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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, **DRAFT**
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Proposal for a

COUNCIL REGULATION

**repealing Regulation (EEC) No 3975/87 and amending Regulation (EEC) No 3976/87
and Regulation (EC) No 1/2003, in connection with air transport between the
Community and third countries**

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EXPLANATORY MEMORANDUM

1. INTRODUCTION

1. The scope of Council Regulation (EEC) No 3975/87¹, laying down the procedure for the application of the EC competition rules in the air transport, is limited to air transport between Community airports.² Council Regulation (EC) No 1/2003³, which will replace the procedural provisions of Regulation (EEC) No 3975/87 as from 1 May 2004, does not change this⁴. Therefore the Commission has only limited powers to enforce the competition rules, by means of e.g. fact finding, requiring undertakings to bring to an end infringements imposing remedies and penalties with regard to air transport between the Community and third countries.
2. From a regulatory point of view this is an anomaly. For all other economic sectors, with a few minor exceptions, procedural implementing regulations have been adopted and are fully applicable, when the effects of anti-competitive agreements or abusive behaviour are felt on the EU market.⁵ Furthermore, the Merger Regulation⁶ does not make a distinction between intra-Community air traffic and air traffic between the EC and third countries. This leads to a situation where similar structural transactions - (global) airline alliances on the one hand, full scale mergers on the other hand - are treated by very different competition enforcement regimes. From a regulatory, in particular competition policy perspective, however any decision towards structural changes in the airline industry should be triggered by the needs of the individual actors and not be affected by the institutional advantages or disadvantages of different available competition rules enforcement regimes. It is obvious that the present regulatory situation does not provide the industry with the necessary level playing field. The EU therefore needs to ensure that the same competition rules and enforcement tools apply to international aviation as apply to internal-EU routes.
3. The Commission submitted in the past several proposals to the Council to extend the scope of Regulation (EEC) No 3975/87 to cover also air transport between the Community and third countries. In fact, the initial proposal of the Commission of 1981 for Regulation (EEC) No 3975/87 included international air transport with third countries.⁷ However, in the course of the discussion of the Commission's proposal in the Council at the time it became clear that, in order to reach agreement on the

¹ OJ No L 374 of 31.12.1987, as amended by Council Regulation (EEC) No 1284/91 (OJ No L 122 of 17.5.1991), Council Regulation (EEC) No 2410/92 (OJ L 240 of 24.8.1992) and by Council Regulation (EC) 1/2003 of 16 December 2002 (OJ L 1, 04.01.03, p. 1).

² Article 1 of the Regulation.

³ OJ No L 1 of 04.01.03, p. 1.

⁴ Article 32 under c of Regulation (EC) No 1/2003 excludes from its scope air transport between Community airports and third countries.

⁵ The exceptions being tramp vessel services and cabotage (see Article 1 of Regulation (EEC) 4056/86 applying the EC competition rules to maritime transport, this exclusion is also contained in Article 32, under a) and b) of Regulation (EEC) No 1/2003.

⁶ Regulation (EEC) No 4064/89, as amended by Regulation (EC) No 1310/97 (OJ L 180, 9.7.1997, p. 1).

⁷ Submitted by the Commission to the Council on 10 August 1981 (OJ C 291 of 12.11.1981, p. 4).

proposal, its scope would have to be restricted to international air transport within the Community.⁸

4. In 1989, the Court of Justice in its judgment of 11 April 1989 in the *Ahmed Saeed* case⁹ confirmed its judgment in *Nouvelles Frontières*¹⁰ as regards the application of Article 81 of the Treaty and ruled that Article 82 of the Treaty is directly applicable by national courts, even in the absence of an implementing regulation under Article 83 of the Treaty or of action by a Member State Competition authority or by the Commission (under Article 84 or Article 85 of the Treaty respectively). In light of the judgment, the Commission proposed again that the Council adopt regulations extending the scope of its powers to enforce the competition rules so as to include EC third country air transport.¹¹ The Council did however not act on the Commission's proposal.
5. In 1997, the Commission considered that a number of new factors had arisen which made it even more necessary to endow the Commission with the same powers of action vis-à-vis transport on Community third country routes as those which are conferred to it by Regulation (EEC) No 3975/87 for intra-Community air transport¹². In particular, the Commission referred to the regulatory context, which had changed substantially, since the introduction of the third air transport liberalisation package with effect from 1993. As the Commission noted, with the removal of regulatory restrictions on the commercial conduct of air carriers, competition issues became increasingly pressing. The Commission therefore considered that it should be equipped with the appropriate enforcement tools to ensure that the beneficial effects of the liberalization process were not to be partially offset by restrictive or abusive behaviour on the part of European or non-European commercial operators, to the detriment of consumers. Furthermore, the Commission emphasised the weakness of the external aspect of the aviation market with its system of bilateral agreements between Community Member States and third countries and the need to create a more structured legal framework.
6. The above reasons are still valid today. In addition, recently important new developments have taken place which render the need for appropriate enforcement tools to apply the competition rules to air transport between the Community and third countries even more pressing. First, international aviation alliances have become increasingly important and significantly impact the play of competition within today's airline industry. Second, from the logic of the Court's recent judgment in the open skies cases follows the need for a coherent policy for international aviation, including an effective enforcement of the Community competition rules. These two industry-shaping developments are as follows.

⁸ This change was made by Memorandum No 2 and incorporated in Article 1(2) of Regulation (EEC) No 3975/87 (OJ No L 374, 31.12.1987, p. 1). Initially the Commission's powers did therefore also not extend to domestic transport. However, in the context of the third package of air transport liberalization measures the scope of Regulation (EEC) No 3975/87 was extended to cover also air transport within a Member State (Council Regulation (EEC) No 2410/9210 of 23 July 1992, OJ No L 240 of 24.8.1992).

⁹ Case 66/86 [1989] ECR 803.

¹⁰ Joint Cases 209-213/84 [1986] ECR 1425.

¹¹ COM(89) 417 final of 8.9.1989 (OJ no C 248 of 29.9.89 p. 7).

¹² COM(97) 218 final of 16.05.1997 (OJ No C 165 of 31.05.1997, p. 13).

2. INCREASING IMPORTANCE OF INTERNATIONAL CO-OPERATION AGREEMENTS IN THE AVIATION SECTOR

7. The number of international alliances and other forms of co-operation agreements in the aviation sector between Community airlines and airlines from third countries has increased significantly in recent years. Like intra-Community air transport alliance agreements, such international co-operation agreements often comprise close co-operation on the key parameters on which airlines normally compete, such as schedules, capacity, tariffs, revenues, frequent flyer programmes etc and therewith in principle fall within the scope of the EC competition rules¹³.
8. The Commission has investigated in particular a number of alliance agreements between Community and US airlines, as to their compatibility under the EC competition rules. In 1996, the Commission initiated proceedings in various air alliance cases, focussing on the transatlantic routes covered by those alliances.¹⁴ In the absence of a specific enforcement Regulation for the application of the EC competition rules on transport between the Community and third countries, the legal basis for these proceedings was Article 85 (ex- Article 89) of the Treaty, which empowers the Commission, if it finds that there has been an infringement of the EC competition rules, to propose appropriate measures to bring it to an end and, if this is not done, record such infringement in a reasoned decision and authorise Member States to take the measures, the conditions and details of which it shall determine, needed to remedy the situation.
9. The Commission's experience in dealing with these cases under Article 85 of the Treaty has shown that, although eventually in the cases at stake a satisfying solution for the identified competition issues was found¹⁵, the lack of appropriate enforcement powers is unsatisfactory from the point of view of enforcement as well as time-consuming and cumbersome. In particular, the Commission lacks the appropriate tools, which are necessary for the fact-finding process. Although the Commission applies as much as possible *mutatis mutandis* the procedures of Regulation (EEC) No 3975/87, in practice it has to rely on the willingness of the parties to provide the Commission with the necessary facts. Furthermore, Article 85 of the Treaty does empower the Commission to record an infringement in a reasoned decision. However, it does not empower the Commission to adopt a decision requiring the undertakings concerned to bring such infringement to an end and imposing the remedies which are necessary to address the competition concerns, as foreseen in Article 7 of Regulation (EC) No 1/2003. Such measures will have to be taken by the competent authorities in the Member States concerned. Although the Commission in its recent investigations into transatlantic alliance agreements in the aviation sector closely co-operated with the competent authorities of the Member States concerned, it is clear that this practice does not ensure fully an effective and coherent application of EC competition law. The EU therefore needs to ensure that the same competition and enforcement rules are applied to international aviation as they are to internal EU routes.

¹³ It should be noted that Community competition law would apply only if there is an effect on trade between Member States. Such an effect would have to be determined on a case-by-case basis.

¹⁴ Annual Competition Report 1996.

¹⁵ On 24 October 2002 the Commission decided to close its proceedings with regard to the alliance agreements between KLM/NorthWest and Lufthansa/SAS/United respectively, in the latter case after the parties had proposed certain remedies addressing the identified competition issues.

10. The extension of the competition enforcement rules to include also international air transport to and from the Community would afford airlines the clear benefit of a common EU-wide enforcement system as to the legality of their agreement under the Community competition rules according to a much less ponderous and more direct procedure than that of Article 85 of the Treaty. Also after Council Regulation (EC) No 1/2003 will become applicable the Commission will continue to play a prominent role in the application of EC competition law in the field of international air transport. In order to ensure a coherent competition approach within the network of EC competition authorities, the Commission envisages continuing setting policy through its decisions practice in appropriate cases. Only by overcoming the Commission's existing investigation and enforcement limitations the airline industry's need for a level playing field for all air transport activities as basis for growth and consumer welfare can be ensured.

3. THE COURT'S JUDGMENTS IN THE "OPEN SKIES" CASES

11. The recent Court's ruling in the "open skies" cases¹⁶ is expected to accelerate the pace of change in the aviation sector. Changes in the international regulatory environment will increase the possibilities for European airlines to restructure their businesses and regroup by engaging in alliance, merger and acquisition activity. Moreover, with the introduction of the European Company Statute, airlines will have the possibility of becoming truly European businesses with a European-wide operational platform.
12. The Court found that Member States acted illegally in agreeing bilateral agreements that discriminate between Community air carriers on the basis of the nationality of their owners. Under Community law, such discrimination is illegal and all Community carriers, as long as they have some sort of establishment in a Member State, must be able to fly international routes from there, regardless of where in the Community their principle place of business is, or of where in the Community their owners originate. It arises from the judgments of the Court that the principle of non-discrimination on the basis of nationality prevails in all the agreements, even if the air transport relation is organised bilaterally by the Member States without touching the Community competences which would justify an agreement by the Community.
13. Member States are required to open their traffic to the companies of the other Member States. Under these conditions, the air transport sector cannot be any longer considered as fragmented along national borders. There is no longer reason for competition rules applied to air transport within the Community to be different from those involving third countries. The Commission should consequently have the same powers when dealing with an intra-Community co-operation between airlines than

¹⁶ Cases C-466/98, C-467/98, C-468/98, C-469/98, C-471/98, C-472/98, C-475/98 and C-476/98 against the United Kingdom, Denmark, Sweden, Finland, Belgium, Luxembourg, Austria, Germany. The judgment establishes that Member States acted illegally when they entered into agreements with the United States on a number of issues where Community laws are in place. The judgment specifically identified slots, intra-Community fares and Computerised Reservation Systems as being matters of Community competence. The Court also found that Member States acted illegally in agreeing bilateral agreements that discriminate between Community air carriers on the basis of the nationality of their owners.

with co-operation agreements between a Community company and a carrier originating from a third country.

14. Furthermore, following the Court's judgment the Commission has requested the Council to grant the Commission the appropriate mandate for negotiations with the United States in order to establish a coherent policy for international air transport.¹⁷ An effective enforcement of Community competition laws is an essential part of such a co-ordinated air transport policy. The current competition regime does not provide sufficient level playing field either to the industry or to Member States since internal EU air traffic and international traffic to and from the Community are subject to different enforcement regimes, even though companies and alliances treat them as a single business. Accordingly, the need for an effective enforcement of the EC competition rules to international air transport has become yet more important in the light of the Court's judgment.

4. NO FURTHER NEED TO RETAIN REGULATION (EEC) NO 3975/87

15. As said Regulation (EC) No 1/2003 will as from 1 May 2004 replace the procedural provisions laid down in the Regulation (EEC) No 3975/87¹⁸. The substantive provisions of Regulation (EEC) No 3975/87 will however remain in place.
16. The provisions in Regulation (EEC) No 3975/87 which Regulation (EC) No 1/2003 does not repeal are Article 1 (setting out the scope of the Regulation), Article 2 (providing for an exception for technical agreements), and Article 20 (the entering into force of the Regulation). In addition, Article 6(3) continues to apply as a transitional regime to exemptions under Article 81(3) granted before 1 May 2004 until the date of expiration of those decisions. The practical meaning of Article 1 will be reduced if, as it is proposed, the competition enforcement rules will also apply to air transport between the Community and third countries and the limitation in scope in Article 1 would thus have to be removed. Article 20 has no independent standing. Therefore, basically the only really substantive provision of Regulation (EEC) No 3975/87 would be Article 2, providing for an exception for certain types of technical agreements.¹⁹
17. Article 2 of Regulation (EEC) No 3975/87 has been interpreted very strictly by the Commission as relating only to purely technical agreements²⁰. It has never been formally applied so far in practice and is of a merely declaratory nature.²¹ Moreover, in appropriate cases, there would be alternative ways for the Commission to provide its views on purely technical provisions falling outside the scope of Article 81(1),

¹⁷ Declaration of the European Commission on the implications of the judgements of the Court of Justice in the "open skies" cases of 19 November 2002 (COM(2002)649 (final).

¹⁸ Article 39 of the Regulation.

¹⁹ In this regard Regulation (EEC) No 3975/87 is different from other regulations in the transport sector, notably Regulation (EEC) No 1017/68 (inland transport) and Regulation (EEC) No 4056/86 (maritime transport), which both contain block exemptions.

²⁰ That is, agreements with the sole object and effect to achieve technical improvement or cooperation.

²¹ See in this sense the Commission decisions in the FEFC (OJ L 378, 31.12.1994, p. 17 par 66) and FETTCSA (OJ L 268, 20.10.2000, p. 1 par 146-147) cases, with regard to a similar provision for technical agreements in Article 3 of Regulation (EEC) No 1017/68 and Article 2(1) of Regulation (EEC) No 4056/86 respectively.

e.g. by deciding in an individual case on the inapplicability of Article 81, where the Community public interest so requires, or by possibly issuing a Commission notice.

18. Since there is after Regulation (EC) No 1/2003 becomes applicable no longer a clear justification for the continued existence of Regulation (EEC) No 3975/87 it is proposed, rather than to extend the scope of Regulation (EEC) No 3975/87, to repeal the remaining provisions of Regulation (EEC) No 3975/87 entirely and achieve the envisaged extension of the competition enforcement rules to air transport between the Community and third countries by making the appropriate amendment in Regulation (EC) No 1/2003. As a result an important simplification of legislation will be achieved, with all forms of air transport being covered by Regulation (EC) No 1/2003.

5. DATE OF APPLICATION

19. In order to avoid a complicated transitionally regime it would be most advisable to apply the proposed Regulation as from the date that the amendments of Regulation (EEC) No 3975/87 by means of Regulation (EEC) No 1/2003 will apply, therefore as from 1 May 2004. Following that date, only Article 6(3) of Regulation (EEC) No 3975/87 should continue to apply to the existing exemption decisions until the date of expiration of those decisions.

6. AUTHORIZATION TO GRANT CERTAIN BLOCK EXEMPTIONS

20. The proposed amendments for the competition enforcement rules to cover also air transport between the Community and third countries should logically be combined with the power of the Commission to grant also block exemptions in those cases, as it can already do in the case of air transport between Community airports pursuant to Council Regulation (EEC) No 3976/87²².
21. In the context of the various sets of measures liberalizing the internal aviation market and the concomitant application of the competition rules applicable to airlines, the Council conferred at the same time on the Commission the power to adopt block exemption regulations.
22. The Commission's general experience with such block exemptions is that they satisfy a genuine need for legal certainty on the part of air carriers and other market operators, while providing an incentive to abandon previous, more restrictive agreements. Such a need also exists in the case of air transport on Community third country routes.
23. In regard of the concomitant proposal to extend the EC competition enforcement rules to air transport between the Community and third countries, the Commission considers that it should also have the power to grant block exemptions for such links as it may in the case of air transport between Community airports pursuant to Council Regulation (EEC) No 3976/87.

²² OJ No 374, 31.12.1987, p. 9, as most recently amended by Regulation (EEC) No 2411/92 (OJ No L 240, 24.8.1992, p. 19).

24. Therefore it is proposed to amend the scope of Council Regulation (EEC) No 3976/87 to cover also air transport between the Community and third countries. This will empower the Commission also to grant block exemptions to airline agreements, decisions and concerted practices in respect of international air transport between the Community and third countries with regard to joint planning and co-ordination of airline schedules, the holding of consultations on tariffs for passengers with their accompanying baggage in so far as they are essential to interlining, consultations on tariffs for freight on scheduled air services, the joint operation of a service on a new or less busy route, slot allocation at airports, and common purchase and the development and operation of computer reservation systems.
25. The Commission recognizes that restrictions of competition on routes between the Community and third countries are likely to have distortive effects within the Community in the same way as restrictions on routes within the Community.
26. It therefore intends to adopt, on the basis of powers to be granted to it by the proposed extension of Council Regulation (EEC) No 3976/87, a regulation granting a block exemption subject to compliance with certain conditions and obligations while taking account of the situation as regards the block exemption currently applicable in the sector of air transport between Community airports²³. The said exemption should be granted for a limited period and be periodically reviewed as to its scope in view of the foreseeable development of a more competitive environment.

7. CONCLUSION

27. The Commission accordingly proposes that the Council adopts the proposed Regulation, amending Regulation (EEC) No 3975/87, Regulation (EEC) No 3976/87 and Regulation (EC) No 1/2003, enabling the Commission to enforce the Community competition rules and adopt block exemptions for air transport operations between the Community and third countries
28. The proposed Regulation will make the following amendments to these Regulations:
 - a) repeal Regulation (EEC) No 3975/87, with the exception of Article 6(3) which provides for a transitional provision allowing the Commission to revoke or amend existing exemption decisions;
 - b) deletion of the words "between Community airports" in Article 1 of Regulation (EEC) No 3976/87;
 - c) deletion of Article 32 point (c) in Regulation (EC) 1/2003, which excludes from its scope air transport between the Community and third countries;
29. The Commission accordingly proposes that the Council adopt the proposed Regulation, amending Regulation (EEC) No 3975/87, Regulation (EEC) No 3976/87

²³ At present the only block exemption Commission Regulation based on Council Regulation (EEC) No 3976/87 is Regulation (EEC) No 1617/93 (OJ No L 155, 26.6.1993, p. 18) as most recently amended by Regulation (EC) No 1105/2002. This regulation provides for a block exemption under certain conditions and obligations as regards consultations on passenger tariffs and slot allocation at airports until 30 June 2005.

and Regulation (EC) No 1/2003. The proposed Regulation replaces the proposals submitted by the Commission in 1997²⁴, which are accordingly withdrawn.

30. The proposed Regulation presented by the Commission with this memorandum falls within the field covered by the European Economic Area and is accordingly of relevance to it.

²⁴ COM(97) 218 final, OJ No C 165, 31.05.1997 p 13.

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(Text with EEA relevance)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 83 thereof,

Having regard to the proposal from the Commission²⁵,

Having regard to the opinion of the European Parliament²⁶,

Having regard to the opinion of the Economic and Social Committee²⁷,

Whereas:

- (1) Neither Council Regulation (EEC) No 3975/87 of 14 December 1987 laying down the procedure for the application of the rules on competition to undertakings in the air transport sector²⁸, as last amended by Regulation (EC) No 1/2003²⁹, nor Regulation (EC) No 1/2003 itself applies to air transport between the Community and third countries.
- (2) Consequently, the Commission does not enjoy powers of investigation and enforcement with regard to infringements of Articles 81 and 82 of the Treaty in respect of air transport between the Community and third countries equivalent to those enjoyed as regards air transport within the Community. In particular, the Commission lacks the requisite fact-finding tools and the powers to impose remedies which are necessary to bring infringements to an end or to impose penalties in respect of proven infringements. Furthermore, the specific rights, powers and obligations assigned to national courts and the competition authorities of the Member States by Regulation 1/2003 do not apply to air transport between the Community and third countries; the same holds true for the mechanism for co-operation between the Commission and the competition authorities of the Member States provided for in Regulation 1/2003.

²⁵ OJ C [...], [...], p. [...].

²⁶ OJ C [...], [...], p. [...].

²⁷ OJ C [...], [...], p. [...].

²⁸ OJ L 374, 31.12.1987, p.1

²⁹ OJ L 1, 4.1.2003, p. 1.

- (3) Anti-competitive practices in air transport between the Community and third countries may affect trade between Member States. Since the mechanisms enshrined in Regulation (EC) No 1/2003, the function of which is to implement the rules on competition under Articles 81 and 82 of the Treaty, are equally appropriate for applying the competition rules to air transport between the Community and third countries, the scope of that Regulation should be extended to cover such transport.
- (4) Article 2 of Regulation (EEC) No 3975/87 is of a purely declaratory nature and should therefore be deleted. With the exception of Article 6(3), which should continue to apply to decisions adopted pursuant to Article 81(3) of the Treaty prior to the date of application of this Regulation until the date of expiry of those decisions, Regulation (EEC) No 3975/87 will, following the deletion of most of its provisions by Regulation (EC) No 1/2003, cease to serve any further purpose; it should therefore be repealed.
- (5) By the same token, an equivalent amendment should also be made to Council Regulation (EEC) No 3976/87 of 14 December 1987 on the application of Article 81 (3) of the Treaty to certain categories of agreements and concerted practices in the air transport sector³⁰, as last amended by Regulation (EC) No 1/2003. That Regulation, which empowers the Commission to declare by way of Regulation that the provisions of Article 81(1) do not apply to certain categories of agreements between undertakings, decisions by associations of undertakings and concerted practices, is at present explicitly limited to air transport between Community airports.
- (6) The Commission should be empowered to grant block exemptions in the air transport sector in respect of traffic between the Community and third countries as well as in respect of traffic within the Community. Accordingly, the scope of Regulation (EEC) No 3976/87 should be broadened by abolishing its limitation to air transport between Community airports.
- (7) Consequently, Regulation (EEC) No 3975/87 should be repealed, and Regulation (EEC) No 3976/87 and Regulation (EC) No 1/2003 should be amended accordingly,

HAS ADOPTED THIS REGULATION:

Article 1

Regulation (EEC) No 3975/87 is repealed, with the exception of Article 6(3), which shall continue to apply to decisions adopted pursuant to Article 81(3) of the Treaty prior to the date of application of Regulation (EC) No 1/2003 until the date of expiry of those decisions.

Article 2

In Article 1 of Regulation (EEC) No 3976/87, the words "between Community airports" are deleted.

³⁰ OJ L 374, 31.12.1987, p. 9.

Article 3

In Article 32 of Regulation (EC) No 1/2003, point (c) is deleted.

Article 4

This Regulation shall enter into force on the third day following that of its publication in the *Official Journal of the European Communities*.

It shall apply as from 1 May 2004.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, [...]

For the Council

The President
[...]