

FLYING ON THE EDGE OF LEGALITIES – SAFEGUARDING FAIR COMPETITION IN EUROPEAN AND INTERNATIONAL AVIATION

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There are no international rules of competition. With less state interference, airlines are increasingly seeking unfair advantages through market-distorting business practices. Hence, fair competition is nowadays becoming a hot, crucial topic. The increasing commercial influence of non-European carriers seems to have caused serious concerns in the European Union. The European Commission sanctions infringement of the rules on state aid by EU airlines regardless whether injury actually occurred. There is a presumption that state aid as such distorts the internal market. Consequently, as a matter of principle, state aid – especially on a massive, disruptive scale – is incompatible with fair competition when it comes to third country airlines operating in the EU market. In addition to government support, there are other factors distorting fair competition and the level playing field in the aviation industry, meaning an urgent solution to the problem is needed. An instrument more appropriate and effective than Regulation (EC) 868/2004 needs to be developed to safeguard fair and open competition in the EU's external aviation relations. Ultimately, as the aviation industry is becoming increasingly global, we should explore the possibility of creating an international, truly global airline regulatory policy covering competition between airlines and an institution which would regulate global airline competition and create a level playing field for all.

Keywords: fair competition, 'Middle-Eastern 3', subsidies, unfair advantage, Regulation (EC) 868/2004

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I. INTRODUCTION

The airline sector has undergone a significant evolution in the last decades. The focal point of this evolution is the widespread shift from regulation to liberalization and de-regulation. This shift has transformed the structure of the airline sector and has, in many ways, affected its competitive intensity. With less state interference, airlines are increasingly seeking unfair advantages through market-distorting business practices; new conflicts are arising regularly and the need for a level playing field is becoming more apparent as many airlines are struggling for their economic survival or going bankrupt, all pointing to the need for an urgent solution to the problem.

In the European Union aviation plays a fundamental role, both for the citizens and the economy in general. By supporting more than 11 million jobs and contributing more than 860 billion EUR to the European GDP¹, it makes a vital contribution to economic growth, employment, tourism, people-to-people contacts as well as the regional and social cohesion of the European Union. However, the aviation industry in Europe is increasingly running into turbulence. One after another, we are witnessing European airlines going bankrupt or being bought up. Among the reasons for this decline are a worsening political environment and aggressive growth among non-European airlines since the late 1990s. Hubs in Asia and the Persian Gulf want to usurp Europe's role as a major aviation center, consequently placing tens of thousands of jobs at risk.

Fair competition is increasingly becoming a hot, crucial topic. While it is vital to ensure a business climate that enables EU carriers to compete internationally, the EU's external aviation policy must also stress the importance of fair and open competition. When, for example, subsidies, unfair practices, inconsistent application of regulatory frameworks and a lack of transparency in financial reporting of companies are used to distort the market, it is legitimate to defend the industry against unfair competition.

The increasing commercial influence of non-European carriers (especially the ones from the Middle East) seems to have caused serious concerns in the European Union about the impact on more established carriers and their bu-

¹ "Aviation: Benefits Beyond Borders", Report prepared by Oxford Economics for ATAG, April 2014, p. 38. It should be noted that these figures include considerable indirect and induced effects which multiply the impact of aviation on the economy. The whole report available at URL visited September 1st 2015: http://aviationbenefits.org/media/26786/ATAG_AviationBenefits2014_FULL_LowRes.pdf.

business, and has given rise to efforts to strengthen regulation in the pursuit of a level playing field.²

Over the past months, we have witnessed serious allegations over Qatar Airways, Etihad Airways and Emirates Airline, three large airlines which are owned by the respective governments of Qatar and the United Arab Emirates, for having received large subsidies since the year 2004.

The subsidies certainly make it hard for non-subsidized airlines to compete and also violate the spirit of fair air service agreements, distort the international aviation market and simply give those airlines unfair advantage. Consequently, it is important that competition, both within the European Union and externally, should not be distorted by unfair practices.

Within the European Union, the European Commission has opened a series of in-depth investigations into cases of potential state aid to airlines in several European Union member states. The concern is that airlines receiving such aid obtain an undue economic advantage that competitors do not enjoy, thereby distorting competition within the European Union single aviation market.

On 20 February 2014, the European Commission adopted new guidelines on state aid to airports and airlines (Aviation Guidelines), which came into force after their publication on 04 April 2014.³

Those new guidelines contain a remarkable amount of criteria for assessing the presence of State aid within the meaning of Article 107 (1) of the EU Treaty (paragraphs 26 to 66) and for the next few years they shall constitute the benchmark for financial assistance to airlines and airports.⁴

At the same time, non-EU carriers have reinforced their global position. For example, the fastest regional traffic growth in the world is happening in the Middle East, where by 2030 the region's airlines will represent 11% of the world's traffic, up from 7% in 2010.⁵ The global competitive pattern has changed significantly with the rise of the Gulf carriers providing so-called 6th

² Wassenbergh, H., *The International Airline Industry: The Straightjacket of Competition Law*, Annals of Air and Space Law, Vol. XXIX, 2004, pp. 185 – 199.

³ OJ C 99, 04/04/2014, p. 3. In addition, the Commission published MEMO/14/121 on FAQs and a policy brief on the guidelines, retrieved February 1st, 2015 from URL: http://ec.europa.eu/competition/publications/cpb/2014/002_en.pdf.

⁴ Giesberts, L., *State Aid to Airports and Airlines, The new Aviation Guidelines of the European Commission*, Zeitschrift für Luft- und Weltraumrecht (German Journal of Air and Space Law), Vol. 64, No. 2, 2015, pp. 258 – 259.

⁵ European Commission Press Release, *Transport: New horizons for EU aviation*, Brussels, September 26, 2012, retrieved February 1st, 2015 from URL: http://europa.eu/rapid/press-release_IP-12-1027_en.htm.

freedom services (connecting markets through inter-continental routes via their hubs), increasing their market shares, positioning themselves aggressively for the future with massive new investments in aircraft and airports and taking advantage of a worldwide network of highly liberal bilateral air services agreements. With further importance, governments in the Gulf region have invested heavily in aviation infrastructure, *de facto* turning aviation into a strategic instrument to promote the global role of the region.

II. PRINCIPLES OF FAIR AIRLINE COMPETITION

There are no international rules of competition. Most airlines are government-owned and the airline sector is one of the few industries (generally) not covered by the World Trade Organization's (WTO) General Agreement on Trade in Services (GATS). Instead, bilateral air transport agreements govern access to thousands of markets worldwide and ensure a balance of interests as well as comparable market conditions. That is precisely why such agreements are enormously important to the mostly private European carriers in competition with the (government-owned) airlines from third countries.

As a matter of principle, state aid – especially on a massive, disruptive scale – is incompatible with fair competition. In fact, it erodes competition and reduces market access. In the European Union, according to the EU Treaty (i.e. the European “constitution”), state aid is incompatible with the principles of a liberalized internal market in any industry, i.e. from the cement market to telecommunication, energy and aviation. State aid is only allowed if it meets one of the exemptions set out in the EU Treaty (Article 107).

A crucial criterion is the so called “private investor test”. European Union law does not prohibit public entities to participate in the internal market, but it expects that such government entities behave like a private investor and be fully transparent with respect to their support to private companies.

The European Commission sanctions infringement of the rules on state aid regardless of whether injury actually occurs. There is a presumption that state aid as such distorts the market. Consequently, affected companies are not obliged to demonstrate injury.

In the internal market, the European Commission has applied and enforced these rules in the aviation sector. The European Commission has grounded European Union airlines and forced airports⁶ into bankruptcy requiring them to

⁶ Malev, the Hungarian national airline, went bankrupt and ceased operations in February 2012. Olympic Airways also ceased operations after it was ordered to

repay unlawful state aid without requiring competitors to demonstrate injury caused by such state aid. The same principles should apply to state aid granted by governments of third countries.

With no doubt, mature European airlines are ready to compete with any airline from any other part of the world, however, competition must be based on fair and equal opportunities with the same rules applying to all parties. If there is evidence that governments finance airlines doing business in the European Union or if governments directly or indirectly invest in European airlines in order to deviate traffic to their hubs, such behavior should be subject to full transparency and should be sanctioned in case of infringement of applicable laws.

a. EUROPE vs. THE GULF

In my opinion the current European bilateral arrangements with the Gulf states are generous. For instance, from the European perspective Germany has very liberal air transport agreements with the United Arab Emirates. The market is largely open: carriers like Emirates Airline can select from among three German airports and expand capacities and frequencies at will. Hamburg was additionally approved as a fourth destination point by the German side. In addition, Emirates Airline also served a route between Germany and the United States between 2006 and 2008. The Gulf airlines now have more than 100 weekly flights versus less than 20 weekly flights allotted to German carriers. By comparison, three airline companies from the world's most populous nations – China and India – fly 40 weekly frequencies to Germany.

Due to the relatively small market in the Gulf region, European airlines offer few flights to Doha, Dubai or Abu Dhabi. For example, European Union airlines fly no more than twice a day to those destinations. At the same time, the Gulf state airlines now already serve the same routes with up to ten times as many flights daily. They collect passengers in Europe with travel destinations in India or Southeast Asia and direct the connecting traffic to their own hubs, taking jobs with them. One long-haul aircraft operated by a German airline creates approx. 400 jobs⁷ – we therefore need to be careful about how

repay state aid. Cyprus Airways and Estonian Air could be mentioned as the latest tragic EU examples from 2015.

⁷ *Lufthansa Policy Brief 2/2013*, May 2013, p. 2, retrieved April 10th, 2015 from URL: https://www.lufthansagroup.com/fileadmin/downloads/en/policy-brief/02_2013/LH-PolicyBrief-May-2013.pdf.

we handle traffic rights. However, instead of being able to expand their operations to Asia and Africa, the European airlines have reduced their network to South East Asia and Africa over the past years, letting the Middle-Eastern 3 take over.⁸

b. THE GULF vs. EUROPE

It may be useful at this point to say a few words about the carriers from the Middle East which are enthusiastically expanding their fleets and operating hugely expanded routes throughout the world – certainly far more than anyone involved in international aviation would have thought possible a decade ago.

The unprecedented growth of the three Gulf carriers is a challenge global aviation has not experienced in its long history. Putting capacity in the markets at prices that other airlines cannot reasonably match, the aviation policy of the United Arab Emirates and Qatar are true game changers. This has led to a radical shift of market shares and connectivity from Europe to the Gulf.

The Persian Gulf governments have declared air transport a strategic sector and are providing them with generous support. The emirate of Dubai has a “consensus based partnership” between the government and the airline Emirates. Other Gulf state carriers, such as Etihad and Qatar Airways, also enjoy tailor-made regulatory conditions.

Airlines from the Gulf region are increasing their presence not only in Europe, but worldwide in many countries, increasingly securing business for their

⁸ Lufthansa (list includes points operated by LH's subsidiaries) has (partially) stopped service to the following destinations: Calcutta, Hyderabad, Manila, Karachi, Lahore, Sydney, Ho Chi Minh-City, Sanaa, Tashkent, Katmandu, Denpasar/Bali, Pusan, Male/Maldives, Mahe/Seychelles, Colombo, Nairobi, Khartoum, Harare, Mauritius, Entebbe, and Lusaka. Austrian Airlines has given up the following destinations: Denpasar, Melbourne, Sydney, Shanghai, Kuala Lumpur, Singapore, Colombo, Kathmandu, Bombay, Rangoon, Phuket, Jeddah, Riyadh, Beirut, Damascus, Tripoli, Baghdad, Nairobi, Johannesburg, and Harare. Swiss International Air Lines with its subsidiary Edelweiss Air has given up the following destinations: Ho-Chi-Minh-City, Manila, Jakarta, Colombo, Karachi, Kuwait, Abu Dhabi, Jeddah, Riyadh, Teheran, Beirut, Damascus, Baku, Yaoundé, Lagos, Accra, Malabo, Harare, Douala, Libreville, Tripoli, Bengasi, Tunis, Casablanca, Kilimanjaro, Mombasa, Agadir, Djerba, Monastir, Luxor, Marrakesh, Marsa Alam, Mauritius. Air France has stopped flights to: Jeddah, Karachi, Khartoum, Kuwait, Manila, Muscat, Sana'a, Sydney, Teheran, Abu Dhabi, Arusha, Bahrain, Chennai, Damascus, Dar Es Salaam, Denpasar, Doha, and Harare etc. Most of those destinations are now increasingly served by the Middle-Eastern 3.

fast-growing aircraft fleets. The problem is, market opportunities and competitive conditions for airlines from the Middle East and countries in the European Union have meanwhile become utterly imbalanced.⁹

Gulf carriers offer tickets in all classes at relatively low prices, but interestingly enough, they also seem to be waging a price war among themselves in order to fill their planes (sometimes oversized for the markets they serve) in order to maintain a market share or in some cases not to be forced out of the market completely.

In this context, it should be noted that most bilateral air service agreements contain provisions that the tariffs applied by airlines should reflect costs. However, it is a question of political willpower to apply and enforce such provisions.

Only fair agreements on traffic rights can remedy the situation.

III. THE WHITE PAPER ALLEGATIONS

In early 2015, three US airlines (Delta, American, and United Airlines) have published a white paper in which they claim that Emirates Airline, Qatar Airways and Etihad were receiving billions of dollars in subsidies. The paper also contends that Middle-Eastern airlines were competing unfairly under the terms of the open skies agreement between the United States and the United Arab Emirates. The serious allegations outline that Gulf carriers generate their growth by taking substantial portions from other market participants with no evidence that they actually meaningfully stimulate market growth. Taking into account the number of aircraft ordered by the Gulf carriers, the additional capacity they bring into the market will continue to exceed the market growth by far for years to come.

The governments of Qatar, Abu Dhabi and Dubai have allegedly granted over \$40 billion in subsidies¹⁰ and other unfair benefits to their state-owned carriers in order to stimulate their economies by promoting the flow of international passenger traffic through their Gulf mega-hubs.

⁹ The expansion of the Gulf carriers has resulted in a massive shift in traffic flows. Approximately 80 per cent of the passengers occupying seats in an aircraft of the Gulf carriers are flying beyond the Gulf hubs to destinations in Asia and Africa.

¹⁰ Carrey, B., *U.S. Airlines Allege Unfair Competition From Gulf Carriers*, AIN Online, retrieved May 5th, 2015 from URL: <http://www.ainonline.com/aviation-news.com/air-transport/2015-03-06/us-airlines-allege-unfair-competition-gulf-carriers>.

The study undertaken by the three US carriers has produced evidence that the Gulf carriers' rapid expansion is attributable in great measure to the governmental aviation policy and not the carriers' private initiatives in line with the principles of a liberalized market. Based on the study, state-owned Qatar Airways, Etihad Airways and Emirates Airline are now using this huge, artificial cost advantage to exploit the liberal access to the European, and even more dangerously, open access they have to the US market.

Shortly after the publication of the study, the Middle-Eastern 3 disputed the claim that they are subsidized. At a later stage they argued that EU and US carriers have equally been granted substantial subsidies from the government.

To remedy the situation, the European authorities would need to apply the same principles to aviation as in other fields of international trade. Foreign companies doing business in Europe need to adhere to the same principles which apply to European companies doing business in Europe.

IV. OTHER DISTORTING FACTORS

In addition to government support, there are other factors distorting fair competition, which include:

- Environmental (cost of carbon emissions): EU rules seldom apply to non-EU competitors. Carriers like Emirates Airline or Qatar Airways save millions and can thus offer lower prices for detour routes to Asia that do more harm to the environment – just the opposite of what the European Union wants to achieve.
- Passenger rights provisions and consumer protection: compensation payments for cancellations are mandatory in Europe – even if the airlines are not at all at fault. Such examples rarely exist in other sectors and regions of the world. The European Commission has proposed a number of revisions to the Regulation (EC) 261/2004, which shall further oblige EU airlines.
- Export credits: government guarantees with extremely low interest rates for the purchase of aircraft gained major importance in 2009. This has resulted in massive distortions of competition because only airlines from non-producer countries may apply for guarantees. Gulf carriers benefit, while EU airlines from producer countries are left out of the deal.¹¹

¹¹ E.g. Export-Import Bank of the United States (Ex-Im Bank) is the official export credit agency of the United States federal government. Operating as a government

- Production costs: Europe-based airlines are at a competitive disadvantage internationally if their production costs are higher than those of other airlines. EU carriers are certainly handicapped by higher costs resulting from congested airports and airspace in Europe, as well as higher air traffic management and airport charges.

a. INDUSTRIAL RELATIONS

Labor costs related to high labor standards and well developed social protection systems are higher in the European Union than in most other world regions.

There is no doubt that, like flags of convenience in maritime, Middle-Eastern carriers are hiring most of their staff from third countries – if for no other reason, then because there are simply not enough trained personnel in the individual Middle-Eastern countries to meet the needs of their growing airlines.

Middle-Eastern airlines are paying pilot wages that are similar or higher than those that are paid by other Western or EU airlines – as there is a general shortage of experienced pilots in today's international aviation and, if an airline wishes to operate long haul aircraft, it must pay Western equivalent wages to its pilots. On the other hand, when it comes to flight attendants and ground personnel, which represent the majority of the airline's workforce, the financial facts may not be the same.

According to a last year's ruling by the International Labor Organization from June 2015, Qatar Airways has been discriminating against its female employees, in breach of international labor laws. The airline's policy of reserving the right to terminate the employment of pregnant women and its banning of female employees from being allowed to be picked up or dropped off at the company premises by an unrelated male amounts to sexual discrimination. The ILO also expressed concerns about the contractual obligation for employees to declare their marital status and the fact that some are employed on a "single status" basis, despite removing the clause that required employees to obtain prior permission from the company to get married.

Based on the submitted White Paper, Qatar Airways, Etihad and Emirates Airline have cumulatively saved more than 3 billion USD thanks to union

corporation, the bank finances and insures foreign purchases of United States goods for customers unable or unwilling to accept credit risk. Congressional authorization for the bank lapsed as of July 1, 2015. As a result, the bank cannot engage in new business, but it continues to manage its existing loan portfolio.

bans and employment conditions which have resulted in below-market labor costs.

Employment conditions on carriers from countries that do not have an established history of maintaining first-rate conditions of employment should be a subject deserving of serious and continuing public examination.¹² Nevertheless, it is hard to imagine that loose labor laws could be defined as subsidies.

The above mentioned issues could be addressed in negotiations with partner countries aiming to create a level playing field, e.g. by respecting international labor and environmental standards.

b. MARKET ACCESS, FINDING THE LAST LOOPHOLES

Traffic rights – also called freedoms of the air – are the backbone of international air transport. They are negotiated by states/countries. Traffic rights encompass transit and transport agreements for air travel between states and enable fair and equal market access.

In light of the aggressive push by the Gulf state airlines to expand, these rights are of decisive importance (airlines can only provide air service between two countries if the corresponding traffic rights have been agreed).

The UN International Civil Aviation Organization (ICAO) distinguishes among eight different traffic rights: the first two freedoms govern transit traffic. These were laid out in the Chicago Convention in 1944. The remaining rights govern commercial freedoms and are mostly concluded bilaterally between contracting parties.

c. FIFTH FREEDOM CONTROVERSIES

The freedoms of the air are a key factor in determining the international commercial aviation route network. Entitlement to operate international air services under these freedoms becomes valid only after national authorities have granted their consent, either through multilateral and bilateral treaties (air services agreements), or through *ad hoc* authorizations.

Fifth freedom traffic has always been especially controversial and sought after. In European history fifth freedom traffic rights have sparingly been given on a small number of occasions and sometimes carefully traded for increased frequencies. Airlines granted fifth freedom traffic rights included Air New Zealand, Qantas, Air India and Kuwait Airways at London Heathrow (LHR),

¹² Mendelsohn, A., *Flags of Convenience: Maritime and Aviation*, The Aviation & Space Journal, Vol. XIII, No. 1, January - March 2014, , pp. 4 – 5.

Singapore Airlines at Frankfurt International (FRA), Jet Airways at Brussels (BRU), Emirates Airline at Hamburg International (HAM), Eva Air and Malaysia Airlines at Vienna (VIE), Air China and LAN Chile at Madrid (MAD), China Airlines at Rome (FCO). Such rights were established by the Chicago Convention on International Civil Aviation of 1944 and are defined by the International Civil Aviation Organization (ICAO) as “the right or privilege, in respect of scheduled international air services, granted by one State to another State to put down and to take on, in the territory of the first State, traffic coming from or destined to a third State”.

Recently we have witnessed Italian carriers challenging the validity of such authorizations before the Italian courts. Controversially enough, these cases involved Emirates Airline and Qatar Airways.

In March 2013, ENAC, the Italian civil aviation authority, authorized Emirates Airline to land at Milan Malpensa (MXP) and board passengers travelling on to the United States.¹³ However, at the end of 2013, Alitalia Cai S.p.A. brought an action against ENAC and the Ministry of Infrastructure and Transport, challenging the legitimacy of the authorization in light of international and European legislation. As a result, the administrative court of first instance declared the given authorization null and void in April 2014. An appeal against this decision was filed by Emirates before the Council of State, along with a request for a precautionary suspension of the first instance judgment. In May 2014, the Council of State granted the requested suspension, stating that the decision had an impact on public interest and consumers.

As there are no provisions which would allow such fifth freedom traffic in the bilateral agreement dating back to 1992, the controversial authorization was given based on the so-called “*Sblocca Italia*” act¹⁴, which introduced urgent

¹³ Masutti, A.; Laconi, A., *Emirates Granted “Fifth Freedom Rights” For Milan - New York Flights: A New Target On EU - U.S. Routes*, Mondaq, May 21, 2013, retrieved May 15th, 2015 from: <http://www.mondaq.com/x/240244/Aviation/Emirates+Granted+Fifth+Freedom+Rights+For+MilanNew+York+Flights+A+New+Target+On+EU+US+Routes>.

¹⁴ Act of 11th November 2014, n. 164, *Conversione in legge, con modificazioni, del decreto-legge 12 settembre 2014, n. 133, recante misure urgenti per l'apertura dei cantieri, la realizzazione delle opere pubbliche, la digitalizzazione del Paese, la semplificazione burocratica, l'emergenza del dissesto idrogeologico e per la ripresa delle attività produttive* (Conversion into Act, with Amendments, of the Decree Law of 12th September 2014, n. 133, regarding Urgent Measures for the Opening of Construction Sites, the Performance of Public Works, the Computerization of the Country, the Simplification of Bureaucracy, the Emergency of the Hydrogeological Imbalance and the Recovery of Production Activities).

measures to kick-start the Italian economy, and which was promulgated in November 2014. Under the title “*Urgent Measures for the Improvement of Airport Functionality*” a sub-article is devoted to regulating the regime on authorizing foreign airlines to operate fifth freedom flights.

An analogous controversy was developing in respect to authorization which was granted to Qatar Airways in the spring of 2013 regarding the route Chicago (ORD) – Milan Malpensa (MXP) – Doha (DOH).

In 2014, Cargolux Italia S.p.A. launched proceedings against ENAC claiming that such authorization had been illegitimately granted. The decision of the administrative court that revoked the authorization was likewise appealed before the Council of State, and the request for a precautionary suspension of the first instance judgment was awarded.³

In particular, Cargolux asked the Court to suspend the ENAC authorization in question. In that respect, it is noteworthy that in order to perform those services in Italy, ENAC’s authorization is necessary for international airlines as Article 6 of the Chicago Convention states that all international air services, in order to operate in a foreign state, must be given authorization from that state (“No scheduled international air service may be operated over or into the territory of a contracting State, except with the special permission or other authorization of that State, and in accordance with the terms of such permission or authorization”).

The Court of first instance ruled in favor of the petitioner, suspending ENAC’s authorization preventing Qatar Airways from further operations on the Milano Malpensa (MXP) – Chicago (ORD) route.

Qatar Airways had appealed against such decision before the Council of State (Consiglio di Stato) and asked for a precautionary measure which would revoke the suspension ordered by the Court of first instance.

Finally, the Council of State issued a decree on the precautionary request; the Council of State found in favor of the appellant. Therefore, the suspension of ENAC’s authorization by TAR - Lazio was revoked and Qatar Airways was again allowed to operate at Milan-Malpensa (MXP) airport. The decision of the Council of State took into account the public interest at stake in the matter.

Cargolux Italia S.p.A. is still challenging the last Council of State decree before the Supreme Court of Italy and the final result is to be seen. However, in the meantime, the agreement reached by Alitalia Cai and Etihad, the national carrier of the United Arab Emirates, for the acquisition of 49% of Alitalia’s

shares in August 2014 came into effect on 1 January 2015 and, interestingly enough, Alitalia has decided not to continue with the case before the Supreme Court.

As mentioned in the previous chapter, the United Arab Emirates' national airline, Etihad, has recently been active in penetrating the European market and finding access loopholes by using a different approach: it acquired equity in ailing European carriers, namely Air Berlin, Alitalia, Air Serbia¹⁵ and Darwin Airline, using them to expand its network and market reach.¹⁶

This is possibly against normal practices as required by an open market economy according to which a financially weak airline would have to be substantially restructured and downsized. In the case of Etihad, the contrary has happened – Etihad has injected vast amounts of money in these ailing European airlines in order to expand the feeder system to their Abu Dhabi-based network.

Furthermore, Etihad has not disclosed how it is financing its investments, which have in 2015 reached over 1.5 billion EUR – an extraordinary amount of capital for a company without any commercially earned profit.

Importantly, under bilateral air services agreements, carriers *may* have to be substantially owned and effectively controlled by the designating states and/or its nationals.

In the Etihad cases, the minority stake rule has been kept, but the managerial and board positions have been carefully allocated so that the nationality clauses embodied in bilateral air services agreements do not come at stake. However, it looks that the ownership and nationality are becoming increasingly blurred.¹⁷

¹⁵ While Serbia is not an EU member state, as a candidate country it must adhere to the Union's pre-accession policies and guidelines. Following Etihad's takeover of Jat Airways, the EC requested Serbia to clarify the airline's new ownership structure. While a carrier from outside Europe can hold a minority stake in an EU airline or a country aspiring to join the block, it must prove that the effective control is still in the hands of the majority shareholder.

¹⁶ The European Commission (EC) launched an investigation into Etihad's investments in European airlines in April last year as part of a wider examination into whether foreign ownership of European carriers complies with EU airline licensing rules. The Commission has doubts whether Etihad's investments are in line with European Union rules on ownership and effective control of EU airlines.

¹⁷ Dempsey, P.S., The Future of International Air Law in the 21st Century, *Zeitschrift für Luft- und Weltraumrecht (German Journal of Air and Space Law)*, Vol. 64, No. 2, 2015, p. 228.

A similar case might be rising up in Hungary. Being left without a national air carrier, the Hungarian government is exploring possible partnership with Emirates and granting fifth freedom permissions to gain better access to currently unserved markets.

The above mentioned cases certainly show that we still tend to be led by national interests and rely on *ad hoc* initiatives for negotiations based on individual authorizations, instead of having a strong common external aviation policy. In doing so, we must always remember that we are looking to strengthen the competitiveness of the entire value chain of the European aviation, and all elements within it, not only the interest of the end-consumer.

V. A DOUBLE-EDGED SWORD

We cannot deny that Middle-Eastern carriers have increased consumer choice, filled a gap in the market by taking travelers to numerous destinations not served by others, and helped contribute to the EU and US economy, trade and tourism. Importantly, Middle-Eastern carriers also provide a much-needed competitive alternative to legacy carriers, airline alliances and fares which are sometimes kept artificially high.

Furthermore, many legacy carriers have far too often played safe with long-established routes, and ignored new and growing markets such as the Indian subcontinent and Africa.

Regulators and decision-makers in the aviation sphere need to consider whether artificially protecting legacy carriers is worthwhile if that eventually leads to higher prices, limited choice, poor service and unrealized economic activity. Erecting barriers certainly does not create value. More competition, more connectivity and more choice for consumers and businesses does.

a. WHAT CAN WE LEARN FROM OUR COMPETITORS?

A key component of Dubai's economic and trade policy is its Open Skies policy. Dubai is one of the true pioneers of aviation liberalization having adopted an open skies policy as one of the cornerstones of its economy ever since late Sheikh Saeed bin Maktoum Al Maktoum signed the Dubai Commercial Air Agreement with Her Majesty's Government in July 1937, long before Emirates was established in 1985.

The Agreement triggered the Open Skies policy of Dubai. It gave the British Government landing permission en route to India and elsewhere and it was quickly evident that it helped strengthen Dubai's position as an important

trading outpost in the Gulf. In the 1950s, HH Sheikh Saeed bin Maktoum Al Maktoum, the ruler of Dubai at the time, decreed a policy of open seas, open skies and open trade, in part to help eliminate the dependence on oil resources. This was one of the first contributions to building the business-friendly Dubai of today which was subsequently complemented by the creation of free zones and other business investment-friendly incentives. Today oil revenue constitutes a mere 1.8% of Dubai's GDP, whereas aviation related activities and tourism make up approximately 30%.¹⁸

Middle-Eastern carriers further benefit from smart, forward-looking governmental strategies to stimulate passenger growth by setting low airport fees, low corporate taxes and minimal passenger-related fees and taxes which drives significant economic benefit to the host countries.

Next to providing connectivity and direct employment, the large-scale economic activity through purchases of goods and services has a multiplier effect which creates indirect and induced employment. The report 'Emirates' Impact in Europe' by Frontier Economics¹⁹ quantifies Emirates' operational impact in Europe and provides detailed coverage of these impacts in all of the European Union member states that Emirates operates to.

The research estimates that Emirates' direct, indirect and induced impact from its operations in the European Union supports 85,100 jobs across the member countries, equivalent to €6.8 billion of GDP.

VI. HIGH TIME FOR AN UPDATE?

a. REGULATION (EC) 868/2004

On the external side, Regulation (EC) 868/2004²⁰ was intended to protect against subsidization²¹ and unfair pricing practices causing injury to European

¹⁸ Botros, M., *History of Dubai Civil Aviation Celebrated*, Gulf News, December 08, 2014, p. 17, retrieved April 1st, 2015 from: <http://gulfnews.com/news/uae/government/history-of-dubai-civil-aviation-celebrated-1.1423918>

¹⁹ Retrieved June 18th, 2015 from: http://content.emirates.com/downloads/ek/pdfs/int_gov_affairs/Emirates_Economic_Impact_in_Europe.pdf

²⁰ Regulation (EC) N° 868/2004 of the European Parliament and of the Council of 21 April 2004 – Official Journal, April 30, 2004, L 162/1.

²¹ According to *the Regulation*, a subsidy exists when a government, regional body or other public organization makes a financial contribution that confers a benefit. It may take a form of: grants, loans or equity infusion, potential direct transfer of funds or the assumption of liabilities; revenue that is otherwise due but which is

Union carriers in the supply of air services from non-EU countries. However, strong calls have been made for developing more effective EU instruments in the aviation sector to protect European interests against unfair practices. Regulation (EC) 868/2004 has never been used and the industry argues that the Regulation is not practicable as it has been modelled on tools used in anti-dumping and anti-subsidy for goods and is not properly adapted to the specificities of the aviation services sector. A more appropriate and effective instrument would need to be developed to safeguard fair and open competition in the EU's external aviation relations.

b. WHAT IS THE RELEVANCE?

The loss of market share sooner or later translates into the elimination of flights and ultimately to the reduction of the fleet, thus reducing consumer choice and jobs.

It is important to see that airlines employ an overwhelming majority of their employees at their home hubs. For example, some 70,000 Lufthansa employees work directly in Germany, Air France employs 60,000 people in France, British Airways 40,000 in the United Kingdom, etc. Without traffic flows, not only these jobs and their added value would be threatened over the long term, but also tens of thousands of jobs at suppliers and in the logistics industry.

Europe is in jeopardy of losing a leading position in air transport that has been built up over decades. E.g. Airbus is building production sites in Asia to be closer to important customers. If European airlines lose further ground, this trend will only intensify.

Europe's network airlines offer optimal flight connections even to far-flung regions; however, Europe needs to preserve the diversity of connections. Alternatively, it might happen in the future that transiting in the Middle East will be the only option for eastward bound travels.

VII. POSSIBLE SOLUTIONS

To remedy the current situation, the European Union has recognized the need for developing a more effective instrument to safeguard safe competition in EU external aviation relations. The Council, in consultations with Member

forgone or not collected; the supply of goods or services other than general infrastructure, or their purchase by a public body...

States and the industry has agreed with the European Commission to analyze possible options. In that sense, there are ongoing considerations which include amendments to the current Regulation (EC) 868/2004. Alternatively, adopting a new, improved Regulation which would completely replace the current Regulation (EC) 868/2004 is seen as a valuable option.

Another solution to the problem could be a regulatory arrangement in the form of a model clause included in bilateral air services agreements, which states would use as a means to identify, prevent and eliminate anti-competitive abuse, under enforceable sanctions (e.g. suspension or restriction on the use of traffic rights available under air transport agreements).

Ultimately, as the aviation industry is becoming increasingly global, we should explore the possibility of creating an international, truly global airline regulatory policy covering competition between airlines, and an institution which would regulate global airline competition and create a level playing field for all.

VIII. CONCLUSION

In the grand aviation politics, the playing field is seldom level to begin with. Nor is it always possible to try levelling it.

At this concluding point, I shall cite Alan Tan, my ex-professor of air law from the National University of Singapore who once said that states are simply not born equal – some have superior geography, others have a big population base for their airlines to benefit from, and through the decades, it was the successful, well-run airlines from small, strategically-located countries that have maximized those advantages, often in tandem with a government willing to provide airport hub infrastructure and other incentives. KLM, Singapore Airlines, Korean Air, Emirates, Qatar Airways, Ethiopian Airlines and Copa are good examples. These sixth-freedom carriers were able to maximize (some might say exploit) their advantages to collect and funnel passenger “feed” from other countries through their well-located and efficient hubs. The success of this strategy depends largely on geography, of course, but also generous or unlimited third-and-fourth freedom rights exchanged with other countries.

As previously mentioned, “fair and equal opportunity” is a familiar concept in bilateral air services agreements, but it has not been sufficiently tested under the traditional, uncompetitive, international air transport system. However, increasing liberalization and competition requires that airlines should be

able to compete under fair competitive conditions, although this is easier said than done.

There is no doubt that the hot potato in international aviation is currently the ongoing state aid issue. Rightly, given the competitive distortions it can cause, however, rules appropriate on an international basis are not easy to agree on. In the European Union during the 1990s airlines were allowed to receive substantial state aid, principally in order to help them restructure to meet the new competitive environment, although a much stricter approach is now taken. A strict approach may not be appropriate for airlines in other parts of the world, at different stages of need or development. For example, the US was a stern critic of EU practice during the 1990s, but took a different view to requests by its airlines for aid post 9/11 – and the EU then became the critic.

The existing diversity in national, institutional and economic arrangements already underlines that the international playing field is not level. Despite these inevitable differences, substantial efforts have been undertaken in the context of ICAO to harmonize safety, security and economic regulation in the global airline industry. However, differences among states with regard to fiscal policy, labor policy and bankruptcy conditions will have an ongoing impact on competitive conditions in the international airline industry. The more liberalization stimulates competition in international air transport, the more important it is for airlines to have fair and equal opportunity to compete. But, as said, this is not easy. However, the effort must be made if competition is ultimately to be sustainable.

Sažetak

Dario Klasić *

LET PO RUBU ZAKONITOSTI – OČUVANJE PRAVEDNOG TRŽIŠNOG NATJECANJA U EUROPSKOM I MEĐUNARODNOM ZRAKOPLOVSTVU

Pravila tržišnog natjecanja među zrakoplovnim tvrtkama ne postoje na međunarodnoj razini. Pošteno tržišno natjecanje poseban je izazov kada se zrakoplovne tvrtke moraju prilagoditi potpuno drukčijim regulatornim, pravnim i društvenim okvirima. Sporazumi o zračnom prometu čine jedini pravni okvir za pošteno tržišno natjecanje. Kako bi očuvale konkurentnost svojih nacionalnih zrakoplovnih tvrtki na liberaliziranom tržištu, neke vlade dolaze u iskušenje pomoći svojim nacionalnim zrakoplovnim tvrtkama na načine koji drugim tvrtkama onemogućuju pošteno i ravnopravno tržišno natjecanje. Tijekom proteklih mjeseci svjedočili smo ozbiljnim optužbama da su tvrtke Qatar Airways, Etihad Airways i Emirates Airline, tri velike bliskoistočne zrakoplovne tvrtke u vlasništvu vlada Katara, odnosno Ujedinjenih Arapskih Emirata, od 2004. primile pozamašne subvencije. Zbog tih subvencija tvrtkama iz Europske unije, koje takve subvencije ne primaju, otežano je tržišno natjecanje, a njima se i narušava pravedni duh sporazuma o zračnom prometu i međunarodno tržište zrakoplovnih usluga te im se jednostavno osigurava nepravedna prednost.

Sve veći trgovački utjecaj neeuropskih prijevoznika (posebno onih s Bliskog istoka) izazvao je ozbiljnu zabrinutost u Europskoj uniji zbog utjecaja na etablirane prijevoznike i njihovo poslovanje te je ponukao na uvođenje oštrije regulative kako bi se osigurala ravnopravnost tržišnog natjecanja. Uočeni problemi ne odnose se samo na neskriveno subvencioniranje i državne potpore zrakoplovnim tvrtkama već i na jeftiniji pristup aerodromskoj infrastrukturi, gorivu i kapitalu te pretjerano korištenje prava šeste slobode i općenito labavo radno zakonodavstvo.

Unatoč relativno snažnom međunarodnom zakonodavnom okviru radni uvjeti u nekim tvrtkama i dalje su loši, a prava radnika uporno se krše usprkos mnogim konvencijama i zakonima koji uređuju tržište rada. Postoje ozbiljne indicije da se na nekim rastućim tržištima zrakoplovnih usluga radnopravni standardi ne primjenjuju u potpunosti.

Kako bi se zaustavio trend koji se kreće prema nepravednom tržišnom natjecanju, potrebne su konkretne mjere koje će osigurati ravnopravne uvjete na tržištu za sve međunarodne i europske operatere koji posluju na europskim aerodromima. Uredba (EZ)

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868/2004 pokazala se nepraktičnom i teško primijenjivom te je potreban novi pravni instrument koji će zaštititi europske interese od takvog nepravednog postupanja.

U ovome izlaganju istražiti ćemo mogućnosti za rješavanje tog problema i očuvanje načela pravednog tržišnog natjecanja. Jedno od temeljnih pitanja kojima ćemo se baviti jest ono odabira najprikladnijeg alata za bavljenje tim problemom. U tome smislu, uzet ćemo u obzir mogućnost izmjene trenutačne Uredbe ili usvajanja nove, koja će zamijeniti Uredbu (EZ) 868/2004, te predložiti regulatorno uređenje u obliku ogleadne odredbe u sporazumima o zračnom prometu koje bi države članice Europske unije rabile kao dodatno sredstvo detekcije, prevencije i uklanjanja zlouporaba koje narušavaju tržišno natjecanje. Dok se te odredbe ne počnu primjenjivati i sve dok se strane tvrtke ne počnu pridržavati transparentnih finansijskih i računovodstvenih načela i isključe državne potpore i subvencije, njihova prava prometovanja u EU-u trebalo bi ograničiti.

Ključne riječi: pošteno tržišno natjecanje, "Middle-Eastern 3", subvencije, nepravedne povlastice, Uredba (EZ) 868/2004