

**EU REGULATION 868 OF 2004: REPORT OF A UNILATERAL APPROACH ON REGULATING UNFAIR
SUBSIDISATION AND UNFAIR PRICING PRACTICES AND ITS FAILURE**

This paper is designed to provide a comprehensive overview of the EU Regulation No. 868/2004 concerning protection against subsidisation and unfair pricing practices regarding non-EU carriers and causing injury to Community air carriers. The analysis will focus, at first, on the exegetical scrutiny of the legal categories encompassed by the Regulation. In addition to this, while considering the peculiarities of such legal instrument, attention will be given to the critical assessment of its effectiveness. The Regulation, indeed, having received criticism, is in need of a profound revision. In this context, this paper will try to take into account the policy alternatives. In light of the failure of Regulation 868, which is to be seen as the expression of a unilateral and regional approach, there would seem to be the necessity for the aviation sector to reconsider the topic of subsidisation and unfair pricing practices in a more international oriented manner.

TABLE OF CONTENTS

1. INTRODUCTION.....	4
2. THE PURPOSE OF REGULATION 868/04.....	5
3. KEY DEFINITIONS.....	6
3.1. Subsidisation.....	6
3.1.1. <i>Subsidies ex Regulation 868 vs. State aid under Art. 107 TFEU...</i>	7
3.2. Unfair pricing practices.....	8
3.2.1. <i>The notion of 'non-commercial advantage'</i>	9
3.3. Material injury to the Community industry.....	11
4. THE INVESTIGATION.....	12
5. THE EFFECTIVENESS OF THE REGULATION. FACING A FAILURE?	13
6. THE EU EXTERNAL AVIATION POLICY AT THE CROSSROADS. A TOPICAL ROLE FOR BILATERAL AIR SERVICES AGREEMENTS?	14
7. CONCLUDING REMARKS	15

1. INTRODUCTION

The European Single Market is one of the EU's greatest achievements¹. It has fostered relevant economic growth, as well as, promoted the creation of a competitive and consumer-friendly environment. This is clear with respect to the aviation sector, which has been progressively modelled on the original idea of liberalising the internal market by abolishing restrictions between Member States.

The process of liberalisation of the internal aviation market is twofold. On the one hand, from a regulatory point of view, the so called 'three packages' and the more recent Regulation No. 1008/2008 have influenced in a significant manner the European aviation industry.² On the other, even more importantly, the European jurisprudence has encompassed the applicability of the EU competition rules to the transport sector and, therefore, to air transport.³

In particular, the application of the competition rules contained in Articles 101-109 of the *Treaty on the Functioning of the European Union* (henceforth 'TFEU')⁴ is to be necessarily seen as an attempt to forestall all those distortive behaviours, which may affect competition from the inside. In other words, there is a need for preventing the European players, i.e. the Community carriers, from putting in place anti-competitive conducts, such as agreements and abuse of dominant position. On the other hand, the TFEU also takes into account the phenomenon in which distortive activities are carried out by EU Member States. Art. 107 TFEU, indeed, labels as incompatible with the internal market "any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings".

¹ Such notion has been defined and continuously encompassed by the EU Commission. Recently, the Commission has described the European Single Market as "one territory without any internal borders or other regulatory obstacles to the free movement of goods and services. The European Single Market has generated new opportunities and economies of scale for European companies that have strengthened industrial competitiveness, it has created jobs and offered greater choice at lower prices for consumers and it has enabled people to live, study, work where they want. It has contributed to better integrating EU firms into international value chains and strengthening the global competitiveness of European companies". Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions, *Upgrading the Single Market: more opportunities for people and business*, COM(2015) 550, Brussels on 28.10.2015, at 1.

² The process of liberalization of the EU internal aviation market consists of three regulatory packages. The first package (1987) included several legal instruments, the purpose of which was to promote competition between EU airlines. In particular, with respect to fares, even without removing all the restrictions, it introduced a scheme of fare zones, within which the airlines were to be allowed to act freely. The second package (1990) took into consideration commercial aspects, such as fares – introducing the double disapproval system -, access to market and capacity, but it was only with the adoption of the third package, consisting of three regulations, that the Single Aviation Market in Europe was guaranteed. All the principles set out in the third packages were included, at a later time, in the Regulation n.1008/2008, which represents today the centrepiece of the liberalized regulation of the EU aviation industry. For a detailed analysis of the three packages here mentioned, see, among the others, E.M. GIEMULLA, L.WEBER, *International and EU Aviation Law*, Kluwer Law International, Alphen aan den Rijn, 2011, 142-160.

³ The leading case on the point is *Ministère Public v. Lucas Asjes*, generally known as the *Nouvelles Frontières* case, which marks a turning point in the Commission's attempt to introduce an element of liberality into the Community air transport sector. On the question on whether the competition laws applied to the transport sector, the European Court of Justice (henceforth "ECJ") definitively confirmed that as with all other general rules of the E.C. Treaty, the competition rules did so apply. Moreover, the ECJ held that implementing legislation was necessary in order to establish a system ensuring that competition shall not be distorted in the Common Market. Cases 209-213784, *Ministère Public v. Lucas Asjes*: [1986] E.C.R. 1425, [1986] 3 C.M.L.R. 173. See also B. ADKINS, *Air Transport and E.C. Competition Law*, Sweet & Maxwell, 1994, 6-8.

⁴ Consolidated version of the Treaty on the Functioning of the European Union, 2008, O.J. C 115/47, (hereinafter "TFEU").

In addition, in the past decades, the urgency of regulating the internal anti-competitive implications resulting from distortive behaviours of non-EU actors has increasingly drawn attention. Such asymmetry is evident if comparing, for instance, the EU market with the ones of the Gulf States, which still seem to be anchored on the State-national airline model. Based on these premises, in 2004 the European Union, in order to prevent anti-competitive effects resulting from subsidies granted by non-EU countries to their domestic carriers, adopted the Regulation No. 868/04,⁵ (hereinafter ‘Regulation 868’ or ‘the Regulation’).

The present work will analyse the legal categories envisaged by the above-mentioned piece of legislation, trying to deal with the issues emerging out of the definition of its key concepts. Moreover, a scrutiny of its actual effectiveness will show that the Regulation is far from having achieved its original target. In doing so, this paper will take into consideration concrete policy alternatives, such as a profound revision of the Regulation itself and the inclusion of an *ad hoc* clause within the context of bilateral and/or multilateral air services agreements.

2. THE PURPOSE OF REGULATION 868

Even though Regulation 868 might be deemed as a natural response to the astonishing growth of Middle-East carriers, i.e. Emirates, Qatar Airways and Etihad Airways, the original *ratio* for its adoption is a different one. The enactment of such instrument was, indeed, formally suggested by the development of a package of aid measures by the U.S. Government, thought for supporting the huge financial losses suffered by national airlines after the terrorist attacks of 11 September, 2001.⁶ The Commission’s reaction to the U.S. subsidisation was immediate,⁷ and eventually resulted in the enactment of Regulation 868 so that to provide a sort of legal protection to the European carriers.

However, it seems fair to affirm that the actual reason behind the adoption of the Regulation is to be found in the innate structural difference between the strictly regulated and liberalized European market and the fragmented, unregulated and not harmonized international market.⁸

⁵ EC Regulation No. 868/2004 of the European Parliament and of the Council *concerning protection against subsidisation and unfair pricing practices causing injury to Community air carriers in the supply of air services from countries non Members of the European Community*, OJ L 162, 30.04.2004.

⁶ Such package of aid measures, comprising USD 5 billion direct compensation and USD 10 billion by way of subsidizing loans and loan guarantees, also includes the so called ‘Aviation Insurance Program’. This programme has been extended two times, in 2009 and 2013, and it will expire in 2018. In particular, it provides passenger and third party liability insurance for U.S. carriers at below-market costs. Besides, this programme was part of a package of measures, including cash payments by the U.S. Governments to its airlines. Under 49 U.S.C. §44301-44310. See www.faa.gov/about/office_org/headquarters_offices/apl/aviation_insurance (last access on 15.02.2016). See on the point: J. BALFOUR, *EC Policy on State Aid to Airlines Following 11 September 2001*, in *Air & Space Law* 27, issue 6, 2002 at 398. See also for a detailed economic analysis, M. BLAIR, *The Economics of Post-September 11 Financial Aid to Airlines*, 36 *Indiana Law Review* 36, 2003, 397.

⁷ The Commission reacted quickly, and while recognising the exceptional situation that the U.S. carriers were facing, ruled out any possibility that it might accept measures, which would create distortion between States and between Airlines. In particular, throughout a Communication, the Commission underlined that “the events of September 11 were not to be allowed to undermine the European ‘one-time, last-time’ principle, nor were the events to be used as a pretext to bypass the existing aid rules in order to fix pre-existing problems”. Communication from the Commission to the European Parliament and the Council, *The Repercussions of the Terrorist Attacks in the United States on the Air Transport Industry*, COM (2001) 574.

⁸ This is fittingly confirmed in the Explanatory Memorandum that accompanied the proposal of Regulation 868/04. “The airline industry in the Community is facing a critical challenge: the need for it to compete with third-country airlines which benefit from generous subsidies, while the Community industry is subject to strict rules on Government aid. [...] This instrument is designed to restore the ‘equality of arms’ with some of our competitors in providing protection against

Moreover, as a matter of fact, it is to be observed that the Regulation is based on an earlier Council Regulation 4057/86, dealing with unfair pricing practices in maritime transport.⁹ However, the purpose of Regulation 868/04 seems to be broader, encompassing both unfair pricing practices and unfair discriminatory subsidisations.¹⁰

3. KEY DEFINITIONS

3.1. SUBSIDISATION

Art. 4 of Regulation 868 outlines the notion of subsidisation by spelling out several conditions, in the presence of which a subsidy shall be deemed to exist. From a systematic point of view, such conditions can be gathered into three classes:

- *From an objective perspective*, there must be a financial contribution. This element may consist of: (i) direct transfer of funds, such as, grants, loans or equity infusion, potential direct transfer of funds or assumption of liabilities, such as, loan guarantees; (ii) foregone or not collected revenue otherwise due; (iii) supplies of goods and services other than general infrastructure or purchases of goods and services. This list is illustrative and not exhaustive.¹¹
- *From a subjective point of view*, the analysis consists of two main points.

On the one hand, in identifying the active subject of the contribution, that is, who actually grants the subsidy, the Regulation encompasses both: (i) the Government or a regional body or other public organization of a non-EU country; and (ii) private bodies vested with functions normally performed by the Government.

On the other, in order for a financial contribution to amount to an actionable subsidy, it must be granted to a specific enterprise or industry or to a particular group of enterprises or industries within the jurisdiction of the granting authority. In other words, the passive subject of the subsidy has to be certain and specific (principle of specificity).¹²

- *Finally, on a commercial level*, a benefit has to be conferred. However, the lack of definition of this term *de facto* undermines the concrete possibility of application of the Regulation.

unfair practices in air transport”. Explanatory Memorandum to COM (2002) 110 – *Protection against subsidisation and unfair pricing practices in the supply of airline services from countries not members of the EC*. Link available at www.eumonitor.eu/9353000/1/j4nvhdjdk3hydzq_j9vvik7m1c3gyxp/vi8rm2z6wszn (last access on 16.02.2016).

⁹ ECC Council Regulation No. 4057/86 on *unfair pricing practices in maritime transport*, OJ L 378 (1986). Such Regulation covers only ‘unfair pricing practices’ by ‘third-country ship-owners’ engaged in international cargo liner shipping – as opposed to bulk shipping – on routes to, from or within the Community. Furthermore, it envisages as ‘anti-competitive’ only those ‘unfair pricing practices’, which are found to cause major injury to Community ship-owners. See on the point: S.McGONIGLE, *Past its use-by Date: Regulation 868 Concerning Subsidy and State aid in International Air Services*, in *Air & Space Law* 38, Issue 1, 2013, 7-10.

¹⁰ This is fittingly confirmed by the preamble of Regulation 868/04. In particular, whereas (2), in specifying the object of the Regulation, elucidates which ‘unfair and discriminatory practices’ can adversely affect the competitive position of Community air carriers. “Such unfair and discriminatory practices may result from subsidisation or other forms of aid granted by a Government or regional body or other public organisation of a country not being member of the Community or from certain pricing practices by a non-Community air carrier which benefit from non-commercial advantages”.

¹¹ S. McGONIGLE, *Past its use-by Date: Regulation 868 Concerning Subsidy and State aid in International Air Services*, at 7.

¹² *Id.* See also F. BERGAMASCO, *State Subsidies and fair competition in Internal Air Services: the European Perspective*, in *Issues in Aviation Law and Policy* 15, 2015, 35-36.

3.1.1. SUBSIDIES EX REGULATION 868 vs STATE AID UNDER ART. 107 TFEU

The comparison between the *lex generalis*, Articles 107 *et seq.*, and the *lex specialis*, Regulation 868, may show remarkable and interesting differences.

Firstly, from a literal perspective, Regulation 868 represents a peculiar piece of legislation within the European context. It formally borrows the term ‘subsidy’, which is related to the U.S. and the international tradition rather than to the European.¹³ The external essence of the Regulation is indeed confirmed by the fact that the definition of subsidy *ex Art. 4* seems to be shaped on the one adopted by the World Trade Organization (hereinafter “WTO”).¹⁴

On the other side, a relevant asymmetry ensues from the legal comparison. While Art. 107 TFEU is based on the identification of an actual distortion or a threat of distortion in terms of competition, Regulation 868 addresses the attention on the concept of ‘benefit’, although without defining such a term. Furthermore, Art. 108 TFEU provides the Commission with the possibility of carrying out an investigation in order to assess the compatibility of the aid with the internal market. This investigation is essentially twofold. On the one hand, the Commission will carry out a mere quantitative test, which will lead to exclude from consideration the smallest amounts of aid.¹⁵ On the other, the EU competition system relies on the so-called ‘market economy investor principle’¹⁶,

¹³ On the comparison between U.S. experience and European legal tradition on the topic, see for instance D.H.SCHENK, *The Cuno Case: a Comparison of U.S. Subsidies and European State Aid*, in *European State Aid Law Quarterly* 3, 2006, 3-4. The author underlines, indeed, that “U.S. law has no direct equivalent of Art. 87(1) [now Art. 107(1)] of the European Treaty with respect to State aid”.

¹⁴ As a matter of comparison, Art. 1 of the Agreement on Subsidies and Countervailing Measures reads as follows: “For the purpose of this Agreement, a subsidy shall be deemed to exist if: (A) there is a financial contribution by a Government or any public body within the territory of a Member, i.e. where: (i) a Government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfer of funds or liabilities (e.g. loan guarantees); (ii) Government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits); (iii) a Government provides goods and services other than general infrastructure, or purchases goods; (iv) a Government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the Government and the practice, in no real sense, differs from practices normally followed by governments; and (B) a benefit is thereby conferred”. Agreement on Subsidies and Countervailing Measures, April 15 1994, Marrakech Agreement Establishing the World Trade Organization, Annex 1A, *the legal text: the results of the Uruguay Round of Multilateral Trade Negotiations* 231 (1999) 1869 U.N.T.S. 14. Link available at https://www.wto.org/english/docs_e/legal_e/24-scm.pdf (last access 19.02.2016).

¹⁵ Such principle falls under the name of ‘*de minimis* doctrine’. This doctrine, originally thought for dealing only with anti-competitive agreements *ex Art. 101 TFEU*, has been taken into account, as a sort of procedural filter, by the Commission within the assessment related to the compatibility and validity of State aid in the European market. As a matter of fact, a State aid will fall under the application of *de minimis* rule where it will exceed the ceiling of Eur 200.000 over a period of three years. See A. ZEMPLINEROVA, *The Community State Aid Action Plan and the Challenge of Developing an Optimal Enforcement System*, in I.LIANOS, I.KOKKORIS, *The Reform of EC Competition Law*, Kluwer Law International, Alphen aan den Rijn, 2010, at 523. Furthermore, the author interestingly notes that the application of the above mentioned doctrine is a decisive instrument, which might help the Commission to efficiently carry out its tasks. This has been confirmed by the EU Commission throughout the adoption of the Commission Regulation No. 1407/2013 of 18 December 2013 *on the applications of the Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid*. Having said that, however, mention must be made to the recent legal issues arising out of the practice of ‘cumulating State aid’, which may, in a sense, deprive the *de minimis* test of its effectiveness. See on the point: P. STAVICZKY, *Cumulation of State Aid*, in *European State Aid Law Quarterly* 1, 2015, 117-129.

¹⁶ The principle has also been called, *inter alia*, ‘the market economy investor test’, ‘the market economy investor principle’, ‘the informed investor test’, ‘the informed private investor test’, as well as, ‘the prudent private investor test’. See P.ANESTIS, S.MAVROGHENIS, *The Market Investor Test*, in M.S.RYDELSKY (ed.), *The EC State Aid Regime: Distortive Effects of State Aid on Competition and Trade*, Cameron, London, 2006, pp. 109 and seq. The French literature also uses different names for this principle, see on the point: G.KARYDIS, “*Le principe de l’opérateur privé*”, *critère de*

according to which, State aid would not be labelled as incompatible if, in the same circumstances, the same financial contribution would have been granted, under normal market conditions, by a private investor. However, Regulation 868 differs from internal EU State aid law as it “does not take into account the ‘market investor principle’, whereby there is no scope for exemption in case of development of economic activities or rescue aid”.¹⁷

As final remark, it should be pointed out that the Regulation clearly adopts a narrower approach to the one adopted by Art. 107 TFEU, which, through the expression ‘*in any form whatsoever*’, seems to encompass also subsidisation given in the form of fiscal privileges. Such aspect takes on relevance especially when considering the Gulf States. The fiscal regimes of those countries are such, that they might be considered as factual subsidies, conferring a commercial benefit to their national carriers and then falling, at least in theory, under the umbrella of Regulation 868. All of this aside, the discussion on fiscal regimes will be examined in depth while scrutinising the concept of ‘non-commercial advantage’.

3.2. UNFAIR PRICING PRACTICES

Pursuant to Art. 5 of the Regulation, “unfair pricing practices shall be deemed to exist on a particular air service to or from the Community where non-Community air carriers: (i) benefit from a non-commercial advantage; and (ii) charge air fares which are sufficiently below those offered by competing Community air carriers to cause injury”.

With respect to the first element (i), there is uncertainty on what a non-commercial advantage is. Should attention be addressed on the original *ratio* of the Regulation, it would be clear that a non-commercial advantage could be identified, for instance, in the above-mentioned ‘Aviation Insurance Program’ launched by the U.S. Government.¹⁸ Conversely, were the Regulation interpreted taking into account the contemporary structure of the worldwide aviation industry, it could be argued that any advantage might be classified as commercial.

Focussing on the second element (ii), the Regulation itself points out a list of parameters to be considered while assessing the actual unfairness of the pricing practice. Art. 5(2) foresees that the comparison of the airfares shall take into account a number of relevant commercial and economic factors.¹⁹ In addition, from a practical perspective, the Regulation explicitly calls for the Commission’s activity in order to develop “a detailed methodology for determining the existence of unfair pricing practices”.²⁰ However, so far the Commission has not complied with such a requirement, not establishing, therefore, a clear methodology for distinguishing unfair from normal competitive pricing practices.

qualification des mesures étatiques, en tant qu’aides d’Etat, au sens de l’Article 87§ 1 du Traité CE”, in *Revue Trimestrielle du Droit Européen* 2003, at 391.

¹⁷ I.H.Ph. DIEDERIKS-VERSCHOOR, *An introduction to air law*, 9th revised edition, Wolters Kluwer, Alphen aan den Rijn, 2012, at 112.

¹⁸ *Supra* note 6.

¹⁹ Art. 5(2) of the Regulation reads as follows: “when comparing airfares, account shall be taken of the following elements: (a) the actual price at which tickets are offered for sale; (b) the number of seats proposed at an allegedly unfair price out of the total number of seats available on the aircraft; (c) the level of service proposed by all carriers providing the like air service in question; (e) the actual costs of the non-Community carrier providing the services, plus a reasonable margin of profit; and (f) the situation, in terms of points (a) to (e), on comparable routes”.

²⁰ Art. 5(3) of the Regulation.

Nonetheless, the critique carried out up to this point seems to confirm the assumption that Regulation 868 represents a *unicum* if considering EU competition law and policy in its entirety. While the general EU competition rules tend to protect consumers from high and unreasonable fares, the Regulation has, among its targets, the primary ambition to protect and defend airlines, and EU aviation industry in general, from overseas interferences. Accordingly, Regulation 868 would seem to have aimed at maintaining *stricto sensu* a level playing field rather than encompassing benefits for consumers. Although it is evident that the consumers would benefit where non EU-carriers were to offer fares lower than the ones of EU competing airlines, priority is given to the industry and its participants.

3.2.1. THE NOTION OF 'NON-COMMERCIAL ADVANTAGE'

The Regulation does not expressly define the term 'non-commercial advantage'. Therefore, the demarcation between what constitutes a non-commercial advantage and what constitutes a commercial one is left to interpretation. A preliminary reference should be made to the preamble of Regulation 868, which encompasses, in a sense, a distinction between subsidy and non-commercial advantage.²¹

Notwithstanding the lack of definition and case law, the analysis should also take into account, as per *analogia legis*, the aforementioned Regulation 4057/86 dealing with shipping.²² The only complaint examined under this Regulation can be found in the *Hyundai Merchant Marine* case²³. In such case, the Commission held that the exclusive right to carry certain kinds of strategic commodities, tax benefits as well as write-offs constituted non-commercial advantages.²⁴ In the light of the Commission's interpretation, it could be argued that similar advantages may be found in the aviation sector as well. The U.S. Fly America Act,²⁵ for instance, provides that any travel funded by the U.S. Government must take place on a U.S. flag airline. This clearly constitutes a benefit for U.S. airlines, *de facto* creating a monopoly with regard to U.S. Government travel contracts both on domestic and international routes. However, the reference to the *Hyundai* case would seem to be somewhat unsatisfactory. It is difficult, indeed, to understand why an advantage that results in a commercial advantage (monopoly) should be considered as a non-commercial one. In other words, the Commission evidently failed in clarifying whether the non-commercial nature of the advantage must pertain to its origin or to its consequences on the market. It is clear that were the latter approach

²¹ Whereas (9) of the Regulation provides that "an examination of the pricing practices of a third-country air carrier should be restricted to those limited number of cases where the air carrier is benefitting from a non-commercial advantage which cannot be clearly identified as a subsidy". Albeit potentially relevant for practical purposes, such a distinction, failing in providing a clear legal framework, would only seem to describe non-commercial advantage as a marginal sub-category of the main one of subsidisation *ex* Art. 4. From a systematic point of view the Regulation seems to encompass non-commercial advantage as a closing clause, which potentially would be able to include other forms of advantage not ascribable to the category of subsidy as defined in Art. 4 of the Regulation. On the other hand, as a matter of fact, this distinction would seem to be of utmost importance for the complainant. While for demonstrating subsidy, indeed, the complainant must provide evidence of the financial transaction between the public body and the carrier, such burden of proof is not required for demonstrating the existence of a non-commercial advantage.

²² It is useful to remind that, under according to Regulation No. 4057/86, an 'unfair pricing practice' means the charging of rates lower than normal when that is made possible by the fact that the ship-owner concerned enjoys non-commercial advantages which are granted by a third country. See Art. 3(b) of Regulation No. 4057/86.

²³ Case AT/39.850, *Hyundai Merchant Marine Co., Ltd.*, Regulation (EEC) No. 15/89, OJ L (1989).

²⁴ The Commission imposed redressive measures, noting that the market share of Hyundai Merchant Marine could have been maintained only enjoying these advantages. See F. BERGAMASCO, *State subsidies and fair competition in international air services: the European perspective*, at 58.

²⁵ 49 U.S.C., Subtitle VII, Part A, subpart I, Ch. 401, §40118.

to be adopted, all advantages would have a commercial component and would result, hence, in constituting a commercial advantage.

On a different tier, the issue relating to the definition of non-commercial advantage is a topical one if considering the Gulf carriers. A number of factors, outside the control of these airlines' management and not easily identifiable as subsidies, contribute, indeed, to 'unlevel' the playing field.²⁶

The first relevant factor is geographical. The location of their hubs inevitably leads to long-haul hub-and-spoke systems resulting in a significant reduction on the average operational costs.²⁷ Conversely, the typical European hub-and-spoke structure is composed of a combination of long haul flights feed by short-medium haul flights. This implies the necessity for EU carriers to maintain heterogeneous fleets resulting in an increase of operational costs.²⁸

A further factor is constituted by the peculiar fiscal regimes of the Gulf States. The absence of any corporate tax in those jurisdictions would confer, at least in theory, evident advantages to the national carriers. However, from an economic perspective, the absence of corporate taxes does not *per se* distort competition on an international level.²⁹ Being tax regulation a domestic matter, it would be ventured to affirm the need for levelling national fiscal regimes across the world for the sake of competition. The economic analysis has also shown that the discrepancy in terms of fiscal regimes might lead to advantages related to labour costs.³⁰

On the other side, on a legal level, there is the need for taking into account the particular structure of airport charges in the Gulf States. In particular, focussing on landing charges imposed to national carriers landing in Dubai, the economic analysis has demonstrated that such charges are remarkably low and have the potential to confer an advantage to the national carrier, Emirates Airline.³¹

3.3. MATERIAL INJURY TO THE COMMUNITY INDUSTRY

In order for the Regulation to be applicable, the above examined subsidies and unfair pricing practices must cause material injury to the Community industry.

²⁶ As noted by De Wit "the playing field may be unlevel, but that does not mean that is 'tilted'". For the sake of completeness, it is to be observed that 'non-commercial advantages' are often referred to as 'comparative advantages' in the economic literature. See J.G.DE WIT, *Unlevel Playing Field? Ah Yes You Mean Protectionism*, in *Journal of Air Transport Management* 41, 2013, at 24.

²⁷ In case of long-haul hourglass hubs, such as Dubai, Abu Dhabi and Doha, both the distance advantages and the economies of scale of the aircraft act to depress the unit costs. Moreover, the use of wide-body aircrafts, such as Boeing 777-300 and Airbus 380-800, and the increase of stage length imply a reduced cost per seat-kilometer. *Id.*

²⁸ For an economic comparison of the two types of hub-and-spoke systems, see R.DOGANIS, *Flying Off Course: The Economics of Interntional Airlines*, Routledge, 2002, 102-108.

²⁹ J.G.DE WIT, *Unlevel Playing Field? Ah You Mean Protectionism*, at 27.

³⁰ This results from a two-level salary system, in which low wages are paid for low-skill activities, such as ground-handling, catering, logistics and call centers. Despite higher salaries are paid to professional like pilots and managers, the overall labour costs are lower than in European countries, where a more developed social State brings large additional expenses even for low-skill work. *Id.*

³¹ *Ibid* at 28.

From an objective perspective, the Regulation encompasses not only the case in which the distortive behaviour has caused a material injury, but also the one that, at least potentially, would be able to do so (threat of material injury). Although the definition of material injury does not clarify the matter, Art. 6 sets out a procedure, according to which an injury can be factually determined. The determination, therefore, shall involve an objective examination of: (i) the level of fares of the air services under consideration; (ii) the effect of such air services on fares offered by Community air carriers; and (iii) the impact of those air services on the Community industry, expressed throughout the use of a number of economic indicators.³² In addition, it is explicitly foreseen that the determination of the injury must be based on positive evidences. In other words, only facts and not mere allegations, conjectures or mere possibilities may contribute to determine the presence of an injury.

On the other hand, the Regulation refers to the Community industry as potential victim of the injury. For this purpose, ‘Community industry’ is defined in Art. 3(b) as “the Community air carriers supplying like air services as a whole or those of them whose collective share constitutes a major proportion of the total Community supply of those services”.

Conclusively, the Commission is also required to verify the existence of a direct and casual link between the material injury – or the threat of it – and the unfair practice.

4. THE INVESTIGATION

Pursuant to Art. 7 of Regulation 868, an investigation shall be initiated by the Commission “upon the lodging of a written complaint on behalf of the Community industry by any natural or legal person or any association”. However, when there is sufficient evidence of the existence of unfair subsidies or unfair pricing practices, the Commission may also decide, on its own initiative, to commence an investigation.

Furthermore, the Commission shall open an investigation within 45 days from the lodging of the complaint and shall publish a notice in the *Official Journal of the European Union*.³³ Such notice of initiation of the proceedings has the purpose of involving all the concerned parties, implicitly calling for a consultative activity between all the players involved.³⁴

Although, formally, the investigation shall be concluded within nine months from its initiation, the Commission may prolong it where: (i) negotiations with the third country concerned have progressed to a point that a satisfactory resolution of the complaint appears imminent; or (ii) additional time is needed for achieving a resolution, which is in the Community’s interest.³⁵

In practice, the investigation may lead to three potential scenarios. First and foremost, where the investigation succeed in showing the existence of subsidies or unfair pricing practices, the Commission may impose redressive measures, whether provisional or definitive, which “shall

³² Art. 6 (1)(b) provides a non-exhaustive list of economic indicators, such as number of flights, utilisation of capacity, passenger bookings, market share, profits, return on capital, investment, employment. No one or more of these factors can necessarily give decisive guidance.

³³ It is to be underlined that, according to Art. 7(2), if the issue in question is being discussed within the framework of a bilateral agreement by the Member State concerned, the abovementioned deadline shall, at the request of the Member State, be extended for up to 30 days. Any additional extension shall be decided by the Commission on a case-by-case basis.

³⁴ Art. 7(3) of the Regulation.

³⁵ Art. 8(1) of the Regulation.

preferably take the form of duties imposed upon the non-Community carrier concerned”.³⁶ In addition, the Regulation establishes a sort of proportionality principle, according to which the measures imposed shall not exceed the actual benefit conferred.³⁷

The investigation may also be terminated without measures: (i) where the complaint is withdrawn; (ii) where redressive measures are unnecessary; or (iii) where a satisfactory remedy has been obtained under a Member State’s air service agreement with the third country concerned.³⁸

Finally, pursuant to Article 13 of the Regulation, the Commission may decide not to impose redressive measures “upon receipt of satisfactory voluntary undertakings”³⁹, under which the non-EU Government or the non-EU carrier undertake, respectively, to eliminate the economic benefit or to cease the distortive behaviour.

5. THE EFFECTIVENESS OF THE REGULATION. FACING A FAILURE?

Regulation 868 has received severe criticism with respect to its actual effectiveness. It has never been applied so far, neither upon carrier’s complaint nor upon Commission’s initiative and the Association of European Airlines (AEA) strongly criticised its weaknesses and shortcomings.⁴⁰ The most interesting point highlighted by the AEA is related to the burden of proof. The European airlines, indeed, are required to provide concrete evidences of a financial contribution in order to file a complaint against a potential subsidisation, but, in most of the cases, they cannot have access to such data.⁴¹ This lack of transparency is typical of the State-controlled airlines, such as the Gulf carriers, which are unlikely to publish annual financial data. The economic literature has indeed pointed out that the common ownership of airlines, airports, ground handlings and civil authorities may hide the presence of unfair and anti-competitive behaviours.⁴²

³⁶ Art. 9 of the Regulation.

³⁷ In particular, Art. 12 of the Regulation provides that: “the level of measures imposed to offset subsidies shall not exceed the amount of subsidies, calculated in terms of benefit conferred on the recipient enterprise, from which the non-Community carriers have been found to benefit, and should be less than the total amount of subsidies, if such lesser level were to be adequate to remove the injury to the Community industry”. In line with that, it is foreseen, yet in the same provision, that: “the level of measures imposed to offset unfair pricing practices benefitting from a non-commercial advantage, shall not exceed the difference between the fares charged by the non-Community air carrier concerned and the air fares offered by the competing Community air carrier concerned, but should be less if such lesser level were to be adequate to remove the injury to the Community industry. In any event, the level of measures should not exceed the value of the non-commercial advantage granted to the non-Community air carrier”.

³⁸ Art. 11 of the Regulation. It should be underlined, on this point, that it is the Regulation itself to encompass a potential – and relevant – role for bilateral air services agreements within the context of a ‘non-judicial’ composition of the question.

³⁹ Such undertaking can be reached where “(a) the Government granting the subsidy or non-commercial advantage agrees to eliminate or limit the subsidy or non-commercial advantage or take other measures concerning its effects; or (b) any non-Community air carrier undertakes to revise its prices or to cease the supply of air services to the route in question so that the injurious effect of the subsidy or non-commercial advantage is eliminated”.

⁴⁰ See F.BERGAMASCO, *State subsidies and fair competition in international air services: the European perspective*, 55-56.

⁴¹ Association of European Airlines (AEA) Response to the European Commission DG Trade Public Consultation on a Future Trade Policy, July 2010, at 3.

⁴² See J.G.DE WIT, *Unlevel Playing Field? Ah You Mean Protectionism*, at 30. “It is to be noted that an aviation supply chain based on vertical integration, where the State or the ruling family owns all the enterprises involved, is likely to create synergies and cost reductions for airlines *per se*”. See also J.F.O’CONNELL, *The rise of the Arabian Gulf Carriers: An insight into the business model of Emirates Airline*, in *Journal of Air Transport Management*, Vol. 17, issue 6, 2011, at 341.

Furthermore, AEA has described the Regulation as a “toothless animal”. Despite recognising the vital relevance of the Regulation, the Association has affirmed that, to date, such instrument does not provide actual legal protection to the Community industry. In this context, the inadequacy of the Regulation has two main origins. On the one hand, as continuously observed, the lack of clarity of definitions, such as the ones of ‘benefit’ and ‘non-commercial advantage’, evidently undermines the Regulation’s efficacy. On the other side, from a systematic point of view, the Regulation, adopting a unilateral approach, would seem to forget, at least in part, that commercial aviation is historically based on a network of bilateral and multilateral relationships.⁴³

Yet, the comprehensive failure of the Regulation seems to derive from a sort of misconception. It is true that nowadays the European aviation is a highly regulated environment, but it is similarly clear that, when looking at the international reality in its entirety, the legal scene does appear profoundly fragmented. As a result, trying to synchronise the competitive behaviours of EU and non-EU actors throughout the adoption of a unilateral and regional instrument rather than creating a bilateral or international *forum* would seem to be at any rate utopian.

6. THE EU EXTERNAL AVIATION POLICY AT THE CROSSROADS. A TOPICAL ROLE FOR BILATERAL AIR SERVICES AGREEMENTS?

The Commission has taken into consideration several ways for reforming Regulation 868 and, more in general, to strengthen the comprehensive EU’s external aviation policy. In this respect, in its Communication No. 556 of September 2012, the Commission addressed the main issues regarding the development of a competition policy, aiming at being efficient internationally.⁴⁴ It also recognized the lack of transparency – and the potential anti-competitive implications – of the Gulf Carriers.

With specific regard to Regulation 868, the Commission itself, acknowledging that the current legal framework does not provide protection to EU carriers, has drawn up a Roadmap to highlight all the possible policy alternatives.⁴⁵ In doing so, the Commission has contemplated the possibility of a comprehensive revision of the Regulation based on a decisive clarification of the main concepts, a simplification of the procedure framework and the potential introduction of new measures and sanctions.⁴⁶

⁴³ Bilateralism in the regulation of commercial aspects of aviation is the legacy of the Chicago Convention 1944. For the sake of completeness, mention must be made to Art. 6: “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, in accordance with the terms of such permission or authorization”. Convention on Civil Aviation (Chicago 7 Dec. 1944). 15 U.N.T.S. 295. *Entered into force* 4 Apr. 1947 (hereinafter ‘the Convention’).

⁴⁴ Communication from the Commission to the European Parliament, the Council the European Economic and Social Committee and the Committee of the Regions, *The EU’s External Aviation Policy – Addressing Future Challenge*, Brussels, 27.09.2012 COM(2012) 556 final. Link available at http://ec.europa.eu/transport/modes/air/international_aviation/doc/com_2012_556_fr.pdf (last access 01.03.2016). The Communication, *inter alia*, assesses the impact of the rapid emergence of foreign air carriers, including Emirates, Etihad Airways and Qatar Airways, and considers how best to ensure fair competition in international air transport including through the revision of Regulation 868/04.

⁴⁵ Commission Roadmap, *Protection against subsidisation and unfair pricing practices causing injury to Community air carriers in the supply of air services from countries not members of the European Community*, COM(2013), Brussels, 07.2013. Link available at http://ec.europa.eu/smart-regulation/impact/planned_ia/docs/2014_move_009_unfair_pricing_practices_en.pdf (last access 02.03.2016).

⁴⁶ *Ibid*, at 3.

One further option could be the adoption of a new piece of legislation, which would entirely repeal Regulation 868. In such a case, the revision would primarily focus on embracing a wider range of unfair pricing practices, including, for instance, discriminatory charges.⁴⁷

Having said that, this paper wants to consider two valid alternatives, which might enhance the level of protection of the European carrier. On the one hand, there is the need for creating an international *forum* in which a global policy on subsidisation and unfair pricing practices could be developed. Even if certain authors call for WTO's role in such a regulatory activity,⁴⁸ a fitting solution would seem to be, perhaps, giving broad power to the International Civil Aviation Organization (henceforth "ICAO" or "the Organization"), which, in 2013, recognising the primary need for a global fair competition policy, adopted a *compendium* of measures to be implemented in the following years.⁴⁹ Accordingly, ICAO drafted a proposed model clause in order to adopt safeguard measures to ensure fair competition in international air transport.⁵⁰ Moreover, in addressing the issue of State aid/subsidies, the Organization encouraged individual States to include in their bilateral air services agreements a specific clause so that to "ensure that aids/subsidies do not adversely impact on competition in the parties' marketplace".⁵¹

In line with this, both the Commission and the Member States have begun to include a 'subsidy clause' in their agreements.⁵² Very recently, in June 2016, the Commission has been officially entrusted with the mandate of negotiating a new comprehensive package of agreements concerning aviation with the Gulf States. These agreements will also address competitive issues, as well, as implications deriving from subsidisation and unfair pricing practices.⁵³ As a result, the development of a 'model clause' dealing with competition in general, and subsidies and unfair pricing practices in particular, might also be a key tool so that to contrast the lack of transparency in airlines' financial accounts.

7. CONCLUDING REMARKS

As this paper has tried to highlight, Regulation 868 raises issues both on a theoretical and practical level. While its rationale seems to be properly justified, due to the need of preventing distortive behaviours carried out by non-EU players, the Regulation does not constitute an effective instrument for EU airlines and the Commission for hindering such unfair practices. In other words, in spite of

⁴⁷ *Id.* In reconsidering the current approach, the Commission suggests "developing a radically simplified defence instrument". In this context a comparative reference may be made to "the U.S. International Air Transportation Competition Act of 1979, which grants the Secretary of Transport extensive power and discretion to introduce sanctions against foreign operators if U.S. operators are subject to discrimination or unfair practices by foreign States or airlines".

⁴⁸ See for instance R.ABEYRATNE, *Trade in Air Transport: Have we Lost Our Way?*, in *Journal of World Trade* 47, No. 3, at 647.

⁴⁹ This has been the primary topic of the 6th Worldwide Air Transport Conference. ATConf/6, 21.03.2013. Link available at: <http://www.icao.int/meetings/atconf6/Pages/default.aspx> (last access on 03.03.2016).

⁵⁰ ICAO Doc. 9587, Appendix 4, at 8.

⁵¹ *Ibid.* "States should bear in mind that provision of State aid/subsidies, which confer benefits on national air carriers, but are not available to competitors in the same market, may distort trade in international air services and may constitute unfair competitive practices", at 10.

⁵² See Air Transport Agreement between the European Commission and its Member States and the United States of America, 25.04.2007 (2007/339/EC), Art. 14. See also the Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of Australia concerning Air Services, London, 10.07.2008, Treaty Series No. 26 (2012) CM8343, Art. 5.

⁵³ European Commission, Press Release, *International Aviation: New EU-Level Agreements will Benefit European Passengers and Businesses*, Luxembourg 7 June 2016. Link available at: http://europa.eu/rapid/press-release_IP-16-2065_en.htm (last access on 05.07.2016).

creating a sort of general legal framework, the examined piece of legislation still seems far to be actually enforceable and applicable.

The critique has underlined two main deficiencies. On the one hand, in terms of regulatory technique, too many relevant terms are not appropriately defined. On the other, even more importantly, the foreseen procedure, to date, is too burdensome for the EU carriers. It has been noted, for instance, the difficulty for the EU carriers to demonstrate the existence of a financial contribution and lodging, therefore, a complaint against subsidisation.

Conclusively, acknowledging the necessity of revising the Regulation, this paper recommends taking into account varied options. In particular, two are the most suitable alternatives.

The first, that underpins an international approach, is to appoint an independent body, such as ICAO, in order to create a uniform and global policy on the point. ICAO should, therefore, carry out a twofold policy. On the one hand, the Organization should constitute the international *forum* in which regulating competition issues relating to international air transport. On the other, ICAO should keep on promoting the use of *ad hoc* clauses governing subsidisation of airlines, which have to be implemented on a bilateral or multilateral basis in air services agreements.

The second, instead, calls for bilateralism to regulate competition aspects in general, and subsidisation and unfair pricing practices related issues. For their intrinsic structure, indeed, air services agreements seem to constitute the best *forum* in which regulating, *a priori*, such distortive conducts and their potential economic consequences.

BIBLIOGRAPHY

TREATIES/INTERNATIONAL LAW

Convention on Civil Aviation (Chicago 7 Dec. 1944). 15 U.N.T.S. 295. *Entered into force* 4 Apr. 1947.

Agreement on Subsidies and Countervailing Measures, April 15 1994, Marrakech Agreement Establishing the World Trade Organization, Annex 1A, *the legal text: the results of the Uruguay Round of Multilateral Trade Negotiations* 231 (1999) 1869 U.N.T.S. 14

Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of Australia concerning Air Services, London, 10.07.2008, Treaty Series No. 26 (2012) CM8343

EU LEGISLATION

ECC Council Regulation No. 4057/86 *on unfair pricing practices in maritime transport*, OJ L 378 (1986)

Regulation (EEC) No. 15/89, OJ L (1989)

EC Regulation No. 868/2004 of the European Parliament and of the Council *concerning protection against subsidisation and unfair pricing practices causing injury to Community air carriers in the supply of air services from countries non Members of the European Community*, OJ L 162, 30.04.2004

Consolidated version of the Treaty on the Functioning of the European Union, 2008, O.J. C 115/47

Commission Regulation n. 1407/2013 of 18 December 2013 *on the applications of the Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid*

OFFICIAL DOCUMENTS OF THE EUROPEAN UNION

Communication from the Commission to the European Parliament and the Council, *The Repercussions of the Terrorist Attacks in the United States on the Air Transport Industry*, COM (2001)

Explanatory Memorandum to COM (2002) 110 – *Protection against subsidisation and unfair pricing practices in the supply of airline services from countries not members of the EC*

Communication from the Commission to the European Parliament, the Council the European Economic and Social Committee and the Committee of the Regions, *The EU's External Aviation Policy – Addressing Future Challenge*, Brussels, 27.09.2012 COM(2012) 556 final

Commission Roadmap, *Protection against subsidisation and unfair pricing practices causing injury to Community air carriers in the supply of air services from countries not members of the European Community*, COM(2013), Brussels, 07.2013

Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions, *Upgrading the Single Market: more opportunities for people and business*, COM(2015) 550, Brussels on 28.10.2015

European Commission, Press Release, *International Aviation: New EU-Level Agreements will Benefit European Passengers and Businesses*, Luxembourg 7 June 2016

NATIONAL LEGISLATION

U.S. America Fly Act, 49 U.S.C., Subtitle VII, Part A, subpart I, Ch. 401, §40118

JURISPRUDENCE

Cases 209-213784, *Ministère Public v. Lucas Asjes*: [1986] E.C.R. 1425, [1986] 3 C.M.L.R.

Case AT/39.850, *Hyundai Merchant Marine Co., Ltd.* [1989]

BOOKS

B. ADKINS, *Air Transport and E.C. Competition Law*, Sweet & Maxwell, 1994

P.ANESTIS, S.MAVROGHENIS, *The Market Investor Test*, in M.S.RYDELSKY (ed.), *The EC State Aid Regime: Distortive Effects of State Aid on Competition and Trade*, Cameron, London, 2006

I.H.Ph. DIEDERIKS-VERSCHOOR, *An introduction to air law*, 9th revised edition, Wolters Kluwer, Alphen aan den Rijn, 2012

R.DOGANIS, *Flying Off Course: The Economics of International Airlines*, Routledge, 2002

E.M. GIEMULLA, L.WEBER, *International and EU Aviation Law*, Kluwer Law International, Alphen aan den Rijn, 2011

A. ZEMPLINEROVA, *The Community State Aid Action Plan and the Challenge of Developing an Optimal Enforcement System*, in (Ed.) I.LIANOS, I.KOKKORIS, *The Reform of EC Competition Law*, Kluwer Law International, Alphen aan den Rijn, 2010

ARTICLES

J. BALFOUR, *EC Policy on State Aid to Airlines Following 11 September 2001*, in *Air & Space Law* 27, issue 6, 2002

F. BERGAMASCO, *State Subsidies and fair competition in Internal Air Services: the European Perspective*, in *Issues in Aviation Law and Policy* 15, 2015

M.BLAIR, *The Economics of Post-September 11 Financial Aid to Airlines*, in *Indiana Law Review* 36, 2003

J.G.DE WIT, *Unlevel Playing Field? Ah Yes You Mean Protectionism*, in *Journal of Air Transport Management* 41, 2013

G.KARYDIS, “*Le principe de l’opérateur privé*”, *critère de qualification des mesures étatiques, en tant qu’aides d’Etat, au sens de l’Article 87§ 1 du Traité CE*”, in *Revue Trimestrelle du Droit Européen*, 2003

S.McGONIGLE, *Past its use-by Date: Regulation 868 Concerning Subsidy and State aid in International Air Services*, in *Air & Space Law* 38, Issue 1, 2013

J.F.O’CONNELL, *The rise of the Arabian Gulf Carriers: An insight into the business model of Emirates Airline*, in *Journal of Air Transport Management*, Vol. 17, issue 6, 2011

D.H.SCHENK, *The Cuno Case: a Comparison of U.S. Subsidies and European State Aid*, in *European State Aid Law Quarterly* 3, 2006

P. STAVICZKY, *Cumulation of State Aid*, in *European State Aid Law Quarterly* 1, 2015

WEBSITES

www.faa.gov/about/office_org/headquarters_offices/apl/aviation_insurance (last access on 15.02.2016)

www.eumonitor.eu/9353000/1/j4nvhdjdk3hydza_j9vvik7m1c3gyxp/vi8rm2z6wszn (last access on 16.02.2016)

https://www.wto.org/english/docs_e/legal_e/24-scm.pdf (last access on 19.02.2016)

http://ec.europa.eu/transport/modes/air/international_aviation/doc/com_2012_556_fr.pdf (last access on 01.03.2016)

http://ec.europa.eu/smart-regulation/impact/planned_ia/docs/2014_move_009_unfair_pricing_practices_en.pdf (last access on 02.03.2016)

<http://www.icao.int/meetings/atconf6/Pages/default.aspx> (last access on 03.03.2016)

http://europa.eu/rapid/press-release_IP-16-2065_en.htm (last access on 05.07.2016)

OTHER SOURCES

Association of European Airlines (AEA) Response to the European Commission DG Trade Public Consultation on a Future Trade Policy, July 2010

ICAO, Doc. 9587