport Systems: The Case of Aviation' (2004) 21(1) *Asian Development Review* 37, also presents case studies of development in China, Thailand and India.

⁶⁵ Czerny, 'Code-sharing and its effect on airline fares and welfare' (2006) CNI-Working Paper No. 2006-15, Center for Network Industries and Infrastructure (CNI) at Berlin University of Technology.

of operating permission, alliances which do not involve the acquisition of substantial ownership or effective control are the next best option.⁶⁶

Regulators and competition authorities can either approve or prohibit an alliance or adopt a decision with remedies. A database on 'Regulatory Actions on Major Airline Alliances' can be found on the website of the International Civil Aviation Organization (ICAO).⁶⁷ Most applications for immunity concern air traffic on routes between the US and Europe. Although there are at present more than a hundred jurisdictions with competition law regimes, the database contains only regulatory actions of the US DOT (39 cases), European Commission (24 cases), the UK Office of Fair Trading (3 cases), the Australian Competition and Consumer Commission (8 cases) and the New Zealand Commerce Commission (2 cases).⁶⁸

Legal procedures and requirements for approval of alliances differ between countries.⁶⁹ In the US, international airline alliances apply to the Department of Transportation (DOT) for immunity from antitrust litigation, which DOT has the sole authority to confer or withhold. DOT considers several broadly defined factors such as the 'public interest' and 'foreign policy', and also relies on the Department of Justice (DOJ) to complement its qualitative approach with a more quantitative analysis of the proposed alliance similar to the approach DOJ utilizes for domestic airline mergers.⁷⁰ DOT generally grants antitrust immunity subject to a review after five years. DOT has also granted antitrust immunity for alliance partners to jointly set fares on an individual basis. However, in some instances, coordinate pricing between alliance members has not been permitted. According to Chang and Williams, the US DOT's policy in the 1990s was to strategically grant anti-trust immunity to transatlantic alliances subject to the conclusion of Open Skies Agreements with the governments of the airlines involved.⁷¹

⁶⁶ See Balfour, 'EC competition law and airline alliances' (2004) 10 *Journal of Air Transport Management* 81.

⁶⁷ ICAO's database of regulatory actions on major airline alliances is at: <<http://www.icao.int/icao/en/atb/epm/ecp/AirlineAlliances.pdf>>.

⁶⁸ Since competition law came into effect in Singapore in 2006, the Competition Commission of Singapore has excluded two airline agreements from Section 35 prohibition of the Competition Act: the Qantas-British Airways Joint Services Agreement and the Qantas-Orangestar Co-operation Agreement; both decisions were made in 2007. Details of the decisions may be found online at the Competition Commission's website at: <<http://www.ccs.gov.sg/PublicRegister/Notifications+Decisions+-+Public+Register.htm>>.

⁶⁹ Lu, *op cit*, n 52, is a detailed study of the problems facing international airlines due to conflicts arising from the applications of varying competition laws by the US and EC on airline alliance activities.

⁷⁰ See Schlangen, 'Differing Views of Competition: Antitrust Review of International Airline Alliances' (2000) *University of Chicago Legal Forum* 413. Schlangen highlights the similarities and differences in the antitrust analysis by DOT and DOJ.

⁷¹ Switzerland and Belgium signed open skies agreements with the US in 1995; in 1996 Swissair, Austrian Airlines Sabena and Delta Air Lines were granted antitrust immunity by the US authorities. A full Open Skies deal was signed by the French and US government in Oct 2001, which enabled the Air France-Delta alliance to be granted antitrust immunity: see Chang and Williams, *op cit*, n 59. In Fennes' view, the US 'opens skies policy and its twin arrangement, the enticing bait of antitrust immunity, represents one of the most important breakthroughs in changing the international regulatory framework of commercial air transport ...': see

The European Commission's approach to a proposed alliance has been to investigate its effect on competition by considering market shares on the relevant routes as well as legal and/or practical barriers to entry by potential competitors. Alliances have often been permitted to proceed subject to remedies. The types of remedies ordered by the Commission in order to mitigate the potential negative effects on competition have included:

- (i) freezing or reducing frequencies on the routes in question;
- (ii) constraints on fare reductions for the services offered by the parties to make it more difficult for them to engage in anti-competitive pricing strategies;
- (iii) parties agreeing to allow would-be competitors access to their frequent flyer programs and airport slots, as well as allowing competitors to interline with the parties;
- (iv) relaxation of bilateral constraints by governments in order to allow competition; and
- (v) wider remedies such as undertakings from the airlines not to offer volume related discounts or bonus commissions.⁷²

The welfare and competition effects of alliances and code-sharing have been intensely studied.⁷³ Amongst the oft cited benefits are that alliances offer more extensive networks where partners are complementary resulting in decreased costs and fares, and better quality of service. However, they also raise competition concerns on routes where partners are competitors as this reduces competition and may preclude competitors from entering the markets served by alliances. While on some routes there is strong competition between alliances, this is not the case in every instance. On some routes, a particular alliance might be the only operator and competitors face too high

Fennes, 'The European Community and the United States: expanding horizons and clipped wings', European Air Law Association, Eleventh Annual Conference in Lisbon, 5 November 1991.

⁷² Balfour examines in detail the Commission's decisions on the Lufthansa / SAS alliance in 1996, the KLM / Alitalia alliance in 1999, the Lufthansa / Austrian Airlines alliance in 2002, the British Airways / SN Brussels Airlines cooperation agreement in 2003, as well as three transatlantic alliances for which investigations stretched from 1996 to 2002. See Balfour, *op cit*, n 66.

⁷³ The literature analyzing the effects of these cooperation agreements is extensive and includes Bilotkach, 'Price competition between international airline alliances' (2005) 39(2) *Journal of Transport Economics and Policy* 167; Brueckner, 'International airfares in the age of alliances: the effects of codesharing and antitrust immunity' (2003) 85(1) *The Review of Economics and Statistics* 105; Brueckner and Whalen 'The price effects of international airline alliances' (2000) 43(2) *Journal of Law and Economics* 503; Clougherty, 'Globalization and the autonomy of domestic competition policy: an empirical test on the world airline industry' (2001) 32(3) *Journal of International Business Studies* 459; Hassin and Shy, 'Code-sharing agreements and interconnections in markets for international flights' (2004) 12(3) *Review of International Economics* 337; Oum, 'Key Aspects of Global Strategic Alliances and the Impacts on the Future of Air Canada and other Canadian Air Carriers' (2001) Research paper commissioned by the Canada Transportation Act Review; Park and Zhang, 'An empirical analysis of global airline alliances: cases in North Atlantic markets' (2000) 16 *Review of Industrial Organization* 367; and Whalen, 'A panel data analysis of code sharing, antitrust immunity and open skies treaties in international aviation markets' (2007) 30(1) *Review of Industrial Organization* 39.

hurdles to have any chance to access such markets. Recently, increasing public concern in the US over the possible anticompetitive effects of international airline alliances prompted a congressman to propose legislation in February 2009 that calls for a federal government study of alliances and the antitrust immunity they receive.⁷⁴

3.3 The Future: Competition Policy for Imperfect Aviation Markets

3.3.1. EU revises block exemption for IATA conferences

In 2005, the European Commissioner for Competition made a proposal to lift the exemption for IATA passenger tariff conferences which allows members to discuss interlining prices for scheduled passenger flights.⁷⁵ This was followed in July 2006 by the US DOT proposal to revoke long standing antitrust immunity held by the IATA to set passenger and cargo prices for US-Europe and US-Australia flights, claiming the growth of airline alliances has made the pricing conferences unnecessary.⁷⁶ Competition authorities argued that the growth of international aviation alliances has enhanced competition, lowered fares and offered consumers more choices, making it difficult to justify a continuation of the exemption.

In October 2006, European Commission acted decisively to revoke the exemption IATA passenger tariff conferences have enjoyed in phases.⁷⁷ For routes within EU, tariff conferences ceased to be exempt from January 2007, for routes between the EU and the US and Australia, from June 2007 and routes between EU and other non-EU countries, from October 2007. To prolong the exemption for routes to non-EU countries, IATA will have to provide data to the commission showing that IATA interlining continues to benefit consumers. The new regulation also ended the block exemption for IATA slots and scheduling conferences. Since the EC decision, Australia's ACCC has also ended immunity for IATA tariff conferences at the end of June 2008 for markets to and from Australia.

3.3.2. US-EU Open Skies

The success of domestic deregulation of airlines in the US and the EU naturally led to considerations for 'Open Skies' between Europe and the US. The US had negotiated bilateral 'Open Skies' agreements with several individual European governments in the 1990s. However about 10 EU Member States including Britain, which account for

⁷⁴ Legislation introduced by Rep. James Oberstar, H.R. 831, 'A Bill to Ensure Adequate Airline Competition Between the United States and Europe', 3 February 2009. Its provisions have since been attached to the Federal Aviation Administration (FAA) Reauthorization Bill.

⁷⁵ Commission's Discussion paper on Regulation 1617/93 (IATA Tariff and Slot Conferences) may be viewed at the Commission's website at: <http://ec.europa.eu/competition/antitrust/others/air_transport.html>.

⁷⁶ See US DOT proposal at the agency's website: <<http://www.dot.gov/affairs/dot7506.htm>>.

⁷⁷ Commission Regulation 1459/2006, OJ 2006 L272/3. See European Commission. 'Competition: Commission revises Block Exemption for IATA passenger tariff conferences' (2 Oct 2006) IP/06/1294, Brussels.

about half of all EU-US traffic, had not signed Open Skies agreements with the US.⁷⁸ One outcome was the failed merger of KLM and British Airways in 2000 because of the risk of jeopardizing routes to US under the bilateral treaties.

The European Commission had argued throughout the 1990s that the bilateral Open Skies Agreements between US and individual member states resulted in fragmentation of Europe's common aviation market and therefore infringed EU law. On 5 November 2002, the European Court of Justice made a landmark decision that declared the then existing national bilateral treaties illegal.⁷⁹ With the uncertainty hanging over the bilateral treaties, the European Commission was given the mandate it had long sought to begin negotiations for an open aviation area with the US in 2003. The US-EU aviation pact⁸⁰ that was finally announced in March 2007 (for open skies from March 2008) ended the 'dangerous legal uncertainty that has clouded transatlantic aviation for five years'. It is expected to result in cheaper flights that will boost transatlantic traffic by 50% or 26 million passengers a year within five years as well as trigger further consolidation of EU airlines through mergers.⁸¹

Under the pact, European and American airlines can fly any route between any European city in the 27-nation bloc and one city in the US. However, while US carriers can operate services between European countries, European airlines will not be allowed to fly from city to city within the US. Restrictions on foreign investment in US airlines remain. Second stage talks have begun in May 2008 and are aimed at opening up the US domestic market and at easing current ownership restrictions on foreign investment in US airlines. The most significant outcome of the pact has been to open up access to London's Heathrow Airport which had previously limited rights to fly between US and Heathrow to four carriers (British Airways, Virgin Atlantic, United Airlines and American Airlines).

The landmark US-EU Open Skies deal has prompted discussion of airspace liberalization in Japan⁸² as well as within ASEAN.⁸³ The US and China have also begun discussions on a US-China open skies deal.⁸⁴ The pace of liberalization has however been painfully slow, with governments having to weigh the benefits of traffic growth

⁷⁸ Robyn, Reitzes and Moselle, 'Beyond Open Skies: The Economic Impact of a US-EU Open Aviation Area', in Hamilton and Quinlan (eds), *Deep Integration: How Transatlantic Markets are Leading Globalization*, Johns Hopkins University Center for Transatlantic Relations, Washington, D.C. and Centre for European Policy Studies, Brussels, 2005.

⁷⁹ Judgments of the Court, in Case C-466/98 *Commission v UK* [2002] ECR I-9427; Case C-467/98 *Commission v Denmark* [2002] ECR I-9519; Case C-468/98 *Commission v Sweden* [2002] ECR I-9575; Case C-469/98 *Commission v Finland* [2002] ECR I-9627; Case C-471/98 *Commission v Belgium* [2002] ECR I-9681; Case C-472/98 *Commission v Luxembourg* [2002] ECR I-9741; Case C-475/98 *Commission v Austria* [2002] ECR I-9797; and Case C-476/98 *Commission v Germany* [2002] ECR I-9855.

⁸⁰ EC-US Air Transport Agreement, OJ 2007, C301 E/143.

⁸¹ 'EU agrees US open skies deal', *The Financial Times*, 23 March 2007.

⁸² 'Japan in open skies airport access push', *The Financial Times*, 31 March - 1 April 2007.

⁸³ 'ASEAN Open Skies seen to gain momentum this year', *The Inquirer*, 9 April 2007.

⁸⁴ 'US presses China for Open Skies deal', *The Straits Times*, 14 April 2007.

against threats to the commercial interests of their own country's carriers. National carriers in many instances, fearful of foreign competition, continue to lobby fiercely for the protection of their own interests.

4. CONCLUSION: THE ABANDONED OCEANS AND CONTESTED SKIES

Despite the international liner shipping and aviation sectors being key infrastructure providers for global trade and mobility, competition in these two sectors is a fairly recent phenomenon. The two sectors have presented different kinds of challenges to antitrust and competition authorities, generating numerous studies both for as well as against their exemption from competition laws. Beginning in the late 1970s, the US was the first mover to deregulate the airlines sector and to introduce reforms in the regulation of the international shipping sector -- which have resulted in greater competition and lower prices in both sectors. In 2006, the EU adopted a tougher stance by becoming the first jurisdiction to remove exemption for IATA passenger tariff conferences from 2007 and for liner shipping conferences from 2008. Other forms of cooperative agreements in both sectors however continue to receive favourable treatment under competition laws worldwide.

Gibson and Donovan⁸⁵ have highlighted the increasing comparative disadvantage of the US, first, in shipbuilding and, later, in operating a US flag foreign going merchant marine fleet. The exemption of the shipping conferences from antitrust law for most of the previous century helped to preserve an industry that was in obvious decline, that is, until the passage of the OSRA in 1998. Reitzes and Sheran have argued that this policy change to favour shippers over carriers was 'not unexpected, given the general importance of international trade to US businesses and the further diminution in the already small number of US flag carriers. The two largest US flag carriers, American President Lines and Sealand, have been acquired by foreign-owned carriers (Neptune Orient Line in 1997 and Maersk in 1999, respectively) in recent years.'⁸⁶ As a result, the industry structure of international shipping has become increasingly concentrated through acquisitions and mergers even as freight rates have declined with increased competition.

While many nations have chosen to follow the US lead in abandoning national flag carriers for the oceans, the international skies remain a contested domain, greatly distorted by an arcane web of restrictive national aviation policies. Immunity for cooperation between airlines through ASAs, code sharing and alliances continues to be justified and justifiable as a result of market distorting regulations: foreign ownership restrictions that obstruct efficiency enhancing cross-border mergers and acquisitions, state aids for national carriers, bilaterally negotiated air rights, as well as restrictions to airport access. The spread of the 1970s US innovation, the low cost carrier, to other

⁸⁵ Gibson and Donovan, *The Abandoned Ocean: A History of United States Maritime Policy*, Columbia, University of South Carolina Press, 2000.

⁸⁶ See Reitzes and Sheran, *op cit*, n 16, at p 56.

regions of the world (only) in the past decade, has certainly benefited passengers greatly. The terms of the recent US-EU Open Skies agreement however illustrate that restrictions on substantial foreign ownership of airlines and on domestic flights by foreign-owned airlines within the US remain obstacles in the liberalization process.

The international transport sectors, with their network characteristics, continue to pose challenges to national competition policy which must be tailored to deal effectively with their unique characteristics - not so much in terms of traditional concerns of competitive prices and abuse of dominance but, rather, conflicting national interests, especially with regard to foreign ownership and air rights. Even as the international shipping sector consolidates and adjust to the full application of competition law in the EU, there will be greater convergence of competition policy in the airline sector, albeit at a pace that continues to leave much to be desired. The clear desirability for international harmonization and compatible regulatory approaches to reduce the potential for conflicting application of competition laws is apparent. Proposals for 'an integrated international policy position, leading to the eventual establishment of an independent supranational airline regulation authority' are not new.⁸⁷ While this will be beneficial globally, national agendas and local conditions differ. The uncertain distribution of benefits causes one to be sceptical that we will be able to witness the establishment of such a supranational airline regulation authority in the near future.⁸⁸

⁸⁷ Round and Findlay, 'Competition policy in international airline markets: an agenda and a proposed solution', presentation at 17th International ECMT/OECD Symposium on Transport Economics and Policy, Berlin, 25-27 October 2006.

⁸⁸ This scepticism is shared at the general level by Guzman, 'Is international antitrust possible?' (1998) 73 *New York University Law Review* 1501. Guzman suggests that negotiations on antitrust policy be combined with negotiations of other issues as concessions in other areas of negotiations may be necessary to compensate countries that will suffer a loss under a cooperative antitrust policy.