LIBERAL BILATERAL AGREEMENTS OF THE UNITED STATES: A DRAMATIC NEW PRICING POLICY

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ABSTRACT

In 1977 United States' international aviation policy took a radically new direction. Instead of regulated competition, the policy now sought greater reliance on free market forces, emphasising low scheduled prices.

To introduce the new principles, a totally different form of bilateral agreement was developed. Other States were persuaded to accept the terms, both by the grant of route rights to the US and by the threat of traffic otherwise being diverted to neighbouring countries. The products were "liberal" agreements. About 20 have been concluded.

Foremost in these agreements were pricing articles which restricted governmental powers to reject airline price proposals. Unless both affected governments agreed, the price could not be rejected - "double-disapproval". A less extreme version permitted governments to reject prices unilaterally where the traffic originated in their territory - "country-of-origin".

This thesis traces the development of the policy into liberal bilateral agreements; it examines the novel pricing terms in detail, with emphasis on the limited grounds on which prices may be disapproved. Finally, it outlines variations in the different agreements and considers possible future directions.

LES ACCORDS LIBERALES ET BILATERALES DES ETATS UNIS: UNE NOUVELLE POLITIQUE DE TARIF DRAMATIQUE

PRECIS

Peter Harbison

Dans l'année 1977 la politique de l'aviation internationale des Etats Unis prenait une direction qui était radicalement nouvelle. Au lieu de concurrence reglée, à ce moment là la politique cherchait plus de confiance au fonctionnement du "marché libre".

Pour introduire les nouveaux principes, un type d'accord bilatérale tout à fait différent était developpé. Des autres pays étaient persuadés d'accepter les termes de l'accord, à cause de la concession de nouveaux droits de passage aux Etats Unis et aussi la menace de la diversion du trafic aérien aux pays voisins. Les résultats étaient des accords "libérales". Environ vingt accords ont été conclues.

Tout d'abord aux accords étaient les propositions de tarif qui restreignaient les pouvoirs gouvernementales à l'égard des rejet des propositions de tarif. Excepté que les deux gouvernements intéressés s'accordaient, on ne pouvait pas rejeter le tarif - "la désapprobation réciproque". Une version moins extrème permettait des gouvernements de rejeter unilatéralement les tarifs où le trafic provenait de son territoire - "le pays d'origine".

Ce thèse remontait à l'origine du développement de cette politique dans les accords libérales et bilatérales; il examine en détail les termes de la nouvelle structure de tarif, et appuye sur les causes limitées de la désapprobation des tarifs. Finalement, it décrit les variations entre les accords différentes et considère des directions possibles à l'avenir.

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APPENDICES

I N D E X

CHAPTER 1. INTRODUCTION: "OPPORTUNITIES RATHER THAN RESTRICTIONS"

"Our central goal in international aviation should be to move toward a truly competitive system. Market forces should be the main determinant of the variety, quality and price of air services... Our policy should be to trade opportunities rather than restrictions." (1).

This statement by President Carter in 1977 set the scene for a dramatic shift in US international air transport policy. The reflection of this policy, through the US' subsequent bilateral agreements, caused the most dramatic change in nature of such agreements since the negotiation of the "Bermuda Agreement" in 1946 (2).

These agreements have come to be known as "liberal". Their distinctive characteristics are reliance on "market forces" to determine capacity, frequency, entry and, above all, pricing (3).

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(1) Extract from letter from President Jimmy Carter to Secretary of the Department of Transportation Brock Adams, 6 October 1977.

(2) Air Services Agreement between the US and UK, January/February 1946; 3 UNTS, 253 (also 1946 US Av. R., 105 and UK Treaty Series No. 3, 1946). The earliest public hint of the extension of US deregulatory policies outside the domestic environment actually appeared in a letter from President Carter to CAB Chairman Robson on 22 April 1977. The relevant part of this letter read "As you know, one of this Administration's key objectives in the field of aviation is the encouragement of price competition among carriers, a policy which will yield substantial benefits to consumers. While special circumstances sometimes exist with respect to the international aviation environment, encouraging such competition is also an important element of our foreign economic policies."

(3) As will be seen, route rights were however explicitly kept apart.

At the time of President Carter's statement, the US was engaged in a renegotiation of the US-Japan bilateral agreement. The content of President Carter's informal redirection of US policy was a response to the perceived need to disown the relatively restrictive approach which had been taken in the Bermuda II agreement with the UK. This had been strongly criticised in the US and was seen as antithetical to the domestic deregulatory spirit (4).

1.1 The Need for a New Direction in US Policy

US domestic deregulatory moves had begun under the Ford Administration and were gaining great momentum by 1977. Also, quite apart from the inevitability that domestic theory and practice would spill over into the international arena, the US had for some time considered the possibility of a new direction in bilateral agreements - particularly as little success had been achieved in persuading foreign governments to accept formal agreements on charter operations, until then a competitive cornerstone of US international policy.

The "Bermuda" scheme (5) had, after all, endured throughout the remarkable changes of the thirty years following World War II. As observed by a TWA Vice-President following the conclusion of Bermuda II, "Mr H.A.L. Fisher wrote that if a treaty serves its turn for 10 or 20 years, the wisdom of its framers is sufficiently confirmed" (6). Bermuda I has survived for more than three decades and still forms the backbone of the bilateral system.

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(4) "Air Services Agreement Between the Government of the United States of America and the Government of the United Kingdom and Northern Ireland", 23 July 1977; TIAS 8641. See below, Chapter 3.

(5) See below.

(6) "The United States Attitude: A View from TWA", Thomas Taylor; Ae. J., February 1978, 60 at 61.

More directly, the US' liberal interpretation of the Bermuda scheme had become largely incompatible with the usage in most other bilateral arrangements. On the critical issue of capacity control, one of the British participants at the original Bermuda I negotiations noted in November 1977 that: "By the late 1960s, however, there were few bilateral air agreements involving countries other than the USA which did not in some way control capacity. Despite the almost invariable Bermuda facade, the effect of attaching confidential understandings between governments to the published Bermuda text was to control capacity in one way or another." (7).

This is not to suggest however that the new agreements have, or are likely to, assume the quasi-multilateral role of the original Bermuda I agreement.

It is highly unlikely that the full force of their competitive provisions will be acceptable to the majority of states. Nonetheless they have characteristics which will ensure their impact on the international air transport structure for the foreseeable future; some of their elements will inevitably find their way into other bilateral agreements and national policies. The very precariousness of the system is a novelty in itself (8).

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(7) "Bermuda II - a discussion of its implications: A British Airways View", Peter Jack, Ae.J., February 1978, 55 at 55 (both this and the statement by Mr Taylor were made at an Air Law Group symposium held at the Royal Aeronautical Society on 30 November 1977. See also Peter Haanappel, "Bilateral Air Transport Agreements - 1913-1980", (1980) 5 International Trade Law Journal, 241 at 263 ("Secret Memoranda often totally change the meaning of a bilateral air transport agreement, for instance, from a Bermuda I type agreement into a predetermination type agreement"); and H. Raben "Deregulation", Presentation to 1st Netherlands Colloquium on International Air Transport, 26 August 1980, at P.4 ("Side-letters are abundant, but they are not normally public. What do they contain? Secret liberal concessions of otherwise restrictively minded States? Or unspeakable conditions which States prefer not to make public?").

(8) "Government aviation agreements were traditionally long-duration contracts. In this they differed from certain airline agreements, such as pooling arrangements, as it was assumed that policy was not to be confused with

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Most radical departures of the US' liberal bilateral strategy have been:

(i) the totally new pricing formula;

(ii) the creation of a free-market styled competitive international structure; and

(iii) the use of route-grant incentives to persuade bilateral partners to accept the new pricing and competitive philosophy of the US - a process to become known as "routes for rates".

1.2 Objective of this Paper

This paper attempts an exposition of the more important new pricing provisions contained in the agreements. The origins of the new bilateral strategy and its means of implementation will also be examined. These are vital to assessing the extent of the changes made and possible future directions.

First, however, some general reflections on the place of bilateral agreements in the air transport system and an outline of the liberal genus.

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(8) Continued.

expediency. Bermuda I set a record and reigned for over 30 years. In sharp contrast, a national policy such as Australia's is now under review scarcely two years after it was launched (the review has in fact subsequently been dropped). A venerable institution seems to have been shaken. The Air Transport Association notes the fact explicity when it considers, as we have seen, that the United States is to its detriment - giving lasting advantages to foreign countries in the form of routes and access to the US market in return for promises or precarious arrangements on fares." See for example ITA Bulletin No. 33, 5 October 1981.

CHAPTER 2. ALL BILATERALS ARE LIBERAL, BUT SOME ARE MORE LIBERAL THAN OTHERS

The fact that bilateral agreements are necessary at all "is a product of the legal history of international aviation" (1). A reflection of that history is embodied in Article 1 of the Chicago Convention, which provides that "the contracting States recognize that every State has complete and exclusive sovereignty over the airspace above its territory".

From this starting point, any agreement between governments which exchanges air service rights, permitting intrusion into that sovereignty, is to some extent "liberal". This is of course to ignore the fact that practice over 35 years has suggested certain standards within which "conservative" and "liberal" will be broadly acceptable.

The purpose here is, however, to emphasise the fact that any judgement on "liberalism" is a highly subjective one and to re-emphasise the all-pervading influence of sovereignty in the regulation of international air transport.

2.1 Sovereignty and Bilateral Agreements

The principle of state sovereignty, including sovereignty over territorial airspace, is the starting point for consideration of any facet of the economic regulation of international air transport. Only by derogation or concession from this principle can aircraft of one state pass through another's airspace. Closely associated is the concept of aircraft nationality (normally accorded by registration in the home-state). This has developed as an apparently inevitable corollary of a bilateral system which has built upon the sovereignty foundation.

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(1) Frank E. Loy, "Bilateral Air Transport Agreements: Some Problems of finding a fair route exchange". Contained in "The Freedom of the Air", Ed. McWhinney and Bradley 174 at 174.

Two aspects of airspace sovereignty should be clearly distinguished: the first, which is so well settled today as to be of little more than academic interest concerns the analogy of international maritime law's "freedom of the seas" founded inter alia on the right (or necessity) to international communication trade (2). While the freedom of the seas developed over a period of centuries out of a recognition of mutual interest, the fate of territorial airspace was resolved in the infancy of aviation for predominantly protective, military defence reasons as a result of the First World War.

Then as the boundaries of aviation expanded, the defence motive was increasingly supplemented by political and economic interests (3). Despite the identity of interest which all states had in furthering aerial commerce, there was the familiar clash of individual interests over the allocation of respective shares in that commerce. As Goedhuis observed in 1942: "The reason why several states applied a restrictive principle in aviation (during the 1930s) was that through their geographical position or otherwise, they expected to be able to secure for themselves a larger share in air communications or in the benefits arising therefrom than they would have been able to secure if freedom of passage prevailed. They may have known that by prohibitory regulations they hampered the building up of a world air net; they may even have realised that by obstructing air communications their own interests in having the best communications possible were injured, but this injury was in their eyes outweighed by the ultimate advantages they thought to reap hoping that the other states would be forced to let them have a share in air communications greater than what they would have been able to receive otherwise." (4).

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(2) See for example Goedhuis, "Civil Aviation After The War", 36 AJIL (1942), 596 at 607.

(3) cf Sand et al, "An Historical Survey of the Law of Flight", Institute of Air and Space Law, McGill University, Pamphlet No. 7 (1961), pp 23, 24.

(4) Goedhuis op. cit., 611.

Thus airspace sovereignty was not at issue during the Chicago and subsequent multilateral ICAO conferences in the late 1940s (5). The debate concerning exchange of the "5 freedom" (6) privileges was raised within the broader and distinctly separate context of national sovereignty, i.e. within the terms of general international law. Clearly it is impossible to consider the structure of international aviation regulation without arranging it in the framework of state sovereignty. The question is thus one of the "fredom of air transport" rather than "freedom of airspace" - the right to land and trade rather than the right to fly. The distinction is made clear by the different provisions made for (commercial) scheduled service operation in Article 6 of the Chicago Convention, on the one hand and, on the other, for (non-commercial) "non-scheduled services in Article 5 (7).

Any commercial privilege (including transit privileges) granted to foreign airlines exists therefore only by virtue of specific concession from this sovereign power, by the exercise of a multiplicity of political, economic and other reasons, unique to each state and to each bilateral relationship. "Juridically, the result of the adoption of the theory of unlimited territorial sovereignty was that rights of transit or landing enjoyed by foreign aircraft could only arise from contract or treaty;

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(5) However, it may not be entirely correct to say, as does Bin Cheng ("The Law of International Air Transport", at 120), that Article 1 of the Chicago Convention was "purely declatory", for the original US draft Convention (Doc. 16, Chicago Proceedings, op. cit., p. 554 at 556) provided only for recognition of the sovereignty of other contracting parties - i.e., implying that this was, for the US at least, a contractual matter. The 1st Interim Report of the Drafting Committee Sub-Commitee 2 of Committee 1 reverted to the general grant of the Paris Convention (Chicago Proceedings, Doc. 356, p. 679 at 671).

(6) For an explanation of the "freedoms" of the air, see Appendix 3.

(7) Article 6 requires "special permission or other authorization" before any privilege may issue; Article 5 provides a "right" of transit and a "privilege" of a flight or discharge - the intention being, for the purposes of Article 5, that non-scheduled "flights" be ad hoc.

... they were the creatures not of law, but of compact. They could never be real rights, because pacta tertiis nec nocent nec prosunt... . Politically and economically the result of the adoption of the principle of territorial sovereignty was that transit and landing facilities became commodities to be bargained for and sold to the highest bidder, the price exacted often having little or nothing to do with civil aviation." (8).

The Chairman of the US delegation to the Bermuda talks in 1946, George Baker, expressed one important aspect of this in very simple terms. Talking of the areas of dispute over competitive philosophy at the Chicago Convention, he stated "there appeared in this area at Chicago a conflict of philosophies far broader than aviation alone and this is a point upon which I should like to put the greatest stress. While there is an understandable desire on the part of those for whom aviation is the driving interest in life to work out particular problems of international importance within that field, it cannot be forgotten that the Foreign Offices and State Departments of the various countries of the world must inevitably look upon agreements within aviation as in but one area, even if a terribly important area, in the broad and even more vital overall field of general international relations. It was no chance that the schism at Chicago appeared where it did and it was not a schism which could easily be closed by the careful use of the dictionary and the exact spelling out of thoughts and phrases." (9).

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(8) Jennings "International Civil Aviation and the Law", 22 B.Y.I.L., (1945), 191 at 192.

(9) George P. Baker, "The Bermuda Plan as the Basis for a Multilateral Agreement", lecture delivered at McGill University, 18 April 1947. Reprinted in Lowenfeld, "Aviation Law", 2nd edition, 1981, 2:1.13.

Within this practical, political and legal framework, a network of bilateral air services agreements became inevitable. Attempts had been made at the Chicago Conference, and for several years afterwards, to develop a formula for multilateral exchange of operating rights, but the range of philosophies was so great as to prevent realistic agreement.

As to the importance of multilateral route exchanges - a critical element in the negotiation of US round of liberal bilaterals - their commercial importance was always carefully guarded, even to the extent of keeping them outside the scope for multilateral exchanges. "The route pattern in international exchanges of rights is of such importance that the United Kingdom and United States governments have always regarded it as essential to reserve the negotiation of routes for separate bilateral treatment in all discussions of a multilateral agreement." (10).

2.2 The Place of Pricing in Bilateral Agreements

Of critical importance to most governments at the Chicago Conference was however the avoidance of uncoordinated pricing; "it was against a pre-war background of excessive competition in Europe, with its corollary of burdensome subsidies, rate warfare and other unfair competitive devices, and the revival of intense national rivalries, that the various problems were considered" (11). In this area, at least, many states actually welcomed a limitation on their sovereign powers!

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(10) Sir George Cribbett, "Some International Aspects of Air Transport". 6th British Commonwealth and Empre lecture, Jl.R.Ae.Soc. (1950), 669 at 680.

(11) Id., 674.

As a result, a framework was established in 1945 within which airline operators conferences could be held to negotiate and coordinate tariffs. The place and role of such conferences, through participation in IATA (the International Air Transport Association), has been lucidly described in the following terms: "For much the same reasons as the world does not have free trade, but has GATT and other general trade arrangements (not to mention unilaterally imposed duty systems), to protect national producers and to prevent dumping, so too governments have agreed that rates applied by their flag carriers in scheduled services should be subject to controls. This is a fundamental feature of inter-governmental bilateral agreements. International service by its nature involves at least two jurisdictions. No one government can prevent the other from controlling rates or can prescribe unilaterally rates for international service. The inter-relationship of rates in the marketplace gave birth to multi-lateral rate making recommendations through airline conferences, subject to government approval." (12).

The US CAB accepted this cause - albeit not without some powerful dissenting arguments - in 1946 (13). As will be seen below, the Bermuda scheme provided for and, arguably, relied upon multilateral tariff coordination through IATA Traffic Conferences (14).

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(12) J.G. Tomka-Gazdik, "The Distinction between Scheduled and Non-Scheduled Air Transportation", International Bar Association Conference on the Role of Charter Transport in International Aviation, Amsterdam 17-18 April 1975.

(13) Agreement, CAB No. 493, IATA Traffic Conference Resolution, 6 CAB 639 (1946).

(14) Bermuda I, op. cit., Annex II.

2.3 The "More Liberal" Agreements

With this background, fundamentally unchanged over 30 years, the new US policies were introduced. In most respects the basic principles were retained (15); it was the usages which changed, the nature of the trading process in particular, but also the tariff mechanisms. These will be considered in detail below.

Almost all agreements concluded by the US since Bermuda II have thus been "more liberal" than their predecessors in their combination of liberal pricing, charter arrangements, entry and capacity.

There is no formal classification, but depending on the reference point used, the US has negotiated between 15 and 25 liberal texts in this period. Some superficially "less" liberal agreements become more liberal in their application, for example where their neighbouring markets are regulated with few restrictions; the converse is also true.

For present purposes, the agreements will be classified according to the nature of their pricing clause rather than their overall - subjective - competitiveness or "liberalism". Not all of the agreements will be covered. Where a common theme exists, representive clauses will be used; exception will be illustrated by specific reference. The classification is as follows:

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(15) For example, even "... the "open skies" doctrine does not come into conflict with the sovereignty principle... This approach leaves the inalienable sovereign rights of states intact but would require them to adopt a behaviour which opens the skies in practice subject to mutual agreement on possible government intervention." H.A. Wassenbergh, Senior Vice-President of KLM, "Liberal Bilateral Air Agreements between the US and Europe and their Impact on Latin America", speech delivered to the Ninth A.L.A.D.A. Conference, Aruba, 2-5 May 1979.

US LIBERAL AGREEMENTS (To 1 May 1982) (16)

Country	Date	Pricing Article
1. The 1977 Agreements		
Singapore	September 1977	Double Approval
Senegal	October 1977	
Liberia	October 1977	
Nigeria	November 1977	
Belgium	November 1977	
Mexico	December 1977	
2. The First Liberal Agreements		
Netherlands	March 1978	Country-of-Origin
Israel	August 1978	Double Disapproval
Korea	September 1978	Double Disapproval
Papua New Guinea	October 1978	Country-of-Origin
Germany	November 1978	Country-of-Origin
Fiji	(May 1979)	Country-of-Origin
3. Fully Liberal: Double Disapproval		
Belgium	November 1978	Double Disapproval
Jamaica	April 1979	
Singapore	June 1979	
Thailand	June 1979	
Costa Rica	August 1979	
Taiwan	October 1979	
Netherlands Antilles	January 1980	
Finland	March 1980	
Jordan	June 1980	
El Salvador	April 1982	
4. Variations		
Australia	December 1978/May 1980	Country-of-Origin
New Zealand	April 1980	Country-of-Origin
UK	July 1977 et seq.	(Country-of-Origin)
China	September 1980	Double Disapproval Band Pricing
Philippines	October 1980	
Barbados	April 1982	
ECAC	May 1982	

(16) For references to texts see Bibliography.

2.4 The Form of the New Agreements

It will be seen that several forms of agreement have been used to introduce the various liberal regimes. These include "Protocols", "Exchanges of Notes", "Agreed Memoranda of Understanding" in addition to the comprehensive form of full "Air Services (or Transport) Agreement" (ASA).

In each case their binding effect on the parties appears identical. Each is a "treaty" pursuant to Article 2(1)(a) of the Vienna Convention and is equally governed by international law (17). The "simplified" treaty form, of, for example, Exchanges of Notes and Agreed Memoranda is "very common" (18). The juridical differences "between formal treaties and treaties in simplified form lie almost exclusively in the method of conclusion and entry into force" (19). Thus this category of agreement may, and frequently does, enter into force on signature subject to the wishes of the parties. They may be made subject to ratification but this is not otherwise necessary to bring them into force (20). A Protocol or ASA is almost invariably made subject to formal ratification.

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(17) The Vienna Convention on the Law of Treaties 1969. Article 2, paragraph 1(a) provides: "(a) "treaty" means an international agreement concluded between States in written form and governed by international law whether embodied in a single instrument or in two or more related instruments and whatever its particular designation." While the Convention is not formally in effect, it is regarded in most areas as an authoritative codification of international law.

(18) II Yearbook of the International Law Commission 1966, 188.

(19) Ibid.

(20) See, for example, "Oppenheim's International Law", ed. Lauterpacht, 8th ed., 907, 908.

Where the terms of a subsequent agreement, including a Protocol, amend, for example, an existing ASA, then those amended terms govern relations between the parties for the duration of the later agreement (21) - unless a contrary intention is expressed. In interpreting any such intention, particularly where direct conflict exists, it appears that the subsequent conduct of the parties can be important, not only as "a means useful for interpreting the Agreement", but also as "a possible source of subsequent modification" of the respective rights of the parties (22).

The US has apparently taken a highly pragmatic approach to the type of document used as a vehicle for its competitive policies. In this respect it has been very much subject to the wishes of the bilateral partners. The later agreements however seek to make any amending text an integral part of the overall compact, so that each exists and falls together. In this way, the consequences of renunciation by the foreign government become more extreme, i.e., they cannot merely revert to the pre-competitive status quo.

2.4.1 Their Domestic Nature

For US purposes, bilateral ASAs are described as "executive agreements" (23), part of a category described by McNair as "intergovernmental agreements" (24). This less formal nature,

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(21) Ibid.

(22) Arbitration Decision Interpreting Provisions of the US-Italy Air Transport Agreement, 1946; TIAS 5624; (1963/4), 38 I.L.R., 182 at 249.

(23) See, for example Lissitzyn, "Bilateral Agreements on Air Transport", 30 J. Air L. & C. (1964) 248.

(24) McNair, "The Law of Treaties" (1961) at 19. Note however that the agreement within Taiwan was concluded between the "American Institute on Taiwan" and the "Coordination Council for North American Affairs".

not generally requiring parliamentary approval (25), is in keeping with many other technical arrangements between governments. It avoids unnecessarily cumbersome and time-consuming procedures; "since such arrangements normally contain specific provisions for services on particular routes and between particular terminals, they must be flexible and subject to modification without much delay" (26).

With this introductory background, an exploration of the new bilaterals and their origins may now be undertaken.

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(25) Congressional approval is not required in the US. See, for example, statement on the President's role and the status of US aviation agreements by US Attorney-General Clark in 1946, 40 Op. Attorney-General 451-454 (1940 - 1948), cited in Whiteman, "Digest of International Law", (1970), Vol. 14 at 219-221.

(26) Lissitzyn, "The Legal Status of Executive Agreements on Air Transportation - Part II", 18 J. Air L. & C., 12 at 21.

CHAPTER 3. THE OVERNIGHT SHIFT IN US INTERNATIONAL POLICY: NEW BILATERAL NEEDS

3.1 The 1977 Environment

By the mid-70s, US international policy was in need of refreshment (1). The effectiveness of its programmed charter strategy had begun to wane (2). Although the charter share of the total North Atlantic market was at an all-time high (3) the US flag carrier market share was being steadily eroded (4). Programmed charters had served the purpose of relaxing controls on each set of bilaterally exchanged rights and, in so doing, provided an escape valve for US policy aspirations.

Charters had, however, been born on the wrong side of the blanket and were rarely legitimised formally in bilateral agreements (5). As a result, they were vulnerable to abrupt

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(1) As a result of the consistent difference between the policy of the US and most of its bilateral partners, it may be in the US' interest to encourage continuous change - if not instability - in international markets. Without this, the more conservative policies of most other governments tend eventually to encircle and annul US initiatives.

(2) Admitted in the wake of the nationalistic 1963 (Kennedy) US International Aviation Policy, 29 J. Air L. & C., (1963), 366, and developed through the 1960s, the use of charters as a vehicle to gain additional entry and pricing freedom allowed this form of service to develop many of the operational characteristics of scheduled services - to the extent that they become "programmed" rather than non-scheduled. For a succinct summary, see "Trends in International Aviation and Governmental Policies", Paper delivered by IATA Director General, Knut Hammarskjold, to a Symposium on International Aviation Policy, Kingston, Jamaica, 31 January 1979, at 11, 12. These services were made possible by virtue of Article 5 of the Chicago Convention, although the framers could never have foreseen its eventual use.

(3) Accounting for 29% of total passengers carried in 1977 (Source: IATA).

(4) Attributed partly to the growth of non-US origin traffic, whose preferences tend to be for national flag transportation

(5) Even when such agreements were achieved, they were normally limited to 12 months' duration, renewable if mutually agreed.

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termination or modification according to the wishes of the other country. The Nixon policy of 1971 (6) supported the negotiation of charter bilaterals but results were scarce (7).

On the North Atlantic, furthermore, ECAC states were showing signs of coordinating their stand on charterworthiness rules multilaterally. A multilateral charterworthiness agreement between ECAC members on North Atlantic charters had been concluded on 5 June 1975 (8).

A central international policy issue of the mid 70s was inevitably the reconciliation of the varying views on charter/scheduled coexistence (9). It continued to be fertile ground for dispute at the ICAO Special Air Transport Conference in 1977 (10), this

(5) Continued.

This absence of de jure recognition was a matter of concern to Scoutt and Costello, "Charters, the new mode: Setting a new course in international air transportation", 39 J. Air L. & C. (1973) 1 at 18. An exception was the US-Canada Non Scheduled Air Service Agreement, 8 May 1974, US T I A S 7826

(6) Policy statement on International Air Transportation, Department of State Bull., 20 July 1970, 86 91

(7) According to the CAB Chairman, Secor Browne, the US sought basic clauses in these agreements (i) routes to be controlled "by formulae similar to those used in our bilateral agreements on scheduled services"; (ii) capacity - no limits, (iii) "bilateral machinery" to avoid "substantial impairment" of scheduled services, and (iv) a definition (of charterworthiness). Remarks before Royal Aeronautical Society, 13 March 1972, see for example Scoutt and Costello, op. cit. at 19

(8) ICAO SATC WP/9 at 5.

(9) See, for example, "Final Report of The Think Tank on a Coordinated Policy for International Commercial Aviation" (1978), Graduate Institute of International Studies, Geneva, Document Series No. 1. Constituted of key industry, government and academic figures, The Think Tank focussed on reconciling the regulation of scheduled and charter services.

(10) See, for example ICAO Circular 136-AT/42 (1977), "Policy Concerning International Non-Scheduled Air Transport". Also Report of Special Air Transport Conference, ICAO Doc. 9199, S.A.T.C.

Conference served, if anything, to emphasise the breadth of the differences on charter regulation. Perhaps the last straw for the US had in fact been the failure to conclude a charter bilateral with the UK as part of the Bermuda II agreement - a de facto acceptance that there had been no mutual acceptance of the relative role to be played by charters (11).

The Ford Administration policy (12) provided little in the way of assistance. It was in many respects a statement of the existing situation, in stark contrast to the radical direction subsequently taken in the Carter Negotiating Policy of 1978 (13)

3.2 The Role of Charters in Pricing

The US' initial support for charters in the 1960s was, arguably, to provide room for the strategically important "supplemental" airlines in the wake of the Vietnam war. However, this justification had, by the late 1970s, long since become secondary. The commercial advantages for the US of international programmed charter introduction were in avoidance of the strict routing, designation and capacity controls contained in scheduled bilateral agreements, however the "supplemental" distinction was retained

(11) The Agreement did contain references to charters of course (e.g., Article 14 and Annex 4), it also reflected consensus on the desirability of negotiation of a bilateral charter agreement, containing, for example, "progressive charterworthiness conditions" (Annex 4, paragraph (3))

(12) "International Air Transportation Policy of the United States", 8 September 1976. After years of soulsearching, this ephemeral policy was a disppointment. It was finally produced, in some haste, to offer a platform for the Bermuda II negotiating team.

(13) Op. cit. The "Principal Objectives" section of the Ford policy concluded, however:

> "We recognize the fundamental importance of maintaining a scheduled US flag system to meet the public need for regular and frequent air services on an economically sound basis. We also recognize the growing demand for low-cost services and the inherent efficiencies of full plane operations generally characterized by charter-type services. Most importantly, we recognize the need to have governmental policies that will accommodate the competitive interrelationships between these two types of services."

The most valuable relaxation of bilateral controls achieved by mass charters had been in the pricing area. Charters were the "pricing spur" for scheduled services (14).

This had led to a curious regulatory structure in which prices on scheduled services were forcibly maintained by the CAB at levels above those on charters in order to support those services (15).

At the dawn of the new liberal bilateral agreements in September/October 1977, a major philosophical rearrangement was therefore necessary if low scheduled prices were to be admitted. This step was, however, inevitable if there were - as is suggested below - to be compatibility between domestic and international policies of the US. The ingenuousness of deregulation could not embrace an artificial division of this type between scheduled and charter (16).

(14) See Below, Chapter 5.

(15) The reciprocal protection, helping to insulate scheduled services from charter competition, is the imposition of certain conditions on the charter services such as round-trip and advance purchase requirements. These and similar conditions, are today frequently attached to low scheduled fares also, to attempt to segregate "discretionary" from "non discretionary" travellers.

(16) Charters domestically had never assumed the important role which they played internationally on the North Atlantic, for example. The step to low domestic scheduled prices was therefore somewhat easier, albeit not entirely painless. The first deeply discounted scheduled fare in the US was American Airlines' "Super-Saver". This was introduced on trans-continental routes in March 1977, despite the protests of charter tour operators that it was uneconomic and designed to destroy Advance Booking Charters (ABC) services in those markets. The CAB permitted the fare to go into effect, but expressed reservations about its economic soundness and instituted an investigation to determine its impact on competitive charter service (Order 77-3-80). One subsequent low fare later in 1977 was actually disapproved because of its potential impact on charters (Order 77-9-23; this was a United Airlines proposed GIT fare). However, in October 1977, the Board seemed to accept the inevitability of developments when it noted that

(continued..)

3.3 Parents of the New International Attitude

This then is the cross-road at which US policy-makers found themselves in September/October 1977. Before the US could embark on a new liberal bilateral policy, some fundamental changes were necessary. While constrained internationally by a network of longstanding agreements, the domestic revolution made inevitable the export of deregulation, both conceptually and practically.

There is value in exploring in a little more detail the specific causes for the US' new direction internationally. This not only helps to understand the motivation of the US negotiators internationally over the succeeding years, but also indicates some of the areas where US policy will need to readjust in the future if its liberal international policy is to be revised or rejected (17).

As time progressed, it became increasingly difficult to associate the causes from the effected changes. For example, the impact of the Laker Skytrain was a vital liberal lubricant at the time but was, itself, part of both the result and the reason.

(16) Continued.

"the introduction of sharply discounted scheduled fares in prime domestic charter markets is likely to continue" (in the course of a Rulemaking proposal to liberalise charters; SPDR - 61, Docket 31520, 14 October 1977).

(17) The suggestion that US policy could reverse in the near future is daring. It is at present probably near the extreme of acceptable policy for a nation like the US; apart from indications that the deregulation "honeymoon" domestically is coming to an end, it would seem that the only direction in which US policy can move is back towards more conventional, well tried, principles - underlying which is the desire, or need, to protect national flag carriers.

Among the main reasons for change were the following:

- Domestic deregulation
- "Small government"
- The industry and economic climate
- The new Carter team
- Bermuda II
- The Laker Skytrain

3.3.1 Domestic Deregulation

This had already been discussed seriously for several years (18). The prospect of lower fares was a popular platform for politicians, which developed into a broadly based belief that the domestic industry would genuinely benefit from less regulation. Great publicity was given to the comparable fare levels in intra-state services, for example in California where there was no price control; here Pacific South West Airlines (PSA) offered significantly lower per mile rates in certain markets than did the larger, regulated inter-state operators (19).

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(18) According to former CAB Chairman, Secor Browne, "the actual sequence of events is highly interesting. As I recall, it all started with Senator Kennedy's hearings in February 1975. For those of you who would be interested there is a fascinating Harvard Business School study that came out a year or so ago of the organization and strategy for those hearings. Senator Kennedy, and his advisors were looking for an issue with visibility and populist appeal. Certainly, deregulation of the airlines turned out to be such an issue." ("Air Service in the 1980s -- Setting the Stage: the Stormy Air Ocean"; speech by Secor D. Browne before the Airport Operators Council International (AOCI), Mexico City, 30 September 1980).

(19) See, e.g., "Oversight of CAB Practices and Procedures", Hearings before the Senate Subcommittee on Administrative Practices and Procedures of the Senate Judiciary Committee, 94th Cong., 1st Sess. (1975).

By the end of 1976, substantial publicity had been given to the various legislative initiatives. Already five bills had been circulated or were in preparation and there was some expectation that legislation would pass the floor of the Senate in early Spring 1977. As it was, a further 18 months would pass before President Carter signed into law the Deregulation Act (20).

Despite the lack of new legislation, the draft Bills created an environment in which Chairman Kahn and the CAB were able to take a relatively cavalier approach to the limits of the existing law - knowing that any legal inconsistencies would shortly be made irrelevant.

Even until mid-1977, there remained a popular assumption outside the US that deregulation was strictly a domestic phenomenon. This ignored the ad hoc but explicit interventions of President Carter in the international pricing area; even in purely operational terms it would be difficult to imagine that the US airlines' networks could successfully operate under distinctly separate systems. Also, most foreign carriers are limited to one or two access gateways in the United States, behind which they are obliged to rely upon US carriers for connecting transportation; given the geographic extent of the US, the domestic fare structure would therefore affect most through fares beyond the first gateway.

Conceptually, too, a separation was unthinkable. For example, a two day sequence of hearings in the United States Senate on the Bermuda II agreement began on 29 November. These were the first in a series before the Aviation Sub-Committee (chaired by Senator Howard Cannon) on the subject of international aviation policy. Further hearings, focussing on government organization in international aviation, were held in early 1978.

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(20) 1978 Airline Deregulation Act. Almost unnoticed, a first major step towards cargo deregulation had occurred in legislation in November 1977 - the "Omnibus Aviation Bill", HR6010, took the all-cargo deregulation provisions from the genuine regulatory reform bills then before both Houses. Most importantly it provided for the phasing in of unlimited route entry.

In announcing plans to hold the hearings, in August 1977, Senator Cannon said that he was concerned "that at a timo when we are trying to improve our domestic air transportation system by introducing more of the principles of free enterprise, we are agreeing to bilateral arrangements that increase the role of government regulation and restrict competition in international aviation to a greater degree than ever before (21).

3.3.2 "Small Government"

To the momentum already possessed by the deregulation movement was added President Carter's electoral pledge to reduce regulation and the involvement of government generally in the marketplace.

It was not surprising therefore that on taking office in January 1977, he followed the advice of his White House aviation advisors to support strongly the domestic aviation deregulation moves already under way. Justifying this approach, inter alia, was the thesis that "support (for aviation deregulation legislation) may produce a "quick hit", to fulfill campaign commitments to cut outdated and unnecessary programs, benefit consumers, challenge special interest influence over the bureaucracy." (22).

As it turned out, the "quick hit" was not to be; there was, nonetheless, an apparently unprecedented White House involvement in day-to-day international air transport (pricing) issues during the next few months (23).

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(21) See International Aviation Hearings before Senate Aviation Subcommittee, 95th cong., 1st Sess. at 63-88 (1977).

(22) Memorandum of 22 December 1976 entitled "Executive Summary: Options on Airline Regulation Reform", addressed to the President-Elect from Simon Lazarus, Mary Schuman and Harrison Wellford, Members of the Transition Advisory team.

(23) See IATA Reg. Aff. Rev., Vol. 1, No. 1, 3 November 1977, pp. 5-8 and 27-38.

3 The Industry and Economic Climate

US carriers were divided as to the merits of deregulation; a majority opposed the concept. Financially, 1976 had been a recovery year for the US economy. Airlines had performed fairly well and many showed reasonable profits, with 1977 figures even stronger (24). Furthermore, "the short-term outlook up to the end of 1978 (indicated) fairly favourable economic conditions" (25).

3.3.4 The Carter Appointees

The advent of a new Administration in the US always results in widespread personnel changes, but on President Carter's arrival the characters were such and their mandate for innovation so broad that unprecedented aviation policy reversals became possible. To attribute a great part of the change to certain key individuals is inevitable.

Furthermore, the inter-Agency struggle for supremacy was never greater than during this period of major regulatory change. With two powerful departments, State and Transportation, as well as a long-standing congressional agency, the CAB, all involved in international aviation policy, areas of responsibility frequently overlapped substantially.

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(24) The domestic trunk carriers showed net revenues of $276 million in 1976 after a net deficit of $67 million in 1975. An all time record year followed in 1977 with a net of $384 million, to be surpassed in 1978 ($762 million). Source: CAB Handbook of Airline Statistics.

International results were also strong. In 1976 IATA member airlines (domestic and international) had their best year since 1969, with a total operating profit of $1,106 million. IATA Director-General, Mr Knut Hammarskjold's "Report on the State of the Air Transport Industry, 1977", Page 3. At that time 1977 estimates showed strong results.

(25) Ibid.

The fact that President Carter appointed Alfred Kahn as Chairman of the CAB undoubtedly did a great deal to accelerate and facilitate US policy change. Within a few weeks, Chairman Kahn became an internationally known combination of hero and villain (26). Kahn's philosophical leadership and his ungenuous approach to politics made him a central character in each of the major developments of the two years following his appointment in June 1977.

Among the many innovations in which he was involved, he was personally author of the so-called "IATA Show Cause Order" (27). The impetus for the CAB created by his arrival also created a greater instability in the always doubtful balance of policy power between the key Departments of State, Transportation and, to a lesser extent, Justice. This in turn produced a rivalry to be seen as policy leaders - which at this time meant deregulation movers.

3.3.5 Bermuda II

In some ways, the Bermuda II agreement was "the most anticompetitive understanding ever entered into by the United States, as it gave up in large part, multiple designation and established controlled designation. It drastically curtailed fifth and sixth freedom rights for US carriers. It established a complex regime for capacity and schedule limitations." (28).

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(26) The White House Office of Management and Budget (OMB) had no doubt as to who should be chosen for the post and proposed Kahn to President Carter. When directed to provide five choices from which the President could select, the OMB supposedly merely resubmitted Kahn's name written in five different ways - an indication of their belief in his credentials.

(27) Order 78-6-78, 12 June 1978.

(28) Edward J. Driscoll, NACA, opening testimony at International Aviation Senate Hearings, op. cit., at 28. The agreement was nonetheless also the first to include incitements to "innovative", "individual" airline pricing.

This type of criticism of the agreement was offered by numerous figures in the United States. Taken together with its failure to produce any direct linkage between charter and scheduled, there were in fact grounds for believing that Bermuda II contained more restrictions than any other US bilateral agreement. Against this, Alan Boyd, the US Chief Negotiator in the Bermuda II talks, made the point that the practice could be equally as important as the form. He observed that capacity control provisions in the Bermuda II were necessary because the UK had increasingly been interpreting the 1946 agreement unilaterally; he also defended the treatment of charters in Bermuda II as "at least as liberal... as presently exist. Charters are included for the first time in the basic agreement on air services." (29).

In the present context, the Bermuda II agreement provided the direct stimulus for the new wave of bilaterals. This it did in two ways:

(i) It actually provided the pricing key, overlooked by most of its opponents at the time, which helped to create an environment in which low prices became not only desirable, but inevitable. This was the Laker Skytrain; the service began on 26 September 1977.

(ii) It provoked a widespread belief, in government, in the Congress and publicly that a new bilateral course was necessary.

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(29) Aviation Week and Space Technology; 5 December 1977. In fact charters were not actively provided for.

3.3.6 The Laker Effect: The "Regulatory Accident" (30)

Had it not been for a decision of the UK Court of Appeal in December 1976, it is conceivable that the Bermuda II agreement would have included single destination on all routes (31). There would have been no Laker Skytrain; the whole policy reorganization in the US would have occurred far less dramatically and, arguably, with much greater difficulty. US policy-makers in fact had greatness thrust upon them.

The Court decision had been a confirmation of Laker's position that the UK Government had acted ultra vires in "de-designating" Laker Airways (32). The timing of this decision was critical

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(30) This expression was coined by IATA Director-General, Mr Knut Hammarskjold, in 1977: "While Skytrain may prove to be a vital and appropriate service in the London-New York market, it is a regulatory accident. Both US and UK authorities... initially sought to prevent its operation." It had "characteristics which distinguish it from both scheduled and charter operations." ("Report on The State of the Air Transport Industry", 1977, op. cit., at 10).

(31) The UK's objective had been "single designation on the North Atlantic"; Patrick Shovelton (leader of the UK negotiating team), "Bermuda II - A Discusssion of its Implications; Negotiation and Agreement", Ae.J., February 1978, 51 at 53.

(32) Laker Airways v Department of Trade (1977) 2 All ER, 182. The case was constitutionally important, turning on the issue of executive prerogative.

In 1972 Laker had been awarded a licence by the CAA to operate a "Skytrain" service between New York and London. Notice of designation was duly made to the US in February 1973; the US CAB granted an operating permit in March 1974. This was subject to Presidential approval, not forthcoming at the time.

In July 1975, the UK Trade Secretary reversed the CAA's decision and withdrew the designation, upon which the US CAB's conditional approval was withdrawn, never having been signed by the President. In the following year, the Trade Secretary issued a "Policy Guidance" paper (Cmnd.) purportedly in exercise of statutory powers; inter alia this sought to codify a single designation policy, with no place for Laker. Laker brought an action on the grounds that the Trade Secretary's action was ultra vires, in conflict with the governing statute. Hence, Laker maintained, the airline's designation could not be withdrawn.

(continued..)

to the negotiations, almost midway through the 12 month notice period following the UK's Notice of Termination on 22 June 1976. As the leader of the UK delegation observed, this "was bound to effect the negotiating stance taken by the UK on single designation" as it effectively obliged the Government to seek a New York-London role for Laker. Clearly British Airways could not be displaced.

Hence, "one of the objectives of the UK negotiating team in Bermuda II became the assurance that Laker Skytrain might operate under the new agreement" (33). Double designation was agreed for the London-New York and Los Angeles routes and the die was cast.

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(32) Continued.

The Court of first instance and the Court of Appeal (led by Lord Denning) found in favour of Laker.

While leave was granted to appeal to the House of Lords, this option was not pursued to its conclusion. The Trade Secretary had been replaced; the new incumbent, Mr Dell, held different beliefs. "In fact the process of appeal to the higher court had begun before Dell's arrival and was in practice irreversible. To general dismay, he refused to go to the Lords... by now the public appeal of Skytrain was only too obvious. Arguments became so fierce that at one point Dell thumped the table. It was his neck on the political block, he told his officials." ("Fly me, I'm Freddie", Eglin N. & Ritchie, pub. Weidenfeld & Nicholson (1980), pp 214, 215.)
Mr Dell had envisaged "negotiating a special arrangement with the US to cover the operation of Skytrain as licensed the CAA" (Aviation Daily, 16 February 1977, 251). This the US was predictably unprepared to accept.

(33) Shovelton, op. cit., 53.

3.4 Seeds of the New Bilateral Strategy

3.4.1 Origins of the "Matching" Philosophy

As will be seen below (34), the concept of "matching" or "meeting" a competitor's price is fundamental to liberalized pricing. Its importance in a new competitive environment became clearly apparent at this early stage. As an indication of the pricing impact of the Skytrain service, the lowest available New York-London scheduled fare permitted by the CAB at the time was an Advance Purchase Excursion fare (APEX) priced at $350 (35).

Laker's proposal was for one way fares only (in keeping with the standby concept); these were to be $135 New York to London and $101 (£59) London to New York, making a total rountrip cost of $236 from the US.

On 23 August 1977, Pan American submitted to the CAB a "Justification of North Atlantic Passenger Fare Agreement" (36) in which it presented justification for an agreement reached between IATA airlines at a Conference in Geneva, 10-12 August 1977 (37). This proposed three new fares: a Budget fare, a standby fare and a Super-Apex; the standby and Budget fares were available only on the New York-London route, while the Super-Apex was to be effective on "most North Atlantic markets". The proposed effectiveness of the agreement was from 1 October 1977 to 31 March 1978.

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(34) Chapter 6.

(35) CAB Order 77-9-55, Docket 29123, Appendix A.

(36) CAB Docket No. 29123.

(37) For example, IATA Press Release No. 8, 15 August 1977. The budget and standby fares, restricted to New York-London, were to be offered, subject to capacity limits, by the three third and fourth freedom operators (British Airways, Pan American and TWA; 7 0 0 seats each per week in each direction), and three fifth freedom operators (Air India, 350 seats; El Al, 200 seats; and Iran Air, 250 seats). The new, low Apex ("Super-Apex") fares were agreed not only for New-York London, but also to other European destinations. At this stage New York was the only US gateway affected.

Pan Am maintained that, "each of the three fares is proposed as a competitive response to the Laker 'Skytrain' fares. That is the principal point. Pan Am did not choose these low fare levels. Laker did and, with some misgivings, the Board approved them... A competitive response is necessary." (38).

The eventual outcome of the proposals was in fact that the Laker-competitive fares were approved, but at this stage, Pan American still felt it necessary to state that "while the Laker fares are too low, the three IATA fares, and particularly the Budget Fare, are sufficiently cost related that they are not predatory and are justifiable on that basis apart from the need to meet competition." (39).

Hence, Pan Am was concerned that the IATA carriers could be prevented from matching the Laker fare on the grounds that such action was predatory on Laker's Skytrain! It was to avoid this type of anomaly that specific provision was subsequently made in liberal bilateral agreements to permit all competing carriers to match <u>any</u> fare filed by a competitor (40).

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(38) Pan Am justification, op. cit., 2.

(39) Id., 3.

(40) See below, Chapter 6.

The Board's issue of a permit to Laker had also contained provision for suspension if "the UK Government should unilaterally restrict the capacity or fares of US carriers operating a service in the market competitive with (Laker' (Laker's)", (Order 77-6-68, p. 1).

At this stage there was also another competitor to contend with - the defence of the charter pricing spur. In what Pan Am described as "an ironic and extraordinary document", the Department of Justice had filed on 15 August, requesting the CAB to suspend the proposed fares on the ground that they were "likely to be predatory, coincidentally or intentionally, with respect to charter services" (41). DoJ believed that introduction of the fares would place charter services "in danger of being permanently eliminated". It stressed that its concern was "with competition, and only coincidentally with competitors. If charter services die, the only vestige of price competition in international aviation dies with them." (42).

DoJ then sought to interpret the effect of the Presidential statement of 22 April on price competition (43) "The President, who must approve the Board's action in this case, has made clear that he favors price competition in international aviation. Some might argue that the President's position mandates approval of all proposed international fare reductions. However, the President's position cannot reasonably be construed to support this type of "discriminatory sharp shooting", which may well have the effect of destroying competition in the long run." (44) In the course of this filing the Justice Department also made a proposal eventually to lead to the series of "suspension agreements" (45). "Even if the Board permits these fares to become effective, it is essential that the Board nevertheless continue to monitor closely their effect on charter competition in the North Atlantic market." (46).

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(41) Department of Justice filing, Docket 31232 et al, 15 August 1977, pages 2, 3.

(42) Ibid.

(43) See above, page 1.

(44) DoJ filing, op. cit., 6, 7. The use of the words "discriminatory sharp-shooting" have developed a particular meaning in this context. See predation and discrimination sections below, Chapter 7

(45) See below, this Chapter.

(46) DoJ filing, op, cit., 7.

As will be seen, DoJ's fears were subsequently overridden, but the issues still remained to be addressed. Meanwhile, the basis for price matching had been established.

3.4.2 The Beginnings of Scheduled/Charter Price Competition

Thus in September 1977 the scene was set for a new form of price competition for the North Atlantic. From this moment, bilateral liberalization of scheduled pricing controls became essential to US international policy (47).

The transition from reliance on charter price competition to low scheduled pricing was rapid, but it raised some painful strategic questions. These centred around the DoJ concern that the long-term implications of low scheduled prices would be to drive charters from the market (in the short term it was assumed that the Laker operation would maintain an adequate competitive thrust on the North Atlantic) (48).

Remarkably, at this time of regulatory upheaval, the longstanding and carefully developed charter competition policy was discarded without any formal reevaluation. In effect the principles were developed from the practice - a deductive rather than the more usual inductive process. The only guideline was the Presidential directive to "trade opportunities, not restrictions".

(47) From this starting point flowed also the need to achieve for scheduled services the market access and capacity freedom which went with charters. (See below, Chapter 5.)

(48) With the demise of Laker Airways in February 1982, it remains to be seen whether the concern is a real one. Even assuming the DoJ scenario to be accurate, it should be noted that the supplemental airlines are still in existence - although the US' "supplemental" classification no longer exists and those airlines now operate scheduled services of a type very similar to their previous programme charters. They also of course retain charter authority.

In a matter of weeks in September/October 1977, the US totally redirected its international pricing policy in a manner unprecedented in post war aviation. To understand the strategy of subsequent years, a step-by-step account of those weeks offers valuable insight.

. 7 September: The Board issued an order suspending and initiating an investigation of standby, "Budget" and Super-Apex fares filed by six carriers for the London-New York market. No formal consideration had yet been given to the Pan Am justification of the IATA package; oral argument on this had been set for 7 September. The specific fares at issue were part of this package (49).

In suspending the fares, note was taken of submissions by US supplemental airlines that "the proposed fares are uneconomic and predatory, and will destroy the North Atlantic charter market" (50). The Department of Justics had restated, but differently, its argument raised at the Pan Am filing - "the fares are predatory and will drive the supplemental carriers out of business" (51).

. 14 September: The President was less than enthusiastic in accepting the Board's decision. In a letter to Chairman Kahn, the President approved "the temporary suspension for foreign policy reasons" (52).

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(49) CAB Order 77-9-43. (Note a tariff package is "submitted"; actual individual tariffs are "filed".)

(50) Id., 1

(51) Id., 2

(52) Letter from President Carter to Chairman Kahn, 14 September 1977.

He noted, however, the importance of the "North Atlantic aviation fare structure "to US" foreign economic policy", thus linking "economic" with general foreign policy (which was more clearly provided for under S.801 of the Federal Aviation Act as an exercise of Presidential power), and reserved "ultimate decision on the merits of the final order which I expect to receive by September 16" (53).

16 September: After due consideration, the various filings were dealt with together. The standby fare (at $256 New York -London) was approved, as being an "appropriate competitive response" (54); the Super-Apex proposal was disapproved as it was clearly "intended to compete primarily with charters, and not with Skytrain... and the presence of Skytrain merely offers an opportune occasion for introducing it" (55).

The Budget proposal raised a different problem. Although again regarded more as a response to charter prices, the Board felt constrained not to limit the scheduled carriers only to a standby reply to Laker. Hence, it was approved, but "subject to an increase to a more appropriate fare level" (56).

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(53) Ibid. S.801 (b) provides for the President to disapprove a CAB suspension, etc., of international tariffs "for reasons of national defense or the foreign policy of the United States".

(54) Order 77-9-55, page 5. When approving the Skytrain (Order 77-6-68, op, cit.), the Board had set out rough guidlines within which it believed appropriate responses could be made to this "experiment in low fare scheduled service".

(55) Id., pp 9-10.

(56) Id., p. 1.

The Board concluded on an almost plaintive note which transparently presented the dilemma in the whole transformation which was taking place:

"No agency that regards its principal responsibility as one of protecting the consumer can be happy about suspending proposed reductions in fares, or altering them in such a way as to make them less attractive to the public... But we cannot ignore the fact that the Super-Apex, and, to a lesser degree the budget fare, threaten the survival of what any impartial reader of recent history must agree has been the prime source of competition in this market - competition which has provided demonstrable low-fare benefits to travellers."

However, it continued, "We must be careful not to confuse a policy of competition with a policy of laisse faire (sic). The entire logic of our antitrust laws is that competition is not necessarily self-sustaining; that it is necessary to prescribe the rules of the game. This is all the more true where there exists in the market, beyond the reach of the antitrust laws, a collective body of all the major competitors, which serves as an agency for setting their rates in concert and even, as in this case, a limitation on capacity. The notion that we must in these circumstances blindly permit any and all rate reductions agreed upon by such a body, which create a genuine possibility of restoring the market more nearly exclusively to its tender mercies, can only be characterized as either disingenuous or naive." (57).

(The agency referred to was of course IATA. Hence the Board, somewhat naively, assumed here that IATA provided the threat to US competitive policies; this overlooked the more elusive role of foreign governments - which of course also possessed the ability to control entry and capacity in addition to prices.)

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(57) Id., 13.

. 26 September: President Carter was undaunted at the prospect of being characterized in this way. On 26 September, he rejected the decision as "inconsistent with this Administration's foreign economic policy" (58).

Stressing a commitment to "the benefit of American consumers", the President was "not convinced that these innovative, carrier-initiated, low fares would damage the international aviation system" (59). (Significantly, the emphasis was here on damage to the "system" rather than to charter services per se.)

The fares were thus permitted to go into effect. As a result charter-competitive scheduled fares were introduced for the first time on the North Atlantic.

There were two further matters, however. First, unknown to the CAB, the Department of State had negotiated an ad hoc "suspension agreement" (in an Exchange of Letters) with the UK on 19/23 September with the purpose of permitting suspension of the fares if they subsequently proved to be "predatory" (60) - thus, in part, responding to the CAB's concerns.

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(58) Letter from President Carter to CAB Chairman Kahn, 26 September 1977. On this occasion, the President referred expressly to his powers under Section 801 of the Federal Aviation Act.

(59) Ibid.

(60) See Exchange of Letters 19/23 September 1977, TIAS 8811. It was not however specified whether they must be found "predatory" vis-a-vis, for example, charters, other scheduled services, or even the "system" as a whole. The suspension agreement was necessary because the terms of the Bermuda II agreement did not provide for suspension of tariffs already in effect; the ad hoc arrangements permitted suspension on 6 weeks' notice (see, for example, Order 77-10-139, Docket 31564). Chairman Kahn was not party to the decision to make this agreement with the UK,

(continued..)

Secondly, the Board was recommended to "liberalize charter rules" to make charters "more competitive with the new low fare scheduled flights and more responsive to the foreign economic policy reasons for encouraging low fare passenger service" (61).

These two steps heralded the new era of US bilateral policy, the former by establishing the groundwork for a new form of bilateral dialogue between governments, in negotiating expressly on the issue of tariffs; the latter, by setting in motion the basis for charter/scheduled competition.

In fact the suspension agreements proved to be more cosmetic than real. By February 1978, as the low fare trend extended beyond the UK market, at least a dozen further such agreements had been signed (62), but no low scheduled price was ever withdrawn as being "predatory" on charters. The strategy nonetheless had a cautionary effect; numerous low-fare filings were rejected for markets where no suspension agreement was sighed (63).

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(60) Continued.

complaining that, while "everybody and his grandmother" was involved in it, no explicit communication had been received from the Department of State (Aviation Daily, 4 October 1977, page 178). Kahn, who was most upset at President Carter's 26 September decision, only learned of the agreement at the beginning of October.

(61) President Carter letter, 26 September 1977, op. cit.

(62) IATA "Reg. Aff. Rev.", Vol. 2, No. 4, 3 February 1978, 175. Among those agreeing were Belgium, Germany, Israel, Netherlands, each of whom concluded liberal agreements with the US in 1978.

(63) Ibid. Approximately 21 rejections occurred, some of which were subsequently reversed on signature of an agreement. Approximately 7 bilaterals already permitted ex post facto disapproval of tariffs.

3.4.3 The Essence of Bilateral Intergovernmental Pricing

By moving to reliance on tariff bilateralism, the US was in effect reversing a 1973 Administration position (put forward by the CAB in Order 73-4-64). This was, in essence, that a multilaterally effective tariff structure could not be developed through bilateral negotiations between governments. In Pillai et al v CAB (64), the US Court of Appeals, District of Columbia, had rejected the validity of this position and vacated the Board's Order denying the petitioner's request for review of an IATA North Atlantic fare structure.

This structure was in fact an extension of the status quo - with the 1972 levels to be applied in 1973. The Board had approved this arrangement reluctantly, believing that all alternatives had been attempted, including attempted fares negotiations with European governments. This was the only occasion when inter-governmental bilateral tariff negotiations had been attempted by the US.

The majority in Pillai however stated that "while the Board did conduct bilateral discussions, these were all aimed at procuring unanimous multilateral agreement, rather than individualised understandings pertaining to separate routes. There is a vast difference between the strategy appropriate to achieving bilateral as opposed to unanimous agreement - and the Board's commitment to unanimity above all else is demonstrated by the fact that it continued to allow each individual country to exercise effective veto power over any change in the overall rate structure ." (65).

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(64) 12, Avi., 18,037.

(65) Id., 18,044.

There was, declared the Court, no indication in the record that "United States Government representatives made any effort with any other individual government or foreign airline to achieve any bilateral rate agreement on any single route, although the international intergovernmental airline framework is based on bilateral underlying agreements between the United States and each individual foreign country" (66).

These arguments were rejected at the time by the Board and Administration, but appear to describe the thinking which was now being introduced into US tariff policy on the North Atlantic in 1977. The next step was to "market" pricing, leaving the airlines themselves to establish tariffs relevant in each bilateral market; however, the inherent governmental interest in its national market has ensured unprecedented regulatory intervention in tariff details - a prime example being the minutely detailed US-ECAC negotiations of 1981/82 (67).

3.4.4 Increasing Charter Liberalisation and Supplemental Entry

Although the whole suspension agreement "experiment (was) related to charters and charter liberalization" (68), pressures by the CAB to create a direct linkage in these items were not successful. Chairman Kahn and the Board favoured suspension of the scheduled fares until the foreign governments concerned "agreed to accept the United States charter rules" (69).

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(66) Id., 18,038.

(67) See below, Chapter 8.

(68) Per Joel Biller, US Department of State Deputy Assistant Secretary, reported in Av. Daily, 4 October 1977, 178.

(69) Letter of 4 October 1977 from CAB Chairman Kahn to DoS Secretary Vance and DoT Secretary Adams. Av. Daily, 7 October 1977, pp 202-203. The letter was copied to several other interested parties. At the top of the list were the National Security Council and Department of Defence, each very interested in the future of charters.

Philosophically this approach would have been counter to the Carter directive of "trading opportunities rather than restrictions"; in practical terms it would have dulled the momentum towards greater pricing competition. Thus, the less obvious but more acceptable option was retained. This was one occasion where Kahn's directness would probably have been unsuited to bilateral strategy.

Always the pragmatist, Kahn immediately set in motion a massive programme of charter liberalization, whose eventual objective was to remove entirely the regulatory distinction between the two forms of service (70). Inherent in this was (i) liberalization of charterworthiness rules themselves and (ii) allowing the participation of the "supplemental" airlines in scheduled carriage. Each of these was rapidly achieved.

By the end of 1977, US restrictions on OTCs (71) and ABCs (72) had been removed or greatly reduced in so-called "interim" liberalization (73). On 14 March 1978 the Board instituted a proceeding to establish "Public Charters", an omnibus type removing most restrictions on charters (74). The Board's feeling

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(70) Here Kahn's cavalier attitute dominated. The Board in fact had, until amending legislation was passed in 1978, a statutory duty to maintain a distinction under the Federal Aviation Act. See, for example, discussion in CAB Docket 23944, 3 June 1976, "Supplemental Renewal Proceedings", extending supplemental carrier authority. In November 1977 the Justice Department opined that "the line between charter and scheduled carriers is crossed whenever public solicitation by the direct air carrier is allowed" (Av. Daily, 7 November 1977).

(71) "One Stop Inclusive Tour Charters".

(72) "Advance Booking Charters".

(73) CAB Docket 29926, Part 378a, 8 November 1977 and Docket 31520, Part 371, 15 December 1977.

(74) SPDR-64, Docket 32242 and SPDR-61, Docket 31520 op. cit.

of urgency was such that an "emergency blanket waiver" was granted to "all US and foreign direct and indirect air carriers authorized to operate passenger charters" (75), for a "temporary" 90-day period beginning 19 April 1978 - even before comments were received on the original proposal.

This was in fact the beginning of public charters. The waiver permitted (i) intermingling of passengers of different charter types, (ii) elimination of minimum group size requirements, (iii) the sale of one-way ABCs (the first time that anything but round-trip sales had been permitted), (iv) the operation of less than planeload charters, (v) selective price discounts and a variety of other increases in flexibility. A minimum contract size of 20 was however retained, ostensibly continuing the scheduled/charter distinction.

As sole dissenter to this waiver decision, Member O'Melia described it as a"cavalry charge gesture" (76); it remained in effect until the formal "Public Charter" decision replaced it on 14 August 1978, in broadly similar, but permanent, terms (77). Existing charter types which were more restrictive than public charters were to be phased out by 1 January 1979 (78).

These actions raised the next problem. Most countries were not prepared to accept liberal charterworthiness provisions of this kind. Hence, to complete its liberal bilateral programme, at least country-of-origin charter provisions had to be included.

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(75) Order 78-4-122. (Order 78-5-85 subsequently withdrew one of the waivers which would have permitted "part-charters", the carriage of charter passengers on scheduled services. Part charters only became permissible under US law on 1 January 1982.)

(76) Order 78-4-122, 6.

(77) Reg. SPR-149, Part 389 "Public Charters", Final Rule, adopted 14 August, effective 15 August.

(78) With two exceptions; affinity group charters and special event charters were retained.

A different problem was raised by the grant of scheduled authority to supplemental airlines, the other charter-deregulatory move. Here the issue was entry, rather than charter rules. It was not until September 1978 that "temporary exemption authority" gave international scheduled routes to the first supplementals (79).

3.5 The New Bilateral Needs

While the momentum of these developments was growing it was readily apparent that extreme changes in the international regulatory structure would be necessary if US objectives were not to be thwarted.

From the events of September/October 1977 the following needs emerged for a successful competitive policy:

1) there must be head-on competition in pricing between scheduled and charter services; this entailed unqualified ability to "match" competitors' prices (80);

2) charter rules must be liberalized to the extent that all competitive restrictions on their operation were removed;

3) carrier entry, particularly to extend the opportunities for "supplemental" airlines, must be expanded (81);

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(79) CAB Order 78-9-2, 1 September 1978; the authority was effective 12 September. Capitol International was awarded rights between Brussels-Boston/Chicago/New York; World Airways between Amsterdam-Baltimore/Chicago/Detroit/Newark and Oakland. These awards were made in the course of the "US-Benelux Low Fare Route Proceedings", Order 78-6-97. As will be seen below, this was the first of the so-called "multiple permissive route award" cases to be initiated for international routes.

(80) In fact the CAB subsequently partially limited this ability by preventing increases in normal economy fares - a type of ad hoc predation prevention. See, for example, Order 78-9-38, suspending TWA increase proposals.

(81) This of course went hand-in-hand with the broad economic objective of freedom of entry generally.

4) linked closely with the third need, any constraints on capacity, other than those of the marketplace, must be removed; and

5) given the likely contraction of charter services, expanded route access must be guaranteed for scheduled operations (this was not a major problem for the US as extensive rights already existed for US carriers; the accent in US negotiations was now to be on intermediate and beyond rights).

In more general terms, the US had now to prepare, institutionally and strategically, for bilateral intergovernmental confrontation over tariff disputes. As will be seen, its hard-line bilateral provisions in this respect place enormous strains on the whole liberal bilateral structure.

A further need, felt by the Board, was for at least interim protection for charters through the medium of linking low scheduled fares directly with charterworthiness relaxation; as seen above, this was not to be (82).

The next Chapter will explore the way in which these new objectives were moulded and shaped into a totally new bilateral negotiating strategy.

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(82) Of interest at this stage is the total pre-eminence in policy evolution of passenger fares. Freight rates and operations generally followed - and often - led in terms of actual deregulation, but it was always passenger fares which attracted and influenced the policy formulations. The various Orders in the CAB's Show Cause Proceeding on IATA tariff formulation (see, e.g., Order 78-6-78) barely if ever referred to freight rates, while affecting them equally. As a result, paradoxically, it was relatively easy to introduce domestic cargo deregulation. (The first step was in the "Omnibus Aviation Bill, HR 6010". See above). President Carter's first international pricing intervention had however concerned freight rates; letter to (then) CAB Chairman Robson from President Carter, 22 April 1977, concerning TWA filed rates (CAB Docket 30716).

CHAPTER 4. FORMULATION AND IMPLEMENTATION OF AN INTERNATIONAL NEGOTIATING STRATEGY

Two issues now had to be addressed by the US' regulators.

First was the obvious need to develop a coherent overall policy, but this had to be done quickly. Bilateral negotiations with liberalising terms were already taking place - partly with a view to dispelling the cloud created by adverse comments over Bermuda II and, hopefully, preparing for a more liberal agreement with Japan (1).

Existence of a formal negotiating policy would offer the dual advantage of (i) setting out specific objectives against which US negotiators could measure their achievements (and decide whether or not to proceed to agreement) - i.e., a "Credo" and, (ii) to guarantee, for the President and for Congress that another Bermuda II "mistake" could not occur (2).

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(1) As will be seen below, more liberal agreements were negotiated with Senegal (17 October), Belgium (18 October), Liberia (28 October): Nigeria (4 November); Singapore (2 December), Mexico (19 December). A common feature was encouragement of "innovative" scheduled pricing and country-of-origin charter rules. Each was "paid for", usually by route grants.

(2) Thus, CAB Chairman Kahn suggested "if our negotiators are forced to reject a final offer, that action will have the full backing of the President... (Sometimes) the best result we can achieve at the bargaining table may be so bad that it would be better to come home with no agreement, at least forthe time being." Av. Daily, 3 October 1977, p. 172.

Second was the method of implementing these objectives. The international structure had existed based on more or less homogeneous bilateral principles for over 30 years. A new incentive was necessary. The US now turned to selective, aggressive negotiations and to a carrot and stick approach in which the carrot was prominent in a way never seen before "routes for rates".

In the following outline it should be emphasised that these two issues were pushed forward side-by-side, rather than sedately in sequence as would traditionally have happened. The seeds of a new policy were already sown, they only needed more coherent and comprehensive formulation. Hence the more dramatic moves not to be explicitly expressed in the policy itself - were in the methods of implementation.

4.1 Introducing the New Objectives to Bilateral Partners

The only apparent method of disseminating the new policies was actively to seek out willing partners and develop a quasi-multilateral structure in much the same way as the US and Uk spread the Bermuda I concepts in the 1940s. Thus, "instead of reacting passively to individual requests by foreign governments for discussions, the (US) could canvass the world, select out the potential partners offering them the most promising of opportunities, and actively seek out negotiations with them on a bilateral or multilateral basis." (3).

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(3) CAB Chairman Kahn, reported in Interavia Newsletter, 8853, 4 October 1977, p. 4. Kahn had been appearing before a seemingly unending round of congressional hearings - on this occasion the House Aviation Subcommittee in late September.

From this it was a short step to fixing onto the "promising opportunities". "Belgium has for years been anxious for access to Atlanta, and Belgium is, I'm told, very receptive to liberal charter arrangements and might be receptive to low fare scheduled proposals." (4). The link was not difficult to perceive - but why had the US never used this lever before?

The answer is focal to the shift in bilateral theory which now occurred the US had not "needed" anything from Belgium before and, crucially, was not concentrated on the "consumer" interest before the need to balance flag benefits.

As soon as the self-imposed restrictions of obtaining equal trade benefits were removed, whole new vistas could be opened up. Other countries could not be anticipated to experience the same impulses as the US, however, so that they had to be "given" something extra new route access to the valuable US markets As the following brief examination will show, the value of these gifts was partly illusory, they incorporated a belief in the traditional value of route rights with the devaluation of that value caused by the US' grant of multiple access to the same routes

Chairman Kahn captured the essence of the overall change in supporting "an approach that focuses clearly and directly on serving the interest of the consumers of airline services". To date, US negotiators had "tended to view bilateral negotiations as a mechanism for exchanges of benefits, especially city-pair routes, in the interest of the air carriers of the bargaining parties" (5).

Kahn's attitude was that the international aviation trading process should not be a "zero sum game", i.e., the equation was not "what foreigners obtain from us, we "lose", and

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(4) Chairman Kahn; interview with the "Washington Star", reported on 30 September 1977.

(5) Reported in Journal of Commerce, 30 November 1977.

conversely". Instead, by redefining the beneficiaries of the process as consumers rather than airlines, he believed that "we gain both by what we "give" and by what we receive" (6).

4.2 The Air Transport Trading Process

Few nations, including the US, feel totally comfortable with the risk policy inherent in many of the liberal bilateral route exchanges. As this discomfort can quickly translate into undermining a bilateral agreement, it is worth examining briefly the transition required by the new trading policy.

Essentially, bilateral trading philosophies may inevitably be traced back to the "freedoms of the air" (7) and, as UK Trade Secretary Edmund Dell has observed, "in civil aviation when one refers to freedoms, one is referring to the most restrictive arrangements in international commerce" (8). So long as the freedoms are traded, so economic value will be assessed to each route, or, e.g., third/fourth freedom exchange.

Despite the US' newly professed reliance on free competition and the interests of the consumer, certain cynics remained. Mr Patrick Shovelton has maintained that "the plain fact of the matter is - and let us have no hypocrisy about it - that both of us (US and UK) believe in mercantilism - that is to say in promoting and developing our own commercial interests" (9).

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(6) Alfred E. Kahn, "The changing environment of international air commerce", Air Law, Vol. III, No. 3, 1978, 163 at 168. Prepared for a Symposium at Georgetown University, 4 March 1978. (Note the use of "commerce" rather than "transport" in the title.)

(7) See Appendix 3. These are not "freedoms" in fact, but mutually exchanged privileges.

(8) Speech to the Financial Times Aerospace Conference, 31 August 1978, 4.

(9) "Bermuda II Et Al", 38 Chartered Inst. Transp. Jl. (1979) No. 10, 289 at 292. The speech was delivered at the Brancker Memorial Lecture in London on 12 February 1979.

Mr Dell was even more ungenerous to the US strategy. He defined mercantilism as "not so much a theory about the way nations ought to enter into international trade relations so much as a description of the way they do in fact enter into such relationships. They seek to look after their own interests. Their interests in civil aviation are very often measured in balance of payments terms. Mercantilism is just a bad word recently revived, to describe the normal process of calculation of national interest and regulation of national activites in which governments engage, sometimes misguidedly, when they have some power to exercise and where they see some national interest at risk or some advantage to be gained." (9).

More specifically, "the negotiation of bilateral air transport agreements has always been based, at least in theory, on the idea of "fair exchange" - of a satisfactory degree of reciprocity" (11).

This appears to have been the principle which led the British to denounce the Bermuda I agreement in 1976. The Note of Denunciation complained "primarily of an imbalance of benefits" between the two nations (12), permitting the US airlines to gain too large a part of the market.

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(10) Dell, op. cit., at 2,3. The politician in him continued:

> "We in this country perhaps understand mercantilism rather well because for two centuries we operated, with the approval of that great free trader Adam Smith, the system of the Navigation Acts under which British cargo was reserved to British ships. When we decided our merchant fleet could beat any competition, we repealed the Navigation Acts and started preaching to the world about the evils of flag discrimination."

- the implication being that the US as the world's strongest aviation nation, might have varying motives for espousing the free market.

(11) "On What Principles Should Bilateral Advantages be Assessed?", ITA Bull., 13 January 1958, 29.

(12) Larsen P., "Status Report on the Renegotiation of the US-UK Bilateral Air Transport Agreement"; 2 Air Law, (1977), 82.

The classic exposition of traditional aviation bilateral trading was contained in an article by Frank Loy, at the time Deputy Assistant Secretary of State in the US DoS (13). He described the Bermuda I principles as seeking a balance between freedom from arbitrary controls and some limitation on excesses of capacity offerings (14). The route exchange in particular was characterised by "equally fundamental" principles. "First, the governments sat down to trade commercial air rights for commercial air rights ... Second, the negotiators aimed at an exchange of air rights which had an approximately equal value for each side." (15).

While these initial estimations of value could subsequently prove inaccurate, Loy believed that in any negotiating process the parties "seek roughly equal opportunities to gain commercial rewards defined in monetary terms" (16).

Given this "financial balance" attitude and the place of the freedoms in the equation, it becomes predictable that nations will tend to regard national traffic as its entitlement, seeking (at least) a 50% share for their flag carriers in any bilateral arrangement. In such cases, all other bilateral elements are strongly influenced (17).

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(13) "Bilateral Air Transport Agreements: Some Problems of Finding a Fair Route Exchange", Frank Loy, in "The Freedom of the Air"; ed. McWhinney and Bradley, 1968, Pub. Sijthoff/Leyden and Oceana Pubs./NY, p. 174.

(14) Id., at 176.

(15) Ibid.

(16) Id., 177.

(17) See, e.g., Wassenbergh, "Public International Air Transportation Law in a New Era", Pub. Deventer, 1976 at 23.

In these terms it may therefore be appropriate to express the US' new negotiating strategy in a new equation which sees an additional "want" on the US side, requiring a balance on the bilateral partner's side. Certainly, there was negligible chance of introducing the competitive pricing and associated terms under the standard trading system. Some remuneration had to be offered.

Thus, while the trade may have been of "opportunities" rather than restrictions, the foreign partner had to receive an additional opportunity apart from the benefits which should flow from greater competition. What then balanced this for the US' side of the equation?

It should be noted first that not every partner actually perceived the greater competitiveness as a benefit from its side - hence an element of "throwaway" marketing was necessary on the part of the US, in order to persuade the customer, in his own interests, to "buy". Apart from this, nonetheless, there were to be gains for the US. Chairman Kahn's redefinition of "we" thus offers part of the answer; the US consumer would benefit.

Gradually, US recognition of a further national benefit became more explicit. By 1979, Klem & Leister were describing another "attitudinal shift" in US policy as the basis of the new policy; extrapolating from domestic deregulation experience, they saw that "aggressively pursuing increased competition would yield substantial benefits to US carriers" (18).

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(18) R. Klem & D. Leister, op. cit., (Chap. 6, fn 27), 568.

So in most ways it would seem that the underlying balance of (national) economic benefits has not been greatly altered. Whether in the long run there will be reversion to the zero-sum game philosophy remains to be seen. If the more cynical attitudes of Messrs. Dell and Shovelton are to be adopted, such a return must be probable where a threshold is reached beyond which the survival of national flag carriers become threatened (19).

4.3 The Threat of Traffic Diversion: "The Fifth Column"

Superimposed on the new trading equation was a very different sort of incentive - the promise that reluctant customers for the competitive package would risk the erosion of "their" traffic flows to other routes.

On the North Atlantic for example, "the size of the market and the geography of Europe make each country capable of drawing traffic away from its neighbours if more competitive prices are offered" (20).

In a newly destablised regulatory structure, with former charter airlines now offered "scheduled" prices and services very similar to their former programmed charter operations, the threat became significant.

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(19) Chairman Kahn in 1978 disclosed a US concern which suggests that the route-grant policy may in fact have been little more than pragmatic acceptance of a process which was bound to occur in any event. Shortly after taking office in 1977, he "was privileged to have a discussion of international bilateral aviation policy with one of our government officials, who began the conversation by observing to me that the next several years were going to be very trying for us, since our airlines enjoyed a very large share of world markets, and one foreign government after another could be depended upon to insist on negotiations looking to expand the landing rights of its carriers in our country. The best we could hope to do, he said, would be to dig in our heels, "give" up as little as possible, and in this way hold our losses to a minimum." Kahn, "Changing Environment", op. cit., 164, 5.

(20) Klem & Leister, op. cit., 575, 6.

As the epitome of the new strategy, Chairman Kahn's words rang clearly for each of the US' trading partners:

> "In these circumstances, the protectionists are, I believe, in a losing fight. It will become more and more difficult for them to hide behind protectionist walls, because there is a huge fifth column behind those walls - their own travellers and shippers..." (21).

As the value of route grants diminished as a negotiating weapon in the more competitive operating environment, so this became a vital part of the strategy. A pragmatic conclusion, belying its theoretical origin.

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(21) Kahn, op. cit., 173.

CHAPTER 5. ESTABLISHING A "COMPETITIVE" FRAMEWORK

"United States international air transportation policy is designed to provide the greatest possible benefit to travelers and shippers." (1). A major design in this scheme has been to "create new and greater opportunities for innovative and competitive pricing." (2).

As will be seen in the next Chapter, these pricing objectives have led to radically different bilateral tariff provisions. These provisions however must be read in the context overall of a different regulatory and operating environment (3). Without this new environment, insistence on low fares and rates could, it was argued, only result in greater, not less governmental intervention.

Initiating the US-Benelux Low-Fare Proceeding, the CAB expressed, in a nutshell, the new approach: "We believe carrier managements, rather than the Board, are in the best position to decide which US points and what pattern of operations will best enable them to offer low-fare services successfully." (4). In order to provide the necessary freedom to carrier managements, a complete infrastructure change was necessary, affecting:

- Designation,
- Capacity,
- Route and
- Charter provisions.

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(1) 1978 Policy, op. cit., 1, "Introduction".

(2) Id., 2, "Translating Goals into Objectives".

(3) i.e., Compared to that established under the Bermuda I principles which governed most of the US' bilateral relations. See below.

(4) Order 78-6-97, 13 June 1978, 43 Fed. Reg. No. 121, 22 June 1978, 26761 at 26763.

Together with "prices". the 1978 Policy had described these as "interrelated, not isolated problems to be resolved independently". Thus they were to be presented in negotiations as an "integrated US position" (5).

A chief description of the various resultant bilateral terms and their implementation is thus essential an appreciation of the application of the pricing clause.

5.1 Designation and "Multiple Permissive Route Awards"

A US objective was now "flexibility to designate multiple US airlines in international air markets" (6). The Policy explained this as follows: "The designation of new US airlines in international markets that will support additional service is a way to create a more competitive environment and thus encourage improved service and competitive pricing. Privately owned airlines have traditionally been the source of innovation and competition in international aviaition, and it is, therefore, particularly important to preserve for the US the right of multiple designation." (7).

The Bermuda I scheme had not explicitly provided for any limit on scheduled designation (8) but, with the exception of the US after the mid-1960s, single designation was the norm. Attempts by the US to admit further scheduled flag carriers had however created disputes based mainly around the capacity provisions (9).

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(5) 1978 Policy, op. cit., 2, "Translating Goals into Negotiating Objectives", (the elements were described in the Policy as "routes, prices, capacity, scheduled and charter rules and competition in the marketplace...").

(6) Ibid.

(7) Id., 3, "Explanation of Objectives".

(8) Bermuda I agreement, op. cit., Articles 2, 6, 12. It did not, of course, cover charter services.

(9) On this and other issues, see Bermuda I interpretations in T. Pyman, "Australia and International Air Law", in O'Connell, D.P., ed. "International Law in Australia", 141 et seq.

However, the Bermuda II agreement had been explicit in imposing designation restrictions (10), which the US was now anxious to avoid in any future agreement.

Each of the liberal agreements differs, first, from Bermuda I in providing for designation for both "scheduled" and "charter" carriers (11). This now provided for greater stability for charter-designated airlines, which had in the past been authorised in a broad variety of informal methods, permitting equally informal ad hoc disapproval.

The US was not and has never been prepared, however, to withdraw the distinction between route grants for scheduled and charter, so that scheduled-designated carriers remain limited by specific route grants (12).

There is to be no limitation whatever on designation (either quantitatively, or as is seen below, qualitatively). The earlier agreements are not as explicit as the later standard, in providing only "the right to designate airlines" (13).

The more modern agreements leave no doubt, in that, "Each Party shall have the right to designate as many airlines as it wishes to conduct international air transportation in accordance with this Agreement and to withdraw or alter such designations." (14).

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(10) Bermuda II, op. cit. Article 3 and Route Annex. These also were limited to scheduled designation.

(11) Note: Nowhere in the texts is "charter" defined.

(12) This has led to criticism by Wassenbergh as a limitation of the US' bilateral partners to compete. "Innovation in international air transportation regulation (The US-Netherlands' agreement of 10 March 1978)", Air Law, Vol. III, No. 3, 1978, 138 at 141,2 and 144-6.

(13) E.g., US-Netherlands agreement, Article 2(a).

(14) E.g., US-Barbados agreement, Article 3(1). (The Thai agreement makes such designations subject to consistency with each party's "domestic laws and policies"; Article 3(1).)

To make clear the scheduled/charter route distinction, the Article continues: "Such designations shall be transmitted to the other Party in writing through diplomatic channels, and shall identify whether the airline is authorized to conduct the type of air transportation specified in Annex I or in Annex II or in both." (15).

Annex I contains the "Scheduled Air Service" route grants; Annex II the "Charter Air Service" provisions.

5.1.1 Multiple Permissive Route Awards

The concept of the Multiple Permissive Route Awards (MPRAs) applied to scheduled services is nowhere described in the agreements. It has nonetheless offered a very basic modification of traditional understandings of "scheduled" service (16). The title provides its own description: designation is to be not only "multiple" but also "permissive" for scheduled airlines.

Under this form of route authorisation - used only by the US - no public service obligation is imposed on the scheduled airline to perform the specific service authorised. This means first that a large number of potential entrants may be designated (as a "competitive threat") and secondly that incumbent airlines may exit and re-enter at will.

This permissive aspect is presumably considered to be within the prerogative of any country designating its carriers. Insofar as this concept is a departure from recognised norms of "scheduled" behaviour in the approximately 1500 other bilaterals which have been negotiated since 1945, this position may be questionable and has never been resolved. It is a creation of the CAB and extends to international routes a controversial domestic policy (17).

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(15) Ibid.

(16) See e.g., Report of Think Tank, op. cit., 7.

(17) First formulated domestically in Order 78-4-121, the "Oakland Service Case".

Arguably, permissiveness is a natural and necessary result of the subsequent demise of charter operations. It introduces to scheduled operations many of the characteristics of charters.

For a policy in search of an international free market the step may be a necessary one. As described in the Oakland Case, the principle is simple: "The distinguishing feature of our proposed policy of permissive awards to all qualified applicants, therefore, is not that a greater number of carriers will wind up serving some or all of the markets, but that it will be the competitive forces of the marketplace, and not the Board, which ultimately will select the carriers that will so serve. Moreover - and this of the greatest importance - not only will the marketplace initially select the carrier or carriers who will serve each market, but it will go on doing so on a continuous, real-time basis, because at all times there will be additional carriers holding permissive authority who will be waiting in the wings, on the lookout for any sign of faltering or complacency on the part of the carrier or carriers first selected."

The impact of the introduction of MPRAs has not been as great as originally expected (although it is of course impossible to estimate the importance of the "threat"). This is possibly attributable to the harsh economic environment of the early

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(18) Id., 33. See, for origins of the Benelux Case and MPRAs, (op. cit.) 3 IATA Reg. Aff. Rev. No. 2, 55-60 and 92-130. The Benelux countries (Belgium, Netherlands and Luxembourg) had been singled out for the first award because both Belgium and the Netherlands had concluded liberal agreements with the US and "while there is no formal agreement with Luxembourg, that country has historically been receptive to such services"; Order 78-6-97, op. cit., 26763, footnote 19.

1980s; alternatively viewed, it reflects the prior similarity between scheduled and programmed charter services - as many of the new "permissive" US entrants were former supplementals operating similar services (19).

If not inevitable, it is at least highly likely that, by diminishing the public service responsibility of scheduled operations, the system will erode the more traditional scheduled operations and multistop services, through emphasis of point-to-point pricing advantages. One further aspect is that those US airlines which take advantage of this form of authority may shift operations between the various US liberal markets according to traffic fluctuations. This would appear to offer a broad competitive advantage to US airlines, agglomerated through the various agreements. (The same however applies to reallocating resources within the massive US domestic market, an argument which has also been raised in international contexts (20).)

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(19) See e.g. the decision in the Benelux Case, Order 79-9-6. Recipients of route awards included Evergreen International, T.I.A., Capitol International, DHL Airway, Seaboard and World Airways. Taneja suggests inadequate market density and excess capacity among other reasons for "minimal effects" of multiple designation generally; N. Taneja, "Procompetitive Agreements: A Preliminary Analysis", Presentation to the Conference on Economic Regulation of Air Transport, Massachusetts Institute of Technology, 9 October 1980. Also, by the same author, "Airlines in Transition", Lexington Books at 65.

(20) See e.g. Philippine Airlines' Chairman Cruz', Testimony in CAB's IATA Show Cause Order Proceeding, Docket 32851.

As with the other new concepts of the liberal strategy, the novelty of MPRAs has not permitted a full showing of their potential market impact. It may be that in an expanding economic environment they will play a more important role.

5.2 Capacity/"Fair Competition"

Among the many complexities in developing a totally new form of bilateral arrangement was the dimension added by including charters beside scheduled services. Hence, while the basic capacity provision is so simple as to be almost non-existent (21), the more general issue of competition under the bilaterals required careful treatment. The 1978 Policy's objective in this area was "Expansion of scheduled service through elimination of restrictions on capacity, frequency and route operating rights... We will seek to increase the freedom of airlines from capacity and frequency restrictions. We will also work to maintain or increase the route and operating rights of our airlines where such actions improve international route systems and offer the consumer more convenient and efficient air transportation." (22).

The Bermuda I agreement had been a triumph of compromise, reflected in its capacity provisions (23). Capacity was to "bear a close relationship" to public requirements, its "primary objective" being based on third and fourth freedom demand. Fifth freedom traffic (a critical issue at Bermuda) was to be guided within the terms of one of the best-known clauses in the history of bilateral aviation agreements:

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(21) See below. This is consistent with an uncontrolled designation scheme, the two issues being closely connected.

(22) 1978 Policy, op. cit., 2 and 3. The limitation to "scheduled" appears to be based on the assumption that these charter services already had this freedom.

(23) Bermuda I agreement, op. cit., "Final Act".

Total ".. capacity should be related

(a) to traffic requirements between the country of origin and the countries of destination,

(b) to the requirements of through airline operation, and

(c) to the traffic requirements of the area through which the airline passes after taking account of local and regional services." (24).

As to the respective participation of the two parties' airlines in the traffic, the agreement provided, equally notoriously, "that there shall be a fair and equal opportunity... to operate" on the agreed routes. Also, the interests of the other party's "air carriers" were to be considered, "so as not to affect unduly" their services on those routes (25).

Bermuda II had provided a step towards more careful control, reflecting the worldwide trend towards predetermination. This was achieved largely through a formalised consultation process and "mechanical formula" linked to tariff control and load factors (26). These were clearly out of the question for the US' new scheme.

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(24) Id., paragraph (6).

(25) Id., paragraphs (4) and (5). Together, these clauses sought to protect against "unfair trade practices" (Baker, op. cit., 10).

(26) Bermuda II agreement, op. cit., Article 11 "Fair Competition" and Annex 2. The complex arrangement is explained in "Bermuda II; Summary and Analysis of US/UK Air Services Agreement", IATA GIA Bulletin No. 17 (amended October 1977). Bermuda I had provided only for "regular and frequent consultation"; "Final Act", paragraph (9).

The first and main difference under liberal agreements is that no standards of any kind exist to limit the level of total capacity. There is, instead, a prohibition against unilateral capacity limitation of the other party's designated airlines. The only control envisaged in the competitive system was the airlines' self-imposed constraints of "the pricing of competitors (to prevent them) from providing excessive capacity" (27).

The clauses, virtually unchanged from the US-Netherlands agreement to the US-Barbados agreement, read:

> "(3) Neither Party shall unilaterally limit the volume of traffic, frequency or regularity of service, or the aircraft type or types operated by the designated airlines of the other Party, except as may be required for customs, technical, operational or environmental reasons under uniform conditions consistent with Article 15 of the Convention. (4) Neither Party shall impose on the other Party's designated airlines a first refusal requirement, uplift ratio, no-objection fee, or any other requirement with respect to the capacity, frequency or traffic which would be inconsistent with the purposes of this Agreement." (28).

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(27) ICAO, ATRP/2 - WP/6, 20 February 1979, 4. See also Wassenbergh, US-Netherlands agreement, op. cit., 144-146 and 151,2. Wassenbergh adds the requirement that "capacity should be related to demand" (Id., 151). Raben, also discussing the Netherlands agreement, talked of a "close relationship to the requirements of the public"; "The Real Test: Does a Liberal Bilateral Work?", ITA Bulletin No. 18, 12 May 1980, 411 and 412.

(28) US-Barbados agreement, Article 11.

By removing any reference to third, fourth or fifth freedoms, part of the mosaic of "internationalisation of traffic" (29) is made possible. Conceptually, and practically this is important in removing disputes over, for example, sixth freedom operations, any "freedom" distinction becoming irrelevant where no capacity control exists. The "primary", third and fourth freedom justification of the Bermuda I agreement has disappeared (30).

The second change relates to the nature of competition. In view of the evolving role of charters since 1977, the relevant provision has evolved in one important aspect. At first, a "fair opportunity" was to be permitted to each party's designated airlines to compete (31); this later became "fair and equal opportunity" (32). In each case reference was to the "international air transportation services" (33) covered by the agreement, rather than "any route... covered by the Agreement", which appears in Bermuda I (34).

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(29) Wassenbergh, Aruba, op. cit., 369.

(30) For earlier US positions, see e.g. "Ten Years of Commercial Aviation", G. Besse and R. Mathieu, ITA Studies, 651/8-E, 1965, 45-50. Even now, though, "internationalisation" did not extend to charter services - most of the earlier agreements limited rights to third and fourth freedom, cf Wassenbergh, US-Netherlands agreement, op. cit., 144.

(31) US-Netherlands agreement, Article 5(a).

(32) US-Thailand agreement, Article 11 (1).

(33) US-Netherlands agreement, Article 5(a); "services" was omitted in later agreements.

(34) Id., "Final Act", paragraph (4).

The reasons for the initial change were explained as follows: "The deletion of "equal" and the deletion of applicability to a "covered route" were necessitated by the conversion of what was a scheduled service only agreement into one covering both scheduled and non-scheduled services. Charter flights, the chief form of non-scheduled services, are authorized between all points in both countries rather than confined to routes, hence the deletion of applicability to covered routes only. Also, some designated carriers will be authorized to perform only charter services. Since scheduled services are inherently superior to charters in their flexibility to compete there is no way the Governments could be responsible to provide charter-designated airlines with an equal opportunity to compete with scheduled services. Hence the deletion of equal." (35).

Subsequently, "equal" opportunity was reintroduced, presumably because the US now considered its charter competitiveness adequate. The original wording persists however in the earlier agreements. The standard wording today reads: "Each Party shall allow a fair and equal opportunity for the designated airlines of both Parties to compete in the international air transportation covered by this Agreement." (36).

A third variation from the traditional competition concept is in those mutual interests which are to be taken into account by the parties. Instead of accounting for the other party's airlines' interests, the new language "more properly" (37) relates to the other party's interests in its own designated airlines.

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(35) ICAO, ATRP/2-WP/6, op. cit., 3. The description is by Donald Farmer, then Director of the CAB's Bureau International Aviation.

(36) US-Thailand agreement, Article 11 (1) was one of the earliest of the new texts. In addition, specific anti-discrimination provisions also appear: "(2) Each Party shall take all appropriate action within its jurisdiction to eliminate all forms of discrimination or unfair competition practices adversely affecting the competitive position of the airlines of either Party."

(37) ICAO ATRP/2-WP/6 op. cit., 3. The change appeared in the earlier agreements, but later agreements omit the provision altogether, relying on the anti-discrimination clause.

A final point to note may be more symbolic than real. Airlines' "opportunities" to "operate" now became "... to compete". Whether this makes a substantive change is not clear. For example, Lowenfeld has said of the original, Bermuda I, wording: "This clause does have meaning, though it is susceptible to misinterpretation. I believe, and I think the consistent American interpretation has been, that this clause calls for equality of opportunity to compete, to start the race together, if you will, but not necessarily to finish together. This clause is in essence a non-discrimination, not an affirmative action, clause." (38).

Although this interpretation may be controversial, it suggests that, for the US at least, the change is a clarification rather than an amendment. Clearly, some (or many) states believe strongly in the need for their airlines to "finish the race" also. This may well be a symbolic bone to fight over in the future.

5.3 Routes

As has been seen, routes - in the form of bilateral grants - played an important part in "buying" the new system. To this extent they were peripheral to the competitive environment, not perceived as a policy objective in themselves but as necessary evils. Some of the strongest criticisms of the US Policy from within have been directed at these "route-giveaways", the trading of "soft" for "hard" rights (39). Certain of these grants have a conceptual importance in establishing optional, flexible routing ("rover-points") (40) but, in the main, the 1978 Policy on routes was implicitly aimed at greater access for US carriers.

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(38) Lowenfeld, 3 Air Law 1978, 5, cited in Dold, op. cit., 143.

(39) E.g., Senate Subcommittee Hearings

(40) See Below.

The objective was expressed in terms of: "Encouragement of maximum traveler and shipper access to international markets by authorizing more cities for non-stop or direct service, and by improving the integration of domestic and international airline services." (40).

This expanded to mean: "Increasing the number of gateway cities for non-stop or direct air service offers the potential for increasing the convenience of air transportation for passengers and shippers and improving routing and market opportunities for international airlines. In addition, enhancing the integration of US airline domestic and international air services benefits both consumers and airlines." (41).

So long as foreign airlines were limited to one or a small number of gateways, so competition concentrated on the major hubs - which in turn developed as transfer points for behind-gateway traffic. Given one point in the US, most bilateral partners would select New York on the east or Los Angeles to the west.

A combination of technology advance and bilateral conservation on the part of the US had caused non-stop and direct routings to lag well behind their potential and desirable levels. The new policy was thus a logical step.

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(40) 1978 Policy, op. cit., 2.

(41) Id., 4.

Although the added route options available to the US were not extended to their bilateral partners (42), certain routing limitations were eased. Change of gauge restrictions are removed and the specified points can be served in any order, or omitted according to the wishes of the designated airline with no loss of rights (43). Previously, at least in combination service, routings and aircraft changes had been carefully controlled (44).

5.3.1 Rover-Points

In view of the turbulent times and uncertain value of route rights, it became a valuable option for a foreign government to be able to amend its route choice after conclusion of a liberal agreement. Jamaica was apparently the first country to whom the US conceded so-called rover-points.

In that agreement, Jamaica was granted no less than ten unspecified points in the US, together with several unspecified beyond routes (45). The ten points were "to be selected by the Government of Jamaica and notified to the US Government. Changes in the points selected may be made at intervals of not less than six months with 60 days' notice to the US Government." (46).

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(42) Prompting Mr Raben to suggest that "full competitive opportunities" had therefore not been exchanged as Dutch airlines would "be prevented from competing with US designated airlines between Amsterdam and US gateways not specified in the Netherlands route authority; "The Real Test", op. cit., 411. In most cases, the US gained unlimited route rights.

(43) See US-Barbados, Annex I, Sections 2,3.

(44) Bermuda II introduced certain innovations in route controls, however. See e.g. Annex 1, Section 5. Nonetheless, the Bermuda II Route Annex covers 28 pages in the agreement.

(45) US-Jamaica agreement, Article 3.

(46) Id., footnote 3. It was never clear why Jamaica should justify a grant of 10 points, when countries with much larger potential traffic flows were restricted to a handful.

This flexibility still fell short of the MPRA scheme, given the six month/sixty day requirement; while in some way, "permissive", it is more so in terms of intergovernmental relations rather than of airline, marketplace flexibility.

5.4 Charters; Bilateral Terms and Domestic Rules

The 1978 Policy seeks only "Liberalization of charter rules and elimination of restrictions on charter operations." (47).

It goes on to explain that "The introduction of charters acted as a major catalyst to the expansion of international air transportation in the 1960s. Charters are a competitive spur and exert downward pressure on the pricing of scheduled services. Charters generate new traffic and help stimulate expansion in all sectors of the industry. Restrictions which have been imposed on the volume, frequency, and regularity of charter services as well as requirements for approval of individual charter flights have restrained the growth of traffic and tourism and do not serve the interests of either party to an aviation agreement. Strong efforts will be made to obtain liberal charter provisions in bilateral agreements." (48).

There are actually two elements in this objective: to amend bilateral terms and to liberalise charterworthiness rules. The two are distinct, one international, the other domestic. This is so because, in the absence of any bilateral or multilateral description of charters (49), this form of carriage has been described purely in domestic legislation and rules which set out eligibility and operational requirements.

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(47) Op. cit., 2.

(48) Id., 3.

(49) See below, this Chapter.

The liberal bilaterals have not sought agreement on these terms; they have merely required that the bilateral partner cede its right to describe what a charter shall be under the agreement (50). (The US, in the "public charter" form, has undoubtedly the least restrictive charter rules of any of its liberal bilateral partners (51).)

Subject to the exceptions noted in this Chapter, the general provisions of the liberal agreements apply equally to charter and scheduled services. The bilateral terms relating specifically to charters are not in fact the important part of the charter equation; the critical issue is the (domestic) rules which they introduce. Before considering these, however, an outline of the bilateral terms is necessary.

5.4.1 Bilateral Provisions

Each of the liberal agreements provides at least for (i) country of origin charter rules to apply, (ii) the right to operate third and fourth freedom combination one-way or round-trip charters, with stopovers en route at will, and (iii) the right to carry traffic from the designated carrier's country beyond the territory of the other party, with transit or stopover in the other party's territory (52). In every case most-favoured-nation rules apply (53).

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(50) The cession of rights is either for country-of-origin or "double country-of-origin"/country of designation charter operations, depending on the agreement. These terms are explained below.

(51) See below. Chile, with whom the US does not have a liberal agreement, has virtually no restrictions and permits fifth freedom charters of foreign operators.

(52) US-Netherlands agreement, Article 4(a). Fourth freedom transit/stopover rights are not permitted however.

(53) I.e., the country of origin may not apply more liberal rules to any other airline. Strictly speaking this is a "most favoured carrier and nation" rule; see Wassenbergh on US-Netherlands agreement op. cit., 144 and Article 2(c) US-Netherlands agreement.

No liberal agreement permits fifth or sixth freedom charter carriage. This is a vestige of traditional protectionism and an exception to the "internationalisation" concept (54); a designated carrier may not carry traffic between the other party's territory and a third country, without a stopover of at least two consecutive nights in its home country (55). In some cases a derogation from this is permissible in the following terms:

> "Each Party shall continue to extend favourable considerations to applications by designated airlines of the other Party to carry such traffic on the basis of comity and reciprocity." (56).

Given the potential additional access to the lucrative US market which this could provide, the clause is omitted from many agreements.

The only substantive addition to this scheme, which exists in some agreements, is the grant to one party's designated airline to use either party's charter rules for traffic originating in the other party's territory - "double country-of-origin". Thus US carriers may apply US charter rules to traffic which they uplift in Belgium destined for the US. (The right does not however extend automatically to the Belgian designated carriers in this example. The home country retains domestic control over its own designated carriers, so that "country of designation" is a more appropriate description.) The 1978 US-Belgium agreement was the first to contain this extension:

> "In addition, airlines of one Party may also operate charters originating in the territory of the other Party in compliance with the charterworthiness rules of the first Party." (57).

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(54) See above.

(55) US-Netherlands agreement, Article 4 (b) (i).

(56) US-Netherlands and US-Germany agreements, Article 4 (b); US-Belgium (1978) agreement, Article 4 (2).

(57) US-Belgium (1978) agreement, Article 2 (3).

Moreover,

> "When such regulations or rules of one Party apply more restrictive terms, conditions or limitations to one or more of its designated airlines, the designated airlines of the other Party shall be subject to the least restrictive of such terms, conditions or limitations." (58).

The clause later fell into disfavour in the US and has not been widely used. As explained in the "Levine Memorandum", these could allow "circumvention of scheduled route rights through adoption of scheduled operations as charter rules (thus permitting open access to the US), interchangeable charter rules (on the Belgian model) should be limited to those offered to all aviation partners by the foreign government." (59).

This contrasts strongly with the use proposed by the terms for charter entry, as outlined in the Conclusion below.

(Note: In later agreements, the charter provisions are normally found in Annex 2.)

5.4.2 US Domestic Charterworthiness Rules

Only four types of charter remain under US charter rules - affinity group, single entity, military and "public" charters. Of these, "public charters" are the sole broadly commercial form.

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(58) Id., Article 2(4). In the "free-market" environment, the decision as to "more restrictive" is presumably left to the airline. Although this extra-territorial application has the potential for dispute, this has apparently not occurred to date.

(59) Levine Memorandum, op. cit., 4.

Since September 1979, they have differed from scheduled in only two important ways in terms of public availability:

(i) individually ticketed passengers have a 7-day advance purchase requirement;

(ii) passengers purchasing through an intermediary ("indirect operator") may do so up until departure but must form part of a group contract for 20 seats (60).

The subsequent introduction of part-charter authority on 1 January 1982 has helped virtually to make redundant the scheduled/charter distinction in the US (61) - and hence for charter services between the US and its liberal bilateral partners.

As will be seen from the conclusions below, the potential impact of these liberalised charter rules is enormous. So far, the potential has not been recognised, but the charter spur philosophy survives.

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(60) The final changes in this process were on 23 August 1979 in a series of rules. See 44 Fed. Reg. 170, 30 August 1979, 50824-834 and 44 Fed. Reg. 169, 29 August 1979, 50591-50611. For an analysis of the complex of implications of removing the direct-sale prohibition on charters, see the author's description in 5 IATA Reg. Aff. Rev., No. 4, 177-184.

(61) Order 81-12-46. This deceptively simple concept was described by a US official as "an air transportation marketing form involving a carrier-charterer contract for hire of part of the space (defined in seats plus baggage or in bellyhold or maindeck cargo capability such as a pallett space) on a non-chartered flight, typically one in scheduled air service, for the transportation of persons, baggage, or freight, separately or in combination, the charter usually being under conditions of carriage set by contract, tariff, governmental regulation, or some combination thereof, which in the case of a charterer who resells space create charterer's obligations (rather than carrier obligations) to the ultimate user regarding transportation or reimbursement." ICAO ATRP/6-WP/7, 8 March 1982, 3.

5.5 Conclusions: The Competitive Strategy of the Levine Memorandum

An analysis of US policy options is provided in the frank and extremely cynical "Levine Memorandum" (62). This offers an excellent insight into US (CAB) strategy; whether or not formally part of the government's thinking (63), it highlights

(i) the varied uses to which the new clauses may be put, charter provisions in particular, and

(ii) the distinct advantage held by the US in interpreting the new provisions as their drafters and promulgators.

Among other specific issues, the Memorandum sets out two principal strategies. These work on a "time horizon" of 20 years (64).

The preferred approach, requires the following "key pieces":

(i) "exercisable multiple-designation rights";

(ii) "either deregulation of pricing or double-disapproval of proposed prices" (65).

This combination, given capacity and routing freedom, would, it was believed, "naturally tend to create the market forces that will lead to competitive prices" and other governments would find it "politically difficult... to keep rejecting low fare offers" (65). Designation freedom was the essential element; in a market where only two carriers operated governments would find it "more popular politically" to protect a flag-carrier from additional entry "than protecting it from lower fares" (65).

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(62) Op. cit.,

(63) A subsequent request from the Argentine Government for clarification of the Memorandum's status prompted a disavowal by the US DoS.

(64) Memorandum, op. cit., 3.

(65) Ibid.

Here is nothing unexpected; the use of scheduled competition and only a moderate reference to creating indirect pressures on governments. It is upon this basis that the liberal pricing clauses are designed to work.

The "second-best negotiating solution" (66) is less conventional and highlights the potential role of ultra-liberal charter rules. Where Belgian-style double-country-of-origin charter rules applied, "complete market access is provided for both US and foreign originating traffic" (66). Additionally, following conclusion of this type of agreement, the US could later "unilaterally authorise the retailing (by airlines) of charter tickets to the public" (66) - which in fact occurred shortly afterwards (67).

"The simple result (would) be an open increase in scheduled competition." (68). That is, merely by a total conceptual redefinition of charters, this "simple" result could be achieved.

If this was becoming unconventional in terms of responsible international relations, the next step was even more so. Recognising that a degree of scheduled liberalisation must be acceptable before the foreign partner would accept such open charter rules, a different negotiating strategy could be employed in some situations. Essentially the strategy would be to commence with "a rather full agenda of scheduled passenger and cargo topics" and then offer the Belgian charter clause as a "compromise" (69).

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(66) Id.,.4.

(67) See above.

(68) Memorandum, 4.

(69) Ibid. At the time, the US had recently concluded an ad hoc referendum charter agreement with Peru. The Memorandum, at 5, continued: "In evaluating how simply such a compromise can be accomplished, consideration must be given to the level of aviation sophistication held by the country

(continued..)

Quite apart from the merits of this reasoning as a bilateral attitude, it highlights clearly the similarity in the CAB's eyes, of scheduled and charter operations. In its various ramifications this is an important part of the bilateral policy.

Whether it is a realistic option to fully liberalised scheduled prices remains to be seen when charter growth returns. Even given greater scheduled stability in the future, the potential offered by charters provides some ability to the US to continue to destabilise the overall market (70).

Substantively, the Levine document also proposed careful avoidance of any restrictive agreement during the US negotiating compaign (given that the policy should have a 20 year time span). This ruled out bilaterals with a liberal appearance "but in which the liberal features are withdrawn in a side letter", because in Europe, the main target of the Memorandum, "there are few if any secrets concerning the true nature of our international aviation agreements." (71).

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(69) Continued.

that we are negotiating with. For example, if Peru was very cautious and restrictive with scheduled designations and capacity limits while at the same time freely willing to accept country-of-origin US charters, it is apparent they did not really know the nature of public charters, since these two positions are contradictory." The Peruvian agreement was apparently never consummated.

(70) Where "single" country-of-origin rules apply, airline flexibility is hampered by the (probably) more restrictive rules operative in the foreign country. Hence full market access is not available at both ends of a point-to-point route. This shortcoming may be partially remedied by the commingling provisions present in all of the charter agreements. Thus, a multi-stop charter operation, where both terminals use US rules, would be almost equivalent to full end-to-end scheduled rights with one or more intermediate blind sectors.

(71) Memorandum, 5.

In Europe, instead, reliance has been placed strongly on the threat of traffic diversion to stimulate competitive pressures. For example, "we think that bona fide "diversion" of France-destined traffic to other gateways is the only means toward a pro-competitive agreement with the French" (72).

Thus Prices, consistently throughout the policy, are the key. The next chapter will examine the mechanics of the pricing clauses, in light of this competitive framework.

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(72) Id., 7.

CHAPTER 6. THE NEW PRICING CLAUSES

The purpose of this chapter will be to examine the pricing clauses introduced by the US in liberal agreements. In doing so, it will be necessary to consider the different methods used by governments for oversight of bilateral pricing. The distinction is in the degree of surrender of "sovereign" disapproval power.

In a system where "the consumer" and "competition" become pre-eminent elements of the aviation policy of a major participant such as the US, inevitably the focus becomes lower prices. The object of the competitive framework described above has been to make possible new price control methods which either accentuate unilateral control or, theoretically, permit the withdrawal of government supervision altogether.

It should be stressed that the object of the bilateral provisions described below is to proscribe governmental approval and disapproval powers only.

The methods for establishing those prices are addressed only indirectly, if at all (1). Until the signing of the US-Netherlands Protocol in March 1978, all scheduled pricing had remained subject to the approval of both the origin and destination countries ("double approval"). The Dutch agreement introduced country-of-origin pricing control for scheduled services. Subsequent liberal agreements introduced a "double (or mutual) disapproval" system; more recently, further variations, using these basic forms, were developed.

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(1) The CAB's Show Cause Order on IATA, op. cit., would have had a similar result for tariff establishment to that which US bilaterals had for approval. However, other than its cautionary and undiplomatic impact on the air transport world, it has not been made effective. The US-Germany agreement contains an "IATA" clause (i.e., relating to establishment), but is alone in this among new liberal texts.

except for variations in specifics the terms of the liberal agreements are basically consistent - probably essential if the US wished to establish a homogeneous network of liberalisation.

Intrinsically the non-intervention terms are not complex. Difficulty arises in their interpretation partly because they are new and tend to be radically different from their predecessors; secondly, because certain limited exceptions exist where states may intervene.

To consider the clauses in their context (given that they must be applied side-by-side with conventional agreements) each of the available forms of governmental pricing control will be described below.

6.1 "Double Approval" Control

"Rates to be charged by the air carriers of either Contracting Party between points (in their respective territories) shall be subject to the approval of the Contracting Parties within their respective constitutional powers and obligations. In the event of disagreement, the matter in dispute shall be handled as below." (2).

These words from Bermuda I, universally adopted, prescribe the process under which all scheduled tariffs must be approved by both third and fourth freedom governments before entry into five. Thus, positive assent is required from each of the terminal parties (3).

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(2) Bermuda I, Annex 2 (a).

(3) Assent by non-disapproval has been a common practice, but this constitutes no waiver of the power to disapprove.

This practice had been followed, without variation, for all scheduled prices since the beginnings of modern international air transport. For the vast majority of governments, this system still applies. Only third and fourth freedom traffic is governed within these terms but there is inevitably also a practical link with intermediate fifth freedom prices.

6.2 Country-of-Origin Pricing

Under this bilateral scheme, the government in whose territory the carriage begins has exclusive control over tariffs offered on routes between the two parties' territories (4).

There was a precedent for control on this basis. Country-of-origin pricing was, de facto, a common practice governing international charter services. Being point-to-point, usually round-trip operations, the country of (temporary) destination usually had no great interest on the price levels applied - at least until traffic grew to levels which threatened its scheduled flag carrier's fourth freedom traffic. Even then, the interest in encouraging inward tourism was frequently a controlling element.

Although currency exchange fluctuations since 1972 had created often substantial directional tariff differences on scheduled services, little consideration had ever been given to use of country-of-origin rules for scheduled pricing. Partly this was undoubtedly due to the inherent conservatism of most regulators in a double approval system; it could also have been the result of US' wishes to protect charter carriers; perhaps also because scheduled services were regarded as forming part of a network - and inconsistent with unilateral tariff processes.

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(4) The reference is actually to the point where the "itinerary" begins. The exclusive control may in some cases be tempered by agreed guidelines. See below.

The relevant agreements contain no definition as such of a country-of-origin pricing regime, the intent being expressed rather in the application of the clause. In fact the term itself rarely appears. Furthermore, the practice is granted as a derogation from a general practice and not as a starting point:

> "... Neither Contracting Party shall prevent the institution or continuation of any fare or rate or any wholesale or retail price which is proposed or offered by a designated airline of the other Contracting Party, except where the first point on the itinerary (as evidenced by the document authorizing transportation by air) is in the territory of the first Contracting Party, unless otherwise agreed by the Contracting Parties..." (5).

Each party's disapproval powers are thus immediately limited to

(i) tariffs offered or proposed by the other party's airlines;

(ii) when the passenger's (etc.) itinerary begins in its territory (6).

The power extends thus to third freedom traffic, as well as round-trip traffic originating in the home country.

The clause applies equally to scheduled and charter prices; this is clear from the "designated" airline reference, which covers both types of service (7).

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(5) US-Netherlands, US-Germany, Article 6(d).

(6) Note that the limitations on disapproval powers refer only to prices of the other party's airlines - a combined result of the derogation method of expressing the control and of each country's retention of sovereignty over its designated airlines. This occurred in each of the country-of-origin agreements.

(7) See above.

Apart from establishing the first "liberal" pricing text in aviation history, this key sentence of the US-Netherlands agreement was also a milestone in tacitly ending a long-standing disagreement between the two parties over the carriage of sixth freedom traffic (ther "internationalisation" process). Prompted by US airlines, the CAB and other US bodies had, as noted earlier, disputed the Dutch contention that traffic transitting Amsterdam en route between other European countries and the US was third and fourth freedom to the Dutch. The US maintained that it was a form of fifth freedom (i.e., "Sixth") and that therefore, under a quasi-proprietary doctrine (8), KLM had far greater access to American gateways than was justified.

The US had tended to be pragmatic, if not directly selective, in its use of this doctrine, but this became logically incompatible with the new pro-competition consumer-oriented policy. Acceptance that the "document authorizing transportation by air" was sufficient indication of the traffic's point of origin thus disposed at least of US arguments over sixth freedom; it was patently impossible to maintain a country-of-origin pricing regime where there could be dispute over what constituted national origin traffic.

This is not to say that other countries similarly accepted that sixth freedom operations should in future be treated differently - least of all the Netherlands' traffic-generating neighbours, which feared the diversionary impact of low fares through a neighbouring gateway. (This was a prime motive of the US in its new approach on sixth freedom; the threat of traffic diversion was essential for the extension of bilateral "liberalisation".)

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(8) See above.

6.3 Country of Designation Pricing

In the negotiations leading up to conclusion of the US-Netherlands agreement, the US proposed this pricing form. Any prices proposed or offered by the other party's airlines could not be disapproved "except by agreement between the Contracting Parties" (9).

Thus government disapproval power would follow the flag of the airline rather than the traffic origin; a government could disapprove any tariff of its own designated airline for both third and fourth freedom traffic. Third country airline pricing was not considered at this early stage, but would presumably have been subject to double approval.

The Netherlands delegation in 1978, however, "wished to retain sole control over at least the tariffs and prices to be quoted in the Netherlands air traffic market for Netherlands-originating traffic" (10).

Hence, the US proposal was stillborn; that country has concluded no "country-of-designation" agreements. In practice it would probably not differ very greatly from full double disapproval; the US in fact also offered a double disapproval clause to the Dutch in the negotiations (11), but cannot have been very optimistic for its prospects of acceptance at that time.

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(9) Wassenbergh, US-Netherlands Agreement, op. cit., 147.

(10) Id., 148.

(11) US-Belgium, Article 2. See also, e.g., US-Thailand, Annex II, Section 2.

The concept is important, however, because so-called "double country-of-origin" charter provisions (first contained in the Belgian agreement of November 1978) are in fact country-of-designation charter rules. Insofar as such rules govern (price-related) conditions, they can therefore be regarded as relevant in this context. The particular nature of charter markets gives validity to this type of intermediate control. The home government retains control of its own designated carriers and these carriers tend to have much greater influence over charter markets than over scheduled.

6.4 "Double Disapproval" (or "Mutual Disapproval")

Where a double disapproval agreement is in effect, no tariff can be disapproved or prevented from entering into effect unless both parties so agree. It appears that, under existing bilaterals, mutual agreement has never been reached to disapprove a tariff; this form of control is in practice very close to "market" control - if in fact market controls exist in international air transport.

Like country-of-origin provisions, the double disapproval clause is written in the form of prohibition of disapproval rather than a requirement to approve. Thus, while each party may require all tariffs to be filed by the other party's designated airlines..

> "...Neither party shall take unilateral action to prevent the inauguration or continuation of fares, rates or prices or the rules governing their availability that are contained in tariffs filed with it by the designated airlines of either Party for scheduled or charter air transportation between the territories of the two Parties." (12).

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(12) US-Israel, Article 6 (a) (D).

That is to say, for all third and fourth freedom routes, unilateral disapproval of prices filed by either party's airlines is not permissible.

Also, certain criteria must be applied before even a mutual decision to disapprove may be taken. As will be seen below these criteria are highly subjective. Consequently, application of the control depends very much on the philosophies of the parties to the agreement. The more "liberal" element prevails in this system.

The example taken from the US-Israel agreement is the basic double disapproval text; further inroads to tariff liberalisation were made under later double disapproval agreements. As will be seen in the "Matching" and "Price Leadership" sections below, the (sovereign) right of disapproval is in some cases waived also for services by third country airlines as well as for services of the two parties' airlines beyond the other party's territory.

Consultations between the parties may be requested at any time when one is dissatisfied with a price or proposal, but until there is agreement to disapprove, the price may remain or enter into effect (13). Any filed price may enter into effect with the minimum of formality (14). This contrasts with the more rigid requirements of the double approval system where one party ay veto a proposal. If consultations are then held between the parties, the price may not go into effect until agreement is reached.

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(13) US-Thailand, Article 12 (3).

(14) See below.

Both the country-of-origin and double disapproval systems can create legal difficulties under national legislation insofar as waiver of sovereign powers is necessary. The total withdrawal (albeit by mutual consent) of unilateral power to suspend a price created problems even for the US (15).

6.5 "Band" Pricing

Numerous permutations exist for combining different pricing types in one scheme. These will be explored in more detail below. The first formal adoption of a "band" concept was in the US-China agreement in 1980, representing a compromise between conservative and liberal philosophies. Subsequent agreements include US-Philippines and US-Barbados. A form also appears in the ad referendum US-ECAC agreement (16).

The common element of band pricing is the establishment of one or more reference points, around which various types of pricing control are agreed.

The reference point can be established by any of the main pricing methods already detailed - by mutual agreement between the parties, by the country-of-origin or, theoretically, by the airlines subject only to double disapproval.

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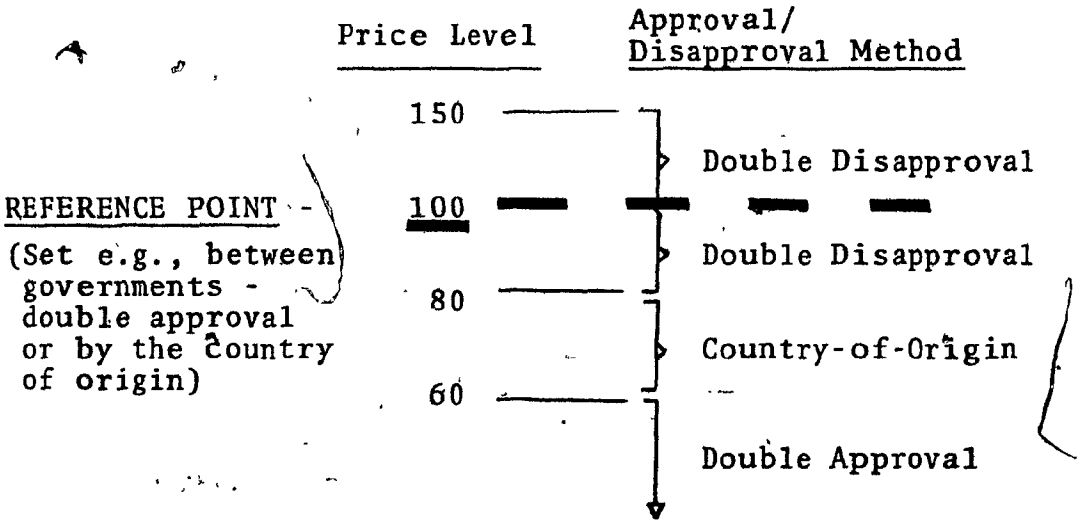
(15) During hearings on the IATCA in the Senate Aviation Subcommittee, the issue was raised whether, pursuant to an Executive agreement of this kind, the CAB would be in violation of its mandated powers under SS.404 and 1002(j) of the Federal Aviation Act; Hearings on S.3363 Before the Subcommittee on Aviation of the Senate Committee on Commerce, Science and Transportation, 95th Cong., 2nd Session, 124-147 (1978).

(16) See below. The US-ECAC agreement was however limited to scheduled pricing. It did not extend to other bilaterally regulated items such as capacity, designation, etc., which remain subject to the individual bilateral agreement concerned.

The flexibility limits around the reference point are usually contained in the agreement itself. The breadth of the band and the controlling regime within the band are matters for negotiation between the parties. As such there is a broad scope for compromise.

Thus, there may be, for example, a 20% band below the reference point within which double disapproval principles apply, with a further 20% below governed by country-of-origin pricing. Any prices below that level would be subject to double approval. Upward pricing limits can also be agreed, but this is not usually controversial.

Thus:



The US necessarily regards such variations on the liberal model as diminishing the market orientation of the agreement. The derogation can be varied greatly by adjustment of the bands - and, should the parties agree, variations could even occur in the bands applied to each.

The corollary is that governments which are reluctant to enter a "take-it-or-leave-it" fully liberal scheme may be attracted to this method in the future. It offers a real middle ground between opposing philosophies and may well outlive the fully liberal type for this reason.

6.6 "Matching" (Meeting)

As was seen in Chapter 3, the ability to "match" a competing airline's prices was quickly seen as essential to the liberal market form. The right to match thus overrides all other restrictions on pricing (17).

A further purpose of the provision is to preclude discrimination between national and foreign airlines' pricing for locally originating traffic under a country-of-origin agreement. Without it, one government could, theoretically, require the other Party's airlines to charge higher prices (e.g., by applying one or more of the disapproval criteria), thereby giving the national carrier(s) a competitive advantage.

Like many other simple concepts, complications arise in the application; the different agreements also extend matching privileges to different carriers and routes, as will be seen below.

6.6.1 General Principles: The Meaning of Matching

The early texts were straightforward. Article 6(c) of the US-Netherlands agreement, after limiting governmental intervention to the country of origin, provided:

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(17) I.e., it overrides, for example, the possibility of governmental intervention on the grounds of predation, even though a more powerful carrier may be pricing below cost to match the prices of a minor participant.

> "However, each Contracting Party shall permit any designated airline of the other Contracting Party to institute or continue a fare or rate or a wholesale or retail price which matches, or provides for a substantially similar fare, rate or price and for substantially similar terms and conditions as, any fare or rate or any wholesale or retail price which is approved or permitted for its own airline or airlines."

This contains the basic matching provisions. Any "designated" airline of the other party may match. Matching is permitted by all designated airlines of the foreign government (i.e., charter and scheduled); they may match the prices of any airline of the home party. There is thus to be no prevention of scheduled prices matching a charter price.

Strictly speaking there are actually two actions permitted in this text: (i) matching and (ii) providing "for a substantially similar fare, etc.". The implication is that a matching price is one which is identical in every respect to the matched price; the second type is only similar, but equivalent for market purposes.

Presumably to avoid this distinction, the later agreements talk of "meeting", apparently a generic term which describes both actions.

The US model double disapproval clause thus contained the following definition of the term "meet":

> "... the right ... to establish on a timely basis, using such expedited procedures as may be necessary.
>
> (a) an identical or similar price on a direct, interline or intraline basis, notwithstanding differences in conditions relating to routing, roundtrip requirements, connections, type of service or aircraft type, or
>
> (b) such price through a combination of prices." (18).

---

(18) US Model Double Disapproval Clause, paragraph 4. This text was submitted to the Second ICAO Air Transport Conference in March 1980; ICAO AT-CONF/2-WP/11.

6.6.1.1 The TWA Complaint

One example of the possibility of disputes under this provision concerned interlining "connections". It arose in the US-Germany market; TWA complained to the CAB that the German Government had wrongfully prevented TWA from marketing certain very low Lufthansa through fares to internal German points beyond the Frankfurt gateway serviced by TWA (19). Onward service was possible only on Lufthansa. TWA argued that it had offered to pay Lufthansa the "standard interline prorate" for its share of the interline transportation involved; German rejection of the TWA proposal was therefore contrary to the bilateral matching provision.

Lufthansa, which was joined in the action, responded with an argument going far beyond the immediate issue. It argued firstly that the word "connections" in Article 6(e) excluded interlining. In support of this, Lufthansa maintained that no airline should be obliged to interline with another carrier against its wishes and against its commercial interests. The very low fares at issue would, it argued, be unprofitable if interlining were obligatory (20).

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(19) Complaint of TWA, 17 December 1980, Docket 39072. See particularly Order 81-2-68. The relevant US-Germany text required parties to: "permit any airline to institute or continue a fare or rate or a wholesale or retail price which matches, or provides for substantially similar terms and conditions as, any fare or rate or any wholesale or retail price which is approved or permitted for other airlines. Further, to afford effective and non-discriminatory access to markets by airlines, each party agrees to regard conditions relating to routings, connections, and aircraft type as substantially similar for the purposes of this subparagraph."; Article 6(e).

(20) The argument continued that Lufthansa's bilateral rights had been "obtained against a background of almost universal application of the practice of interlining normal international fares and rates... While Lufthansa has every intention of continuing its past practice of interlining normal fares, it does not believe that either it or its government is committed to adopt the practice in respect of revolutionary, marginally profitably, deeply discounted fares."; Lufthansa Reply, Docket 39072.

In its finding, the CAB took the view that third and fourth freedom carriers had historically supported matching on both intraline and interline bases as long as the "appropriate prorate requirements" were met; "presumably therefore the parties would have specified intraline connections had they meant to depart from this long-standing industry practice" (21).

The outcome was inconclusive in terms of interpretation of the matching clause - although the CAB had the long-term advantage of having placed on record a finding in favour of TWA. The case illustrates not only the potential variety of disagreement but also the way in which fundamental philosophical/commercial differences can surface in the absence of traditional oversight powers.

6.6.2 Categories of Route to Which Matching Can Apply

6.6.2.1 Third and Fourth Freedom Routes

(a) Matching only by designated airlines of the contracting parties:

This situation is provided for under the US-Netherlands agreement quoted above. Dutch- and US-designated are given the right to match any price offered by the other party's airlines. While this is not restricted to country-of-origin agreements, double disapproval agreements tend to provide for the more extensive options described below.

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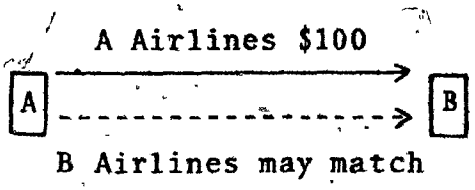
(21) Order 81-2-68, 7, 8. "Intraline" involves change of flights, each on the same airline; "interline" implies the use of more than one airline. The matter was subsequently terminated by the Board "without prejudice", but not until the two airlines had been permitted by their governments to meet to negotiate a settlement; Order 81-6-103.

Example:



(Where A & B are the contracting parties)

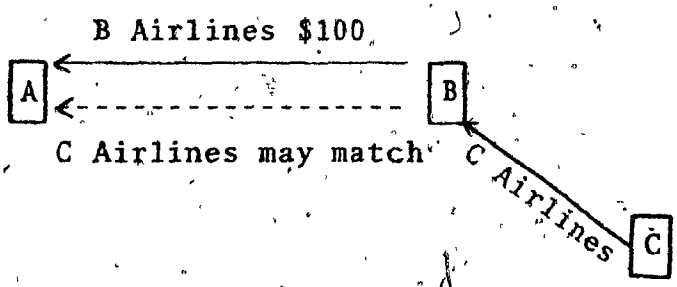
(b) Matching by any airline, including third country airlines:

This may be provided for as follows:

> "... each contracting party shall permit any airline to institute or continue a fare or rate or a wholesale or retail price which matches, or provides for a substantially similar terms and conditions as, any fare or rate or any wholesale or retail price which is approved or permitted for other airlines." (22).

For third party airlines, this right arises in either its fifth or sixth freedom operations:

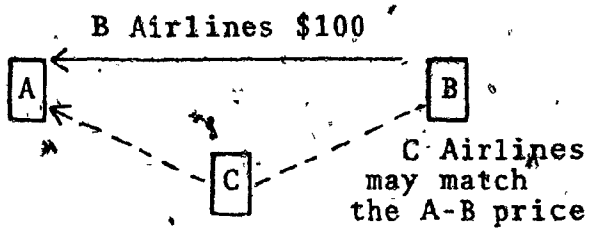
Example: (i) Fifth Freedom



(22) US-Germany, Article 6(e). A similar result arises, de facto, where reciprocity requirements are attached to third country price leadership (see below).

Such fifth freedom rights are, however, rare (23). More probable is the sixth freedom case:

Example: (ii) Sixth Freedom



6.6.2.2 Fifth Freedom Routes

Each of the liberal agreements provides extensive fifth freedom rights for the US (subject to third party approval) and, to a much lesser extent, to its various bilateral partners. To take full advantage of these rights and to extend the somewhat limited scope of bilateral pricing, special fifth freedom matching rights were extended mutually. Thus, the US-Germany Pricing Article, concluded:

> "This paragraph shall apply as well to fares, rates, prices, and conditions filed by designated airlines of one contracting party for its operations between the territory of the other contracting party and any point in a third country." (24).

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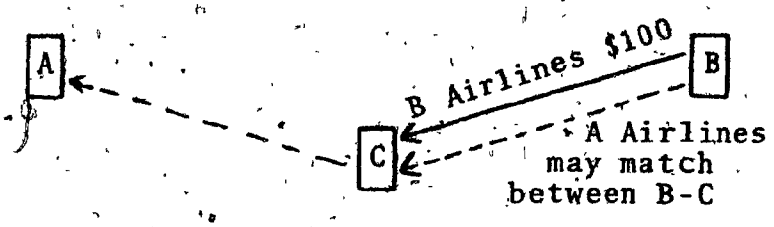
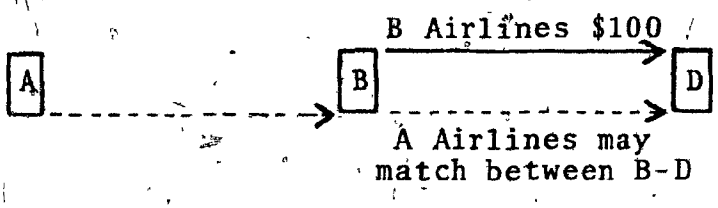
(23) The agreements do not of course grant the operating rights to third country airlines. The matching provisions are merely permissive where rights already exist.

(24) US-Germany, Article 6(e).

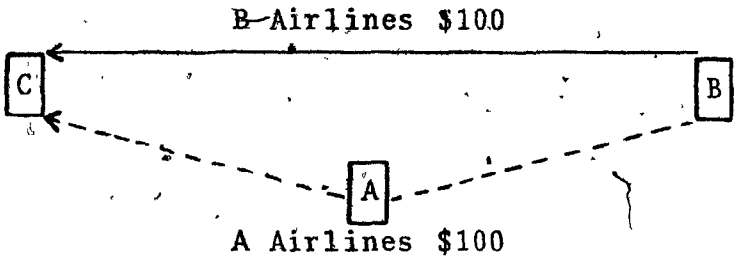
Example: (a) Intermediate



(b) Beyond Gateway



(c) Behind Gateway



Matching in this case is limited to prices offered by designated airlines; A Airlines does not therefore automatically gain the right to match possibly lower prices offered by, e.g., D Airlines between B & D. The acquiescence of country D in this pricing scheme is also necessary (25).

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(25) The 1980 Model Country-of-Origin Clause provides also for interline matching. (See below, under Price Leadership for equivalent provisions.)

6.7 Price Leadership

The principle of price leadership is totally new to air transport; its practical impact is much broader than matching. No definition exists of the term, nor does it appear in the liberal agreements; like most other pricing elements, it arises by mutual exclusion of sovereign disapproval rights.

Leadership differs from matching/meeting in that prices may actually be undercut or "led" - (i) by third country airlines on the parties' third and fourth freedom routes, and (ii) by the parties' airlines on respective fifth freedom routes.

In such cases, the only intervention permissible is subject to the four disapproval criteria set out in the pricing article (26) - overriden where applicable by the matching provisions.

This is a massive departure from traditional pricing policies and few countries have knowingly undertaken to permit price leadership. As two CAB officials have written: "It is truly a new step for two governments to agree to permit third-country matching and price leadership privileges in "their" travel markets without even requiring reciprocity as a condition of qualification." (27).

The revolutionary new concept is easily overlooked in those cases where it applies. First exemplified in the US-Belgium agreement of 1978, the model double disapproval clause provided:

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(26) See next Chapter.

(27) Richard Klem and Douglas Leister, "The Struggle for a Competitive Market Structure in International Aviation: The Benelux Protocols take United States Policies a Step Forward"; 11 Law and Policy in International Business (1979), 557 at 581.

"Neither Party shall take unilateral action to prevent the inauguration or continuation of a price charged or proposed to be charged by:

(a) an airline of either Party or by an airline of a third country for international air transportation between the territories of the Parties, or

(b) an airline of one Party for international air transportation between the territory of the other Party and a third country,

including in both cases transportation on an interline or intra-line basis." (28).

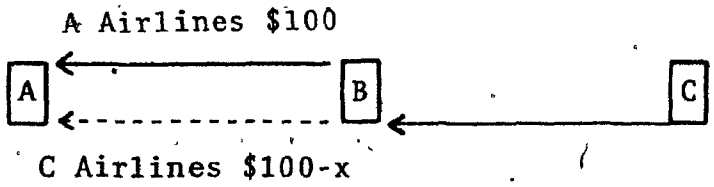
The model country-of-origin clause is similarly worded, but with the necessary retention of powers over third freedom prices (29).

That text is however no more than a model, as apparently no country-of-origin agreements have applied its terms.

Example: (i) Third Country Price Leadership

(Again, either fifth or sixth freedom options are available)

(a) Fifth Freedom



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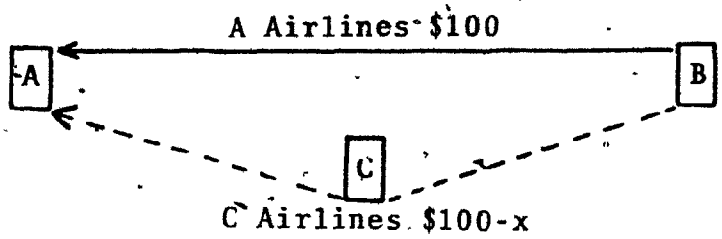
(28) 1980 Model Double Disapproval Clause, op. cit., 3. Emphasis added. Also, e.g., US-Thailand, Artcile 12(3).

(29) 1980 Model Country-of-Origin Clause, op. cit., paragraph 3.

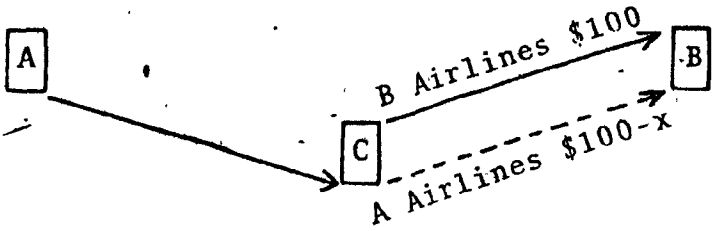
(b) Sixth Freedom



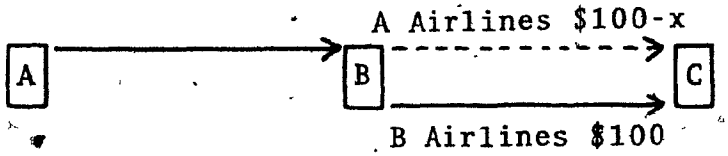
It should be stressed that the result in each of these cases is to place third country airlines on an identical footing to the parties' own airlines for pricing approval/disapproval purposes (30).

Example: (ii) Fifth Freedom Price Leadership

(a) Intermediate



(b) Beyond Gateway



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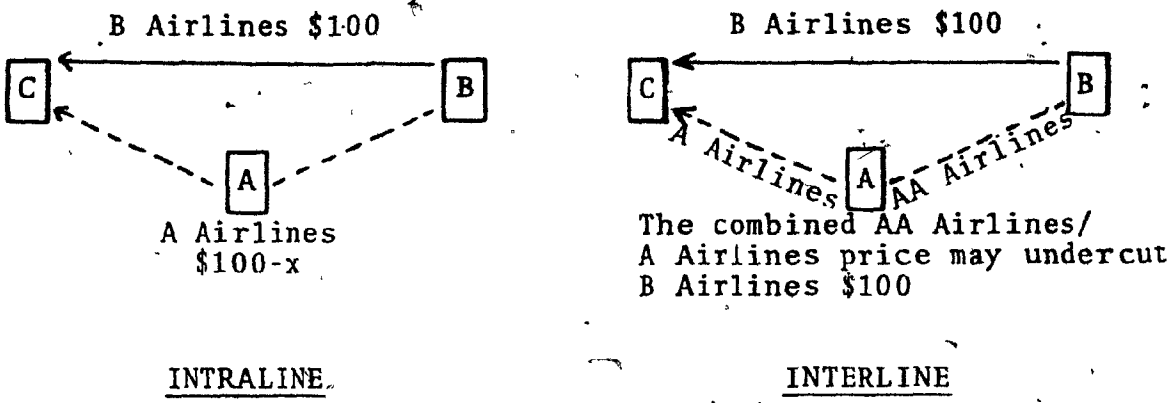
(30) Terms governing third country airline entry and capacity remain subject to their respective bilateral controls however. This permits more control over fifth freedom than sixth freedom price leadership for obvious reasons.

(c) Behind Gateway



INTRALINE INTERLINE

(This third type gives sixth freedom price leadership rights for the two parties' airlines, on either "interline or intra-line basis".)

As can be seen, conceptually these new provisions are not difficult to grasp. Difficulty arises over interpretation of the sometimes obscure wording - the more so because the terms are totally new to air transport. Given the enormous difference between the end product and traditional price competition, there is also perhaps a subconscious intellectual reluctance to appreciate just how radically different these new provisions are (31).

6.8 Other Pricing Provisions

The Price-related requirements contained in the liberal agreements are less dramatic, maintaining the consistent theme of minimal government involvement. The provisions which will be considered here are:

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(31) It should be noted that the potential is far greater than the realised change. So long as liberal agreements are virtually limited to the US and certain of its partners, this will remain true. Furthermore, in the US-Finland agreement (see below) there was an explicit withdrawal from third-country leadership in one instance where it would have added greatly to competition.

1. Filing
2. Consultation
3. Dispute Resolution.

6.8.1 Filing Requirements

Most conventional bilateral agreements state that each party "shall require" the filing of prices by the other party's designated airline (32). The liberal agreements depart from this in giving permissive powers.

Thus,

> "Each Party may require notification to or filing with its aeronautical authorities of prices proposed to be charged to or from its territory by airlines of the other Party." (33).

Filing periods are then provided as maxima, with special provision for short-notice filing:

> "Notification or filing by the airlines of both Parties may be required no more than 45 days before the proposed date of effectiveness for passenger services and 60 days for cargo services. In individual cases, notification or filing may be permitted on shorter notice than normally required." (34).

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(32) E.g., US-Switzerland, (1949), Annex VII, TIAS 1929. The Bermuda agreement, Annex 2, provided that "any new rate ... shall be filed". Under such agreements the CAB probably has an obligation to require filing, pursuant to S.1102 of the Federal Aviation Act.

(33) US-Thailand, Article 12 (2). (The filing provisions are common to most of the liberal agreements.)

(34) Ibid.

Finally, specific reference is made to charter prices; only wholesale prices may be required to be filed:

> "Neither Party shall require the notification or filing by airlines of the other Party (or by airlines of third countries) of prices charged by charterers to the public for traffic originating in the territory of that other Party." (35)

6.8.2 Consultations

The procedure created for consultations is elemental. In the event of disagreement the disputed price goes into effect under double disapproval agreements; under country-of-origin pricing, the disputed price will normally be resolved by the party for whose territory the affected traffic would be third freedom.

The first step is for one party to issue a "notice of dissatisfaction"; consultations must then be held within 30 days. The only other mandatory provision is in connection with the securing of "information necessary for reasoned resolution of the issue":

> "If either Party believes that any such price is inconsistent with the considerations set forth in paragraph 1 of this Article, it shall request consultations and notify the other Party of the reasons for its dissatisfaction as soon as possible. These consultations shall be held not later than 30 days after receipt of the request, and the Parties shall cooperate in securing information necessary for reasoned resolution of the issue. If the Parties reach agreement with respect to a price for which a notice of dissatisfaction has been given, each Party shall use its best efforts to put that agreement into effect. Without mutual agreement, that price shall go into or continue in effect." (36).

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(35) Ibid. The self-explanatory phrase in brackets does not appear in all agreements.

(36) Id., Article 12(3). Paragraph 1 contains the permissible grounds for disapproval. See Chapter 7.

The country-of-origin agreements are similar (except that a 30 day limit is imposed for the notice period); they merely omit the last sentence of this clause (37).

6.8.3 Dispute Resolution

The liberal scheme explicitly excludes arbitration in pricing disputes in any way which could lead to external judgements on price levels.

Thus, Article 14 of the US-Thailand agreement ("Settlement of disputes") provides:

> "Any dispute arising under this Agreement which is not resolved by a first round of formal consultations, except those which may arise under paragraph 3 of Article 12 (Pricing), may be referred by agreement of the Parties for decision to some person or body..." (38).

The pricing clause referred to brings in the consultation process where one party is dissatisfied with a price on the grounds that it offends one or more of the four disapproval criteria (39).

This reinforces the finality of failure to agree during price consultations. There is to be no appeal.

It may be that adjudication - given its time constraints and formality - is inadequate to deal with fast-moving market pricing. If so, arbitration would be ineffectual. This is, arguably, not sufficient reason for prohibiting it. An improved, expedited form of arbitration could help to overcome this criterion.

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(37) US-Netherlands, Article 6 (c); US-Germany, Article 6 (d).

(38) US-Thailand, Article 14 (1). Emphasis added.

(39) Thus referring, in turn, to Article 12 (1). See next Chapter.

Pricing disputes have not however been "litigated" frequently under traditional (double approval) bilateral agreements. While most contain provision for reference to some external authority, the Bermuda model only contemplates reference to ICAO "for an advisory report" at the option of either party (40).

Ironically, Bermuda II in 1977, had ambitiously constructed a detailed new dispute avoidance scheme - in recognition of the fact that so much intergovernmental disagreement arose in this area (41). This concentrated on extensive consultation procedures, including the operation of a semi-permanent "Tariff Working Group", but, like the liberal agreements, arbitration was excluded on pricing issues (42).

The new, flexible system necessary for market pricing was thus, in retrospect, unlikely to reverse this reluctance to arbitrate - except for one key element: previously, disagreement meant veto. Now, under both double disapproval and country-of-origin agreements, disagreement became irrelevant; the new price remained (43). The cost of disagreement thus escalated many-fold; without some resort to "justice", this offers the likelihood of severe strains on the agreements' very existence.

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(40) Bermuda I, Annex II (g); reference was actually to the "Provisional" ICAO in 1946.

(41) Article 12 and Annex 3 established the framework. See for explanation, IATA's "Bermuda II: Summary and Analysis", op. cit., 15-22. Patrick Shovelton, "Bermuda 2 et al", op. cit., 291, described the "great pains" to which both sides went to overcome the "great difficulties of interpretation" of the Bermuda I rate article.

(42) Article 17 (1).

(43) Except, of course, for third freedom/origin traffic in country-of-origin agreements. The impact of this difference is to reverse the burden of proof, as the home country's decision prevails.

CHAPTER 7. THE CRITERIA FOR GOVERNMENT DISAPPROVAL OF PRICES

In this chapter detailed attention will be given to the specific criteria which must apply before governments may disapprove prices under liberal agreements. It is necessary to note however that certain general wording exists which also addresses disapproval, notably under country-of-origin regimes.

7.1 General Limits

General limits are accepted by both parties on their ability to disapprove tariffs of the other party's airlines. These are an often indistinguishable mix of normative and recommendatory wording; much clearly depends upon the mutual "spirit" of the two parties.

The general limitations appear firstly in the Preamble to the Protocol as a whole and secondly in the introductory wording of the pricing Article itself. The two should apparently be read in conjunction.

7.1.1 The "Objectives" of the Agreement

The US-Netherlands agreement offers a useful model for consideration.

After referring to the mutual desire for competition among airlines with "minimum governmental regulation", the Preamble continues:

> "Intending to make it possible for airlines to offer the traveling and shipping public low-fare competitive

services and increased opportunities for charter air services in the North Atlantic..." (1).

(This was still a transition stage for the US in its charter/scheduled policy. The German agreement later in 1978 also contained this wording but, presumably at Germany's insistence, was preceded by cautionary guidelines on the mutual role of charter and scheduled services.)

The Pricing clause does not add greatly to the Preamble, substituting "desire" for the previous "intending"; of necessity it limits the scope of the Article's application to the actual scheduled routes agreed, "as well as" to charters:

"Both Contracting Parties desire to facilitate the expansion of international air transportation opportunities over the routes specified in the Schedule attached to the Agreement, as amended by Article 3 of the Protocol, as well as in charter transportation." (2).

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(1) US-Netherlands, Preamble. The US-Thailand agreement, slightly amended, reflects the later wording of the 1978 Policy. By this time the charter reference was no longer necessary: "Desiring to make it possible for airlines to offer the traveling and shipping public a variety of service options at the lowest prices that are not predatory or discriminatory and do not represent abuse of a dominant position, and wishing to encourage individual airlines to develop and implement innovative and competitive prices...".

(2) US-Netherlands, Article 6(a). Later agreements dispensed with this type of wording in the Pricing clause.

7.1.2 Achievement of the Objective

The parties then set out the ways in which they intend to go about putting these aims into practice. According to the US-Netherlands text, the objective of facilitating expanded opportunities is best met by creating an environment in which the airlines can offer a variety of service options at the lowest tariffs possible (i.e., not predatory, discriminatory or monopolistic). This can be at least partly achieved by specific "encouragement" to individual airlines.

> "This objective can best be achieved by making it possible for airlines to offer the traveling and shipping public a variety of service options at the lowest fares, rates and prices that are not predatory or discriminatory and do not tend to create a monopoly. In order to give weight to this objective, each Contracting Party shall encourage individual airlines to develop and implement competitive fares, rates and prices." (3).

The wording remains so broad that it is unlikely that any specific obligation is created yet; the second sentence, however, provides the transition from introductory wording to a normative form.

Important at this stage was the omission of any implication that the Parties would favour tariff coordination, either bilateral or multilateral (4). The governments, to the contrary, undertake to encourage "individual" airlines to develop "competitive" prices.

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(3) Ibid.

(4) cf the US-Germany agreement, which is unique among liberal agreements in containing specific reference to IATA. See Appendix 4.

The adjective "competitive" in the second sentence is sufficiently ambiguous that it could either refer back to (and be limited by) the "lowest fares, etc." in the previous sentence, or introduce a more general concept, i.e., that all tariffs should be subject to the individual and competitive requirement.

Wassenbergh, however, understood that the "lowest fares, rates and prices should be competitive", i.e., that "competitive" was in fact limited in this way. Thus, he believed that "the Parties ignore the possibility of setting the lowest fares, etc., through inter-airline agreement (e.g., through IATA Traffic Conferences)" (5), because these are to be set individually; on this reading there can be no overall intention to exclude tariff coordination. Furthermore, the US never formally challenged this, nor specifically objected to multilateral tariff negotiations involving routes and airlines covered by liberal agreements.

If the Wassenbergh interpretation is correct, the essence of this provision is therefore as follows: The Parties agree to encourage airlines individually to set the lowest competitive prices - but not necessarily the others.

This interpretation would not be inconsistent with the 1978 Policy, nor with the fundamental assumption of the US' liberal (and other) bilateral partners that scheduled prices would continue to be coordinated. Subsequently IATA, in the course of sweeping changes to its structure, made provision for airlines tointroduce "innovative" tariffs for their third and fourth freedom traffic - thus removing any potential inconsistency between liberal agreements and the concept of multilateral tariff coordination (6).

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(5) Wassenbergh, US-Netherlands Agreement, op. cit., 147.

(6) This is explicitly recognised in the US-ECAC negotiations (see below). For the innovative provisions see IATA "Provisions for the Conduct of the IATA Traffic Conferences",

(continued..)

This is the only direct interface in the liberal agreements between airline tariff development and the governmental role. As such it represents the only excursion in the present paper to marketplace pricing.

It is necessary however to stress the fact that prior airline consultation is not, of itself, grounds for disapproval of a price under liberal agreements - subject always to relevant national laws governing anti-trust and trade practices. This is clear both from the above interpretation and from actual practice under the agreements.

The final general constraint appears in the wording which introduces the specific criteria. Thus, each designated airline should set its prices "based primarily on commercial considerations in the marketplace" (7).

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(6) Continued.

paragraph VIII, 15. The provision is explained in Raymond R. Cope's Statement of 20 August 1979 in the CAB's Show Cause Order Legislative Proceeding, Docket 32851, Exhibit IATA-300, at 16-18. For a general description of the amendments see ICAO FRP/4-WP/8, "Developments Concerning IATA Traffic Conference Machinery since FRP/3".

Wassenbergh later explained ""It would seem that the revised IATA Traffic Conference procedures are fully compatible with the objectives of a double-disproval regime for pricing as participation in the conferences is voluntary and the revised provisions leave room for innovative additional pricing by individual airlines."; "Tariff Policy and Regulatory Policy in International Air Transportation", ITA Bulletin No. 35, 15 October 1979, 787 at 794.

Taking this argument one step further, there is then no necessary exclusion of charter pricing within IATA. If it is accepted that the scheduled price system is adequately competitive when operating in this way, there is no good reason why charter prices should be excluded. At present, however, IATA's Articles of Association do not admit charter-only airlines and charter prices are not negotiated in Traffic Conferences (despite the fact that on many routes IATA airlines maintain significant charter operations).

(7) US-Netherlands, Article 6(a).

From 1979 onwards, the word "primarily" was dropped, implying total reliance in the later agreements (8).

This, then, provides the framework within which the specific criteria must be viewed.

7.2 Specific Limits

Governments may only intervene to prevent prices in order to prevent:

(i) Predation,
(ii) Discrimination,
(iii) Monopoly effects,
and (iv) Subsidy (9).

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(8) It is a nebulous requirement - for example an airline may consider retention of market share to be one such consideration. For those agreements which exist as an extension of an earlier A.S.A., some qualification is possible. For example, Article 11 of the original US-Netherlands agreement of 1957 - to which the 1978 text is a Protocol, provides that: (scheduled) tariffs "shall... on the routes provided for in this agreement be reasonable, due regard being paid to all relevant factors, such as cost of operation, reasonabl profit and the rates charged by any other carriers, as well as the characteristics of each service". Thus tariffs must not only be "primarily commercially based", they must also be "reasonable".

(9) Subject to reservations expressed below concerning country-of-origin agreements. At first sight it may seem anomalous that in the general part of the Pricing Article reference is made only to three of these elements in "achievement of the objective" of competition, i.e., predation, discrimination and monopolism. This could be explained by the fact that the earlier reference is addressed to airlines' market behaviour. Subsidy is external to the market and each Party necessarily must retain the ability to "protect" airlines - presumably its own - from subsidised (non-market) pricing by other governments.

Under double disapproval agreements, mutual agreement of the two parties must be reached before any proposed or existing price can be rejected. Hence the complaining party must convince the other party that a breach of the agreement has occurred before there can be disapproval. In country-of-origin agreements, the burden of proof is de facto reversed, at least for national origin traffic; where the country-of-origin is satisfied that a third freedom price offends the criteria, unless the other party can persuade it otherwise the price will be rejected. Fourth freedom traffic is in effect subject to the same principles as double disapproval.

The provisions are expressed in the following items:

Country-of-origin:

"... governmental intervention should be limited to prevention of predatory or discriminatory practices, protection of consumers from the abuse of monopoly power, and protection of airlines from prices that are artificially low because of direct or indirect governmental subsidy or support." (10).

Double disapproval:

"Intervention by the Parties shall be limited to:

(a) prevention of predatory or discriminatory prices or practices;

(b) protection of consumers from prices that are unduly high or restrictive because of the abuse of a dominant position; and

(c) protection of airlines from prices that are artificially low because of direct or indirect governmental subsidy or support." (11).

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(10) US-Netherlands, Article 6(a); US-Germany, Article 6(a).

(11) US-Thailand, Article 12(1). In sub-paragraph (b) the words "dominant position" replaced "monopoly power" which appeared in some earlier double disapproval agreements. See below.

There is visibly little difference between the first (Netherlands) agreement and the later ones (e.g., Thailand) (12). Perhaps worthy of note are the controlling verbs ("should be limited" in the country of origin agreements and "shall be limited" for double disapproval) and the substitution of the broader "dominant position" for "monopoly power".

The first of these changes probably reflects the difference between the two types of control in that the country-of-origin has the final say in case of a dispute over its third freedom traffic; a mandating verb would thus be incongruous. The use of "should" is probably the root of uncertainty of whether the words are "hortatory" or binding for the country-of-origin. The Dutch certainly regarded the wording as being only a recommendatory limit to their disapproval power.

On 21 April 1978, a mere three weeks after the Protocol was concluded, the first dispute occurred over the question of whether the paragraphs were recommendatory or obligatory. An "Explanatory" Memorandum was then agreed upon, explicitly "stipulating that Article 6(a) governs each Party's review of fares, rates and prices of the designated airlines of the other Party regardless of the country in which the traffic originates". Furthermore, the understanding provided that "Article 6(b) would apply to all filings" (13). It is not apparent whether similar agreement was reached in the case of other country-of-origin agreements.

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(12) The most recent, US-Barbados agreement is again almost identical. In sub-paragraph (a), however, the word "unreasonably" is added before "discriminatory", apparently reflecting more accurately the domestic US guidelines. (See below.) Given the context, the substitution of "prices or practices" for "practices" is probably unnecessary, as practices would appear to embrace prices as a generic term. The present text will focus on pricing predation.

(13) Wassenbergh, US-Netherlands agreement, op. cit., 150.

For double disapproval there can however be no confusion; neither party can unilaterally disapprove a price, so that the party which receives a complaint retains a veto.

The use of "dominant position" rather than "monopoly" has not been explained, but appears to be better designed to describe monopolistic situations where there are at least two carriers in the market - given that the "market" can be defined very broadly, to include, for example, parallel routes and intermediate and beyond sectors.

7.2.1 "The Prevention of Predatory ... Prices or Practices"

The concept of predatory pricing is a young one at law. It is closely linked with antitrust philosophy and legislation. Necessarily the US has been instrumental in its evolution in general economic theory and its insertion in liberal bilateral agreements (14).

A consideration of US legislative background and judicial pronouncements is thus essential. Given the absence of international experience with the concept, the subject is treated here in somewhat more detail than would otherwise be necessary.

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(14) In the course of a dispute over allegedly predatory fares between the US and Germany, the US CAB noted "... the statement by the German authorities during the recent negotiations that predation concepts play little role in German jurisprudence and that the pertinent bilateral language was suggested by the American side". CAB Order 82-1-85 at p. 5, footnote 17. See below.

As the US is the common element in the various bilaterals which include this wording, its national pronouncements are likely to be of central importance. Although not binding, they are influential; furthermore, in double disapproval agreements, the US view tends to be dispositive, insofar as a "veto" exists.

7.2.1.1 The Legislative Basis

As amended by the (domestic) Airline Deregulation Act of 1978, Section 101(35) of the Federal Aviation Act of 1958 defines "predatory" as: "any practice which would constitute violation of the antitrust laws as set forth in the first section of the Clayton Act (15 U.S.C. 12)".

(The International Air Transportation Competition Act of 1979 makes no change to this (15)).

The only relevant legislative history of Section 101 (35) shows a Congressional intent that "the (Civil Aeronautics) Board not utilize its power to use the rubric of predatory to find lower fares unlawful unless such fares are truly unlawful" (16).

According to the CAB, Congress implemented this intention "by defining predation in such a way as to require an affirmative showing that the complained of pricing behaviour had risen to the level of an actual violation of the antitrust laws" (17).

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(15) The IATCA's only reference to predation in a specifically international context appears in Section 2, which sets out the "Declaration of Policy" for the CAB. See Federal Aviation Act, S.102 (7).

(16) Report of the Senate Aviation Subcommittee of the Committee on Commerce, Science and Transportation to accompany S.2493, 95th Congress 2nd Session, February 6, 1978, at pp 107,8.

(17) CAB Order 80-12-59 at p. 3.

Furthermore, the Board maintains, the Act places the burden of showing pricing behaviour to be unlawful upon the complainant, "as in all other low fare cases" (18). This applies for domestic cases, at least. This burden is not however repeated in the bilateral texts.

One other indication is that the Board's early thinking on the subject may have been influenced by an internal discussion paper circulated in February 1978 (19). Entitled "Regulation of Predatory Behaviour", the paper suggested that "the destruction of competitors by itself does not imply predation" (20). This would occur only where, after competing carriers have been driven from the market, the survivor raises fares above previous competitive levels. The paper suggested that the purpose of intervention by the Board should be to prevent "harm to consumers, not competitors... consumers are worse off only if fares are permitted to rise above competitive levels" (20). Under this scenario even a monopoly operation could be "competitive" where it offered sufficiently low fares to deter other entrants. As will be seen these themes are repeated, with variations, in later thinking.

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(18) Ibid. Also, in Order 82-1-85, 19 January 1982, Lufthansa v Pan Am, the Board noted that Lufthansa "has failed to present an adequate basis for its claim that (the disputed) fares are predatory because they are below cost", at 7.

(19) CAB Press Release 78-11, 1 February 1978.

(20) Ibid.

7.2.1.2 The Cases (21)

7.2.1.2.1 Domestic

The main domestic US consideration of predatory pricing in air transport has been in two cases involving complaints by Air Florida against Eastern Air Lines' fares (22).

Only once has the Board made a finding of predation (23). It was prior to passage of the 1978 Deregulation Act, but the Board has not distinguished it on these grounds (24).

The first of the Air Florida cases, decided in March 1980, explored the concept of predation in some detail. The decision included formulation of a set of criteria necessary to establish at least a prima facie case of predation under US law. Applying these to the facts, the CAB dismissed Air Florida's complaint. The Air Florida criteria have been applied to a later, international, complaint (25) so that the case warrants careful examination.

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(21) Non-aviation examples of litigation over "predation" are of limited value in interpretation of the word's use in bilateral agreements. The present text will therefore focus on CAB interpretations insofar as they provide guidance to the positions taken by US aviation policymakers.

(22) Orders 80-3-194, 28 March 1980 and 81-1-101, 21 January 1981

(23) Order 77-7-17; 7 July 1977. See below.

(24) In Order 80-3-194 the earlier case was distinguished on the facto; p. 7 footnote 6. See also below.

(25) This was Lufthansa German Airlines v Pan American World Airways (Order 82-1-81 of 18 January 1981). Like the Air Florida Case, this was an enforcement complaint brought under S.411 of the Federal Aviation Act and issued under delegated authority by the Director of the Bureau of

(continued..)

Air Florida complained that Eastern had, inter alia, offered competing fares which were "uneconomically low, and thus, by implication, predatory" (26). The services in dispute were "tag-end" segments, i.e., they "would have been uneconomic for Eastern to operate for their own sake, but were run in order properly to position Eastern aircraft and personnel for purposes of maintenance and systematic scheduling" (27). As a result marginal costs were estimated on the basis that the flights would otherwise have positioned empty (28).

These accounted for $2.76 per passenger (29) - on various routes ranging up to 269 miles (Miami-Gainesville, where the actual fare offered was $22.22).

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(25) Continued.

Compliance and Consumer Protection. Hence it is primarily a "domestic" decision. Lufthansa simultaneously filed a tariff complaint under S.1002(j) of the Act on the same facts. In its finding on this complaint, the full Board (in Order 82-1-85 of 19 January 1982) did not refer to the domestic precedents, but made only minor changes in the test effectively applied. A S.1002(j) complaint involves interpretation of the bilateral terms; S.1102 of the Act requires that the Board's exercise of its powers be consistent with tis obligations under bilateral agreements.

(26) CAB Order 80-3-194, p. 1.

(27) Id., 2.

(28) Marginal costs are the additional costs directly associated with carrying one additional passenger. Stated another way, they represent the difference in cost to the airline of operating with a seat empty or filled.

(29) Eastern's figure, but effectively accepted in the decision. Costs were those for actual passenger service (food, beverages, baggage, handling, ticketing and reservations).

The Order set out its definition of predation as occurring "when a firm charges a price for a product that is below cost, with the expectation that by doing so it can drive its rivals out of the marketplace and subsequently raise its price to a monopoly level, recouping its previous losses and earning additional monopoly profits" (30).

Further elaboration is subsequently added

- that monopoly profits must reasonably be expected to endure for a "sustained period" (31).

- that the persistence in losses over a long period would tend to distinguish predation from "legitimate price experimentation" (31); and

- that "barriers to entry and exit in a market must be significant "to constitute rational predatory behaviour (32).

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(30) Order 80-3-194, 2. The same definition is used in Order 82-1-85, op. cit., 4.

(31) Id., 3.

(32) Ibid, cf. however the possibility of other strategic considerations. "A dominant firm might profit by eliminating one relatively small firm from a market or product line if that harsh example teaches its other competitors a lesson. In strategic terms, the dominant firm will seek to establish a credible threat to pursue the same policy either within this market or in other markets when entry or other undesired behaviour occurs." J. Brodley and A. Hay, "Predatory Pricing: Competing Economic Theories and the Evolution of Legal Standards", (1981) 66 Cornell L.R. No. 4, 738 at 742. This article offers an excellent and comprehensive account of the development of the law in the face of radical economic reappraisal of the concept of predation.

Before examining the Air Florida test, two further observations should be made.

First, the question of intent flickers among each of these conditions. Intent per se as a determinant of predation has not been satisfactorily dealt with by the Board, as will be seen below.

Secondly, although not expressly stated, it appears from the decision that dominance in the particular market is an important factor, e.g., in terms of actual capacity offered (33).

The Air Florida Test

1. Did the airline set its fares below marginal cost in any city-pair at any time?
2. If the answer to question 1 is yes, did the airline persist in losing money after the fares had been shown to be unprofitable?
3. Could the airline reasonably have hoped to attain a position of monopoly power in the markets concerned?
4. Did the airline accompany its fare reductions in the markets concerned with increased flight schedules in order to gain market share?

Each of these questions must be answered affirmatively to indicate predation; however, predation could still exist despite a negative answer to question 1, "where predatory intent was obvious". (34).

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(33) Order 80-3-194, 5-8. This was an important issue in the Lufthansa Case, below. As will be seen, it raises interesting questions in the specific area of liberal bilateral agreements.

(34) Id., 4. There is no elaboration in this or later cases of this vague but potentially important exception. As noted above, the present case was an enforcement complaint; the Air Florida test is in fact stated as a preliminary to any formal investigation.

7.2.1.2.1.1 Marginal Cost/Intent

The basic cost criterion applied by the test is that of short-run marginal cost. Prices above this level are presumed non-predatory (35). The presumption will only be rebutted where predatory intent is well established (36).

As short run marginal costs are frequently difficult to measure, average variable cost may be applied when necessary (37). The Board has, however, explicitly rejected the use of long-run marginal costs (38).

By admitting intent as a second-level consideration, the test moves away from one extreme economic theory towards what Brodley and Hoy describe as the "marginal cost-plus-other-factors-standard" (39). Unfortunately the Board has not taken the opportunity of discussing criteria for determining intent.

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(35) This implies that the Board and all relevant legislation accepts the validity of marginal pricing. "If this were not the case, discount fares would essentially be defined out of business, thereby spelling the end of competition in the airline industry." Order 80-12-59, 11 December 1980, American Airlines; p. 3, footnote 3.

(36) See also, e.g., Order 80-12-11, 4 December 1980, Swift Aire Lines Inc., v Gem Investors Inc., et al, p.2, footnote 2.

(37) This reflects the Areeda and Turner pricing rule, which is currently favoured in the US Courts. It strongly favours defendants. According to Brodley and Hoy, op. cit., 768, no plaintiff has yet prevailed under this rule, which has been described as "a defendant's paradise" (P. Williamson, "Predatory Pricing: A Strategic and Welfare Analysis (1977), Yale L.J. 284, at 305).

(38) Order 82-1-1-1 (the second Air Florida case), op. cit., p. 7, footnote 8. Arguably, this may have turned on the specific facts.

(39) Brodley and Hoy, op. cit., 769. The article lucidly explains the terms used here.

It is an anomaly, perhaps insoluble, that the only example of a CAB predation finding expressly rejected the relevance of intent (40), preferring instead to concentrate on "objective" facts and effects. Here the larger carrier, Hughes Airwest, was accused of "discriminatory sharpshooting" for proposing a fare reduction which was "clearly discriminatory and selective, in the classic geographic sense; it proposes this particular discount in only two markets in its entire system" (41).

As (a) one of these markets was critical to the survival of a smaller airline and (b) that airline would have been driven out of business by the fare and (c) Airwest would then have occupied a monopoly position, so the fare was "obviously predatory in its effect" (42).

The link between discriminatory and predatory pricing is an interesting one; the "sharpshooting" argument was used by Lufthansa in its complaints (43). Although Order 77-7-17 relied on "classic" principles, there is a general legislative prohibition against predatory pricing which derives from a proscription against price discrimination by a company serving several markets (44).

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(40) Order 77-7-17, op. cit., 3. "We are not interested in reaching conclusions about (the airline)'s conscious motives."

(41) Ibid.

(42) Ibid. In the Air Florida Case, the Airwest decision was distinguished on the grounds that, on the earlier occasion, the "low fare threatened the survival of a commuter whose existence may well have been critical to the preservation of competition in the markets involved". Even if Air Florida had been driven from the market by Eastern in 1980, the Board believed that "meaningful competition" would have continued. Order 80-3-194, p. 7, footnote 6.

(43) See below.

(44) Robinson-Patman Act, (1976) 15 U.S.C. 13 and 13a amending the Clayton Act. The later Act however is expressly limited to sale of commodities and transportation services are excluded; see, e.g., Gordon v New York Stock Exchange, 422 US 659 (1975).

7.2.1.2.1.2 Subsequent Persistence in Loss

As Eastern's fare was found to be above marginal costs the remaining question became academic. It was suggested nonetheless that if the fares "did at some point fall below marginal cost", then maintenance of or increase in previous capacity levels was necessary to show predation. Air Florida had suggested that the reduction evidenced economic loss of a predatory nature. This was not found "convincing, since the decrease in flights actually tends to show that predation did not occur" (45).

7.2.1.2.1.3 The Reasonable Expectation of Monopolisation

In Air Florida, it was concluded that no reasonable expectation of monopolisation existed on most routes. On one route however, a "virtual monopoly" had been achieved. This was, nevertheless, found not conclusive in itself. There had been no increase in fares "to a monopoly level... which would be expected if predation had occurred".

The decision attributed this to the ease of entry and exit in the market. Hence, "even a virtual monopoly on this route segment does not appear to have conferred sufficient market power on Eastern to make predation a viable strategy" (46).

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(45) Order 80-3-194, p. 5.

(46) Id. 6. This appears consistent with the philosophy mooted in the CAB internal discussion paper of February 1978 (see above).

7.2.1.2.1.4 Market Expansion

The final question to which a positive answer is required appears mainly objective. It relies on the assumption that a predator will accompany excessively low prices with capacity expansion. While this is not inevitably so, the decision notes that "an absolute decrease in flight offerings is normally inconsistent with predatory conduct, unless the firm is a monopolist that has already driven its rivals from the market and is now engaged in raising prices to monopoly levels" (47).

Nonetheless, capacity expansion is not conclusive per se. Eastern did increase capacity on one route but, on the facts, it was concluded that this did not indicate "the likelihood of predatory intent" (48) - i.e., again reverting to the subjectivity of perceived intent.

7.2.1.2.1.5 The High Standard of Proof under the Air Florida Test

Clearly, a finding of predatory pricing will not readily issue under this test. Air Florida, in its second action, argued "that the Bureau's standards for determining whether a complainant has shown that a competitor's fare reductions are predatory are so tough that the Bureau has created "an impermissible test of presumptive lawfulness, which the courts have made clear they strongly disfavor"." (49).

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(47) Id. 7. Note that where prices are below marginal cost, reducing capacity reduces losses. Conversely, where cost levels are similar, the competitor with greatest capacity suffers the greatest losses.

(48) Ibid.

(49) 81-1-101, op. cit., 2. The subsidiary quotation is taken from Air Florida's petition, p. 20.

While the Board rejected the argument, there must inevitably be concern that anti-trust principles will be undermined by too strict a test - particularly in a newly deregulated industry.

7.2.1.3 International Cases

The main international case which is covered by the terms of a liberal bilateral agreement is Lufthansa v Pan American (50). Like the Air Florida action, it was brought both as an enforcement proceeding and as a tariff complaint, the first considered by the Bureau of Compliance and Consumer Protection, the second by the Board. Only in the enforcement proceeding was the Air Florida test applied, but no difference otherwise appears in the result (51). The Board's decision on the tariff complaint makes no reference at all to any other domestic or international CAB decision.

The actions here concerned US-Germany fares offered by Pan Am:

(i) "two-for-one pass fares"; each revenue passenger travelling on Pan Am's domestic network between 4 September - 24 October 1981 was given the right to purchase two full-fare tickets for the price of one to Germany on Pan Am (and to several other non-European markets served by Pan Am);

(ii) special normal economy fares; these were at greatly reduced levels, permitting no interlining or stopovers.

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(50) 82-1-81 and 82-1-85, op. cit. A subsequent Lufthansa petition for reconsideration of both decisions was rejected in Order 82-4-96, 16 April 1982. See also the "Visit USA Fare/Export Inland Contract Rate Investigation", CAB Docket 40269.

(51) In Air Florida, the tariff complaint decision did not specifically apply the Bureau's test, but reference was made to it and the end result was the same. In Lufthansa no reference was made by the Board to the Bureau test, but it is clear that the two decisions are inseparable, subject to the observations below. See also footnote (25) above.

Lufthansa attacked both fare types using several separate arguments. Each, it was alleged, was inter alia predatory within the meaning of the 1978 Protocol; they should be suspended pursuant to S.1102 of the Act (52).

Under the US-Germany country-of-origin pricing arrangement, governmental intervention in pricing is "limited to prevention of predatory or discriminatory practices..."; prices per se are not to be "predatory or discriminatory" (53).

Article 6(c) of the Protocol provides for a notice of dissatisfaction to be given where one contracting party objects to a fare level, and consultations are to follow within 30 days. Failing agreement during the consultation, Article 6(d) precludes prevention of any fare originating in the other party's territory.

On this occasion, it appears that the required diplomatic notice was served (although Pan Am alleged the contrary (54); the issue was unfortunately not addressed in the Board's decision). Consultations were held on 10 November 1981, when the German delegation objected strongly to the fares, particulary the low economy fare. These came at a sensitive stage in the US-ECAC negotiations (55).

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(52) Section 1102 of the Federal Aviation Act requires the Board to act consistently with the terms of any international agreement of the US.

(53) US-Germany agreement, op. cit., Article 6 (a). The intervention clause must be assumed to include predatory prices under the description "practices"; in, e.g., the US-Thailand agreement, any ambiguity is cured by referring to "prices or practices" (Article 12(1)(a)).

(54) Pan Am's Answer to Lufthansa'a complaint, 30 October 1981, in Docket 40172; p. 2, footnote 1. Pan Am believed that, in the absence of notice, the fares were properly in effect and could not be dislodged.

(55) See below.

To some participants the Lufthansa complaint was regarded as a test case of the validity of the disapproval criteria at a time when a limited multilateral double disapproval pricing regime was being contemplated. In the event, no compromise was possible diplomatically.

Hence, although the Board clearly felt Lufthansa's complaint to be groundless, it decided to undertake a "limited investigation" of the fares in recognition of "the strong views expressed by the German authorities during recent consultations" (56).

The Bureau's treatment of the enforcement complaint was cursory, briefly applying the Air Florida test. It found that Lufthansa had failed to show the fares were below marginal cost or that a reasonable likelihood existed of Pan Am attaining a monopoly position owing to present competition and ease of entry. The complaints "therefore must fail on that basis alone" (57). There was no consideration of intent, perhaps because, on the facts, a monopolistic intent appeared remote.

Dealing with the tariff complaint, the Board was almost equally abrupt on the issue of predation. It applied the same two criteria, albeit in a different way, but with the same results.

As a preliminary - and to date the only - statement of criteria to be applied specifically in bilateral interpretation, it is an important text.

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(56) Order 82-1-85, op. cit., 4.

(57) Order 82-1-81, op. cit., 8.

7.2.1.3.1 Different Standards for Defining Predation

First, it impliedly allows that "predatory" can have a different meaning from that applied domestically; this is done by leaving open the bilateral meaning, merely stating the "US standards" in the same terms as the Air Florida definition (58).

Again leaving open the possibility of duality, the Board, after brief consideration of German and EEC predation standards, concluded however that "we need not and do not decide for purposes of this order the proper construction of the Protocol if German and American laws were to conflict on the meaning of predation" (59).

This relatively positive step is then at least partly negated by reference to "the statement by the German authorities during the recent negotiations that predation concepts play little role in German jurisprudence and that the pertinent bilateral language was suggested by the American side" (60).

The Board here seems to imply two propositions:

(i) in each liberal bilateral relationship a compromise definition may be developed, where the other party has its own interpretation of the concept;

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(58) Order 81-2-85, op. cit., 4.

(59) Id., 5. The German standard is quoted as "below cost pricing that is either conducted in an unbusinesslike manner with resultant general harmful effects on the economy or has the specific goal of excluding competition from offering their services thus depriving them of the opportunity to compete". Id., footnote 17.

Technically, the Board noted, this standard was not "strictly relevant to an investigation under the Federal Aviation Act ...", but it tended to support the CAB analysis. Ibid.

(60) Ibid.

(ii) where no such substantive interpretation exists in the bilateral partner's jurisprudence, then US domestic rules should apply - the more so as the US proposed the original text, based presumably on a domestic understanding of "predation".

7.2.1.3.2 The Cost Standard

A significant potential compromise on the costing basis appears in the decision. The Board does not commit itself to any new methodology, but, presumably as a result of the inter-governmental talks, a new criterion is applied - "total cash operating expense". This is defined as "equal to total carrier operating expenses less depreciation" (61). To arrive at an appropriate figure, the Board examined historic load factor data for Pan Am's service in the market; it then determined that the cash operating expense required a lower load factor. Hence a contribution to fixed costs was possible (62).

This would appear in a rather more palatable standard internationally, but it is not clear whether the Board has actually adopted this approach, or merely used it as a persuasive indicator in the circumstances. The concept was in fact introduced in the context of demonstrating that Pan Am's fares were not irrational but made a contribution to profit.

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(61) Ibid. While apparently not committing itself to this standard, the Board notes that it "offers one reasonable lower bounds proxy for marginal cost".

(62) This referred specifically to the special economy fare issue. In fact the application was less tidy than the principle. Load factor data was only available for a two-year period ending nearly 12 months prior to the analysis; furthermore, this was total load factor data rather than "economy class compartment" load factor to which the operating expense was applied.

A potential (and probable) setback to this type of analysis in the future may be the erosion of the CAB's reporting requirements under the combined effects of deregulation and "sunset".

As with so many areas of air transport, the domestic/international interface is such that application of different standards for each could lead to extreme difficulty.

7.2.1.3.3 The Likelihood of Market Dominance

Regardless of any other considerations, it was clear that the Board considered the absence of any such likelihood to be dispositive of the complaint.

On the basis of present market share alone, there was no prospect that Pan Am would drive Lufthansa from the marketplace "or otherwise achieve a monopoly postion" (63). In view of this, the Board could not contemplate the possibility of Pan Am's raising the fares to monopoly levels in the future to "recoup current losses" (64). The Bureau, in the enforcement proceeding, noted also in this context the relative freedom of entry in the market (65).

7.2.1.4 Conclusions and Comment

The diffuse indicators to date of what constitutes predatory pricing make predictions of future behaviour hazardous - the more so as the US is apparently the sole source presently of relevant pronouncements. The following paragraphs outline the clearer principles established and speculate on some aspects peculiar to liberal bilateral arrangements.

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(63) Ibid. Lufthansa's market share of the total scheduled market was 51%, Pan Am's 26%, with the balance occupied by other US carriers; 0.5% was accounted for by 3rd country carriers.

(64) Ibid.

(65) Order 81-1-101, op. cit., 8.

7.2.1.4.1 Conclusions

.1 In the absence of determinations by the US' bilateral partners, US interpretations of predation will tend to prevail.

.2 In view of the substantial domestic/international interface and the relatively advanced status of domestic interpretation of the concept, US domestic principles, particularly the Air Florida test, will be highly influential (66).

.3 The standards in both the Lufthansa and Air Florida tests are very high, making a predation finding extremely unlikely. The burden of proof is on the party alleging predation.

.4 The US concept of predation is rooted in the antitrust principles of the Sherman & Clayton Acts. There is thus a requirement for a finding that a carrier seeks total monopolisation of a particular market rather than, e.g., merely increased market share (67).

.5 In rebutting accusations of predation, great reliance is placed on the levels of existing market share, actual competition and entry/exit freedom. In liberal markets entry is assumed to be easy.

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(66) See also below for CAB's comments on applicability of domestic discrimination principles to international services. The provisions of "internal law" cannot, however, permit the US to justify a particular course of action inimical to the agreement. Article 27, Vienna Convention, op. cit.

(67) For the purposes of the Lufthansa Case, the Board seems to have regarded the particular market as being US-Germany, not merely the city pairs actually at issue.

.6 The role of intent in determining predation is far from settled.

.7 It is improbable that universally acceptable criteria can be established. This devolves from

(i) the US' reliance on marginal cost as a basis (despite the Lufthansa statements), flowing from the fear of excessive restriction of competition by intervention (68);

(ii) the preclusion of the possibility of arbitration in case of dispute over prices; this is common to each of the liberal agreements; if intergovernmental consultation fails, there is no further recourse.

.8 The CAB will continue to play a de facto role in development of bilateral predation principles so long as it receives tariff complaints from competitor airlines (69), despite the fact that it is not thereby interpreting any bilateral agreement. Tariff complaints, moreoever, can only be entertained after notification of dissatisfaction by the complaining airline's government to the US government (and, arguably, following consequent consultation) (70).

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(68) See Order 80-12-59, op. cit., 3 footnote 3.

(69) "The preferable means for challenging a fare on economic grounds is a tariff complaint" - rather than a third party enforcement action; Order 82-4-96, op. cit., 3 footnote 2.

(70) Order 81-8-86; Complaint by China Airlines and Korean Air Lines against Japan Airlines and Flying Tiger rates, 31 August 1981, p.2. This is in fact a logical result of the bilateral provisions.

Inevitably the foregoing reflect US positions alone and should thus be closely questioned. Examples of grey areas include the following.

7.2.1.4.2 Comments

.1 Entry. The freedom of entry and exit is a critical consideration in a potential monopolisation. Despite CAB assumptions, entry freedom in international albeit liberal, markets is not as great as in domestic US operations. Quite apart from economic factors, scheduled service entry is in most cases "free" only for US carriers, owing to the widespread use of single designation policy by non-US governments.

While this may be answered by observing that those governments are free to amend their policy, it would be wrong to ignore that this status generally existed at the time of conclusion of the agreement and was assumed likely to continue.

Furthermore, it must be assumed, despite the radically new direction of the liberal agreements, that every bilateral partner expected its flag carrier to remain in the market - otherwise the temptation of "routes for rates" would not have existed.

As a result, genuine complicating factors are introduced which may require special recognition in interpreting these provisions.

.2 Multiple designation vs predation. On a similar theme, it must be clear from the Lufthansa Case that a predation finding against a US carrier is virtually impossible when more than one US carrier is in the market (70a). This may be technically appropriate under US legislation, but it must be questionable whether other governments would knowingly accede to a pricing process exception which could only work, if at all, to the detriment of their single destination flag carrier.

(70a) I.e., Because no single US carrier is likely to gain even a majority market share.

Under even a modified balance of benefits scheme there may be grounds for treating each Party's aggregated flag force as a competitive unit for these purposes. There is ample precedent for a "collective predation" theory in the charter-protective scheduled pricing policy of the CAB over more than a decade. (This, it should be noted, was however not a product of bilateral balance of benefits philosophy but rather of US competitive and other beliefs.)

.3 Predation vs subsidy. Finally it must be questioned whether government subsidy - also prohibited under the agreements - raises a presumption of predation. The purpose of subsidy generally is to support below cost operations. Where this leads to market expansion, predatory/monopolistic objectives might be attributed.

Nonetheless, any direct link with predation would be extremely difficult to demonstrate, particulary if it is necessary to show direct subsidy on a particular route. On the other hand, there seems little value in a non-subsidy provision designed to prevent only the vastly subjective "artificially low" prices.

7.2.2 "The Prevention of ... (unreasonably) Discriminatory Prices or Practices"

Where predation is difficult to deduce for lack of general understanding of the concept, so discrimination suffers from a surfeit of usage. It has been described as "the act of charging different customers prices that differ by varying proportions from the costs of serving them" (71).

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(71) CAB Regulation PS-93, adopted 22 May 1980 as Amendment No. 70 to Part 399 - "Statements of General Policy". Page 1.

The term or its derivatives appears frequently in relevant US legislation but without definition; in liberal bilaterals it arises in differing contexts in "Fair Competition" and "Commercial Operations" provisions in addition to appearing in at least two paragraphs of the Pricing article. Additionally, a comprehensive CAB policy statement exists on discriminatory pricing (72).

The liberal agreements vary in permitting governmental intervention for discriminatory "prices" and "practices" (where it presumably includes prices generically); in some cases reference is to both "prices or practices". Normally, discriminatory practices per se will be dealt with under other provisions, notably "Fair Competition", or in tandem with the Pricing article (73). Nor are they exclusively prohibited in liberal agreements, being implied or expressed in most if not all bilaterals.

The present text will concentrate on pricing discrimination, insofar as it is possible to distinguish this from other discriminatory practices. Discussion will cover both general pricing discrimination principles and its relationship with cross-subsidy between routes and service types.

As with predation issues, the CAB has sought to apply to the US-Germany bilateral its general price discrimination principles in the Lufthansa v Pan Am Cases (74).

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(72) Id.

(73) See, e.g., TWA v FRG & Lufthansa (Order 81-2-68, 13 February 1981). Also concerning "tying arrangements", Foremost International Tours v Qantas (Order 78-10-129, 26 October 1978) and the Lufthansa v Pan Am Cases (op. cit.). The TWA Case was brought under the discriminatory practices provisions of the International Air Transportation Competition Act 1979.

(74) Op. cit.

Before considering the Lufthansa Case, a summary of the CAB's discrimination policy is essential (75).

7.2.2.1 CAB Discrimination Policy

While limited explicitly to domestic circumstances, the Board noted that the underlying premises were equally applicable "in many pertinent respects" internationally (76). In the Lufthansa Case, the Bureau effectively determined the policy fully applicable in a liberal market, at least for enforcement purposes (77).

Under the newly liberalised, deregulated system the Board established a higher threshold than previously for a finding of discrimination. Four criteria were now to be met before rejection as being "unreasonable discrimination" (78), i.e., forms of pricing recognised to be discriminatory but permissible.

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(75) PS-93, op. cit.

(76) Id., 9. It stated however that international discrimination principles would be addressed "in more detail shortly"; Ibid. This has not occurred.

(77) Order 82-1-81, op. cit., 5. "Given the similarity in competitive attributes between domestic markets and this market, we see no reason to impose a stricter discrimination standard in the latter." The attributes were (i) pricing freedom, (ii) open entry, (iii) multiple carrier designations, and (iv) actual multiple airline direct service, together with indirect operations.

(78) Defined to mean "unjust discrimination or unreasonable preference or prejudice"; PS-93, op. cit., 10.

The criteria for "unreasonable discrimination" are:

1. a reasonable probability exists that the price will result in significant long-run economic injury to passengers or shippers;

2. the price is actually discriminatory according to a "reasonable cost allocation or other rational basis";

3. the price does not provide transportation or other statutorily recognised benefits that justify the discrimination; and

4. the "actual and potential competitive forces" cannot reliably be expected to eliminate the undesirable effects of the discrimination within a reasonable period (79).

Each of the four must be found to be present.

Before the new rule, no formal definition had existed; the (ad hoc) case law placed the burden of economic justification upon a carrier shown to be proposing a discriminatory price. This appears to coincide broadly with existing non-US policy (80). So-called "status" fares (e.g., youth or family fares) which previously had been presumptively illegal are also now judged in the same way as other discrimination cases.

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(79) 14 CFR Part 399 paragraph 36, as amended by PS-93.

(80) The UK CAA's (1981) policy for example is "progressively to diminish discrimination and cross-subsidisation between routes and between fare types. Each fare should be related to long-run costs at a level which will yield sufficient revenue to cover the costs of efficient operations, including an adequate return on capital." Exceptions exist to permit matching competition or response "to a cyclical shortfall of demand"; "Civil Aviation Act 1980: Statement of Policies on Air Transport Licensing", CAA Official Record Series 2, No. 465, 28 April 1981, paragraph 19.

(continued..)

For the purposes of bilateral interpretation specifically, it should be recalled that governmental intervention may occur to prevent "discriminatory" practices/prices; the standard is thus not "unreasonably discriminatory" as defined by the CAB. It is of great interest, therefore, that the most recent liberal agreement, with Barbados (initialled in 1982), uses the words "unreasonably discriminatory" (81).

In the same way as the domestic/international interrelationship makes it difficult to maintain separate predation standards for each, so any distinction for discrimination would be difficult to support. This point was graphically illustrated by the facts in the Lufthansa Case.

7.2.2.2 Lufthansa'a Discrimihation Complaints

(On this issue also, Lufthansa initiated two proceedings, a third party enforcement action and a tariff complaint. Despite the Bureau's application of domestic standards, noted above, the Board did not even attempt to define discrimination in its response to the tariff complaint (82)).

Lufthansa alleged Pan Am's "two-for-one" fares (83) to be discriminatory on three main limbs:

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(80) Continued.

Australia's (1978) policy, as expressed by the Minister for Transport, is for "fare types which are ... systematically and efficiently based on costs", Australian Parliamentary Debates: House of Representatives, 11 October 1978, 1700.

(81) US-Barbados agreement, Article 12(1)(a).

(82) Order 82-1-81 and 82-1-85, op. cit.

(83) Described above in the "Predation" section.

(i) they discriminated against Pan Am's international passengers who had not flown domestically on Pan Am;

(ii) they discriminated against Pan Am's German-originating passengers, so that these passengers subsidised those originating in the US (84);

(iii) they represented "the kind of discriminatory sharpshooting" condemned by the Board in Order 77-7-17 "...in that they single out particular international markets for predatory attack..." (85).

This latter allegation, which is closely linked with predatory pricing issues discussed above, was applied also to the special low economy fares offered by Pan Am.

Hence, two allegations of cross-subsidy are raised:

1. between domestic and international, and

2. between different international markets.

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(84) The fares were available for one-way or round-trip, so that passengers who had originated in Germany could in principle benefit on the one-way fare back to Germany.

(85) Complaint of Lufthansa, Docket 40172, 22 October 1981. The 1977 Order referred to by Lufthansa is the Airwest Case discussed in the "Predation" section. Lufthansa did not raise a "status" discrimination argument; the "two-for-one" fares were available only between family members, but there was no "spouse" or similar limit.

Both the Board and the Bureau appeared to fall short of adequate treatment of the first type (86). The Board, considering the tariff complaint, merely failed to find the pass "unreasonable" (87); the Bureau resisted substance entirely, stating only that Lufthansa had failed to substantiate its allegation (88).

The second type was dealt with in more detail (89). The Board, observing the different North Atlantic bilateral regimes, was "not convinced" that Pan Am had engaged in "a selective and discriminatory price-cutting strategy". Thus, firstly, Pan Am was not found "guilty of discrimination among markets". Further, it believed, Pan Am's passengers on other European routes would not subsidise "below cost" special economy fare passengers.

This finding was based more on pragmatism and predation principles than on discrimination principles; the fares were "not below the pertinent costs". The Board then formulated a form of non-discriminatory-competitive-environment theory: if the fares were, in any case, below cost, the competitive situation in other transatlantic markets would preclude adequate compensatory gains (90).

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(86) As noted above, similar issues are under consideration; CAB Docket 40269.

(87) Order 82-1-85, 7.

(88) The Bureau offered a practical but legally irrelevant alternative for German-originating passengers who did not wish to subsidise Pan Am's US-originating traffic - they could use a competing airline. Order 82-1-81, 6 footnote 23.

(89) This may be explicable by the fact that special economy fares were also involved in this allegation. The Board had already noted the German government's concern being focussed more on these fares.

(90) Order 82-1-85, 6. As the Board observes, the whole issue is probably moot in any event as the fare fell within the SFFL zone of automatic approval, giving the Board no power to disapprove it.

Lufthansa's "discriminatory sharpshooting" argument, taken from the Airwest Case (91), was however attacked head-on by the Bureau, while making clear that it was addressing only the enforcement proceeding and not the tariff complaint. It believed that the claim of market-by-market discrimination was erroneously based "on the outdated notion that, to be lawful, fares in different markets must be related to one another on the basis of some common standard such as mileage" (92). "Market-by-market differential pricing was clearly anticipated as a consequence of fare flexibility and is therefore not, in and of itself, unlawful. Lufthansa must, at a minimum, show long-term economic injury to some category of consumers before we will initiate (an) enforcement proceeding in response to a discrimination complaint (93).

7.2.2.3 Discrimination between service types

There is a further type of tariff discrimination not raised by the Lufthansa proceeding, the classic example being cross-subsidy by economy passengers of discount fare paying passengers on the same service.

For many years, it was CAB policy to restrain increases in normal economy fares where it was believed that below (fully allocated) cost discount fares were being offered. The policy behind this policy was to limit scheduled service low fare competition with charters, or, alternatively, to preclude "predation" by scheduled airlines.

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(91) Order 77-1-17.

(92) Order 82-1-81, 6 (citing and supporting an extract from Pan Am's answer to the complaint).

(93) Ibid. This requirement being the first limb of the Board's domestic standard. See above.

This objective became redundant with the spread of low scheduled fares and erosion of charters. By January 1980, the CAB's senior staff economist was able to suggest forcefully that two-tiered pricing was generally not discriminatory, based on empirical evidence under deregulation (94). An extract from his paper helps provide a candid insight into the new direction of CAB discrimination thinking:

> "Since coach fares are not often set at twice the level of some discount fares, does it then necessarily follow that coach passengers are cross-subsidizing discount passengers? That is, are coach passengers paying more than the cost of service, as has frequently been alleged, so that airlines may carry discount traffic that does not cover its costs? Unless airline managements are grossly incompetent, we must surely reject the notion that discount traffic does not cover at least its marginal costs of carriage, including marginal capacity costs. If it did not, airlines could increase their profits simply by offering less capacity and refusing to carry discount traffic. Instead, airlines have waged an intense competitive struggle during the past two years to expand their carriage of discount traffic, so we must conclude that this traffic is covering at least its marginal costs. We also know, from the current financial data, that if all passengers were to travel at deep discount fares, airlines would fall far short of covering their total costs of operations. In sum, it is reasonable to believe that discount passnegers now pay fares that are no lower than marginal costs, but which are significantly lower than the average costs of providing air transportation services."

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(94) "Is the Current Airfare Structure Discriminatory?"; CAB internal memorandum, 4 January 1980, from Dr Robert Frank, Director, Office of Economic Analysis to the Board.

(95) Id., 2, 3.

Dr Frank's conclusion was that the airfare structure probably is not discriminatory in "most city-pair markets; while a uniform structure might emerge one day, nothing we know now enables us to deny that the most likely general outcome will be the survival of the two-tiered fare structure we now observe in most markets." (96).

Dr Frank may have underestimated the airlines' long-term need (real or only perceived) to expand market share in the newly-deregulated environment - a factor which would undermine the short-term rational economic behaviour approach. However, his paper marked a watershed in US discrimination policy. Its informal nature does not represent any adopted policy, but the Board has - as seen above - subsequently adopted Dr Frank's general philosophy in many respects.

7.2.2.4 Conclusions

The status of discrimination as a pervasive but ill-defined concept is clearly unsatisfactory. Again economic philosophy is well advanced in the US, although many governments have explored the area during the past decade, for example through the medium of restrictive trade practices legislation.

For the purposes of liberal bilateral agreements, as has been noted, arbitration is precluded concerning Pricing clauses; as the concept of discriminatory practices appears in several other contexts in the agreements, however there is a possibility of authoritative independent resolution, should either party win (97).

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(96) Id., 8.

(97) See, e.g., US-Barbados agreement, Article 14 & US-Thailand agreement, Article 14, for model arbitration provisions.

The issue is made more complex by the existence of US domestic legislation compelling the CAB to institute action against foreign governments and airlines which engage inter alia in "unjustifiable or unreasonable discriminatory, predatory or anti-competitive practices against a United States' air carrier" (98). In such cases the bilateral provisions offer only one part of a more complex confrontational exercise. Different objectives are involved and different standards applied.

In light of this certain conclusions may be drawn.

.1 For the CAB at least, the purpose of the discrimination intervention provisions is to protect consumers. It is, according to the Board's test, not sufficient to show a competitive disadvantage to one party's airline(s).

.2 As concluded for predation intervention, above, it is difficult for the US to apply different standards for domestic and international cases. The domestic position now seems well settled, so that the "high threshold" for intervention could influence international judgments, making mutually agreed prohibition very unlikely.

.3 The CAB's pricing discrimination guidelines appear to be more relaxed than its bilateral partners, although explicit modern statements are rare in air transport policies.

.4 Different standards apply for other forms of discrimination - e.g., under the bilateral "Fair Competition" articles on the US' IATCA. These forms are applied in order to protect airlines from suffering competitive disadvantage per se - thereby distorting the bilateral balance of benefits. Given that the same facts may give rise to dispute under both the "Pricing" and, e.g., "Fair Compeition" articles, it is difficult to reconcile the different objectives involved.

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(98) IATCA, S.23, amending S.2 of the International Air Transportation Fair Competitive Practices Act of 1974 (49 U.S.C. 1159b). See, e.g., the TWA v FRG Case, op. cit.

7.2.3 "Protection of Consumers from Prices that are Unduly High or Restrictive because of the Abuse of a Dominant Position" (99)

This ground for governmental intervention has appeared in various forms since its first expression in the US-Netherlands agreement as "protection of consumers from the abuse of monopoly power" (100).

A common denominator is the objective of "protection of consumers...". None of the Dutch, German or Israeli agreements refers to an "unduly high" criterion, but otherwise this appears now to be standard. Occasionally the words "or restrictive" are omitted and there is various exchange of the term "monopoly power" (1) for "dominant position".

Reasons for the variations are best known to the US negotiators; no clear pattern emerges. However, some principles can be derive (to which exceptions exist):

1. the purpose of intervention is to protect "consumers";

2. additionally, the offending prices must be

   (a) "unduly high"
   or (b) "(unduly) restrictive"
   and (c) attributable to an abuse of monopoly power/dominant position.

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(99) US-Thailand, Article 12, (1), (b).

(100) US-Netherlands, Article 6(a).

(1) US-Costa Rica, Article 12, (1), (b).

Ample room is thus left for subjective judgments. As no criteria exist at this stage, speculation on the value of the terms used in the second of the above principles is not productive. As will be seen below, even economically based "scientific" judgment on appropriate levels (e.g., relating costs to actual prices) is not easy; the addition of the adjective "unduly" merely complicates the exercise further.

7.2.3.1 The "Consumer"

The correct starting point is with "consumers". This is the only one of the four intervention provisions directly aimed at consumers, but suffers from the lack of any definition (2). As the focal element in the US' Negotiating Policy this is perhaps a strange oversight. While occasional reference is made to the interests of "travellers and shippers" in the Policy, this is not expressly described as a complete definition.

One possible method of defining the word is to subtract the airline industry from all those having an interest in air transport, the remainder being "consumers". This is not particularly helpful and is, in practice, not comprehensive. The dictionary definition contributes little:

> "One who uses up an article produced, thereby exhausting its exchangeable value : opposed to producer." (3).

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(2) This is an extremely rare, if not unique, provision in a bilateral trading agreement. It is interesting to speculate whether any enforceable right is vested in "consumers" under domestic (or international law) jurisdiction to oblige the respective regulatory authorities to intervene in appropriate cases.

(3) Oxford English Dictionary (Repr. 1970).

Travellers can readily be described as consumers of air transport services. "Shippers" also must be included, but it should be recalled that many shippers actually overshadow airlines in terms of commercial power. The idea of "protection" in such cases is misleading.

There are other categories of consumer - travel and shipping agents, acting for commercial purposes at least in a dual agency role; tour operators and charterers who purchase transportation in multiple units; and finally, paradoxically, airlines themselves. Through the interline system, airlines frequently make use of the services of others, both in the carriage of traffic and in their overall marketing of air transportation.

Add to this the relative value to the "consumer" of short-term interests (e.g., in low fares) and long-term interests (e.g., in the continuance of a multiplicity of airlines and an interlining network) and even the more straightforward part of this intervention heading becomes clouded.

7.2.3.2 "Unduly High (or Restrictive)" Prices

Like beauty - or ugliness - unduly high prices may be a matter of opinion. In the CAB's "Twelve Market" Case an attempt was made to adjudicate on the proper level of international fares(4). As apparently the only "scientific" approach internationally and, as it contains similar elements to those which would presumably be raised in a bilateral dispute, the outcome merits consideration.

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(4) The 1979 IATCA established a "Standard Foreign Fare Level" system, under which a benchmark fare for each US international city pair is adjusted regularly according to CAB cost calculations based on US carrier costs. The benchmark for most purposes was the actual economy level, applied on 1 October 1979. A zone ranging between -50% and +25% (according to route area) is established around the SFFL, within which any filed fare is automatically approved. To accommodate CAB concerns that a number of base level fares were too high, the Act provided for the Board to adjust a limited number, where they were shown to be "unjust or unreasonable". The Board selected 12 markets. See IATCA, Section 23; Order 80-2-140; CAB Law Judge decision, 2 July 1980, Dockets 37730 and 37744; Order 80-8-66.

The Board selected 12 international markets served by US carriers in which it believed inadequate competition - with various causes - had permitted excessively high prices. After developing four possible methods for determining whether the actual fare levels were too high, the CAB eventually retreated, embarrassed. The backdown was partly due to inadequate preparation and presentation, but the result strongly suggested two conclusions:

(a) It is extremely difficult for a regulatory body to determine "scientifically" that a price on any given route is too high (or, for that matter, too low). None of the four methods developed by CAB staff was adequate individually; neither could their use in parallel, i.e., for cross reference, create markedly greater plausibility. The admitted margin of error of itself was too great to provide a meaningful measurement.

(b) That "networking" is an essential part of an airline's marketing strategy. An airline, according to several of the submissions during the case, cannot isolate each individual route as a marketing entity. It must seek overall profitability, which entails treating its total network as a complementary system of routes - so that, e.g., some become "feeders" and others trunks. To attract traffic onto potentially profitable trunk routes it would be logical to underprice the feeders - a shortfall which is met by raising the trunk route levels above the "correct" levels.

The networking argument is controversial but as an argument against assessing fare levels on individual routes it was never formally accepted by the CAB, even though its Law Judge had been convinced (4); the Board did not, however, reject the argument.

Additional competition would inhibit the practice - if it exists - but there is little likelihood that any bilaterally agreed method of measuring "correct" or "reasonable", lower levels could ever be established.

The interpretation of "restrictive", when used, must be similarly uncertain; it is apparently an offshoot of discrimination but is so vague as to be virtually meaningless in the present context.

7.2.3.3 Abuse of "Monopoly Power"/"Dominant Position"

In addition to the finding of "unduly high", etc., abuse must be shown of actual market power. Consistently with the predation principles described above, it is apparent that monopolisation is not outlawed per se; there must be an "abuse" of such power (as noted earlier, the substitution of "dominant position" is to take account of influence situations where actual monopoly does not exist).

Otherwise there is little of substance to derive from this phrase. While existence of a monopoly is, seemingly, readily detected, a dominant position already becomes subjective. Nonetheless, given the state of the international marketplace, it is most improbable that such a position could develop - the more so where the CAB supports almost a presumptive threat of entry in liberal markets - a monopoly thus not being a monopoly (5). Certainly, from the text, the monopoly position must actually be abused.

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(5) See the Air Florida Case, above.

7.2.3.4 Comments and Conclusions

Although superficially more substantive than the other grounds for governmental intervention, monopolism is equally difficult to isolate in practice.

Two final observations concerning monopolism should be made here. First, the later agreements tend to overlook the possibility that monopoly can lead to unduly low fares - for example as proposed in the Airwest Case above. This would not necessarily be subject to attack under the predation head, which is in any case designed to protect airline competition rather than consumers directly.

The point is far from merely academic. As a result of excessively low fares, consumers could well be deprived of service benefits such as frequency and variety of service and interline options, etc.

Secondly, given that the parties to each agreement seek some form of benefit, in addition to supporting consumers, could monopoly consist of a "flag", rather than single airline, monopoly? For example, where one party has two designated carriers operating on a route and the other none, could the first party (rather than airline) have a monopoly? Clearly this is inconsistent with US domestic competitive theory, but the point may derive relevance from the international context. In view of the balance of power, it perhaps is more likely that a party would wish to assert that prices are unduly low as a result, thereby keeping its own flag carriers from the market. The later agreements would appear unable however to accommodate the low fare argument.

7.2.4 "Protection of Airlines from ... Governmental Subsidy or Support" (6)

This cause for government intervention specifically cites support from a government as justification, thereby excluding cross-subsidy of, e.g., an airline subsidiary of a conglomerate from other activities or cross-subsidy of routes by an airline.

Once again, an inherent difficulty exists in interpreting this phrase. The impact of subsidy by an airline's government is much wider than enabling the airline to offer a particular fare. Furthermore, there are few governments which overtly and specifically subsidise their national airline.

These facts therefore create at least two problems in application: firstly, action against a particular price offered - by rejecting it - is often an inadequate response to a practice which generally has a long term effect (7); secondly, the assessment of what constitutes "indirect" subsidy or support is nearly impossible, unless some a priori agreement on principles exists.

Nonetheless, this is and always will be a serious concern of privately-owned airlines competing with government-owned flag carriers. It is a concern which increases in a quasi-free international market where it is government policy to maintain an airline presence, whether for political or general economic reasons.

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(6) The US-Philippine agreement is unique in omitting this ground for intervention. See below, Chapter 8.

(7) For example, a fully government-owned airline could suffer extreme overall losses for some time (just as many privately-owned airlines can): if after say 3 years, the government stepped in and directly subsidised the airline to help it continue operating, (a) the competitive damage would already have occurred and, (b) future prices might not necessarily be "subsidised".

It is almost certainly included at the express wish of US airlines. Foreign government subsidy and support were key targets of dissatisfaction as airline losses mounted in 1981 (8). As such, it may be more a token gesture than real evidence of intent to act.

The impact of subsidy, if it does occur, will normally be such that the overall purpose of the bilateral agreement is undermined. Merely to address particular prices applied in a market at a certain time would be futile.

7.3 Conclusion

Some of the most successful and durable clauses in international air transport agreements are intentionally ambiguous. They must, however, have a valid meaning. They cannot be totally without effect. It remains to be seen whether the wording of these four grounds for disapproval will succeed and endure.

In their application it appears that they will offer only a cautionary, "political" influence (9). They are intended, after all, to limit the grounds for governmental intervention rather than to facilitate it. As such, there are grounds for the belief that their aggregate purpose is to quantify the proposition that governmental intervention will occur only in "exceptional circumstances" (10).

This interpretation is undoubtedly controversial. To date however no evidence has arisen to suggest any more acceptable.

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(8) Together with "discriminatory" practices, foreign government flag carrier subsidies were the targets of attack by US airlines in Senate Hearings.

(9) For example, even the renowned practice of "dumping" is not outlawed - apparently because it would soften and confuse the predation principles.

(10) As in the quasi-country-of-origin pricing agreement between the UK and Australia; Press Release by Australian Minister for Transport, Mr Ralph Hunt, 13 May 1981.

CHAPTER 8. EVOLUTION OF THE AGREEMENTS

The scope of the present subject makes it impossible to do justice to the important differences appearing in the various agreements referred to generically in this paper as "liberal". They are in fact all different in smaller or greater ways. Unlike the quasi-multilateralism produced in the late 1940s and 1950s following the Bermuda I model, the new agreements did not develop in a vacuum.

They therefore had to force their way to the sun through a dense and healthy network of agreements. Consequently their evolution was rapid. While many of the classic terms have remained virtually intact throughout, significant changes have taken place where the casual eye might notice only a small omission or addition (1). Therefore, it is essential to pay at least brief attention to the agreements themselves.

They may be categorised in various ways, but, to illustrate their evolution past and probable, four groups will be described here:

(1) The 1977 agreements;

(2) The first liberal agreements;

(3) Full double disapproval; and, finally,

(4) The "restrictive" liberal agreements.

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(1) For example, the sometime omission of "equal" from "fair and equal opportunity to complete"; or the impact of limitations on third country airline price leadership.

8.1 The 1977 Pre-Liberal Agreements: "Innovative" Pricing and Country-of-Origin Charters

Today, these agreements are of little more than historical interest. They epitomised the first anxious steps away from the Bermuda II agreement, but preceded dramatic conceptual change.

In each case "innovative low rates" were to be encouraged, at "the lowest possible level....which can be economically justified" (2). These words applied only to scheduled, "designated" airlines, as the transition to charter equality was yet to appear. In addition, however, each also included a country-of-origin charter agreement, usually in the form of a Memorandum of Understanding attached to the main agreement.

The first to move was Singapore. Following negotiations from 19-23 September 1977, Singapore emerged with the US gateway rights it had been seeking for years (San Francisco). As seen in Chapter 3, these were critical days for US policy change. The Singapore agreement was a siren of things to come - but the US' main objectives were on the North Atlantic for the time being.

Similar texts were negotiated with Senegal and Liberia in October 1977, with Nigeria in November; the European breakthrough was made when the US-Belgium Bermuda-type agreement was first amended on 16 November. (A country-of-origin charterworthiness agreement had already been concluded in June 1977.) The combined effect of (a) the grant to the Belgians of a new US gateway (Atlanta), (b) this emotive new wording and, (c) the general turmoil over North Atlantic pricing in late 1977, made further breaches of tradition inevitable (3). The US-Belgium Protocol was heralded as the new US model text to replace Bermuda II.

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(2) For example, US-Liberia agreement, Article VI (1).

(3) The charter MoU had however specified that "passenger charter air traffic should not be permitted to cause substantial impairment of scheduled air services", a vestige removed in the 1978 US-Belgium agreement.

Finally, in December, similar agreement was reached with Mexico; although a special relationship applied, being North American neighbours, the value of this breakthrough also carried weight.

The vital step was by then a little over two months away.

8.2 The First Liberal Agreements: From Country-of-Origin to Double Disapproval

8.2.1 US-Netherlands : March 1978 : Country-of-Origin : Protocol

On 11 March 1978, the US DoS announced that US and Netherlands delegations had agreed to recommend to their governments "the conclusion of an agreement which will significantly expand the opportunities for low fare competitive services, both scheduled and charter, between the two countries". The announcement described the provisions contained in the proposed agreement as "substantially different from those in effect in other bilateral air transport agreements".

Ambitiously, the statement continued, these provisions "will help avoid the kind of intergovernment disputes which have occurred in several situations and will allow, with a minimum of governmental intervention, the free play of normal market forces to the benefit of the consumer" (4).

The US had entered the talks seeking a "public ally" to support the new Policy and to offer a model for future agreements (5). The Netherlands were persuaded to sign a country-of-origin scheduled pricing agreement, together with a country-of-origin charter regime, in return for the grant of two new routes to the US.

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(4) US DoS Press Release, 11 March 1978.

(5) Wassenbergh, US-Netherlands Agreement, op. cit., 153; see also Klem and Leister, op. cit., 576, 577.

Apart from the strange new wording of the pricing article, the Protocol excluded any control on designation or capacity, introducing for the first time under Article 5 ("Fair Competition"), the requirement that the designated airlines of both Contracting Parties have a "fair opportunity to compete".

The Parties agreed to attempt to expand the Protocol into a full agreement at further consultations; this "could then serve as a model bilateral air agreement" (6). This was however not to be and similar sentiments in later Protocols have also failed to bear fruit.

The high hopes for the new agreement were however temporarily dimmed following a dispute over the correct interpretation of country-of-origin provisions. Whereas the Dutch maintained that the country-of-origin should have unfettered control over prices for services originating in the Netherlands, the US maintained that exercise of such power was subject to the general intervention restrictions of the pricing article. The dispute was however rapidly resolved (7).

In addition to the dramatic introduction of country-of-origin pricing rules to scheduled air services, the Dutch acceptance of country-of-origin charter provisions drove a deep wedge into the ECAC attempts to develop a multilateral standard for charter rules on the North Atlantic. As well as Belgium, Yugoslavia had already concluded this type of charter regime with the US and the addition of the substantial Dutch charter market probably spelled the end to the hopes of those who sought a regulated North Atlantic pricing system - the more so as, three days later, the CAB issued its Notice of Proposed Rulemaking on "Public Charters" (8).

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(6) DoS Press Release, op. cit.

(7) See Chapter 6.

(8) See Chapter 5.

8.2.2 US-Israel : August 1978 : Double Disapproval (Conditional) : Protocol

Although the US-Netherlands agreements included an understanding that consultations would be held in June to consider a "similar agreement" between the US and Netherlands Antilles (whose representatives attended the Dutch talks), the next liberal agreement negotiated by the US was with Israel.

This provided a further shock even to those already becoming familiar with the idea of country-of-origin pricing. This was the first "double disapproval" agreement negotiated by the US. Together with absence of controls on designation or capacity and a country-of-origin charter article, Israel received four additional gateways in the US, together with expanded beyond and intermediate authority. Israel had sought additional gateways for several years, in addition to New York, but so long as the US "did not effect a major change in its negotiating policy", its requests were "futile" (9).

The double disapproval pricing regime did not however become effective immediately, owing to uncertainties on the Israeli side as to the probable impact, feeling the need to have a breathing space in which to adjust to some of the new liberal provisions. Until 1 August 1979, unilateral rejection of new prices was permitted, following "timely consultations with the other Party", provided the disapproving party believed the proposed level to be "predatory, discriminatory or an abuse of monopoly position" (10).

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(9) Fodor & Bernstein, "The new protocol relating to the United States-Israel air transport agreement of 1950"; 13 The International Lawyer (1979), 356 at 358.

(10) US-Israel, Memorandum of Understanding.

This became the first illustration of "phase-in" provisions which appear in different forms in several later agreements.

More importantly, the new agreement contained explicit matching provisions for "airlines of third countries" in addition to the Parties' airlines. This was to be subject to reciprocity on the part of the third countries forservices of one Contracting Party's airline between the third country and the other Party (e.g., in return for Netherlands giving El Al matching rights Amsterdam-New York).

Moreover, the full force of the "mutual disapproval" pricing clause was to apply to third country airlines where "both Parties have concluded agreements with a third country which include provisions similar to those in (the mutual disapproval clause). "Only then were scheduled or charter prices" between the territories of the two Parties and via such third country...", to be governed by the mutual disapproval provisions (11).

Clearly, one third country envisaged as potentially having "similar" provisions was the Netherlands.

8.2.3 US-Korea : September 1978 : Double Disapproval : Memorandum of Understanding

The Korean MoU, negotiated in Washington between 18-22 September 1978, was the US' first excursion into a liberal bilateral outside the North Atlantic. The negotiations were convened at the request of the Korean Government, which had suggested its openness to pricing liberalisation in return for new rights for Korean Airlines. In the event, Korea was awarded the new gateway of New York as well as non-stop rights to Los Angeles (removing a previous mandatory stop-over requirement in Honolulu).

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(11) US-Israel, Article 6(a) (E) (1) and (2).

Despite its different form (the only liberal Memorandum of Understanding), its terms modelled very closely those of the Israeli agreement for pricing. As with that agreement, Korea was also given a year's grace within which to make the transition to full mutual disapproval; in the meantime unilateral disapproval was possible on the same terms as under the Israeli agreement (12).

Korea was however less willing than Israel to accept the full strength of new capacity and designation proposals of the US. Hence, Article 4, "Fair Competitive Practices", contains no requirement for fair opportunity to compete. Instead it concentrates on elimination of "all forms of discrimination or unfair competitive practices". The "multiple designation" Article (13) is also at least superficially more cautious than the Israeli agreement - although there was subsequently no limit on US designation levels.

While the understanding does not grant fifth freedom charter rights, "each party should consider applications by designated airlines of the other party to carry such traffic on the basis of comity and reciprocity" (14).

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(12) Perhaps for this reason, the Israeli and Korean agreements were apparently treated as aberrations from the "hard-line". Klem and Leister, op. cit., of the CAB, ignored both of these agreements in their analysis of liberal agreements.

(13) US-Korea, Article 5.

(14) Id., Article 2 (C).

The liberalisation of the Korean market was not in itself as important as the potential threat which it offered to Japan. Protracted US-Japan discussions had produced no progress, despite the CAB's institution of a Trans-Pacific Route Proceeding intended to increase designation and competition (15).

8.2.4 US-Papua New Guinea : October 1978 : Country-of-Origin; US-Fiji : May 1979 : Country-of-Origin

Still applying the principle that sixth freedom countries would be far more receptive to liberal bilateral agreements, the US turned its attention to the South Pacific. Difficulties had always existed with Australia, the largest market in the region, concerning designation, capacity and charters, most recently precipitated by the proposed entry of Continental Airlines to the route. When the Australian government indicated that it would agree to the entry of Continental in return for US approval of a Qantas low fare package, the moment seemed right.

In October 1978, agreement was reached with Papua New Guinea containing country-of-origin pricing and open designation and capacity clauses; country-of-origin charter rules were also to apply. In return for these liberalisations Papua New Guinea was granted rights to Honolulu and Guam. Under a similar agreement concluded in May 1979, Fiji received rights to Honolulu and one point to be selected from Portland, Seattle or Denver, together with expanded intermediate rights.

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(15) One beneficial spinoff of US liberalisation was the stimulus which it gave to the sale of US aircraft. As one of the major exports of the United States, this side of air transport has always been a necessary element in US international policy, whether or not always explicit or obvious. Shortly after the formal signing of the MoU on 22 March 1979, Boeing announced the sale to Korean Air Lines of 10 Boeing 747s (valued at $660 million), equipped with Pratt and Whitney engines (valued at a further $110 million). KAL also took options on 8 further Boeing 747s for delivery in 1983/84. Other liberal agreements, notably with "Pacific-rim" countries, had similar comparisons.

The subsequent US-Australia agreement (which could not be classified as liberal although it contained a different form of country-of-origin pricing) (16), was apparently not greatly influenced by any threat of diversion under these agreements; nonetheless, Continental was admitted to the route and the US approved the Qantas package.

8.2.5 US-Germany : November 1975 : Country of Origin : Protocol

Of all the agreements concluded by the US since 1977, the German Protocol is incomparable in importance. For a variety of reasons, it was Germany which informally requested renegotiation of its bilateral agreement, at about the time of conclusion of the US-Netherlands agreement.

Other than pressure placed on the German government by the rapidly spreading APEX and budget fares, Pan American in early 1978 began offering "Budget" service between West Berlin and New York via London. No approval was required from the German government for such services (17). Germany remained strongly opposed to US international deregulatory moves however (18).

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(16) See below.

(17) Pan American's operation was made possible by the unique situation of West Berlin, which remains under the jurisdiction of the Governments of the Western allies; additionally, the Bermuda II agreement had entrenched such rights for US carriers via London.

(18) For example, on 16 March 1978 Lufthansa's Chairman Herbert Culmann delivered a stinging attack on US policies to the Bonn American Businessmen's Club. This prompted CAB Chairman Kahn's observation that "Amsterdam and Brussels are not far from Frankfurt" (see above).

To seek to impose a pricing philosophy on a foreign government by means of the threat of diversion was not a welcome addition to the international relations of air transport. Neither did it augur well for an untroubled and harmonious interpretation of the subsequent agreement. Probably for this more than any other reason, the German agreement has given rise to a series of disagreements between the two governments.

To attribute conclusion of the US-German agreement entirely to this pressure would be wrong. Route rights were at stake. In fact, during the course of the negotiations, Germany took the approach that total open skies was preferable to all concerned to a form of semi-liberalisation. This position was taken in the full knowledge that the value of route rights which the US would be conceding in such a system would be far more "valuable" than the US would receive in return.

In the event, Germany agreed to a country-of-origin pricing regime, broadly similar to that contained in the US-Netherlands agreement and received phased-in rights to six additional US points, with virtually unlimited intermediate and beyond rights. US airlines were granted authority to operate between any point in the US and any point in Germany via any intermediate points to any beyond points. In each case the grants were "without directional limitation" (19).

This has been the only liberal agreement negotiated by the US where the bilateral partner was more or less at "arm's length" and where the US could be granted valuable route rights to more than one major gateway.

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(19) US-Germany, Article 3.

(20) This excludes, e.g., the US-Netherlands Antilles agreement where several different island destinations were involved.

The agreement was hailed as benefiting "passengers, shippers, scheduled and non-scheduled airlines and the travel industry of both countries by encouraging low fares and additional competition service opportunities" (21).

It permitted matching by "any airline"; each party was also to consider "sympathetically" other prices proposed by "designated airlines" where these were intended to obtain "effective and/or non-discriminatory market access" (22).

Particularly mindful of the need to attempt to disseminate some form of pricing multilateralism and in view of the relative geographic situation of the Netherlands, the matching paragraph was also extended to prices filed "by designated airlines of one Contracting Party for its (sic.) operations between the territory of the other Contracting Party and any point in a third country" (23).

8.2.5.1 The "IATA Clause"

The German agreement is unique in its direct reference to continued use of IATA Conference machinery in drawing up tariff proposals for submission to the Parties for approval (24).

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(22) Joint Statement of the Parties, 1 November 1978; US DoS Press Release No. 410.

(22) US-Germany, Article 6(e).

(23) Ibid.

(24) Id., Article 6(b).

Although, strictly speaking, such a provision was unnecessary (as none of the liberal agreements contains actual preclusion against the use of IATA Conference machineries), the statement is of interest in that it places beyond doubt the possibility that tariffs under such a regime can be developed through the participation of designated airlines in "price coordination or price setting activities of the International Air Transport Association (IATA)"; the clause further envisages possible approval of any "IATA agreements setting prices in any market" (25).

8.2.5.2 Charters and Cargo

Inevitably, the agreement provided for unlimited designation and no restrictions on capacity. The Joint Statement of the Parties draws particular attention to the charter liberalisation under the new country-of-origin regime and refers specifically to application of public charter rules, by now effective for services from the United States: "This far reaching agreement provides that fares and rates as well as charter rules will be subject to the sole control of the country of traffic origin. This will permit the introduction of more innovative low fares and will allow the operation of charter air services under the liberal CAB public charter rules from any point in the US to the Federal Republic. Charter rules from Germany are also liberalised." (26).

Combination charters had not been accepted by Germany, but, in the Memorandum of Understanding, "the delegations agreed to further review permitting airlines, under country-of-origin rules, designated for charter service to procide combination passenger and cargo charter service on the same flight" (27).

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(25) Ibid.

(26) Joint Statement, op. cit.

(27) US-Germany, Memorandum of Understanding.

Article 11 of the Protocol provided for further consultations with the objective of concluding a full air transport agreement "within six months". As the Protocol contains certain derogations from fully liberal charter provisions, an accompanying Memorandum of Understanding provided that "in the interim period" the "basic protections" of the overall agreement should be extended to charter designated airlines and that "there should not be any discrimination against charter airlines" (27).

Air cargo was and is a major element in the US-Germany air transport policy and there had been extensive disagreements over the practice of trucking (under which for example freight originating in one country could be trucked to a "cheaper" or otherwise more attractive gateway in another country for onward air transportation); in the MoU, "the delegations reaffirm their adherence to current liberal policies of each government relating to service movements of international air cargo" (27).

8.2.5.3 Capacity

One final constraint existed on the application of capacity. This appears in Article 5(e) of the Protocol which provides that "Article 10 of the Agreement shall be deleted as far as the traffic between the territories of the two Contracting Parties is concerned". In other words the original Bermuda I capacity controls for fifth freedom traffic still apply. The MoU noted that consideration had been given to deletion of this provision and that the matter could be reviewed "within the next two years in order to determine whether continued retention of the Article for such traffic was necessary". If a dispute on the issue were to arise "in the interim", then a "liberal attitude" was to be taken (27).

The German agreement represented for the US by far the largest market to be liberalised even to the more limited extent of country of origin pricing (and certain other restrictions). In view of its genesis, it is understandable that disputes have occurred in how the interpretation of the letter and the spirit of the agreement. No further, liberalising, text has been negotiated and it seems extremely unlikely that Germany would contemplate any further move in this direction even if the US itself still saw advantage in such a step.

8.3 The Fully Liberal Agreements

The German agreement signalled the end of the beginning. During the next two years the core of the US' double disapproval agreements was negotiated. Nine agreements were concluded. In almost every case some compromise of US' objectives, small or large, was necessary; as time progressed, the pressure for at least temporary protection produced its own variations.

Impetus was undoubtedly provided by the Belgian agreement; typically, it was inspired by a mix of encouragement and threat (of diversion).

8.3.1 Belgium : November 1978 : Double Disapproval : Protocol

The Netherlands agreement had unsettled the Belgian authorities, who considered that the route grants to the Netherlands had been rather more generous than those received by Belgium in their October 1977 agreement. Requests by Belgium for further renegotiation of their bilateral agreement led to the initialling on 8 November 1978 of a new Protocol. In return for granting Sabena two new routes to the US, the US was by now in a mood to insist on an Israel-type double disapproval agreement rather than the more moderate forms of country-of-origin pricing contained in the Dutch and German agreements.

As described by Klem and Leister, the Belgian "protocol was developed primarily as a model based on the operating experience with the original Dutch protocol and the recognition of the operating limitations of the country-of-origin approach" (28). Here was a clear illustration of the bargaining value of route rights in the cause of liberalism.

A further gateway in the US was to be added when the Protocol was expanded into a "new air transport agreement governing all types of air services which would incorporate the provisions of this Protocol and would update provisions on other aspects of the Agreement" (29).

In addition to a double disapproval pricing arrangement and the explicit prohibition of limitations on designation or capacity, the Belgium agreement offered three further innovations. The first was "open skies" for cargo operations, with scheduled (and charter) services authorised between any points in the two countries (30). Secondly, a "double country-of-origin" charter regime was established, which appeared also in some charter double disapproval agreements (31). Thirdly, the price leadership provision was unprecedented in a fully liberal environment.

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(28) Op. cit., 579.

(29) US-Belgium, Article 15. The linking of the route to this proposed agreement - which never eventuated - was contained in a footnote to the route schedule in Article 3 of the agreement.

(30) Id., Article 3 (2). Beyond rights were however restricted for Belgian carriers.

(31) Id., Article 2.

Unlike the Israel agreement, there was here no interim or phase-in provision. It thus became the first North Atlantic market to be fully governed by double disapproval pricing provisions, and - until the US-Finland agreement in 1980 - the last formal liberalisation affecting the North Atlantic (although, as will be seen below, less formal liberalisations were achieved with the UK).

The combination of Belgium, the Netherlands and Germany was, however, believed sufficient to destabilise the market. Neither was the "open skies" cargo regime only intended as a gift to Belgium: "Within the north transatlantic air travel market, there are great cross-elasticities of demand and interacting effects. Any significant movements (such as new lower prices) in one market quickly affect the other markets. For example, air cargo is trucked throughout Europe for air shipment to and from the United States. Built into the competitive prices that shippers pay are the economic costs of trucking the cargo to various gateways and the rates that are charged by the airlines at those gateways. Any significant price movements - either increases or decreases - will divert cargo from one gateway to another. For this reason, in aviation language diversion is synonymous with competition... The same is true of passenger gateways." (32).

There could be no clearer expression than this of the diversionary role assigned to the liberal markets. The US' next objective was the Pacific where "prices... (were) even higher than they were on the North Atlantic" (33). Little success had been achieved with Latin American countries, but one success occurred in the Caribbean shortly before attention was to focus on the Pacific.

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(32) Klem and Leister, op. cit., 585.

(33) Ibid.

8.3.2 US-Jamaica : April 1979 : Double Disapproval : Protocol

Despite hopes at the US-Netherlands negotiations it had not yet been possible to conclude a liberal agreement with the Netherlands Antilles. A major obstacle was the concern of the Antillean authorities over the potential effects of multiple US carrier entry on its market. The same apparently did not apply to the Jamaican government.

Without any phase-in requirements, the agreement permitted for double disapproval of scheduled prices, unlimited designations and absence of capacity controls; for charters there was a double country-of-origin provision coupled with most favoured nation requirements (i.e., "if the Aeronautical Authorities of either Party promulgate charterworthiness rules which have different conditions for different destination countries, each Party shall apply the most liberal of such conditions as well to charter air services between the United States and Jamaica") (34).

Continuing the incremental, evolutionary development of the liberal bilaterals, the Jamaica agreement now went on to include "combination charters", i.e., mixed passenger/cargo charters. Such services would be permitted when "mutually agreed" or "fifteen months after the Protocol entered into force, whichever occurs first" (35). Thus at the latest, the provision came into effect at the latest on 4 July 1980, fifteen months after the formal signature of the Protocol on 4 April 1979.

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(34) US-Jamaica, Article 2 (5). The Belgium agreement had contained a similar but slightly more limited most-favoured nation clause. Under this, the only other charterworthiness rules to be taken into account were those "applicable to North Atlantic services" of either Party; US-Belgium agreement, Article 2 (4).

(35) Id., Article 4 (1).

The most eye catching provision in the Jamaica agreement was however the grant to Jamaica of no less than 10 scheduled gateways in the US, with beyond rights to any three points in Canada and, via San Juan to any one point in Europe. Accompanying this generous grant was the first use of "rover points"; each of the points may be changed every six months (36). This was the apogee of US route grant generosity.

8.3.2.1 Protection for Smaller Partners

Experimenting with built-in protections for smaller countries, Article 11, "Periodic Review", permitted each party "at any time after the expiration of three years from the entry into force of this Protocol and periodically thereafter at intervals of three years, to request a general review of the provisions of the Agreement and this Protocol and the manner in which they have operated in practice". There was then a requirement for consultation within 60 days for the purpose of review, but it is left unclear whether the dispute resolution provisions of the main agreement could be applied to this article. This clause did not become a model, perhaps because of its lack of "teeth".

Some protection also afforded in that price leadership by third country airlines is specifically made subject to reciprocity in the respective fifth freedom markets for the Parties' airlines (37). For once, US carriers' beyond and intermediate rights were not totally unfettered. These combined restraints did not however meet the concerns of many countries, and the US was shortly to make further concessions.

In June 1979, a refinement of the Belgian principles was possible, with two significant new agreements in the Pacific.

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(36) Id., Article 3. Particularly suited to the seasonal, "charter-type" market of the Caribbean, it is not apparent that advantage has been taken of this right.

(37) Id., Article 6 (4) (c).

8.3.3 US-Singapore : June 1979 : Double Disapproval : Agreement

With Belgium, Singapore had been one of the early bilateral partners to agree to liberalise pricing and charter operations. The September 1977 agreement had provided for stimulation of low fare pricing options, but nonetheless still included references to IATA pricing. Although it provided access for Singapore to the US West coast for the first time, when the Korean agreement was signed, Singapore believed itself relatively disadvantaged. Also, having lodged a $900 million order with Boeing in May 1978, Singapore Airlines (and its government) perhaps believed further US concessions to be justified.

The new agreement allowed Singapore to designate three additional points in the United States which, as under the Jamaica agreement, could be altered on 60 days notice to the US. Singapore also received unlimited intermediate rights (although service via Japan was postponed until 1 July 1981), and beyond the USA to any points in Canada (38).

In return, the now usual provisions relating to mutual disapproval, with third country price leadership, unlimited designation of scheduled and charter carriers, absence of capacity controls, double country-of-origin charter rules with most favoured nation provision, were also included.

The Singapore agreement was expected to increase pressure on the larger markets of the Philippines and Japan (39).

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(38) US-Singapore, Annex 1, Section

(39) In Order 80-9-152 of 25 September 1980, the CAB granted SIA temporary exemption authority to serve Tokyo three times weekly on round trips between Singapore-Los Angeles. The Parties also, rather unusually, took the opportunity to attack the Australian ICAP (op. cit.) which, at the time, was causing great concern to the Singapore and other south east Asian governments. This came in the accompanying MoU where it was stated that "both delegations reaffirm their governments' traditional opposition to anti-competitive aviation practices such as monopolies, duopolies

(continued..)

8.3.4 US-Thailand : June 1979 : Double Disapproval : Agreement

By this time the temptation of new routes and the threat that Singapore Airlines' expansion strategy would now be greatly boosted made Thailand a prime candidate for liberal partnership (40). Although Thailand already possessed Honolulu-Los Angeles rights, these had been unused since Air Siam's demise in 1975. Thai Airways' interest was in a route to Seattle, with rights via Tokyo.

The Thailand agreement is apparently the closest to the US model of any liberal bilaterals concluded in this era. It includes unlimited designation and capacity controls, mutual disapproval scheduled pricing, double country-of-origin charter rules with most favoured nation provisions and fifth freedom/third-country airline price leadership.

The agreement, one of the few full ASAs (rather than merely a Protocol), contains the minimum of derogation from competitive principles: even the provision for price leadership on routes between the US and Thailand for third country airlines is not made subject to reciprocity (41).

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(39) Continued.

and other comparable abuses". ("Duopoly" was the expression used by Singapore to describe the situation under which bilateral partners with strong mutual traffic flows agreed through-pricing mechanisms limiting the market access of fifth and sixth freedom airlines. This undermined Singapore Airlines' expansion plans for the valuable routes to Europe, but the limited access policy also inhibited SIA's expansion potential for the Pacific market.)

(40) In contemporary discussions with Malaysia, however, the US had been unable to achieve concessions.

(41) The US-Thailand agreement has been used to illustrate many of the standard texts elsewhere in this paper. See also Appendix 5.

8.3.5 US-Costa Rica : August 1979 : Double Disapproval : Agreement/MoU

In contrast to the publicity which was given to these new agreements in the Pacific, the Costa Rican agreement went almost unnoticed - despite its being the first Latin American country to cooperate in this way.

Part of the reason may have been the novel conditions attached. Until now, the US had preferred to avoid any liberalised agreement which fell short of its main ojbectives, rather than create a precedent for a more restrictive form. That the Costa Rican agreement varied from this principle was probably the result of two factors: (i) that the US had so far not succeeded in liberalisation of any Latin American agreement, and (ii) the growing awareness that many countries were unwilling to move straight from a traditional, tried and tested form of bilateral control directly to a totally unknown, uncontrolled regime.

8.3.5.1 More Protection for Smaller Partners

The US-Costa Rica agreement in fact consists of a full liberal bilateral ASA, as yet unsigned, together with a Memorandum of Understanding which introduces the full text of the US' model bilateral agreement subject to certain designation and pricing restrictions. Under the MoU, the full agreement became "provisionally effective" upon signing of the MoU. It only comes into "final, effective force" on exchange of diplomatic notes.

It was presumed that such exchange could take place before 1 November 1982, as the MoU provisions modifying the agreement expire on that date. Thus, it would appear that all agreement expires if no further action is taken. However, it is of course competent to the parties to draw up a further extension to the MoU.

The effect of the protective provisions is to withhold the application of full competition on the primary routes operated by the flag carrier of the smaller country, Costa Rica. The key route, Miami, was thus limited in the following way:

Single designation for non-stop service on the route, with up to two further airlines providing multi-stop service; capacity and frequency were however to be unrestricted.

Pricing was to be subject to country-of-origin rules for the duration of the MoU (42).

Charter services were to be subject to a 21-day advance purchase requirement with substitution and fill-up restrictions.

In the second most important market for Costa Rica, New Orleans, only a single designation restriction applied; otherwise, the general provisions of the agreement intervened, including double disapproval scheduled pricing and double country-of-origin charter rules.

Apart from these two routes, the full vigour of the agreement was to apply (43).

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(42) The Costa Rican MoU provides a rare explicit description of what process is followed when agreement is not reached following notice of dissatisfaction by either party under country-of-origin regime. It provides that "in case of a failure of the parties to reach agreement... either party may take unilateral action to prevent the inauguration or continuation of a price for which a notice of dissatisfaction has been given..."; paragraph II.B.3.

(43) In December 1979, the CAB awarded Costa Rican rights to 13 US airlines to serve that country from 18 US gateways. Pan American and Eastern Airlines received the "protected" Miami and New Orleans awards respectively, but the CAB's Bureau of International Aviation requested the law judge in the proceeding to explore other means of "imposing" competition on the US carriers in such single designation

(continued..)

8.3.6 Taiwan : November 1979 : Double Disapproval : Agreement

Again designed to increase pressure on Japan to liberalise price on the Pacific, the US was prepared to take a limited political risk in concluding a full fledged air transport agreement with Taiwan (44).

The political sensitivity of the agreement was reflected for example in the accompanying Agreement that permitted the Taiwanese flag carrier, China Air Lines, to operate to the United States under that name and secondly, in the absence of any reference to nationality, from the substantial ownership and control provisions.

Like Korea and Singapore (pre-1977), Taiwan had not previously possessed scheduled authority to US points. This was rectified in the agreement by the grant to the Taiwanese carrier of rights to Guam, Honolulu, Dallas, Los Angeles, New York, San Francisco and Seattle (45) via intermediate points and beyond to one point in Europe, plus one point in Central or South America. This was a relatively generous dispensation and China Air Lines again, like Singapore Airlines and Korean Air Lines had in their turn, initiated service by operating all-cargo flights. In the Taiwanese case this was to New York.

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(43) Continued.

markets. This could be, for example, by the threat of backup carrier designation so that, if the incumbent failed to offer sufficiently low fares, it would be "un-designated". Although the law judge in this proceeding strongly rejected the proposal, the CAB for a long time afterwards continued to press for this approach in restricted markets, thereby, arguably, undermining the original purpose of the provision.

(44) For formal purposes the agreement was actually between the "American Institute on Taiwan" and the "Coordination Council for North American Affairs".

(45) Only two of the points Dallas, New York, Seattle, were to be served before 1984.

The pricing regime established was full double disapproval, permitting third country airline price leadership on the designated routes and fifth freedom matching by the parties' airlines. Designation and capacity were to be uncontrolled; double country-of-origin charter rules with most favoured nation provision completed the basic package.

For the time being this completed liberalising moves in the Pacific. Coupled with the more limited moves with Fiji, Papua New Guinea and Australia (46), enough had been achieved to ensure routes would be servied with low fares forthe foreseeable future. Japan was unmoved but pressures were increasing on the Philippines.

The long-awaited agreement with the Netherlands Antilles was next added to the list.

8.3.7 Netherlands Antilles : January 1980 : Double Disapproval : Protocol/MoU

The Costa Rican agreement had suggested a compromise position for the Parties, following previous concerns of the Antillean authorities that US carrier designation could overwhelm the national flag carrier, ALM. Thus, an agreement (as Protocol to the existing ASA) was drawn up side by side with a MoU. This time, the arrangement was to be a tidier one. Unlike the Costa Rican plan, the Protocol and MoU came into effect simultaneously, with the MoU modifying the effect of the Protocol at the latest until 31 March 1983. Thus, in the absence of any further action by the Parties, the full terms of the Protocol automatically become applicable as of that date:

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(46) See below.

The Miami route was, in similar terms to the Costa Rican agreement, made the subject of limited designation and charter restrictions. Otherwise the agreement was a model liberal agreement, with double country-of-origin charter rules and MFN provision, no capacity or designation limits and "fair and equal opportunity to complete". All new continental US and beyond rights granted to the Antilles were made subject to "rover" provisions (47).

8.3.7.1 Increasing Doubts about the Value of "Protection"

The Antillean MoU contains an interesting postscript to the CAB's concerns about single designation, providing that "while this Memorandum is effective, either Party may designate an additional carrier to serve the Miami/Fort Lauderdale-Netherlands Antilles market if the previously designated airlines have been unable to maintain levels of service adequate to meet market demand. The newly designated airline may begin operations 30 days after the other Party has received the designation unless that Party requests consultation. Consultations will take place within 30 days of the date they are requested (48).

Despite indications by the US a month later at ICAO's second Air Transport Conference that liberal provisions of bilaterals would be applied carefully in "fragile" markets (49). The CAB had promptly initiated a Miami-Netherlands Antilles Service Case on 1 February which prescribed the course to be followed in limited designation markets:

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(47) US-Netherlands Antilles, Annex I, Section

(48) MoU, Section II.B.2.

(49) ICAO ATC/2, op. cit., Report.

> "As in other cases involving limited entry markets, we will take into account the offer or failure to offer lower prices in determining which carrier or carriers should be selected. We also want to consider regulatory approaches to create incentives for carrier performance resembling those that exist where our designation powers are not limited and to explore ways to replace a chosen carrier which does not perform effectively. We expect the parties and the judge to explore what those approaches might be. (Examples might include temporary certification, experimental certificates, price and service conditions, back-up awards and other possibilities.)" (50).

Inevitably, this engendered caution among those remaining countries which aspired to expansion into the US market. Clearly, the stakes were high; the risk to which the national flag carrier became exposed was extreme, but new US gateways had always been greatly valued.

8.3.8 Finland : February 1980 : Double Disapproval (Conditional) : Protocol

Among the staunchest opponents of US deregulatory moves internationally were the Scandinavian countries. Hence, neighbouring Finland offered some hope of creating a local pressure were a liberal bilateral to be concluded.

Agreement was reached, but at a price. Finland became the US' only liberal partner where US flag service neither existed nor was immediately expected. It was important therefore for the US to forge a firmly competitive agreement if it were to be sure that the less tangible "soft" rights (low fares) were gained in our relationship to the "hard" (route) rights granted to Finland. Finland was granted three new gateways (51).

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(50) CAB Order 80-2-6.

(51) US-Finland, Article 3. The routes were: (i) New York via any intermediate points, (ii) to Seattle and onto one point in California (Finnair elected to operate to Los Angeles), and (iii) via Anchorage beyond to Tokyo, but without fifth freedom traffic rights on that sector.

8.3.8.1 Protection of a More Durable Kind

By early 1980, the US badly needed both to maintain negotiating momentum and to penetrate the Nordic routes. Only this could explain the significant derogations from the model which it was prepared to make in the Finnish text. Although it contained a basic double disapproval pricing clause, unique wording restricted third country leadership and matching privileges. Strict reciprocity was to be required in each case.

Thus the double disapproval regime for Finland-US service would only apply to third country airlines where "relevant arrangements provide for reciprocity"; furthermore, only where "relevant arrangements with third countries reciprocally so provide" were the parties required to allow third country airlines even to match ("meet") prices offered by designated airlines (52). Consequently, in the absence of such reciprocal agreements, third country airlines were not even permitted necessarily to offer the same low fares which were provided by the designated airlines. On one of the most sensitive issues of liberal bilateralism, the US had taken a step backwards.

The matching clause does however permit airlines of one party to offer similar prices to those charged by any airline between the territory of the other party and a third country (i.e., fifth and sixth freedom) (53).

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(52) Id., Article 6 (4) (b) and Article 6 (5) (b).

(53) Id., Article 6 (4) (a); this was clearly relevant for the US-Scandinavia market.

Despite its inclusion as a "fully" liberal agreement, the US-Finland agreement is thus not a full member of this group. It is included nonetheless because entry by US carriers could readily overcome the competitive "deficiency" (54).

Double country-of-origin charter rules were however to apply (which included combination charters from the US) and a most favoured nation clause, applicable only to North Atlantic markets (55). Article 5 of the Protocol, "Fair Competition", is notable though for its requirement for "a fair opportunity for the designated airline"; by omission of the word "equal", charter operations are not placed on the same competitive level as scheduled prices, thereby in effect protecting them against scheduled service competition.

This may have been partial compensation for the more restrictive pricing scheme, particularly if "charters" are ever to be employed in the way envisaged in the "Levine Memorandum" (56).

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(54) Another difference, unique to the US-Finland agreement, occurs in the grounds for intervention by the parties. Thus Article 6 (2) provides the usual grounds, adding at the end "... or because of other similar reasons". This appears to qualify only the subsidy clause, but somewhat ambivalently. If limited in this way, there is no obvious reason for its addition.

(55) Id., Article 2 (4) and (5).

(56) See above.

8.3.9 Jordan : February 1980 : Double Disapproval : Agreement

The burgeoning traffic growth on North Atlantic-Middle East routes made the prospect of new US carrier entry very attractive. This was, however, one area where the State Department firmly governed the CAB's enthusiastic but unconventional brand of "diplomacy" (57).

The Jordan agreement was produced with a minimum of publicity; it followed very closely the model double disapproval pricing terms. No phase-in period or other derogation was included.

There was to be a full double disapproval regime with provision for price leadership by third country airlines and by the parties' airlines in fifth and sixth freedom markets. Double country-of-origin rules were to apply for charters, with provision for most favoured nation treatment.

It had been necessary to establish a bilateral link with Jordan and, in view of the contemporary proposals for operation of a consortium airline between the Middle East and the US, the agreement appeared to take on additional importance (58).

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(57) With Saudi Arabia, for example, the US was in 1981 still able to accept "rights of first refusal" for charter service; Order 81-6-123. This contrasts strongly with US' competitive policies; see, for example, Order 79-4-138, attacking the Irish government's application of the principle

(58) Some details of the proposed consortium of Arab airlines were provided in a speech by ALIA's President and Chairman, Ali Ghandour, at the second Lloyd's of London Conference in New York, 29/30 April 1980. It was proposed that five airlines would form the basis of the consortium, ALIA, Gulfair, Kuwait Airways, MEA and Saudia. It was to become "the region's international operator", arising out of a recognition by the parties concerned that they could not "singly mount an international operation with any measure of success or establish economically viable technical facilities".

Jordan was granted routes to New York, Houston, Chicago and Los Angeles (after 1 June 1983) via Amsterdam, Copenhagen and Vienna. An innovation in this area was a form of "rover" point provision for intermediate routes (59).

8.3.10 El Salvador : April 1982 : Double Disapproval : Agreement

(Postscript) After a lapse of nearly a year and a half, a further full double disapproval agreement was reportedly negotiated with a second Central American state, El Salvador. Together with neighbouring Costa Rica's competitive arrangement (if extended beyond 1982), this could prove important in the long run, but the present economic and political situation of the region makes any prediction suspect.

8.4 Variations on the Liberal Theme

Apart from the essentially liberal agreements described in the preceeding section, the US has, since 1978, also negotiated several amendments to existing bilateral agreements which contained some liberalising features but retained, e.g., designation and capacity restrictions sufficient to cause the US to continue to regard them as restrictive.

8.4.1 "Restrictive" Agreements with Liberalised Pricing

Hence, modifications were made to pricing procedures with the UK, Ireland, Scandinavia, Australia and New Zealand. Many of the features of these agreements have remained a matter of knowledge to the parties themselves. Others, like the Exchange of Notes with Australia establishing a country-of-origin pricing regime have been adequately publicised. In many ways these agreements provide excellent illustrations of the way US policies operate - not the least through the forms of compromise produced.

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(59) US-Jordan, Annex I, Section 1 (A).

8.4.2 Band Pricing

A second category of "less liberal" agreements comprises those between the US and China, the Philippines and Barbados, the most recent comprehensive agreement negotiated with the US. While not mutually exclusive of the "restrictive" category, these agreements are of particular interest in that they suggest possible directions for the future; as a significant compromise between full liberalism and a more traditional conservatism, they offer features which may in the long term prove to be acceptable to a much broader range of regulatory thinking.

The pricing innovation contained in these bilaterals is that they provide for the establishment of reference fares, around which "zones" or bands of pricing flexibility are permitted, made subject to, e.g., country-of-origin or double disapproval (60). Detailed examination of the basic principles in these agreements has been extended through North Atlantic Tripartite discussion involving the US, ECAC States and Canada.

This paper will not deal with each of the agreements, but several merit consideration where they or their concepts are likely to have an influence on future regulation.

8.4.1 "Restrictive" Agreements: Country-of-Origin Pricing, Express or De Facto and the Interface with Other Philosophies

8.4.1.1 Australia : December 1978/ May 1980 : Country-of-Origin (Conditional) : Exchange of Notes

As the key terminal traffic generator in the South Pacific, Australia was an early target for US competitive policies. The

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(60) See also Chapter 6.

present agreement is the result of a fascinating philosophical (and highly pragmatic (61)) tug-of-war between two policies with a broadly similar end point, but diametrically opposed means of achieving it.

The published agreement with Australia addresses only the issue of pricing, although a specific but temporary understanding was also reached in 1978 concerning actual frequency levels for Qantas, Pan Am and Continental on US-Australia routes.

The negotiation process was set in motion by a combination of factors. The US intention to designate an additional carrier was foremost, sparking a revival of the long-standing capacity/designation dispute (62).

Australia was also feeling pressure from the spread of US low fare policies. Partly as a result of these, it was undertaking an overall policy review; New Zealand's approval of Pan Am's "budget" fares from the US stimulated the process.

Initially the Australian intention in formally requesting consultations was to review "most of the major provisions of the agreement" in the light of the threatened entry of a second US carrier on the route (63).

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(61) See, e.g., the "mercantilism" theory expressed in Chapter 4.

(62) See, e.g., Pyman, op. cit. Weight was given to Australia's position by the highly unsuccessful entry (and departure) of American Airlines in the mid-1970s.

(63) Australian Acting Minister for Transport; "Financial Times", 24 January 1978.

In reality, this was no common bilateral negotiation; it was the meeting of two recently-formulated, radically new policies. Their one mutual objective was stimulation of low prices. From that point they diverged violently: Australia to greater governmental oversight, the US to reliance on market forces (64). One sought double approval pricing, the other, double disapproval; the compromise was a country-of-origin regime.

Measured in terms of philosophical concessions, the US gave most; in practical terms, it was an evenly fought duel. The end result was one in which low prices and a new entrant were introduced; against this, Australia's capacity/frequency controls were, if anything, entrenched (65).

The Exchange of Notes, formalised on 28 December 1979/10 January 1980, actually gives formal voice to a Memorandum of Consultations drawn up one year previously (December 1980) whose pricing provisions were for effectiveness 1 February 1979. The terms of the Notes are regarded as "amending and supplementing" the 1957 bilateral Agreement between the Parties, which is basically a Bermuda-type. It was this Agreement which had permitted Continental's entry.

Also at that time, the Parties had agreed that "both countries will continue their present liberal charter practices for travel between the United States and Australia" (66).

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(64) In practice the difference has not been as clear.

(65) As Taneja observed, however, "the United States gave very little and it received very little"; US International Aviation Policy", 66.

(66) Joint Statement of the US and Australian delegations; 14 December 1978. As observed in Chapter 2, "liberal" could be used to describe any agreement which permits entry to its territory of another nation's airline for commercial purposes. Hence it might be wrong to dispute this statement concerning charters. The bilateral charter regime is however considerably less liberal than many others;

(continued..)

In fact, however, Australia's insistence on capacity and frequency controls side-by-side with low prices left little room for uncontrolled charters. The combination of these various elements thus leads the US to continue to treat this as a restrictive market.

The "interim" pricing provisions contained in the Notes were subsequently given some permanency following further negotiations in May 1980; by this time the Australian authorities had accepted that the system was workable. This decision was undoubtedly helped by the conclusion of a US-New Zealand agreement the previous month (67).

These negotiations also reflected new agreed procedures to be followed in the settlement of capacity disputes. At this time, the US granted Australia rights to Los Angeles, in addition to the existing San Francisco gateway on the West Coast. This further grant appears partly to have been a US concession in return for indefinite extension of the interim agreement in May 1980.

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(66) Continued.

Australia's International Civil Aviation Policy (ICAP), announced on 11 October 1978, in fact stated that it would "preclude at this time, significant charter operations running parallel with scheduled services". (Statement of Australian Minister for Transport on Intl. Av. Policy, 11 October 1978; Proceedings of Australian House of Representatives, p. 1701).

(67) See below.

8.4.1.1.1 The "Country-of-Origin Arrangement" (68)

The Exchange of Notes does not however refer in any detail to these parts of the bargain but describes, briefly, the terms of the "country-of-origin arrangement". This is a rare use of the term in US bilaterals which, as seen, otherwise establish the situation by exclusion (69).

The agreement is in fact consistently distinguishable from other US bilaterals in this respect - i.e., in prescribing rather than excluding, courses of action.

All one way or round trip tariffs are made strictly subject to approval by the country-of-origin - without the usual US limits on intervention, so that unfettered discretion is given to the respective regulatory authorities.

If, however, one party seeks consultations to discuss "either country's tariff package" then "adverse action on any proposed tariff" cannot be taken until after the consultations (70).

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(68) US-Australia, paragraph (B).

(69) This reflected the Australian authorities' concern that, under Air Navigation Regulation 106A, they could not divest themselves of full control over, at least, Australian-origin traffic. Hence, the usual negative form of words could not be used.

(70) US-Australia, paragraph (B) (3).

The most substantial departure from other US provisions is in the disapproval and procedural powers retained by Australia (but not the US). First, it retained the power to "discuss" Australian-origin tariff proposals "individually" with each designated airline; secondly it "reserves the right" (a) to approve, (b) to vary, and (c) to reject any filed tariff and to "direct the adoption in its stead of such tariff as is considered fair and reasonable" (71). In this way, Australia is expressly able to establish price floors; the practical application of most country-of-origin arrangements may in fact result in this situation.

Furthermore, the Australian aeronautical authority apparently retains the right to apply these provisions to the Australian-designated airline(s) (only) for US-origin tariffs. The only restriction on Australia's freedom of action is that "discussion of tariffs with United States designated airlines shall be limited to traffic originating in Australia" (72).

The pricing provisions end with a requirement on the governments that they "liberally encourage the introduction of innovative price and quality of service offerings" (73).

The US has not concluded any further agreement along these lines. Few countries occupy the strong negotiating position of Australia, with an almost total reliance on end-to-end traffic flows, and relatively limited possibility of diversion to parallel markets. Probably only under these circumstances would the US be obliged to concede so many issues.

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(71) Id., paragraph (B) (2). This reflected the requirements of ANR 106A; footnote (69) above.

(72) Ibid. Note that this method does not raise anti-trust issues. The agreement does not even provide expressly for inter-carrier negotiations.

(73) Id., paragraph (B) (4).

If the Australian agreement is interesting as the anti-pole of US policy, so the US-New Zealand text shows the effects of being caught between the two.

8.4.1.2 New Zealand : April 1980 : Country-of-Origin : Memorandum of Consultations Effecting Amendments to Agreement (74)

The outcome of the US' 20-25 April 1980 negotiations with New Zealand attracted strong criticism from CAB Chairman Cohen for its derogations from full competitive objectives. While it did indeed fall far short of the US' model objectives, it greatly facilitated competition in the Pacific when taken in combination with the Australian agreement. It established country-of-origin scheduled pricing but with significant protection in many areas.

As a country able to benefit from sixth freedom traffic flows to and from its larger neighbour, New Zealand was a natural target for the US liberal approach. The offer of new gateways in the US was an attractive incentive for New Zealand, but the heavy reliance on international aviation for its international political and communications links created a cautiousness towards adopting radically different bilateral strategy (75).

Additionally, New Zealand was torn between the "two major philosophical responses" which had emerged from the "conflict generated by seeking lower fares at the time of steep increases in costs" in its two largest markets, Australia and the US. "The policies of the United States and Australia have a direct bearing upon New Zealand's economic and political interest and also upon the future of Air New Zealand which is faced with major decision on re-equipment." (76).

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(74) In this way the original texts were "deleted", i.e., cannot presumably be revived. The Memo. and original ASA thus appear inseparable.

(75) See the "External Civil Aviation Policy of New Zealand" released in December 1979.

(76) Id., paragraph 6.3.

In the event, New Zealand opted for a "flexible and pragmatic" bilateral policy (77) which allowed it to accept all forms of regulation with its more powerful partners. Its general approach would be to "seek liberal regimes with reasonable safeguards" governing its "attitude to the regulation of capacity pricing and charters" (78).

The US agreement achieved just that; New Zealand also received two new ("rover") points in the US, with any intermediate points "in the South Pacific, including American Samoa" (79) and beyond Canada, Europe and the UK. (Rights already existed to Honolulu and Los Angeles.) US carriers were given access to any realistic combination of routings to and through New Zealand (80).

Country-of-origin scheduled pricing was accompanied by provision for price matching by the designated airlines on their respective fifth freedom routes - mainly intended for US-Australia. Third party airlines were to receive the same rights, subject to reciprocity (which Australia accepted in the following month).

Like the Australian amendment, however, no limitations were placed on the "right to approve or disapprove" country-of-origin prices - other than the requirement for non-discriminatory treatment of the other Party's designated airline(s).

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(77) Id., paragraph 4.10.

(78) Id., paragraph 6.2.

(79) Id., Amended Route Schedule, paragraph 1; this appears to suggest a grant of cabotage rights between Samoa and the other US points.

(80) Id., paragraph 2.

8.4.1.2.1 Further Protection for New Zealand

The preambular section of the Pricing Article did however add a new form of words, aimed directly at protecting carriers' interests:

> "Prices on each specified route shall be established at the lowest levels consistent with the maintenance of high standards of safety, the provision of competitive services appropriate to public demand and a reasonable return on investment after meeting the full costs of efficient operations by the designated airlines on the route in question without subsidisation from other routes or from other sources." (81).

Designation controls were also included, although the Bermuda principles of the basic agreement were to continue; for the first five years from effectiveness of the new agreement, the US undertook not to designate more than two scheduled airlines at any one time - a significant withdrawal from the US' competitive principles (82).

Charters were to be governed by strict country-of-origin rules. As a guiding principle, there were to be "fair", but not necessarily equal, opportunities to compete between charter and scheduled services (83), a 30-day advance filing period was required for incoming charters and a "catch-all" protection was contained in strikingly novel provisions:

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(81) Id., Article 11 (2); of note also is the fact that no reference is made in the agreement to serving consumers' interests per se. The "competitive services" are to be "appropriate to public demand", a very different criteria.

(82) It is possible however that, by mid-1980, the US was already forming the view that extensive multiple US airline entry in international markets was unrealistic, either as a desirable option or as a matter of US carrier choice. This was never expressed, however.

(83) Id., Article 12 (7) (a).

> "Each Contracting Party shall take into consideration the interests of the other Party in both its designated airline and in the ability of its national or localized infrastructure to absorb high levels of tourism during particular seasonal periods. Should either Contracting Party find that its national or localized infrastructure is going to experience a critical over-saturation level, it may then request consultations which shall be held as soon as possible, and in no event later than 30 days. At such consultations the aggrieved Party shall present its findings. If agreement is reached during such consultations each Party shall use its best efforts to effect the agreed solution." (84).

A final novelty was that the agreement was given a minimum term of three years; at that time it could be terminated by either Party on only three months' notice (85).

8.4.1.3 US-UK : July 1977, March/April 1978, March 1980 : Conventional : Agreement - et seq.

The most vital compromise of all has been on US-UK routes. From helping precipitate the US Policy (as a result of Bermuda II), the UK quickly moved towards accommodation with the US on both route expansion (but on careful reciprocity principles) and on prices.

Thus, while the US-UK market remains governed by the Bermuda II (86) provisions, the UK began to take a more relaxed attitude to pricing from about the end of 1977 (87). Writing in September 1978, Mr Peter Reed of the CAA observed that: "For about a year, we have had a de facto competitive price regime, with the most interesting results." (88).

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(84) Id., Article 12 (7) (b).

(85) Id., Article 12 (9).

(86) The British were first to sign a "suspension" agreement with the US. See Chapter 3.

(87) Subject to a further route exchange and a vaguely worded understanding for flexiblity on charter regulation (see, e.g., Lowenfeld, "Aviation Law", 2nd Edition, Documents. Supplement, 665-692).

(88) Peter Reed, "Competition and Regulation in International Aviation: A European View", 22 July 1978. The paper was

(continued..)

This has been in the nature of an informal country-of-origin control (89). It was not, however, without controversy. In February 1978, the UK disapproved Braniff's proposed Dallas/Fort Worth - London fares, "insisting" that Braniff refile "at the high IATA levels between New York and London" (90). CAB Chairman Kahn believed this to be "the final confirmation of our worst fears about Bermuda II: that they (the UK) were intending to use that document as a basis for thorough cartelization" (91).

The CAB reacted on 28 February by threatening retaliation against British Caledonian by suspending its proposed fares on Houston-London (92). President Carter accepted the opportunity to use this bargaining weapon in negotiations held 6-17 March (93).

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(88) Continued.

presented to a Conference of the Travel Research Association, New York Chapter. Mr Reed's "interesting results" were that experience to date had shown no reductions in the "price inelastic segment of the market" (e.g., full economy fares) under the liberalised approach; added competition had led only to reductions at the "low" end. As recession bit deeply in 1981, however, so the competitive battle brought down these higher yield fares.

(89) There has been no express statement however.

(90) Alfred Kahn, "Should we be searching for an international order or, how chaotic is "chaos"?"; Speech to the International Aviation Club, Washington DC, 16 May 1978.

(91) Ibid.

(92) Docket 32183, 28 February 1978 and letter dated the same day from CAB Chairman Kahn to President Carter.

(93) Letter of 6 March from President Carter to CAB Chairman Alfred Kahn.

The outcome was a Memorandum of Consultations in which it was agreed to extend the applicability of low fares on a much wider range of routes: "Airlines operating scheduled services during summer 1978 and winter 1978/79 across the North Atlantic will be able to operate between the 14 US gateways and the UK gateways with low fares including standby, budget and advance purchase. This will provide advantages to travellers between other US gateways and British gateways, previously available only on the New York-London route, and will allow the airlines of both countries greater freedom to compete fairly in the air travel market. In addition the understanding promises that each country will consider favorably other innovative air fare proposals based on the mutual understanding that there is reciprocity in the treatment of each other's airlines. Both countries have agreed to review the position this autumn." (94).

This vague wording appears to indicate mostly a meeting of minds (derived both from mutual interest and from the awareness of each others' retaliatory abilities), rather than a permanent, binding contract on pricing. Thus, importantly for the British, there was no irrevocable withdrawal from the Bermuda II pricing (or other) principles.

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(94) Joint Press Statement, issued by the Office of the White House Press Secretary, Washington, 17 March 1978.

"In addition, the United States and the United Kingdom have initialed a bilateral charter agreement liberalising charter rules in the US-UK market. The agreement specifies the rules that will now apply on charter services between the two countries. The addition of this agreement settles most of the issues outstanding from the Bermuda 2 Agreement and will assure that travellers have a better choice of low fares on various types of air services."

CAB Chairman Kahn ascribed two reasons to the British acceptance of the compromise, apart from the immediate threat against British Caledonian:

"It is no secret that there were influential people in the Executive Branch and Congress ready at the time of the controversy over the Braniff fares to renounce the agreement. And it is no secret that it was their realization of this fact that helped persuade the British to let the original fares go into effect." (95).

"A second factor, I am convinced, was the far more liberal agreements we had more recently entered into with the Belgians and the Dutch... It was not mere coincidence, I assure you, that we concluded the agreement with the Dutch - with their acceptance of country-of-origin rules not just for charters but also for pricing of scheduled services - right in the middle of our negotiations with the British, and it was not mere coincidence either that almost immediately after announcement of that agreement, the British decided to accept the prices we had approved for scheduled service between our two countries as well." (96).

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(95) See, e.g., letter of 21 February 1978 from Senator Cannon (Chairman of the influential Senate Commerce, Science and Transportation Committee) to Secretary of State Cyrus Vance. This expressed "serious concern" at the Braniff dispute and concluded: "in light of the United Kingdom's unilateral and discriminatory actions with respect to low fares proposals; the lack of charter rights; and the general anti-competitive and restrictive nature of the Bermuda II agreement, I would urge that the United States give serious consideration to renouncing Bermuda II and beginning negotiations on an agreement which can better serve the air passengers of both countries."

(96) Alfred Kahn, Speech to International Aviation Club, 16 May 1978, op. cit.

The UK has therefore been a leader in low fare US-Europe destinations, despite the formal framework; this is due partly to the Laker operation and, subsequently, to the laissez faire policies of the Thatcher government - an interesting reflection on the way in which mutuality of intent can drasticaly alter a bilateral tariff clause (97).

8.4.2 "Band" Pricing (98)

It has been clearly seen that individual markets have developed their own variety of different forms reflecting special needs and concerns.

None of these, alone, offers the scope for general adoption. In "band" pricing, a more generally acceptable formula may have been discovered. Three agreements have been concluded by the US containing this scheme; they range from "restrictive" (99) to liberal. Whether or not the US-ECAC ad referendum agreement (100) is ratified, the fact that serious consideration on a multilateral scale was given to the concept suggests it has a broad appeal.

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(97) The Bermuda II tariff clause, despite overall US critism of the agreement, had contained substantially new wording, for example promoting the initiation of "innovative, cost-based tariffs" by "individual airlines" (Article 12 (2)). Among other new provisions, including the establishment of a "Tariff Working Group", the parties agreed to "keep one another formed of such guidance as they may give to their own airlines in advance of or during traffic conferences of the International Air Transport Association..." (Article 12 (9) (a) and (b)).

(98) See Chapter 6.

(99) I.e., according to the surrounding competitive environment created by the agreement. The agreements are with China, Philippines and Barbados, respectively.

(100) See below.

As a combination of different pricing schemes, band pricing does not preclude the use of any other variation in bilateral terms - whether in matching/leadership or capacity, designation and routing controls. In other words, rather than existing as an independent style, it can occur in any bilateral form.

8.4.2.1 China : September 1980 : Band Pricing : Agreement (1)

The China Agreement is not considered by the US as liberal. It is nonetheless undoubtedly more flexible on pricing that it would have been if concluded three years previously. It is important as the first of the price band agreements.

The basis for the Chinese system is double approval; this is then followed by a complex and highly detailed set of provisions permitting downward, short-notice filing for passenger fares.

The operative text reads:

> "...each Party shall permit any designated airline to file and institute promptly, using short-notice procedures, if necessary, a fare for scheduled passenger services between a point or points in the United States of America and a point or points in the People's Republic of China, provided that:
>
> (a) the fare is subject to terms and conditions as agreed in Annex IV to this Agreement, and such fare would not be less than 70 per cent of the lowest normal economy fare approved for sale by any designated airline for travel between the same point or points in the United States of America and the same point or points in the People's Republic of China..." (2).

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(1) The agreement was part of a highly publicised package, including textile trade, maritime transport and consular services.

(2) US-China, Article 13 (3) (a).

Thus, to be automatically acceptable, the prices must be made subject to a minimum number of restrictions, including, e.g., advance purchase requirements (3). The purpose of this provision - as can be seen from the nature of the restrictions - was to avoid diversion from economy fare levels. This concept was later adopted in the US-ECAC agreement (4).

In addition to this, a variety of "matching" options is provided. If "subject to similar terms and conditions as the matched fare", then

- where the matched fare is offered by another designated airline "in whole or in part" over the specified, or other routes, the same 30% downwards limit applies;

- where it is offered by a non-designated airline (e.g., of a third country) "in whole or in part" over the specified route, the 30% downwards limit applies;

- where offered "solely" by a non-designated airline over a non-specified (e.g., parallel) route, the matching flexibility is limited to 20% downwards (5).

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(3) Annex IV to the agreement provides:

"Discount fares within the zone of pricing flexibility described in paragraph (3) of Article 13 of this Agreement shall be subject to conditions of the type generally applicable to same or similar fares in other international air transportation markets. Such discount fares shall be subject to conditions in not less than four of the following categories:

. Round trip requirements
. Advance purchase requirements
. Minimum-Maximum length of stay requirements
. Stopover restrictions
. Stopover charges
. Transfer limitations
. Cancellation refund penalties
. Group size restrictions
. Return travel conditions
. Ground package requirements."

(4) See Below.

(5) Id., Article 13 (3) (b). Note the use of "match" rather

(continued..)

Furthermore, these provisions were also to be applied "mutatis mutandis, to fares of the designated airline(s) of the other Party for the provision of international air service between the territory of the first Party and a third country", i.e., for through traffic (6).

The same regime does not apply to cargo rates, where double approval procedures apply; except that there may be no discrimination against filings by designated airlines of the other party (7).

Other provisions of the Agreement are not innovative; for charters, country-of-origin rules apply, but flights remain subject to specific approval (8).

---

(5) Continued.
than "meet", presumably (i) restricting the offering of fares to exact models of the original, then (ii) extending the provision as described.

(6) Ibid.

(7) Id., Article 13 (4).

(8) Undoubtedly the value of an air transport agreement with China did not rest entirely in its commercial potential; as described by President Carter at the public signing ceremony, it represented "a new and vital force" for world peace and stability. In such cases, compromise of economic ideals is always possible.

8.4.2.2 Philippines : October 1980 : Band Pricing : Agreement/MoU

The US-Philippines agreement was a more liberal version of the China pricing formula. It followed a period of 20 years without a formal agreement between the two countries (9). It resolved a number of problematic issues for the parties; in addition, the Philippines received intermediate rights in Japan, two new US gateways with one point beyond and further phased-in rights.

Accompanying and preparing the agreement was a Memorandum of Understanding designed to allow for "an orderly transition" until the agreement became fully effective on 1 September 1982 (10).

The Philippines had not been receptive to US competitive policies; Philippine Airlines' Chairman Roman Cruz had been a vociferous opponent (11). Thus it was no surprise that the agreement fell short of full US model terms in important ways - to an extent which would never have been contemplated by the US 18 months earlier.

Taking a positive attitude, CAB Chairman Cohen maintained that the agreement "belies belief that we pressure our trading partners into signing liberal agreements, and, that small carriers cannot remain competitive with US carriers" (12).

---

(9) "Interim Arrangements" had applied since 10 August 1974.

(10) Both MoU and Agreement may be terminated during the course of the MoU on 180 days' notice; MoU, Section F (2). The combination follows the Netherlands Antilles agreement/MoU pattern, rather than the Costa Rican.

(11) See, e.g., Cruz, "American Aero-Imperialism", op. cit.

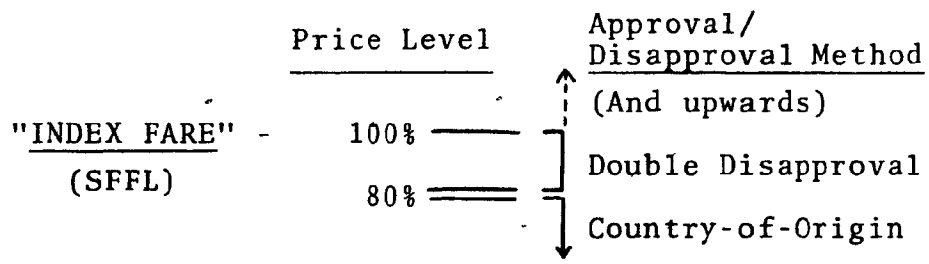
(12) Marvin Cohen, Speech to MIT/ITA Symposium, Boston, 16 October 1980.

Most important derogations from the full liberal model were the omission of charters from the agreement and imposition of specific limitations on scheduled carrier designation. The MoU imposed additional capacity and frequency constraints, with a more limited designation than the full agreement; capacity and frequency restrictions were replaced in the agreement by a standard liberal clause (13).

Pricing provisions of the agreement are unaffected by the MoU. They were to apply immediately. Most important was the "band" formula used, but several other important changes were made from the US model.

In fact two price bands were created. Based on an "index fare level" (14), a double disapproval regime applied for passenger fares down to 80% of the index fare (15); below this level, prices were made subject to a country-of-origin system (16).

i.e.:



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(13) US-Philippines, MoU, Sections A, B, C and agreement, Article 11.

(14) US-Philippines agreement, Article 12 (4) and (6) (a) At least for the present, the index fare level adopted the CAB's Standard Foreign Fare Level in effect on 1 October 1980, amended quarterly; Annex II.

(15) Ibid. Under Article 12 (7), there is a total prohibition against unilateral intervention on cargo prices.

(16) Id., Article 12 (4) and (6) (b). No maximum percentage is set.

The essence of the system is made clear in Article 6 (4). After setting out the notice and consultation requirements, when dissatisfaction is expressed over a price, the Article provides:

> "... If the Parties fail to reach agreement, the price shall go into effect unless a Party disapproves such price pursuant to its rights under paragraph 6 (b) of this Article."

Paragraph 6 then sets out (a) the prohibition against and (b) the prescription for unilateral intervention:

> "(6) With respect to unilateral action by a Party to prevent the inauguration or continuation of any passenger price proposed or charged by the airlines of either Party for international air transportation between the territories of the Parties:
>
> (a) Neither Party may take such action if the price is equal to or greater than 80 per cent of the appropriate index fare level as defined in Annex II;
>
> (b) Either Party may take such action provided that the price is less than 80 per cent of the appropriate index fare level, but only with respect to traffic for which the first point on the itinerary (as evidenced by the document authorizing transportation by air) is in its own territory."

"Meeting" provisions permitted the parties' carriers to meet each others' prices in third and fourth freedom markets as well as between the other party's territory and third countries (17);

---

(17) Id., Article 12 (5) (a) and (b). The text refers to meeting prices "proposed or charged in the marketplace"; this apparently implies acceptance that market fares can be other than those filed, but raised difficulties for government over sight of the "meeting" provisions.

third country airlines could meet prices offered in the parties' third and fourth freedom markets, but only subject to reciprocity (18).

Intervention under either price band is governed by wording which is unique in the liberal texts, in noticeable ways:

(i) by removing the subsidy provision;

(ii) by adding the possibility of "restrictive" prices under the "dominant position" criterion (19); and

(iii) by introducing the concept of "uneconomic" (20).

The criteria appear in the following terms:

"... Intervention by the Parties shall be limited to:

(a) protection of consumers from discriminatory prices or practices or prices that are unreasonably high or restrictive due to the abuse of a dominant position; and

(b) protection of airlines from predatory prices that are artificially low or uneconomic."

---

(18) Id., Article 12 (5) (c).

(19) Id., Article 12 (1) (a).

(20) Id., Article 12 (1) (b). In this Article "uneconomic" is used to qualify the words "predatory prices", whereas in the preamble it appears as an alternative to predatory.

For practical purposes, these criteria will be applied, if at all, in the context of country-of-origin disapproval; here, it will be recalled the burden of proof is de facto placed on the party whose flag carrier's price is the subject of a notice of dissatisfaction. Hence, these amendments could produce additional latitude for the parties, compared with, e.g., the Dutch and German country-of-origin agreements.

The next band agreement contained a much broader price range and made no provision for below-the-band country-of-origin pricing.

8.4.2.3 Barbados : April 1982 : Band Pricing : Agreement

The US-Barbados agreement (21) erred little from the US model agreement; it may even illustrate the US new preferred text. The competitive environment which it creates differs only from the earlier model in its price band formula and, like the US-Philippines agreement, in making third country airline "meeting" provisions subject to reciprocity (22). It does not limit capacity or designation, allows double country-of-origin charters and is basically double disapproval pricing.

Cargo prices may not be unilaterally disapproved, regardless of level; thus, again like the US-Philippines agreement, cargo prices are not affected by the price band formula (23). The same applies to "first class" and "premium" class passenger prices (24).

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(21) Still a referendum at the time of writing.

(22) US-Barbados, Article 12 (8). This extended the definition of "meet" to include:

"the right to establish on a timely basis, using such expedited procedures as may be necessary, an identical or similar price on a direct, interline or intra-line basis, notwithstanding differences in conditions, including but not limited to, those relating to routing, distance, roundtrip requirements, connections, type or conditions of service, aircraft configuration or type, or such price through a combination of prices."

(23) Id., Article 12 (6).

(24) Id., Article 12 (7).

The passenger fare band is described in Article 12 (5) and, in view of the foregoing exclusion, covers only economy and discount prices - although these are defined only by exclusion. It covers prices between 115% and 40% of the "base normal economy fare" (25).

i.e.:

	Price Level	Approval/ Disapproval Method
	115%	Double Disapproval
"INDEX FARE" (SFFL) -	100%	
	40%	

(As the first price band system to include charter prices, it is of at least historical interest that the US has accepted a "charter-price floor" for the first time. Below 40% of the Index Fare, even US-origin charter prices must be approved by Barbados (26).)

---

(25) Id., Article 12 (5) (A) (i). This is explained in the agreement itself (rather than the Annex) as:

> "... the lowest available fare for normal economy-class service filed for and permitted by the United States Civil Aeronautics Board to go into effect on or after October 1, 1979 for travel originating in the United States, for each U.S.-Barbados city-pair market, as adjusted for cost changes consistent with the Standard Foreign Fare Level computations published periodically by the United States Government."

cf. the US-Philippine agreement, where the initial reference point was at the date of the negotiations.

(26) Id., Article 12 (5) (A) (ii).

The agreement specifies the machinery as follows. If, following the observance of consultation procedures, agreement has not been reached, then,

> " (i) unless both Parties agree otherwise, a passenger price will continue in effect or enter into effect on the proposed date of effectiveness if it is at least 40 per cent but nor more than 115 per cent of the base normal economy fare in effect on the date the price is filed;
>
> (ii) either Party may take action to prevent inauguration or continuation of a passenger price if such price does not meet the conditions specified in paragraph (5) (A) (i)." (27).

This was the first full agreement between the US and Barbados, replacing a 1972 Understanding. No confrontation occurred between the two countries immediately before the negotiations, but as a tourist destination Barbados had an interest in expansion of service from the US. Barbados received rights to three US gateways under a limited "rover" grant with a further route to be granted if and when Barbados removed restrictions on US intermediate rights. The disparity between this and the much more generous grant to Jamaica may reflect the concerns of US airlines at the US' generosity in trading "hard" rights for "soft" (28).

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(27) Id., Article 12 (5) (A).

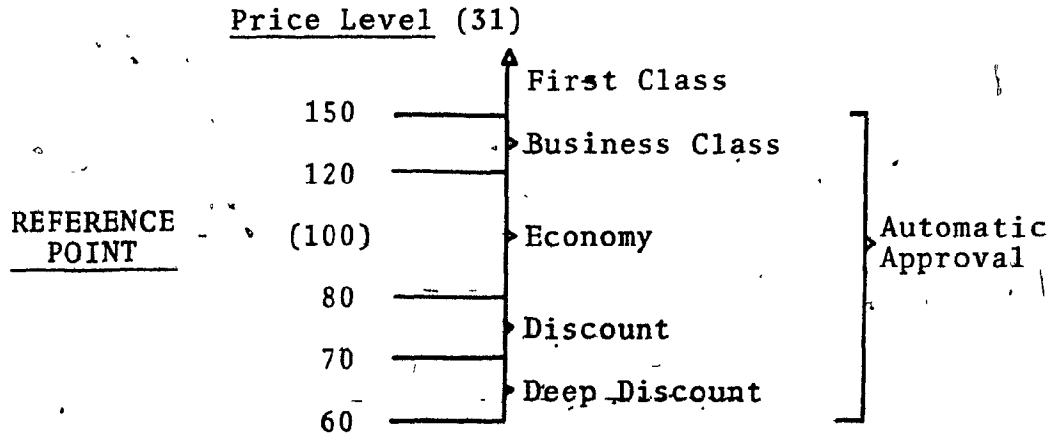
(28) See above.

8.4.2.4 ECAC : Memorandum of Understanding

On 2 May 1982, a multilateral pricing agreement was provisionally concluded in what was described as a "unique development in the history of international aviation" (29).

Representatives of the US and nine European nations signed a Memorandum of Understanding providing for automatic approval of US-Europe scheduled fares within agreed price zones (30). Subject to confirmation of adherence by 15 June, the zone system was to go into effect on 1 July 1982 for a 6 month trial period, with the possibility of renewal or "approval on a permanent basis" (30).

The agreement provides for five tariff levels built around the specifically (bilaterally) agreed reference point for each route:



(29) ECAC Press Release, No. 54E, 5 May 1982, 2, quoting Mr Erik Willoch, ECAC President.

(30) The nine countries were Belgium, Germany, Greece, Ireland, Italy, Netherlands, Portugal, Spain and the UK. Yugoslavia initialled the agreement and was expected to sign. France and Switzerland expressed support; US-DoT Press Release 14-82, 3 May 1982, 2, and US-ECAC, Article 8.

(31) The limits of the bands vary by up to 10 percentage points, but the above diagram is intended as an indicator only. Seasonal and directional variation also occur.

Given the complexity of the tiered system, the parties went to pains to elaborate conditions - including seating density (e.g., to separate business class from economy class) (32).

Inevitably, this derogates considerably from the US' competitive objectives, although provision is included for such matters as short-notice matching filings (33).

There appears to be no provision for disapproval of fare levels falling within the zones, although the temporary existence of the agreement would tend to encourage reasonableness. (Outside the zones, applicable bilateral terms apply.) A "Tariff Working Group" is however to be established, to meet either "at the initiative of any Party" or at least ~~once~~ every six months (34). Its powers are limited to mutual examination and consideration of the fares in question, but it could well assume a more structured nature in any permanent agreement which may be negotiated.

The agreement was a product of several factors, including the severe financial difficulties of many airlines operating on the North Atlantic; in this climate, the continuing threat of the CAB's finalisation of the IATA Show Cause Order (thereby precluding US carrier participation in IATA tariff coordination on North Atlantic routes) appeared influential on European governments.

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(32) Annex 1 to the Memorandum. At the time of writing, this text was not available.

(33) US-ECAC, Article 4.

(34) Id., Article 7. cf Bermuda II's Tariff Working Group, above. A separate Working Group is also established to draft a permanent agreement, which may include cargo and charter prices (Article 6).

As the Memorandum contains agreement not to prevent (or require) carrier participation in multilateral tariff coordination for the purpose of automatic approval within the zone, the Show Cause Order's effectiveness if suspended at least for the term of the agreement (35).

Apart from its unique quasi-multilateral nature (36), the zone system bears a similarity to the US-China agreement in that (i) the reference point in each bilateral market was established by agreement between the parties, (ii) certain conditions must be attached for the lower zones; and (iii) concentration was on price flexibility, without amendment of the other, pre-existing, bilateral terms.

Although the scheme does not amount to intergovernmental tariff negotiation as such, it was necessary to agree each bilateral route's initial reference point. From that point it is clearly envisaged that actual pricing levels be left to airlines, individually or multilaterally, to determine.

The Memorandum is unprecedent in international aviation. It offers the possibility of a challenging new order in pricing regulation. For this reason, its functioning will be closely watched by regulators and airlines throughout the world, as an apparent compromise between the US' model competitive system and the traditional regulatory style.

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(35) US-ECAC, Article 2.

(36) The agreement is in one aspect actually bi-partite, with the US constituting the first party and the European governments the second party. There is no similar agreement among the European governments to govern intra-European fares.

CHAPTER 9. CONCLUDING REFLECTIONS

1977 saw the beginnings of a revolution in the regulation of international air transport. Never before had any developed aviation power moved out of the mainstream of bilateral policy. For more than three decades the Bermuda system had been accepted in one form or another - by all nations; the only aberration, strongly pressed by the US, was the widespread use of programmed charters through the 1960s and 70s. The revolution has not totally succeeded, but the aviation world will never be the same again.

The purpose of this paper has been to seek to interpret the main elements of this new policy as effected through bilateral agreements. The causes, the motivating forces behind the new agreements have been considered in as far as they explain the motivation and meaning behind the new terms - and as they may also provide indications to where US policy will lead in future.

Throughout, the objective has been to add a further dimension to the novel and undefined words of the so-called liberal agreements. Superficially, this is not difficult; the problems arise as much in comprehending the vastly different direction of the new policy as in understanding its verbal expression.

Simply stated, in its extreme form, the bilaterals preclude governmental controls on:

prices;
capacity; or
designation, for third and fourth freedom services.

Routes remain strictly in the government domain, except for charter services, where no "commercial" constraint may be imposed. In several cases, similar provisions exist for the parties' fifth and sixth freedom routes.

9.1 Inherent Conflict

This simplicity is, unfortunately, illusory. This is because the US policy is a breed apart, unique; it is not readily acceptable to foreign governments. Even where liberal agreements have been concluded, the perceived benefit derived by the foreign partner has not generally been the competitive framework, but rather the value of new route grants - in some cases combined with the need to protect national interests by avoiding traffic diversion to other gateways.

(There has been a dual irony in the negotiating process itself - first that the very fact of responding to a threat of this nature is antipathetic to the concepts of the free market and of predominant consumer benefit; secondly that the actual value of the route-grant benefit is immediately eroded, not only by the devaluation of route entry itself, but also because few non-US carriers have the market power to exploit more than one or two US gateways.)

Consequently, one of the parties in each relationship is, conceptually, a reluctant partner (1). Where it entered the agreement seeking a benefit, that benefit was determined in traditional terms, in enhanced flag carrier and national market viability - not in esoteric, competitive terms.

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(1) There are exceptions, notably the Netherlands.

If these benefits do not materialise, discontent develops. It is here that the bilateral formula is made complex through its simplicity.

Whether on detailed issues such as a specific fare level, or on broader grounds, minimal scope exists for unilateral, protective action by a concerned government. This is a new and often unwelcome status for national regulatory bodies; it is, moreover, one which imposes great stress on the particular bilateral agreement and on the regulatory framework itself.

It is thus important to determine the parameters of governmental scope for intervention, whether unilateral or mutual. As has been seen, the scope in the pricing area is heavily limited. There is virtually no escape-valve, short of denunciation. If the liberal agreements are to survive in their more purist versions, then this is a challenge which must be met.

9.2 The Importance of Being Different

Most importantly for the system overall is that, US policy and the liberal agreements are, in regulatory terms, the cuckoo in the nest. They represent an aggressively different minority in what is otherwise a homogeneous bilateral network. Out of a probable 2000 air transport bilateral arrangements and formal agreements governing international routes, the liberal agreements account for some 20.

Yet, visibly, their market significance has been far greater. While in some ways the US' policies have gained from the interaction between liberal and traditionally-regulated routes, they have promoted new problems. A major one has been more frequent intergovernmental consultations.

This is a fact which concerns foreign governments and the US alike. In 1980, DoS Deputy Assistant Secretary Boyd Hight expressed the need to "find common ground with those aviation partners who are resistant to liberalisation" (2). He observed that while the US' professed aim was to stimulate market forces, "one of the ironies of our liberal policy is that in some respects it may increase rather than diminish government's role. This is particularly true in our dealings with developed regulatory regimes, and one of the most persistent problems in pricing." (2).

The significance of pricing's centrality will be considered further below, but more generally this statement evidences the effect of pursuing any different course in international affairs where the interests of other states are at stake. When an economically powerful nation follows that course, the system becomes inherently unstable.

This paper began by suggesting that instability was in the US' interests; emperical evidence would support the validity of such a statement. More difficult to determine is where US interests in fact lie at any particular time - whether they are genuinely mercantilistic (3) or whether the consumer/competitive interest prevails. But, so long as the proposition is correct, it must be assumed that, so far as the US is able, a degree of instability will remain in the system.

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(2) "US International Aviation Policy", Boyd Hight, US DoS Deputy Assistant Secretary; Address to the Second Lloyd's of London International Civil Aviation Conference, New York, 30 April 1980.

(3) See above, Chapter 4.

Like most value judgments, this observation is subject to a threshold being reached, upon which the option becomes counter-productive. This therefore prescribes the limits of effectiveness of any given course, but far from being fixed, these limits fluctuate with time and opinion.

In these terms, it would seem that, after a period in 1980/81, where US policy went very close to that threshold, a plateau has now been reached. Strategic, or even perhaps philosophical reappraisal of IATA tariff coordination has made possible a multilateral approach to liberalisation (at least of scheduled pricing) on the North Atlantic. Should this succeed, a new range of possibilities opens up; towards this end, there is merit in at least temporary withdrawal from the threshold. There is, after all, always the potential threat of re-emergence of the charter force, in a form not yet seen on a large scale (4).

9.3 Coordination of Tariffs

Since the failure of the Chicago Conference to determine procedures for collective fare and rate formulation by governments, no serious consideration has been given to the possibility The US-ECAC understanding offers a possible exception however. It may be argued that by establishing the parameters of (automatically) acceptable fares in each respective bilateral market, the US and ECAC governments have in fact at last intervened into the tariff formulation process.

Were the price bands to be, say, in the range of 2-5%, this argument would have greater force. However, given the actual breadth of the zones, it is unrealistic to treat this as inter-governmental tariff establishment.

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(4) I.e., the "public" charter form.

The role of price formulation will almost certainly remain with the airlines, individually, bilaterally or multilaterally. Following a period in which the US CAB perceived IATA tariff formulation as being directly counter to US interests, there now appears to be a recognition that benefits can be derived from US carrier participation - most notably in terms of easing direct intergovernmental stress.

It has in fact never been US (5) policy to prohibit the functioning of IATA. The 1978 Policy makes no mention of it (6) at all.

While, as noted above, this paper is concerned only with the prescription of governmental approval processes rather than formulation of prices per se, it is useful to draw the distinction in order to define the limits of each. the US-ECAC agreement makes clear that there is no incompatibility between a double-disapproval regime - i.e., intervention by governments - and multilateral formulation of tariffs by airlines: an "... important feature of the Understanding is that the signatory aeronautical authorities undertake not to prevent any carrier from participating in multilateral tariff co-ordination while the arrangement is in force" (7).

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(5) As opposed to US CAB: the independent status of the CAB has often however made the interpretation of US policy very difficult.

(6) As CAB member o'Melia observed in his dissent in the CAB's IATA Show Cause Order, "If the Executive Branch agencies had in mind overturning the IATA ratemaking mechanism, this would have been an excellent time to surface such a plan. It does not do that."; Order 78-6-78, op. cit. At this stage, the Policy was still in draft form. At no stage in its development did it contain reference to IATA.

(7) ECAC Press Release, op. cit., 2.

9.4 The Policy Equaliser

That being said, it is paradoxical that a vital part of the present regulatory change is causally related to amended airline procedures: the enforcement of tariffs.

It is an area in which there has been little change at formal, government level - but in which practices have altered dramatically since the late 1970s. An "unofficial" redirection such as this was possible because, for most purposes governments had delegated their tariff enforcement function to the airlines themselves.

When "punitive" enforcement was terminated in IATA and replaced by a new recommendatory system, many governments found themselves lacking in legislative powers to perform the punitive role (8).

Where tariffs are not enforced, i.e., where no real obligation is imposed on airlines and retail outlets to observe filed tariffs, then the intent and direction of any bilateral provision can be dramatically affected. Discounting, or non-enforcement, is a great policy equaliser.

The procedural difference between the development of tariffs and their approval thus rapidly diminishes when the eventual price offered in the market place depends entirely on market pressures. It therefore now seems inescapable that in any country where excess capacity exists, its policy objectives will be seriously undermined. In today's environment there is, as a result of the political dangers of attempting to cause prices to be raised, a type of self-imposed laissez-faire. It may be that this will be the most durable of all the US' liberalising moves.

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(8) See, e.g., ICAO FRP/4 - WP/8 op. cit. IATA's change was in turn the result of market pressures, making realistic enforcement impossible. To some extent the same market pressures were the result of government policy changes - particularly the US - in other areas.

Ironically, the only option open to governments, should they seek to restore stability, is to impose greater restrictions on the non-pricing policy tools available to them - capacity and entry. This is probably the greatest threat to the long-term viability of the US' liberalising programme. The scheme does not provide for "remedial action in case of an economic emergency. This will have to be developed between governments. The machinery for such action, if available at all, exists only at the bilateral level and may be of doubtful effectiveness." (9).

9.5 Pricing: The Last Word - and The First

The Bermuda I agreement itself was the offspring of a pricing dispute (10). This dispute focussed attention clearly upon the central importance of tariffs and attention has rarely wavered in the intervening 36 years.

The issue was resolved by making explicit the power of each government to disapprove any tariff proposed to or from its territory; or, stated differently, the approval of each affected government was required before a service could be operated.

The US has sought to reverse this equation through its liberal agreements. In doing so it has introduced a design which makes disapproval virtually impossible. Tentatively disapproving the IATA Traffic Conference machinery in 1978, the CAB stated that "circumstances have changed dramatically since 1946... US carriers have ceased to dominate international aviation and the bargaining power of our allies is now much more equal to our own... (It) is no longer reasonable to assume that US carriers

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(9) Raben, "Does a Liberal Bilateral Work?", op. cit., 414.

(10) Baker, "The Bermuda Plan", op. cit., 2:1.15.

alone have the resources to engage in price competition... Furthermore, we believe that modern air transportation has proved itself to be quite adaptable to regulation by the marketplace, and that we as regulators should rely increasingly on competition to promote the public interest." (11).

The next few years will show whether there has been a similar "modernisation" of the attitudes of states towards retaining sovereign control over commercial aviation in their airspace. Preliminary signs are not convincing. Price control has long been regarded as a clear exercise of sovereignty and will not be lightly conceded unless some durable national benefit ensues.

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(11) CAB IATA Show Cause Order, op. cit., 25840, 25842.

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UNITED STATES POLICY FOR THE CONDUCT OF INTERNATIONAL AIR TRANSPORTATION NEGOTIATIONS

Introduction

United States international air transportation policy is designed to provide the greatest possible benefit to travelers and shippers. Our primary aim is furthering the maintenance and continued development of affordable, safe, convenient, efficient and environmentally acceptable air services. Our policy for negotiating civil air transport agreements reflects our national goals in international air transportation. This policy provides a set of general objectives, designed particularly for major international air markets, on the basis of which United States negotiators can develop specific negotiating strategies.

Maximum consumer benefits can be best achieved through the preservation and extension of competition between airlines in a fair marketplace. Reliance on competitive market forces to the greatest extent possible in our international air transportation agreements will allow the public to receive improved service at low costs that reflect economically efficient operations. Competition and low prices are also fully compatible with a prosperous U.S. air transport industry and our national defense, foreign policy, international commerce, and energy efficiency objectives.

Bilateral aviation agreements, like other international agreements, should serve the interests of both parties. Other countries have an interest in the economic prosperity of their airline industries, as we do in the prosperity of ours. The United States believes this interest is best served by a policy of expansion of competitive opportunity rather than restriction. By offering more services to the public, in a healthy and fair competitive environment, the international air transport industry can stimulate the growth in traffic which contributes both to profitable industry operations and to maximum public benefits.

Goals of U.S. International Air Transportation Policy

The U.S. will work to achieve a system of international air transportation that places its principal reliance on actual and potential competition to determine the variety, quality, and price of air service. An essential means for carrying out our international air transportation policy will be to allow greater competitive opportunities for U.S. and foreign airlines and to promote new low-cost transportation options for travelers and shippers. Especially in major international air transport markets, there can be substantial benefits for travelers, shippers, airlines and labor from increasing competitive opportunities and reducing protectionist restrictions. Increasing opportunities for U.S. flag transportation to and from the United States will contribute to the development of our foreign commerce, assure that more airlift resources are available for our defense needs, and promote and expand productivity and job opportunities in our international air transport industry.

Translating Goals into Negotiating Objectives

U.S. International Air Transportation Policy cannot be implemented unilaterally. Our objectives have to be achieved in the system of international agreements that form the basic framework for the international air transportation system.

Routes, prices, capacity, scheduled and charter rules, and competition in the marketplace are interrelated, not isolated problems to be resolved independently. Thus, the following objectives will be presented in negotiations as an integrated U.S. position:

1. Creation of new and greater opportunities for innovative and competitive pricing that will encourage and permit the use of new price and service options to meet the needs of different travelers and shippers.
2. Liberalization of charter rules and elimination of restrictions on charter operations.
3. Expansion of scheduled service through elimination of restrictions on capacity, frequency, and route and operating rights.
4. Elimination of discrimination and unfair competitive practices faced by U.S. airlines in international transportation.
5. Flexibility to designate multiple U.S. airlines in international air markets.
6. Encouragement of maximum traveler and shipper access to international markets by authorizing more cities for non-stop or direct service, and by improving the integration of domestic and international airline services.
7. Flexibility to permit the development and facilitation of competitive air cargo services.

Explanation of Objectives

1. *Pricing.* The U.S. will develop new bilateral procedures to encourage a more competitive system for establishing scheduled air fares and rates. Charter pricing must continue to be competitive. Fares, rates, and prices should be determined by individual airlines based primarily on competitive considerations in the marketplace. Governmental regulation should not be more than the minimum necessary to prevent predatory or dis-

criminatory practices to protect consumers from the abuse of monopoly position, or to protect competitors from prices that are artifically low because of direct or indirect governmental subsidy or support. Reliance on competition and encouragement of pricing based on commercial considerations in the marketplace provides the best means of assuring that the needs of consumers will be met and that prices will be as low as possible given the costs of providing efficient air service.

2. *Charters.* The introduction of charters acted as a major catalyst to the expansion of international air transportation in the 1960's. Charters are a competitive spur and exert downward pressure on the pricing of scheduled services. Charters generate new traffic and help stimulate expansion in all sectors of the industry. Restrictions which have been imposed on the volume, frequency, and regularity of charter services as well as requirements for approval of individual charter flights have restrained the growth of traffic and tourism and do not serve the interests of either party to an aviation agreement. Strong efforts will be made to obtain liberal charter provisions in bilateral agreements.

3. *Scheduled Services.* We will seek to increase the freedom of airlines from capacity and frequency restrictions. We will also work to maintain or increase the route and operating rights of our airlines where such actions improve international route systems and offer the consumer more convenient and efficient air transportation.

4. *Discrimination and Unfair Competitive Practices.* U.S. airlines must have the flexibility to conduct operations and market their services in a manner consistent with a fair and equal opportunity to compete with the airlines of other nations. We will insist that U.S. airlines have the business, commercial, and operational opportunities to compete fairly. The United States will seek to eliminate unfair or destructive competitive practices that prevent U.S. airlines from competing on an equal basis with the airlines of other nations. Charges for providing airway and airport properties and facilities should be related to the costs due to airline operations and should not discriminate against U.S. airlines. These objectives were recognized by the Congress in legislation enacted in 1975, and their attainment is required if consumers, airlines, and employees are to obtain the benefits of an otherwise competitive international aviation system.

5. *Multiple Airline Designations.* The designation of new U.S. airlines in international markets that will support additional service is a way to create a more competitive environment and thus encourage improved service and competitive pricing. Privately owned airlines have traditionally been the source of innovation and competition in international aviation, and it is, therefore, particularly important to preserve for the U.S. the right of multiple designation.

6. *Maximum Access to International Markets.* Increasing the number of gateway cities for non-stop or direct air service offers the potential for increasing the convenience of air transportation for passengers and shippers and improving routing and market opportunities for international airlines. In addition, enhancing the integration of U.S. airline domestic and international air services benefits both consumers and airlines.

7. *Cargo Services.* We will seek the opportunity for the full development of cargo services. Frequently demand for such services requires special equipment and routes. Cargo services should be permitted to develop freely as trade expands. Also important in the development of cargo services are improved facilitation, including customs clearance, integration of surface and air movements, and flexibility in ground support services.

Negotiating Principles

The guiding principle of United States aviation negotiating policy will be to trade competitive opportunities, rather than restrictions, with our negotiating partners. We will aggressively pursue our interests in expanded air transportation and reduced prices rather than accept the self-defeating accommodation of protectionism. Our concessions in negotiations will be given in return for progress toward competitive objectives, and these concessions themselves will be of a liberalizing character.

Proposed bilateral agreements which do not meet our minimum competitive objectives will not be signed without prior Presidential approval.

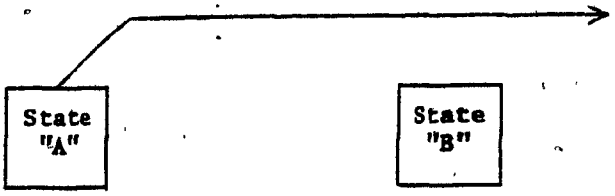
"FREEDOMS OF THE AIR"

(ICAO FRW (Mexico City) - WP/7; 11/2/82)

1. The 1944 International Civil Aviation Conference in Chicago developed an International Air Transport Agreement which defined five freedoms of the air which would be granted amongst Contracting States in respect of scheduled international air services. The Agreement entered into force on 8 February 1945, but only 12 States had notified their acceptance of it by the end of 1981. However, the five freedoms were subsequently incorporated on a bilateral basis into a large number of agreements between States 1/, and are widely recognized as follows (the examples refer to an aircraft or airline registered in State "A" 2/).

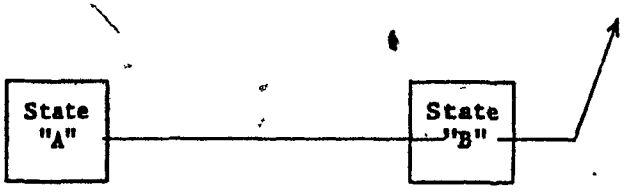
First freedom: The privilege to fly across the territory of another State without landing.

Example:



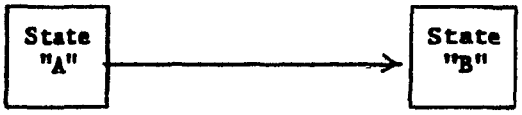
Second freedom: The privilege to land in another State for non-traffic purposes (that is for refuelling, mechanical reasons, etc., but not for putting down or taking on load).

Example:



Third freedom: The privilege to put down in another State revenue passengers, mail and cargo taken on in the State of airline/aircraft registration.

Example:

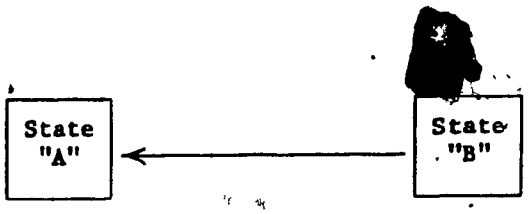


1/ The first and second freedoms, commonly known as the transit or technical freedoms, are also granted on a multilateral basis through the International Air Transit Services Agreement which also emerged from the 1944 Chicago Conference, entered into force on 30 January 1945, and had been ratified by 95 States by the end of 1981.

2/ The International Air Transport Agreement refers to the *aircraft* of the States concerned, while bilateral agreements refer to the *airlines* of the States concerned. The nationality of an aircraft is equated with the State in which it is registered. The nationality of an airline is defined more loosely by its state of "registration", "principle place of business", "headquarters", "residence", etc.

Fourth freedom: The privilege to take on in another State revenue passengers, mail and cargo destined for the State of airline/aircraft registration.

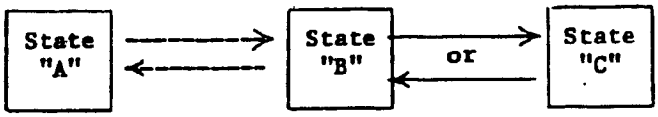
Example:



The fourth freedom is almost without exception granted together with the third freedom through the bilateral arrangement between the pair of States concerned.

Fifth freedom: The privilege for an airline/aircraft registered in one State and en-route to or from that State to take on revenue passengers, mail and cargo in a second State and to put them down in a third State.

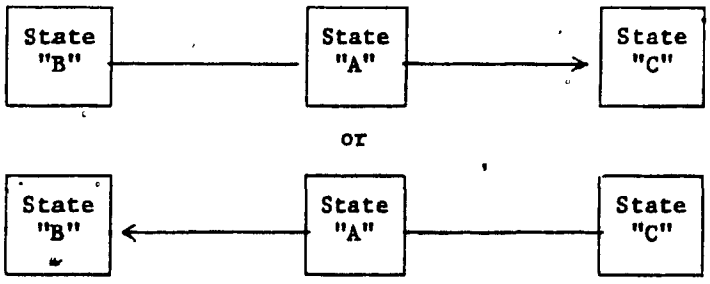
Example:



The fifth freedom is almost without exception granted for both directions concerned. It involves three pairs of bilateral arrangements (in this case (i) between States "A" and "B", (ii) between States "A" and "C", and (iii) between States "B" and "C").

2. Since 1944, a number of uncodified variations and additions to the above five freedoms have emerged. Of particular relevance to the multilateral tariffs situation are "cabotage", whereby a single State controls the traffic and tariffs between points in its own territory or territories, and the controversial "sixth freedom", whereby an airline/aircraft registered in one State may take on revenue passengers, mail and cargo in a second State, *transport them via the State of registration,* and put them down in a third State.

Example of "sixth freedom":



"Sixth freedom" is essentially a combination of the third and fourth freedoms; the reason it is controversial is that it may be questionable whether the intermediate stop is a commercially necessary part of the journey concerned (in the example States "B" and "C" may consider that the true origin and destination of at least some of the traffic concerned are "B" and "C", particularly where more direct routings are available between "B" and "C" without passing through "A", and that regulation of this traffic and the tariffs concerned are their prerogative, the interest of State "A" being ancillary only; on the other hand State "A" may consider that its interest is a primary one, particularly in the case of passengers en-route from State "B" to State "C" or vice-versa who may wish to stop over in State "A" for reasons other than a necessary change of flights).

US MODEL PRICING ARTICLES, 1980

Example of a model Country-of-origin Pricing Article (as submitted by the US to ICAO ATC/2)

Pricing (Country of Origin)

1. Each Party shall allow prices for air transportation to be established by each designated airline based upon commercial considerations in the market-place. Intervention by the Parties shall be limited to:

a) prevention of predatory or discriminatory prices or practices;

b) protection of consumers from prices that are unduly high or restrictive because of the abuse of monopoly power; and

c) protection of airlines from prices that are artificially low because of direct or indirect governmental subsidy or support.

2. Each Party may require notification to or filing with its aeronautical authorities of prices proposed to be charged to or from its territory by airlines of the other Party. Notification or filing by the airlines of both Parties may be required no more than 60 days before the proposed date of effectiveness. In individual cases, notification or filing may be permitted on shorter notice than normally required. Neither Party shall require the notification or filing by airlines of the other Party or by airlines of third countries of prices charged by charterers to the public for traffic originating in the territory of that other Party.

3. If either Party believes that a price proposed or charged by

a) an airline of the other Party or an airline of a third country for international air transportation between the territories of the Parties; or

b) an airline of the other Party for international air transportation between the territory of the first Party and a third country, including in both cases transportation on an interline or intra-line basis,

is inconsistent with the considerations set forth in paragraph 1 of this Article, it shall notify the other Party of the reasons for its dissatisfaction as soon as possible. In the case of a proposed price, such notice of dissatisfaction shall be given to the other Party within 30 days of receiving the notification or filing of the price. Either Party may then request consultations which shall be held as soon as possible, and in no event later than 30 days after receipt of the request. The Parties shall co-operate in securing information necessary for reasoned resolution of the issue.

4. If the Parties reach agreement with respect to a price for which a notice of dissatisfaction has been given, each Party shall use its best efforts to put that agreement into effect.

5. If,

a) with respect to a proposed price, consultations are not requested or an agreement is not reached as a result of consultations; or

b) with respect to a price already being charged when notice of dissatisfaction is given, consultations are not requested within 30 days of receipt of the notice or an agreement is not reached as a result of consultations within 60 days of receipt of the notice,

either Party may take action to prevent the inauguration or continuation of the price for which a notice of dissatisfaction has been given, but only with respect to traffic where the first point on the itinerary (as evidenced by the document authorizing transportation by air) is in its own territory. Neither Party shall take unilateral action to prevent the inauguration or continuation of any price subject to this Article, except as provided in this paragraph.

6. Notwithstanding paragraph 5 of this Article, each Party shall allow:

a) any airline of either Party or any airline of a third country to meet a lower more competitive price proposed or charged by any other airline or charterer for international air transportation between the territories of the Parties; and

b) any airline of one Party to meet a lower or more competitive price proposed or charged by any other airline or charterer for international air transportation between the territory of the other Party and a third country. As used herein, the term "meet" means the right to establish on a timely basis, using such expedited procedures as may be necessary, an identical or similar price on a direct, interline or intra-line basis, notwithstanding differences in conditions relating to routing, roundtrip requirements, connections, type of service or aircraft type.

Example of a model Dual or Mutual Disapproval Pricing Article (as submitted by the US to ICAO ATC/2)

Pricing (Dual Disapproval)

Each Party shall allow prices for air transportation to be established by each esignated airline based upon commercial considerations in the market-place. Intervention y the Parties shall be limited to:

a) prevention of predatory or discriminatory prices or practices;

b) protection of consumers from prices that are unduly high or restrictive because of the abuse of a dominant position; and

c) protection of airlines from prices that are artificially low because of direct or indirect governmental subsidy or support.

2. Each Party may require notification to or filing with its aeronautical authorities of prices proposed to be charged to or from its territory by airlines of the other Party. Notification or filing by the airlines of both Parties may be required no more than 45 days before the proposed date of effectiveness for passenger services and 60 days for c- -o services. In individual cases, notification or filing may be permitted on shorter n ce than normally required. Neither Party shall require the notification or filing by airlines of the other Party or by airlines of third countries of prices charged by charterers to the public for traffic originating in the territory of that other Party.

3. Neither Party shall take unilateral action to prevent the inauguration or continuation of a price charged or proposed to be charged by:

a) an airline of either Party or by an airline of a third country for international air transportation between the territories of the Parties, or

b) an airline of one Party for international air transportation between the territory of the other Party and a third country, including in both cases transportation on an interline or intra-line basis.

If either Party believes that any such price is inconsistent with the considerations set forth in paragraph 1 of this Article, it shall request consultations and notify the other Party of the reasons for its dissatisfaction as soon as possible. These consultations shall be held not later than 30 days after receipt of the request, and the Parties shall cooperate in securing information necessary for reasoned resolution of the issue. If the Parties reach agreement with respect to a price for which a notice of dissatisfaction has been given, each Party shall use its best efforts to put that agreement into effect. Without mutual agreement, that price shall go into or continue in effect.

4. Notwithstanding paragraph 3 of this Article, each Party shall allow:

a) any airline of either Party or any airline of a third country to meet a lower or more competitive price proposed or charged by any other airline or charterer for international air transportation between the territories of the Parties, and

b) any airline of one Party to meet a lower or more competitive price proposed or charged by any other airline or charterer for international air transportation between the territory of the other Party and a third country.

As used herein, the term "meet" means the right to establish on a timely basis, using such expedited procedures as may be necessary:

a) an identical or similar price on a direct, interline or intra-line basis, notwithstanding differences in conditions relating to routing, roundtrip requirements, connections, type of service or aircraft type, or

b) such price through a combination of prices.

US-THAILAND ARTICLES: PRICING, DESIGNATION, FAIR COMPETITION AND CHARTER ANNEX

ARTICLE 3

Designation and Authorization

(1) Each Party shall have the right to designate as many airlines as it wishes, consistent with its domestic laws and policies, to conduct international air transportation in accordance with this Agreement and to withdraw or alter such designations. Such designations shall be transmitted to the other Party in writing through diplomatic channels, and shall identify whether the airline is authorized to conduct the type of air transportation specified in Annex I or in Annex II or in both.

(2) On receipt of such a designation and of applications in the form and manner precribed from the designated airline for operating authorizations and technical permissions, the other Party shall grant appropriate authorizations and permissions with minimum procedural delay, provided:

(a) substantial ownership and effective control of that airline are vested in the Party designating the airline, nationals of that Party, or both.

(b) the designated airline is qualified to meet the conditions prescribed under the laws and regulations normally applied to the operation of international air transportation by the Party considering the application or applications; and

(c) the Party designating the airline is maintaining and administering the standards set forth in Article 6 (Safety).

ARTICLE 11

Fair Competition

(1) Each Party shall allow a fair and equal opportunity for the designated airlines of both Parties to compete in the international air transportation covered by this Agreement.

(2) Each Party shall take all appropriate action within its jurisdiction to eliminate all forms of discrimination or unfair competition practices adversely affecting the competitive position of the airlines of the other Party.

(3) Neither Party shall unilaterally limit the volume of traffic, frequency or regularity of service, or the aircraft type or types operated by the designated airline or airlines of the other Party, except as may be required for customs, technical, operational or environmental reasons under uniform conditions consistent with Article 15 of the Convention.

(4) Neither Party shall impose on the other Party's designated airlines a first refusal requirement, uplift ratio, no-objection fee, or any other requirement with respect to the capacity, frequency or traffic which would be inconsistent with the purposes of the Agreement.

(5) Neither Party shall require the filing of schedules, programs for charter flights, or operational plans by airlines of the other Party for approval, except as may be required on a non-discriminatory basis to enforce uniform conditions as foreseen by paragraph (3) of this Article or as may be specifically authorized in an Annex to this Agreement. If a Party requires filings for information purposes, it shall minimise the administrative burdens of filing requirements and procedures on air transportation intermediaries and on designated airlines of the other Party.

ARTICLE 12

Pricing (Mutual Disapproval)

(1) Each Party shall allow prices for air transportation to be established by each designated airline based upon commercial considerations in the marketplace. Intervention by the Parties shall be limited to:

(a) prevention of predatory or discriminatory prices or practices;

(b) protection of consumers from prices that are unduly high or restrictive because of the abuse of a dominant position; and

(c) protection of airlines from prices that are artificially low because of direct or indirect governmental subsidy or support.

(2) Each Party may require notification to or filing with its aeronautical authorities of prices proposed to be charged to or from its territory by airlines of the other Party. Notification or filing by the airlines of both Parties may be required no more than 60 days before the proposed date of effectiveness. In individual cases, notification or filing may be permitted on shorter notice than normally required. Neither Party shall require the notification or filing by airlines of the other Party or by airlines of third countries of prices charged by charterers to the public for traffic originating in the territory of that other Party.

(3) Neither Party shall take unilateral action to prevent the inauguration or continuation of a price proposed to be charged or charged by (a) an airline of either Party or by an airline of a third country for international air transportation between the territories of the Parties, or (b) an airline of one Party for international air transportation between the territory of the other Party and a third country, including in both cases transportation on an interline or intra-line basis. If either Party believes that any such price is inconsistent with the considerations set forth in paragraph (1) of this Article, it shall request consultations and notify the other Party of the reasons for its dissatisfaction as soon as possible. These consultations shall be held not later than 30 days after receipt of the request, and the Parties shall cooperate in securing information necessary for reasoned resolution of the issue. If the Parties reach agreement with respect to a price for which a notice of dissatisfaction has been given, each Party shall use its best efforts to put that agreement into effect. Without mutual agreement, that price shall go into or continue in effect.

(4) Notwithstanding paragraph (3) of this Article, each Party shall allow (a) any airline of either Party or any airline of a third country to meet a lower or more competitive price proposed or charged by any other airline or charterer for international air transportation between the territories of the Parties, and (b) any airline of one Party to meet a lower or more competitive price proposed or charged by any other airline or charterer for international air transportation between the territory of the other Party and a third country. As used herein, the term "meet" means the right to establish on a timely basis, using such expedited procedures as may be necessary, an identical or similar price on a direct, interline or intra-line basis, notwithstanding differences in conditions relating to routing, roundtrip requirements, connections, type of service or aircraft type, or such price through a combination of prices.

Charter Air Service

Section 1

Airlines of one Party whose designation identifies this Annex shall, in accordance with the terms of their designation, be entitled to perform international air transportation to, from and through any point or points in the territory of the other Party, either directly or with stopovers en route, for one-way or roundtrip carriage of the following traffic:

(a) any traffic to or from a point or points in the territory of the Party which has designated the airline;

(b) any traffic to or from a point or points beyond the territory of the Party which has designated the airline and carried between the territory of that Party and such beyond point or points (i) in transportation other than under this Annex; or (ii) in transportation under this Annex with the traffic making a stopover of at least two consecutive nights in the territory of that Party.

Section 2

With regard to traffic originating in the territory of either Party, each airline performing air transportation under this Annex shall comply with such laws, regulations and rules of the Party in whose territory the traffic originates, whether on a one-way or roundtrip basis, as that Party now or hereafter specifies shall be applicable to such transportation. When the regulations or rules of one Party apply more restrictive terms, conditions or limitations to one or more of its airlines, the designated airlines of the other Party shall be subject to the least restrictive of such terms, conditions or limitations. Moreover, if the aeronautical authorities of either Party promulgate regulations or rules which apply different conditions to different countries, each Party shall apply the most liberal regulation or rule to the designated airlines of the other Party.

Section 3

Neither Party shall require a designated airline of the other Party, in respect of the carriage of traffic from the territory of that other Party on a one-way or roundtrip basis, to submit more than a declaration of conformity with the laws, regulations and rules of that other Party referred to under Section 2 of this Annex or of a waiver of these regulations or rules granted by the aeronautical authorities of that other Party.

ARTICLE 6

Fares, Rates and Prices

(a) Both Contracting Parties desire to facilitate the expansion of international air transportation opportunities over the routes specified in the Schedule attached to the Agreement, as amended by Article 3 of this Protocol, as well as in charter transportation. This objective can best be achieved by making it possible for airlines to offer the traveling and shipping public a variety of service options at the lowest fares, rates and prices that are not predatory or discriminatory and do not tend to create a monopoly. In order to give weight to this objective, each Contracting Party shall encourage individual airlines to develop and implement competitive fares, rates and prices. Accordingly, the Contracting Parties agree that such fares, rates, and prices should be set by each designated airline based primarily on commercial considerations in the marketplace and that governmental intervention should be limited to prevention of predatory or discriminatory practices, protection of consumers from the abuse of monopoly power, and protection of airlines from prices that are artificially low because of direct or indirect governmental subsidy or support.

(b) Each Contracting Party may require the filing with its aeronautical authorities of fares and rates and of wholesale prices to be charged by designated airlines of the other Contracting Party. Neither Contracting Party shall require the filing by a designated airline of the other Contracting Party of prices or rates charged by charterers to the public for charter traffic originating in the territory of that other Contracting Party. If a Contracting Party is dissatisfied with a fare, rate or price filed, it shall notify the other Contracting Party as soon as possible, and in any event within 30 days of receiving notification of the fare, rate or price. Either Contracting Party may then request consultations which shall be held as soon as possible, and in no event later than 30 days of the receipt of the request. If agreement is reached during such consultations, each Contracting Party shall use its best efforts to put such agreed fares, rates or prices into effect.

(c) Notwithstanding paragraphs (E), (F), or (G) of Article 11 of the Agreement, neither Contracting Party shall prevent the institution or continuation of any fare or rate or any wholesale or retail price which is proposed or offered by a designated airline of the other Contracting Party, except where the first point on the itinerary (as evidenced by the document authorizing transportation by air) is in the territory of the first Contracting Party, unless otherwise agreed by the Contracting Parties. However, each Contracting Party shall permit any designated airline of the other Contracting Party to institute or continue a fare or rate or a wholesale or retail price which matches, or provides for a substantially similar fare, rate or price and for substantially similar terms and conditions as, any fare or rate or any wholesale or retail price which is approved or permitted for its own airline or airlines.

US-GERMANY PRICING ARTICLE

ARTICLE 6

Fares, Rates and Prices

(a) Both contracting parties desire to facilitate the expansion of international air transportation opportunities for scheduled airlines over the routes specified in the Route Schedule attached to the Agreement, as amended by Article 3 of this Protocol, as well as for charter air transportation. This objective can best be achieved by making it possible for airlines to offer the traveling and shipping public a variety of service options at the lowest fares, rates and prices that are not predatory or discriminatory. In order to give weight to this objective, each contracting party shall encourage individual airlines to develop and implement competitive fares, rates and prices. Accordingly, the contracting parties agree that such fares, rates, and prices should be set by each designated airline based primarily on commercial considerations in the market place and that governmental intervention should be limited to prevention of predatory or discriminatory practices, protection of consumers from the abuse of monopoly power, or protection of airlines from prices that are artifically low because of direct or indirect governmental subsidy or support.

(b) Where both contracting parties permit designated airlines to participate in price coordination or price-setting activities of the International Air Transport Association (IATA), and where both contracting parties have approved an IATA agreement setting prices in any market, prices filed by designated airlines pursuant to that approved agreement for the markets that are the subject of that agreement shall be approved by both contracting parties, except that where any designated airline has chosen not to adhere to any such agreement, prices proposed by that airline shall be reviewed in accordance with the objectives and procedures contained in this Article, and the failure of any airline to participate in such price-setting or price-coordination activities or the nonconformity of any proposed price to the terms of any IATA agreement shall not, in itself, constitute a valid reason for disapproval of the proposed price by the contracting party with the power to review the price. For the purposes of this paragraph, the term "price" refers to fares, rates, prices, or conditions governing their availability.

(c) Each contracting party may require the filing with its aeronautical authorities of fares and rates and of wholesale prices to be charged by designated airlines of the other contracting party. Neither contracting party shall require the filing by a designated airline of the other contracting party of prices or rates charged by charterers to the public for charter traffic originating in the territory of that other contracting party. If a contracting party is dissatisfied with a fare, rate or price filed, it shall notify the other contracting party as soon as possible, and in any event within 30 days of receiving notification of the fare, rate or price. Either contracting party may then request consultations which shall be held as soon as possible, and in no event later than 30 days after the receipt of the request. The contracting parties agree to cooperate on a continuing basis in securing the airline accounting information necessary for reasoned resolution of consultations regarding fares, rates, and prices. If agreement is reached during such consultations, each contracting party shall use its best efforts to put such agreed fares, rates or prices into effect.

(d) Notwithstanding paragraphs (e), (f), and (g) of Article 11 of the Agreement, neither contracting party shall prevent the institution or continuation of any fare or rate or any wholesale or retail price which is proposed or offered by a designated airline of the other contracting party, except where the first point on the itinerary

(as evidenced by the document authorizing transportation by air) is in the territory of the first contracting party, unless otherwise agreed by the contracting parties.

(e) Notwithstanding paragraph (d) above, each contracting party shall permit any airline to institute or continue a fare or rate or a wholesale or retail price which matches, or provides for substantially similar terms and conditions as, any fare or rate or any wholesale or retail price which is approved or permitted for other airlines. Further, to afford effective and non-discriminatory access to markets by airlines, each party agrees to regard conditions relating to routings, connections, and aircraft type as substantially similar for the purposes of this subparagraph. Additionally, each contracting party shall sympathetically consider non-matching fares, rates, prices, or conditions which are proposed by designated airlines for the purpose of obtaining effective and/or non-discriminatory market access. This paragraph shall apply as well to fares, rates, prices, and conditions filed by designated airlines of one contracting party for its operations between the territory of the other contracting party and any point in a third country.

US-ECAC MEMORANDUM OF UNDERSTANDING

ARTICLE 1

DEFINITIONS

For the purposes of this Understanding, unless otherwise stated, the term:

a) "Understanding" means this Memorandum of Understanding, its Annexes and any amendments thereto;

b) "Party" means any State whose aeronautical authorities have been committed, by the confirmed signature of its delegate below, to administer their responsibilities in conformity with the provisions of this Understanding;

c) "Scheduled transatlantic passenger services" means the public transport of passengers and their baggage on scheduled air services between the territory of the United States on the one hand and, on the other, the territory of any other Party;

d) "Fare" means the price to be charged for scheduled transatlantic passenger services, including the conditions governing the availability or applicability of such price and the charges and conditions for ancillary services.*

More specifically:

i) "Economy fare" means a fare offering space equivalent to a seating pitch of not more than 34 inches and not less than 9 seats abreast in Boeing 747 aircraft; 8 abreast for L1011-DC10; and, 6 abreast for narrow-bodied aircraft.

ii) "First class fare" and "business class fare" shall be defined by the airline establishing the fare, subject to approval of such definition under the principles and procedures provided for in the applicable bilateral agreements.

iii) "Discount fare" means a fare which is listed in Annex 1, paragraph 1, of this Understanding and not excluded pursuant to the notes to that Annex.

* This Understanding does not provide for the regulation of rates of commission.

iv) "Deep discount fare" means a fare which is listed in Annex I, paragraph 2, of this Understanding and not excluded pursuant to the notes to that Annex.

v) "Basic fare" means a fare applicable during the period from 15 September to 14 May (Eastbound) and from 15 October to 14 June (Westbound).

vi) "Peak fare" means a fare applicable during the period from 15 May to 14 September (Eastbound) and from 15 June to 14 October (Westbound).

ARTICLE 2

GENERAL ELEMENTS

1) While this Understanding is in force, no Party shall make participation in multilateral carrier tariff co-ordination a condition for approval of any fare, nor shall any Party prevent or require participation by any carrier in such multilateral tariff co-ordination. In addition, no discrimination against any carrier shall be permitted on the basis of its participation or non-participation in such multilateral tariff co-ordination. No Party shall require, as a result of this Understanding, any carrier to refile any fare presently in effect.

2) The Parties shall encourage their airlines to make their best efforts to establish a simple, transparent and cost-related tariff structure covering user demands. The Parties shall facilitate these efforts by giving them any support within their legal possibilities.

3) Any carrier designated by a Party to this Understanding to operate scheduled transatlantic passenger services may file any fare in respect of such services between its territory and the territory of another Party. The approval of such fares shall be subject to the relevant principles and procedures provided for in the bilateral agreements or arrangements in force between the two Parties (e.g., double approval, country of origin or double disapproval pricing articles) applied as indicated in this Understanding.

4) Nothing in this Understanding shall be deemed to affect in any way the treatment by Parties, under existing bilateral agreements or arrangements, of fares intended to match fares in effect between the territories of the Parties.

5) This Understanding shall apply only to fares for transportation between United States/Europe city-pairs listed in Annex II.

ARTICLE 3

PRICING ZONES AND PROCEDURES

1) In applying the provisions of the relevant bilateral air service agreements or arrangements, the Parties shall, during the period this Understanding is in force, approve or, as the case may be, refrain from notifying dissatisfaction with, specified fares filed by the carrier of another Party in accordance with Article 2,3) within specified pricing zones constructed as set out in Annex II.

2) Any fare filed above or below the zone referred to in paragraph 1) above for the fare-type in question, or not corresponding to one of the definitions set out in Article 1,d),i), ii), iii) and iv), shall continue to be subject to tariff arrangements under the applicable bilateral air service agreements or arrangements. In this connection, each Party shall consider the views of the Tariff Working Group in any report transmitted pursuant to Article 7,2),c) and, with due regard to those views, exercise its best efforts, consistent with its rights and obligations under applicable bilateral agreements or arrangements, to ensure that fares offered for travel to and from its territory are consistent with sound commercial considerations and the need for a functioning, coherent, and stabilized air transport system.

ARTICLE 4

TARIFF FILINGS

1) All fares outside the agreed pricing zones shall continue to be filed with the relevant aeronautical authorities with the period of notice specified in the applicable bilateral air service agreements or arrangements. Where no notice is specified in the applicable bilateral air service agreements or arrangements, and for all filings within the agreed pricing zones, fares shall be so filed not less than 30 days prior to their proposed effective date, except in the case of matching filings, where filings on shorter notice shall be accepted, and in other special circumstances, where filings on shorter notice may be accepted.

2) If a Party intends to disapprove a fare it shall give notification not later than 15 days before its effective date.

ARTICLE 5

CENTRAL AGENCY FOR FARE INFORMATION

1) The Parties shall give common consideration to the value and feasibility of a central agency dealing with information on the fares approved by the Parties to this Understanding.

2) The above shall involve consideration of the following and of any other relevant factors:

   a) the possibility of collecting and recording together, for all carriers performing services between the United States and other Parties to this Understanding, all such fares and the conditions for their application as are approved by the Parties concerned;

   b) the possibility of rapid access by any airline or government concerned to the data so collected; and

   c) evaluation of the cost of setting up, operating and using the central agency.

ARTICLE 6

WORKING GROUP

During the time this Understanding is in force, the Parties shall appoint a working group composed of representatives of the Parties, of ECAC States not parties to this Understanding if they so wish, and of other governments as the Parties may agree. The working group shall review the functioning of this Understanding and shall draft a permanent agreement for consideration by the Parties, considering also the question of including cargo and non-scheduled passenger services.

ARTICLE 7

TARIFF WORKING GROUP

1) A Tariff Working Group shall be composed of representatives from the United States and not more than 2 from each other Party and shall meet at the initiative of any Party and in any case not less than once in each period of six months.

2) The Tariff Working Group shall:

   a) if any Party registers a preliminary view that the fare in question may be below costs and/or disruptive, examine any fare approved, under Article 3,2) above, outside the zone in Article 3,1) for the fare-type in question;

   b) consider any other questions relating to fares which have arisen under the Understanding; and

   c) report to the Parties on a) and b) above.

FINAL CLAUSES

ARTICLE 8

This Understanding shall terminate six months after the date of its entry into force (unless renewed) or upon the coming into force of a permanent agreement on North Atlantic scheduled service pricing, whichever occurs earlier.

ARTICLE 9

1) The undersigned delegates, by affixing their signatures to this Understanding, if confirmed by subsequent notification to the ECAC Secretariat not later than 15 June 1982, commit their aeronautical authorities to administer their responsibilities in conformity with the provisions of this Understanding.
2) This Understanding shall enter into force on 1 July 1982.
3) This Understanding shall be open for signature at the ECAC Secretariat by the aeronautical authorities of other ECAC Member States subject to acceptance, by all Parties to this Understanding, of the reference fare levels and pricing zones applicable to the routes covered by such new signatures and of any exceptions to the definitions in Annex I.

Done this second day of May, 1982, at Washington, D.C.