



POLICY SERIES

NO. 160 • FEBRUARY 2014
FRONTIER CENTRE FOR PUBLIC POLICY



NATIONALISM IN THE SKIES

THE SQUARE PEG IN A ROUND WORLD

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Date of First Issue: February 2014.

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ISSN 1491-78

Ideas for a better tomorrow
www.fcpp.org

FCPP Policy Series No. 160 • February 2014

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Executive Summary

The 1944 Chicago International Aviation Conference, known as the Chicago Conference, was convened to determine how best to deal with air transportation between countries. A multilateral or borderless trade was proposed by the United States (hereafter U.S.) but it failed to emerge as the accepted approach in Chicago. From that time on, countries have dealt with each other on a bilateral or country-to-country basis. This has hamstrung the industry since.

A bilateral trade in air services means that each country has the right to require that the airline of the country with whom it is negotiating be "substantially owned or effectively controlled" by that country. By its very definition, this prevents airlines around the world from accessing foreign capital and prevents consolidation beyond a country's border.

These artificial blocks also deter new entrant airlines, prevent trans-border consolidation and encourage government subsidies of its national flag carrier. They affect pricing, scheduling and competition. Air transportation, the most global of industries, remains nation-bound.

The paper reviews this background as well as the strategies that have developed by airlines to work-around the constraints of the bilateral system. The first of such strategies was the 1993 grant of anti-trust immunity between KLM Royal Dutch Airlines and Northwest Airlines. That de facto merger gave birth to the alliance strategy. Currently, the metal neutral joint venture is the vehicle of choice. The paper finds each strategy to be problematic.

The emergence of a unified and single European Community rapidly advanced a liberalization agenda. A borderless Europe allowed airline consolidation within the European Union (hereafter E.U.). Almost simultaneously, consolidation of airlines within the United States, from six to its now three trunk airlines, took place.

The paper examines some of the suggestions as to how liberalization could be achieved. Although a comprehensive E.U.-U.S. agreement would have been of such strength that it would have resulted in the collapse of the Chicago bilateral system (referred to as the 'big bang approach to liberalization'), the 2010 agreement between the two avoided the core question of foreign ownership and control of the airlines of the other and thus failed in its attempt at liberalization.

A more gradual path to liberalization may lie ahead through a number of avenues: the development of new agreements or pacts between like-minded countries; amendment to the Chicago Convention; or through recourse to the Annex on the Trade in Air Services under the General Agreement on Trade in Services (GATS).

While liberalization is unfolding, another event is simultaneously taking place. The Gulf airlines, with their long-haul technology and geographic centrality, have changed established global patterns. Their strength has resulted in new arrangements and partnerships, all of which could influence the speed of liberalization. So great are these undercurrents of change in the aviation sector that analysts claim "predictions of the shape of the industry over the next five years are dangerous."



Statement of the problem

Nationalism in the air world traces its roots to the 1944 Chicago Civil Aviation Conference. By 1944, the air industry had made great strides forward. Air travel was capable of covering large distances and countries sought to facilitate the access to the skies of the other. The Chicago Conference was convened to establish the trade which would govern international air services.

The U.S. urged the 54 other country representatives to adopt a free-market in the trade.

With a weakened air industry, the United Kingdom (hereafter U.K.) viewed the U.S proposal of multilateral liberalism as not in its economic best interests. A number of participants joined the U.K. position. By the close of the Chicago Conference, the U.S. multilateral approach was rejected. Since then, countries have negotiated entry to each other's country on a country-to-country, or bilateral, basis.

Under the bilateral system, each Government will designate the airline it is putting forth for air service. Each Government has the right to demand that the airline the other country is designating for air service between the two countries be "substantially owned and effectively controlled" by either the country or the citizens of that country. This effectively prevents airlines from access to foreign capital. Although countries should be free to decide if its *own* airlines should be open to direct foreign investment, this decision should not affect the ability of other countries from opening their airlines to investment.

Because of this freeze on access to markets, airlines cannot merge across borders, cannot acquire airlines of other countries and cannot even tap into international equity markets or private equity investors to the extent that other industries do. No other global industry faces such limitations. This is especially problematic in times of severe economic crisis as it reduces the tools available to fight the economic downturn.¹

Nationality based restrictions are a poor fit with sustainability and profitability. At a 0.3 per cent historic average financial return, the airline industry is not even covering its cost of capital. For an industry that has never earned a real rate on return on what its investors' capital requires, freezing access to markets and disallowing airline consolidation is hardly optimal.

Trans-border consolidation and mergers would not only help industry sustainability, it would also allow the industry to make better use of routes and allow airlines the ability to create new pricing strategies, to change fares and flights and to better respond to changing markets. In the absence of the ability to merge with foreign airlines, countries often resort to state aid and state subsidies to its airline. This results in market distortion.

Nationality based restrictions provide real barriers to entry and exit. Although the restriction on the foreign flow of capital may not be behind the collapse of an airline, it certainly hinders recovery. Further, the freeze on access to capital is an unnecessary challenge to new entrant airlines. Lacking the ability to access international equity markets, new entry becomes almost impossible and certainly, more expensive.

Despite these obstacles, cross-border airlines have taken place with strategies having developed to skirt these restrictions. Each new strategy, however, has come with its own set of problems.

The first strategy aimed at skirting nation-based restrictions was the historic January, 1993 grant by the U.S. of anti-trust immunity to KLM Royal Dutch Airlines and Northwest Airlines.

It began the process of dismantling nation-based considerations and led to the creation of global alliances. Global alliances, groupings of airlines held together by a variety of commercial arrangements, are another means of circumventing nation-based restrictions.

Yet, over time, global alliances showed their limitations. Cumbersome and not an ideal vehicle for expansion, the alliances were composed of partners with various and changing synergies and relationships. Some alliances operated with a fair degree of commercial independence and some were highly integrated. The infidelity and movement between the various alliance partners has made them inherently unstable.

The 2002 decision by the European Court of Justice was landmark. The Court found that the bilateral air service arrangements individual member states had negotiated with the U.S. were incompatible with an integrated European aviation strategy. As a result of the decision, member states of the E.U. were required to abandon nationalism. Although the decision could have moved the aviation business from a "regulated market of protected national flag-carriers to a truly global business where cross-border mergers and acquisitions are as commonplace as they are for banks,"² its effect, though historic, did not lead to true commercial freedom.

Although the court decision did result in a global re-examination of nationalism in the air industry, there was no accompanying full liberalization of airspace. Rather, it led to a further strategic innovation—the metal neutral joint venture in which commercial



*...although it is historical accident that we are nation-bound,
nationality in a global industry like aviation has made little sense.*

arrangements were structured with an indifference to nationalist concerns, such as which country operates the 'metal' (or aircraft). The metal neutral joint venture between airlines became a condition precedent in the U.S. to a successful grant of anti-trust immunity (ATI). A proliferation of such deals followed. These legally binding agreements have resulted in the creation of super-carriers with interesting policy and legal implications.

These strategies and legal advances have allowed the airlines greater capacity, new markets, new customer generation, joint selling and marketing, reduced airport handling and other airport charges. They have had the positive effect of strengthening the financial position of the carriers and providing passengers with almost seamless connectivity. Yet, the solutions are problematic and their longevity is limited. A multilateral solution is required.

This paper explores the history of the trade in international air rights between countries and how nationalism emerged as the basis for that trade. It examines the 'work-arounds' that have been created to circumvent nationalism. It questions the continued reliance on nationalism and bilateral arrangements. It looks to the solutions proposed by international bodies.

The paper takes the position that although it is historical accident that we are nation-bound, nationality in a global industry like aviation has made little sense. It agrees with respected air negotiator and diplomat, John Byerly that:

Murder is bad but foreign ownership is not necessarily a bad thing. Consumers want a low fare, their bags not lost and a good price and whether it's Air France, Singapore or United, they don't really care. They don't care about the flag on the tail. Credit Suisse can buy First Boston and Ford can buy Jaguar, yet the most global of industries can't be global. Why not completely eliminate foreign ownership now?³

A consideration of whether nationalism should continue to govern the international trade in air services requires an examination of how it became part of the process in the first place.

How nationalism became part of international air policy

On September 11th, 1944, U.S. President Franklin D. Roosevelt invited 54 State representatives to meet in Chicago “to make arrangements for the immediate establishment of provisional world routes and services” and for “the principles and methods to be followed in the adoption of a new aviation convention.”⁴ At the Chicago Conference, the U.S. proposed the adoption the free exchange of air traffic rights.

Negotiation was difficult. Although the U.S., supported by the Netherlands and Sweden, pursued the multilateral adoption of a free market in aviation, some of the participating countries preferred bilateral arrangements.

Its post-war aviation industry weakened, the U.K. sought protectionism with oversight on air routes, frequencies and tariffs by an international body. During those five weeks in Chicago, the competing philosophies of free market and protectionism were at loggerheads. Each denounced the philosophy of the other as extreme.

The Times newspaper of London claimed that the U.S. used a “big stick” in pursuit of multilateralism. Yet, U.S. insistence on a multilateral approach originated from a fear that any course other than a multilateral one would lead to quotas and limitations and become an invitation to cartels. The U.S. approach—prescient as it turned out—claimed that competition alone would best serve the interests of passengers and shippers.

Although the U.S. had urged the country representatives to acknowledge and grant each other that permission to fly into each others skies, this proposal failed. Article 6 of the Convention on International Civil Aviation required that “no scheduled international air service may be operated over or into the territory of a contracting State, except with the special permission or authorization of that State.”⁵ Since, countries seeking air services between them have proceeded on a country to country basis.

Aside from the U.S. concern regarding cartels, quotas and limitations, there were further limitations to the approach in Chicago.

Because of the bilateral approach, small countries felt compelled on nationalist grounds to create an air service, notwithstanding a lack of money or market to support one. Driven by competitive prestige to create an air service, the air services of small countries ended up being mostly state-owned. If market forces had been left to govern, airline operations would have been more constrained and kept pace with demand.

In 1959, Foreign Services diplomat Albert Stoffel described the unhealthy state of some airlines due to the bilateral system.

“In many cases, small countries...are conducting far-flung operations in air transportation which have little or no relationship to the size of their countries, their populations or their economies.”⁶



...the 1995 narrowly avoided a trade war between Japan and the U.S. over FedEx routing...

With its emphasis on nationalism, however, there was a darker side to the Chicago Convention. By 1944, the world community was of the view that only a multilateral open approach to economic matters could avoid the aggression and market shocks that accompanied nationalist-based decisions.

In fact, a short few months before the Chicago Conference, the Bretton Woods Conference on monetary and financial issues had been convened to ensure that policies based on nationalism were forever avoided.

"Economic nationalism was seen by the U.S. and other nations as a factor in the Great Depression, as well as in the aggression that led to the war. The Bretton Woods Conference ...led to ...the creation of the World Bank, the International Monetary Fund (IMF), the General Agreement on Tariffs and Trade (GATT), as well as the evolutionary process that led to the creation of the World Trade Organization (WTO)—in short, a multilateral system of increasingly more open world trade in goods, and later in services, that led to what we call today the global economy."⁷

The liberal free market approach to civil aviation proposed by the U.S. at the Chicago Conference was consistent with the barrier-free approach to world trade which emerged at Bretton Woods and if consistency were a true value, the U.S. approach to the trade in air services would have resulted.

Nationalism, however, won the day; the unhealthy by-product of this system is that every negotiation between countries carries with it the real possibility of diplomatic stand-offs and showdowns.

The denial of a staging base for the Canadian military and the new visa requirements which accompanied the refusal to grant Emirates Airlines enhanced service to Canada in 2010; the 1995 narrowly avoided trade war between Japan and the U.S. over FedEx routing; the famous U.K. denial of rights to U.S. carriers to Heathrow Airport (known as Bermuda II) which, if denounced in the U.S., would have set in motion the "taking out of carriers between the two countries... with the only question being who would cry uncle first" all suggest that the better approach at the Chicago Conference would have been a multilateral one, as at Bretton Woods.⁸

Practical problems with the Chicago Convention

Along with the structural problems of the bilateral system, there exist practical difficulties with it. First, it gives rise to a restrictive approach, one where countries settle “into a pattern of negotiating tit-for-tat.”⁹ The U.S. negotiated with countries it wanted to do business with and other countries did the same. The result has been a mish-mash of about 4000 bilateral air transport agreements around the world, each detailing which airlines can fly, how many airlines can fly, how often they can operate, which airports they can access use and what prices they can charge.

Further, any change—no matter how minor—requires re-negotiation and further rounds of meetings. The result is a time-consuming process where larger countries amassed a backlog of negotiations. With a two year wait not unusual, new air services and market opportunities are either delayed or lost altogether. Once an agreement was in place, the inherent delays resulted in a reluctance to change even the slightest traffic right.

Third, the multitude of agreements created a patchwork of agreements and an operational minefield for the airlines.

The result of piecing so many agreements together on a bilateral basis is an incredibly complex, Balkanized and often byzantine mosaic for regulating commercial international aviation.¹⁰

To ensure that nationalist boundaries were maintained, the Chicago International Agreements provided that States seeking air services between them could withhold or revoke a permit if the airline of one country was not to truly owned by either the government or a national corporation of the contracting country. This is known as the substantial ownership and effective control clause.

A further clause, Article 7, allowed countries the right to restrict the contracting country the right to carry passengers or cargo to other points within its territory. Thus, a Canada originating flight can not, for example, travel freely from its Canadian home base to various points throughout a neighbouring country. Instead, the airline is required to return to Canada before moving to a further point in that foreign country.

Although this kind of routing results in inefficiencies, higher consumer prices and a poor environmental record, it is especially problematic in cargo with its requirements for the inexpensive and just-on-time delivery of goods.

Thus, for example, until amendments were achieved between the two countries in 2006, FedEx had to drop off all its U.S. originating cargo in one location in Canada and could not unload parcels throughout the country. The 2006 amendments liberalized the trade in air services by allowing FedEx to drop off at multiple destinations within Canada. FedEx was, however, still prevented from picking up and transporting cargo from one city to the next within Canada.

As the Chicago Convention allowed air services to be traded in piecemeal exchanges, not all countries dealt with each other in similar fashion. Thus, airlines have been required to navigate a maze of bilateral air service agreements between countries in deciding routes for the delivery of passengers and goods.

Prior to the 2008 U.S.–E.U. agreement, FedEx, with its major European hub in Paris would travel from the U.S. to Stansted Airport outside London to deliver its U.K. bound express goods and to collect goods outbound to the continent. But because FedEx had not been granted the right from the U.K. to fly to France, FedEx was required to transport its U.K. outbound cargo to Paris by truck or hire a U.K. plane to fly the cargo to Paris. At the same time, FedEx planes would fly empty from Stansted to Paris.

Given that not all countries dealt with the question similarly, some countries, such as India, decided to simply exempt cargo from restrictions. With 40 per cent of its exports by value travelling by air, India realized the significance of cargo to the economy and unilaterally declared open skies for all cargo flights.

Not many countries have taken that significant a step¹¹ and the air industry remains constrained by severe limitations on foreign market access and cross-border ownership.

Therefore, despite its international routings, the air industry has never been able to attain the status as a global player. It remains perhaps the only global industry required to have exclusively national companies. Regulators cannot even approve international mergers because of the national ownership requirements in their bilateral agreements.

Reflecting on nationalism in the air world and recent reports tying the poor financial health of the industry with the bilateral approach, Jeffrey Shane, the architect behind the 1992 U.S. Open Skies and recently appointed general counsel to International Air Transport Association (IATA) asks:

“Why is it that we’re still stuck in this anachronistic world? That we haven’t unleashed the true power of this industry for the benefit of national economies everywhere and for the global economy? I look at this industry and I think: What would it look like if it didn’t have these completely bizarre and unique restrictions on their corporate structures?”¹²

Over the years, innovative strategies developed to work around the anachronism of the bilateral system. Along with these strategies, geo-political events—beginning with the *Single European Act* of 1986 and culminating in the 2002 European Court decision—such as a borderless Europe, reshaped thinking on a continued reliance on the bilateral trade of the Chicago Convention and set the stage for a true free trade in the skies.

Innovations and geo-political events work around the nationality-based restrictions

Anti-trust immunity: nationalism's first 'work-around'

Everyone agrees that current ownership and control caps block airlines from merging across borders and that anti-trust immunity for alliances is essentially the only way airlines have found to gain some merger-like benefits. Anti-trust immunity is "a work-around", concedes John Byerly.¹³

In general, anti-trust laws protect consumers by prohibiting collusive anticompetitive behaviour. Yet, in certain situations, the U.S. Transportation Secretary is permitted to grant immunity from anti-trust laws, even if the arrangement would reduce competition. The following conditions must be met:

1. the agreement is necessary to meet a *serious transportation need* or to achieve *important public benefit*, including international comity and foreign policy considerations; and,
2. those serious transportation needs or those public benefits cannot be achieved by reasonable available alternatives that are less anti-competitive.¹⁴

The combined effect of the provisions, claims Andrew Stober of Washington's Center for Global Development, is that:

"Approval is granted based on an alliance's enhancing or negligible effect on competition and the public benefits it could provide."¹⁵

First to take advantage of anti-trust immunity were airlines, KLM-Royal Dutch and Northwest Airlines in 1993. Three months earlier, their respective countries, the Netherlands and the U.S. had entered into an Open Skies Agreement. As international mergers are prohibited under the bilateral trade in air services, the KLM-Northwest Airline de facto merger was historic. It allowed the two airlines the ability to significantly enhance access to the markets of the other. The de facto merger could not have taken place without the anti-trust immunity provisions in U.S. laws.

Equally, the de facto merger could not have taken place without the 1992 Open Skies policy put in place by the first Bush administration. Under that policy, the Open Skies bilateral agreement between the two countries allowed reciprocated and wide access by the Netherlands and the U.S. to each other's country. Shortly after the Open Skies agreement was inked, the U.S. granted anti-trust immunity allowing the two airlines to co-operate on commercial arrangements.

Two considerations prompted the George H.W. Bush administration to look favourably to Open Skies. First, previous bilateral air agreements had focussed on gateway

entry, that is, entry to the major cities. Non-gateways and local economies were given little consideration. For example, previous policy would have denied KLM the right to fly from the Netherlands to non-gateway Orlando, even though neither international carrier, Pan-Am nor TWA had any intention of serving that market. Second, as the U.S. carriers had ample access to the markets they required, a policy limiting foreign competition made little sense.

That all changed with the Open Skies policy. The 1992 Open Skies agreement between the U.S. and the Netherlands was significant. It allowed KLM and other Dutch airlines to fly to any point in the United States. Although the grant was reciprocal, the Netherlands was a small country and the greater benefactor of the policy was KLM.

Three months later, anti-trust immunity was conferred on the Northwest Airlines and KLM, creating the Wings Alliance. This resulted in a virtual merger between the two airlines. Armed with anti-trust immunity, the Wings Alliance was able to skirt caps in the air service agreements (ASAs) on ownership and control.

The grant of anti-trust immunity to the Wings Alliance was historic. It was the first global strategic alliance.

"This broad-based alliance involved the full integration of each carrier's networks, market, planning/pricing, promotion, administrative activities and other activities."¹⁶

USAir and British Airways followed with a like merger in 1993 followed by United and Lufthansa. Each of the three alliances had in common a code-share on many routes covering a wide geographical area and a great degree of operating and marketing integration.¹⁷

The gains each obtained varied depending on the deal. The NW/KLM alliance allowed a roughly even gain in revenue. The British Airways/USAir deal allowing code sharing on domestic flights followed a \$400-million investment by British Airways in USAir.¹⁸

The grant of anti-trust immunity to the Wings Alliance between KLM and Northwest Airlines and the de facto merger it allowed set in motion the concept of a free border in aviation. As a means of skirting the constraints of nationalism, it led to the creation of alliances.

Strong reasons made the grant of anti-trust immunity and its merger-like effect an attractive prospect for the respective airlines, KLM and Northwest. Even though the Netherlands-U.S. Open Skies had allowed access to any reciprocating foreign city, the gain could be shallow as one of the airlines, for example, may decide not fly there because of the cost of providing non-stop or direct service relative to passenger demand.

Yet, the anti-trust immunity between the airlines meant that by the addition of only 4 cities, the KLM /Northwest code-share alliance resulted in the connection by Northwest to 30 cities which it could now claim as its own. Similarly, the USAir and British Airways alliance allowed British Airways to market service to 52 US cities that it didn't actually fly to. The KLM/NW arrangement had overcome the restrictions which either deny an airline's access to foreign markets or make such access cost prohibitive. It provided the traveller an "anywhere to anywhere" service.

The Government Accountability Office weighs in on the KLM Royal Dutch-Northwest alliance

The 1995 United States General Accounting Office (GAO) was commissioned immediately after to review those initial alliances. Its report, *Airline Alliances Produce Benefits, but Effect on Competition is Uncertain*, followed. It found alliances an attractive means to overcome or work around the restrictions in bilateral accords on the routes that airlines can fly, the frequency of the flights and the fares they can charge.^{[19](#)}

Yet, the GAO also found a downside to alliances. It found that although the grant of anti-trust immunity had provided “sizeable benefits” to the two carriers, NW and KLM,^{[20](#)} the benefit to these two carriers was probably at the expense of competing carriers.

The wide access granted to KLM under Open Skies became tempting to other European countries. Following the US-Netherlands Open Skies agreement, bilateral accords were struck with Austria, Belgium, Denmark, Finland, Germany, Luxembourg, Norway, Sweden, Switzerland and Iceland. For these countries, anti-trust immunity was never a consideration. They simply sought market access.

The year following the GAO Report, Germany and the U.S. signed an Open Skies agreement between them. The German government made it clear that they would enter into an Open Skies agreement only if Lufthansa and United were granted anti-trust immunity. The signing of the agreement was held in abeyance while anti-trust immunity was sought. In May, 1996, the Open Skies agreement between Germany and the U.S. was signed.

In the announcement of the US/ Germany OpenSkies, Commerce Committee Chairman, Larry Pressler (R-S.D.) likened Open Skies to a “huge magnet.” He claimed that the Lufthansa/United alliance, when combined with the NW/KLM alliance, would result in 50 per cent of passenger traffic to Europe being carried by alliances.^{[21](#)}

Robert Crandall, former CEO of American Airlines took a less enthusiastic view of the Lufthansa/United alliance claiming that it disadvantaged other carriers who were not able to access a similar deal. The Clinton/Kohl deal, sold as part of a political agenda endorsing the new Germany, created a cartel, he claimed.^{[22](#)}

There was no going back. The KLM-Northwest anti-trust immunity led to the United-Lufthansa ATI. This led the French to seek a similar deal. The creation of alliances followed. Today, nearly every major US and European airline are part of an alliance. They are entrenched to such a degree that, surpassing Pressler’s estimate, they now represent about 80 per cent of capacity across the Atlantic and Pacific and between Europe and Asia.^{[23](#)}

The brand alliances: nationalism's second 'work-around'

The bilateral system restricted airlines from efficiently serving every destination its customers sought in its own aircraft. The ATI didn't suit every airline. The brand alliance strategy developed to address network economics by allowing groupings of carriers to tap into wider networks.

With its merger-like qualities, the Northwest/KLM joint venture of the early 1990s was referred to as an alliance. It differed from the 'brand' alliances which emerged in the late 1990's.

The U.S./Germany Open Skies agreement and anti-trust grant between Lufthansa and United Airlines which preceded it got the ball rolling on the alliance strategy to such an extent that Byerly refers to it as "the baby that became the Star Alliance."²⁴

To some airlines, the alliance strategy provided an alternative to the merger-like integration of those early deals. The alliance strategy allowed the airlines to remain independent with a pass-off of transportation in a foreign country to an alliance partner. The brand alliances were groupings of airlines bound together under varying commercial arrangements.

Within the alliance were differing levels of integration. At the lower end of the range, there was limited co-operation, such as ticketing arrangements (known as interlining), a shared frequent flyer program or lounge access. At the mid-range of co-operation were code-sharing arrangements. The highest level of integration belonged to those governed by anti-trust immunity allowing direct co-ordination on prices, routes and scheduling with revenue and cost sharing.

The first and the largest of the brand alliances was the Star Alliance. Star Alliance was created in 1997, oneworld in 1998 and SkyTeam in 1999.²⁵

Alliances allowed an airline access to domestic markets in a more price competitive way. It allowed airlines the ability to consolidate and provide efficiency in operations. Yet, alliances were difficult constructs. Although each of the brand alliances developed distinct strategies, attempts at cohesion within the alliance were complicated by the varying management teams, backgrounds and cultures of the airlines within the alliance.

The hardest thing in working in an alliance is to co-ordinate the activities of people who may have different instincts and a different language and maybe worship slightly different travel gods, to get them together in a culture that allows them to respect each other's habits and convictions, and yet work productively together in an environment where you can't specify everything in advance.²⁶

Of the 650 or so alliance agreements, many involved code-sharing where partners could place their two letter code on each other's flights. Unable, however, to discuss the important issues, such as the number of daily flights, times, prices, discounts and other scheduling arrangements, alliance partners were each operating inefficiently. The ability to provide seamless travel for its customers and to enhance efficient operations for the carrier was the reason for the alliance. Yet, without anti-trust immunity, operational efficiency remained illusive. In Jeffrey Shane words: "If you can't talk price, the alliance won't be that good."²⁷

Further, with little reciprocated loyalty between members, the alliance became a fragile arrangement among many members. Some members were seen as having "bootstrapped" themselves into the big leagues with the alliance providing the small player minimal benefit when it was needed.

Up to a point a carrier from a small country can bootstrap itself into the big leagues by joining a global alliance. But as David Bentley (Big Pond Aviation) points out: "I am one of several people in this industry who believe that alliances don't suit all airplanes. Star Alliance membership hasn't exactly been a godsend for SAS and British Midland International nor did being in oneworld help Mexicana in its hour of need."²⁸

The varying airline backgrounds and cultures, the different airline strategies, the wide range of membership within the alliances, all combined to provide a predictable result. Alliances became known for their instability and infidelity. The core loyalty of member airlines was to its individual airline business rather than to the alliance. Movement—such as, for example, the exit of Continental from Skyteam to Star, the departure of Aer Lingus from oneworld, USAirways from oneworld to Star—resulted.

In recent years, a change occurred within the alliances. That change was precipitated by the 2002 E.U. decision finding there were no borders in the E.U. Thereafter, the alliance framework of loose co-operation formalized and airline partnerships strengthened.

The 2002 decision by the European Court of Justice was of such consequence that it generated remarkable re-thinking by certain countries, notably, the U.S. which questioned whether the court decision would bring about an end to nationalism in the skies. The Government Accountability Office reported in 2004 that: "These experts [U.S. government and industry officials] agree that complying with the Court of Justice decision will require that nationality-based restrictions be eliminated."²⁹

In response, and while E.U.-U.S. negotiation was underway, key airlines within the alliance—rather than waiting to see whether nationality-based restrictions would be eliminated—sought further gains through a "deep" alliance. Key members of each of the three trans-Atlantic brand alliances were granted anti-trust immunity by the E.U. and U.S. authorities allowing them to operate in a metal neutral manner.

Deeper relationships were prompted by other pressures taking place around the globe. Along with European liberalization, a change in established global patterns had emerged with the Gulf airline concept.



Meanwhile, there is another, parallel evolution. The new Gulf airline concept—for it is a whole new model—has rocked the established industry, particularly the European network airlines, which see it as a threat to expanding their long-standing sixth freedom markets. Founded on the three pillars of ultra long-haul aircraft technology, geographic centrality and a more liberalised aviation marketplace, Emirates Airline is rolling out a rapid expansion strategy comparable only with airlines in the emerging markets of Asia.³⁰

Changes were of such depth that by June, 2011, the *Airline Leader* considered that “predictions of the shape of the industry over the next five years [was] dangerous.”³¹

The 2002 European Court of Justice decision begins the process of dismantling the bilateral system

First stage E.U.–U.S. agreement (2007)

The *Single European Act* of 1986 established a single European market. That Act anticipated that within the single market, there would be a free movement of goods, including the civil aviation industry.

Liberalization under the Act was to occur in three successive phases, the third to be effective on January 1st, 1993. Importantly, this final phase allowed Member States to grant the right to establish airlines in the country of any Member State and to permit traffic rights on all E.U. routes.

Despite the liberalization imperatives, the substantial state ownership of E.U. airlines resulted in a lag of about a decade before liberalization of the air industry was fully addressed. With many of the airlines fully or partially state-owned, the respective national governments had, claims Michael J. Harrison's study on the European Union, "major incentives to intervene and protect as long as possible before E.U. wide competition policies came into effect."³²

As a consequence and despite the E.U. aims, the U.S. and the various E.U. member states continued to sign bilateral ASAs between them. This all came to a halt in 2002. In November of that year, the European Court of Justice ruled that the seven Open Skies ASAs which the U.S. had signed with individual E.U. member states violated E.U. law.

Specifically, the court found the nationality clause in the Open Skies ASAs between the U.S. and individual member states to be discriminatory and contrary to the overall purpose of the E.U.

The nationality clauses, it found, violated the principle of non-discrimination which required enterprises to be recognized as "community" firms rather than the nationals of a particular member state. Nationality based clauses in the ASAs were seen as potentially preventing the European air industry from consolidating into "economically stronger international businesses."³³ Equally, the clauses could inhibit the mobility of goods, capital, labour and services to "effectively prevent any E.U. airlines with global ambitions from establishing international operations in an E.U. member state other than its own."³⁴

The result of the ruling was bilateral ASAs by Member States were prohibited. To ensure compliance, the European Commission Director General for Transport and Energy sent a letter to E.U. member states in January, 2003 threatening legal action "should any member state make unilateral amendments of their agreements with the U.S."³⁵

The European Commission set out to establish a new framework for the aviation sector in light of the Court's urging to find "pragmatic solutions to the many difficult political and legal questions raised by these judgments." With an agenda intended to cover "market access, ownership and control, leasing, convergence on the application of competition rules, safety and institutional arrangements," the breadth of the negotiations was wide.³⁶

Given this mandate, the European Commission began negotiations of ASAs on behalf of all member states. It sought an air service agreement which would allow air services between the E.U. and the U.S. "on a fair and equal basis." Its wide goal was an Open Aviation Area between the two territories, allowing E.U. carriers access to the internal U.S. market. This would require the removal of nationality clauses on foreign ownership.

London's Heathrow Airport is of such deep-seated global importance that it has been referred to as the airport where "the whole world changes planes."³⁷ The 1977 bilateral ASA (known as Bermuda II) between the U.S. and the U.K. had restricted U.S. access to Heathrow to two airlines whereas British airlines enjoyed wide access to the U.S. Since that date, access to Heathrow had remained an irritant to liberalization. In return for wider access to Heathrow, the U.K. had demanded the right to purchase U.S. airlines (a loosening of foreign ownership) or the right to fly from city to city in the U.S. picking up passengers (cabotage).

The agreement reached in 2007 (first stage) went into provisional effect on March 30th, 2008. The agreement allowed E.U. airlines to operate to the U.S. from any point in the E.U. This, of course, allowed greater access to Heathrow Airport prompting the U.K.'s Transport Committee to criticize the agreement claiming that at heart, it had allowed the U.S. to achieve access to the E.U. market, importantly at Heathrow Airport, without addressing cabotage or foreign ownership or control of U.S. airlines. The Committee labelled the agreement "Unequal Skies."

Second stage E.U.-U.S. Agreement (2010)

The second stage agenda focussed squarely on foreign investment opportunities, tackling the thorny questions of ownership and control of airlines. The U.S. and E.U. positions were strikingly similar. Both negotiating positions agreed that the question of airline ownership and control, routes flown, frequency and fares were commercial decisions best left to the airlines to decide.

Yet, foreign ownership and investment hit the wall of strong opposition in the U.S. The political reality was that since 9-11, airlines had become the weapon of choice in the war on terrorism. The case of Dubai ports International unleashed a "typhoon of xenophobia."³⁸ Although foreign ownership of the port operations had passed "like a knife through butter,"³⁹ it then moved to the political arena, where, "hyped up by Lou Dobbs,"⁴⁰ its chance of Congressional action diminished.

A further pressing concern of foreign ownership and control was that of labour. Labour feared foreign influence in wage issues and possible cost-cutting if ownership

requirements were loosened or relaxed. Labour claimed foreign investment could strengthen the hand of management.

"Changes to the US laws would require a new law and Congress has been reluctant to act, partly because airline worker unions, notably those representing pilots, fear their jobs would be put at risk if American carriers combine with their EU peers."⁴¹

With the social dimension not part of the E.U. agreement, their concerns, conceded Byerly, were not illegitimate. Although attempts were made to carve out questions of national security, the issue would not dissipate and ultimately, the question of foreign ownership was avoided.

The second stage negotiations also dealt with further liberalization between the U.S. and E.U. Under the heading "further liberalisation of traffic rights," was the question of cabotage to the U.S. market. Cabotage raises similar questions as raised by foreign ownership. Thus, any change to the cap on foreign ownership and on cabotage ultimately required Congressional action, something seen as not forthcoming.⁴²

The June, 2010 signing of the second stage agreement left unresolved "the long awaited goal of loosening barriers to foreign ownership and control of US airlines."⁴³ As the U.S. and E.U. account for over half of the world's traffic, if true liberalization had been achieved, the rest of the world would have been forced to follow.

Although the E.U.–U.S. Agreement left open whether it was even possible to move beyond the constraints of nationalism and create a global air enterprise, the air industry between the two regions in fact moved on.

Canada inks an agreement with the E.U. but doesn't move on it

With this substantial activity on the file between the U.S. and the E.U., former CEO of Air Canada, Pierre Jeanniot asked why Canada was not seeking better access to the vast E.U. market.⁴⁴ In "Where's Canada?", a 2008 *National Post* article, he urged that Canada seek an agreement. Access to the vast EU market would more than compensate for the increased competition that Canadian carriers would face in Canada, he claimed. Further, Canadian travellers would benefit from increased competition.

There was some initial hope for progress as while foreign ownership had proven to be a hurdle in the U.S., it appeared to be less so in Canada. Canada endorsed the E.U. transatlantic common aviation area in December, 2009 allowing Canadian airlines to operate direct services to the E.U.

In 2009 and to circumvent foreign ownership restrictions, the Canadian Parliament passed amendments to the *Canada Transportation Act* upping the 25 per cent cap on foreign ownership. The amendments delegated to the Governor General in Council

the right to increase the percentage to 49 per cent. Thus, unlike the U.S. where foreign ownership was a hurdle, Canada allowed foreign ownership restrictions to be reduced to regulation.

Although the Bill received Royal Assent thereby permitting increased foreign ownership and allowing regulations to be developed to that end, no regulations ever issued.

The lack of advancement on foreign ownership had also put a halt to the remaining phases of the E.U.–Canada Agreement. While other countries, notably the U.S. moved ahead, Canada was left behind. The federal government's stall has had a wide negative effect with Canadians, its aviation industry and its airports having been disadvantaged as a result.

David Gillen, Director of Transportation Studies at U.B.C.'s Sauder School of Business claims that if the commitments in Phases two through four of the Canada-E.U. agreement had been adopted, it would have presented "significant new opportunities for carriers in both jurisdictions" leading to consolidation and integration of the carriers.⁴⁵

In Europe, important deals were taking place. With a borderless Europe, Lufthansa incorporated into its structure several significant partners. British Airways was able to consolidate with Iberia and thereafter, with the creation of International Airlines Group (IAG), acquire British Midland International (bmi) and Spanish low cost carrier, Vueling. Similarly, in the U.S., consolidation was taking place with the six U.S. trunk carriers now reduced to three. These strengthening of corporate structures negatively impacted Canada.

With WestJet's narrow presence on the international stage, Air Canada is limited in its ability to consolidate within its borders. The authors of an article in the Canada–Europe Transatlantic Dialogue claim that the strengthened E.U. and U.S. air industry through consolidation ended up leaving Canada's air industry behind.

The United States and the European Union have however moved beyond their first stage arrangement, further liberalizing traffic rights and thereby leaving Canadian airlines in an even more disadvantaged position with less commercial opportunities than their United States competitors.⁴⁶

Building on studies, notably those by IATA and the U.K. Civil Aviation Authority linking a country's productivity and market expansion with the liberalization of its air transport sector, the International Institute of Transport and Logistics warned in 2008 that Canada's restrictive 2007 Blue Skies trade in air had not kept pace with the liberalized access of the U.S. Open Skies policy.

The continued failure to liberalize had not only constrained Canada's opportunities in trade, investment and tourism, the Institute found, it had also hampered growth opportunities for Canada's air transport sector. The recent E.U.–U.S. Open Aviation Area, it cautioned, had placed Canada in a precarious situation.

"The E.U.–U.S. Open Aviation Area agreement has put Canada in a rather precarious competitive situation. Canada has a lot to lose economically because

many Canadians route their overseas travel via U.S. hub airports and an increasing proportion of foreigners route their travel to Canada via U.S. hubs because they can find cheaper, more frequent and convenient flights.”⁴⁷

Many Canadian airports, particularly Toronto and Vancouver, had positioned themselves as preferred connection points for European traffic as well as Latin America and Asian traffic with a final destination outside the U.S. The lack of visa requirements for connecting passengers along with Canada’s geographic position had it in a preferred competitive position. Yet the lack of progress resulted in Canadian airports losing any advantage in capturing that traffic.

Since the March, 2009 amendment which set in place the possibility of increasing foreign ownership, the file has stalled. There is little sense of when or if it will advance.⁴⁸ With consolidation comes profitability and the downside of waiting is that advantages are often lost.

The U.S. and E.U. airlines move on

Shortly following the end of second stage negotiations, the European Commission granted anti-trust immunity (ATI) to British Airways, American Airlines and Iberia, giving the oneworld alliance the same anti-trust immunity already enjoyed by SkyTeam and the Star Alliance across the Atlantic.

Some suggest a link could be made between the stall on foreign ownership in the second stage negotiations and the grant of ATI three weeks later to oneworld, the last of the three alliances granted ATI.

“Two recent European decisions reveal much about the complex realities of transatlantic aviation. In the first, European transport ministers agreed to join the USA in signing a protocol that embodies the second stage of an EU-US air transport agreement, even though it leaves the most thorny issue—airline ownership and control—unresolved. Less than three weeks later, the European Commission said it would accept conditions offered by American Airlines, British Airways and Iberia, giving the oneworld alliance clearance for the same anti-trust immunity already enjoyed by SkyTeam and Star Alliance across the Atlantic.”

Link or not, even though the E.U.-U.S. agreement failed in its liberalization goals, the clearance to oneworld gave all three global alliances anti-trust immunity. The immunized metal neutral joint ventures which followed provided a complete ‘work-around’ to nationalist concerns.

Yet, immunized metal neutral joint ventures do not provide the security and stability of ownership. They come with their own set of problems and policy issues. Similarly, the grant of anti-trust immunity is under scrutiny and challenge in the U.S. The problems inherent in both make a workable solution all the more pressing.



Immunized metal neutral joint ventures—the current work-around

The brand alliances had served a purpose. They had allowed airlines to co-ordinate schedules and to provide an 'anywhere to anywhere' travel experience.

Over time, however, the alliances turned out to be fragile, almost unworkable constructs. Likening the brand alliances to "dating," the Director of McGill University's Institute of Air and Space Law, Paul Stephen Dempsey, claims greater stability and fidelity is achieved through ownership, which he likens to marriage.⁴⁹

Marriage was not to be. The idea of foreign ownership of airlines had hit the wall of political reality in the U.S. leaving the immunized, metal neutral joint venture to become the marriage.

"Brian Pearce, chief economist at the International Air Transport Association, points out that antiquated bilateral treaties on flying rights between nations also inhibit full mergers, so airlines are finding inventive ways to achieve the same results. Airline alliances, he added, had not resolved issues such as unproductive scheduling clashes. "This is the next step from the alliance. Airlines have found they can plan their businesses more effectively in a joint venture."⁵⁰

Although the original KLM-Northwest arrangement was a metal-neutral one, the

alliances were not. Rather, they consisted of members, some with and some without anti-trust immunity (ATI). Those with ATI operated in a “comfort zone” for discussion on rates, fares and routes.

That all changed in 2004. That year Air France and KLM merged. Yet, KLM’s partner, Northwest did not have ATI with Air France and same was sought, rejected and subsequently granted in 2007. Aside from the 1993 NW-KLM merger, it lays claim to the title as the first metal-neutral U.S.-E.U. joint venture.

Star followed in 2009 and, following the E.U. second stage negotiations, oneworld in 2010. In each case, a condition of the ATI grant was the parties were compelled to enter a metal neutral joint venture within eighteen months of the ATI grant.

Problems with the metal neutral joint venture

The metal neutral joint venture does not provide the security of ownership. If ownership is a marriage, the metal neutral joint venture is a lesser concept. Calin Rovinescu, Air Canada’s CEO likens it to “not a full marriage, but think of it as going steady with a ring.”⁵¹

This suggests a less than stable legal construct. Former KLM general counsel Paul Mifsud claims the metal neutral joint venture raises red flags.

First, the metal neutral joint venture represents such a dramatic change and such a layered concept that he questions whether the parties truly understand that they have entered a legal minefield. For example, the Star Alliance has more than 20 U.S. and foreign carriers. There exists a sub-set of nine with anti-trust immunity (ATI). Two of that subset, United and Lufthansa, have one agreement (the Atlantic +) providing greater integration amongst them than that of the other members with ATI. When Continental was included, it became a member of the Star ATI as well as an immunized agreement amongst a further subset (known as the A++ agreement).⁵²

With these layered arrangements, claims Mifsud, it is not unlikely that the underlying trust issues could end up in a Court. The architect of Open Skies, Jeffrey Shane, agrees.

“As UnderSecretary of State at the DOT, Jeffrey Shane is arguably the most influential force in recent times in driving global liberalisation through open skies. He joined with another lawyer, Warren Dean in concluding that “alliances have become as complicated as the international regulatory environment in which they operate...alliance members can have no confidence in their ability, as defendants in a treble-damages case, to explain to a court after the fact the dynamics of a commercial aviation joint venture and the exigencies of networked operation.”⁵³

Second, the non-immune junior partners are now relying on the networks of the major partners who are legally bound to compete against them.

Third, if all future requests for ATI require a metal neutral joint venture, it is not that clear that such an opportunity will present itself by the major players to the smaller non-immune partners.

"To make matters more interesting," Mifsud adds, past cases had the major ATI partners centered in the North American market. Now, Star and oneworld senior partners, United and American Airlines have entered into joint ventures with Japanese carriers. Without an ATI amongst all members, however, a curious exercise in anti-trust law emerges. American Airlines, for example, will be aware of pricing and market specifics regarding both its European and Pacific partners yet cannot share that information with either.

"Absent ATI, the exchange of internal pricing, route or market allocation information represents a per se violation of the antitrust law. However, because of metal neutral joint venture involves close co-operation and revenue sharing, parties to such a joint venture will be closely sharing internal pricing and route allocation.

This means that the US partners in Star Alliance and oneworld will be aware of substantial details of both their European and Pacific partners' pricing and market allocation details. *However their immunity does not extend to any cross sharing of the information. In other words, American Airlines remains subject to the full penalties of the anti-trust laws if it reveals information it learns from JAL or BA, or vice versa.*⁵⁴ (emphasis added)

The different regulatory processes, varying time frames in the ATI grant and various criteria for approval and monitoring between countries further complicates the issue.

Aside from these serious hurdles, Congress has expressed dissatisfaction with the apparent leniency with which anti-trust immunity has been granted. Chairman of the House Transportation Committee, James Oberstar (D-MN) proposed a three year sunset clause for the D.O.T. grants of anti-trust immunity and a study by the Government Accountability Office on the framework considered by the Department of Transport in granting immunity.

On the plus side, IATA claims substantial benefits through network integration with joint ventures. Benefits include a wider range of schedules, a seamless service and better product. Yet, IATA also points to the potential of anti-competitive harm, a situation especially possible in hub-to-hub operations where "co-operating airlines could decide to restrict the supply of ticket inventory to non-stop or hub-to-hub passengers, forcing fares higher."⁵⁵

Solution:

Towards a free market in the sky

If they ever made sense, the nationality restrictions in the bilateral trade in air services from the 1944 Chicago Conference have now been stretched to the breaking.⁵⁶ The latest ‘work-around’, the grant of anti-trust immunity along with the metal neutral joint venture, is not a long-term solution. Rather, it remains an “inadequate and temporary alternative to genuine industry rationalisation,” claims strategy analyst, *Airline Leader*.⁵⁷

The only workable solution is one where aviation becomes a truly global business with cross-border mergers and acquisitions commonplace. Yet, how is long term rationalization achieved and can it be achieved under the terms of the Chicago Convention?

The director of the International Aviation Law Institute at DePaul University College of Law, Brian Havel claims that the Chicago Convention has persisted over the past seven decades because “few if any states combine the aeropolitical power and global influence to unseat the Chicago regime on their own.”⁵⁸ A comprehensive E.U.-U.S. aviation agreement would have been of such Leviathan significance that it would have resulted in an immediate re-tooling of the Chicago Convention. Equally, claims Shane, one of the most influential forces in airline liberalization, would be a move by the powerful International Airlines Group to purchase American Airlines.

Absent actually addressing nationality and foreign ownership, a number of approaches have emerged to deal with the Chicago Convention’s restrictions on industry expansion.

One solution proposed is to place the trade in air transport services under the World Trade Organization (WTO). As the legal successor to the General Agreement on Tariffs and Trade, the WTO was established in 1995 to oversee trade policies and to seek liberalization in economic trade. The General Agreement on Trade in Services (GATS) seeks the goal of transparency, non-discrimination between trading partners and market access. These goals have been included in an annex to the GATS, known as the Annex on Air Transport Services.

Although this Annex excludes air traffic rights or services, it maintains a wide jurisdiction over the selling and marketing of air traffic services, defined as “opportunities for the air carrier to sell and market freely its air transport services.” The Annex terms require a review by the parties every five years for possible expansion of its coverage. The breadth of its current definition and the possibility of expansion make recourse under the W.T.O. a possibility.

A multilateral approach to facilitate market access in air services is not new and there exist many nations which have arranged to liberalize their air transport sector with neighbouring regions. In 1991, the Andean Pact nations (Bolivia, Peru, Ecuador, Columbia and Venezuela) concluded a pact granting each the freedom to travel

within each other's region. In 1994, a Single Aviation Market was advanced between New Zealand and Australia providing for "no constraints" in service from or within the each other's territory.⁵⁹ The European Commission proposal of a transatlantic common aviation area is another multilateral approach.

A North American multilateral solution could result in the integration of the aviation markets in North America as part of NAFTA.⁶⁰ The concept gained some traction in Ottawa in 2006. Despite the 2007 proposal between Canada, the U.S. and Mexico to establish a Trilateral Open Skies Pact with carriers recognized as NAFTA carriers, Mexico's subsequent withdrawal ended the idea. Although commentary suggests the idea died due to differences in the respective air markets of the three countries, similar market differences did not dissuade the E.U.'s Common Transport Policy.⁶¹

The International Civil Aviation Organization (ICAO), the official U.N. organ created by the Chicago Convention, continues to urge increased liberalization. Participants at the 2013 gathering agreed to the reduction of barriers to a free trade in aviation. A report by global consultancy, McKinsey linking restricted equity flows and fragile profit margins in the air industry has made liberalization and co-operation among member states an urgent priority.

Recourse could originate under the terms of the Chicago Convention. Article 94 allows for amendment with a two-thirds majority vote of the Assembly. With the growing membership of ICAO, however, amendment becomes increasingly difficult claims DePaul University's Havel.

He calls the possibility of a multilateral solution under the Chicago Convention "illusory." With no evidence that the world's 194 States (190 of which are currently party to the Convention) are willing to resort to multilateralism, the solution of a replacement to the Chicago Convention under the auspices of ICAO will not occur.

The political costs, the divergence of views from Russia and China on one hand and the U.S. on the other on the meaning of liberalization, the divergence of views of these three super-powers on the permissible jurisdictional reach of international legal institutions, the self-interest of all countries in maintaining their flag carriers, the potential de-stabilization of the current regime by splitting it into two factions all make the possibility of a multilateral solution under ICAO remote, he argues.

Further, Havel suggests that a multi-lateral approach may prove difficult given that compliance requirements on safety, rules and standards may result in confusion on which regime would govern. Though imperfect, he sees the Chicago Convention as "a fixed compass within international law."⁶²

Michael Milde, author of *International Air Law and ICAO*⁶³ accepts that amendment under ICAO would be difficult and time-consuming given that when the Convention was adopted in 1944 there were only 52 of the current 190 States. However, he claims that the vast geo-political, technical and economic transformative changes in the industry since have reduced the Chicago Convention to an historic freeze frame of 1944 and distant from today's airline needs.

There is, Milde claims, historical support for the position that the Chicago Convention

was intended as an interim measure. First, some of the speeches from the 1948 meeting on a multilateral accord thereafter suggest that many countries did not intend for the Chicago Convention's bilateral approach to become the permanent means of aviation regulation. Second, the language of the Chicago Convention, such as the Preamble's nod to the role of civil aviation in the economic improvement of nations suggests a multilateral approach. Importantly, Article 77 allows contracting States to combine their air services or routes.

Milde claims that the concept of "exclusive sovereignty" over one's airspace must be balanced with other rules of international law, such as the fundamental principles of the United Nations Charter. That Charter provides for the sovereign equality of states and the fulfilment of obligations in good faith with a peaceful resolution of differences. While acknowledging that there exists a hurdle, he urges amendment through ICAO.

Air negotiator, Byerly puts forward the solution of a multilateral convention under the auspices of ICAO for the reciprocal waiver of nationality clauses. His solution is attractive. Not only would it advance the liberalization agenda at a quicker pace, its focus of a true market, rather than one based on the grant of anti-trust immunity, makes it a compelling alternative.

While a multilateral solution is sought, recent years have witnessed a new liberalism or pragmatism in national policies, one in which the Middle East carriers are changing the game and transforming the alliance partnerships.⁶⁴ Aviation analyst CAPA claims the "Gulf siblings" are changing the dynamics, seemingly "careless of global alliance affiliations."

Not only are the Gulf carriers changing the Chicago Convention's nationality based focus and causing a re-consideration of global alliances, the strength of the Gulf carriers may be what brings about needed change.

"The Big Three of the Gulf may prove to be the acid that dissolves some of the bonds of the airline alliance partnerships. With the change in market realities that they have wrought with their ambition, success and geographic convenience, the industry is showing a new pragmatism in who they are willing to partner with."⁶⁵

Business decisions are taking hold and the time is approaching when it will be considered unseemly for a government to object to the ownership of an airline. Canada's awkward nationalism against Emirates and Etihad Airways of April, 2010—only three years ago—seems now like a generation ago. Air Canada's partnership of April, 2013 with U.A.E.'s Etihad Airlines is the new way of doing business.

The metal neutral joint venture and anti-trust immunity cannot continue to respond to the new needs of the air sector. A global political influence and will is required to move beyond the nationalist bindweed of the Chicago Convention. It represents an era long passed.

Endnotes

1. The background of the issue is provided by International Air Transport Association (IATA), *Agenda for Change*.
2. *The Economist, Open skies and flights of fancy*, October 2nd, 2003.
3. Comments by John R. Byerly, Chief Air Negotiator in DePaul University College of Law, *Conversations with Industry Leaders*, October 8th, 2010.
4. Azzie, Ralph, *Specific Problems solved by the Negotiation of Bilateral Air Agreements*. Of the 54 invited guests, only USSR and Saudi Arabia did not appear. Air transport expert, Michael Milde claims that the absence of USSR was "a major disappointment." There emerged a concern that the secrecy, mistrust and isolation of the USSR regarding co-operation on its airspace represented early warnings of the cold war. The official version claimed USSR non-attendance was prompted by hostile policy by Portugal, Switzerland and Spain towards Russia.
5. The Chicago Convention also resulted in the establishment of the International Civil Aviation Organization (ICAO) whose purposes were to regulate the safety, communications and the technological aspects of international civil aviation. In: What should be next after open Skies, International Aviation Issues Seminar (Washington, D.C.) December 6th, 2012, John R. Byerly sees ICAO as "the best way to give coherence and predictability to what would otherwise be absolute chaos in the skies."
6. Stoffel, Albert, "American Bilateral Air Transport Agreements on the Threshold of the Jet Transport Age", *Journal of Air Law & Commerce*, 26,2 (spring, 1959). In the January 14th, 1995 article, "The Struggle to Keep Iberia Aloft", the *New York Times* recounts the billions of dollars invested by Spain to keep Iberia in the air, suggesting it was "an expensive vehicle for waving the flag around the globe." The February 2, 2012 issue of *Businessweek* claims that "governments have long helped bankroll their national airlines, buying both prestige and guaranteed service on certain routes." The counter argument, claims Rigas Doganis, aviation consultant and former CEO of Olympic Airlines, is that a country's air service ensures adequate continuous contact to the world, employment generation, tourism development, inflow of foreign exchange and new taxing ability.
7. Mifsud, Paul V., *Metal Neutrality and the Nation-Bound Airline Industry*, *Air and Space Law* 36, no. 2 (2011):117-130 at 118.
8. The description of the events subsequent to Bermuda II are Byerly's in his October 8, 2010 *Conversation with Industry Leaders* series with DePaul University College of Law. The other examples include: (1) Kenny, Colin, "Drop the gloves with the U.A.E.", *The Ottawa Citizen*, January 8th, 2011. Senator Kenny weighed in on the U.A.E. response to denied access to carriers, Emirates and Etihad with name-calling referring to them as "bullies" and "pompous thugs"; (2) In *Protectionism, Prestige and National Security*; The alliance against the multilateral trade in International Transport, Randall D. Lehner draws on the narrowly avoided trade constraints between Japan and the U.S. in the summer of 1995 to argue against nationalism. The dispute originated over the right of FedEx to route flights from the Philippines through Japan and onwards. Despite a bilateral agreement, the entire network, claimed Japan, belonged to its carriers.
9. Byerly, John F., Transcription of speech notes: *Open Skies and Aviation Liberalization: Achievements and Challenges*, JFK Chamber of Commerce, September 14th, 2011.
10. *Supra*, footnote 3.
11. For example, in 2003, China and Australia lifted all restrictions on freighter operations between and beyond countries.
12. Jeffrey Shane, former Under-Secretary of Policy, Department of Transportation (USA) and current general counsel for the International Air Transport Association in *Conversations with aviation leaders*, DePaul University College of Law, October 8th, 2012.
13. "Ownership rules: Stepping stones", *Airline Business*, August 18, 2010.
14. The Department of Justice role is supervisory and its analysis is done under the *Sherman Antitrust Act* and the *Clayton Act* which set out antitrust prohibitions against restraint of trade.
15. Stober, Andrew, "Who Soars in Open Skies? A Review of the Impacts of Anti-trust immunity and International Market Deregulation on Global Alliances, Consumers and Policy Makers". *Journal of Air Transportation*, (2003) Vol. 8, No. 1 at page 116.
16. Stober, Andrew, "Who Soars in Open Skies? A review of the impacts of anti-trust immunity and international market deregulation on global alliances, consumers and policy makers, *Journal of Air Transportation*, (2003) Vol. 8, No. 1 at page 118.
17. Government Accountability Office 1995, *Airline alliances produce benefits but effect on competition is uncertain*, at page 4.
18. *Supra*, at page 5. For an assessment of the epic contest for domestic routes, see *Hard Landing*, by Thomas Petzinger Jr. Unlimited code-sharing, he claims, would allow the entire route system of a U.S. carrier to become a feeder system for British Airways. Jeffrey Shane claimed that the deal allowed British Airways to in effect "buy access into the U.S. market."

19. *International Aviation: Airline Alliances Produce Benefits but Effect on Competition is Uncertain*, April, 1995.
20. The GAO estimated a benefit to Northwest Airline at \$125- to \$175-million in 1994.
21. Chairman Pressler also hoped that the traffic increase would result in a potential alliance between British Airways & American Airlines and a re-negotiation of Bermuda II (which restricted U.S. carriers from access to Heathrow Airport). Pressler's hope was that Bermuda II would be "cast into the great trash heap of protectionist trade policy where it belongs." *Congressional Record*, Volume 142, Number 74 (May 23rd, 1996) [Senate].
22. *Conversations with Industry Leaders*, DePaul University, College of Law, September, 2009. Crandall claims the fall-out of the policy was that American airlines were disadvantaged and European airlines, who at the time were in decline, benefitted.
23. "The economic benefits generated by alliances and joint ventures", *IATA Economics Briefing*, November 28th, 2011, page 1.
24. *Supra*, footnote 3.
25. The Star brand became the largest group. SkyTeam made advances in network integration with oneworld's carriers "leaders in the world's most desired destinations."
26. *Airline Alliances* by Paul Stephen Dempsey, McGill University Institute of Air & Space Law, quoting Michael E. Levine, former airline executive and government aviation expert.
27. *Conversations with Industry Leaders*, DePaul University College of Law, October 8, 2012.
28. Knibb, David, "Ownership: Finding a new frontier", *Flightglobal*, April 18th, 2011.
29. *Transatlantic Aviation: Effects of Easing Restrictions on US-European Markets*, GAO, July, 2004 at page 23.
30. *Airline Leader*, June, 2011, "Global airline alliances: transformed by anti-trust immunity, but confronted with uncertainty".
31. *Supra*.
32. Harrison, Michael J., *European Integration and Transatlantic Air Services Agreements: Who has the authority?* (2003), American Consortium on European Union Studies at page 14 noting that Lufthansa remained 37 per cent German government owned until 1997; Air France was 94.2 per cent owned by the French government until 1996 and 20 per cent by 2002; Finnair (60.7 per cent); KLM (38.2 per cent); Sabena of Belgium (33.8 per cent); and Austrian Airlines (51.9 per cent).
33. Commission of European Communities (2002a), point 6.
34. Commission of European Communities (2002a), annex 5.
35. As reported in *European Union and Transatlantic Air Services Agreements: Who has the authority?*, American Consortium on European Union Studies (ACES) by Michael Harrison at page 21.
36. Council of Ministers (2003).
37. Petzinger, Thomas, *Hard Landing, the epic contest for power and profits that plunged the airlines into chaos*, Three Rivers Press, New York, at page 424.
38. John Byerly's phrasing, according to Jeffrey Shane in *Conversations with Industry Leaders*, DePaul University College of Law.
39. Jeffrey Shane's phrasing, *supra*.
40. A self-described "independent populist", the controversial Lou Dobbs hosts a business show on the Fox network. In an August 3, 2009 *New York Times* article his then hosting of the CNN show was described as a "publicity nightmare for CNN" and one that "seems to contradict the network's 'no-bias' brand."
41. *Financial Times*, "Brussels to push for EU-US airline mergers", September 25th, 2012.
42. A further unresolved issue of wide implication is that of environmental measures and the EU inclusion of foreign airlines in its carbon emissions trading scheme. The trade in carbon emissions, claimed the Financial Times, was threatening to set off a global trade war.
43. *Flightglobal*, "Phase two of EU-US Open Skies to be signed this month", June 7th, 2010.
44. Jeanniot, Pierre, "Where's Canada?", *National Post*, April 10, 2008.
45. Gillen, David, *Canadian International Aviation: Policy and Challenges* (February, 2009) at page 6.
46. Glynn, Mark & de Mestral, Armand, "Rethinking foreign ownership: The key to opening transatlantic skies", *Canada-Europe Dialogue*, April, 2011, at page 3.
47. *Analysis of Canada's Bilateral Air Services Agreements: Policy Focus on Asia-Pacific Region*. In like vein, John Byerly's speech at the Airports Council International meeting in December, 2012, claimed the victims of Canada's Blue Skies policy were "airports, cities and consumers."

48. Air Canada, in its Annual Information Form of March, 2012 cautions its investors that it cannot "predict if or when the provisions relating to foreign ownership limits will come into force." On October 9, 2009, Canada's *Globe and Mail* newspaper reported that after agreeing to up foreign ownership limits, Ottawa then demanded reciprocity on airline ownership. The *Globe and Mail* reported that this was a condition not initially mentioned and one unlikely to attract other countries.
49. *Airline Alliances*, by Paul Stephen Dempsey, Institute of Air & Space Law, McGill University.
50. *The Guardian*, "Virgin Atlantic's Delta deal shows airline mergers are inevitable", December 15th, 2012.
51. *Conflicting Regulatory Approach to Aviation: An Impediment to the Industry's Viability and Growth*, comments by Calin Rovinescu, Air Canada's CEO in a speech on September 22nd, 2011 to the American Bar Association.
52. The merger in Europe and subsequent alliance agreements between American Airlines, British Airways and other European partners are equally complex. The controversy surrounding these agreements can be seen in the differing approaches taken by the DOT and DOJ. The DOJ claimed the agreement resulted in a loss of competition on key routes.
53. *Airline Leader*, June, 2011, Global airline alliances transformed by anti-trust immunity but confronted with uncertainty, at page 10.
54. Mifsud, Paul V., "Metal Neutrality and the Nation-Bound Airline Industry", (2011) Vol. 36 *Air & Space*, No. 2, 117 at 126.
55. IATA, *The Economic Benefits generated by Alliances and Joint Ventures*, November 28th, 2011 at page 8. The brief claims that the wide range of available options to passengers, the possibility of new air entrants and carve-outs (disallowance in part) by competition authorities of routes where anti-competitive effects are likely "may exert an effective restraint on pricing power."
56. "The Chicago Convention of 1944 created", claims Mifsud, "the curious practice of a two-government buffer between international airlines and the marketplace"; Mifusd, Paul V., "The Fast Track to a Modern Air Transport Policy", *Air and Space Law*; DeLege Ferenda, "Essays in Honor of Henri A. Wassenberth".
57. "Middle East Carriers: How international aviation was transformed in 30 days", *Airline Leader*.
58. Havel, Brian and Sanchez, Gabriel S., "Do we need a new Chicago Convention?" *Issues in Aviation Law and Policy*, Volume 11:1, page 7.
59. See: *Overview of trends and developments in international air transport*, ICAO Secretariat (2009) for a full list of liberalization agreements.
60. This idea was proposed by Pierre Jeanniot, O.C., C.Q., B. Sc., LL.D., D. SC in *Liberalization of air traffic – Open Skies pacts good for Canada; Opening up to more airline competition would lower fares*, Montreal Economic Institute, May 15, 2005.
61. Recent reports claim Canada is seeking an expanded agreement with Mexico to ease air travel restrictions. While the agreement may increase business opportunity, Canada's visa requirements mean that any increase in tourism traffic will be in Mexico's favour. (*Globe and Mail*, "Canada-Mexico air travel accord set to boost tourism and business links", February 10, 2014).
62. *Supra*, footnote 56.
63. Milde, Michael, *International Air Law and ICAO*, Eleven International Publishing (2008)
64. As witnessed in the strengthening of Etihad Airways' airberlin, Air France-KLM code-share, Qantas' elopement with Emirates, (ending its two decades partnership with British Airways), the recent partnering of Air Canada with Etihad Airways.
65. "Middle East Carriers: How international aviation was reconfigured in 30 days", *Airline Leader*.

Further Reading



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