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**A Single European Sky? The emerging EU Air Transport
Regulatory Framework**

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INTRODUCTION

Member States have been notoriously reluctant to relinquish powers to the EU in the field of transport in general, and air transport in particular. The close link between many national carriers and their state, the symbolic importance of a 'flag carrier' and the perceived need to ensure the maintenance of vital air links through a carrier under state control contribute to explaining this.

The judgment of the Court of Justice in *Nouvelles frontières*¹ in 1986 opened the door to the development of a Community competition policy in the field of air transport. Between 1987 and 1992, three packages of measures were adopted to liberalise the sector. Liberalisation has allowed for one significant development in the industry, viz. the rise of so-called ‘low-cost’ or ‘no-frills’ airlines. In other respects, liberalisation has had little impact on the structure of the sector. The international legal context of air transport and the persistence of Member States in maintaining bilateral agreements with third countries have significantly limited the impact of intra-EU liberalisation.

The recent judgments of the Court over bilateral air service agreements entered into by a number of Member States and the US, most of them under the so-called ‘Open Skies’ format, promises however to significantly alter the landscape for international air transport to and from the Community. While the judgments fall short of attributing competence to the EU for the negotiation of such agreements, they may nevertheless ultimately lead down that road.

The purpose of this paper is to investigate the limits to liberalisation resulting from the close link between international and intra-EU trade in air transport services and the extent to which the ‘Open Skies’ judgments of the Court of Justice assist in resolving the hiatus between internal market and international regulation in this field.

¹ Joined cases 209 to 213/84 *Criminal proceedings against Lucas Asjes and others* [1986] ECR 1425.

THE LEGAL FRAMEWORK OF LIBERALISATION

Prior to liberalisation, the legal framework for the provisions of air transport services between the Member States consisted of a complex network of bilateral air service agreements (ASAs) following the template established by the Chicago Convention of 1944. Most ASAs were designed to ensure parity between carriers of either State on traffic between the two states. Among other things, ASAs universally provided for governmental approval of fares.

The whole system of ASAs within the EC came under threat following the *Nouvelles Frontières* judgment. In that case, the Court of Justice held that the EC Treaty provisions on competition applied to transport, notwithstanding the existence of specific provisions in that Treaty relating to a common transport policy.² The consequence of this would be that common fares agreed between airlines would constitute anti-competitive agreements and that governmental approval of air fares would be contrary to what were then Articles 3(f) and 85 of the EC Treaty.³ The Court fell short of holding that the competition rules had direct effect in the field of transport, so that national courts could not on their own invalidate these practices. Nonetheless, it would suffice for the Commission to take a decision finding that a

² See paras 35 to 45 of the judgment.

³ now Articles 3(1)(g) and 81 EC.

price-fixing agreement between airlines was incompatible with EC competition law for national courts to then be in a position to do so.

In this context, it would have been possible for Member States who were lukewarm about liberalisation to engage in a war of attrition, modifying their practices to the minimum required to comply with judgments of the courts and decisions of the Commission. Ultimately, however, the system was doomed. In that sense, a process of liberalisation the speed and contours of which were determined by the Council rather than the Commission and the Court was a way for the Member States to regain some degree of control over a process which was escaping them.

Liberalisation was effected gradually in three 'packages' adopted in 1987,⁴ 1990⁵ and 1992 respectively. The current framework is contained in three key regulations:

⁴ See Council Directive 87/601/EEC of 14 December 1987 on fares for scheduled air services between Member States OJ 1987 Mo L374/12; Council Decision 87/602/EEC of 14 December 1987 on the sharing of passenger capacity between air carriers on scheduled air services between Member States and on access for air carriers to scheduled air service routes between Member States OJ 1987 Mo L374/19 and Council Regulation (EEC) No 3976/87 of 14 December 1987 on the application of Article 85 (3) of the Treaty to certain categories of agreements and concerted practices in the air transport sector OJ 1987 Mo L374/9.

⁵ Council Regulation (EEC) No 2343/90 of 24 July 1990 on access for air carriers to scheduled intra-Community air service routes and on the sharing of passenger capacity between air carriers on scheduled air services between Member States

- Regulation 2407/92,⁶ which requires Member States to grant operating licenses to carriers owned and controlled by Member States or their nationals subject to a number of conditions defined in the Regulation, concerning mainly the financial fitness of the operator;
- Regulation 2408/92,⁷ giving access to Community carriers to all routes within the Community, including domestic routes, subject to some limitations before April 1997;
- Regulation 2409/92,⁸ which replaces the system of governmental approval of fares by one of notification by airlines of fares to the relevant governmental authorities; the possibility for governments to object to a fare are limited to exceptional circumstances and subject to a procedure of supervision by the Commission.

⁶ OJ 1992 L240/1.

⁷ OJ 1992 L240/8.

⁸ OJ 1992 L240/15.

IMPACT OF LIBERALISATION ON INTRA-EU AIR SERVICES

Intra-European air traffic has increased very substantially in the period following liberalisation. Between 1992 and 1999, capacity on intra-EU inter-state flights has increased over 50%, from 142 726 to 214 481 available seat kilometre (ASK).⁹ It would, however, be imprudent to attribute too much to liberalisation for that increase. In the same period, total world traffic excluding North American domestic services increased 41% from 1 676 678 to 2 363 232 ASK.¹⁰

Fare data is difficult to interpret. In the last decade, fully flexible fares have increased substantially, especially business class fares. On the other hand, promotional economy fares have decreased.¹¹ This would suggest that there is a healthy degree of competition in the leisure/low-cost segment of the market but far less so in the business travel segment. The Commission takes as evidence of the increase in competition in the market the fact that the level of fares on a given is inversely correlated to the number of carriers active on that route: fares on monopoly routes tend to be between 5 and 17% higher than on duopoly routes and between 10 and 24%

⁹ EC Commission Directorate General Energy and Transport, Updating and development of economic and fares data regarding the European Air Travel Industry, 2000 Annual Report (study carried out by BAE Systems), p. 2-3.

¹⁰ Ibid.

¹¹ EC Commission Directorate General Energy and Transport, op. cit. note 9, at p. xx.

higher than on routes served by three carriers.¹² The contrary would be surprising. Nonetheless, these figures must be manipulated with caution: monopoly routes tend to be thinner routes, on which the break-even point tend to be higher. To that extent, higher fares may well be due, at least in part, to the higher cost of operating the route just as much as it may be linked to the absence of competition. Moreover, the Commission seems to base its definitions of monopoly and duopoly routes by reference to direct services only. Given the adoption of a hub-and-spoke network structure by most major carriers outside the low cost sector, indirect services may in some cases constitute a viable alternative, especially on longer routes. Lower operating ratios, rather than fare levels, may give a better indication of the competitive pressure resulting from the presence of multiple carriers on a route. Thus, operating ratios tend to be higher on routes from Stockholm or Vienna, which would often be monopolistic or duopolistic, than on routes from Brussels or Paris, which tend to attract more carriers.¹³ Here too, however, the degree of correlation remains inconclusive. For instance, operating ratios on routes from Dublin tend to be on the low side even though most of these routes are monopolistic or duopolistic.

¹² EC Commission, 'The European Airline Industry: From Single Market to Worldwide Challenges', COM (1999) 514 Final, at p. 23.

¹³ See EC Commission, *op.cit.* note 12, at p.24.

It seems, therefore rather difficult to draw firm conclusions on the impact of liberalisation on the basis of aggregate statistical information on the number of services and fares offered.

IMPACT OF LIBERALISATION ON THE STRUCTURE OF THE EUROPEAN AIRLINE INDUSTRY

NEW ENTRANTS

The number of carriers within the Community has increased from 132 in 1993 to 164 in 1997.¹⁴ However, this masks a high degree of turnover and relative stability among the major carriers. In other words, there is a non-negligible number of new-entrants in the market but relatively few of these entrants are able to survive for long. A qualitative rather than quantitative analysis of the new entrants provide some rather more interesting information on the impact of liberalisation on the evolution of the industry. From this perspective, a salient feature during the last decade has been the apparition on the market of low-cost carriers,¹⁵ especially in the United Kingdom and Ireland but also, more recently, in other Member States, such as Germany.

¹⁴ Ibid., at p. 22.

¹⁵ Low-cost carriers operate on the basis of a different business model than full service carriers. Through, *inter alia*, point-to-point services only, tight rotations, use of secondary and cheaper airports, use of a small range of aircraft types(ideally a single type), minimal service on board and on the ground, they are able to operate at significantly lower costs and therefore offer substantially lower fares than full service carriers.

Taking into account the 'low-cost carrier' factor may assist in providing an explanation for the ambiguities encountered in the previous section in relation to fares. Low cost carriers compete with traditional full service carriers in the leisure travel market but far less so in the business travel market. They therefore bring competitive pressure on full service carriers promotional fares but not so much on fully flexible economy or business fares. The divergent price trends on fully flexible fares and promotional fares are therefore consistent with the view that competitive pressure following liberalisation comes primarily from the low-cost carriers. Similarly, the low operating ratios on routes from Dublin, even though most of them are mono- or duopolistic might be a result of the heavy presence on many of these routes of Ryanair, the low-cost and highly successful Irish carrier.

MERGERS AND ACQUISITIONS

The structure of the European airline industry is, as the Commission itself noted,¹⁶ remarkable for what has *not* happened following liberalisation. There have been very few cross-border mergers and acquisitions and the ranks and size of the major players, low-cost carriers excepted, have not changed much.

¹⁶ EC Commission, Communication on the consequences of the Court judgements of 5 November 2002 for European air transport policy, COM(2002) 649 Final, at pp3-4.

Compared to US carriers, European airlines are small. On a worldwide basis, Europe's largest airline,¹⁷ British Airways, ranks fifth, the first four places being occupied by US carriers. In 2001, the output of the top four US carriers was a little under twice that of Europe's four largest carriers.¹⁸ The relative statistics are broadly similar to what they were in 1992.

Admittedly, inherent differences between the US domestic and intra-European markets partly explain the gap between US and EU carriers. Smaller distances, the existence of a good rail transport infrastructure and links, including high speed rail links between major economic centres, make rail a more viable alternative to air transport than is the case in the US. In addition, lack of space coupled with environmental concerns severely limits the potential for growth at major airports and, therefore, the provision of additional air transport services. The intra-European market is therefore likely to remain substantially smaller than the US market, providing a smaller home base for European airlines.

Even taking this into account, however, the European airline industry remains overly fragmented. In 2000, the number of European airlines stood at 140. By comparison,

¹⁷ Measured in revenue passenger kilometre (RPK). Other measures (such as number of passengers or fleet size) accentuate even more the difference between US and European carriers.

¹⁸ British Airways, Lufthansa, Air France and KLM had a combined output of 345604 RPK, compared to 639870 RPK for United, American, Delta and Northwest Airlines.

the US, with a domestic market which is about three times bigger than the European one has around 90 carriers. In addition, competition from low-cost carriers in the intra-European market accentuates the need for major full service carriers to have a sufficient size to be global carriers.

In the current regulatory framework, however, mergers between major airlines is practically impossible. Liberalisation has left the regulatory framework for air transport between the EU and third countries intact. This remains governed by bilateral Air Service Agreements (ASAs) between individual Member States and third countries. Such agreements invariably allow for either party to object to the provision of air service by a carrier owned or controlled by a third party state or its nationals. Thus, while British Airways could, for instance, acquire a controlling stake in KLM using internal market rules on freedom of establishment, KLM would lose its traffic rights between the Netherlands and third countries. This makes a merger or acquisition deeply unattractive, especially as most major flag carriers make most of their profits on long-haul routes.

Unable to merge, major European airlines have had to adopt second-best strategies:

1. acquire a controlling stake in a smaller carrier established in another Member State competing head-to-head with the flag carrier of that state on domestic and regional routes;
2. acquire a controlling stake in a smaller carrier established in another Member

State and restructure the network of the target to feed into the acquiring airline's hub;

3. forge commercial alliances with other major carriers inside and outside Europe.

The acquisition By British Airways of TAT and Air Liberté in France and of Delta Air (later renamed Deutsche BA) and the series of acquisitions of small airlines in various Member States by the SAir group constitute examples of the first of these strategies. It has been the least successful of the three, as shown by the spectacular downfall of Swissair. Squeezed between the dominant flag carrier at one end of the market and low-cost airlines at the other, the second-tier carriers have experienced great difficulties operating at a reasonable level of profitability. BA sold the merged TAT and Air Liberté to the SAir Group in 2000 and is currently looking for a buyer for Deutsche BA. The purchase and later resale to SAS of a 30% stake in Norwegian carrier Braathens SAFE by KLM has followed the same pattern.

The second of these strategies might be illustrated by the purchase and transformation of Irish carrier Cityjet by Air France and of Air UK by KLM. At the time of its purchase by Air France, Cityjet operated, at a substantial loss, on the London City to Dublin route. It now operates a number of routes between Paris and secondary

destinations on behalf of Air France under a franchise agreement.¹⁹ Similarly, KLM gradually trimmed Air UK (renamed KLM UK) domestic routes and non-strategic (viz. not Amsterdam-bound) European routes. KLM UK now operates exclusively on routes between Amsterdam and British provincial and secondary airports and is in the process of merging operations with KLM Cityhopper, KLM's main other regional subsidiary.

Commercial alliances, however, have constituted the main response of all major carriers to the impossibility to merge. There are currently four main global alliances:

- One World, centered on American Airlines, British Airways, Cathay Pacific and Qantas, whose European flag carriers also include Aer Lingus, Finnair and Iberia;
- The Star Alliance, around United Airlines, Lufthansa, Thai Airways and Singapore Airlines, whose other European partners include SAS and BMI;
- Skyteam, with Air France, Delta, Mexicana, Korean Air, Alitalia and, in Central Europe, Czech Airways and
- The unofficially named 'Wings' alliance, around KLM, Northwest and Continental and Malaysian Airlines

¹⁹ The destinations served by Cityjet from Paris are Dublin, London, Edinburgh, Gothenburg, Bologna and Florence. The only non-Paris bound route served by the Irish carrier is Dublin to Malaga.

All airline alliances provide for codeshare agreements on key routes, connections between the hubs of the respective partners and reciprocal frequent flyer benefits. Beyond this, co-operation varies greatly and is not uniform even within the same alliance. The greatest degree of integration is to be found in the oldest of these partnerships, viz. that between KLM and Northwest: joint exploitation of most North-Atlantic routes with common fares and the aircraft of either carrier being used as the circumstances require; extensive code-sharing from each other's hubs; common sales and marketing, with a single partner being responsible for marketing the products of both in a given region of the world, etc... Within Europe, KLM attempted to reproduce the template of close co-operation and, indeed, take it further in a close partnership with Alitalia. The objectives were ambitious and would have seen both airlines operating virtually as a single airline on the basis of a joint venture in scheduled passenger and cargo air transport.²⁰ It would have been fascinating to see whether such a joint venture could have constituted an effective alternative to merger, by-passing the legal obstacles created by bilateral ASAs. *Prima facie*, it is difficult to see how this could be so. Even though the aircrafts would still have been owned and operated by the two airlines, effective control would have passed to the joint venture. There was therefore a substantial regulatory risk that third party states in ASAs entered into by the Netherlands and Italy could have objected to the KLM/Alitalia partnership providing air services to and from those third countries because of non compliance with the nationality clause in the ASAs. Admittedly, Italy and the

²⁰ Maintenance, ground handling and charter flights were excluded from the joint venture.

Netherlands do not, for the majority of third country airlines, constitute major markets and, to that extent, the regulatory risk was lower than with some other alliances, such as the aborted BA-KLM partnership.²¹ In the event, the partnership collapsed amid bitter recriminations around the development of the Malpensa hub airport and delays to Alitalia's privatisation.

Clearly, airline alliances provide some of the benefits that can be expected from consolidation by merger.

Firstly, alliance with a local strong player which, in the majority of cases, means the flag carrier, seems to be the only effective way for a European airline outside the low-cost sector to penetrate the market of another Member State. The failures of BA and Swissair are, in this respect, indicative of the difficulty for an airline to compete head-to-head with a flag carrier on its local market through a secondary airline. Indeed, flag carriers have tended to strengthen rather than weaken their position on their domestic markets.²² Even when that secondary carrier is transformed into a feeder airline, it

²¹ In the BA-KLM case, the US regulatory authorities had made it clear that they would object to a comparable arrangement. This, however, has to be put in the context of the persistence, but unfruitful, efforts of the US to obtain an Open Skies agreement with the United Kingdom, giving access to Heathrow to all US airlines to replace the current Bermuda II agreement, which allows only two US carriers to fly into Heathrow.

²² Thus, Air France has acquired virtually all small carriers established in France and its main remaining competitor (Air Lib) collapsed, leaving Air France in a situation of near monopoly. In Germany, Lufhansa acquired Eurowings, depriving KLM of its main feeder airline on the German market.

will not necessarily be a smooth ride for the acquiring carrier. Admittedly, the secondary airline can afford to operate at a lower profitability level, given that it contributes to feeding passengers onto the main carrier's more profitable inter-continental flights. Even so, a sufficient number of transfer passengers must be generated, particularly as the airline may, on point-to-point services to its hub, compete with low cost carriers.²³

Secondly, alliance with another flag carrier enables the airline to offer its customers a much wider range of destinations than it could do on the basis of its own resources alone and benefit from each other's strengths in particular markets.²⁴

The greatest weakness of partnerships, however, is their actual or potential instability. The worldwide nature of these alliances also fragilises their stability, as a change of partners in one region can have knock-on effects in others. For instance, the future of the long-established partnership between KLM and Northwest is not clear in the light of the proposed tripartite alliance in North America between Delta, Continental and Northwest, given the participation of Delta in the Skyteam alliance.

²³ Thus, KLM UK felt compelled to abandon its London Stansted-Amsterdam route and transfer it to low-cost operator Buzz (at the time still under KLM ownership) due to a low-level of transfer passengers on the route.

²⁴ For instance, in the KLM/Alitalia partnership, KLM had started to pull out of some destinations in Australia and South America, in which it had a weak position and Alitalia a comparatively stronger one.

THE COURT OF JUSTICE OPEN SKIES JUDGMENTS

The Commission has long taken a dim view of individual air service agreements between EU Member States and third countries, especially so-called 'Open Skies' agreement with the US. In the view of the Commission, Open skies agreement with individual Member States place European carriers at a disadvantage with US carriers, especially with regard to 'fifth freedom' rights, which gives US carriers access to the intra-EU cargo market, with no corresponding benefit for European airlines.²⁵ Secondly, through a network of open skies agreements, US airlines are able to fly from any point in the US to most points in the EU, whereas European airlines remain restricted to flying from their home country. For the Commission, a much preferable solution would be for air service agreements to be negotiated at EU level, treating the EU as a single territorial entity for the purposes of these agreements. Faced, however, with strong resistance in the Council, the Commission decided to initiate proceedings in December 1998 against eight Member States (Belgium, Denmark, Germany, Luxembourg, Austria, Finland, Sweden and the UK) challenging the compatibility of

²⁵ Although European airlines enjoy the same fifth freedom rights in the USA, there are few viable onward destinations: see EC Commission, Communication on the consequences of the Court judgments of 5 November 2002 for European air transport policy, COM (2002) 649 final, at para 14.

the ASAs these States entered into with the US with EU Law. The Court delivered its long awaited judgments in the eight cases on fifth November 2002.²⁶

A first line of argument by the Commission²⁷ consisted in affirming the existence of an exclusive competence of the EC to conclude air transport agreements with third countries, with the consequences that Member States would be in breach of EU law by the mere fact of entering into such agreements, whatever their contents. The Commission first sought to rely on Opinion 1/76,²⁸ in which the Court had held that the Community has competence to enter into an international agreement with a third country where the conclusion of such an agreement is necessary in order to attain an objective of the EC Treaty that cannot be attained by autonomous (internal) rules. Furthermore, that external competence of the Community in this situation is an exclusive one. In the light of the discussion above, and the virtual impossibility for an airline to become a truly pan-European air carrier under the current framework of agreements between individual Member States and third countries, one could have

²⁶ Cases C-466, 467, 468, 469, 471, 472, 475 & 476/98 *Commission v UK, Denmark, Sweden, Finland, Belgium, Luxembourg, Austria and Germany* respectively, [2002] ECR I-0000.

²⁷ This applies to all actions except that against the UK, which was limited to breach of the then Article 52 of the EC Treaty (now Article 43 EC) owing to the specificity of the US-UK ASA (the 'Bermuda II' Agreement). The Article 52 aspect of the question is discussed below.

²⁸ *Opinion 1/76 Re Agreement Establishing a European Laying-up Fund for Inland Waterway Vessels* [1977] ECR 741.

some sympathy with the Commission's argument. This, however, was flatly rejected by the Court. According to the Court, it was not established that the distortions resulting from individual agreements by Member States with third countries could not have been avoided by concerted action between the Member States rather than by conclusion of an agreement by the Community itself. While true, this, however, is an extremely restrictive reading of the Court's earlier caselaw. There will be few occasions in which concerted action by the Member States will not be a viable alternative to Treaty-making by the Community itself. A more elegant way to reach the same conclusion was followed by the Advocate-General in the case: what Opinion 1/76 was concerned with was establishing the competence of the Community to enter into agreements, rather than the exclusivity of that competence. It is only in a second step, once the competence is exercised, that it becomes exclusive.

The Commission also sought to rely on another Court decision to argue for an exclusive competence of the Community to conclude air transport agreements. According to the *ERTA* case,²⁹ once the Community has adopted a complete set of common internal rules to regulate a particular matter, Member States are precluded to enter into commitments with third countries which affect those common rules or distort their scope. The Commission contended that the third liberalisation package constituted such a common set of rules and that the agreements entered into by the Member States with the USA interfered with those rules. More specifically:

²⁹ Case 22/70 *Commission v Council (re ERTA)* [1971] ECR 263.

1. The network of Open Skies Treaties give access to US carriers to intra-Community air traffic rights, under the fifth freedom clauses in these agreements, outside the framework established by Regulation 2408/92 on access to intra-Community air routes for Community air carriers;
2. Those treaties contain provisions on fares on these routes outside the framework of Regulation 2409/92 on fares and rates for air services;
3. Those treaties contain provisions concerning access to computerised reservation systems ('CRSs') outside the framework provided by Regulation 2299/89 on a Code of Conduct for CRSs;
4. The general clause on fair competition affected the issue of access to airport slots, covered by Regulation 95/93.

The Court dismissed the argument regarding airport slots on the ground that the treaties did not specifically refer to airport slots and that the Commission had not therefore established the existence of an international commitment concerning them. It also rejected the main argument concerning fifth freedom rights, on the ground that Regulation 2408/92 was concerned with access to intra-Community routes by *Community* carriers and not with access to these routes by third country carriers. On the other hand, it did find that the Member States could not enter into commitments regarding fares on these routes nor regarding access to CRSs. This was so even if the clause in the agreements were to ensure compatibility with the internal Community

regulatory framework. Such competence was exclusively reserved to the Community, in application of the *ERTA* caselaw.

While the success of the Commission on competence issues was thus somewhat limited, it nevertheless scored a more significant victory in relation to the nationality clause in the agreements. According to the Court, such clauses were incompatible with Article 43 EC,³⁰ in so far as they discriminated against Community carriers established or wishing to establish themselves in another Member States. Some governments sought to argue that provision of services with thrid country fell outside the scope of the EC Treaty, which is concerned with services within the EU. While the argument is technically correct as regards the scope of Article 49 EC on freedom to provide services, it was nonetheless irrelevant since what was at issue was freedom of establishment in another Member State rather than freedom to provide services.

ASSESSMENT OF THE COURT'S JUDGMENTS

Airline regulation in the EU presents us with a clear case of disfunctioning owing to an incompatibility between different sub-parts of the regulatory system. The nature of the airline industry is such that internal (intra-EU) and external trade are inextricably linked. There is incompatibility in the sense that the problem is not merely that different regulatory systems are adopted for internal and external trade but rather the operation of one system prevents the other from fulfilling its purpose. The system of

³⁰ Article 52 of the EC Treaty at the time.

regulation for international air traffic rights through bilateral ASAs prevents consolidation in the European airline industry that the internal market logic should lead to. While airlines have adapted to that situation, notably through alliances, these nevertheless remain second-best options. To what extent does the Court judgments assist in revolving that incompatibility?

Prima facie, the Court seems, in the way it approaches the issue of competence, to wash its hands of the problem by construing the issue of incompatibility in a narrow way. The Court does not see an inherent incompatibility between the internal system of regulation and the international one. Thus, for the Court, it is only where the international agreements fall within the scope of the internal rules that Community exclusive competence will arise.³¹ Indirect impact on the overall logic of the system of regulation is not enough. Thus, the Court finds in favour of exclusive Community competence only in relation to a fairly narrow set of issues (fares on intra-Community routes and access to CRSs) on which there was a complete set of Community rules meant to apply to third country carriers as well as Community carriers.

The position taken by the Court is understandable. The answer that it gives has to be appreciated in relation to the question being asked. The problem with ASAs is not that they are ASAs *per se*. It lies in the contents of the rules which are contained in those ASAs, and especially with the nationality clause therein. From a formal-legal

³¹ See, e.g., para 108 in the judgment in case C-476/98.

perspective, therefore, it makes sense to locate the problem as one of incompatibility of the substance of the ASAs with internal market rules — *in casu* Article 43 EC on freedom of establishment — rather than one of competence. Yet, there is a flavour of legalism in that approach. As many governments pointed out, they had tried to negotiate an extension of the nationality clauses to cover Community carriers only to be met by a flat refusal from the US. The very structure of ASAs makes the negotiation of extended nationality clauses difficult since, in effect, it amounts to a unilateral concession by the third country.

Still, the ultimate outcome of the case may not be that different to what would have been achieved by recognising an exclusive competence to the EU. Given the extreme difficulty in negotiating the extension of the nationality clause on a state-to-state bilateral basis, the only effective way to comply with the judgment of the Court will be for the EU to enter into European-wide ASAs agreements with third countries. This is the direction that the Transport Council reluctantly took at its December 2002 meeting.³² Smaller Member States are especially worried by this prospect, since the disappearance of the flag carrier is a distinct possibility with the demise of bilateral

³² See Minutes of the 2472nd Council Meeting – Transport, Telecommunications and Energy, (15121/02), at p. 27 (available on the Council's website).

ASAs. Ireland has, in this respect, been particularly vocal.³³ It should be noted that the position of the Commission has been substantially strengthened by the judgments, since it now has at its disposal the threat of enforcing the Court's judgments, if need be by requiring recalcitrant Member States to denounce the ASA.³⁴

CONCLUSION

The Court has often been portrayed as a pro-integrationist actor in the institutional setup. To some extent, the restrictive reading of the scope of the Treaty provision on the common transport policy in *Nouvelles frontières* could be seen as an illustration of this. The *Open Skies* judgments, however, show a much more cautious approach. As regards the external competence of the EC, the judgments follow the trend in the last decade of limiting the impact of its bolder judgments in the 1970s, such as the *ERTA* case or Opinion 1/76. A different, more integrationist solution would have been conceivable, had the Court been willing to engage more with the economic context in

³³ At the Transport Council meeting of March 2002, Ireland indicated that the prospect of the Court's judgment on Open Skies agreement was, as far as it was concerned, a 'highly sensitive political issue': see Minutes of the 2420th Council meeting – Transport and Telecommunications – (7282/02), at p. 31 (available on the Council's website). Ireland is also concerned about the regional development aspect concerning the West of Ireland and the disappearance of the 'Shannon stop-over clause', under which for every flight between the US and Dublin there must be a Shannon-US flight. Most carriers comply with this clause by including a stop-over at Shannon on Dublin-US flights in the low season.

³⁴ On the duty to renegotiate or, if need be, denounce an international agreement which is incompatible with EC Law, see Joined Cases C-62/98 and C-84/98 *Commission v Portugal* [2000] ECR I-5171 and I-5215. The case was concerned with agreements entered into before accession to the Community but would apply *a fortiori* to agreements entered into after accession.

which the European airline industry operates — in particular the dependence of major carriers on both internal and international markets — and the political context of negotiations of air service agreements, notably the improbability of extended nationality clauses in these agreements. Instead, the Court retreated to a more formalistic legal analysis. Had these contexts are taken into account, it is plain that Europeanisation of external trade policy in the field of air transport is the only way forward to resolve the conflict between internal and external trade. This may not be of great consequence in this particular case, since the outcome of the Court judgments is likely to be the negotiation of air serviced agreements at Community level in any event. Indeed, the judgments could arguably be seen as an elegant way to reach that result while appearing highly respectful of the role of other actors, and in particular the Council. Nonetheless, this detachment from the economic and political context gives an air of unreality to the judgments and may not always work as effectively as in this case.

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