Scanning the air transport market in Europe and Beyond: the position of airlines and the evolution of technical innovations

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Scanning the Air Transport Market in Europe and Beyond: the Position of Airlines and the Evolution of Technical Innovations

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Introduction

Traditionally, airlines operate their international services in a relatively harnessed manner. While they are in many cases commercial undertakings, their operations are strictly regulated. The Regulations focus not only on strict safety supervision and, increasingly so, on the protection of the environment, but also on market access, which often see severe licensing and designation conditions, market behaviour by virtue of the application of competition law rules, and, of course, passenger protection. Moreover, international and European air law continue to intensify their attention to the increased technical capabilities of aircraft as evidenced by the use of unmanned aircraft and their regulation. This chapter is designed to focus on a selected number of aspects of the above evolution, with particular reference to market access and unmanned aircraft. These subjects will be addressed from an international air law perspective (section 2) and from a European air law perspective (section 3). Finally, section 4 will provide concluding remarks.

Airline Operations from a Global Perspective: Opening Closed Skies Through Air Services Agreements Between States

International civil aviation, as explicitly stated in Article 1 of the Convention on *international civil aviation*, henceforth also referred to as the Chicago Convention (1944), and reiterating customary international law, is based on the assertation that "every State has complete and exclusive sovereignty over the airspace above its territory".[1] In practice, this means that the aircraft of one State has no automatic right to enter the *territory*[2] of another State. This necessitated legal mechanisms to facilitate international civil aviation – i.e. legal mechanisms were necessary to facilitate a permission-based regime. The drafters of the Chicago Convention, thus, ensured the inclusion of Article 6[3] for *scheduled air services*. Article 6 requires that:

> "*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.*"

Thus, prior *special permission* must be granted by the overflown State, and the State of the landing of the aircraft, to the State in which the aircraft is registered. The services targeted in Article 6 of the Chicago Convention (1944), pertaining to the operation of aircraft by scheduled airlines.

This regime has resulted in States predominantly negotiating bilaterally and concluding treaties commonly referred to as *Bilateral Air Service Agreements* (BASA). As of 2022, almost 4,000 BASAs have been registered with the International Civil Aviation Organization (ICAO).[4] Each BASA is drafted taking into account the specifics of each contracting State, as well as the shared aims and objectives of the two parties, covering topics such as routes, ownership and control requirements, and airline designations. Consequently, each BASA is tailormade.

The principal terms of a BASA include conditions for the designation of airlines, that is, which airlines and how many airlines may operate the agreed services on the routes between, behind and beyond the State parties to the BASA. These conditions pertain to:

- *nationality requirements* for designated airlines, in terms of their ownership, that is the nationality of their shareholders, and their management board as expressed in the expression "effective control";
- the *routes* which designated airlines are entitled to fly;
- the *applicability of local air navigation rules* in the State into which the air services are performed by the designated airline(s) of the other State;
- the *capacity* that designated airlines may offer, that is, the size and the configuration of the aircraft;
- the *prices* the designated airlines may quote;
- the maintenance of minimum *safety*, *security and environmental standards*;
- recognition of the "*fair competition*" principle designed to ensure the establishment of a level playing field between the designated carriers;[5]
- *commercial activities*, including code-sharing and the establishment of sales offices in the territory of the other State;
- *user charges* for meeting the costs of access to, and use of infrastructure, such as airports and air traffic control;
- *taxation*, including exemptions from taxes such as fuel taxes; and
- *dispute settlement* and termination of the agreement.

The above conditions are laid down in BASAs, and, increasingly so, in plurilateral or multilateral agreements. The principal terms will be discussed in this chapter, whereas the clarification of others can be found in the publications mentioned in the endnotes.[6]

As outlined above, bilateral or multilateral ASAs are concluded by *States* which may have to be ratified in accordance with the procedures of national law. This guardianship of States differentiates aviation from other industries and explains why it is not subject to the liberal rules of the World Trade Organization (WTO), whose services industries are covered by the General Agreement on Trade in Services (GATS). The operation of air services as described above are outside GATS.

In practice, this regime implies that, for instance, Japan Airlines (JAL) cannot fly from Tokyo and/or Osaka to London and/or Manchester, and *vice versa*, without the backing of such a BASA. Obviously, the same BASA will apply to the services operated by British Airways in the other direction. In traditional

BASAs, JAL and BA would need to obtain approval, at times even prior approval, for the quoting of tariffs for passenger and cargo traffic and the use of capacity on the agreed routes. In all BASAs, airlines must be "designated" for the operation of the agreed international air services. States will only designate airlines, if the nationality, and other requirements as laid down in the applicable BASA, are met. In the above example, the UK will designate British air carriers and the Japanese government Japanese air carriers.

In 1978, the United States (US) initiated a "deregulation" process, pursuant to which the US domestic market was turned into a genuine market for the operation of air services. US airlines were permitted to offer their services between New York and Los Angeles, or between Chicago and Miami, in accordance with their commercial considerations. However, the deregulation process was an internal affair.

In 1992, the US started to apply this market-oriented regime to the operation of air services, but still based services on the BASA system. These agreements, also known as "*open skies*" agreements, leave the operation of the agreed air services to the commercial objectives of the designated carriers, which still had to meet the above-mentioned nationality requirements. In 1992, the first "open skies" agreement was concluded between the US and the Netherlands. In the same year, the, then, European Economic Community (EEC) completed its internal air transport market, liberalising air services *within* the internal market of the European Union (EU).

Liberalising Air Services in the EU

The completion of the internal market in 1992

In the EU, there has been a break away from "bilateralism" between EU States, to a regional approach towards the operation of intra-EU air services, that is, services between airports located in the EU. With the completion of the internal air transport market, the EU took efforts to move away from a protected national aviation industry, to a liberalised market based on the basic principles of the EU, such as the freedom to provide services, the freedom of establishment and "fair competition". The EU achieved this process in three phases, which began in 1987, and concluded in 1992 with the introduction of the Third Package.

Since 1992, EU law has evolved and significantly advanced. The above-mentioned Third Package has since been repealed and replaced by a revision of the Third Package in 2008. This resulted in EU Regulation 1008/2008, which is often referred to as the *Air Services Regulation*.

With this, *national carriers* became *Community carriers* and were given certain rights, notably:

- Which carriers can access the market and under what conditions, thus articulating the distinction between "Community carriers" and "third country carriers", who do not benefit from the freedom that Community carriers enjoy in the vast EU internal market.
- The freedom of such Community air carriers to carry traffic between any airports in the EU, subject to the availability of slots and conditions pertaining to the protection of safety and the environment.
- The freedom for community carriers to set airfares or rates, and how prices should be displayed to consumers.

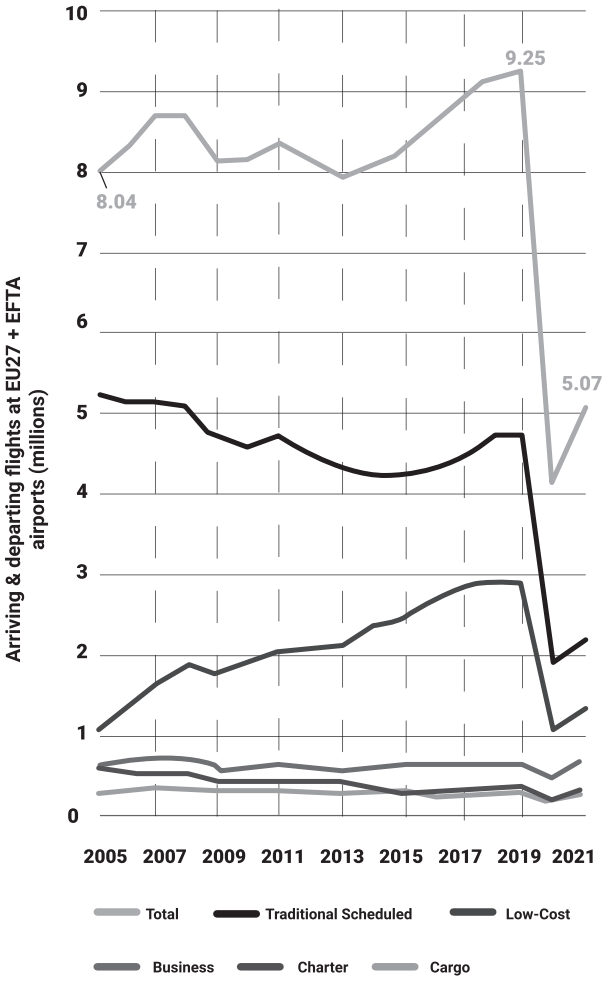
These steps resulted in aviation becoming the first mode of transport, and arguably the only "fully integrated single market".[7] Licenced EU air carriers can fly anywhere within the internal market and charge what the market would pay for the type of service offered.

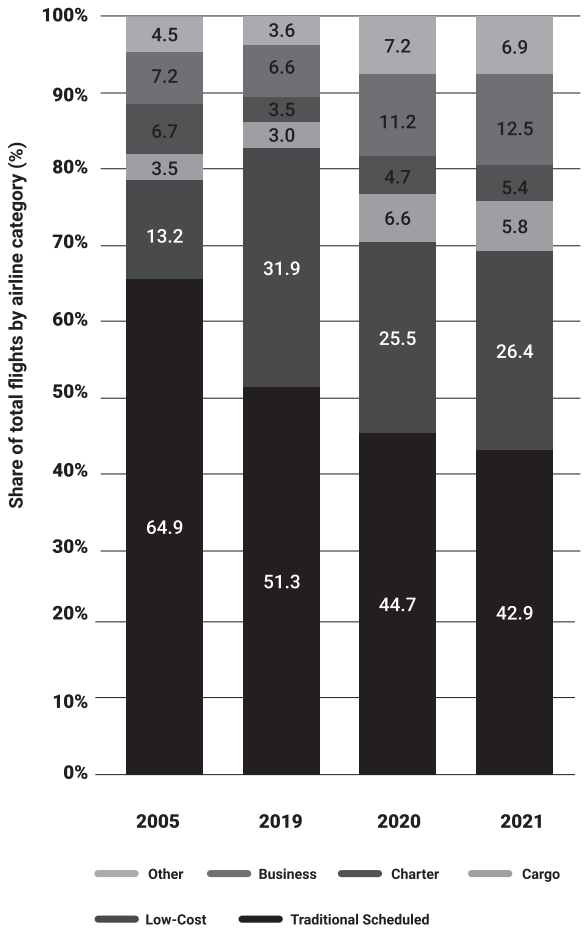
The result of these market conditions has been the disappearance of some long-established national airlines such as Sabena from Belgium and Swissair from Switzerland in 2001. Their disappearance was offset by the rapid growth of many new budget air carriers such as Ryanair, easyJet, Vueling and Wizz Air, and to the point at which the distinction between "full service" and "low cost" carriers has disappeared, as both categories are subject to exactly the same rules, and, as a corollary, harmonising their services in the internal market. As a consequence of the liberalised internal EU market, the number of air carriers operating scheduled routes has grown since 1992, as has the number of direct connections between airports in EU Member States.[8]

The financial capacity and resilience of airlines in and after the COVID-19 pandemic

During the COVID-19 pandemic, many otherwise profitable airlines faced a dramatic fall in revenues and had to increase their capital levels in order to weather the crisis. As part of its impact assessment, the Commission examines the need for possible changes to ensure that EU airlines can continue to have adequate access to capital while safeguarding the EU's strategic autonomy, taking into account existing and future tools at an EU level for foreign investment, respecting social rights and promoting the green transition within the European aviation sector.

The chart below identifies the traffic developments in 2021. It shows parallel developments for the traditional carriers such as Air France, Lufthansa, KLM and Iberia as compared with the low cost carriers, that is, Ryanair, easyJet, WizzAir and Vueling.





Source: EASA Environmental Report 2022, Figure 1.1

The COVID-19 pandemic has, thus, giving the rise of uncertainties about the survival of air carriers generally, included EU air carriers. Moreover, limited access to foreign capital by EU carriers, caused by the strict nationality restrictions governing this industry, may lead to higher costs of capital in an already highly capital-intensive sector. Air carriers are the only part of the aviation supply chain facing such restrictions which is unusual in international business. Moreover, relaxation of such restrictions on the basis of effective reciprocity through ASAs has in some cases been envisaged, but so far not been practically implemented.

The reasons for the reluctance of policymakers to allow broader investment opportunities from sources outside the EU concern the link between the nationality of the carrier and the performance of traffic rights. As explained above, carriers must be designated for the operation of traffic rights, which are the "bread and butter" of airlines. Designation is based on nationality. As a corollary, and as an example, only BA and JAL are entitled to fly between Japan and the UK. In other words, if BA is not regarded as a UK carrier in terms of ownership of its shares, the Japanese side might refuse BA to fly routes between the UK and Japan.

The envisaged revision of the Air Services Regulation

The liberalisation of air services in the EU has been a phenomenal success, supporting growth and allowing citizens to access the enormous benefits that air transport can bring due to reduced fairs, more connectivity (increased frequency and new routes), and greater transparency and efficiency. However, despite this, questions have been raised about the Regulation's suitability.

In 2019, the EU Commission published an evaluation of EU Regulation 1008/2008. This document will hereafter be referred to as "the EC Evaluation (2019)".[9] The introduction of the EU air carrier clause, substituting the nationality of EU States with an EU nationality, has had significant repercussions on market access, both internally, that is, within the EU, as to which see the preceding section, and externally. Indeed, EU States were instructed to designate not only their "own" carriers, i.e. France should not only designate Air France for flights between Paris and Buenos Aires but also Iberia, on the basis of the EU air carrier clause. It follows from the discussion in section 2, above, that third States had to agree with this change of nationality – which they have done in many but not all cases. For instance, the Russian Federation, Brazil, Nigeria and South Africa do not accept the EU nationality of air carriers.

Moreover, the EU air carrier clause has given rise to EU mergers and takeovers, especially among so-called "flag carriers". The EU air carrier clause in conjunction with the concept of "Freedom of Establishment" has also enabled EU air carriers to operate international air services outside their traditional hubs. For instance, Finnair is now permitted to operate services from Rome to Jakarta. Whether such EU carriers have used these opportunities is another question.

All in all, the EC Evaluation (2019) estimates that the EU air carrier clause has "comparatively helped the competitiveness of EU air carriers", because States outside the EU do not offer the same facility.[10] The EU air carrier clause as well as the corporate structures of EU airline groupings such as Air France – KLM, the International Airline Group (IAG), including BA and Iberia, and the Lufthansa takeover of Swiss and Austrian, have impacted the operational and competitive opportunities of EU air carriers. These intensive links between EU air carriers helped them to achieve cost savings in areas such as the organisation of their network, maintenance, marketing of their products and services in the EU and globally, purchase and leasing of aircraft, catering, and coordination of labour conditions to name a few.

Technological Innovations: The Entrance of Unmanned Aircraft into the Aviation Market

A key motivating factor behind the Commission's call for a revision of EU Regulation 1008/2008, in addition to refining the existing text as a result of the COVID-19 pandemic, is the rise of new technologies. Within this context, references to sustainable aviation fuels, improved aircraft design, improved efficacies of air traffic management, as well as, new aviation activities are made in the recent European Commission publications, such as the EC Evaluation (2019). On the latter, this can include what is commonly referred to as "Urban Air Mobility" (UAM).

While there is no fixed definition of "UAM", it can generally be understood to mean a new form of air mobility, that moves people and cargo between places, previously not served or underserved by aviation – at a local, regional, intra-regional or urban level – using revolutionary new aircraft (e.g., electric aircraft), and at a large and scalable way. What this means is utilising the third dimension (the airspace), in order to address a societal need, utilising Unmanned Aircraft Systems (UAS) and Electric Vertical Take off and Landing (eVTOL) aircraft for enhancing urban mobility. One proposed service is the use of eVTOL aircraft to perform commercial air taxi services (Point A to Point B). While the European Union – through the European Union Aviation Safety Agency (EASA) – is still in the process of drafting the aviation safety rules for these aircraft, including those for Operations, the non-safety rules need to also be considered. For example, the following question needs to be answered: "[W]ill it be enough for eVTOL operators

to demonstrate that they meet the required level of safety, as is the case for low and medium-risk UAS, in order to conduct commercial operations or will they also be required to follow the licensing requirements set out in the EU's *Air Service Regulation*, as is currently required for commercial manned operations?"[11]

Currently, it is not clear which approach will be applied to UAM services. Therefore, the revision of Regulation 1008/2008 is an enormous opportunity for the EU to make the position explicitly clear. Whereby, it has the choice to bring UAM services under the same licencing system as manned aviation, or to fully liberalise the future UAM market so long as the operators demonstrate that the activity meets the acceptable level of safety.

Concluding Remarks

It is anticipated that the economic and commercial side of air transport will continue to be regulated by international agreements concluded between States. States have an interest in promoting national policy objectives through the air transport sector. It is trade and policy-wise, a sensitive sector. Agreement on the economic side of the operation of international air services is reached by the achievement of a level playing field created by States for their designated air carriers. Disagreements are solved through negotiations rather than judicial means.

Deregulation and liberalisation of international air transport, as evidenced by, for instance, a relaxation of nationality requirements under national licensing regulations and the increasing number of Open Skies agreements, go hand in hand with the application of competition regimes in different jurisdictions. These developments lead to a restructuring of the airline industry, because designated "flag" airlines do not enjoy any more traditional protection, prevailing under the restrictions of restrictive bilateral ASAs.

The internal market for the provision of air transport services is perceived by most people, and by most EU airlines, as being of positive benefit. It enabled EU airlines to compete in each other's markets, whereas the provisions swept away at virtually a stroke most of the restrictive conditions pertained under the old bilateral regimes.

The EU air transport market has proved to be a dynamic one. This dynamism is exemplified by areas which will require intensive attention during the next decade, among which mention is made of innovative solutions for the operation of unmanned aircraft in the EU air transport market, environmental protection, and access to the EU market for non-EU air carriers.

Endnotes

1. Convention on International Civil Aviation, 15 UNTS 295, UN Doc. 7300/9 (1944), Art. 1.
2. Convention on International Civil Aviation, 15 UNTS 295, UN Doc. 7300/9 (1944), Art. 2.
3. Article 5 covers *non-scheduled flights*. Additionally, Article 7 sets out the rights on obligations for *cabotage*. *See*, Pablo Mendes de Leon, *Cabotage in Air Transport Regulation*, First Edition (Martinus Nijhoff, 1992). Finally, Article 8 sets out the rights and obligations for *pilotless aircraft*. *See*, Benjamyn I. Scott (ed.), *The Law of Unmanned Aircraft Systems*, Second Edition (Wolters Kluwer, 2022).
4. ICAO, "World Air Services Agreements", https://data.icao.int/wasa.
5. *See*, Mike Tretheway and Robert Andriulaitis, Intervistas Consulting, OECD, International Transport Forum, *What Do We Mean by a Level Playing Field*, Discussion Paper 2015 # 06, available online.
6. *See*, B. Cheng, *The Law of International Air Transport* 289–490 (1962); *see also*, P.P.C. Haanappel, *The Law and Policy of Air Space and Outer Space: A Comparative Approach* 109–123 (2003), and Pablo Mendes de Leon, *Air Transport as a Service under the Chicago Convention*, XIX(II) *Annals of Air and Space Law* 523–566 (1994).
7. European Parliament, "Air Transport: Market Rules", https://www.europarl.europa.eu/factsheets/en/sheet/131/air-transport-market-rules.
8. *See*, Mott MacDonald, *Annual Analyses of the EU Air Transport Market 2015*, Final report prepared for the EU Commission, available at the website of the EU Commission.
9. SWD (2019) 285 final dated 9 July 2019.
10. *Ibid.*, at p. 44.
11. *See*, for a more detailed discussion on this topic, Benjamyn I. Scott, "Open Skies for Unmanned Aircraft in Europe: An Outlier or a New Approach?", 46(1) *Air and Space Law 57-8* (2021); *see also*, Benjamyn I. Scott (ed.), *The Law of Unmanned Aircraft Systems*, Second Edition (Wolters Kluwer 2022).

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