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The Third Package of Liberalization in the European Air Transport Sector: Shying Away from Full Liberalization

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TABLE OF CONTENTS

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I. INTRODUCTION

The creation of a Single European Market for the air transport sector in the European Community (EC) is viewed by many as one of the most difficult challenges before the EC, and is indicative of the commitment of the member states to a Europe without frontiers.[1] The liberalization of the EC air transport sector has made significant developments toward a free market approach within the last seven years. Compromise between a wide variety of diverse and conflicting interests[2] has allowed the EC to move away from the old regime of air transport characterized by nationally subsidized carriers which engaged in restrictive and discriminatory practices.[3] This inefficient and anti-competitive environment has now given way to a more competitive and lean marketplace from which passengers enjoy lower fares and a greater variety of services.[4]

The pace of these liberalization efforts has been tempered by the desire of the community to avoid the rather severe consequences which the U.S. had suffered as a result of its rapid deregulation approach in the

1. *Liberalization Creates EC Single Airline Market*, AV. WK. & SPACE TECH., Jan. 18, 1993 at 39 (discussing the Third Package, its potential impact on the EC air transport sector, and the remaining problems which need to be addressed in this sector).

2. Paul S. Dempsey, *European Aviation Regulation: Flying Through the Liberalization Labyrinth*, 15 B.C. INT'L & COMP. L. REV. 311, 311-14 (1992) [hereinafter *Labyrinth*]. *See also Europe's Air Cartel*, THE ECONOMIST, Nov. 1, 1986, at 23.

3. Stacy K. Weinberg, *Liberalization of Air Transport: Time for the EEC to Unfasten Its Seatbelt*, 12 U. PA. J. INT'L BUS. L. 433, 433-39 (1991) [hereinafter *Seatbelt*].

4. *Id.* at 433. *See* Andreas Kark, *Prospects for the Liberalization of the European Air Transport Industry: A Study of Commercial Air Transport Policy for the European Community*, 10 E.C.L.R. 377, 382-387 (1989) [hereinafter *Prospects*]; *Air-Fare War Erupts as EC Opens Its Skies*, THE WALL ST. J., Dec. 31, 1992, at A4 (describing the KLM initiation of price cuts of up to 50%, which were quickly matched by British Airways and SAS).

late 1970's.[5] EC air transport liberalization has been gradually implemented through the adoption of three separate Packages of legislation over a period of five years, with the delivery of the First Package in 1987, the Second Package in 1990, and the Third Package in 1992 coinciding with the Single European Act's general goal of achieving a Europe without frontiers.[6] The Third and final package was expected to move the air transport sector towards a more fully liberated market by loosening up many of the constraints which inhibit European airline competition.[7]

The Third Package, however, is a far cry from the full potential of liberalization in the EC air transport sector even when one considers the short time frame of implementation and the unique circumstances in Europe such as national subsidization of air carriers and high operating costs. The Third Package is disappointing in many respects, such as the significant discretion it leaves in the hands of the Member States, the numerous exceptions from the competition rules allowed to Member States, and the failure to address subsidies, full cabotage rights, and domestic transport policy.[8] Although the EC embraces a gradual implementation of air transport liberalization, this latest package appears to be the product of a watered-down political compromise which balks at the prospect of moving towards the full liberalization potential of the air transport sector.[9]

This paper will focus on the Third Package of liberalization regulations in the EC air transport sector, its potential effects and abuses, and the obstacles which remain to the development of free competition in the air transport sector. In particular, the focus will be on market access to routes and slots, air fares, and the anti-competitive practices which concern them. Although computer reservation systems and ground handling

5. Civil Aviation Memorandum No. 2, Progress Towards the Development of Community Air Transport Policy, COM(84)72 final [hereinafter Memorandum 2].

6. *See generally* Ben Van Houtte, *Community Competition Law in the Air Transport Sector (I)*, 18 AIR & SPACE LAW 61 (1993) [hereinafter *Community Competition (I)*]; Ben Van Houtte, *Community Competition Law in the Air Transport Sector (II)*, 18 AIR & SPACE LAW 275 (1993) [hereinafter *Community Competition (II)*]; For an in depth review of pre-Third Package liberalization efforts in the EC air transport sector, *see also Labyrinth, supra* note 2.

7. *Labyrinth, supra* note 2, at 366-67. *See Seatbelt*, supra note 3, at 444; Werner F. Ebke and Georg W. Wenglorz, *Liberalizing Scheduled Air Transport Within the European Community: From the First Phase to the Second and Beyond*, 19 DEN. J. INT'L L. & POL'Y 493, 527 (1991).

8. *See generally*, Berend J.H. Crans, *EC Aviation Scene*, 17 AIR & SPACE LAW 217 (1992); *Delayed, Again: European Airline Deregulation*, THE ECONOMIST, Jun. 27, 1992, at 78 [hereinafter *Delayed, Again*]; *EC Ministers Approve Liberalization, But 'Safeguards' May Slow Competition*, AV. WK. & SPACE TECH., Jun. 29, 1992 at 21 [hereinafter *Safeguards*].

9. *See* Crans, *supra* note 8, at 223. *But cf.* Ronald Schmid, *Air Transport within the European Single Market - How will it look after 1992?*, 17 AIR & SPACE LAW 199, 204 (1992) (discussing the opposite view that existing European airlines must be protected from the rigors of a free marketplace during the liberalization process).

significantly affect the ability of an airline to effectively compete, these issues will not be discussed in this paper. Part II provides a brief overview of the major liberalization milestones prior to the Third Package, from the Treaty of Rome to the Second Package. Part III examines the regulations of the Third Package, its impact on the air transport sector, and its shortcomings. Part IV discusses the various obstacles which remain to free competition in the EC air transport sector, and also suggests some possible solutions to these problems. The Conclusion summarizes by noting that the Third Package is generally a disappointment in its failure to fully move the EC air transport sector toward a free Single European Market and that future efforts are needed if the potential of full liberalization is to be realized.

II. Pre-Third Package Liberalization Efforts

After World War II, nationally owned and operated air carriers, known as flag carriers, comprised the overwhelming majority of the airline industry in Europe.[10] European nations negotiated with each other for route access and tariffs in a highly restrictive fashion through the use of bilateral agreements, resulting in a complex network of such agreements covering Western Europe.[11] Despite the signing of the Treaty of Rome in 1957,[12] which was intended to promote the establishment of a common market among member states, the air transport sector went virtually unchanged until the late seventies and eighties when active efforts of the Commission and the European Court of Justice (ECJ) eventually led to the Council's adoption of the First Package of liberalization in 1987.[13] A brief overview of these early liberalization efforts and of the First and Second Packages of liberalization is necessary for a more thorough understanding of the Third Package and its implications for the EC air transport industry.

A. The Treaty of Rome

The Treaty of Rome is effectively the basic constitution of the EC, the central purpose of which is to create an economically efficient market and to restrict anti-competitive behavior among Member States.[14] Article (3)(e) of the Treaty specifically provides for "the adoption of a common policy in the sphere of transport."[15] Title IV of the Treaty provides

10. *Flying the Flag*, The Economist, Jun. 12, 1993, at 16.
11. *Id.*
12. Treaty Establishing the European Economic Community, Jan. 1, 1958, 298 U.N.T.S. 11 (1958) [hereinafter EEC Treaty or Treaty of Rome].
13. Ebke and Wenglorz, *supra* note 7, at 493-494.
14. Treaty of Rome, *supra* note 12, art. 3.
15. *Id.* art. 3(e).

articles for the implementation of a common transport policy; however, the application of provisions under these articles to air transport was left to the discretion of the Council.[16] Although the Council had the power under these articles to create a common air transport policy, it was not until 1983 that the Council acted on this power. This delay of some twenty-five years is due to the political nature of the Council which consists of representatives from each Member State and from the fact that the Member States' views on common air transport policy significantly differed.[17]

Over time, the inaction of the Council became glaringly apparent and the question soon arose whether the general competition rules[18] of the Treaty of Rome applied to the air transport sector regardless of the Council's failure to act towards a common air transport policy. Articles 85 and 86 of the Treaty prohibit anti-competitive activities within the EC and were included by the drafters to achieve efficient economic integration of the community.[19] In 1962, the Council adopted Regulation 17[20] which implemented articles 85 and 86 of the Treaty, however, the scope of the regulation excluded the air transport sector.[21] Both the Commission and the ECJ actively expressed their view that the competition rules of articles 85 and 86 applied to the air transport sector.

B. Liberalization Efforts by the Commission and the ECJ

The Commission, which unlike the Council is a non-partisan body, believed that a common market should be achieved as soon as practically possible in keeping with the spirit of the Treaty of Rome. The Commission reasoned that the air transport sector was subject to the Treaty's gen-

16. *Id.* art. 84(2). Article 84(2) reads: The Council, acting by means of a unanimous vote, may decide whether, to what extent and by what procedure appropriate provisions may be adopted for sea and air transport.

17. Ebke and Wenglorz, *supra* note 7, at 502.

18. Treaty of Rome, *supra* note 12, art. 85, 86. Article 85(1) generally prohibits as incompatible with the common market agreements and concerted practices which may affect trade between Member States and have as their object or effect the prevention, restriction, or distortion of competition within the common market.

Article 85(2) states that those agreements or practices prohibited by 85(1) are void.

Article 85(3) provides for exceptions to the application of this rule if the agreement or concerted practice is one which improves production or economic progress and benefits consumers, and which:

a) impose only those restriction on the parties concerned which are necessary, and

b) do not eliminate competition.

Article 86 generally prohibits the abuse of a dominant position within the common market so far as it may affect trade between Member States.

19. *Labyrinth supra* note 2, at 327.

20. Council Regulation 17/62, 1962 O.J. 204.

21. Council Regulation 141/62 1962 O.J. 2753. *See* N. Argyris, *The EEC Rules of Competition and the Air Transport Sector*, 26 Common. Mkt. L. Rev. 5, 6 (1989).

eral competition rules unless the Treaty otherwise provided, and that the Treaty did not otherwise provide that the air transport sector was exempt.[22]

An active ECJ played the pivotal role in the eventual acceptance by the Council that the competition rules of the Treaty applied to the air transport industry. In a series of critical cases, the ECJ actively demonstrated its commitment to the creation a common market, even when this commitment was directly contrary to the meaning and intent of the articles of the Treaty.[23] In the French Seamen's case, the Court held that the general rules of the Treaty, including competition rules, do apply to transport despite article 84(2) which provides that the Council is to decide whether and to what extent provisions are to apply to air transport.[24]

In 1979, the Commission drafted a proposal to the Council stating their position that the competition rules of the Treaty of Rome applied to the air transport industry.[25] This First Memorandum suggested that the Council regulate scheduled inter-regional air services. After modifications by the Council which effectively prohibited access for new airline services on established routes, the First Memorandum was not further acted on.

By 1983, the Parliament had grown tired of waiting for the Council to act on the Commission's proposals relating to a common air transport policy and brought suit against the Council before the ECJ for failing to act.[26] In deciding this case, the Court not only allowed the admissibility of a suit for failure to act, but more importantly held that the Council had indeed failed in its duty to provide a common transport policy.[27]

Meanwhile, in 1984 the Commission issued a Second Memorandum to the Council[28] in which it proposed a more realistic, gradual approach to liberalization.[29] The Commission suggested maintaining the bilateral

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22. Argyris, *supra* note 21, at 8.

23. *See generally* David Mazzarella, *The Integration of Aviation Law in the EC: Teleological Jurisprudence and the European Court of Justice*, 20 TRANSP. L.J. 353 (1992).

> The perspective that is most important to our understanding . . . is that the court decides cases to further the broader purposes of the Treaty of Rome. Instead of seeking to objectively apply the positive law, the Court views itself as an actor in the attainment of the Treaty's goals, namely the establishment of the Common Market. *Id.* at 368.

24. *Labyrinth*, *supra* note 2, at 335. Case 167/73, Commission of the European Communities v. France, 1974 E.C.R. 359.

25. *Air Transport: A Community Approach*, BULL. EUR. COMM. Supp. 5/79 (Memorandum of the Commission) [hereinafter First Memorandum].

26. Case 13/83, European Parliament v. Council of the European Communities, 1985 E.C.R. 1513 [hereinafter Transport Policy Decision].

27. *Id. See also Labyrinth*, *supra* note 2, at 337.

28. Memorandum 2, *supra* note 5.

29. The term 'liberalization' is used instead of 'deregulation' because of the general intent of the Commission to liberate the air transport sector gradually from its traditional national restraints rather than a complete and immediate U.S. style deregulation toward a free market

agreement structure within the EC and providing unified regulations within this structure in order to liberate the air transport sector. The Commission also suggested that revenue sharing, restrictions on routes, and limits on air fares be eliminated from the current structure, and that block exemptions from the competition rules of article 85(1) be granted in these areas during a period of adjustment.[30]

It was not until the ECJ's famous *Nouvelles Frontieres* case that the Court held articles 85 and 86 of the Treaty directly applicable to the air transport industry.[31] The Court held that absent specific regulations governing air transport adopted by the Council under article 87 of the Treaty, articles 85 and 86 could be applied in particular instances by a competent authority of a Member State,[32] or by a reasoned decision on the matter by the Commission.[33] Either of these methods for enforcing articles 85 and 86 against an air carrier engaging in anti-competitive practices could result in a floodgate of litigation brought by aggrieved consumers and travel agents in the national courts of the Member States.[34]

In 1986, the Commission itself took direct action against ten EC airlines for anti-competitive practices by utilizing the Court's holding in *Nouvelles Frontieres*.[35] This action placed considerable pressure on the airlines concerned to enter into discussions with the Commission because of the potential for substantial exposure to law suits from passengers and travel agents.[36] The airlines capitulated to the Commission's threat of a reasoned decision and agreed to mild reforms concerning price fixing, revenue and capacity pooling agreements and slot allocation.[37] These reforms, however, did not come close to approaching the level of liberalization that the Commission sought in its Second Memorandum to the Council.[38] The Commission continued to hold the threat of a reasoned decision over the heads of the EC airlines in an effort to enforce their agreement, and this threat effectively applied pressure on the Council to adopt uniform regulations for the application of the Treaty's competition rules to the air transport sector.[39]

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and the severely negative U.S. style results which this method brings (i.e. bankruptcies, dominant mega-carriers, etc.).

30. Memorandum 2, *supra* note 5. *See Labyrinth*, *supra* note 2, at 342-349.

31. Cases 209-213/84, Ministere Public v. Asjes (Nouvelles Frontieres), 1986 E.C.R. 1425.

32. Treaty of Rome, *supra* note 12, art. 88.

33. Treaty of Rome, *supra* note 12, art. 89. *See Labyrinth*, *supra* note 2, at 339.

34. *See Labyrinth*, *supra* note 2, at 339.

35. Ebke and Wenglorz, *supra* note 7, at 509 (these airlines included Air France, Aer Lingus, Alitalia, British Airways, British Caledonian, KLM, Deutsche Lufthansa, Olympic, Sabena, and SAS); Argyris, *supra* note 19, at 10-11.

36. *See Labyrinth*, *supra* note 2, at 350; *See also* Kark, *supra* note 4, at 403.

37. *See Labyrinth*, *supra* note 2, at 351-352.

38. *Id.*

39. Argyris, *supra* note 21, at 11.

C. The First Package of Air Transport Liberalization

Although the recent holdings of the ECJ and the Commission's threat of action against the EC airlines for anti-competitive behavior placed pressure on the Council to consider and implement the proposals of the Second Memorandum, the Council remained unable to reach a necessary consensus on the application of the competition rules to the air transport sector due to divergent interests and viewpoints of the individual Member States.[40] In 1986, however, the very goals of the EC were significantly changed by the adoption of the Single European Act (SEA) which accelerated the date for achieving a Single European Market without frontiers to 1992.[41] The SEA not only provided for the establishment of a Single European Market for air transport,[42] but also changed the voting requirements for decisions concerning the establishment of a single market for air transport from unanimous voting to qualified majority voting.[43] Free of the shackles of unanimous voting and still under pressure from the Commission and ECJ, the stage was set for the Council to take action towards the achievement of a unified market in the air transport sector.

Due to these factors and an increasingly competitive market in the EC, the Council finally adopted the First Package of liberalization in the air transport sector in December 1987.[44] This package, provided for a transition to a more liberalized air transport regime in an attempt to meet the SEA deadline of 1992 for a unified internal market.[45] The scope of this First Package extends only to flights between Member States and not to domestic flights within a Member State or to flights between a Member State and a non-EC country. Specifically, this package is comprised of: (1) application of the competition rules of the Treaty of Rome, articles 85 and 86, to the air transport sector,[46] (2) application of the article 85(3) exemption provision to the air transport sector[47] and the block exemptions adopted thereunder,[48] (3) rules concerning scheduled air

40. *See Labyrinth*, *supra* note 2, at 351.

41. Single European Act, Feb. 28, 1986, 1987 O.J. (L169) 1 (effective July 1, 1987) [hereinafter SEA].

42. *See Id.* art. 13.

43. *See supra* note 41, art. 13. The political significance of this change in voting method was critical to breaking the deadlock in the Council which is comprised of a representative from each Member State. No longer can a single or minority group of Member States render the Council immobile to act on air transport legislation.

44. 1987 O.J. (L374) 1-25 (December 14, 1987 agreement on the first package of liberalization).

45. *Id.*

46. Council Regulation 3975/87, 1987 O.J. (L 374) 1.

47. Council Regulation 3976/87, 1987 O.J. (L 374) 9.

48. Commission Regulation 2671/88, 1988 O.J. (L 239) 9 (block exemptions for airline agreements concerning capacity, revenue pooling, air fares, and slot allocations); Commission

fares,[49] and (4) rules concerning capacity sharing and market access.[50] Each of these components of the First Package are briefly discussed below.

1. Application of the Competition Rules

Regulation 3975/87 provides detailed rules for the application of articles 85 and 86 to the air transport industry. The regulation allows exemptions from these rules for certain technical agreements between airlines which improve the operation and efficiency of the air carriers if they provide a benefit to consumers and do not have restrictive practices as their objective or effect.[51] The regulation also gives the Commission the jurisdiction to hear complaints of article 85(1) and 86 violations by Member States or natural persons with a legitimate interest, and to levy fines against violating enterprises.[52]

2. Group Exemptions to the Competition Rules

Regulation 3976/87 applies article 85(3) which provides for the establishment of group exemptions from the application of the competition rules of Regulation 3975/87. This regulation gives the Commission the power to exempt certain types of agreements in the air transport industry from the competition rules.[53] These group exemptions may be subject to certain conditions[54] which, if not met, may result in the revocation of the exemptions or in the imposition of a fine.[55] The Commission immediately acted on its newly granted power and adopted three regulations creating block exemptions for airline agreements, computer reservation systems, and ground handling to allow for a transitional period in order to facilitate the development of competition.[56]

Regulation 2672/88, 1988 O.J. (L 239) 13 (block exemptions for computer reservation systems); Commission Regulation 2673/88, 1988 O.J. (L 239) 17 (block exemptions for ground handling services).

49. Council Directive 87/601, 1987 O.J. (L 374) 12.

50. Council Decision 87/602, 1987 O.J. (L 374) 19.

51. *See* David Banowsky, *Cutting Drag and Increasing Lift: How Well Will a More Competitive EEC Air Transport Industry Fly?*, 24 INT'L LAW. 179, 189-190 (1990); *See generally* Council Regulation 3975/87, *supra* note 46.

52. Council Regulation 3975/87, *supra* note 46; *Labyrinth*, *supra* note 2, at 361.

53. Council Regulation 3976/87, *supra* note 47, art. 2. (Agreements which may be exempted include capacity and revenue sharing, rates, slot allocations, computer reservation systems (CRS), and ground handling).

54. *Id.* art. 2(3).

55. *Id.* art. 7.

56. *See generally* Commission Regulations 2671/88, 2672/88 and 2673/88, *supra* note 48.

a. The Airline Agreements Block Exemption Regulation

Commission Regulation 2671/88, like the other two block exemption regulations, provided broad exemptions until January 1, 1991, thereby giving substantial protection to then existing airlines.[57] Regulation 2671/88 grants exemptions for airline agreements concerning capacity sharing, revenue pooling, tariff (air fare) consultations, and slot allocations.[58] Capacity limitation agreements must provide a satisfactory spread of service over the less busy periods, cannot result in anti-competitive market segmentation, and must allow the airlines involved the freedom to vary their capacity and schedules and to withdraw without penalty on short notice.[59]

Revenue pooling agreements under 2671/88 require that the less favorably scheduled air carrier receive a transfer of revenue which cannot exceed 1 percent of the total revenue, and that the transfer be fixed prior to the offering of the service.[60] Additionally, each carrier must be free to vary the capacity offered.[61]

Tariff (air fare) consultations under Regulation 2671/88 must be voluntary and non-binding on the participants, and must be open to the observers from the Commission, Member States, and airlines on the routes concerned.[62] The consultations must be limited to the definition and construction of airline tariffs only, and cannot discuss capacity limitations or travel agent compensation. The rates must not discriminate on the basis of nationality or residence of passengers and the airlines must be free to offer other rates.[63]

Slot allocation agreements must, under 2671/88, be open for participation to all interested carriers and the slot allocation rules must be clearly defined and fairly applied, and must not base priority rules on the identity of an airline.[64]

b. The Computer Reservation System (CRS) Block Exemption Regulation

Regulation 2672/88[65] grants exemptions for CRS agreements, but provides for certain conditions to insure competition in an essentially oligopolistic CRS market. Subscribers, usually other airlines and travel

57. *See, e.g.*, Commission Regulation 2671/88, *supra* note 48, art. 8; *see also* Ebke and Wenglorz, *supra* note 7, at 511.

58. Commission Regulation 2671/88, *supra* note 48.

59. *Labyrinth*, *supra* note 2, at 362; Argyris, *supra* note 21, at 25.

60. Argyris, *supra* note 21, at 26.

61. *Id.* at 26.

62. *Labyrinth*, *supra* note 2, at 362; Argyris, *supra* note 21, at 28.

63. *Labyrinth*, *supra* note 2, at 362; Argyris, *supra* note 21, at 28.

64. *Labyrinth*, *supra* note 2, at 363; Argyris, *supra* note 21, at 29.

65. Commission Regulation 2672/88, *supra* note 48.

agents, must be free to add, drop, or switch systems on short notice without penalty, and CRS vendors must not partition the market.[66] Additionally, a CRS must neutrally display the flights of airlines seeking access to the system, and airline commissions paid to travel agents may not be based on the volume of bookings made in the system in which the airline has an economic interest.[67]

c. The Ground Handling Block Exemption Regulation

Regulation 2673/88[68] grants exemptions for ground handling agreements on conditions that purchasers of such services are free to switch or add other suppliers on short notice, and that the rates for such services not be discriminatory based on the identity of any airline.[69]

3. Air Fare Rules

Council Directive 87/601[70] provides rules for proper authorities of the Member States to approve of fares. Fares may be approved if they are reasonably related to the long term, fully allocated costs of the carrier and cannot be disapproved on the grounds that the proposed rate is lower than that offered by another carrier on that route.[71] In addition, the directive establishes two pricing zones within which carriers may set their prices freely without government restriction.[72]

4. Capacity Sharing and Market Access Rules

Council Decision 87/602 provides rules to liberalize market access and capacity sharing.[73] Instead of the usual bilateral agreement capacity limitation on a given route of a 50:50 ratio, the Decision initially allows airlines to increase or decrease their capacity by 5 percent, and as of October 1, 1989, the Directive allows another 5 percent variation for up to a 60:40 ratio.[74]

Decision 87/602 also allows Member States to have the right of multiple designations, which allows the Member State to appoint more than one carrier to a given bilateral route if that route has a required minimum

66. *See* Banowsky, *supra* note 51, at 191-92.
67. *Labyrinth*, *supra* note 2, at 363.
68. Commission Regulation 2673/88, *supra* note 48.
69. *Labyrinth*, *supra* note 2, at 363; Argyris, *supra* note 21, at 31-32.
70. Council Directive 87/601, *supra* note 49.
71. *Id.* at art. 3.
72. *Labyrinth*, *supra* note 2, at 359; Ebke and Wenglorz, *supra* note 7, at 511-12; Council Directive 87/601, *supra* note 49, at art. 5. The two zones established are: (1) the Discount Zone, which extends from 90% to 65% of the referenced fare, (a one way non-restricted more than fare), (2) the Deep Discount Zone, which runs from 65% down to 45% of the referenced fare.
73. Council Decision 87/602, *supra* note 50.
74. *Id.* art. 3; Ebke and Wenglorz, *supra* note 7, at 512.

number of passengers.[75] The Decision also allows Community carriers to establish flights between major airports in their home country and regional airports in another Member State.[76]

Most importantly, Decision 87/602 allows Community carriers to engage in Fifth Freedom rights[77] so long as the first or last airport of the flight route is within the home country of the carrier and so long as there is at least one regional airport involved.[78]

5. Summary

Although the First Package was intended to be the first step in a process of liberalization of the air transport industry, the reforms had little overall effect on the development of competition, especially in the area of air fares. Given the broad scope of the block exemptions, this result should not be surprising as the existing airlines remained fairly protected from increased competition.[79] On the other hand, the application of the competition rules to the air transport sector and the creation of limited Fifth Freedom rights demonstrated a willingness of the Member States to change.[80]

D. The Ahmed Saeed Case

In 1989, the ECJ again took an activist position when it held in the Ahmed Saeed[81] case that the competition rules of the Treaty of Rome directly applied to the air transport sector, and that the competition rules applied to all EC air transport flights, whether domestic, inter-EC, or between a Member State and a non-EC country, although the method of application will be different depending on the type of flight and the type of violation.[82]

The Court held that article 85(1) could be applied to domestic flights and flights between a Member State and a non-EC country under articles 88 and 89 as laid out in *Nouvelle Frontieres*.[83] Most importantly, the Court held that the abuse of dominant position provisions of article 86

75. Council Decision 87/602, *supra* note 50, at art. 5(2).

76. *Id.* art. 6(1).

77. Fifth Freedom rights are the rights of a Member State's carrier to pick up passengers in another Member State and transport them to/from a third Member State.

78. Council Decision 87/602, *supra* note 50, at art. 8(1). (the capacity of the Fifth Freedom flight service must not exceed 30% of the carrier's capacity on any given route).

79. Ebke and Wenglorz, *supra* note 7, at 513.

80. *See Seatbelt*, *supra* note 3, at 441.

81. Case 66/86, Ahmed Saeed Flugreisen et al. v. Zentale zur Bekampfung unlauteren Wettbewerbs e.V., 1989 E.C.R. 838.

82. *See generally* Ebke and Wenglorz, *supra* note 7, at 513-19.

83. *Id.* at 515; R. Strivens and E. Wieghtman, *The Air Transport Sector and the EEC Competition Rules in Light of the Ahmed Saeed Case*, 10 ECLR 557, 562-63 (1989).

also apply across the board to all types of flights, and that the Commission as well as member states could enforce article 86 directly, despite the lack of secondary Community law applying article 86 to domestic and EC-external flights.[84]

Lastly, the Court held that, in light of its rulings on the application of articles 85 and 86 to all types of flights, a Member State violates its obligations under articles 5 and 90(1) when it approves of air fares that are contrary to articles 85 or 86, as determined by the rules of Regulation 2671/88 and Directive 87/601 of the First Package.[85]

The import of this holding is that the Member States must apply the air fare approval system of the First Package in their bilateral agreements with non-EC countries, and that the Member States must also apply these approval procedures for all inter-EC and domestic flights unless new rules and/or exemptions are provided for air fares on these type of flights.[86]

E. The Second Package of Air Transport Liberalization

In light of the moderate impact of the First Package on the air transport sector and the pressure to achieve a unified internal market in air transport by 1993, the Council agreed to act upon recent Commission proposals and adopted a Second Package of liberalization in June of 1990. This package consists of three Council Regulations,[87] two of which effectively replace Directive 87/601 and Decision 87/602 of the First Package, and the third of which merely changes the effective dates in Council Regulation 3976/87 and will therefore not be discussed. Later, in December, 1990, the Commission adopted three Regulations which replace and/or modify the block exemption Regulations 2671/88, 2672/88, and 2673/88 of the First Package.[88] Of these, only the new airline agreements block exemption will be discussed as the other two are merely modifications of the effective dates corresponding to the First Package block exemptions.

84. *See* Ebke and Wenglorz, *supra* note 7, at 515-16; Strivens and Wieghtman, *supra* note 83, at 563-64.

85. *See* Ebke and Wenglorz, *supra* note 7, at 516; Strivens and Wieghtman, *supra* note 83, at 564.

86. *See* Ebke and Wenglorz, *supra* note 7, at 517; Strivens and Wieghtman, *supra* note 83, at 565.

87. Council Regulation 2342/90, 1990 O.J. (L 217) 1 (air fares); Council Regulation 2343/90, 1990 O.J. (L 217) 8 (market access and capacity sharing); Council Regulation 2344/90, 1990 O.J. (L 217) 15 (amending Council Regulation 3976/87 of the First Package).

88. Commission Regulation 82/91, 1991 O.J. (L 10) 1 (amending application dates of Commission Regulation 2673/88: ground handling block exemption); Commission Regulation 83/91, 1991 O.J. (L 10) 3 (amending application dates of Commission Regulation 2672/88: CRS block exemption); Commission Regulation 84/91, 1991 O.J. (L 10) 5 (replacing Commission Regulation 2671/88: airline agreements block exemption - slot allocation agreements exempted).

1. Council Regulation 2342/90 on Air Fares

Regulation 2342/90[89] replaced Council Directive 87/601 and brought significant liberalization changes to the rules for approval and the range of approvable air fares from those of the First Package.[90] The regulation applied only to flights within the EC, and as a regulation it directly bound Member States, unlike a Directive. These significant changes are discussed below.

a. Air Fare Competition

The ability for Community air carriers to introduce lower fares on existing routes was extended in the Second Package to conditional Fifth Freedom rights under the condition that the Fifth Freedom air fares fall within the flexibility zones.[91]

b. Flexibility Zones: Automatic Approval

Like the rules of the First Package, any proposed air fare falling within the flexibility zones is required to be approved by the Member State.[92] The important difference is that an additional normal economy fare zone was added, the discount and deep discount zones were extended, and the flexibility zones now apply to third, fourth and fifth freedom air carriers. The new economy zone extends from 105 to 94 percent of the referenced air fare, the discount zone now extends from 94 to 80 percent of the reference air fare (as opposed to the old 90 to 65 percent), and the deep discount zone now includes any air fare within 79 to 30 percent of the referenced air fare (as opposed to the old 65 to 45 percent).[93] Prerequisite travel restrictions for discount zone tickets that were allowed in the First Package have been significantly removed, however the discount zone is now 11 percent smaller in range.[94]

c. Double Disapproval

When an air fare is above 105 percent of the referenced air fare the new double disapproval system applies.[95] If both Member States concerned do not reject the fare within 30 days of application for approval, the fare shall be considered approved. This disapproval method will probably not be used frequently because it only applies to extremely high

89. Council Regulation 2342/90, *supra* note 87.
90. *See* Ebke and Wenglorz, *supra* note 7, at 517.
91. Council Regulation 2342/90, *supra* note 87, art. 3(6).
92. *Id.* art. 4(3).
93. *Id.*
94. *Id.*
95. *Id.* art. 4(4).

fares.[96]

d. Double Approval

The double approval system applies to fares below the lowest flexibility zone since all other fares fall under either the flexibility zone automatic approval or the double disapproval methods.[97] A proposed fare shall require approval by both interested states. If neither of the states has expressed disapproval within 21 days of the fare's submission, the fare shall be considered approved.[98] The practical difference between this method and the double disapproval method is that only one Member State may prevent the approval of the air fare in the double approval method.

e. Investigation and Consultation/Arbitration

Regulation 2342/90 obliges the Commission to investigate any air fare not within the flexibility zones upon the request of a Member State with a reasonable interest in the route in question.[99] The Commission must decide within 14 days if the air fare is to remain in effect pending the decision, and must make a final decision within two months of the request as to whether the proposed fare is unjustifiably high, or is a form of dumping to the detriment of competition on that route.[100] A Member State affected by the Commission's decision may appeal to the Council within one month.[101] When one Member State rejects an air fare below the flexibility zones under the double approval system, consultation and arbitration procedures are provided to resolve the dispute.[102]

2. Council Regulation 2343/90 on Market Access and Capacity Sharing

Regulation 2343/90 replaced Council Decision 87/602 of the First Package and brought significant liberalization changes to market access and capacity growth.[103] These changes are briefly reviewed below.

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96. *Id.*
97. *Id.* art. 4(5).
98. *Id.*
99. *Id.* at art. 5(1).
100. *Id.* at art. 5(1),(2),(3).
101. *Id.* at art. 5(5). Note that the airlines themselves do not have the right to request a Commission review of an air fare or an appeal of a Commission decision to the Council. Only the Member States themselves have these rights which suggests that they will be used primarily for the protection of flag carriers.
102. *Id.* at art. 6.
103. Council Regulation 2343/90, *supra* note 87.

a. Increased Market Access and Reciprocity

The new regulation grants air carriers third and fourth freedom rights to any airport in the Community,[104] subject to reciprocity of the Member State of the air carrier concerned to allow airlines of another Member State third and fourth freedom routes on the same route.[105] The reciprocity requirement may disadvantage a large air carrier's ability to gain access to routes to other Member States because of its inability to provide reciprocal slots at its airport for the other Member States.[106] Correspondingly, the smaller air carriers at less busy airports may be advantaged in using their ability to grant reciprocal slots to gain access to slot tight airports in other Member States.[107]

b. Public Service Obligations and New Regional Routes

The regulation provides that a Member State may impose a public service obligation on a Community air carrier operating within that State to provide a service to a regional airport which is necessary for the economic development of that region.[108] The reciprocity requirement will not apply for a period of two years to a new route being serviced by air carriers of a Member State with aircraft of 80 seats or less, unless the requesting air carrier also intends to operate with aircraft of the same capacity.[109] This provision has the effect of protecting small carriers on new regional routes from larger air carriers for at least two years.

c. Multiple Designations Allowed

The regulation requires Member States to accept multiple designations[110] on a country-pair basis.[111] In addition, Member States must accept multiple designations on a city-pair basis if minimum route capacity thresholds are met.[112] This provision opens the door for routes which

104. *Id.* at art. 4, 5(1).

105. *Id.* at art. 5(2).

106. *See* Ebke and Wenglorz, *supra* note 7, at 523.

107. *Id.*

108. Council Regulation 2343/90, *supra* note 87, at art. 5(3).

109. *Id.* at art. 5(4).

110. *See* Council Regulation 2343/90, *supra* note 87, at art. 2(h). (A multiple designation on a country-pair basis is the designation by a Member State of more than one air carrier to operate scheduled air services between it and another Member State, and multiple designation on a city-pair basis is the same except that the scheduled services may be between an airport or airport system in the home Member State and an airport or airport system of another Member State. The city-pair basis simply provides for the selection of the airports of another Member State which multiple carriers may service.)

111. *Id.* at art. 6(1).

112. *Id.* at art. 6(2). (The route capacity threshold until Jan. 1, 1992 is either 140,000 passengers or more than 800 return flights per year, after which the threshold is lowered to 100,000 passengers or more than 600 return flights per year.)

have been traditionally limited to a single air carrier of another Member State to other air carriers of that State.

d. Fifth Freedom Rights

Fifth Freedom rights are granted by the regulation conditioned on the requirements that an airport in the servicing air carrier's home State is one of the airports involved in the triangular service between the three concerned Member States and the Fifth Freedom service capacity does not exceed 50 percent of the capacity of the third or fourth freedom service involved.[113]

e. Market Access Exceptions

The regulation provides for significant exceptions which a Member State may use to deny market access. The denial or limitation of access to routes in a Member State may be based on Community, national, regional, or local rules relating to safety, the protection of the environment, and the allocation of slots, or may be based on insufficient airport facilities or navigational aids to accommodate the service.[114]

f. Capacity Increases

Community air carriers may now increase their capacity from the 60:40 ratio allowed under the First Package by 7.5 percent a season.[115] The regulation abolishes capacity sharing limitations on services between regional airports[116] and further states that provisions shall be adopted to abolish capacity sharing restrictions by Member States by 1992.[117] A Member State may request the Commission to limit the capacity growth of an airline if this growth has led to serious financial damage for the air carriers licensed by that State.[118]

3. Commission Regulation 84/91: Fares, Capacity, and Slot Access Block Exemptions

Regulation 84/91[119] replaces the block exemption regulation 2671/88 of the First Package, and is essentially the same except for the addition of an exemption from article 85(3) of the Treaty of Rome for the allocation of slots. The exemption requires that the consultations on slot allocation are open to all interested air carriers and that the rules of priority are

113. *Id.* at art. 8(1).
114. *Id.* at art. 10(1).
115. *Id.* at art. 11(1).
116. *Id.* at art. 11(3).
117. *Id.* at art. 11(2).
118. *Id.* at art. 12(1).
119. Commission Regulation 84/91, *supra* note 88.

established without relation to carrier identity; however, these rules may take account of grandfather rights of an air carrier to previously used slots.[120] In an attempt to assist new entrants,[121] the exemption requires that they be given priority in the allocation of 50 percent of the newly created or unused slots. However, a new entrant may be limited to a maximum of four slots per day.[122]

4. Summary of Second Package

The Second Package of liberalization considerably advanced the EC air transport system towards the goal of a more competitive market in the areas of air fare approval, route and slot access, and capacity growth. However, many obstacles remain to free competition, especially for new entrants. The discretion and exceptions to the rules provided for Member States, the limited Fifth Freedom rights, the lack of cabotage rights, and the restrictive slot allocation procedures continue to allow distortion of competition in the air transport sector. It should be remembered, however, that the second package was intended to be an interim step in the gradual process of liberalization which was to be finalized by the end of 1992 via the expected Third Package.[123]

III. The Third Package Of Liberalization

In June of 1992, the Council adopted the Third Package[124] of air transport liberalization measures which became effective on January 1, 1993 in an attempt to meet the goal of a Single European Market by the end of 1992. This package consists of a Licensing Regulation, a new Route Access Regulation which replaces 2343/90 of the Second Package, and a new Air Fares and Rates Regulation which replaces 2342/90 of the Second Package.[125]

Of additional importance is the adoption in June 1993 of Commission Regulation 1617/93,[126] a block exemption for airline agreements concerning schedules, joint operations, tariffs and slot allocation. Regulation 1617/93 replaces block exemption Regulation 84/91 of the Second Pack-

120. *Id.* at art. 4(1).

121. *See Id.* at art. 4(1)(e). (A new entrant is defined as an air carrier with less than four slots on a given day and requesting more, or an air carrier holding not more than 30 percent of all slots on a day at an airport or airport system and requesting more for use on a route which no more than two other carriers are exercising third or fourth freedom rights.)

122. *Id.*

123. *See* Ebke and Wenglorz, *supra* note 7, at 527.

124. Council Regulations No. 2407/92 on licensing of community air carriers, 1992 O.J. (L 240) 1, No. 2408/92 on access to intra-community air routes, 1992 O.J. (L 240) 8, and No. 2409/92 on fares and rates for air services, 1992 O.J. (L 240) 15.

125. *Id.*

126. Commission Regulation 1617/93 O.J. 1993 (L 155) 18.

age. Lastly and very importantly, the Council adopted Regulation 95/93 in January 1993 which provides common rules for the allocation of slots, an issue which has traditionally been a thorny problem in the EC air transport sector.[127] These regulations will be treated as part of the Third Package for purposes of this paper. They are discussed below, in addition to the three basic Third Package regulations mentioned above. The Third Package regulations on Computer Reservation Systems and Ground Handling will not be discussed in this paper.

A. The Licensing Regulation

The Third Package introduces, for the first time in EC history, a common licensing scheme for community carriers.[128] This Licensing Regulation provides common requirements for the issuance and withdrawal of operating licenses by Member States to air carriers established in the community.[129] The regulation provides superior and exclusive rules for the granting of operating licenses, and air carriers meeting its requirements shall be granted an operating license by the concerned Member State.[130] The general focus of the regulation's requirements are on the financial fitness of the air carrier, both short and long term. Each of the significant requirements of the regulation will be discussed below.

1. Community Ownership

A Member State may not grant an operating license to an undertaking unless its principal place of business is located in that Member State and it main occupation is air transport.[131] Community ownership requires not only majority ownership by Member States and/or nationals of Member States, but also requires that such Member States or nationals shall at all times, effectively control the undertaking.[132] A grandfather provision provides that airlines with outside control that have previously been recognized as community carriers may continue to be considered as such as long as those in control of the carrier at the time of adoption of

127. Council Regulation 95/93 O.J. 1993 (L 14) 1.
128. Council Regulation No. 2407/92, *supra* note 124.
129. *Id.* at art. 1(1).
130. *Id.* at art. 3.
131. *Id.* at art. 4(1).
132. *Id.* at art. 4(2); *Id.* art. 2(g) provides:
'Effective control' means a relationship constituted by rights, contracts, or any other means which, either separately or jointly and having regard to the considerations of fact or law involved, confer the possibility of directly or indirectly exercising a decisive influence on an undertaking, in particular by:
(a) the right to use all or part of the assets of an undertaking;
(b) rights or contracts which confer a decisive influence on the composition, voting or decisions of the bodies of an undertaking or otherwise confer a decisive influence on the running of the business of the undertaking.

the Licensing Regulation remain in control.[133] Some commentators have suggested that the effective control requirement is not clear and may be used as a tool by Member States to withdraw licenses.[134] This standard will also tend to limit investments, mergers, and cooperative agreements between community carriers and non-EC airlines and therefore may put EC carriers at a disadvantage in a globally competitive market.

2. *Demonstration of Financial Fitness*

The financial fitness requirements are the most significant provisions of the Licensing Regulation. Air carriers applying for an operating license for the first time must, by a submitted business plan, demonstrate to the reasonable satisfaction of the competent authorities of the licensing Member State that it can meet its financial obligations for the next two years, and that it can meet its fixed and operational costs for the next three months without income.[135] This requirement raises several concerns, the most obvious of which is the discretion placed in the authorities of the Member State via the reasonable satisfaction standard. This discretion may be easily abused to protect the Member State's national airlines, and even if not abused, it is difficult to believe that a carrier will be able to predict its future air fare revenues with any certainty considering the increasingly competitive market.

Existing license holders must notify their licensing authorities: in advance of any changes in new scheduled service or a non-scheduled service to a continent or world region not previously serviced, of changes in type

133. *Id.* at art. 4(3); Council Regulation 2343/90, *supra* note 87, Annex I (the airlines so recognized are Scandinavian Airlines System, Britannia Airways, and Monarch Airlines).

134. *See* Crans, *supra* note 8, at 218.

135. Council Regulation No. 2407/92, *supra* note 124, art. 5(1), (2); *id.* Annex:

A. Information to be provided by a first time applicant from a financial fitness point of view.

1. The most recent internal management accounts and, if available, audited accounts for the previous financial year.

2. A projected balance sheet, including profit and loss account, for the following two years.

3. The basis for projected expenditure and income figures on such items as fuel, fares and rates, salaries, maintenance, depreciation, exchange rate fluctuations, airport charges, insurance, etc. traffic/revenue forecasts.

4. Details of the start-up costs incurred in the period from submission of application to commencement of operations and an explanation of how it is proposed to finance these costs.

5. Details of existing and projected sources of finance.

6. Details of shareholders, including nationality and type of shares to be held, and the Articles of Association. If part of a group of undertakings, information of the relationship between them.

7. Projected cash-flow statements and liquidity plans for the first two years of operation.

8. Details of the financing of aircraft purchase/leasing including, in the case of leasing, the terms and conditions of the contract.

or number of aircraft, of change in scale of activities, of intended mergers or acquisitions, and change of ownership of ten percent or more.[136] If the licensing authority finds that these changes have a significant bearing on the air carrier's finances, it shall require the carrier to submit a revised business plan incorporating these changes and covering one year after the changes are to go into effect in order to determine if the carrier can then meet its existing and potential obligations. The authority shall then issue a decision based on the revised plan, within three months of its submission.[137] What does this mean? Can an authority reject the change in business plan, and if so, even if done in good faith, is it wise to have a Member State second guessing the business strategy of every air carrier it licenses? This provision does not provide a clear standard by which the authority is to determine whether or not the carrier in question will be able to meet its obligations in the future, nor does it provide any indication of what action the authority is to take if they make this determination. Once again, the possibility for abuse of discretion by the Member State in order to protect its own airline is present.[138]

The Regulation also allows the licensing authorities to suspend or revoke a carrier's license if they believe that the carrier can no longer meet its obligations for a twelve month period due to financial problems. However, a temporary license may be granted pending financial restructuring of the carrier as long as safety is not at risk.[139] If the carrier is under insolvency proceedings, the Member State is not allowed to let the carrier retain its operating license if the competent authority of the Member State is convinced that the carrier cannot be satisfactorily restructured within a reasonable time.[140] This rule also raises the possibility of

136. *Id.* at art. 5(3).

137. *Id.* at art. 5(4); *Id.* Annex:

B. Information to be provided for assessment of the continuing financial fitness of existing license holders planning a change in their structures or in their activities with a significant bearing on their finances.

1. If necessary, the most recent internal management balance sheet and audited accounts for the previous financial year.

2. Precise details of all proposed changes e.g. change of type of service, proposed takeover or merger, modifications in share capital, changes in shareholders, etc.

3. A projected balance sheet, with a profit and loss account, for the current financial year, including all proposed changes in structure or activities with a significant bearing on finances.

4. Past and projected expenditure and income figures on such items as fuel, fares and rates, salaries, maintenance, depreciation, exchange rate fluctuations, airport charges, insurance, etc. traffic/revenue forecasts.

5. Cash flow statements and liquidity plans for the following year, including all proposed changes in structure or activities with a significant bearing on finances.

6. Details of the finances of aircraft purchase/leasing including, in the case of leasing, the terms and conditions of the contract.

138. *See* Crans, *supra* note 8, at 219.

139. Council Regulation No. 2407/92, *supra* note 124, art. 5(5).

140. *Id.* at art. 12.

abuse by the Member State, especially during recessionary periods. Smaller carriers encountering temporary difficulties may be unnecessarily grounded by authorities of a Member State if such action is beneficial to the Member State's flag carrier.[141]

In addition, existing airlines must submit annual audited accounts and information relevant to their continuing financial fitness at the request of the licensing authority.[142] These financial fitness criteria generally do not apply to small air carriers which operate aircraft of less than ten tons and/or less than twenty seats and whose net capital is at least 80,000 ECU. However, the financial fitness criteria will apply if the carrier operates scheduled services or has a turnover which exceeds 3 million ECU per year.[143] It is not clear if this means that such small air carriers are exempt from the criteria only if they operate non-scheduled services.

The financial fitness criteria of this regulation may provide a useful tool to the Commission to ensure that start-up carriers have sufficient capital for the first few months, however, the ability to base a rational decision on projected earnings in a volatile market, the competence of the Member State's authorities to second guess business strategies, and the potential for abuse of the substantial discretion left to the Member States in order to protect their flag carriers significantly detracts from any benefit these criteria provide. A Member State's decision refusing an operating license under these rules may be reviewed by the Commission upon referral by a concerned air carrier,[144] but as long as the Member State acted within the discretion provided by the rules, it is doubtful that the Commission would overturn the decision.

3. *Aircraft Financing and Safety Standards*

As for the ownership of aircraft, the Licensing Regulation only requires that an air carrier have at least one aircraft at its disposal, either through ownership or lease agreement.[145] Possession of a valid Air Oper-

141. *See* Crans, *supra* note 8, at 219.

142. Council Regulation No. 2407/92, *supra* note 124, art. 5(6); *id.* Annex:

C. Information to be provided for assessment of the continuing financial fitness of existing license holders.

1. Audited accounts not later than six months after the end of the relevant period and, if necessary, the most recent internal management balance sheet.

2. A projected balance sheet, including profit and loss account, for the forthcoming year.

3. Past and projected expenditure and income figures on such items as fuel, fares and rates, salaries, maintenance, depreciation, exchange rate fluctuations, airport charges, insurance, etc. traffic/revenue forecasts.

4. Cash flow statements and liquidity plans for the following year.

143. *Id.* art. 5(7).

144. *Id.* art. 13(3).

145. *Id.* art. 8(1).

ator's Certificate,[146] issued in compliance with a Council Regulation on the matter, is a prerequisite to obtaining an operating license.[147] For purposes of safety, the leasing of aircraft, with or without crew, to another air carrier shall be approved by the appropriate licensing authority and the conditions of the approval shall be made part of the lease.[148] The aircraft used by the air carrier shall, at the option of the Member State, be registered in either the Member State's national register or within the community.[149] Registration of leased aircraft in the Member State shall not be required if doing so would require structural changes to the aircraft, and registration requirements may be waived in the event of a short-term lease to meet temporary needs of an air carrier.[150]

4. Grandfather Clause and License Duration

Article 16 of the Licensing Regulation provides that operating licenses in force at the time that the regulation goes into effect shall remain valid for one year, during which the carrier shall make arrangements to conform with the requirements of the regulation.[151] The operating license, approved by a Member State, shall be valid as long as the air carrier meets the obligations of the Licensing Regulation, but Member States may impose an annual review for a new license and every five years thereafter.[152] If an air carrier has not operated in six months, or has not commenced operations six months after the granting of its license, the Member State may require the carrier to resubmit the license for approval.[153] Member States may also require a carrier to resubmit its operating license if there has been a change of ownership. If there has been a change in ownership, the license shall remain valid unless the licensing authority decides that safety is at risk.[154]

B. The Route Access Regulation

The Route Access Regulation[155] is the centerpiece of the Third Package, and is the product of the Council's attempt to create freedom for community air carriers within the entire community, a goal consistent

146. *Id.* art. 2(d) (defining 'air operator's certificate' as a document by the competent authorities of a Member State affirming that the carrier has the ability to secure the safe operation of the aircraft for the activities specified in the certificate).
147. *Id.* art. 9.
148. *Id.* art. 10.
149. *Id.* art. 8(2)(a).
150. *Id.* art. 8(2)(b), 8(4).
151. *Id.* art. 16.
152. *Id.* art. 11(1).
153. *Id.* art. 11(2).
154. *Id.* art. 11(3).
155. Council Regulation No. 2408/92, *supra* note 124.

with the concept of a Single European Market by 1992. Achieving this goal in the air transport sector, however, is overly ambitious considering the short time frame and the unique aspects of the air transport market in the EC. As a result, full cabotage and domestic flights are excluded from the application of these regulations until April 1, 1997. In addition there are several escape mechanisms which allow Member States to avoid application of the rules in certain situations. The significant provisions of the Route Access Regulation are discussed below.

1. Full Freedom Community Traffic Rights and Cabotage Limitation

The Route Access Regulation grants full third, fourth, and fifth freedom rights to community carriers for intra-community routes.[156] Until April 1, 1997, cabotage rights are granted on the conditions that they must be an extension of a flight from/to the home state of the carrier, and the capacity of the cabotage service does not exceed 50 percent of the capacity of the service which the cabotage is an extension of.[157] In addition, Member States may regulate access to domestic routes for air carriers licensed by it until April 1, 1997.[158]

2. Public Service Obligation

Similar to the Second Package, the Route Access Regulation allows Member States to impose a public service obligation to peripheral or development regions, or on thin routes to regional airports in order to provide sufficient air services.[159] If no air carrier has commenced to undertake service on a route under the public service obligation, a Member State may grant one carrier, selected from submissions to tender, an exclusive right to operate the route for up to three years.[160] This exclusive right to operate a public service route shall not apply when another concerned Member State proposes satisfactory alternative means of fulfilling the same public service obligation, or where other forms of transport will provide adequate and uninterrupted service when the capacity offered exceeds 30,000 seats per year.[161] In most of Europe, adequate alternative transport would probably be rail service. The Commission shall investigate, at the request of a Member State, or on its own, to determine if the public service obligation is unduly restricting development of the route.[162]

156. *Id.* art. 3(1).
157. *Id.* art. 3(2).
158. *Id.* art. 3(4).
159. *Id.* art. 4(1).
160. *Id.* art. 4(1)(d).
161. *Id.* art. 4(1)(k), 4(2).
162. *Id.* art. 4(3).

3. Domestic Exclusive Route Grandfather Rights and New Regional Route Protection

Where domestic routes were operated under an exclusive concession by law or contract at the time of application of the Route Access Regulation, and where other forms of transportation are not equally adequate, such exclusive concession may continue until it expires or for three years, whichever comes first.[163] In addition, a Member State may deny access for two years to other carriers to a regional route started by a carrier licensed by it if the aircraft has no more than 80 seats and the total capacity does not exceed 30,000 seats per year, unless the other carrier operates the route with not more than 80 seats available for sale per flight.[164] The Commission may investigate such a situation to determine if development of the route is being unduly restricted.[165]

4. Traffic Distribution, Operational Rules, and Traffic Right Limitations

Of all the provisions in the Route Access Regulation, those in Articles 8 and 9 are the most interesting in that they allow significant methods by which a Member State may place restrictions on route access. First, a Member State may regulate, without discrimination on grounds of nationality or identity of the aircraft carrier, the distribution of traffic between airports within an airport system.[166] This may significantly impact the efficiency of operations for an air carrier operating at an airport system if the carrier is forced to operate at a more expensive or less desirable airport within the system. Second, traffic rights are subject to published community, national, regional, and local operational rules relating to safety, the environment, and the allocation of slots.[167] The application of national, regional, and local rules in these areas allows discretion to the Member States which may be abused for the benefit of flag carriers or those airlines licensed in a particular Member State. The Commission may investigate the applications of these provisions at the request of a Member State or on its own initiative, and a Member State may refer the Commission's decision to the Council.[168] Why cannot an air carrier itself request investigation by the Commission or appeal the Commission's decision? Air carriers competing with the Member State's flag carrier may be prevented from avoiding a restrictive limitation under these provisions.

163. *Id.* at art. 5. *See* note 155
164. *Id.* at art. 6(1).
165. *Id.* at art. 6(2).
166. *Id.* at art. 8(1).
167. *Id.* at art. 8(2).
168. *Id.* at art. 8(3), B(4).

In addition, a Member State may place restrictions on, or even deny, the exercise of traffic rights when serious congestion or environmental problems exist, especially when other modes of transport can provide adequate service.[169] Actions taken for these reasons shall be non-discriminatory, be valid for no more than three years, not unduly affect the objectives of this regulation, not unduly distort competition between air carriers, and not be more restrictive than necessary.[170] Even with these safeguards, it seems highly probable that a Member State may be able to restrict or deny access to carriers for the benefit of its flag carrier, especially if sufficient rail services exist between the home state of the disfavored carrier and the Member State in question. The Commission, on its own or by request from a Member State, may investigate such restrictions and shall indicate if the restrictions may be implemented during the investigation period.[171] Although a Member State may refer the Commission's decision to the Council,[172] an air carrier itself may not.

Lastly, a Member State shall not authorize an air carrier to start a new service or increase a pre-existing service between one of its airports and that of another Member State if an air carrier of the other Member State has been denied similar growth at the airport in question because of slot allocation rules.[173] This rule is to apply pending the implementation of a Council Regulation on common slot allocation rules.[174] In this respect, airlines operating from congested airports are at a significant disadvantage to increase services to airports of other Member States if they are unable to reciprocate slots.

5. *Capacity Limitations*

Capacity limitation agreements between air carriers are effectively prohibited by the Route Access Regulation,[175] however, a notable and questionable exception is provided. If the lack of capacity limitations has led to serious financial damage to air carriers licensed by a Member State. The State may request the Commission review the situation, and on the basis of many factors, including whether the opportunities of air carriers of that Member State to effectively compete are unduly affected, the Commission may decide to stabilize the capacity for scheduled air services to and from that state.[176] Any Member State may refer the Commis-

169. *Id.* at art. 9(1).
170. *Id.* at art. 9(2).
171. *Id.* at art. 9(4).
172. *Id.* at art. 9(6).
173. *Id.* at art. 9(8).
174. Council Regulation 95/93, *supra* note 127.
175. Council Regulation No. 2408/92, *supra* note 124, art. 10(1).
176. *Id.* at art. 10(2).

sion's decision to the Council for review.[177] The term 'unduly affected' is very ambiguous and does not provide a clear standard. Does this mean that if the air carriers of a Member State are inefficient and suffer loss because of competition that capacity restrictions may be re-introduced to the market? If competition is not allowed to force inefficient carriers to become lean and efficient or get out of the marketplace, then what will? Additionally, the inability of an air carrier itself to request review of the Commission's decision places it at the mercy of its licensing Member State. After all, what good are rights if one cannot be heard before they are taken away?

In summary, the Route Access Regulation brings the air transport sector much closer to the goal of an open market than any of the previous packages, but it also allows much discretion to Member States and has the potential for abusive and protectionist practices. In addition, access to full cabotage rights and domestic routes are left to be worked out in 1997.

C. The Air Fare Regulation

The Air Fare Regulation[178] includes one of the more interesting surprises of the Third Package in that the double disapproval and the double approval methods of the Second Package are completely done away. With the stated purpose of allowing air fares to be determined freely by market forces, the Council leaves the fares to be set by the air carriers.[179] The Council recognized, however, that this freedom must be complemented with appropriate safeguards for the interests of consumers and industry, and therefore provided the Member States with the limited ability to reject air fares.

1. Setting Air Fares and Filing Requirements

The new regulation does not apply to non-community air carriers or to public service obligations. Only community air carriers (c.a.c.'s) may introduce new products or lower fares for existing, identical products.[180] Charter fares and cargo fares are set by free agreement of the contracting parties,[181] and all c.a.c.'s must inform the public of air fares and cargo rates.[182] Member States may require that air carriers file new air fares with them not more than 24 hours before the fare takes effect.[183] Until

177. *Id.* at art. 10(3).
178. Council Regulation No. 2409/92, *supra* note 124.
179. *Id.* at art. 5(1).
180. *Id.* at art. 1.
181. *Id.* at art. 3.
182. *Id.* at art. 4.
183. *Id.* at art. 5(2).

April 1, 1997, a Member State may require that air fares on domestic routes, where no more than one carrier or a joint operation of two carriers licensed by that Member State operate, be filed more than one working day but no more than one month before the air fares come into effect.[184]

2. Member State Disapproval

A concerned Member State may at any time withdraw a basic fare[185] which is excessively high to the disadvantage of users in relation to the long term fully allocated relevant costs of the air carrier, including a satisfactory return.[186] A Member State may also decide at any time to stop further fare decreases on a route or group of routes when market forces have led to sustained downward development of air fares deviating significantly from ordinary seasonal price fluctuations and resulting in widespread losses among all air carriers concerned when taking into account their long term fully allocated relevant costs.[187] A Member State deciding to act under these provisions must notify the Commission and all other Member States and air carriers involved. If after fourteen days, neither Member State or the Commission disagrees, the Member State deciding to take such action may implement it.[188] In the case of a disagreement, any Member State involved may require consultations within 14 days to review the situation,[189] but the regulation does not state what the effect of these consultations shall be, especially in the case where no agreement is reached.

3. Commission Review

The Commission may, at the request of an invovled Member State, examine the decision of another Member State to withdraw an excessively high basic fare or stop further fare decreases.[190] Note that an interested air carrier may not itself request that a Member State's decision be examined by the Commission. The Commission may, however, upon a complaint by an interested air carrier, investigate whether certain air fares are either excessively high or result in sustained downward development of air fares under the provisions above.[191] Again, a Member State

184. *Id.* at art. 5(3).
185. *Id.* at art. 2(k). (defining a basic fare as "the lowest fully flexible fare, available on a one way and return basis, which is offered for sale at least to the same extent as that of any other fully flexible fare offered on the same air service").
186. *Id.* at art. 6(1)(a).
187. *Id.* at art. 6(1)(b).
188. *Id.* at art. 6(2), (3).
189. *Id.* at art. 6(4).
190. *Id.* at art. 7(1).
191. *Id.* at art. 7(2).

concerned, but not an air carrier, may refer the Commission's decision to the Council for review.[192] The bottom line of these review procedures is that an air carrier may use the Commission review process offensively against other carrier's fares, but may not use such review process defensively to defend against either a Member State's action or a Commission action against that air carrier's own fares. Unless another concerned Member State decides to defend an air carrier from such action, the carrier is vulnerable to the discretion of a Member State and of the Commission. This vulnerability suggests that political purposes and agenda, such as flag carrier protectionism, may be advanced through such actions.[193]

D. The Airline Agreement Block Exemptions Regulation

The new block exemptions regulation for airline agreements supersedes Commission Regulation 84/91 of the Second Package and provides exemptions from art. 85(1) of the Treaty of Rome for air carrier agreements concerning the joint planning of schedules, joint operations, tariff consultations, and slot allocations.[194] The Second Package regulation's exemption for agreements on joint planning and coordination of capacity have been done away with in the new regulation.

The exemption for agreements on the joint planning of schedules requires that such agreements must be intended to ensure the satisfactory supply of air services and must facilitate interlining.[195] The agreement must not limit or share capacity, prevent any of the involved parties from introducing additional services, prevent quick withdrawal of either party from the agreement, or seek to influence the schedules of other air carriers on the referenced route.[196]

The exemption for agreements on joint operations only applies if the costs and revenues of the operating air carrier are shared, and there has been no direct air service on that route during the previous year or the capacity on the route of the joint operation does not exceed 30,000 seats per year.[197] In addition, the operating air service must not offer a capacity, besides that of the joint operation, of more than 90,000 seats per year at one of the airports involved in the joint operation, nor must the community revenues of the operating carrier exceed ECU 400 million per year.[198] Finally, the joint operation must not prevent the air carriers in-

192. *Id.* at art. 7(8).

193. *See* Crans, *supra* note 8, at 223.

194. Commission Regulation 1617/93, *supra* note 126.

195. *Id.* at art. 2.

196. *Id.*

197. *Id.* at art. 3 (the capacity limitation is raised to 60,000 seats per year for routes longer than 750 km. on which there is at most a twice daily direct air service).

198. *Id.* at art. 3(c), (d).

volved from operating additional air services with independent fares, capacity, and schedules, must not exceed three years and must allow either party to terminate the agreement with less than three months notice.[199]

Tariff consultations may be exempt only if they concern the technical construction and conditions of fares and rates charged, do not concern capacity, give rise to interlining, and if the tariffs are applied without discrimination.[200] In addition, the consultations must be voluntary and open, must not be binding on the participants, and must not include agreements on agent's remuneration.[201]

Exemptions for slot allocation consultations apply only if the consultations are open to all concerned and the rules of priority are made without discrimination on the basis of carrier identity or nationality. They must also be made available to interested parties.[202] Additionally, new entrants must be allocated up to 50 percent of new or otherwise unused slots upon request, and participants in such consultations shall have access to relevant slot allocation information.[203]

The Commission may withdraw the benefit of the block exemption under this regulation if it finds that an agreement has effects which are incompatible with either art. 85(3) or 86 of the Treaty of Rome.[204] In particular, this will be the case where there is no effective price competition on a route which was the subject of tariff consultations, where an air service under joint operation is not exposed to competition by other air carriers or by other modes of adequate transportation, or where a new entrant cannot obtain sufficient slots to allow them to compete effectively with established carriers which results in the substantial impairment of competition on the routes concerned.[205]

E. The Slot Allocation Regulation

As referred to in the slot reciprocity requirement of the Route Access Regulation 2408/92,[206] the Council eventually adopted a regulation on common rules for the allocation of slots at community airports.[207] The allocation of slots at community airports has traditionally been a very sensitive issue and has provided great potential for abusive practices by Member States for the protection of their flag carriers. In adopting the

199. *Id.* at art. 3(f), (g).
200. *Id.* at art. 4.
201. *Id.* at art. 4(c)-(e).
202. *Id.* at art. 5.
203. *Id.* at art. 5(d), (e).
204. *Id.* at art. 6.
205. *Id.*
206. Council Regulation No. 2409/92, *supra* note 124, art. 9(8).
207. Council Regulation 95/93, *supra* note 127.

new slot allocation regulation, the Council recognized the necessity for non-discriminatory rules on slot allocation and also the need to provide for the introduction of new entrants into the market.[208] Generally, the requirements of this new regulation only apply to congested community airports, and the regulation itself must be reviewed for continuation by July 1, 1997.

1. Conditions for Airport Coordination

The regulation provides that a Member State may, at its discretion, designate one of its airports as a coordinated[209] airport for the purposes of allocating slots, if the coordination is done in a transparent, neutral, and non-discriminatory way.[210] A Member State must, however, designate an airport as fully coordinated[211] during periods of slot capacity shortages if, after a thorough capacity analysis with all interested parties, the capacity problems cannot be solved in the short term.[212] A Member State must conduct a thorough capacity analysis when more than half of the carriers at the airport consider the capacity insufficient for operations at certain periods, when new entrants encounter serious problems in obtaining slots, or when a Member State considers it necessary.[213] This rule provides new entrants with the ability to raise the slot allocation issue, but does not provide the same voice for existing carriers unless more than half of all carriers raise the issue. This effect could disadvantage smaller existing carriers at congested airports which are effectively dominated by flag carriers.

The Member State responsible for a coordinated or a fully coordinated airport shall ensure the appointment of a natural or legal person with sufficient knowledge of slot allocation methods as airport coordinator who shall monitor and coordinate slot allocation.[214] Note that the responsibility of a Member State to appoint the coordinator may result in a nationally biased appointment. Fully coordinated airports are also required to have a coordination committee consisting of air carriers, airport authorities, and air traffic control representatives, which shall monitor

208. *Id.*

209. *Id.* at art. 2(f) (A coordinated airport "shall mean an airport where a coordinator has been appointed to facilitate the operations of air carriers operating or intending to operate at that airport.")

210. *Id.* at art. 3(2).

211. *Id.* at art. 2(g) (A fully coordinated airport "shall mean a coordinated airport where, in order to land or take-off, during the periods for which it is fully coordinated, it is necessary for an air carrier to have a slot allocated by a coordinator.")

212. *Id.* at art. 3(3).

213. *Id.*

214. *Id.* at art. 4.

slot allocation and advise the coordinator on the allocation of slots.[215] There is no indication that the coordinator must implement any of the suggestions of this committee, nor is there any clear provision providing a remedy for the committee in such a situation.

2. Process for Slot Allocation

The slot allocation rules of the new regulation provide grandfather slot rights to carriers which have used slots in a previous equivalent scheduling period,[216] and scheduled services and programmed non-scheduled services shall have priority when all slot requests cannot be filled.[217] The coordinator shall also consider any additional priority rules established by the air carrier industry and any recommendations of the coordination committee.[218] The coordinator must also attempt to accommodate ad hoc slot requests for any type of aviation by using slots available from a pool of recently given up slots.[219]

Generally, an air carrier is free to exchange slots with another air carrier or change their use for different routes or services subject to confirmation by the coordinator that airport operations would not be prejudiced, that regional limitations of a Member State are respected, and that the change of slot use does not allow an air carrier to increase its frequency of service to the detriment of an air carrier from another Member State.[220] Slots allocated to new entrants[221] for intra-community use may not be freely exchanged by them or changed in type of use for a period of two seasons.[222] The grandfather rights and the ability to exchange slots appear to provide significant potential for abuse by large established carriers to lock up slots at congested airports.

Upon complaints concerning slot allocation, the coordination com-

215. *Id.* at art. 5.
216. *Id.* at art. 8(1)(a).
217. *Id.* at art. 8(1)(b).
218. *Id.* at art. 8(1)(c).
219. *Id.* at art. 8(3).
220. *Id.* at art. 8(4).
221. *Id.* art. 2(b) provides:
'new entrant' shall mean:
(i) an air carrier requesting slots at an airport on any day and holding or having been allocated fewer than four slots at that airport on that day, or,
(ii) an air carrier requesting slots for a non-stop service between two Community airports where at most two other air carriers operate a direct service between these airports or airport systems on that day and holding or having been allocated fewer than four slots at that airport on that day for that non-stop service.
An air carrier holding more than 3% of the total slots available on the day in question at a particular airport, or more than 2% of the total slots available on the day in question at an airport system of which that airport forms a part, shall not be considered as a new entrant at that airport.
222. *Id.* at art. 8(5).

mittee shall consider the matter and make proposals in attempt to resolve the problems. If the problems cannot be resolved, the concerned Member State may provide for mediation by an air carrier's representative organization, or other third party.[223] This mediation process is not clearly outlined, and does not provide for a result should the complaining parties not come to agreement.

Notwithstanding these slot allocation rules, a Member State may, under certain conditions, reserve certain slots at a fully coordinated airport for domestic, scheduled services on a peripheral or regional route which is considered vital to the economic development of the region under certain conditions,[224] or on public service obligation routes.[225] Note that this may often be used to the benefit of the Member State's flag carrier.

3. Slot Pools

A slot pool shall be set up at any airport where slot allocation takes place. That pool shall contain newly created slots, unused slots, and recently given up slots.[226] In addition, unused slots shall be placed into the pool unless they can be justified as provided for in the regulation. These include the grounding of an aircraft type, the closure of an airport or airspace used on that route, or other similarly exceptional cases.[227] Grandfather slot rights are limited in a similar manner. If slots allocated to an air carrier over a given period are not used at least 80 percent of the time, then the air carrier shall not be entitled to the same slots over the next equivalent period. Finally, those slots shall be placed in the slot pool.[228]

The regulation also requires that a coordination committee meeting

223. *Id.* at art. 8(7), (8).

224. *Id.* at art. 9(1)(a), providing conditions that:

(i) the slots concerned are being used on that route at the time of entry into force of this Regulation;
(ii) only one carrier is operating on the route;
(iii) no other mode of transport can provide an adequate service;
(iv) the reservation of slots shall end when a second carrier has established a domestic scheduled service on the route with the same number of frequencies as the first air carrier and operated it for at least a season. *Id.*

225. *Id.* at art. 9(1)(b).

226. *Id.* at art. 10(1).

227. *Id.* at art. 10(2).

228. *Id.* at art. 10(3)-(5). Justifiable reasons for less than 80 percent utilization of slots are limited to (1) unforeseeable and unavoidable cases outside the air carrier's control; (2) problems of a new scheduled service of no more than 80 seats on a route between a regional airport and the coordinated airport and where the capacity does not exceed 30,000 seats per year; (3) serious financial damage for a Community air carrier concerned resulting in a temporary operating license while under financial reorganization; (4) interruptions in charter services caused by tour operator cancellations provided that slot usage does not fall below 70 percent; or (5) intentional

shall be convened to examine possible remedies, if serious problems exist for new entrants.[229] However, the regulation does not provide for any action these remedies. New entrants have priority rights to 50 percent of the slots. However, this status is lost if a new entrant turns down an offer of slots which are within two hours of the time requested.[230] The loss of new entrant status could be a fatal blow to a small carrier, and since the regulation does not provide exceptions to this rule, it may operate harshly or discriminatorily.

4. *Safeguard Mechanism (Reciprocal Slot Limitation) and Third Country Problems*

An air carrier shall not be allowed to freely exchange slots or change the use of its slots in order to increase services on a route between a fully coordinated airport and another Member State if a community air carrier of another Member State, with equal or less frequency of services on that route, has not been able to obtain the slots at that airport which are necessary to increase its services on the route.[231] In such a situation, the Member State responsible for the fully coordinated airport shall attempt to facilitate an agreement between the air carriers involved.[232] A concerned Member State may request that the Commission investigate the possibility of applying this limitation, if such request is filed within two months of the time that the coordinator has been informed of an air carrier's intention to exchange or change the use of its slots.[233] Lastly, the Commission shall negotiate any slot allocation difficulties encountered by Community air carriers at the airports of non-EC third countries, the remedy for which may be limitation of slots at EC airports for air carriers of that third country.[234]

IV. Remaining Obstacles and Possible Solutions

The Third Package is far from the liberating breakthrough it was expected to be, and many significant obstacles remain before a fully liberalized EC air transport sector can be achieved. Although many of these problems are inherent in the nature of national ownership of flag carriers, many of them result from the regulations themselves or from their failure to address such problems. The gradual implementation approach em-

disruption of an air carrier's services which makes it practically or technically impossible for the air carrier to carry out operations as planned. *See id.* at art. 10(5).

229. *Id.* at art. 10(6).
230. *Id.* at art. 10(7), (8).
231. *Id.* at art. 11(1).
232. *Id.* at art. 11(2).
233. *Id.* at art. 11(3).
234. *Id.* at art. 12.

braced by the EC in the liberalization of this sector should not be used as an excuse to shy away from full liberalization. Where such efforts are feasible they should be embraced and implemented without delay unless there is justification that the effort would be catastrophic to existing airlines, and even then the desirability of protecting such non-competitive airlines should be fully examined.

A. Remaining Licensing and Start-up Obstacles

The community ownership requirements of the Licensing Regulation provides Member States with the discretion to deny an air carrier a license if a non-EC party can exercise effective control of that carrier.[235] The broad definition of effective control[236] may prevent an air carrier from entering into joint ventures with third countries[237] for fear of being accused of not having effective control and having its operating license pulled by a Member State. In today's global transport market this could seriously undermine the ability of smaller EC carriers to form alliances in order to compete with the mega-carriers. The effective control concept should be clarified and restricted to require only majority ownership by EC Member States or persons.

Another drawback of the Licensing Regulation is its financial fitness criteria.[238] Requiring a new entrant to demonstrate, to the reasonable satisfaction of the licensing Member State, that it can meet its financial obligations for the next two years, and that it can meet its fixed and operational costs for the next three months without income may prevent new entrants with marginal surplus capitalization from enterring the market. The discretion of the Member State in this regard is unacceptable and specific accounting standards for determination of financial fitness should be defined if this rule is maintained. In addition, the rule should be restricted to a requirement of sufficient funds to operate for a limited time and should not be dependent on future projections, which often tend to be inaccurate and unreliable.

A related issue is the oversight by the licensing State of any changes in operation or ownership of an existing airline.[239] A change in ownership is relevant to the continuation of a carrier's license; however, second guessing an existing airline's business strategies is ludicrous. Once an air carrier survives the initial new entrant period there is no legitimate reason for oversight other than to prevent anti-competitive practices. For a free market approach to work, carriers must be free to engage in

235. *See* text discussion *supra* part III.A.1.
236. *See supra* note 132 and accompanying text.
237. 'Third Country' is intended to mean a non-EC country.
238. *See* text discussion *supra* part III.A.2.
239. *See supra* note 137 and accompanying text.

whatever financial risk they desire, within the bounds of business law, even if this risk includes the possibility of bankruptcy. For the same reasons, the Member State is given discretion to revoke the license of a carrier which it determines cannot meet its obligations for the next year.[240] This is completely unnecessary, unless, of course, safety is at risk.

In addition to the obstacles created by the Licensing Regulation, operating costs themselves are a significant obstacle to new entrants.[241] The magnitude of such costs in the EC as compared to the United States is significantly higher due to airport and air traffic control fees, high labor costs and low labor productivity.[242] While common regulation of airport and control fees may solve part of the problem, labor costs are a thorny national problem and are not likely to be easily solved at a community level in the near future.

B. Remaining Access Obstacles

The limitation on cabotage rights of EC carriers until 1997 is the last remaining major obstacle to free access to all EC routes, and its removal should promise lower fares for all intra-EC flights.[243] Full cabotage rights will be painful for smaller domestic operators who are unprepared for the new competitive atmosphere. With this in mind, there is no reason to allow Member States to limit cabotage rights when it injures airlines licensed by them. Although similar exceptions have been adopted in the past, one hopes that such an exception will not be adopted when full cabotage is implemented in 1997.

In a related issue, the exclusion of purely domestic flights from the application of the air transport regulations will be removed in 1997.[244] The application of the common air transport rules to domestic flights is necessary to prevent discrimination against air carriers operating cabotage services and to promote lower fares on domestic routes.

The discretion allowed to Member States concerning their ability to restrict route access for airport system traffic distribution purposes and for the application of national and local safety and environmental rules presents the potential for significant abuse.[245] The Member States also have the discretion to restrict route access when they determine that seri-

240. *See supra* note 139.

241. *See Safeguards supra* note 8 (congested airports and air space and the high costs of operating from European airports are likely to inhibit the start of new services).

242. *See, e.g., Flying the Flag*, The Economist, *supra* note 10; Schmid, *supra* note 9.

243. *EC Takes Major Step to Opening Skies to Free Pricing for Member Airlines*, The Wall Street Journal, Jun. 23, 1992, at A17.

244. *See supra* note 158 and accompanying text.

245. *See* discussion *supra* part III.B.4.

ous congestion or environmental problems exist.[246] Abuse of these provisions is made all the more possible when only other Member States, and not air carriers, may refer the matter to the Commission for review.[247] Action by a Member State under these provisions should either be pre-approved by the Commission or be subject to review upon the request of any air carrier.

C. Remaining Slot Allocation Obstacles

The Slot Allocation Regulation brought liberalization to an area of the air transport sector traditionally controlled by the individual Member States and riddled with discriminatory practices. This regulation leaves the potential for abusive practices by Member States and significant issues are left unaddressed.[248] For instance, a Member State is not required to fully coordinate an airport for slot allocation if less than 50 percent of the existing air carriers complain of slot shortages which could lead to the perpetuation of slot allocation practices detrimental to smaller established air carriers.[249] This discretion would be removed if a concerned air carrier could request that a Member State consider full coordination, or that the Commission review the situation.

Other potential problems are presented by the ability of the Member State to appoint the airport coordinator, and the failure of the regulation to explain the impact of the coordination committee on the coordinator's decisions.[250] Also, the grandfather rights provision and the free exchange of slots may also continue to limit the allocation of slots to smaller established carriers and new entrants.[251] Unfortunately, the regulation's medi-

246. *Id. But see Safeguards supra* note 8 (A European official denies that such safeguards will be used as excuses for member states to protect their national carriers because of Commission oversight). This argument fails to recognize that Commission oversight is not always available to concerned air carriers.

247. *See generally Safeguards supra* note 8; *Delayed, Again supra* note 8 (Third Package safeguards could hobble competition).

248. *See* text discussion *supra* part III.E.

249. This would especially be the case where more than 50 percent of the air carriers at a given airport are dominant mega-carriers with the ability to hoard slots amongst themselves through grandfather rights and mutual slot exchange agreements. *But cf.* Schmid, *supra* note 9 (stating that "smaller aircraft require a higher frequency and thus more allocation of slots," and therefore smaller aircraft may be used deliberately to 'stockpile slots' in order to prevent or hinder market access for competitors).

250. *European Airports Assert Their Rights in Battle Over Slots*, The Wall Street Journal, Jan. 7, 1993, at A1 (airports council members complain that airports still play no role in making the allocation rules and that community involvement and interest in lower fares would boost competition).

251. *See Community Competition (II) supra* note 6, at 280 (increasingly difficult for new entrants to obtain sufficient slots at congested EC airports).

ation process for resolving slot allocation disputes and new entrant problems does not provide guidelines for resolving these issues.

In addition, the exceptions provided to Member States allow for the reservation of slots on thin domestic regional routes which are exclusively serviced. It also allows the limitation of an air carrier's ability to exchange slots or change their use in order to increase frequencies on a route, if another Member State's air carrier cannot obtain slots at the fully coordinated airport for the same purpose. These exceptions may be used by a Member State to either protect its own air carriers or to limit the growth of an air carrier operating at one of its coordinated airports.

Various solutions are possible to resolve these problems, such as the removal of Member State discretion through Commission oversight and approval, and limiting or eliminating the exceptions to the allocation rules. The implementation of these solutions, however, would burden the Commission with the bureaurocratic responsibility for the oversight of the slot allocations at all congested EC airports. The best answer may be to follow the U.S. approach and let the air carriers treat slots as commodities.[252] Some limits may be necessary to avoid market domination and discriminatory trading, but this method may provide new entrants and smaller carriers with the ability to expand when necessary.

D. Remaining Air Fare Competition Obstacles

The Third Package leaves discretion to reject airfares that are excessively high to the disadvantage of users in relation to the long term fully allocated relevant costs of the air carrier, to the Member States.[253] The bounds of this discretion are unclear. For instance, what standard is used to determine the disadvantage to users? Additionally, what is required for the long term costs to be moderate, and how are the fully allocated relevant costs of the carrier determined? Most importantly, what measure of satisfactory return is sufficient?

Similarly, a Member State may also stop further fare decreases on a route when market forces have led to sustained downward development of air fares, deviating significantly from ordinary seasonal price fluctuations and resulting in widespread losses among all air carriers. The same type of discretionary concerns arise here also, the most obvious of which is the determination of 'significant deviation' and 'widespread losses'. This discretion may be exercised by a Member State to discriminate against air carriers competing with its flag carrier.

252. *See Delayed, Again, supra* note 8 (the best way to distribute slots is to sell them to the highest bidder); *Flying the Flag, supra* note 10 (a market-based allocation method with appropriate safeguards remains a tantalizing prospect for governments — especially as the money raised could be used to improve airports and air-traffic control).

253. *See* text discussion *supra* part III.C.2.

The review and/or appeal process of air fare decisions is another problem. Air carriers can only be heard by the Commission when they are complaining of other carrier's fares, but cannot be heard to appeal a Member State's action against its own fares. Similarly, an air carrier cannot refer a Commission decision on the matter to the Council. This lack of voice raises concerns that a more competitive carrier may be discriminated against by a Member State and be left without the ability to have the action reviewed.

The current rules may not only work to an air carrier's detriment, but may burden the Commission and Council with continual air fare disputes between Member States.[254] A possible solution may be to return to a double-disapproval system. Whatever the solution, the discretion left to Member States must be restricted and clarified, and the concerned air carriers on the route in question must be given a voice in the matter.

E. Mega-Carrier Domination and Private Subsidies

In addition to the problems with the Third Package of liberalization, market forces unleashed by liberalization itself can tend to result in negative effects if they are not carefully monitored. The liberalization of the air transport market in European Community has brought with it a restructuring similar to that which the U.S. went through after deregulation, which resulted in a limited number of mega-carriers.[255] Commentators suggest that ultimately only five large EC airlines will survive the liberalization efforts[256] as a result of bankruptcies, consolidations, and mergers.[257] Potential mergers, however, will be reviewed by the Commission, and in cases where substantial negative impact is likely the merger may be disapproved.[258]

For existing smaller carriers and new entrants to survive, they will either have to form strong alliances,[259] serve as feeders to the mega-carrier hubs of operation, or find a niche in the market.[260] The advantages of strategic alliances include reducing costs and generating efficiency among smaller carriers, while increasing their collective economy of size.[261] The shake-out in the European Community air transport sector

254. *See Safeguards supra* note 8 (suggesting that the Third Package disapproval system is cumbersome and that the old double disapproval system was less cumbersome and more liberal).

255. *See Seatbelt supra* note 3, at 444-45.

256. *See Labyrinth supra* note 2, at 371-73.

257. Examples of such mergers are the takeover of British Caledonian by British Airways and the merger of Air France, UTA, and Air Inter.

258. See *generally Community Competition (I) supra* note 6, at 68-70.

259. Like the cooperation between Lufthansa, Air France, and Iberia.

260. *See generally Labyrinth supra* note 2, at 371-73; Schmid, *supra* note 9, at 202-03.

261. *See* Schmid, *supra* note 9, at 202; *see generally Community Competition (II) supra* note 6, at 285-86.

will probably continue until a reasonable equilibrium is reached. Of course, these changes are welcome as long as they benefit consumers. The Commission should continue to vigilently review prospective mergers and other cooperative agreements for any signs of anti-competitive practices in the corresponding relevant markets.

The most thorny EC air transport issue is that of private subsidies, which has yet to be addressed by the Council. Subsidization of national air carriers has traditionally been at the core of the restrictive and protectionist practices characterizing the EC air transport sector. Of course, British Airways has been successfully privatized and Air France plans to go private in the near future. However, the majority of the large carriers are nationally owned. An interesting twist resulting from the liberalization is that many of the large subsidized national flag carriers have been acquiring and merging with other carriers to gain dominance and solidify their position in the market. The impact of this practice on the competing private carriers is grossly unfair and the use of subsidies to expand the market position of flag carriers should be greatly restricted.

Subsidies are essentially contrary to free competition and result in a distortion of the market to the detriment of competing carriers and consumers, either through higher prices or through taxes required to pay the subsidies. There are no easy answers to this politically sensitive issue. However, as free market forces continue to place pressure on national flag-carriers, their respective nations may become tired of supporting them. In a larger context, subsidized inefficient air carriers with their associated higher prices chase away world travel and tourism. This in turn, directly and indirectly sacrifices large numbers of jobs.[262] The greater the competitive environment becomes, the more the inefficiency of the flag carrier becomes glaringly visible and the greater the drain on the national economy.[263] As a result, the Council may eventually achieve the qualified majority necessary to adopt subsidy restrictions and privatization incentives.[264] The abolishment of nationally subsidized air carriers may eventually result in the replacement of the old bilateral agreement structure of the EC air transport sector by a common multi-lateral system,[265] and this would effectively open the skies within the EC.

262. *See generally Flights of Fancy European Airlines*, THE ECONOMIST, Feb. 5, 1994, at 69.

263. *See Community Competition (II) supra* note 6, at 286.

264. *See Flights of Fancy European Airlines, supra* note 262 (recent Commission proposal to allow a one-time, last-time subsidy to national flag carriers); *European Airlines; Winged*, THE ECONOMIST, Oct. 2, 1993, at 73 (suggesting that subsidies must end and that regulations must not be re-introduced, even in tough economic times).

265. *See generally Seatbelt supra* note 3, at 446-47.

V. CONCLUSION

While the EC has managed to achieve significant progress towards liberalization of the air transport sector, the Third Package leaves many serious obstacles in the path of the development of competition, especially for existing smaller air carriers and new entrants.[266] These problems need to be addressed if a freely operating Single European Market is to be achieved in the air transport sector.

The EC will likely find that maintaining a pseudo free market approach will result in the creation of tension both between Member States and air carriers which may eventually lead to either the erosion and possible disintegration of the current market regime, or the re-regulation of the industry.[267] In addition, the current regime will continue to limit the benefits that a strong free market could provide. As the weakest links in the chain, the national flag carriers, will continue to distort the true ability of private carriers, especially small and new ones, to compete. If the ability of new players to jump into the game and compete is any indicator of a free market, such distortion cannot be tolerated.[268]

U.S. style deregulation is not necessary to resolve these remaining problems, and the fear of the negative effects of this approach should not smother efforts to address these remaining issues. If the gradual implementation approach is maintained, and if the EC fully applies the competition rules to the dominant mega-carriers, the restructuring effects of further liberalization efforts will not be as severe as those resulting from the U.S. deregulation effort. Although some existing carriers may go by the wayside, that in itself is not necessarily a bad result in a free marketplace.[269] Those Member States which give up their flag carriers may find that the net economic effect is a positive one.

Future unified liberalization efforts are necessary to address the remaining issues concerning free competition in the EC air transport sector.[270] Only in this way can there exist a liberalized market from which consumers fully benefit, and from which the EC Commission can be free of the constant balancing act between the flag carrier protectionism and

266. *See generally* Crans, *supra* note 8; *Flying the Flag*, *supra* note 10 (discussing post Third Package problems such as slot access, flag carrier subsidies, and high operating costs); *Delayed, Again supra* note 8; *Safeguards supra* note 8.

267. *See* Schmid *supra* note 9, at 204-05; *see generally World Wire: EC Weighs Airline Options*, THE WALL STREET JOURNAL, Dec. 1, 1993, at A17 (possibility of re-regulation for ailing national airlines investigated); *Chiefs of Europe's Airlines Give Flak on Industry Woes*, THE WALL STREET JOURNAL, Sep. 17, 1993, at A7A (re-regulation debated); *European Airlines; Winged*, *supra* note 264.

268. *See Safeguards supra* note 8; Schmid *supra* note 9, at 204, *See* Crans, *supra* note 8, at 223.

269. *See* Banowsky, *supra* note 51, at 203.

270. *See generally Flying the Flag*, *supra* note 10; *Delayed, Again supra* note 8.

the development of free competition necessary for smaller existing carriers and new entrants. Given the number of issues left to be resolved by 1997, perhaps the adoption of a Fourth Package of liberalization is appropriate.[271]

271. *See supra* note 243 (EC officials said there was an understanding that the industry will be fully liberalized by the end of the transition period in April 1997).