

TREVOR SOAMES, GEERT GOETEYN AND PETER D. CAMESASCA

European Aviation Law: New Wings Unfolding

I. INTRODUCTION AND OVERVIEW

The aviation industry has been in crisis. The general downturn in the world economy in 2000 would have been sufficient to cause serious problems, but the combination of terrorism, SARS and wars in Afghanistan and Iraq turned an impending storm into a hurricane. Additionally, low-cost carriers started seriously to challenge the established, often network based, airlines. The industry crisis resulted in some significant victims. The economic fragility of the industry is apparent to all, as is the urgent need for deregulation and consolidation.

Now the worst seems to be over, it is time for the industry and the regulators to look forward. Recent developments in Europe already point the way, most significantly the Commission's recent decision concerning the merger between Air France and KLM¹ as well as the EU/US Open Skies negotiations.

This paper outlines the current state of play in the aviation sector in Europe. It also reviews what form the inevitable re-structuring of the aviation industry might take. The first part of the paper deals with the consequences of: (a) the economic crisis; (b) the irrational structure of the airline industry; and (c) the Open Skies judgments and the subsequent Commission negotiations towards an air service agreement (ASA) with the USA. The second part of the paper examines the developments that may be expected in the medium to long term.

2. LATEST DEVELOPMENTS AND CURRENT STATE OF PLAY IN THE AVIATION SECTOR

2.1 Consequences of the Economic Disturbances

The aviation industry suffered four major blows in the first few years of the 21st century, namely the:

* Trevor Soames and Geert Goeteyn are partners of Howrey Simon Arnold & White LLP, Brussels. Peter D. Camesasca is a senior associate at Howrey Simon Arnold & White LLP, Brussels, and Assistant Professor at the Rotterdam Institute of Law and Economics, Erasmus University Rotterdam. The assistance of our colleagues Paris Anestis, Kristian Hugmark and Stamatis Drakakakis in preparing this paper is gratefully acknowledged. Paris Anestis is a partner, and Kristian Hugmark and Stamatis Drakakakis are associates at Howrey Simon Arnold & White LLP, Brussels. Views and opinions expressed in this paper are not those of the firm or its clients.

1. Case COMP/M.3280, *Air France/KLM*, Commission Decision of 11 February 2004.

- Downturn in the worldwide economy, starting in 2000;
- The September 11, 2001 terrorist attacks against the World Trade Center and the Pentagon in the USA, and the subsequent acts of terror in Asia and elsewhere;
- Wars in Afghanistan and Iraq; and
- The outbreak of SARS in Southeast Asia 2003.

At the same time, and partly as a result of these circumstances, the traditional full service airlines have faced ever-increasing competition from, and lost substantial market shares to, low-cost carriers especially on short-haul services in Europe and in the USA.

This resulted in a number of perhaps inevitable consequences, each with competition law implications, primarily (a) bankruptcies and government-inspired rescue operations, (b) other State aid measures in Europe, and (c) the derogation from the “use-it-or-lose-it” principle in the Slot Code of Conduct Regulation.

Bankruptcies and Government Rescue Operations

Shortly after 11 September 2001, a number of European carriers announced that they were on the verge of insolvency. In October 2001, Swissair filed for bankruptcy. Despite the Belgian government’s attempts to save its flag carrier Sabena, Swissair took its Qualiflyer alliance partner with it to the grave. Swissair withdrew its planned capital increase operation, and Sabena found itself in desperate need of a loan to maintain its cash flow. The Belgian government granted a short-term €125 million rescue loan, which was insufficient to save Sabena but enabled the creation of SN Brussels Airlines based on the surviving Sabena subsidiary, DAT.

Sabena had previously received restructuring aid in 1991. Under the “one time, last time” principle, further aid could only be allowed “under exceptional circumstances, unforeseeable and external to the company”.² The Commission Rescue Aid guidelines define the notion of unforeseeable circumstance as being “one which could in no way be anticipated when the restructuring plan was drawn up”. However, the previous restructuring plan proved of little importance to the Commission’s assessment of the aid. The Commission concluded that use of the Belgian reference rate and the short term of the loan (one month with a possible two month extension), in conjunction with the social concerns – Sabena had 13,600 employees and indirectly employed a further 4,000 – justified the aid.

2. Case C-261/89 *Alumina and Comsal* [1991] ECR I-4437.

The situation for many US carriers was even more precarious. 9/11 resulted in a four-day closure of US airspace, increased security costs, a drastic passenger decrease and subsequent fare cuts, and struck the already financially fragile US carriers very hard. The US government granted generous emergency funds to keep its major carriers alive: an immediate \$3 billion to upgrade security in airplanes and at airports, and then the following week, President Bush signed a bill granting airlines \$5 billion in direct aid and another \$10 billion in loan guarantees. US policy represented a U-turn from previous economic downturns, when the USA had been sceptical about providing any financial help to the carriers; the “laissez-faire” approach of the 1990s led to US airline industry consolidation through the collapse of, *inter alia*, Pan Am and later TWA.

The Commission considered that aid granted to US carriers after 9/11 could provide them with an unfair competitive advantage as many European carriers were in severe financial difficulties and could only receive limited financial aid subject to increasingly strict EC State aid rules. The resulting possible distortion of competition between US and European carriers (not least because the USA already had the power to sanction foreign carriers benefiting from State subsidies) resulted in the Commission preparing a draft Regulation to enable the EU to impose protective measures against subsidised non-Community airlines and unfair pricing practices by non-Community airlines. On 11 March 2004, the Council and the Parliament reached a final agreement on the contents of the Regulation.³ It provides for protective measures on condition that the following two criteria are established, namely:

- The existence of subsidies or unfair practices that injure EU industry; and
- An EU interest calling for intervention, balancing the interests of consumers and other interested parties against the interests of the EU industry.

Measures can be provisional or definitive. The exact scope of the measures will be set out in a subsequent Regulation, but measures should preferably consist of the imposition of duties on the non-Community carrier. The Regulation also allows for undertakings to be secured which remedy the injurious effects. Recital 3a states that any Air Services Agreement (ASA) between a Member State and a third country that effectively deals with the practices covered by the Regulation will take precedence over it. The implications of the new legislation will most likely be discussed as part of the overall EU/US ASA negotiations. With both parties having equivalent rights to impose measures, the EU and USA can engage in discussions to establish an agreed position.

3. Regulation of the European Parliament and of the Council concerning protection against subsidisation and unfair pricing practices in the supply of airline services from countries not members of the European Community, not yet published in the OJ, see Commission Press Release IP/04/328.

Aid granted by the US government did not, however, solve the problems of the US carriers. On 9 December 2002, United Airlines filed for Chapter 11 bankruptcy protection. Other airlines such as Hawaiian and Vanguard followed suit, while other such as US Airways remain weak. Chapter 11 of the US Bankruptcy Code permits bankrupt companies to continue operations while developing a plan of reorganization to address debt and capital and cost structures. Despite extensive rationalization of operating costs, United Airlines had to apply for an extension of its Chapter 11 protection, but is expected to come out of bankruptcy during 2004.

Other State Aid Measures in Europe

Apart from the rescue aid granted to Sabena, the Commission authorised the adoption of a number of one-off aid measures to carriers in the aftermath of 11 September 2001.⁴ In a Communication⁵ issued on 10 October 2001, it set out its policy in respect of aid granted as a response to those special circumstances, in effect allowing Member States to indemnify their national carriers for the exceptional losses suffered as a result of the four-day closure of the US airspace, subject to strict conditions.

The Commission had to assess whether the State support granted to certain EU airlines exceeded the losses suffered as a direct result of 11 September 2001. Any amount in excess of the airlines' loss would constitute State aid within the meaning of the EC Treaty. While monitoring the financial relief granted, the Commission concluded – for instance – that the package offered by the Austrian government⁶ met the conditions only in part, and reduced the amount of authorised aid to €1.4 million. The Commission rejected two measures, totalling around €2 million, as most of this sum was intended to cover losses incurred by the Austrian carriers concerned on the entire network, including routes outside the US. The Commission held that the method of calculation did not make it possible to establish a direct link with the closure of US airspace, and that the remainder of the sum concerned 15 September 2001, and so fell outside the relevant period, which was 11 to 14 September 2001. The Commission also refused to allow France to extend the original aid scheme to cover costs incurred by its national carriers beyond the four-day closure of the American airspace.⁷ The aid notified by France, totalling €54.9 million, was rejected by the Commission on the grounds that it did not meet the specified conditions and that in the absence of similar packages notified by other Member States, the extension in question would significantly distort competition in

4. We also note the Charleroi Airport State aid case, see below at 3.2.

5. COM (2001)574.

6. Commission Press Release IP/02/1490 of 16 October 2002.

7. Commission Press Release IP/02/1855 of 11 December 2002.

the internal market. In a similar case, the Commission doubted whether the €5 million compensation for the effects of 9/11 granted by Greece⁸ to two of its air carriers.

The strict Commission approach towards national airlines in financial difficulties was further demonstrated in the *Olympic Airways* case, where the Commission ordered the recovery of €41 million of aid received after 1998, and the repayment of an estimated €153 million of alleged new aid,⁹ and the subsequent enforcement action¹⁰ for non-compliance against Greece. These decisions indicate that the Commission does not intend to let Member States protect national flag carriers that remain in debt for too long a period of time without any serious re-structuring which will restore the airline's financial health. Recently the Commission opened a new formal State aid investigation procedure regarding the grant of unlawful State aid to *Olympic Airways*. The Commission is mainly concerned with allegations that the recent restructuring of *Olympic Airways* (in the form of a spin-off of Olympic Airways' flight operations into a subsidiary that was subsequently re-named as *Olympic Airlines*) was unlawfully subsidised and that the legal arrangements surrounding the spin-off did not comply with EC law. Moreover, there are concerns that *Olympic Airways* did not pay to the State significant amounts of through-put levies.¹¹

Airline losses also included high surcharges on existing insurance premiums, imposed by insurers who had announced the withdrawal (or drastic reduction) of liability cover for war and terrorism risks a few days after the attacks. To ensure that all carriers were adequately covered against such risks, the Commission authorised Member States to introduce temporary mechanisms providing liability insurance for a period of 30 days pending the restoration of an acceptable level of cover by commercial insurers. In its Communication of 10 October 2001, the Commission stated that those measures of support had to be notified and: (a) apply uniformly without restriction to all companies in a given Member State; (b) be limited to a period of one month; (c) be exclusively intended to compensate for the extra costs of insurance resulting from the terrorist attacks of 11 September 2001; and (d) not place the airlines in a more favourable position than prior to 11 September 2001. Should the situation persist beyond the initial 30 day period, Member States were allowed to continue providing a supplementary guarantee to the insurance companies or underwrite the risk directly in accordance with common guidelines concerning duration, level of cover, method of setting premiums, players covered and treatment of third countries. This emergency aid, originally intended by the

8. Commission Press Release IP/03/760 of 27 May 2003

9. Commission Decision 2003/372/EC of 11 December 2002 on aid granted by Greece to Olympic Airways [2003] OJ L 132/1.

10. Commission Press Release IP/03/561 of 23 April 2003.

11. See Commission Press Release IP/04/348 of 24 September 2002

Commission to terminate on 31 December 2001, was extended several times and finally expired on 30 June 2002. To restore normal market conditions following the aviation insurance crisis, the Commission proposed a Community Regulation establishing minimum insurance requirements for all carriers operating in Europe.¹²

The current reform of State aid rules has had an impact on the aviation sector, in particular, with regard to the proposed new guidelines for rescue and restructuring aid (introducing the notion of “urgency” aid”), as well as the extension of the application of the *de minimis* rule in aviation.¹³

Derogation from the “Use-It-or-Lose-It” Principle

The Slot Code of Conduct allows “grandfather rights”, meaning that carriers are allowed to retain slots from one season to the next corresponding season, so long as the incumbent airline uses at least 80 percent of them.¹⁴ However, the industry crisis forced the Community to deviate from this “use-it-or-lose-it” principle. The Parliament and the Council adopted two amendments to Regulation 95/93, one in May 2002¹⁵ (to deal with the effects of US airspace closure) and one in July 2003¹⁶ (to deal with the impact of the war in Iraq and the SARS epidemic). The amendments made the “use-it-or-lose-it” rule inapplicable for the summer 2002, the winter 2002/2003 and the summer 2004 scheduling seasons. As a result, carriers were able to keep their slots with grandfather status, irrespective of whether or not they met the required utilisation thresholds.

2.2 The Irrational Structure of the Airline Business

Having a domestic flag carrier, whether publicly controlled or not, is often a matter of significant importance for many countries. Apart from being a matter of national prestige, a strong airline ensures public air transport on domestic routes, where necessary, and operations to important foreign destinations. A number of national flag carriers have been extensively protected by their national governments even after the liberalisation of the EU/EEA aviation market, often through the grant of State aid. In addition, all national carriers have benefited from the allocation of traffic rights under the ASA system due to the

12. See Commission Press Release IP/02/1357 of 24 September 2002.

13. See Commission Press Release IP/04/290 of 3 March 2004

14. According to a proposed amendment of the Slot Code of Conduct, it is proposed that not only the incumbent but also its code-share partner’s use of the slots allow for retaining the slots, see proposed new Article 10(8) in Common Position adopted by the Council (16305/03 and 5998/04 ADD 1), 19 February 2004.

15. Council Regulation 894/2002, [2002] OJ L 142/3.

16. Council Regulation 1554/2003 [2003] OJ L 221/1.

so-called “nationality clauses”, which require that the majority of an airline is owned by its own nationals.

This has resulted in the aviation sector having some very industry-specific features. In particular, it has allowed many national flag carriers to operate international networks, without necessarily having a sufficiently large domestic market to do so in a commercially viable manner. Such a market structure is unsustainable in a normal commercial environment and it has therefore generally been recognised that the European airline industry is in urgent need of consolidation.¹⁷ However, nationality clauses have made it virtually impossible for airlines to consolidate and rationalise as in other industries; airlines have instead resorted to strategic alliances and sometimes joint ventures characterised by various levels of cooperation.

The recently cleared merger between Air France and KLM¹⁸ is an important indication of likely future developments. The transaction is not a full-scale merger as the new holding company – although fully owning KLM – does not have sole control; 51% of the voting rights will be retained in Dutch hands in order to satisfy the requirements contained in ASAs regarding nationality. The holding company will retain sole control until a period of time has elapsed by when the parties expect that an EU/US Open Aviation Area will have been concluded. The Commission press release issued when the decision was adopted stated that the concentration between Air France and KLM “shows that the long-awaited consolidation of the European airline sector can be done in full respect of competition rules. The merger (...) will provide air passengers with a greater choice of destinations and services without having to pay a higher price on those routes where their presence is the strongest”.¹⁹

Full-blown alliances have been considered by the European Commission to have the same competitive effects as mergers, albeit assessed under the anti-trust rules rather than under the merger regime.²⁰ These arrangements often fall within the scope of Article 81(1) EC and therefore require the application of Article 81(3) EC to ensure that they do not infringe the EC competition rules.

17. The following excerpt from a speech delivered in New York before the World Economic Forum by Commissioner Loyola de Palacio is, in this respect, interesting: “It is to compensate its fragmentation handicap that European carriers have largely adopted the not so satisfactory “alliance” system, meaning a model of loose co-operation that is less stable, less permanent and less beneficial than more traditional forms of commercial consolidation. This model also gives rise to confusion for consumers because of code-shares and the division of responsibility between carriers”. See Commission Press Release Speech/02/41 of 4 February 2002.

18. See above footnote 1.

19. Commission Press Release IP/04/194 of 11 February 2004.

20. The only exception in Europe so far is KLM/Alitalia, which was considered a full-function joint venture and assessed under the Merger Regulation. See Case COMP/JV.19 *KLM/Alitalia*, [2000] OJ C 96/5.

Almost all major airlines are part of one of the global alliances: Star Alliance, **oneworld**, Wings and SkyTeam.²¹ These alliances generally contain all or some of the following features: joint frequent flyer programmes, code-share arrangements as well as a number of far-reaching bilateral co-operation agreements relating to a wide variety of areas of cooperation, including joint route planning, scheduling, marketing and revenue sharing. However, the **oneworld** alliance has a significantly more constrained ability to cooperate due to the continuing lack of antitrust immunity for the crucial American Airlines/British Airways relationship.

There is another important peculiarity, this time relating to the application of EC competition law in the airline sector. Although the Commission has the power to apply Articles 81 and 82 EC fully to intra-EU alliances and other activities, its competence with regard to alliances and other activities affecting third country routes has been far more limited. The Commission could only use the cumbersome procedures of Article 85 EC which allow it to open an investigation in cooperation with the relevant Member State(s) and, if necessary, to propose appropriate measures to bring infringements to an end. If the airlines failed to do so, the Commission had the ability to issue a reasoned decision and propose measures necessary to remedy the situation. In accordance with Article 84 EC, the relevant Member State may also have concurrent jurisdiction and in recent cases (such as *BA/AA II* and *United/bmi british midland*) the Commission let the Member State take the lead under Article 84 – a marked contrast to previous practice.

This anomaly is about to change. After a decade long battle for increased competence to apply the competition rules effectively in the field of air transport, the Commission succeeded on 26 February 2004 in securing the adoption of a new Regulation which grants the Commission the ability to apply directly Articles 81 and 82 EC to air transport between the Community and third countries. The new legislation will enter into force on 1 May 2004, as part of the “Modernisation Package” of competition rules simultaneously with the enlargement of the European Union.²²

In recent years, the Commission has assessed a number of intra-EU strategic alliances, most notably *Lufthansa/SAS/bmi British Midland*,²³ *Lufthansa/Aus-*

21. After the Commission clearance of the Air France/KLM merger, the number of global alliances is effectively reduced to three, as no effective competition remains between SkyTeam and Wings.

22. Council Regulation (EC) 411/2004 of 26 February 2004, repealing Regulation (EEC) 3975/87 and amending Regulation (EEC) 3976/87 and Regulation (EC) 1/2003, in connection with air transport between the Community and third countries, [2004] OJ L 68/1. Regulation 3976/87 is also repealed save for Article 6(3), which will continue to apply to exemption decisions granted pursuant to Article 81(3) EC before the coming into force of Regulation 1/2003, until the expiry of those decisions.

23. Case COMP/37.812 *British Midland/Lufthansa/SAS*, Commission Press Release IP/01/831.

*trian Airlines*²⁴ and, recently, *British Airways/Iberia/GB Airways*²⁵ and *British Airways/SN Brussels Airlines*²⁶, as well as a number of third country alliances, most notably *Lufthansa/SAS/United Airlines*²⁷, *KLM/Northwest*²⁸ and *American Airlines/British Airways I*, while other investigations are still ongoing, most notably into the SkyTeam alliance. The German authorities also dealt with the first of these transatlantic alliances, i.e. *Lufthansa/SAS/United Airlines*, while the OFT has examined *American Airlines/British Airways I* and *II*²⁹, as well as *United Airlines/bmi british midland*.³⁰ In *American Airlines/British Airways II* and *United Airlines/bmi british midland* the UK OFT took the lead, rather than the Commission. Together with the guidance provided in the *Air France/KLM*³¹, *KLM/Alitalia*³² and *United Airlines/US Airways*³³ merger review cases, these precedents have clarified Commission policy on consolidation and the remedies it considers necessary to deal with competition concerns.

The precedents from these cases can be summarised as follows:

- **Market definition** – the demand side perspective, which is considered to be the origin/destination city pair (including services between the airports used by the parties, as well as flights from competing airports serving the same metropolitan area), forms the starting point for the definition of the relevant market. This initial definition may be broadened to include competing flights from neighbouring airports if the catchment areas significantly overlap with those of the airports serving relevant city pair. The Commission takes into account non-stop services, as well as indirect flights to the extent that they are substitutable.³⁴ On short haul routes, competition may also be provided by other modes of transport such as high-speed

24. Commission Decision (2002/746/EC) *Lufthansa/Austrian Airlines* [2002] OJ L 242/25.
25. Case COMP/38.479 *British Airways/Iberia/GB Airways*, Commission Decision of 10 December 2003.
26. Case COMP/38.477 *British Airways/SN Brussels Airlines*, Commission Decision of 10 March 2003.
27. Commission Notice of 30 October 2002, [2002] OJ C 264/5.
28. Commission Notice of 30 October 2002, [2002] OJ C 264/11.
29. The Commission did not open a formal investigation into *American Airlines/British Airways II*, but was heavily involved in the OFT's investigation.
30. As with *American Airlines/British Airways*, the Commission did not open a formal investigation into *United Airlines/bmi british midland*, but followed closely the OFT's investigation.
31. See above footnote 1.
32. See above footnote 20.
33. Case COMP/M.2041 *United Airlines/US Airways*, Commission Decision of 12 January 2001.
34. Indirect services may provide a competitive alternative to non-stop services if marketed as one flight on the city pair in question and if the connection time does not exceed 150 minutes.

trains. Substitutability between non-stop and indirect flights, airports and other modes of transport will depend on whether the facts of the case warrant a distinction between time-sensitive (business) passengers and non-time-sensitive (leisure) passengers. This distinction is more likely to be considered relevant for short haul services, while on long haul flights both time sensitive and non-time sensitive passengers may be considered to form part of the same market. However, this needs to be evaluated on a case-by-case basis and the distinction between time sensitive and non-time sensitive passengers was resurrected by the Commission in *Air France/KLM*;³⁵

- **Competition assessment** – the Commission’s investigation focuses on whether there are any competition issues on those city pairs where the parties’ services overlap. Non-stop/non-stop overlaps, as well as non-stop/indirect and indirect/indirect³⁶ overlaps are taken into account where relevant. Special attention is given to hub-to-hub routes. The Commission recognises verifiable efficiencies created by airline alliances provided that they are passed on to the consumer. With sufficient remedies to ensure low barriers to entry, consumer benefits may outweigh competition restrictions, even on city pairs where the transaction results in a monopoly. The Commission has concentrated on competition issues arising from overlaps between the parties to the transaction (or their alliance partners to the extent that this also creates an overlap). The wider issue of inter-alliance competition has not been investigated in depth but the reality is that network carriers compete on a network level through their alliances (especially when immunised). The *Air France/KLM*³⁷ decision indicates that network effects are becoming increasingly important in airline competition assessments. It was noted that on the demand side, networks are of relevance especially for corporate clients. On the supply side, it was recognised that network carriers compete at network level but the Commission placed great weight and reliance on its established O&D city pair approach, noting that its assessment of the SkyTeam alliance will continue post the *Air France/KLM* decision. It is expected that the long-dormant *SkyTeam* investiga-

35. See above footnote 1.

36. In the *United/US Airways* merger review (and similarly in the recent *Air France/KLM* review), the Commission examined indirect/indirect overlaps between United Airlines (and its alliance partner Lufthansa) and US Airways on city pairs where:

- there was appreciable O/D traffic (more than 30,000 pax p.a.);
- no airline offered a non-stop service;
- the indirect services of the merging parties and alliance partners collectively accounted for an appreciable (between 35%-65%) O/D traffic share; and
- the merger would (including alliance partners) result in a significant addition of market shares (i.e. more than 5-10%).

37. See above, footnote 1.

tion³⁸ will revive after 1 May 2004, when the Commission obtains full competence to assess transatlantic alliances.

- **Remedies** – slot divestiture is the primary remedy to solve competition problems at congested (hub) airports served by transaction parties (or their alliance partners). In *British Airways/Iberia/GB Airways*,³⁹ the Commission indicated (contrary to previous practice) that it would accept slot remedies at Gatwick rather than at British Airways' hub at Heathrow. Similarly, in *Air France/KLM*, the Commission accepted that the main airports serving each of Paris, Milan, and New York were substitutable, and that slot remedies applied only to "Paris", "Milan", and "New York" with no distinction made between, respectively, Charles de Gaulle (CDG) and Orly (ORY); Malpensa (MXP) and Linate (LIN); and John Fitzgerald Kennedy (JFK) and Newark (EWR). It remains to be seen, however, whether these cases signal a shift in policy on behalf of the Commission to accept slot divestitures at competing (but for the parties commercially less vital) airports serving the same relevant city, or whether they remain case-specific decisions. Another new development in the *British Airways/Iberia/GB Airways* case was that the slot commitments relating to two of the four identified "problem city-pairs" – London-Valencia and London-Seville – were conditional upon at least 40 point-to-point passengers travelling daily on the city pairs in question at unrestricted fares in any two consecutive IATA seasons. This number was calculated on the presumption that each flight would expect to carry approximately 13 unrestricted passengers; 40 passengers would allow for three daily profitable operations on the city pair. In addition to slot remedies, the Commission imposed capacity freezes, pricing constraints to avoid predation, blocked space agreements and interlining obligations to encourage new entry. In recent decisions (and *Air France/KLM* is just the latest example), the Commission accepted various safeguards regarding interlining. The parties to the alliance or the merger, as the case may be, can require that the new entrant (or the passenger) pay the difference between the fare charged by the parties and the fare charged by the former. Where the new entrant's fare is lower than the value of the coupon issued by them, the parties may endorse their coupon only up to the value of the fare charged by the competitor. The Commission has also imposed remedies relating to access to joint frequent flyer programmes and CRS displays. Finally, the Commission has also requested Member States to issue declarations pertaining to fifth and sixth freedom rights (for example, see *Lufthansa/SAS/United Airlines*⁴⁰ and *Air France/KLM*⁴¹).

38. Case COMP/37.984, Commission Notice of 27 March 2003, [2002] OJ C 76/12.

39. See above, footnote 25.

40. See above, footnote 27.

2.3 The Open Skies Rulings and the Commission Mandate to Negotiate with the US

The issue of competence to conclude ASAs has been debated for many years. The European Court of Justice finally ruled on the issue in its judgments of 5 November 2002⁴² relating to ASAs between eight Member States and the USA. Of the eight defendants, seven had entered into full Open Skies agreements with the USA. The purpose of these agreements was to liberalize air transport services between the signatory countries, including the right to fly onwards from a destination to a third country (“fifth freedom” traffic rights). The eighth Member State, the UK, did not have an Open Skies arrangement with the USA and air transport services between the two countries were regulated by a more traditional and very restrictive type of ASA concluded in 1976 (commonly referred to as “Bermuda II”). However, all the contested agreements contained nationality clauses, granted traffic rights to airlines owned and controlled by nationals of the contracting parties.

The Commission considered that US carriers were the main beneficiaries of the Open Skies agreements, as the fifth freedom rights granted by the agreements allowed them to cover most destinations within Europe. By contrast, EU carriers only had limited rights, as they could only fly to the USA from their home country and were not entitled to offer US domestic services. Bermuda II was even more restrictive than the Open Skies agreements in the exchange of traffic rights, as it restricted access to London Heathrow to four carriers, two from the UK (British Airways and Virgin Atlantic) and two from the USA (American Airlines and United Airlines).

The Commission further considered that nationality clauses restricted competition between European airlines and prevented consolidation through mergers and acquisitions within the industry. National flag carriers ran the risk of losing traffic rights in the case of an acquisition by an airline of another country as they would no longer be majority-owned and controlled by investors of their home country.

In the cases brought before the Court, the Commission challenged (a) the Member States’ power to conclude bilateral ASAs, claiming the Community had the exclusive competence to do so and (b) the validity of the nationality clause.

With regard to the first issue, the Court rejected the Commission’s argument that the Community had the exclusive power to conclude third country ASAs

41. See above, footnote 1.

42. Cases C-467/98 *Commission v Denmark*; C-468/98 *Commission v Sweden*; C-469/98 *Commission v Finland*; C-471/98 *Commission v Belgium*; C-472/98 *Commission v Luxembourg*; C-472/98 *Commission v Austria*; C-476/98 *Commission v Germany*; C-466/98 *Commission v United Kingdom* [2002] ECR I-09427 et. seq.

on the alleged basis that this was necessary to achieve the objectives of the EC Treaty in the aviation field.⁴³ It then assessed whether, on the basis of the AETR doctrine of implied powers, the adoption of internal Community rules creating a common aviation market had conferred such exclusive external competence on the Community. This would be the case if the international commitments given by Member States in the ASAs were liable to jeopardize the objectives of those internal rules. As Regulation 2407/92 (the licensing regulation) and Regulation 2408/92 (dealing with access to intra-Community routes) only apply to "Community carriers" and not to carriers majority-owned and controlled by nationals of a non-Member State, the Court considered that there was no risk of distortion of the common market. The ASAs under investigation therefore were held not to be in breach of Community law in so far as they regulated the allocation of traffic rights and access to Community routes to non-EU carriers. The Court recognised the Commission's exclusive competence in the harmonised areas relating to the setting of air fares and rates for intra-Community air services, the CRS Code of Conduct and slot allocation. The ASAs under investigation only dealt with the first two issues; they did not contain rules relating to slot allocation. They therefore only infringed the Community's exclusive external competence in these two, very narrowly defined areas.

However, the ECJ upheld the Commission's view that the ownership and control provisions in the ASAs reserving traffic rights to carriers majority owned and controlled by nationals of the contracting parties infringed the EC principle of freedom of establishment contained in Article 43 EC. The Court considered that such provisions prevent EU carriers of one Member State from establishing themselves in another Member State and offering direct air services from that country to US destinations. The ECJ rejected the argument made by some Member States that such restrictions were justified by public-policy reasons and that they had employed their best efforts to eliminate the incompatibility but had not been able to persuade the USA to accept amendments.

The ECJ's ruling on the ownership and control provisions was a major victory for the Commission. Although the Commission had, to a large degree, lost the argument relating to exclusive external competence, the ECJ's judgments in practice took away the very reason for the Member States to keep exclusive control over the negotiations of bilateral ASAs as they were no longer able to reserve traffic rights to their own national carriers.

The impact of the Court's judgments was immediate. The Commission issued a press release⁴⁴ welcoming the rulings and requesting not only the eight

43. This argument was based on the case law of Opinion 1/76.

44. Commission Press Release IP/02/1713 of 20 November 2002.

governments directly concerned by the rulings but also the other seven Member States which had signed bilateral agreements with the USA, to activate the denunciation provisions to ensure compliance with the judgments. It requested all Member States to refrain from undertaking international commitments of any kind in the field of air transport before having clarified their compatibility with Community law. Finally, the Commission urged the Council to grant it the long-sought mandate to negotiate a bilateral EU/US ASA and similar agreements with other third parties.

The Commission's statement constituted an extensive interpretation of the ECJ judgments. In particular, compliance with the Court's decision did not necessarily require termination of the agreements. Compliance could be achieved, for instance, by means of the elimination of the nationality clauses and of the clauses governing the sectors covered by common rules where the Community had been held to have exclusive competence. Nevertheless, Member States were obliged as a matter of Community law to review their bilateral ASAs in respect of those key provisions. Without the nationality clauses the equilibrium of the ASAs was likely to be impaired so jeopardizing their viability⁴⁵ (a fact which might have rendered the Member States liable towards the USA). To complicate matters further, as a result of the judgments any EU air carrier established in any Member State and wishing to provide services to destinations outside the EU was now entitled to do so. The Member States in question could no longer prevent that carrier from operating such services on the grounds of ownership or nationality. The question of the termination of the bilateral agreements thus depended mainly on the value attached to the nationality clause by the contracting parties. In a speech delivered shortly after the judgments, the Associate Deputy Secretary of the US Department of Transport, Mr. Jeffrey Shane, stated⁴⁶ that, while these clauses are most important in the existing Open Skies agreements, the US would be willing to seek "creative" alternatives as the offending provisions were "permissive" from a US perspective.

The unilateral termination of the bilateral agreements could also have had an undesirable and harmful effect for the airline industry in respect of competition policy. The existence of Open Skies agreements had, as a matter of US aeropolitical policy, traditionally been linked to the granting of antitrust immunity to transatlantic alliances between US and European carriers.⁴⁷ Even though

45. This is particularly true for the Bermuda II agreements.

46. Speech delivered to the Forum on Air and Space Law of the American Bar Association in Florida on 8 November 2002.

47. For instance, clearance of the *United/Lufthansa/SAS* alliance was conditional, *inter alia*, upon the conclusion of Open Skies agreements between the USA and Germany, Sweden, Denmark and Norway. See US DoT Order 99-2-22.

the US authorities refrained from calling for the suspension of antitrust immunity, the threat to do so remained a powerful deterrent.

The hardline position adopted by the Commission resulted in hostile reactions from both Member States and the airlines. A more balanced view was adopted by the Commission in its press release of 26 February 2003,⁴⁸ setting out some proposals relating to the division of labour between the Commission and the Member States with regard to the negotiations of ASAs with non-Member States. On 5 June 2003 the Council adopted the Commission's proposals.⁴⁹ The package consisted of three different legislative measures, i.e.:

- (a) Council Decision authorizing the Commission to negotiate a Community-level agreement with the USA, aimed at creating an "Open Aviation Area"⁵⁰ to replace the bilateral agreements concluded by Member States;
- (b) Council Decision authorizing the Commission to negotiate Community-level agreements with other third-countries with a view to replacing certain provisions agreed bilaterally by Member States;
- (c) Proposal for a Regulation on the creation of a system of coordination and cooperation for the negotiation and implementation of ASAs between Member States and third countries. The Council has reached a common position on the draft, which is now with the Parliament for a second reading.⁵¹

The mandate granted the Commission the power to negotiate, in consultation with a special committee appointed by the Council, a comprehensive bilateral agreement aimed at creating an Open Aviation Area, within which EU/US air transport would be fully liberalised. The mandate covers a wide array of subjects, listed in the annexed negotiation guidelines for the Commission. They include, *inter alia*: market access, ownership and control, traffic rights, routes, capacity, frequency, slot allocation, leasing, convergence on the application of competition rules and safety and institutional arrangements.⁵² It allows EU and

48. See Commission Press Release IP/03/284 of 26 February 2003.

49. See Commission Press Release IP/03/806 of 5 June 2003 and Memo/03/126 of 6 June 2003. Referring to the adoption of the measures, Commissioner de Palacio stated: "This is an historic decision. Today we have reached a deal that will enable the European Union to assert itself at international level and to work for the benefit of its consumers and its aviation industry. We aim to launch negotiations with the US within a month on an agreement that will bring together the two largest aviation markets in the world."

50. The expression replaces the hitherto commonly used Transatlantic Common Aviation Area (TCAA).

51. Common Position (EC) 7/2004 of 5 December 2003, [2004] OJ C54 E/33.

52. The mandate combines the scope of the ECJ's findings with the earlier mandate granted to the Commission by the European Council in 1996 to open negotiations with the USA in the field of air transport. In 1996, the Council authorized the Commission to start talks with the USA concerning the "first stage" of a EU/US Open Skies agreement, covers

US representatives to discuss the whole range of issues underlying the opening up of their respective markets, including the delicate questions concerning investment and ownership.

The general mandate to negotiate Community-level agreements with third-countries seeks to align existing bilateral ASAs concluded by Member States with the ECJ's rulings by inserting new "European clauses" intended to replace the old nationality clauses and amending the provisions relating to airfares and rates and CRS. The mandate provides in particular: (a) that the new agreements are to supersede pre-existing conflicting texts approved under bilateral agreements between Member States and third-countries, (b) that the Commission will use as a starting point for negotiations standard clauses developed jointly with the Member States and (c) that the Commission is to identify the countries to be approached, indicating an order of priority. On the basis of the decision reached by the Council on the same date, the Commission is further expected to present proposals for new, individual mandates allowing it to enter into negotiations with third-countries in order to achieve a higher degree of liberalisation through the conclusion of Open Skies-type agreements. The priority countries with which to commence negotiations are to be identified according to their readiness to negotiate Open Skies agreements. In the decision, the Council expressed its agreement in principle to a Commission mandate but as the Commission has yet to submit country-specific proposals in order to obtain a mandate in each specific case, it does not constitute an overall blanket mandate to negotiate EU-wide ASAs with third countries.

In a recent Communication, the Commission recommended that the Council extends the Commission mandate to include all countries neighbouring the enlarged union, and indicated that countries in the Far-East and South Pacific are next in line.⁵³

Finally, the draft proposed Regulation seeks to provide Member States with a framework under which they will be able to renegotiate and amend existing bilateral agreements in a coordinated manner and on the basis of standard texts agreed at European level. Given the multitude of existing bilateral agreements that infringe EC law as interpreted by the Court, this measure is essential for the continued functioning of the international air transport market to be as-

only "soft" issues, such as competition rules. At the same time the Council retained control over this process by imposing its own special committee on the Commission, which was to participate in all negotiations with the USA. Furthermore, the Council disconnected the "second stage", concerning market access and including code-share and leasing as far as this is related to traffic rights, capacity, designation, and airfares and rates. As a result of the Commission lacking authorization to negotiate these "hard" traffic rights, discussions with the USA came to nothing (viz. Communication of the Commission to the Council, SEC (97) 2035 final).

53. Commission Communication COM(2004) 74 final, 9 February 2004.

sured. The draft Regulation provides for a system of notification by the Member States at certain stages, and Commission approval to ensure that there is no discrimination between Community carriers.

3. EXPECTED DEVELOPMENTS

The aviation industry and regulators are at a crossroads. An economic upturn, albeit hesitant, has started. Although many carriers still have serious financial problems things are improving. In any other industry, these conditions would encourage consolidation, which is long overdue, to take place. However, in the aviation industry, this may not happen in the short term for two primary reasons. First, although the situation is improving, most airlines do not yet possess sufficient financial power to undertake the necessary consolidation through, for example, merger and acquisition. Second, and perhaps more importantly, the airlines are likely to remain somewhat reluctant as long as there is no EU/US ASA, and these negotiations are unlikely to lead to an early result.

This section first deals with the potential outcome of the Open Skies negotiations between EU and the USA, which will form the foundation for the future structure of the airline industry. Expected market developments will then be examined.

3.1 Possible Outcomes of the EU/US Open Skies Negotiations

On 25 June 2003, the EU and the USA agreed on the opening of negotiations for a comprehensive ASA. In a joint statement delivered in Washington, the President of the USA, the President of the European Commission and the President of the European Council stated: "We are pleased to announce our agreement to begin comprehensive air service negotiations in early Autumn following the early June decision of the EU Council to approve a negotiating mandate for the Commission. This is an historic opportunity to build upon the framework of existing agreements with the goal of maximising benefits for consumers, airlines, and communities on both sides of the Atlantic. The United States and the European Union will work together in a spirit of co-operation to develop a mutually beneficial approach to this crucial economic sector in a globalized economy.⁵⁴" The first negotiations took place in Washington DC on 1 and 2 October 2003. As expected, the initial negotiations demonstrated that the conclusion of an agreement will be a cumbersome and delicate process. The Commission and the Council both indicated that they were not interested in an "early harvest" agreement, whereas the US side has remained more reluctant to a genuine Open Aviation Area. Although the parties have reported substantial

54. Commission Press Release IP/878/03 of 25 June 2003.

progress in areas such as ground-handling and computer reservation systems, the negotiations seem to be fairly stuck on the issue of foreign ownership rules.⁵⁵ These relate in particular to:

- The right for EU carriers to offer intra-US services;
- The demand by the EU that the USA drop the “fly American” rule for its government employees and armed forces; and
- The level of foreign investment.

Currently, foreign investment through the ownership of equity share capital in national carriers is capped at 49.99 percent in the EU and 25 percent in the US. The question arises whether these barriers will be eliminated, allowing US carriers (or other investors) to acquire controlling stakes in EU airlines and vice versa.

As a result of this, the Council recently “recognised that it would not be possible to conclude an agreement with the United States this year that would deliver the full objectives of an Open Aviation Area, as set out in the negotiating mandate”.⁵⁶ The USA had offered to raise the allowed level of foreign ownership to 49%. The Council concluded that only an agreement which better balanced US and EU interests could be accepted, and that the issue would be further discussed in June 2004.

The Commission’s main trump card to persuade the USA to enter into an ASA with the EU is access to London Heathrow, the EU’s busiest international airport (at least as regards EU/US traffic). Moreover, after the US elections later this year, and regardless of its outcome, US politicians may be more willing to make concessions at the negotiating table.

The exact scope of a EU/US ASA is therefore difficult to predict. A minimalist “early harvest” end of the spectrum, which is not desired by the European Union, could emerge as an Open Skies-type arrangement, granting EU-controlled and US controlled carriers the right to offer air transport services between the EU and the USA. Under such an agreement, current limitations on the provision of domestic US services and foreign investment would, however, remain untouched. This would allow consolidation to take place between EU carriers,⁵⁷ but would not permit EU/US mergers or acquisitions of control. Cooperation between American and European carriers would be restricted to the creation of new, or the strengthening of existing, transatlantic

55. See e.g. *Aviation Daily*, 9 March 2004.

56. Council Press Release 6606/04, 8-9 March 2004, at page 20.

57. The EU limitation on foreign investment does not apply to acquisitions between EU carriers. As such consolidation would not change the “EU” nationality of the merged entity, it would remain entitled to the traffic rights enjoyed separately by the two merging carriers prior to the transaction.

alliances. At the other end of the spectrum, an EU/US ASA could create a single open market (Open Aviation Area) encompassing the provision of both domestic and international air transport services, as well as the abolition of restrictions on investments by EU and US investors in each other's airlines. This would eliminate the regulatory barriers that currently impede consolidation between EU and US carriers and would enable significant re-structuring to take place within the aviation industry.

3.2 Market Consolidation

It has been repeatedly stated by politicians and industry leaders that the European airline industry is in need of consolidation. Commissioner Palacio has stated her vision of a future European market with a handful of strong players with extensive international reach, and with the others focusing on a regional role. This division of labour would require two developments; consolidation to create a smaller number of stronger international players; and the creation of a system where regional airlines operate as feeders to these international airlines in conditions that enable them to compete with low cost carriers.

Consolidation in the medium to long term is likely to happen through mergers, acquisitions and bankruptcies. Depending on the outcome of the Open Skies negotiations, it might also involve US carriers.

The creation or maintenance of commercially viable international networks can be expected to happen through a combination of actions. Mergers and acquisitions will allow existing major long haul carriers to extend their geographic scope. Alliances are likely to continue to play an important role. Finally, the viability of the networks will also depend on the ability of major carriers to build an efficient network of feeder services by smaller carriers.

Major carriers such as Air France, Lufthansa or British Airways which currently have sufficiently large home markets to sustain an extensive network are the most likely airlines that can be expected to build up extensive international networks through merger and acquisitions. The most obvious targets are those carriers which have complementary long haul services, but which are too small to survive in the long run as independent long haul network operators. Iberia would be a possible example of such a carrier.

However, the possibility of growth through consolidation is not unlimited. It is unlikely that any carrier would ever be sufficiently large to offer on an individual basis a truly global service. As in liner shipping, airline alliances can therefore be expected to continue to play a major role. They will enable carriers to offer a worldwide reach. Although they already fulfil that function now, it can be expected that the importance of that particular role will grow. At the same time, however, the number of alliances has in practice been reduced to three following the Air France/KLM merger, and to two if one only counts the immunized alliances (STAR and SkyTeam, but not **oneworld**). The transaction

has absorbed not only KLM in the SkyTeam alliance, but in practice also its current US alliance partner Northwest. In addition, Continental, which currently has a code-share arrangement with KLM, will most likely follow suit. The existing US domestic marketing arrangement of Air France's US alliance partner Delta with Northwest and Continental increases the likelihood of this happening. The Air France/KLM deal has therefore led to the amalgamation of the current SkyTeam and Wings formations, thus reducing the number of alliances from four to three. The extended SkyTeam is now the second largest alliance, and as **oneworld** lacks antitrust immunity, the existing number of fully-fledged alliances is reduced to two.

The efficient operation of an extensive international network also depends on a well-organised feeder network between the hubs and the various spokes. These feeder services form the Achilles heel of the network operators as they are increasingly facing competition from low cost carriers on an important number of these routes. Because these carriers generally operate on a point-to-point basis often on strong O/D markets, their cost base is considerably lower than that of the full-service airlines. This cost advantage has in certain cases been further strengthened by the very advantageous deals offered by airports keen to entice low cost carriers to use their facilities. They are therefore able to undercut significantly the services offered by the network carriers. This has made passengers, including business passengers, reluctant to pay what they consider to be exorbitantly high fares charged by the network carriers. The economic downturn that has forced companies world-wide to reduce costs, as well as the increased competition from (often State funded) other modes of transport such as high speed trains, have aggravated the full service airlines' vulnerability. The creation of a value for money⁵⁸ feeder network has therefore become somewhat of a Gordian knot.

One option open to the network operator is to acquire a smaller airline with a lower cost base to perform the feeder service. Typically, such a carrier would become a subsidiary within the group, independent of the full-service airline but it has proven to be difficult in practice to integrate such a smaller carrier within the group while maintaining the cost advantage (as demonstrated, for example, by British Airways' acquisition and subsequent integration of Cityflyer). A second option is to attract an alliance partner that can offer the required feeder services. However, as these smaller partners will often be national carriers which had to "downsize" due to the lack of a sufficiently large

58. The extra service offered by feeder carriers such as through-checking of baggage, ease of connection, service (in terms of hotel accommodation, meals etc.) when problems such as cancellation of flights occur, means that a passenger is likely to be willing to pay a certain premium above the fare charged by low cost carriers. However, given the significantly increased price sensitivity of all passengers (including business passengers), this premium is unlikely to be substantial.

home market, it is questionable whether they will have a low enough cost base to offer “value for money” feeder services. A third possibility would be to conclude arrangements with a smaller regional operator such as SN Brussels Airlines, which does not necessarily belong to one particular alliance, but can offer feeder services at competitive prices to a number of full service carriers, irrespective of their alliance allegiance. Finally, we have recently seen the new business plan of SAS, which is based on the idea to split its local operations in small and hopefully more cost-efficient units remaining under its control. In this way, SAS hopes to meet the increasing point-to-point competition faced on its city pairs feeding the hubs in Copenhagen, Stockholm and Oslo.

Following the Commission decision finding that Ryanair received unlawful State aid from the Walloon Region for its operation at Charleroi Airport, the balance may alter again.⁵⁹ As a result, Ryanair has already made a number of announcements modifying its operating model and it is reasonable to expect that the other low cost carriers as well as the network carriers will carefully reassess the implications, at least as far as publicly owned airports are concerned.

3.3 Challenges for Competition Law Enforcement in a Consolidation Era

There is a potential clash between commercial interests and competition law when it comes to market consolidation. The Commission has in its assessment of airline alliances and mergers concentrated on those city-pairs where the parties (or their alliance partners) are active, and as a result of the proposed transaction, competition is significantly reduced or eliminated. The impact of alliances and mergers on, in particular, hub-to-hub routes has been the main focus of the Commission’s concern. It has imposed remedies to deal with these issues, in particular the divestiture of slots at hub airports.

With its remedy policy, the Commission has sought to realize two – and to a certain extent mutually exclusive – objectives. It has sought to deal with the competition concerns resulting from alliances and mergers and which, according to the Commission, are present at the level of the individual city pair. At the same time, however, the Commission has sought to safeguard the considerable consumer benefits of networks, which manifest themselves at the network level. A delicate balance between the two objectives needs to be struck. An overly aggressive competition stance risks undermining the efficiency of the airline’s hub operation and therefore of the whole network. This would eliminate the considerable network benefits that airlines have been able to provide.

There are indications, however, that the Commission has lately become more sensitive to the issue of alliance and network competition:

59. Commission Decision of 3 February 2004, see Press Release IP/04/157.

- In more recent cases, but notably *not* in *Air France/KLM*, the Commission has tried to adopt innovative remedies. Thus, in *Lufthansa/Austrian Airlines*,⁶⁰ it adopted for the first time pricing remedies on an alliance that resulted in 100% shares on many routes. In the *British Airways/Iberia/GB Airways*⁶¹ case the Commission accepted slot remedies at Gatwick rather than Heathrow. In addition, the slot commitments relating to two of the four identified “problem city-pairs” London-Valencia and London-Seville were conditional upon at least 40 point-to-point passengers travelling daily on the city pairs in question at unrestricted fares in any two consecutive IATA seasons;
- A second issue arises from the fact that the Commission’s competition assessment tends to deal almost exclusively with the effect of the transaction or alliance on those markets where, as a result of the elimination of competition between the parties, the transaction or alliance leads to a significant reduction of competition. The wider impact of the deal on inter-alliance competition tends to be examined only in a cursory manner.⁶² For the reasons mentioned above, expected industry consolidation will decrease the number of competing alliances, thus increasing the importance of safeguarding healthy inter-alliance competition. This has already impacted the way in which the Commission assessed this issue in *Air France/KLM*, *in casu* the collapsing of Wings into SkyTeam, and the relationship between the merging parties and the three US carriers with whom they are aligned through a US-focused marketing alliance, i.e. Northwest, Delta and Continental.

To the extent that *Air France/KLM* is indicative for things to come, it is reasonable to expect that the Commission will increase its focus on alliance and network competition in the competitive review of continuing consolidation in the aviation sector.

4. CONCLUSION

The last few years have been extremely hard for the full service carriers. They have been caught in a perfect storm of terrorism, war, epidemic and economic downturn. Low cost airlines, on the other hand, fared much better, profiting

60. See above, footnote 27.

61. See above, footnote 25.

62. Indeed, services offered by the parties’ alliance partners are only taken into account to the extent that they lead to a direct overlap between (non-stop or indirect) services offered by the parties. The transaction’s overall effect on alliance competition has to date not been examined in detail yet.

from the increased cost sensitivity of the travelling public (including business passengers and companies) and further adding to the woes of the network carriers by undercutting fares on major feeder routes.

It seems, however, that the full service airlines have seen the worst. The economy is staging a hesitant recovery and the cost cutting measures undertaken by the carriers are starting to bear fruit. Although the condition of the network aviation industry as a whole is still very fragile, there seems to be at least some light at the end of the tunnel.

Network carriers are at a cross roads. The current crisis has clearly shown the weakness of the hub-and-spoke system. The system as devised in the 1990's is not viable in the present climate. Carriers will need to become more efficient to survive in the new environment. As soon as an EU/US agreement has been concluded, full-scale mergers and acquisitions can be expected to take place between the larger carriers to create stronger international players able to offer a wide international network. This does not mean, however, that alliances no longer have a role to play. They will still be necessary to offer a global coverage as in other network industries.

The re-structuring of the industry will also pose significant challenges to the competition enforcement agencies. They will have to devise ways to deal with the competition concerns raised by consolidation while at the same time ensuring that the remedies imposed do not fundamentally undermine the carriers' ability to operate their networks. Inter-alliance competition will increase in importance. It is only in the last few years that regulators have defined a coherent policy how to deal with competition issues raised by carriers working together within a wider alliance structure. They will now have to grapple with ways of safeguarding competition between alliances.