Aviation: Open Skies

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This note covers the negotiations leading up to the 2007 'Open Skies' agreement between the United States and the European Union that began in March 2008, with a draft second stage agreement reached in March 2010.

It also outlines the main transatlantic aviation agreements between the United States and the United Kingdom prior to 2008.

Information on the liberalisation of the aviation market within the European Union is available in Standard Note SN/BT/182. Further briefs are available on the Aviation topical page of the Parliament website.

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1.1 Bermuda 2

A complex bilateral agreement between Britain and the United States defined the rules under which airlines could fly the Atlantic until the 'Open Skies' agreement took effect in 2008, see below). The first agreement, signed in Bermuda on 11 February 1946, became known as Bermuda 1. On 22 June 1977 a second agreement, Bermuda 2, was reached and superceded Bermuda 1. It was subsequently amended in September 1988, June 1990 and March 1991.

The negotiations leading to the June 1990 amendment continued for more than a year. The main points of the package eventually agreed on this occasion particularly affected regional airports:

- American Airlines' existing Chicago–Manchester route was confirmed;
- the US could start two more routes from the US to UK regional airports;
- an additional British carrier was allowed on the London to Boston route;
- the UK could operate two routes from any UK regional airport and any of the UK gateway airports; and
- the Cayman airline was allowed access to an additional gateway point.

More details were given response to a July 1990 WPQ:

> **Mr. McLoughlin**: Administrative arrangements are expected to be completed within the next few days to bring the new agreement into immediate effect. Formal processes will be concluded at a convenient time thereafter. One of the new route opportunities created for the United States will be used to provide cover for the existing service by American Airlines between Chicago and Manchester, which at present operates informally. The two other new route opportunities available to the United States and the two new opportunities for the United Kingdom will be allocated by the authorities of the two countries following applications by interested carriers. This process depends upon decisions initially to be made by carriers according to their commercial judgment. No timetable therefore applies.
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> Existing routes between the United Kingdom and the continental United States are as follows. Services are not operated on all routes.
>
> Between London and Prestwick/Glasgow and Anchorage, Atlanta, Baltimore, Boston, Chicago, Dallas/Fort Worth, Denver, Detroit, Houston, Los Angeles, Miami, Minneapolis/St. Paul, Newark, New York, Philadelphia, Pittsburgh, St. Louis, San Francisco, Seattle, Cincinnati, Washington/Baltimore, Charlotte, Tampa, San Diego and Orlando.Between Manchester and Atlanta, Boston, Chicago, Dallas/Fort Worth, Detroit, Houston, Los Angeles, Miami, Pittsburgh, New York, Philadelphia, Denver, San Francisco, Seattle, Washington/Baltimore, Tampa, San Diego, Newark and Orlando.

> The new agreement will allow two services by the United States, in addition to the existing Chicago—Manchester service, and two by the United Kingdom using any regional airport, including Manchester.[1]

Under Bermuda 2 only British Airways (BA), PanAm and TWA were allowed to use London Heathrow for transatlantic services. Under another set of restrictions, the London air traffic distribution rules (TDRs), operators of international scheduled passenger services who had not previously operated such services from Heathrow were prohibited from using the airport. The impending bankruptcy of PanAm and TWA spurred US negotiators to seek further revisions to Bermuda 2 so as to replace PanAm and TWA with United Airlines and American Airlines.

The then Secretary of State for Transport, Malcolm Rifkind, agreed to remove the restriction to PanAm and TWA in March 1991, though this did not form part of any official revision of Bermuda 2.[2] This paved the way for new operators to use Heathrow. On 11 March 1991 Bermuda 2 was revised to allow American Airlines, United Airlines and Virgin Atlantic to use Heathrow (along with several other concessions). Mr Rifkind summarised the agreement in his statement in the Commons:

> I am pleased to announce to the House that the United Kingdom has this morning reached an agreement with the United States that offers major new opportunities to British airlines on transatlantic routes. The agreement allows two new United States airlines to take over Pan Am's and TWA's Heathrow routes, but with fewer rights than are currently available to Pan Am and TWA.
>
> In addition, the United Kingdom will get an unprecedented wide range of new opportunities to compete in United States markets. United Kingdom airlines - especially British Airways - were closely involved in shaping the package throughout the negotiation, and I am grateful to them.
>
> United Kingdom benefits include, first, the designation of a second British carrier to operate to the United States from Heathrow; secondly, a new facility for second or third United Kingdom airlines to fly on certain existing routes; thirdly, a completely new right to fly to the United States via continental Europe and to fly on from the United States to Mexico, the Caribbean, South America, and the Pacific; fourthly, a new ability to make marketing arrangements with United States airlines, known as code sharing, to all points from which United States carriers code share to the United Kingdom; and finally, opportunities for the first time for joint ventures between United Kingdom carriers and carriers from other European countries. Any growth of United States airlines' frequencies to and from Heathrow will be strictly limited for a three-year period.
>
> Both sides agree that there will be further talks aimed at liberalisation of the British-American market, allowing airlines on both sides to compete on equal terms for transatlantic and internal United States traffic, without the limitations and complications of the present bilateral arrangements. Those talks will address complex questions such as cabotage and inward investment.
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> The agreement has not been easy to negotiate. The latest round continued throughout the weekend, and I place on record my appreciation of the skill and persistence of our negotiating team. The package that it thrashed out is a splendid one, which benefits

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1 HC Deb 26 July 1990, cc400-401W

2 HC Deb 5 March 1991, cc149-150; the statement announced the repeal of the so-called 'Heathrow rules' 1, 2 and 3 which prohibited new operators of international scheduled passenger services; banned charter flights; and limited new domestic services using the airport

> United Kingdom carriers and offers a wide range of opportunities for airlines to compete in offering better services to the travelling public.[3]

The March 1991 agreement was examined by the Transport Select Committee. It looked at the various aspects of the agreement, including which side achieved its negotiation aims; the value of the 'seventh freedom' rights given in the agreement;[4] and the implications for cabotage[5] and inward investment. On 'who got what', the Committee stated:

> The US side achieved its goal of obtaining permission for American Airlines and United Airlines to take PanAm and TWA's Heathrow routes. A compromise on levels of service was reached which effectively restrains the commercial power of US airlines by limiting their operations to the levels operated by United Kingdom airlines, on a route by route basis, over the first three years**. As the US domestic aviation market accounts for half the world's civil aviation, it would not, in our view, create a level playing field if the British Government were to adopt an "open skies" policy on the transatlantic routes when US operators alone can feed from such a strong domestic base**. We therefore welcome the albeit temporary capacity restrictions which have been agreed with the US authorities. We are concerned at the effect which the lifting of these restrictions will have and trust that progress will have been made in the interim on the establishment of a genuinely "level playing field".
>
> The US negotiators' aims were straightforward, those of the United Kingdom less so. There was no single concession within the gift of the US negotiators which matched the estimated benefits of the Heathrow succession to the Americans.
>
> Revisions to Bermuda 2 which benefit United Kingdom airlines are as follows:–
>
> a) Permission for a second (unnamed) United Kingdom airline to fly transatlantic routes from Heathrow;
>
> b) Fifth freedom rights to serve five additional US gateway cities (on top of seven existing) via Canada;
>
> c) Fifth freedom rights to serve Mexico via five additional US gateways (on top or five existing);
>
> d) Fifth freedom rights to serve an additional three South American countries (Chile. Bolivia and Ecuador on top or three existing, Colombia, Venezuela, Peru) from three additional US gateways (on top of two existing, Atlanta and San Juan);
>
> e) Fifth freedom rights through any three US cities to New Zealand, Indonesia, Taiwan, Singapore, Korea and Malaysia.
>
> f) A daily fifth freedom service between Seattle and Australia.
>
> g) Rights to make agreements with US operators for sharing flight codes, thereby increasing the cope for feeding British Transatlantic services, from points which are not among the United Kingdom specified gateways.

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3 HC Deb 11 March 1991, c676

4 there are nine ' freedoms of the air'; the 'seventh freedom' is: "the right or privilege, in respect of scheduled international air services, granted by one State to another State, of transporting traffic between the territory of the granting State and any third State with no requirement to include on such operation any point in the territory of the recipient State, i.e the service need not connect to or be an extension of any service to/from the home State of the carrier"

5 'cabotage' is the transport of goods or passengers between two points in the same country; the eighth and ninth freedoms relate to this

h) Permission to designate up to three United Kingdom airlines on up to four routes, two of which can be newly selected and two can be chosen in return for surrender of rights to existing gateways which are not being used.

i) The acceptance that United Kingdom ownership of less than 50 per cent of European Community airline should not be grounds for withholding the airline's access to the US market on the grounds that it is not owned and controlled by nationals of that European Community country.

j) Permission for United Kingdom joint venture arrangements with airlines from other European Community countries. This is particularly favourable for joint ventures with Belgium, The Netherlands, Luxembourg and Ireland because only one of the parties to the joint venture countries needs the relevant bilateral rights to allow a service including the three countries (eg, Brussels London--Boston). In the case of joint ventures between the United Kingdom and France or Germany, both partners must have bilateral rights with the US, for example, to operate Paris London--Boston.

k) Sympathetic consideration of joint ventures with other countries.

l) The rights for United Kingdom airlines to operate stand alone services between certain European Community countries and the US. These so called "seventh freedom" rights are a radical departure and subject to argument as to their value.

In the words of the Secretary of State a successful outcome required "– a competitive overall balance to be properly maintained". One of the problems with this is the difficulty of putting values on the various concessions. Each concession is a commercial opportunity to develop a particular market and consequently the revenue potential depends upon the enterprise of the airline, as well as the general state of the aviation market. Furthermore the revenues will build up gradually as service are developed and marketing takes effect. In announcing the agreement to the House on 11 March the Secretary of State said that

> "British airlines will enjoy a gross benefit of some £200 million (per annum) more than the likely financial benefit to the United States".

British Airways disputed the figure of £200 million, believing the benefits to be nearer £130 million and well short of the benefits to American carriers. The Department and CAA have since re-estimated the benefits and stated that the balance was still in favour of British interests.

It was inconceivable that, had PanAm and TWA collapsed, no US carriers would have been allowed into Heathrow. We have been told by all but one party that the United Kingdom side did better out of the revisions to Bermuda 2. Understandably BA regrets changes which inevitably diminish its share of the lucrative, transatlantic business market. The fact remains that United and American Airlines have effectively "bought" their slots at Heathrow through the purchase of PanAm's and TWA's rights. This seems contrary to previous and current practices and we can appreciate that by allowing this transfer, the British Government have in effect permitted the propping up (if only temporarily) of two ailing US airlines and allowed two powerful airlines with very large domestic systems to considerably increase the number of their flights between the United Kingdom and the USA and have thereby altered the balance of competition for BA. But we have every confidence that a well-run airline like BA can adapt to meet the challenge for competition; we see it happening already in the current restructuring and joint-venture proposals. Nevertheless, **we recommend that the outturn benefits**

of the new agreement are monitored as closely as commercial sensitivity will permit. This will allow negotiators to make better estimates in the future.[6]

On the value of 'seventh freedoms' the Committee stated:

> A "seventh freedom" is a recent conception taken to mean the right of one country to operate a stand alone service between two other countries. The new agreement gave the United Kingdom rights into the US for a total of three routes from Ireland, Luxembourg and the Netherlands and two each from Belgium. France and Germany. But permission must be obtained from each of these countries before a service can be operated and such permission is unlikely to be forthcoming in the future. There is the possibility, however, that the situation could change radically in a fully liberalised internal market. Mr Sorensen, head of air transport policy at the European Commission, told us that under a single market for aviation in the Community air carriers should be able to fly freely both within the Community and from Community airports to the rest of the world. In which case seventh freedom service are inherent in the whole idea of the single market .
>
> There has been a difference of view concerning the importance to British Airways of the seventh freedoms. The Secretary of State told the House that BA "identified [seventh freedoms] as one or the most important objectives that it hoped the negotiation would achieve". But the Chairman of BA said soon after the acquisition of these rights: "That sounds good but how would you like to get the French and Germans to agree to that?". BA confirmed that the seventh freedom rights had been sought at their instigation but accepted that it may be years before they could be used. The main reason for seeking these rights was, in BA's view, the need for a bargaining counter against European airlines' existing but unused 5th freedom rights which, with the completion or the single market. the US would have to allow. They reared that German, Dutch and French airlines would be able to operate through the United Kingdom to the USA, without the United Kingdom obtaining anything useful in return. In BA's view allowing seventh freedom routes would be the quid pro quo in such an eventuality.
>
> We were told by Mr Wheatcroft that "the value or the rights which British Airways have just gained in the agreement with the United States … will turn entirely on its ability to establish itself in that other European country". Frere Cholmeley took the view that seventh freedoms were "just the sort of thing to which the Commission's proposals on liberalising and harmonising may lead, but those proposals have not yet been produced". Rowe and Maw considered it "a sort of advance approval by the Americans in advance or any Community-US bilateral agreement".[7]

And on cabotage and inward investment, the Committee stated:

> European airlines do not at present have cabotage rights within the USA, that is, they cannot pick up passengers or freight at one US city for delivery at another US city. US airlines would presumably put little value on cabotage rights within the United Kingdom because of the small distances and markets involved but they would value fifth freedoms from London to other major centres in the European Community. The creation of the European Community single market in 1993 and the moves towards single market in aviation raises the prospect of the exchange of cabotage rights between the European Community en bloc and the USA.

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6 Transport Committee, *Developments in European Community Air Transport Policy* (first report of session 1991-92), HC 147, December 1991, paras 108-111 [emphasis in original]

7 ibid., paras 112-114

At present the US enjoys fifth freedoms beyond London to Berlin, Hamburg Munich and Frankfurt, and beyond Prestwick or Glasgow to Oslo. Mr Sorensen when asked whether existing fifth freedom services from third countries would be treated as cabotage after 1992, replied that they would be honoured as acquired rights but that "new fifth freedom traffic rights to third country airlines should not be given from now on because it is of Community interest". Rowe and Maw pointed out that there is a "very basic and fundamental question of aviation law" at stake over cabotage within the single market because it may be in conflict with Article I of the Chicago Convention which provides "that each member state shall have complete and exclusive jurisdiction over the airspace of its territory".

The important question for the British airlines is how to obtain cabotage rights within the US under the existing system of bilateral agreements. Cabotage (and inward investment in the US) was excluded from the agenda on the Bermuda 2 (Heathrow succession) negotiations which took place earlier this year. The Secretary of State told the House that "we did not consider statements of intent by the United States Administration on those issues sufficient to form a crucial part of the existing package "because they depended on eventual Congressional approval" so that he was "certainly seeking cabotage and inward investment rights as part of the ongoing negotiation in the United States". British Airways, however, believes that these issues should have been included in the recent negotiations and that the United Kingdom side in future has nothing with which to bargain. It has been reported that BA would prefer future negotiations to be between Europe and the US rather than in the traditional forum of United Kingdom-US bilaterals. In a private meeting, Mr Skinner, the US Secretary for Transportation, suggested to us that the biggest selling point for cabotage within the US may be the consumer benefits it offers.

At the moment foreign investors may buy up to 49 per cent of the equity in a US airline but can exercise voting rights only up to a maximum of only 25 per cent. On 20 June 1991, Mr Skinner announced that the Administration was willing to back a change whereby foreign investors might acquire up to 49 per cent of the voting stock. GAO confirmed that Congress was sympathetic to foreign investment which would allow financially weak US airlines to continue in operation. Consumers would benefit from more competition on particular route within the US. Mr Lipman did not see "any reason why British Airways could not successfully operate a system inside the United States or American Airlines operate a system inside Europe" .

We support British Airways in its desire for access to the US domestic market and have considerable sympathy for their objective of "keeping the American airlines hungry so that we would be able to have another attempt at cabotage and inward investment in a less rushed political time frame. The continued existence of fifth freedom rights from London may serve as a useful bargaining counter in future negotiations.

We think it unlikely that a small number of discrete cabotage routes within the US will be commercially viable. To operate successfully in the US market an airline needs a feeder network of its own. It is for this reason that BA have indicated a wish to buy into a US airline and came close to investing in United, one of the new US mega carriers now operating into Heathrow. Virgin, on the other hand, preferred to keep out of short-haul operations in the US to concentrate on of offering better value for money on long-haul than American and United. An alternative strategy would be to strengthen a weaker US carrier with investment from a British airline. These are early days in a new battle for transatlantic market share and **we trust that the Government will see a**

role in developing opportunities for British carriers as well as providing better services for consumers. [8]

1.2 Attempts at further liberalisation

Further talks aimed at liberalisation of the Anglo-American market continued throughout 1992; from July 1992 the talks were interlinked with BA's proposed £460 million investment in USAir which would have given BA a 44 per cent equity share. This proposal was resisted by the major US carriers (American, United and Delta Airlines), who pressed the Federal Government not to approve the transaction unless greater access to the UK could be secured for US airlines. In December 1992 BA pulled out of the USAir deal "after the US government had given a clear indication that this particular transaction would not be approved without unwarranted and unilateral concessions by the UK government under the two countries bilateral air services agreement".[9]

BA and USAir eventually agreed to BA investing £200 million in USAir securing an 18.9 per cent equity stake. The deal was given Federal Government approval in March 1993 subject to a twelve month review. The US Transportation Secretary, Federico Pena, agreed to BA's request for 'code-sharing' with USAir[10] and approved plans for USAir to lease aircraft and crews to BA for London-Baltimore and London-Pittsburgh flights. BA welcomed Secretary Pena's statement, stating that it would begin the code-sharing agreement to three US cities on 1 May 1993.[11] According to some British newspaper reports at the time, Secretary Pena's qualified approval of BA's investment in USAir was actually designed to force concessions from Britain. Without these BA would not be permitted to proceed to further stages of its plan for closer link with USAir.[12]

In November 1993 disagreements arose surrounding BA's application to extend its code-sharing agreement with USAir. After a three-month delay the US announced that it would only give approval for the new BA code-sharing services for 60 days rather than 12 months. The UK claimed that this was in breach of the revised Bermuda 2 agreement and threatened to withdraw permission for one flight a week each by American Airlines and United Airlines from London Heathrow to Chicago O'Hare and Washington Dulles respectively. Permission was given to BA and USAir to renew the code-sharing arrangement in March 1994.[13]

In February 1994 the then Transport Minister, Steve Norris, stated that the UK had tabled a liberalisation proposal the previous December which went further than anything previously offered.[14] The US walked out of the talks in December 1993 citing the UK Government's failure to open up Heathrow to all US carriers. It was suggested in the press that it was BA's shrewd lobbying that led the UK Government to refuse further access to Heathrow.[15] The then Secretary of State for Transport, John MacGregor, addressed the issue in May 1994:

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8 ibid., paras 115-120 [emphasis in original]

9 "British Airways pulls out of USAir deal but new talks planned", *Reuters,* 22 December 1992

10 essentially, this meant listing USAir's US flights and BA's transatlantic flights under the same codes in computer booking systems

11 Cleveland OH, Syracuse NY, and Rochester NY

12 "US set for Heathrow showdown," *The Observer*, 2 May 1993

13 during this period Virgin Atlantic also negotiated a code-sharing deal with Delta Airlines; the agreement allowed Delta to block-book a third of seats on Virgin flights between seven American cities and Heathrow; Delta was able to price the seats as it wished and have its own attendants on board; Virgin's seven American destinations were tied into Delta's network of 200 airports

14 HC Deb 22 February 1994, c119W

15 "Even Virgins do it", *The Economist,* 16 April 1994

> … there are real constraints at Heathrow. We are trying to persuade the United States Government--with increasing success, because the arguments are being recognised--that there is not unlimited access to Heathrow. I am also keen to encourage the expansion of regional airports and that is why last December we proposed to the United States Government opening all our regional airports at the first stage.
>
> … I am trying to get the talks restarted and have been seeking a number of ways to do so. I made further proposals to the United States Government in relation to the recent Delta- Virgin code-sharing arrangement, suggesting that we should take advantage of that deal to have some interim agreements to get the talks going again and I included proposals for the regional airports.
>
> … The problem is the United States Government have not accepted our offers in relation to Stansted and the regional airports … It is important that all interests - the airlines and the airports - are involved in the negotiations. We would not fulfil our liberal objectives if we agreed to a deal that would allow United States airlines to exploit their unfair competitive advantage, while giving United Kingdom airlines nothing in return and driving them out of the market. That is the problem and that is why I wanted a balanced deal. I assure my hon. Friend that that deal very much includes giving open access to the regional airports and Stansted as quickly as we can get a positive and constructive response from the other side.[16]

On 5 June 1995 an agreement was reached, though it fell short of a full 'open skies' deal. The then Secretary of State, Dr Brian Mawhinney, gave some information about the agreement in a written answer:

> … passengers will be able to benefit from greater frequency of transatlantic service and wider choice, and the prospect of more competitive fares. The deal allows increased services for British Airways on its Heathrow-Philadelphia route, allows a second US airline to operate the Heathrow-Chicago route, confirms and extends the terms of the regional liberalisation offer which I made last October, substantially liberalises code-sharing arrangements and allows UK airlines the opportunity to carry some US Government traffic which has, up to now, not been open to UK airlines.
>
> Both Governments agreed that the provisions of the agreement would come into effect once the US Government had approved all outstanding code share applications by, British Airways in respect of US Air,
>
> Both Governments have also agreed to begin work immediately on the next stage of negotiations with the aim of opening up further opportunities.[17]

Further details of the agreement included:

- allowing United Airlines to fly into Heathrow from its home base in Chicago;
- restricting United Airlines to the use of the Boeing 767 on this route (which carries only 211 passengers);
- limiting the ability of UK airlines to bid for UK Government business to journeys between five US cities and London but not to points beyond; and
- acceptance by the US of the UK Government's offer of October 1994 to open up all regional airports to US operators.

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16 HC Deb 9 May 1994, cc3-4
17 HC Deb 7 June 1995, c228W

The agreement did not give US airlines any further 'fifth freedom' rights.[18]

2 US-EU agreements

2.1 Framework to manage bilateral agreements

The European Commission (EC) has increasingly viewed bilateral air agreements negotiated individually by each Member State with third countries to be incompatible with an integrated European aviation strategy.

On 5 November 2002, the European Court of Justice (ECJ) delivered its judgment in the cases which the Commission had brought against eight Member States regarding those countries' signing bilateral air service agreements with the United States.[19] In delivering its judgment, the Court considered that Member States had made commitments in areas where competence had been transferred to the Community, such as computerised reservation systems (CRS), intra-Community fares and rates and airport slots. The ECJ ruled that Member States had flouted one of the basic principles of the Treaty of Rome, namely the principle of non-discrimination in the form of nationality clauses in the bilateral agreements. These were judged to discriminate on grounds of nationality, which in turn limited the freedom of establishment of Community companies.[20]

The ECJ's judgments resolved the question of shared competence between the Member States and the Community. They also placed an obligation on the Member States in question to bring their bilateral agreements into line with Community law. The Community institutions and all the Member States spent the period between November 2002 and June 2003 determining what practical measures should be implemented following the judgments, given the complexity of the issues concerned, the importance of the stakes and the various interpretations of the judgments.

On 5 June 2003, the Council of Ministers granted the Commission two mandates.[21] Firstly, a negotiation mandate with the United States, and secondly, a negotiation mandate with all third countries for the revision of clauses relating to the ownership and control of airline companies and all matters coming under the 'exclusive external competence of the Community'. These mandates, in effect, enabled the Commission to negotiate with the US and the rest of the world on the basis of the Community's economic and political priorities.

2.2 Open Skies negotiations, 2003-2006

It was intended that any agreement reached as a result of the EU-US negotiations would replace the bilateral agreements between individual Member States and the US. The EU-US Air Transport Agreement would establish an Open Aviation Area (OAA or 'Open Skies') between the two territories.

The negotiations therefore covered all the arrangements governing air transport between and within the EU and US. This includes:

- the rules governing market access (routes, capacity, frequency);

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[18] i.e. the ability to pick up passengers in a country other than the home country of the airline (in this case the UK) and carry them to points in further countries (Europe, for example)

[19] Austria, Belgium, Denmark, Finland, Germany, Luxembourg, Sweden and the United Kingdom

[20] *Commission of the European Communities v United Kingdom of Great Britain and Northern Ireland. - Case C-466/98*, et al.

[21] previously requested in COM/2003/0094

- how air fares are set;
- how to ensure effective application of competition rules; and
- how to ensure maintenance of high standards of airline safety and aviation security.

The negotiations were also intended to address opening up each side's internal market to the airlines of the other side. A key element in this would be the removal of the special restrictions which apply to foreign ownership and control of airlines in the US and the EU.

The theory behind Open Skies is that it would ultimately produce a more competitive market and generate greater choice of services and lower fares for travellers while taking into account the need to maintain the security and safety of air travel. It would give EU and US airlines complete freedom to serve any pairs of airports in the EU and US (when negotiations began EU airlines were only able to operate between their own Member State and the US and between airports within the EU). Relaxing restrictions on ownership and control would also make it easier for EU and US airlines to enter into mergers and take-overs with each other.

A report prepared for the European Commission by US consultants The Brattle Group estimated that EU-US Open Skies would generate upwards of 17 million extra passengers a year, provide 'consumer benefits' of at least $5 billion a year, and would boost employment on both sides of the Atlantic.[22]

Opposition to allowing the EU to undertake negotiations with the US on aviation policy on behalf of Member States was voiced repeatedly in Parliament. For example, in a debate on air transport in June 2004 then Shadow Transport Spokesman, Damian Green, said:

> The Minister will be aware that the Secretary of State will be asked to sign up to a deal between the Commission and the United States Government that is supposed to provide a much more liberal regime for airlines in Europe and the US … the deal that the Commission has negotiated is a bad one for large parts of the UK aviation industry. It will open up Heathrow to all US carriers, and give US carriers unlimited access to carry passengers and cargo within and beyond the EU. It does not give rights in return for our airlines to fly within the US, to buy a controlling stake in a US airline, or even to change the rules that prohibit by law any US official from using a foreign airline.
>
> Other countries, with less to negotiate with, may well feel that an imperfect deal is better than no deal at all. However, it is very important that the Secretary of State resists this deal. Even if he is isolated, he should stand his ground.[23]

The long-standing chairman of the Transport Select Committee, the late Gwyneth Dunwoody, voiced similar concerns in response to an intervention by John Wilkinson:

> **Mr. John Wilkinson (Ruislip-Northwood) (Con):** The hon. Lady is making a most cogent speech, as usual. Is there not a grave danger that the United Kingdom, which has premier status on the north Atlantic route in particular, could lose that position in the longer term through its extraordinary decision to allow the European Union to negotiate on its behalf air service agreements that should properly be the interest of our country alone?

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22 The Brattle Group, *The economic impact of an EU-US open aviation area*, December 2002

23 HC Deb 8 June 2004, cc188-189

> **Mrs. Dunwoody:** That is exactly the case. This is frightening because, of course, the interests of mainland European airports will not be the same as those of Heathrow. How could they conceivably be? Nor will the negotiation of individual slots or services at both our major airports be capable of any simple solution involving half a dozen other national airlines. That would not only produce great confusion, but place considerable pressure on the Government.[24]

The negotiations, which began in 2002, stalled repeatedly over the following four years. The fifth round of talks on Open Skies ended on 14 May 2004. John Byerly, then US Deputy Assistant Secretary of State for Transportation, said the two sides held "very productive… negotiations".[25] The negotiations focused on competition, safety, pricing, state aid, the environment, consumer protection, and foreign ownership. The bilateral summit in June 2004 failed, however, to reach agreement and negotiations were subsequently halted in the run-up to the November 2004 American Presidential Election. Following the visit of EU Transport Commissioner Jacques Barrot to the United States in March 2005, both sides announced that negotiations would be resumed but did not set a formal date.[26]

The main issue preventing agreement was cabotage, i.e. allowing European airlines to carry passengers and cargo between two points *within* the United States. The *European Information Bulletin* reported in July 2004 that the UK remained opposed to any agreement that did not provide significant access to the US domestic market.[27] It was further reported in April 2005 that M. Barrot had insisted that any 'phased' approach to agreement, as put forward by the US, would still need to include a precise notion on the final agreement, "otherwise I'll not have London's assent".[28]

Reports in early 2006 indicated that British Airways was concerned that more than one third of its operating profits could be 'wiped out' if a deal was agreed, due to the opening up of London Heathrow.[29] There were also concerns that any treaty would prohibit national governments from acting alone to tackle aviation emissions and other environmental issues, and that they would have to consult a joint EU-US committee.[30]

A report in May 2006 indicated that there was strong opposition to any treaty in the US Congress, from US unions and some airlines, particularly Continental.[31] Following the 2006 mid-term congressional elections in the US, the new Transportation Secretary, Mary Peters, announced that the administration would drop the proposed air carrier ownership liberalisation bill. This was a significant setback, as revision of the rules was deemed essential by the EU for their approval of any text.[32]

2.3 Open Skies Stage 1 agreement, 2007

On 2 March 2007 the European Commission agreed the November 2005 text of the draft EU-US Air Transport Agreement. It was approved by all Member States at a meeting of the Transport Council on 22 March, and was signed at the EU-US summit on 30 April. This is a

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24 ibid., c210

25 "US, EU conclude fifth round of 'open skies' talks," *EU Business*, 14 May 2004

26 *European Information – Transport*, April 2005, part 11.16-17

27 *European Information – Transport*, July 2004, part 1.12

28 quoted in: *European Information – Transport*, April 2005, part 11.17

29 see, for example, "BA attacks US 'open skies' deal", *Financial Times*, 19 January 2006; and "BA profits at risk if Brussels sacrifices Heathrow for open skies deal", *The Independent*, 6 January 2006

30 "'Open skies' air treaty threat", *The Guardian*, 20 February 2006

31 "Open skies treaty stalled by US objections", *Financial Times*, 3 May 2006

32 "Open skies hopes suffer as US abandons airline reforms", *Financial Times*, 6 December 2006

first stage agreement. As part of the agreement, negotiations on the second stage would have to begin within 60 days of the date of provisional application of the first part (originally 28 October 2007, finally 30 March 2008).

The main elements of the Agreement are:

- **"Community carrier" concept** permitting EU airlines to operate to the US from any point in the EU;
- Removal of all restrictions on international routes between the EU and US (**3rd/4th freedom rights**), and routes beyond the EU and US (**5th freedom rights**) – 16 Member States already have "open skies" with the US. This agreement extends "open skies" to the remaining 11 Member States, 6 of whom do not currently have an agreement with the US;
- Removal of all restrictions on **pricing** on all routes between EU and US, except for US carriers which can not price-lead on intra-EU routes;
- Removal of all restrictions on **7th freedom[33] flights for all-cargo services operated by EU airlines** but no additional 7th freedom all-cargo rights for US airlines;
- **7th freedom rights for passenger services for EU airlines only**, between the US and any point in the European Common Aviation Area (ECAA);
- Rights to enter into **franchising and branding** arrangements with other airlines or companies;
- Commitment of the US authorities to provide fair and expeditious consideration of anti-trust immunity (ATI) application and assurance that Community airlines qualify for ATI under the agreement;
- Unlimited **code sharing** between EU, US and third country airlines;
- Creation of new opportunities for EU airlines to **wet-lease[34]** aircraft to US airlines for use on international routes between the US and any third country, which was previously prohibited by the FAA;
- A new Annex on ownership, investment and control, which contains the following **binding provisions to the benefit of EU investors in the United States**, subject to the two limitations defined by US Statute:[35]
    1. As much as 25% of voting equity by EU investors and/or 49.9% of total equity of a US airline shall not be deemed to constitute control of that airline;
    2. Ownership of 50% or more of the total equity by EU nationals shall not be presumed to constitute control of that airline, subject to a case-by-case analysis.

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[33] the 'seventh freedom' is the right to carry passengers or cargo between two foreign countries without continuing service to one's own country

[34] a 'wet lease' is any leasing arrangement whereby a company agreed to provide an aircraft and at least one pilot to another company

[35] ownership by all foreign nationals of more than 25 per cent of a corporation's voting equity is prohibited by US law; actual control of foreign nationals is also limited by US Statute

3. Guarantee of fair and expeditious consideration of any transaction involving investment by EU nationals in US airlines.

- The Annex on ownership, investment and control equally relates to **US investments in the EU**. It contains a provision reserving the EU the right to limit investments by US nationals in the voting equity of a Community airline;

- The Annex on ownership, investment and control contains one-sided US binding commitments with regards to **EU investment and control of third countries' airlines** established in a number of States. The United States shall not exercise their rights to object to the operations to the United States of third countries' airlines owned and controlled by EU investors. It also provide for a mechanism to update the list of third countries;

- The Annex provides for rights in the area of **inward foreign investment in Community airlines** by ECAA investors, whereby the Community airlines owned and controlled by ECAA citizens will be treated by the US as EU nationals; and

- A role for the **Joint Committee** in matters concerning ownership and control, which will develop a common understanding of the criteria used by the EU and the US in making their respective decisions in cases concerning airline control.[36]

M. Barrot hailed the Agreement as "a good agreement – it is good for passengers and good for airlines; it is good for the European Union and its individual Member States, for the United States and for the entire transatlantic economy". He further stated that the European side would now enter the next phase of negotiations with the United States "in a strong position", insisting that the "first phase of our transatlantic agreement is not a dead-end":

> I am confident that the process we have started today will continue onwards to deliver greater freedom for investors in aviation, even closer cooperation between the two sides and a healthier air transport industry in general, not just across the Atlantic, but in due course with other countries all over the World.[37]

He was, however, more circumspect once the agreement was signed and was reportedly telling *Europolitics* that there was "more work to do", particularly as regards ownership of US airlines and the 'fly America' policy.[38] In July 2007 M. Barrot also wrote to Secretary Peters and the Chairman of the US House Transportation and Infrastructure Committee expressing concerns about the move by the Democratic-led Committee to tighten further the already tough restrictions on foreign ownership of US airlines.[39]

US Secretary Peters called it an "historic decision" that would "bring new and valuable benefits to air travellers and communities on both sides of the Atlantic":

> Tearing down regulatory barriers allows us to foster more affordable and convenient air travel and gives our airline industry more opportunities to compete, innovate and thrive. By expanding the ability of airlines to fly between Europe and the United States, this

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36 European Commission, *Air Transport Agreement between the EU and US*, 6 March 2007; safety and security also covered

37 EC press notice, "Jacques Barrot welcomes unanimous approval of EU US open skies deal", 22 March 2007: http://ec.europa.eu/transport/air_portal/international/pillars/global_partners/doc/us/2007_03_22_press_release.pdf

38 "Open Sky – the unresolved issues", *Europolitics*, 4 May 2007

39 "Brussels warns US over threat to 'open skies'", *Financial Times*, 17 July 2007

> agreement will spur growth within our aviation network and enhance the freedom of American fliers to choose where and when they travel. We look forward to the positive effects this agreement will bring to the economic, political, and personal relationships between our two continents for years to come.[40]

In a Written Statement to the House, the then Secretary of State for Transport, Douglas Alexander, made the point that "negotiations should resume quickly to make further progress on a second stage". He reported that:

> A number of Ministers spoke to welcome the Agreement. I pointed out that the UK accounts for a 40% share of the EU-US market. The deal on the table did not go the full way to achieving a fully liberalised Open Aviation Area, so it was essential to have a clear timetable for delivering a stage 2 agreement and have real leverage if the negotiations did not proceed as we wished. I proposed a mechanism be established for the automatic withdrawal of rights by the EU if an agreement had not been reached within the timetable set down in the draft agreement. Each Member State would decide which rights it would wish to withdraw. This suspension would apply unless the Council agreed unanimously otherwise. In addition, it was proposed that the start of the agreement be delayed until 30 March 2008 to give airports and airlines more time to prepare. These points were agreed and are reflected in the Council Conclusions, which were adopted unanimously.[41]

In between the announcement of the Commission's agreement on 6 March and the formal agreement of the UK Government and other EU Member States on 22 March, the Transport Select Committee held an urgent session on the draft Agreement during which it took evidence from the then Secretary of State. The European Scrutiny Committee, which was also examining the draft Agreement, asked the Transport Committee for a formal opinion, which the Committee provided after its evidence session.

The Transport Committee was highly critical of the Agreement, arguing that it represented a victory for US interests at the expense of the EU, but most particularly the UK national interest. The Committee's view was that the US had achieved access to the EU market (but most particularly London Heathrow) without conceding anything on the key issues of cabotage in US air space or foreign ownership or control of US airlines. Further, the Committee believed that there was no incentive for the United States to return to the negotiating table as it had obtained all of the key concessions it wanted in the first stage. The Committee stated that the provision to re-close European skies to US carriers if they proved to be difficult two or three years down the line was unrealistic. The Committee labelled the Agreement 'Unequal Skies'.[42]

The European Scrutiny Committee's conclusions criticised the procedure for agreeing the draft and urged a debate before the Commission and the Transportation Secretary signed the Agreement on 30 April.[43] The then Minister for Aviation defended the agreement in a session of the European Standing Committee on 23 April 2007 when the Opposition Spokesman picked up on the Transport Committee's criticisms and the Chairman of the Transport Committee put the Committee's views to the Minister in person.[44]

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40 Statement by Secretary Peters, 22 March 2007: http://www.dot.gov/affairs/peters032207.htm

41 HC Deb 28 March 2007, c108WS

42 Transport Committee Opinion, published as Annex 1 to: European Scrutiny Committee, *Fifteenth Report of Session 2006-07*, HC 41-xv, 2 April 2007, pp9-11

43 ibid., p8

44 ESC Deb 23 April 2007, cc3-28

As to the airlines' views, those in favour of the Agreement believe that it will mean a significant reduction in fares on the key Heathrow-New York transatlantic route by opening it up to competition (currently only four airlines operate services on this route). British Airways' Chief Executive, Willie Walsh, told the Transport Committee that this belief was misguided and that fares on the route were already 'competitive'.[45] Following the Agreement, Mr Walsh urged the UK Government to ensure that a second stage agreement goes ahead that will open up the US market.[46] Both Mr Walsh and Stephen Ridgway, Chief Executive of Virgin Atlantic, told the Transport Committee that the UK Government should veto the Agreement.[47] Mr Ridgway did, however, make it clear that if the Agreement was passed it would not stop Virgin from 'competing in the marketplace'.[48]

Those airlines which are seeking access to the Heathrow-New York market are supportive of the Agreement. For example, Nigel Turner, Chief Executive of bmi, called the UK Government's assent to the Agreement a "brave move in the face of stiff opposition from the two UK airlines that have for years enjoyed a protected transatlantic market from Heathrow". He stated that the Agreement was a "landmark in the history of air links between Europe and the US and the agreement will be a prelude to global liberalisation of air transport".[49]

2.4 Open Skies Stage 2 negotiations, 2008-

The European areas of priority for the second stage are:

- further liberalisation of traffic rights;
- additional foreign investment opportunities;
- effects of environmental measures and infrastructure constraints;
- further access to Government-financed air transportation; and
- wet-leasing.

There is also a mechanism to ensure progress to a second stage agreement to a strictly defined calendar, with the right for each Party to suspend rights if the second stage agreement has not been reached.[50]

Negotiations on stage 2 began on 15 May 2008 in Ljubljana, Slovenia. It was reported that the focus for European negotiators would be on opening up the US market, particularly in terms of airline ownership, and in ending the protectionist 'Fly America' programme whereby US Government staff, including military personnel, are compelled to fly with US carriers or their partners. However, there was a recognition that in a US Presidential and Congressional Election year, the US would be reluctant to make any agreement that could leave its airlines vulnerable to takeovers from European airlines. From the American viewpoint, it was reported that they would propose to broaden the agreement, rather than deepen it, by extending its provisions to approximately 60 non-EU countries.[51] While there was no

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45 Transport Committee, *Uncorrected Transcript* (HC 395-i), 13 March 2007, Q19
46 BA press notice, "Sanctions must deliver next stage", 22 March 2007
47 op cit., HC 395-i, Qq4 and 6
48 ibid., Qq51-52
49 bmi press notice, "bmi praises UK Government's support of EU-US open skies deal", 22 March 2007
50 *2791st meeting of the Transport, Telecommunications and Energy Council*, 22 March 2007
51 "Investment at heart of new Open Skies talks", *Europolitics*, May 2008; "Open-skies talks to focus on US 'protectionism', *The Sunday Telegraph*, 11 May 2008

significant outcome to the Ljubljana meeting, there was speculation before the US elections in November that the US might consider liberalising its airline ownership rules. However, The Guardian reported that "US negotiators have made clear that one demand is off the table, ruling out allowing EU carriers operating internal services within the US".[52]

Talks resumed in June 2009 and though no agreement was reached representatives of European airlines were said to be 'optimistic'. Both parties indicated their willingness to reach agreement before the end of 2010.[53] Another round of talks commenced in January 2010 with issues to be debated including greater opportunities for European airlines to invest in US carriers and preventing restrictions on night flights at European airports. There appeared to be no real enthusiasm on either side to address the issue of opening up the internal US market further to foreign operators.[54] The Transport Minister, Paul Clark, set out the issues in a letter to the Chairman of the European Scrutiny Committee in December 2009:

> During the 5 rounds of discussions to date, both sides have tabled proposals for amending or supplementing the existing agreement. The proposals have covered all the areas mentioned in Article 21(2) of the existing Agreement as priorities for the second stage, i.e.:
>
> a) further liberalisation of traffic rights;
>
> b) additional foreign investment opportunities;
>
> c) effect of environmental measures and infrastructure constraints on the exercise of traffic rights;
>
> d) further access to Government-financed air transportation; and
>
> e) provision of aircraft with crew.
>
> Proposals have also been made in a number of other areas, inclusing security, enhancing the future role of the Joint Committee set up under Article 18 of the Agreement, mutual recognition of certain regulatory determinations, and enhanced cooperation on addressing the environmental impacts of aviation.[55]

The Transport Minister, Sadiq Khan, gave an update on negotiations following an EU Transport Council meeting on 11 March:

> While the US Congress was currently unwilling to relax investment and ownership in US airlines, it was felt that the US had conceded some useful points that would make the agreement mutually beneficial. The Commission raised the three outstanding issues of liberalisation, noise and commercial rights. Member states were broadly supportive of the Commission's approach and welcomed the recent progress on environmental matters. However, there were several interventions by delegations seeking to ensure that the final agreement strikes the right balance. The Council urged the Commission to continue negotiations on this basis.[56]

A draft second stage agreement was finally reached on 25 March. A European Commission press notice set out the terms of the Agreement:

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52 "US may let EU carriers operate domestic flights", *The Guardian*, 3 October 2008

53 "Open Sky II talks enter crucial phase", *Europolitics*, July 2009

54 "Open Sky talks resume as clock begins to tick", *Europolitics*, January 2010; a summary of the key points was provided by the European Scrutiny Committee in a

55 *Letter from Paul Clark MP to Michael Connarty MP*, 3 December 2009

56 HC Deb 18 March 2010, c76WS

... the 2007 agreement did not directly address the key issue of reform of airline ownership and control rules. The provisional agreement reached this week includes a commitment to engage in a process towards such reform. The European Union, based on the positive experience of the EU internal market, has long pressed for such an outcome, arguing that it would represent a key step towards liberating the airline industry from the outdated regulatory constraints in the area of foreign investment that prevent it from acting like any other industry. The provisional agreement sets out a number of incentives to encourage reform: When the United States changes its legislation to allow EU investors majority ownership of US airlines, the EU will reciprocally allow majority ownership of EU airlines by US investors and US airlines will benefit from additional market access rights to and from the EU. Progress towards this outcome will be reviewed regularly.

The negotiators also achieved significant improvements in terms of regulatory cooperation:

- The agreement will strengthen cooperation on environmental matters by requiring the compatibility and interaction of market-based measures (such as emission trading schemes) to avoid duplication; by promoting greater transparency for noise-based airport measures; and by enhancing green technologies, fuels and air traffic management. This cooperation is key to effectively decarbonising international aviation.

- For the first time in aviation history, the agreement includes a dedicated article on the social dimension of EU-US aviation relations. This will not only ensure that the existing legal rights of airline employees are preserved, but that the implementation of the agreement contributes to high labour standards.

- The agreement will raise the already high level of cooperation on security to better allocate resources at threats to the aviation system by promoting maximum mutual reliance on each other's security measures as well as swift and coordinated responses to new threats.

- The agreement further extends the role of the EU-US Joint Committee, the body that monitors the implementation of the agreement and coordinates the various work streams of regulatory cooperation. The new rules will reduce red tape (e.g. by mutual recognition of each other's regulatory decisions) and avoid the wasteful duplication of resources (e.g. joint safety initiatives, one-stop security, facilitation of passengers' travel).

- Market access will be further opened with EU carriers gaining further access to US Government-financed traffic ("Fly America"). Subject to certain changes to the legal framework for noise-based airport restrictions, EU airlines will gain in the future new commercial opportunities to fly between the US and non-EU countries. Furthermore, a number of obstacles to EU and US investments in 3rd countries' airlines will be removed.[57]

The Agreement will have to be approved by the 27 EU Transport Ministers and the European Parliament.

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[57] EC press notice, "Breakthrough in EU–US second-stage Open Skies negotiations: Vice-President Kallas welcomes draft agreement", 25 March 2010; the US response is also available on the Department of Transportation website

3 Airline alliances

The airline market is largely divided into 'alliances' or groups and, within these, airlines will generally charge the same price for airfares. However, this structure should not be used as a means of fixing airfare prices or being anti-competitive. Greater competition *should* lead to cheaper prices. The three largest alliances are oneworld, Star Alliance, and Skyteam.[58]

It was the proposed transatlantic airline alliance between British Airways and American Airlines that broke new ground when it sought formal approval from the US Government for their alliance on 10 January 1997. This intended bilateral alliance eventually failed but BA and AA did go on to form the oneworld alliance in order to compete with other airline groups like the Star Alliance, that formed in the wake of the initial BA-AA negotiations.

When BA and AA proposed their alliance in 1997, Karel Van Miert, the European Commissioner for Competition, threatened to take the UK to the European Court if it approved the alliance without seeking clearance from Brussels. The then Secretary of State for Transport insisted that the UK would have the final say and on 8 July 1998 the UK Government announced conditional approval of the alliance.[59] On the same day the European Commission published its conditions for approving the BA/AA alliance and a further alliance between Lufthansa, SAS and United Airlines. The conditions for approval of the BA/AA alliance were set out as follows:

> **Reductions in frequencies**
>
> On three hub-to-hub routes (London-Dallas, London-Miami and London-Chicago) where
>
> I) the total annual traffic is greater that or equal to 120,000 passengers and
>
> II) BA/AA currently operate, more than 12 frequencies per week,
>
> BA/AA will be obliged to reduce their combined number of weekly frequencies, if so requested by a competitor during a period of six months following authorisation of the alliance.
>
> **Slots and airport facilities other than on hub-to-hub routes**
>
> When a rival airline wished to launch a new service or expand an existing service and cannot obtain the necessary slots in accordance with the procedure laid down in the EC slot regulations, the alliance be obliged to make available the necessary slots in London.
>
> The maximum total numbers of slots to be released under these two remedies amount to 267. This number is based on 1996 traffic figures and will be revised in the light of 1997 figures. [60]

On the same day, the then President of the Board of Trade announced that the UK Government intended to propose that the alliance be approved subject to certain conditions.[61] At the end of October 1998, British Airways and American Airlines announced that they were reducing the scale of the planned alliance, by which time American Airlines, British Airways, Cathay Pacific, Canadian Airlines and Qantas had announced their intention

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58 a list of which airlines belong to which alliance can be found on the OAG website

59 HC Deb 22 January 1997, cc921-928

60 Commission press release IP/98/641

61 DTI press release, "BA/AA Alliance: Margaret Beckett signals conditional approval," 8 July 1998

to form the oneworld alliance. Oneworld was officially founded on 1 February 1999 and was a rather more loose alliance than what had originally been planned between BA and AA.