The Impact of EU Law on the Regulation of International Air Transportation

MARTIN BARTLIK
THE IMPACT OF EU LAW ON THE REGULATION OF INTERNATIONAL AIR TRANSPORTATION
To my mother
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MARTIN BARTLIK
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When aviation experts talk about the present situation of the aviation industry, most of them will refer to the challenges that this industry faces nowadays as a result of the events of the recent past. Thereby 9/11 and SARS are mentioned as the most significant crisis. Only little attention is given to the legal and political challenges that the air transportation sector will face as a result of the ‘open-skies’ judgement delivered by the European Court of Justice in November 2002. This verdict may have an impact on the regulation of international air transportation as significant as the conclusion of the Bermuda I agreement in the 1950s or the introduction of the ‘open-skies’ policy in the 1970s. As one can witness from the efforts by the European Commission to establish a Transatlantic Common Aviation Area, the European model of an integrated supranational market for air transportation services could one day extend to other countries outside the European Union.

Taking into account the developments in the European Union I will show in the following why and how the rising of this new player on the stage of international air transportation regulation will influence the international air transportation sector. Irrespective whether the participation of the European Union in this field is hailed or disliked, it is a matter of fact that in the long run, the EU will become a major player in the regulation of international air transportation. Therefore, it is recommendable to study how aviation is regulated in the EU, how the powers are distributed between the European Commission and the Member States and which legal and political difficulties presently exist and may arise in the future with respect to aviation.

Martin Bartlik
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<th>Abbreviation</th>
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<td>CAA</td>
<td>Civil Aviation Authority (Great-Britain)</td>
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<td>CAB</td>
<td>Civil Aeronautic Board (USA)</td>
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<td>C.M.L.R.</td>
<td>Common Market Law Report</td>
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<td>CTA</td>
<td>Canada Transport Act</td>
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<td>DOT</td>
<td>Department of Transport (USA)</td>
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<td>EEC</td>
<td>European Economic Community</td>
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<td>EC</td>
<td>European Community or reference to EC Treaty</td>
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<td>ECJ</td>
<td>European Court of Justice</td>
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<td>E.C.R.</td>
<td>European Court Report</td>
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<td>ERTA</td>
<td>European Road Transport Agreement</td>
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<td>EU</td>
<td>European Union or reference to EU Treaty</td>
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<td>IASC</td>
<td>International Air Service Commission (Australia)</td>
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<td>ICAO</td>
<td>International Civil Aviation Organization</td>
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<td>GATS</td>
<td>General Agreement on Trade in Services</td>
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<td>GATT</td>
<td>General Agreement on Tariffs and Trades 1947</td>
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<td>NAFTA</td>
<td>North American Free Trade Area</td>
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<td>OECD</td>
<td>Organization for Economic Cooperation and Development</td>
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<td>O.J.</td>
<td>Official Journal of the European Communities</td>
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<td>TCAA</td>
<td>Transatlantic Common Aviation Area</td>
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<td>WTO</td>
<td>World Trade Organization</td>
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Introduction

In this book, two aspects of air transportation are examined, whereby the focus is set on the situation in the European Community and how it may change after the European Court of Justice, the European Union’s highest court, delivered its landmark ‘open-skies’ judgement on 5 November 2002. In Part One, which institution has the treaty-making power to conclude air service agreements with non-EC countries is scrutinized. So far, air service agreements have been concluded by the Member States. But since the European Community is becoming increasingly involved in regulating air transportation and today most regulations with respect to intra-Community air transportation are enacted by the EC, it is necessary to ask whether the Community may also have the treaty-making power to conclude air service agreements with third countries. In this respect the ‘open-skies’ judgement, as will be shown below, may be of highest importance for the future of European aviation and could even have an impact on the worldwide regulation of air transportation.

Part Two deals with the question of the distribution of air traffic rights. Few articles have been written and published on this topic so far. So far this matter was, from a legal and practical perspective, only of secondary importance. Most countries had only few air carriers that were able to offer international air transportation service and thus air traffic rights, which are necessary for the conduct of international air transportation services, were mostly granted to those airlines by their respective countries. Under these circumstances the allocation of air traffic rights did not cause any considerable problems. Again due to the ‘open-skies’ judgement this may change in the future. In the EC, the number of air carriers eligible for obtaining air traffic rights for international operations, may significantly increase in the future and the regulators responsible for this task will have to develop a scheme, how these rights shall be allocated. For this purpose several possibilities for the distribution of air traffic rights will be discussed and their advantages and disadvantages shown. Finally an allocation procedure will be presented that shall serve the needs and interests of air carriers and consumers as well as comply with EC and international laws.
In the exercise of its sovereignty every nation has the right as well as the duty to itself to develop its air power, as represented in part by its air transport, to the extent needed by its domestic and foreign commerce and other legitimate objectives. World organizations may well require sufficient international control so that air transport does not become an instrument of unfair nationalistic economic competition or political aggression and thus the source of serious international misunderstanding and dangerous ill feelings.

John Cobb Cooper¹, *The Right to Fly*, 1947

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¹ (1887–1967); Aviation advisor to US President F. D. Roosevelt, part of the US delegation in the 1944 Chicago Convention on International Civil Aviation, Vice-President of Pan American World Airways, legal advisor to the International Air Transport Association and founder and first director (1951–1955) of the Institute of Air and Space Law at McGill University, Montréal.
PART ONE
The Treaty-making Power to Conclude Air Service Agreements
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Chapter 1

Introduction to International Air Law

Before the question is discussed, whether the European Community or the Member States have the treaty-making power to conclude air service agreement, for a better understanding a short overview of the relevant international public air law shall be given first. International public air law is dominated by the principle of sovereignty over the airspace above a State’s territory. This principle is not only explicitly laid down in Articles 1 and 2 of the Chicago Convention, but is also part of international customary law. It is the basis of all other regulations in international public air law. As a result of the application of the principle of sovereignty, every state decides autonomously to which extent, by whom and when its airspace is used. The permission to use a state’s airspace is formally called ‘air traffic right,’ but commonly also called ‘freedom.’ Depending on the extent of the possibilities to use a state’s airspace, one can distinguish between eight freedoms in international air law:

- The first freedom gives the right to overfly the territory of a state without any landings.
- The second freedom grants the privilege to land in a foreign country for technical reasons.

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1 Convention on International Civil Aviation, 7 December 1944, 15 U.N.T.S. 102 [Chicago Convention].
2 Alfred Verdross and Bruno Simma (1984), Universelles Völkerrecht (Universal International Law), 3rd edn., (Berlin: Duncker and Humblot), 664 [Verdross/Simma].
5 Article 5 Chicago Convention, International Air Service Transit Agreement (7 December 1944), ICAO Doc. 7500, Article I, Section 1, No 1 [Transit Agreement].
6 Chicago Convention, ibid.; Transit Agreement, ibid.
The third freedom gives the right to fly passengers, mail and cargo from the registration state of the air carrier to a foreign state.\(^7\)

The fourth freedom correlates with the third freedom and grants the right to fly passengers, mail and cargo from a foreign state to the registration state of the air carrier.\(^8\)

The fifth freedom extends the third and fourth freedom and grants the right to fly passengers, mail and cargo between two foreign states, as long as the origin or the final destination of such a chain of air transportation services is in the registration state of the air carrier.\(^9\)

The sixth freedom is not an explicitly granted right, but describes a combination of the third and fourth freedom, independently granted to a state by two other states. The sixth freedom enables an air carrier to offer air transportation services between two foreign countries by making a stop-over in the home state of that air carrier. Thereby an airline makes use of the fourth freedom by country A and flies passengers, mail or cargo from country A into its home state, where it makes a stop-over, and continues the flight with the passengers, mail or cargo from country A to country B, thereby making use of the third freedom granted by country B.\(^10\) The sixth freedom is usually used to establish a hub-and-spoke system, but can be also applied, when necessary fifth freedom rights are not granted by two foreign states.

The seventh freedom grants a right to operate between two foreign countries, which are both not the registration state of the operating air carrier. Unlike fifth freedom traffic, there is no link between the flights of the air carrier and its home country. The aircraft used to offer seventh freedom traffic is permanently stationed in one of the two foreign countries concerned.\(^11\)

The eighth freedom, also called cabotage, grants a right to provide air transportation services within one single country.\(^12\)

The first and second freedom are also called ‘technical freedoms’, while the remaining commercially more important air traffic rights are referred to as ‘economic freedoms’. In the recent past, in particular the fifth freedom has become quite important as it allows to combine several flight services and thus to use the capacities

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\(^7\) See definition in the *International Air Transport Agreement*, 7 December 1944, 171 U.N.T.S. 502, Article I, Section 1, No 3 [Transport Agreement].

\(^8\) See definition in Article I, Section 1, No. 4 Transport Agreement.

\(^9\) See definition in Article I, Section 1, No. 5 Transport Agreement.


\(^11\) Diederiks-Verschoor, *ibid.;* Matte, *ibid.* at 144.

\(^12\) Article 7 Chicago Convention.
of aircrafts more efficiently. From a commercial perspective, this freedom may be even the most important freedom. If, for example, on flights between Australia and Europe an air carrier can make only use of the third and fourth freedom, it is limited to offer air transportation services between two destinations only, for example Sydney/Paris or Sydney/Frankfurt. If the same airline is also granted the fifth freedom, it can combine these flights to one single flight, for example Sydney/Frankfurt/Paris. At the same time it will be enabled to offer purely intra-Community flights. Not only will the airline save one aircraft that it can use for different flight connections, it will also increase its load factor on the route between Australia and Europe. The fifth freedom thus allows for a more efficient and profitable use of an airlines fleet. 

Taking into account the increasing competition in the air transportation sector and the reduction of state aids as a result of the privatizations of airlines, the success and survival of an airline will depend very much on the efficiency and profitability it can achieve. The problem of the fifth freedom is that it must be granted by all countries that would be part of such a chain of flights. In the above mentioned example for an Australian air carrier to operate on the route Sydney/Frankfurt/Paris, Germany and France would have to grant the fifth freedom to Australia. If this fails, an airline might be able to bypass this disadvantage and still be able to increase its efficiency and profitability by combining its available third and fourth freedom, which leads to the above mentioned sixth freedom. The idea is that an airline coming from a third state and before continuing flying to another country, makes a stop-over in its own country. As a result it can transport passengers and cargo between two foreign countries. The disadvantage of this model compared to the fifth freedom is that an airline must always make a stop-over in its own country. Whether the sixth freedom can be applicable depends therefore to a large extent on the geographical location of a country. If, for example, Germany, France and Australia do not grant each other the fifth freedom, a German air carrier can still fly passengers, mail and cargo from Paris to Sydney, if it makes a stop-over in Frankfurt. An Australian air carrier, on the other hand, would have difficulties in selling tickets for a flight Paris/Frankfurt via Sydney.

The granting of the different freedoms depends very much on the type of the air transportation services offered. In international air transportation a distinction is made between commercial and non-commercial flights. In the following, non-commercial flights, due to their limited significance for this work, will not be further taken into regard. As far as commercial aviation is concerned, another distinction is made between non-scheduled international air services and scheduled international air services. Scheduled international air services are defined pursuant to Articles 5, 6, 96(a) Chicago Convention as ‘public and planned air transportation of passengers, cargo and mail’. When it comes to non-scheduled air transportation, international law does not provide for any regulation and national laws contain only a few provisions in respect of this mode of transportation. A comprehensive and coherent set of regulations comparable to the one existing for schedule air transportation does not

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exist.\(^{14}\) It lacks, in particular, a positive definition of what is to be understood as non-scheduled air transportation. This is because non-scheduled air transportation covers all kinds of different services, for example taxi flights, sightseeing flights, medical flights, advertisement flights or flights as part of holiday packages.\(^{15}\) Therefore, non-scheduled flights are only negatively defined as not being scheduled air transportation.\(^{16}\) The difference between both modes of transportation arises from the two features ‘planned’ and ‘public’ contained in the definition of scheduled air services. Air transportation services are planned, if the flights are repeated in a pre-determined order and the users can rely on the existence of a regular transportation service.\(^{17}\) While this is the case with scheduled flights, non-scheduled air transportation services are undertaken only, if there is an actual demand.\(^{18}\) The second feature of scheduled air transportation services distinguishing it from non-scheduled flights is that the flights must be made available to the general public, which means everybody must have the opportunity to make use of the air transportation services offered. Of course, not everybody asking for a seat on a flight must be also served, as capacities are limited. Still, a customer can be only refused for objective reasons that are equally valid for everybody, but not based on subjective criteria.\(^{19}\) Unlike non-scheduled airlines, air carriers offering scheduled flights are obliged to contract. Non-scheduled flight services, on the other hand, are not available to the general public, but only to a limited group of persons characterized by specific subjective criteria.\(^{20}\) Non-scheduled airlines are also not burdened with an obligation to contract.\(^{21}\)

Air traffic rights, which are, as indicated above, indispensable for the carrying out of international air transportation services, are granted partly in multilateral treaties and partly in bilateral agreements. The two most important multilateral treaties in this respect were concluded in 1944 and are the Chicago Convention and the Transit Agreement. According to Article 5(1) Chicago Convention the signatory states grant the first and second freedom to all air carriers engaged in international non-scheduled air transportation. This category includes commercial non-scheduled air transportation and private, non-commercial flight. Flights with state aircrafts do not

\(^{14}\) Hofmann/Grabherr, supra note 38 at § 22, para 3; Giemulla, in: Giemulla/Schmid, Pref. to §§ 20-24, supra note 4 at para 15.

\(^{15}\) Hofmann/Grabherr, ibid.; Giemulla, ibid. at para 7.

\(^{16}\) See also § 22 German Aeronautics Act or Article 5(1) Chicago Convention where reference is made to ‘aircrafts not engaged in international scheduled air transportation;’ Giemulla, ibid. § 22, para 4; Schwenk/Giemulla, supra note 13 at 724; Alfred Rudolf, ‘Die sogenannte Pauschalreise-(IT)Charter im Spannungsfeld zwischen Fluglinien – und Gelegenheitsverkehr’ (The so-called holiday package charter flight in the tension between scheduled and non-scheduled air transportation) (1970) Zeitschrift für Luft – und Weltraumrecht (Air and Space L. Rev.) 110 at 113 [Rudolf].

\(^{17}\) Schwenk/Giemulla, ibid. at 613.

\(^{18}\) Ibid. at 614.

\(^{19}\) Hofmann/Grabherr, supra note 3 at § 21, paras 2, 18; Giemulla, in: Giemulla/Schmid, supra note 4 at § 21, para 6.

\(^{20}\) Giemulla, ibid.; Schwenk/Giemulla, supra note 13 at 726f.

\(^{21}\) Hofmann/Grabherr, supra note 3 at § 22, para 6; Giemulla, in: Giemulla/Schmid, supra note 4, Pref. to §§ 20-24, at para 7; Schwenk/Giemulla, ibid. at 615.
fall under this definition as pursuant to Article 3a they are completely excluded from the scope of the Chicago Convention. The more important economic freedoms are also granted to non-scheduled air carriers pursuant to Article 5(2) Chicago Convention, but additional conditions up to total restrictions can be imposed by every single state on the exercise of these freedoms. Air carriers offering schedules international air transportation services require pursuant to Article 6 Chicago Convention a particular permission for any kind of use of a state’s airspace. This regulation contained in Article 6 Chicago Convention is considered as the basis for the conclusion of numerous bilateral agreements, in which States regulated the details of international scheduled air transportation that is to be conducted between their territories. These agreements are the factual as well as the legal basis for international air transportation. Apart from the exchange of air traffic rights, these agreements contain various other clauses that are important for international aviation. It can include provisions on how many air carriers each country is allowed to designate to make use of the air traffic rights that are granted, which aircrafts shall be used and thus how much capacity is offered in a market, how often and when exactly flights have to take place (frequency) or which fares airlines are allowed to charge. The content of air service agreements can vary in every single case and depends very much on the States involved. Air service agreements can be very restrictive and contain detailed regulations, leaving the airlines with only few possibilities to structure their operations. Such an agreement will allow the designation of only one or very few air carriers, the frequency and the type of aircrafts to be used will be pre-determined and the fares to be charged will be also fixed. The reason for such an approach is the desire of a state to protect its national airlines from too much competition. However, since the end of the 1970s a global trend to more liberalization in commercial aviation has set in, when the United States of America decided to deregulate not only their domestic air transportation sector, but also to push for more liberalization of international air transportation. According to this approach, economic questions should not be decided and pre-determined by politicians, but only by the entities involved in the business. Furthermore, it was believed that greater benefits could be achieved, if airlines were placed in a more competitive surrounding. For that purpose, the US introduced a new and more liberal model air service agreement, commonly known

22 Schwenk/Giemulla, ibid. at 630; Giemulla, in: Giemulla/Schmid, ibid. at para 26 (Germany, for example, has concluded about 170 bilateral air service agreements, while the worldwide number is assumed to be at about 4000 bilaterals); Virginia Rodriguez Serrano, ‘Trade in Air Transport Services: Liberalizing Hard Rights’ (1999) 24 Ann. Air and Sp. L. 199 [Serrano].

23 Matte, supra note 10 at 144f.

24 See e.g. Diederiks-Verschoor, supra note 3 (description of Bermuda I as a compromise between the liberal approach of the USA and the protective position of Great Britain, at 49); Robert Burkhardt (1974), The Civil Aeronautics Board (Virgina: Green Hills Company) at 136 [Burkhardt].

25 See e.g. Diederiks-Verschoor, supra note 3 (denunciation of the Bermuda I Agreement by Great Britain in order to conclude a more restrictive treaty (Bermuda II) to protect its airlines, at 51); Schwenk/Giemulla, supra note 13 at 634.

26 Diederiks-Verschoor, ibid. at 51.
as the ‘open-skies’ standard. This kind of an agreement is less restrictive as far as designation, capacity, frequency and especially fares are concerned and leaves it to the airlines to take most of the commercial decisions.27

As far as the granting of air traffic rights is concerned, a particularity exists in respect of the first and second freedom. According to Article 1 Transit Agreement at least the first and second freedom are granted for scheduled international air transportation services in a multilateral agreement. However, some of the geographically big states like Canada, Brazil, Russia and China are not parties to this agreement. This makes it necessary to include the technical freedoms in the bilateral agreements these states conclude with other countries. Due to their size and geographical location the first ones have a strong bargaining power with the first and second freedom in all negotiations on air service agreements. As far as the third, fourth and fifth freedom are concerned, a similar multilateral approach was envisaged in the Transport Agreement. Unlike the Transit Agreement the Transport Agreement was not very popular and was signed only by 11 states. It was and is therefore of no significance and most of the current state parties to the Transport Agreement are, from the perspective of international aviation, still only of secondary importance.28

As far as the air traffic rights, agreed upon in bilateral air service agreements, are concerned, it is important to know that these rights are not granted directly to the airlines, but are exchanged among the contracting states, who, in a second step, pass these rights to the airline(s) registered within their jurisdictions.29 This transfer of air traffic rights to an air carrier goes along with a notification to the other state about which air carrier was granted the air traffic rights. This whole procedure is called designation. The designation is a crucial step before air transportation services between two countries can be offered. Designation is regularly understood as the permission to enter a market and to operate between two or more destinations located in two or more countries.30 Being designated enables airlines to operate from a point within the designating country and it can apply to the other country for permission to fly into and out of its airspace, thereby making use of the rights agreed in the corresponding air service agreement. Although the designated airline must also obtain a separate permission of the other country to enter and leave its airspace, this

27 Ibid. at 52f.
28 Knut Ipsen (2004), Völkerrecht (International Law), 5th edn., (Munich: Verlag C.H. Beck) at 902, para 6 [Ipsen, Intl. Law]; Verdross/Simma, supra note 2 at 664, note 12; it is presently signed by 11 countries of which only The Netherlands are of substantial significance in respect of air transportation services.
29 Matte, supra note 10 at 143; Bin Cheng (1962), The Law of International Air Transport, (London: Stevens and Sons) at 359 [Cheng].
30 See e.g. Eugene Sochor, ‘From the DC-3 to Hypersonic Flight: ICAO in a Changing Environment’ (1989–1990) 55 J. Air L. and Com., 407 (author refers to designation as part of market entry, at 431, n. 78) [Sochor]; Jennifer Yang (1995), Air Transport Regulation in a new Era, (LL.M. Thesis, Institute of Air and Space Law, McGill University), (air traffic right is defined as ‘a market access right which is expressed as an agreed physical or geographical specification, or combination of specifications, of who or what may be transported over an authorized route to parts thereof in the aircraft authorized’, at 101) [Yang].
is usually not very difficult as the only reasons, for which an airline can be withhold this permission, are set out in the air service agreement. Thus, each country has only a limited discretion in refusing an air carrier designated by the other contracting state.31 This also means that whether an air carrier can make use of air traffic rights depends mostly on whether it is designated by its registration state. One of the few reasons for which a permission to enter and leave a State’s airspace could be withheld is, if the majority of the ownership of an air carrier does not belong to the designating state, its citizens or both combined. A clause, commonly referred to as ‘nationality clause’ or ‘substantial ownership clause’, which is usually part of every air service agreement, stipulates that both state parties to an air service agreement can refuse to grant to an air carrier, designated by the other party, the necessary permissions to operate within its airspace, if the majority of the ownership of such an air carrier is not held by the designating state, its nationals and/or both combined.32 This provision guarantees the bilateral nature of an air service agreement and precludes that air carriers from other states can benefit from the granted privileges.33 At the same time the designating state can be held responsible for any incorrect conduct of the air carriers it has designated as it has the authority flowing from its territorial sovereignty to impose duties and obligations on its airlines.

31 See also Matte, supra note 10 at 147; Cheng, supra note 29 at 359, 363; Burkhardt, supra note 24 (sometimes it is even possible that a foreign air carrier is granted the necessary permissions solely for political reasons, although it could be rejected under the applicable bilateral, at 138f.).

32 Schwenk/Giemulla, supra note 13 at 639.

33 Ibid.
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Chapter 2

Regulation of Air Transportation in the European Community

As seen above, international air transportation has always been a matter that was dealt with by States through bilateral air service agreements. With the creation of the European Community and its continuous expansion to various policies, the question has arisen, whether the Community could or even should be responsible for the regulation of international aviation. With respect to the regulatory powers of the European Community, one needs to distinguish, whether the EC adopts acts that are binding on the Member States and/or the citizens of the Community or whether the Community concludes an international agreement with a non-EC country. For both kinds of activities the EC is granted competences in the EC Treaty. Competences that allow the EC to adopt acts that are binding upon the Member States and/or the citizens will be referred to in the following as internal competences or internal powers. Competences that enable the Community to conclude an international agreement are called hereafter treaty-making powers.

THE ESTABLISHMENT OF A COMMON MARKET FOR AIR TRANSPORTATION SERVICES

The main internal competence for adopting regulations relating to air transportation is laid down in Article 80 EC.\textsuperscript{34} This provision says:

(1) The provisions of this title shall apply to transport by rail, road and inland waterways.

(2) The Council may, acting by a qualified majority, decide whether, to what extent and by what procedure appropriate provisions may be laid down for sea and air transport.

Since Article 80(2) EC leaves it to the discretion of the EC Council, whether it wants to adopt measures in the area of air transportation, this field was left out of the agenda of the Community for a long time.\(^{35}\) Mainly because of some judgements of the European Court of Justice, the Council was forced to become involved with air transportation matters. In the ‘French Seamen’ judgement,\(^{36}\) the ECJ ruled that Article 80(2) EC did not excluded the applicability of the EC Treaty to sea and air transport. Still, even then the Council did not held it as necessary to adopt any substantial regulations and, after three years of deliberations, enacted only a Directive on inter-regional scheduled air services,\(^{37}\) which was of limited significance. Although this regulation was of little significance, it, at least, set the liberalization process in motion.\(^{38}\) This process was further accelerated when in 1986, in the ‘Nouvelles Frontières’\(^{39}\) judgement, the Court of Justice concluded that the EC competition laws were applicable on air transportation. From that moment on, the Council became more active in the area of air transportation. In 1987, and thus shortly after the ‘Nouvelles Frontières’ judgement the Council approved a first package of rules regarding air transportation.\(^{40}\) The most important rule of this package was possibly the inclusion of the air transportation sector under the EC competition laws, from which the air transportation industry had been excluded until that moment. However, a transitional period of three years was also adopted until EC competition laws would become fully applicable. During this time, block exemptions were granted, providing immunity for most of the airlines’ activities from the competition rules.\(^{41}\) Other parts of this first liberalization package included the following areas:\(^{42}\)

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\(^{38}\) Button/Swann, *supra* note 35 at 114.


