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Liberalisation of international civil aviation – charting the legal flightpath

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ABSTRACT

The paper focuses on the issue of liberalisation of international civil aviation, examining how the law could accommodate a reform of the Chicago regime. It looks into the strengths and weaknesses of the most prominent legal options available to States to implement liberalisation, namely, amending the Chicago Convention, including market access in air transport in the GATS Annex on Air Transport Services, waiving the nationality clauses and concluding inter-regional air transport agreements. Via this process, the paper aspires to identify the optimal legal path to liberalisation. The analysis suggests that there is no single way to achieve liberalisation nor is there a shortcut. Instead, it appears that what catalyses liberalisation is the combined effect of the interplay between the various legal options. The paper concludes that, however accommodating the law might be, liberalisation occurs when economics and politics merge, an outcome which in international civil aviation appears to be a long way down the road, but certainly not out of sight.

1. Introduction

The debate on the need to liberalise international civil aviation is not new. The regulation of international civil aviation has been a contentious issue from the outset, when the Chicago Convention was still in the making.[2] Market access in air transport, governed by Article 6 of the Chicago Convention, is the outcome of a policy disagreement between the powers of the day over how liberal or restrictive the regulation of international civil aviation should be (Dempsey, 2008). This dilemma has persisted throughout the years, resulting in regulatory change in international civil aviation being modest and driven, mainly, by liberalisation at national level.

The resilience of the Chicago regime to change might point to the fact that it has served the aviation community well over the years. The bilateral regime has protected the industry from flags of convenience and free riders, whilst achieving an exceptional level of safety and security. At the same time, the requirement for "equality of opportunity" in the provision of international air transport services has safeguarded connectivity-what the Chicago Convention has described as the need to "[m]eet the needs of the peoples of the world for safe, regular, efficient and economical air transport".[3]

Seventy years after the signing of the Chicago Convention a very different geopolitical, social and economic landscape has emerged. Technological progress, marked by the advent of the internet, has catalysed change, inaugurating an era of globalisation. Considering that aviation is 'cosmopolitan' by nature, operating under conditions of globalisation of competition should not come as a surprise or entail a radical market and regulatory reconfiguration (Havel and Sanchez, 2011). Yet, the industry's *modus operandi* points to a different reality.

Globalisation of the economy creates the need for access to international capital markets. In aviation, cross-border investment has been discouraged due to the requirement (prescribed in the States' national laws and reiterated in bilateral air services

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[1] The author has written this paper in her personal capacity. Therefore, the views herein should not be attributed to the ITF/OECD.

[2] Convention on International Civil Aviation, *opened for signature* Dec. 7, 1944, 61 Stat. 1180, 15 U.N.T.S. 295 (entered into force Apr. 7, 1947).

[3] See the Preamble to the Convention, in conjunction with Article 44(d). Ibid.

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agreements) that airlines be majority owned and effectively controlled by the country of designation.[4] Nationality restrictions have prevented the industry from consolidating out of fear that traffic rights, negotiated bilaterally between sovereign States, might be jeopardised. This fear has led to the creation of international airline alliances, which, depending on the intensity of airline cooperation, have, on various occasions, been granted antitrust immunity by the competition authorities.

Tapping into international capital markets necessitates a reconsideration of the regulation of international civil aviation; so does the modern world's increased need for connectivity. The momentum the issue of liberalisation has gained is best illustrated within ICAO, where the 38th session of the Assembly requested the Council to develop and adopt a long-term vision for international air transport liberalisation, including examination of an international agreement by which States could liberalise market access.[5]

The question that arises is how best to modernise the regulation of international civil aviation without jeopardising the merits of the Chicago regime, but instead capitalising on and magnifying them. This paper approaches this question from a legal perspective. Its objective is to lay out the main legal options available to achieve liberalisation, outlining their strengths and weaknesses. Through this process, the paper aspires to inform the discussion about the optimal path to liberalisation.

2. In search of air transport's identity – economic activity, public utility and public security considerations

Liberalisation is associated with the opening up of sectors of the economy to market forces. Since these sectors are traditionally protected from competition by means of regulation, liberalisation is often referred to as deregulation. The sectors that are being liberalised are normally concerned with economic activities, that is to say with the provision of goods and/or services on the market.[6] Activities linked to the exercise of State prerogatives, such as the maintenance and improvement of air navigation safety, security and air traffic control, typically fall outside the ambit of economic activities.[7] Determining the nature of air transport activities in particular as economic or non-economic as the case may be calls for an examination of the historical regulation of civil aviation.

The first codification of public international air law occurred in 1919, when the Convention Relating to the Regulation of Aerial Navigation (the so-called, Paris Convention) was adopted.[8] The second codification occurred in 1944, when the Convention on International Civil Aviation (the so-called Chicago Convention) was adopted.[9] Both Conventions enshrine, in their very first article, the principle of national sovereignty, i.e. that every state has complete and exclusive sovereignty over the airspace above its territory. The rationale behind this provision is to be sought in the security and defence considerations prevailing in the aftermath of the First and Second World Wars, when these Conventions were adopted.

The nexus between civil aviation and public security has been sketched out in the Preamble to the Chicago Convention, which, in its opening statement, provides: "[w]hereas the future development of international civil aviation can greatly help to create and preserve friendship and understanding among the nations and peoples of the world, yet its abuse can become a threat to the general security;…". The Preamble goes on to state that the Convention has been concluded in the light of these considerations "in order that international civil aviation may be developed in a safe and orderly manner and that international air transport services may be established on the basis of equality of opportunity and operated soundly and economically". The criteria established in the Preamble have been fleshed out in Article 44 of the Convention, regarding the objectives of the International Civil Aviation Organisation (ICAO). Article 44(d) in particular entrusts ICAO with the objective of fostering the planning and development of international air transport so as to meet the needs of the peoples of the world for safe, regular, efficient and economical air transport.

The established interconnection between public security on the one hand and safety, regularity of service, operational efficiency and economic efficiency on the other hand may hint at the fact that, in the perception of the signatories to the Convention, air transport is not a conventional economic activity, but is bound to operate within a sensitive environment, while possessing also the characteristics of a public utility. The Chicago Convention provision on which States have relied to implement these criteria is Article 6. Article 6 translates the principle of national sovereignty into the context of market access, providing for the principle of economic sovereignty. Article 6 reads: "[n]o scheduled international air service may be operated over or into the territory of a contracting State, except with the special permission or other authorisation of that State, and in accordance with the terms of such permission or authorization".

The principle of economic sovereignty culminated in what appears to be the main obstacle to liberalisation, namely, the nationality restrictions embedded in national legislation and air services agreements. Capping foreign investment in and restricting foreign control of national airlines to ensure that the latter remain majority owned and effectively controlled by the country of airline establishment and designation has been the means by which the

[4] The genesis of the ownership and control requirement must be sought in Article I, para. 5 of the International Air Services Transit Agreement (IASTA) and Article I, para.6 of the International Air Transport Agreement, both produced at the Chicago Conference. Pursuant to these provisions, "each contracting State reserves the right to withhold or revoke a certificate or permit to an air transport enterprise of another State in any case where it is not satisfied that substantial ownership and effective control are vested in nationals of a contracting State…". Neither Agreement provides a definition of the term "substantial ownership and effective control". Generally, substantial ownership is understood as majority ownership, meaning ownership of more than 50% of an airline's voting shares. Although determining majority ownership might prove problematic, especially in cases of privatised, publicly traded companies, the criterion of effective control seems to matter most in the assessment of the authorities. Who actually controls the company (i.e. in whose hands its management lies) is an issue to be decided *ad hoc*. Determining factors are: significant foreign minority shareholdings; one large foreign shareholding with the rest of the capital being divided into small shares; foreign citizenship of members of the Board of Directors, and especially its President (Haanappel, 2001). See EU definition of 'effective control' in Article 2(9) of Regulation (EC) No. 1008/2008 of the European Parliament and of the Council of 24 September 2008 on common rules for the operation of air services in the Community (Recast), OJ L 293/3, 31.10.2008.

[5] See Resolution A38-14, Appendix A, Section I, para. 13 and para. 14, in Resolutions adopted at the 38th Session of the ICAO Assembly (24 September–4 October 2013), Provisional Edition, November 2013, available at: ⟨http://www.icao.int/Meetings/a38/Pages/resolutions.aspx⟩.

[6] What constitutes an economic activity is a recurrent issue in competition law. See, for instance, the case law of the European Courts in Case 118/85, *Commission v Italy,* [1987] ECR 2599, paragraph 7; Case C-35/96, *Commission v Italy*, [1998] ECR I-3851, paragraph 36.

[7] See, for instance, the European Court's ruling in Case C-364/92, *SAT/Eurocontrol,* [1994] ECR I-43, paragraph 27 and Case C-113/07 P, *Selex Sistemi Integrati v Commission,* [2009] ECR I-2207, paragraph 71. See also the European Commission's Decisions in case N 309/2002 of 19 March 2003, Aviation security – compensation for costs incurred following the attacks of 11 September 2001, OJ C 148, 25.6.2003, and in case N 438/2002 of 16 October 2002, Aid in support of public authority functions in the Belgian sector, OJ C 284, 21.11.2002, available at: ⟨http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_N438_2002⟩.

[8] Convention Relating to the Regulation of Aerial Navigation, *opened for signature* Oct. 13, 1919, 11 L.N.T.S. 173.

[9] *Supra* note 2.