

The U.S.-EU Air Transport Agreement: Making the Most of the Second Stage

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**John R. Byerly
Deputy Assistant Secretary for
Transportation Affairs
U.S. Department of State**

- Thank you for inviting me to speak before the European Aviation Club. It's wonderful to see so many friends here.
- And it's a special honor to be introduced by Daniel Calleja, a dear and trusted friend whose visionary leadership and exceptional talent in building consensus were essential to achieving the Air Transport Agreement.
- As you're aware, we will meet in just two days in Slovenia to open the second stage of U.S.-EU air transport negotiations. I'll take a few minutes to recap what we've accomplished in the first stage—it's a success story of the first order—and then I'll focus on the future.
- What did we accomplish in our Air Transport Agreement and how did we do it? Are there lessons we should apply in the second stage?
- Although there are a few observers who've characterized the first-stage agreement as a modest accomplishment—the culinary equivalent of boiling an egg—the truth is a bit different. I'm biased, but surely we've earned two Michelin stars if not a full three. Let's look at the menu of accomplishments.
- I was in Dublin last week. The Air Transport Agreement has transformed the U.S.-Irish aviation market. It has allowed Aer Lingus to take its place among leading transatlantic air carriers by opening new routes to Washington, San Francisco, and Orlando; inking a deal with

JetBlue; and, just last month, announcing an extensive codeshare agreement with United. Moreover, U.S. airlines wishing to fly to Ireland are no longer constrained by the Shannon stop requirement. This has allowed Continental Airlines, for example, to add a second daily non-stop flight to Dublin. The winners: consumers, airlines, our respective economies.

- At London-Heathrow, we've witnessed a market opening like no other in aviation history, a miracle that many considered impossible:
 - Where once only four airlines were allowed to offer air service—and even then, only to some cities in the United States—today a free market thrives. New transatlantic service—service previously outlawed under Bermuda 2—is now being offered from Heathrow:
 - by Air France to Los Angeles;
 - by American Airlines to Dallas and Raleigh;
 - by British Airways to Dallas and Houston;
 - by Continental to Houston and Newark;
 - by Delta to Atlanta and New York;
 - by Northwest to Detroit, Minneapolis, and Seattle;
 - by United to Denver; and
 - by US Airways to Philadelphia.
- Furthermore, the Bermuda 2 requirement that made FedEx fly aircraft half-empty from London to its Paris hub is gone. The result: better service for customers in the UK and on the European Continent, cost-savings for FedEx, and a reduced carbon footprint as aircraft are used more efficiently.
- Among the most impressive innovations to date under the Agreement is British Airways' plan to operate to New York from Paris and Brussels and potentially from more cities outside the UK. Such creative new service is exactly what we sought with the U.S.-EU agreement: whether the carrier is European or American, consumers are the winners.
- Consumers are also the winners with the start of new codeshare service to Spain and Greece. Moreover, the major airline alliances are now offering new codeshares over European intermediate points outside their traditional hubs—such as Lufthansa codesharing on United's flights

between Paris and the United States. Such service increases routing possibilities and consumer choice.

- Pressures to cut prices are already evident, particularly for business fares in previously restricted markets such as Heathrow and also in the important area of corporate contract fares. An article in the New York Times of April 13, for example, described a growing list of discounted business class fares in the transatlantic market, including offers from Air France, British Airways, Lufthansa, Continental, Swiss, and Silverjet.
- New air service and lower prices, however, are not the end of the success story. On the regulatory side:
 - DOT has issued an order that permits U.S. airlines to make use of foreign aircraft with crew for international service, including aircraft with crew from European airlines.
 - The U.S. General Services Administration has issued guidance to ensure effective EU airline access to certain Fly America traffic.
 - United and bmi have been granted antitrust immunity; and DOT, citing the new agreement among other considerations, has issued a tentative decision granting antitrust immunity to the SkyTeam alliance after having turned down a similar application in 2005.
 - DOT has also authorized Virgin Nigeria—an air carrier designated by Nigeria but with a very substantial ownership and management stake by Sir Richard Branson’s Virgin group—to operate to the United States based on the limited waiver of the nationality clause for certain African countries in our new agreement.
 - The U.S. Transportation Security Administration and DG-TREN have signed a formal “Working Arrangement” on airport assessments that moves us an important step forward on the path to one-stop security.
 - Finally, let us not forget that the Agreement resolved the violations of European law identified in 2002 by the European Court of Justice and, in so doing, has provided legal stability not only for the transatlantic market as a whole but for the mergers of Air France and KLM as well as Lufthansa and Swiss.

- Let me turn to the second-stage negotiations.
- I have one message to convey: the United States approaches these negotiations with commitment and enthusiasm. The second stage presents a unique opportunity to deepen and to broaden the scope of aviation liberalization.
- We are, of course, aware of the challenges ahead. No one should expect results overnight. The negotiations will require both sides to focus on what matters most and what's achievable. It's certainly premature for gloom-and-doom predictions about what will happen if the negotiations don't yield the specific results demanded by some.
- What will the United States seek to accomplish in the second stage? Let me address three areas: new traffic rights, environmental constraints, and investment liberalization.
- With regard to traffic rights, we start from the fact that our new "open skies plus" agreement already secures for both sides' airlines unrestricted first, second, third, fourth, fifth, and sixth freedom rights. Moreover, EU airlines have unrestricted cargo seventh-freedom rights. U.S. carriers enjoy more limited opportunities. That's an imbalance in the Agreement that the United States will aim to address in the second stage.
- With regard to environmental constraints, let me start with noise. The International Civil Aviation Organization (ICAO) has spoken, and Europe has endorsed the global consensus on airport noise.
- In the Air Transport Agreement, the United States and European Union committed explicitly to implement the so-called "balanced approach" to noise management that has been adopted by ICAO and incorporated in a European Community directive.
- At its core, the "balanced approach" requires a careful evaluation, including cost-benefit analysis, of the full range of measures for dealing with airport noise concerns before a decision is made about operational restrictions such as night curfews. Alternative measures include land-use

planning, alternate flight paths, and the use of insulation for homes near airports.

- Unfortunately, we have growing concerns about the commitment to good-faith compliance with the “balanced approach” in certain quarters of the EU. Night flight restrictions envisioned for the airports in Oporto, Frankfurt, and Brussels, for example, appear to have been implemented or proposed based on political considerations, not the “balanced approach.”
- For the present, we have raised our concerns in the Joint Committee that is overseeing the implementation of the Air Transport Agreement. But I can’t preclude that the United States may seek more systemic, procedural commitments from the EU in the second stage. These could include a U.S. proposal that the EU replace the noise directive with a more easily enforceable noise regulation.
- A word about aviation greenhouse gas emissions. We believe that the active discussions currently underway in the International Civil Aviation Organization (ICAO) are the right place to tackle this important question. This is a global issue in a global industry that calls for a global solution.
- I should add that the United States has a compelling story to tell about our performance in aviation emissions. Compared to 2000, U.S. commercial aviation is moving 12% more passengers and 22% more freight while burning less fuel and reducing carbon output by a million tons. In fact, between 2000 and 2006, aviation CO₂ emissions in the United States actually declined by about 4%. And we continue to make improvements to maintain that trend.
- We do not rule out the possibility that environmental constraints on the exercise of traffic freedoms may figure in the second stage negotiations. While we plan no proposals at the opening round in Slovenia, the United States believes any eventual discussions should be consistent with ICAO principles and center on performance not the adoption of a particular measure.
- Let me now address the question of liberalizing opportunities for the ownership and control of airlines.

- There are, from our perspective, two different but related aspects of investment liberalization:
 - The one most commonly mentioned—certainly here in Europe— involves liberalizing the laws that limit the ownership and control of European and American air carriers.
 - The second aspect involves dismantling the sticky spider’s web of restrictions in bilateral aviation agreements that form a huge impediment to expanded cross-border investment in and management of airlines around the world.

- With respect to the first aspect, we approach with an open mind the expected European proposal to change U.S. laws that limit foreign ownership of U.S. carriers to 25% of voting stock and prohibit “actual control” by foreign citizens. There are potential benefits to both sides’ economies of expanding investment opportunities on a reciprocal basis and enhancing the ability of airlines to serve a global market. The Department of Transportation made this clear in December 2006 when withdrawing the rulemaking on the interpretation of the “actual control” requirement in U.S. law. DOT wrote:
 - “[T]here are significant benefits to be realized by liberalizing and rationalizing our domestic investment regime for U.S. air carriers. ... [W]e need a way to enable strategic investors ‘interested in long-term gain, not short-term arbitrage’ to participate more meaningfully in the decision-making of U.S. carriers. ... [This] would permit our carriers to catch up with increasingly competitive and financially stronger foreign airlines.”

- If, however, the U.S. Government, including the U.S. Congress, is to be persuaded to change decades-old law, the proponents of change—including the European Union and private sector stakeholders—will need to explain the benefits in clear and convincing terms. To put the point more directly: what are the concrete benefits for citizens of the United States and Europe of allowing greater foreign investment in airlines; how would our lives be changed for the better?

- It’s simply not enough to assert that the rules for investment in airlines should be “normalized.” There are many—and not just in the United

States—who believe that airlines are anything but a normal service industry.

- What this means is that the negotiations will need to tackle in depth several serious and complex issues. These include:
 - the role that U.S. carriers play in America’s national defense under the Civil Reserve Air Fleet (CRAF) program;
 - homeland security issues centered on the tragic reality that U.S. aircraft engaged in domestic flights were the weapons of choice for the September 11 terrorists;
 - the concerns of airline labor about upsetting the balance of power between management and unions;
 - the risks to existing traffic rights in agreements with third countries if U.S. airlines are owned or controlled by EU nationals; and, finally,
 - questions whether rights on paper for U.S. companies to invest in European airlines would be exercisable in the real world—would American investors truly be allowed to take over, for example, Alitalia, Air France, Lufthansa, Iberia, or BA?

- Let me turn to the second aspect of investment liberalization: sweeping away that spider’s web of constraints in bilateral air services agreements that fall under the rubric of the “nationality clause.”

- The longstanding bilateral system for exchanging aviation rights is built around this standard provision in aviation agreements that grants rights to the airlines of a partner country only if those airlines are “substantially owned and effectively controlled” by nationals of that country. For example, only airlines substantially owned and effectively controlled by nationals of India are entitled to operate to the United States under the U.S.-India Open Skies air transport agreement, and *vice versa*.

- This fundamental—indeed, almost defining—element of the bilateral system has long been recognized as a major legal barrier to significant cross-border investment, not to mention cross-border airline mergers. The Commission, pursuant to the so-called horizontal mandate, has sought to loosen somewhat this constraint insofar as ownership and control is lodged in citizens of other EU member states.

- In the first-stage Air Transport Agreement, the United States agreed not to exercise its right to bar air services by any airline designated by some 10 countries in Europe that are not members of the EU as well as 18 African countries on grounds that EU nationals control the airline.
 - To take a concrete example, the United States may not object to flights to the U.S. by a Nigerian airline on grounds that the airline is owned and controlled by British nationals. It was this legal commitment that helped opened the door for DOT to approve flights to the United States by Virgin Nigeria.
- This provision in the first-stage agreement was a first step toward liberalizing airline investment opportunities. It's a step that we will wish to replicate for U.S. investors in the second stage and to expand much more broadly for the EU, the United States, and other countries.
- Thus, in Slovenia, we will propose that, as a core objective of investment liberalization in the second stage, the European Union and the United States should include a much expanded list of countries for which, reciprocally, each side will pledge to forgo existing rights to bar air services on the basis of the nationality clause.
- To be more specific, the United States will suggest a list of over 60 countries for which we propose to achieve this important step of investment liberalization. And, let me add, we do not rule out expanding this list in the course of the negotiations.
- But we should go an important, indeed pathbreaking step further. In Slovenia, the United States will also propose that we negotiate, as part of the second stage, an ancillary multilateral agreement that will be open to accession by other countries that are prepared to enter into reciprocal obligations to lift the barriers to cross-border investment by pledging to forgo recourse to the nationality clause.
- The time for such a multilateral initiative is ripe. And who better to lead the effort than the European Union and the United States? Indeed, the charter for the second-stage negotiations in Article 21 of our Agreement calls on both sides to “establish[] a framework that will encourage other countries to open their air services markets.”

- We do not believe it is either wise or possible to treat U.S.-EU aviation in a vacuum, separate and apart from the broader global aviation market. It is not enough, in our view, to treat the second stage solely as a vehicle for deepening the already extensive liberalization of the transatlantic market. We must also broaden the scope of liberalization wherever possible. Our proposal for a multilateral convention waiving recourse to the nationality clause is a first step. We are prepared to consider additional steps as well.
- In closing, I would like to draw some lessons from the first-stage negotiations that may help us to succeed in the second.
- First, an exercise of this scope and complexity will take time. There will not be an “early harvest,” and we should prepare, as BA’s Rod Eddington urged early in the first stage, for a marathon, not a sprint to the finish line.
- Second, I would urge that we concentrate, as we did in the first stage, on what matters most to consumers and on what is achievable. As much as the European Union may cherish the term “Open Aviation Area,” it is not realistic to think that second-stage negotiations can yield a framework for transatlantic aviation that mirrors the fully integrated EU internal aviation market. I, like many Americans, admire and salute what Europe has accomplished. We do not, however, wish to join the EU—at least not right now!
- Third, it will again be essential to work through complex issues in a way that is open, analytical, and consensus-oriented. For example, when airline labor representatives express concerns about the implications of investment liberalization for the existing balance of power between airline unions and airline management, we have no choice but to roll up our sleeves and tackle the complex legal and policy issues in detail and determine whether we can craft balanced solutions.
- Do we face an impossible task in the second stage? My answer is no. We have the invaluable experience of the first-stage agreement where four years of hard work, commitment, and vision allowed us to achieve what some would call a miracle. And, in Daniel Calleja, Europe has one

of the ablest leaders and negotiators it has ever been my pleasure to know.

- I look forward to beginning this important work on Thursday in Slovenia. But first, I look forward to hearing your comments and fielding your questions.
- Thank you, sincerely, for the honor of speaking before the European Aviation Club today.