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SELECT COMMITTEE ON
THE EUROPEAN UNION

SUPPLEMENTARY REPORT ON THE EFFECT OF THE EUROPEAN COURT OF JUSTICE JUDGMENTS OF 5 NOVEMBER 2002 ON AVIATION RELATIONS BETWEEN THE EUROPEAN UNION AND THE UNITED STATES OF AMERICA

WITH EVIDENCE

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ORAL EVIDENCE

NOTE: Pages of the report are numbered in bold type; pages of evidence are numbered in ordinary type. References in the text of the report are as follows:

(Q) refers to a question in oral evidence
(p) refers to a page of written evidence.

THIRTY-SIXTH REPORT

15 JULY 2003

By the Select Committee appointed to consider European Union documents and other matters relating to the European Union.

ORDERED TO REPORT

SUPPLEMENTARY REPORT ON THE EFFECT OF THE EUROPEAN COURT OF JUSTICE JUDGMENTS OF 5 NOVEMBER 2002 ON AVIATION RELATIONS BETWEEN THE EUROPEAN UNION AND THE UNITED STATES OF AMERICA

2003/0044(COD) Proposal for a Regulation of the European Parliament and of the Council on the negotiations and implementation of air service agreements between Member States and third countries

Abstract

In our earlier Report[1] we recommended that the Council agree to give the Commission two mandates:

- to negotiate with non-EU states to persuade them to accept Community airline designation instead of bilateral national airline designation in air service agreements (ASA);
- to negotiate a fully-liberalised Open Aviation Area with the United States of America (US).

At the 5/6 June Transport Council in Luxembourg, the Council agreed to give the Commission two mandates. One, to negotiate an air service agreement with the United States on behalf of the Community. The other, to negotiate on specific Community issues with other third countries, while allowing flexibility for Member States to negotiate and implement air service agreements bilaterally. The text of the two mandates is confidential and was not available to the Committee.

We examine the detail provided to us and conclude that the Council's mandates appear to be acceptable to UK national interests provided safeguards are introduced into the negotiations for an Open Aviation Area to prevent a phased negotiation from breaking down and leaving the UK in a worse position than it enjoys under the existing bilateral ASA with the US.

[1] "Open Skies" or Open Markets? The effect of the European Court of Justice (ECJ) judgments on Aviation Relations between the European Union and the United States of America (USA); Session 2002-03, 17th Report, HL Paper 92.

PART 1: BACKGROUND

CHAPTER 1: THE MANDATE TO NEGOTIATE AN OPEN AVIATION AREA

1. This Report is a sequel to our Report earlier this year[2]. In that Report, we made two fundamental recommendations:

> "That the Government should agree to a full negotiating mandate for the Commission on the basis that the objective of such a mandate would be the full liberalisation of the aviation industry in the EU and the US" (para 65)
>
> and that the Government accede
>
> "to the approach proposed by the Commission, namely that the Commission assisted by Member States negotiate in the first instance with the United States to remedy those breaches of Community law identified by the ECJ judgments in existing air service agreements with the United States" (para 51).

2. In the conclusions of that Report,

> "We urge(d) the Government, therefore, to attempt to achieve agreement at the June Transport Council so that negotiations can be opened quickly thereafter with the Americans on these specific issues".

The Transport Council, 5/6 June 2003

3. The Transport Council took place in Luxembourg on 5 and 6 June 2003. Appendix 2 contains the formal statement made to Parliament by the Minister reporting the outcome of the Council[3].

4. The Council agreed that the Commission should receive two mandates. One, to negotiate an air service agreement with the United States on behalf of the Community. The other, to negotiate on specific Community issues with other third countries, while allowing flexibility for Member States to negotiate and implement air service agreements bilaterally.

5. The text of these two mandates is confidential[4]. The Committee judged that it was important to know in more detail what issues these mandates covered. We invited the Minister to give oral evidence. The Committee is particularly grateful that the Parliamentary Under Secretary at the Department for Transport, Mr Tony McNulty MP, agreed to come before the Committee even though, as a result of a Government reshuffle, he had been in charge of the aviation portfolio for a few days only. This session of evidence took place on Monday 23 June 2003 and the full transcript is printed with this Report as is the proposed text of the Regulation governing the negotiation and implementation of air service agreements between Member States and third countries (Appendix 4).

6. This inquiry was conducted by Sub-Committee B. The Members of this Sub-Committee are listed in Appendix 1.

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2 *ibid*

3 Hansard, House of Commons, Written Answers, 17 June 2003, Col 111W-113W.

4 Q61.

CHAPTER 2: THE "HORIZONTAL MANDATE"

The Horizontal Mandate

7. The immediate issue triggered by the European Court of Justice judgments of 5 November 2002 was the requirement to bring all EU Member State air service agreements (ASAs) into conformity with Community law. This meant that it would no longer be possible for Member States to limit designation to their own national airlines in bilateral air service agreements. The existing designation would have to change to allow Member States to designate any Community airline. This is known as the Community clause. The "horizontal" mandate was agreed. It is so called because "it is a restrictive mandate. It only applies to Community designation and one or two other issues but it is horizontal because it gives the Commission the right to go off and talk to any third country about those issues. It is not specific to any particular third country….." (Q21).

8. The Committee was nervous about how a mandate to implement the Community clause might operate. We feared, for example, that were the UK Government to negotiate to update an existing ASA with a third party, and other EU Member States did not do so similarly, the latter might enjoy a temporary commercial advantage until such time as they had amended their own ASAs to bring them into line with the ECJ judgments. For this reason, in our Report we recommended that the Commission be responsible for achieving agreement with the US because this would allow for all EU bilateral ASAs with the US to be implemented at the same time (para 51).

9. The witnesses dealt with these concerns in Questions 22 and 23 and argued that the Committee's worries, while understandable in principle, were unlikely, in practice, to have the baleful consequences implied in the Committee's line of questioning.

How the Council's mandates differ from our recommendations

10. In our Report, we recommended that the Council give the Commission two mandates: under one mandate the Commission would negotiate a fully liberalised aviation agreement with the United States; and under the other, the Commission would help Member States fulfil the obligations of the ECJ judgments, by implementing the Community clause with regard to ownership. The two mandates that have emerged from the Luxembourg Council include the requirement to negotiate a Community clause with the US **within** the overall negotiation to achieve an open aviation area with the US (Q26).

Position of bilateral ASAs during a period of negotiation

11. We assume that within the EU/US mandate the Commission will move first to reach agreement on the Community clause. But even if it does so, we are left with a need for Member States to continue to be able to negotiate with the United States during the, presumably lengthy, period in which the Commission negotiates the rest of the liberalisation mandate. The Committee asked how this might be achieved. In reply, the Department said "our expectation is that the current arrangements under Bermuda, which is not "Open Skies", are expected to remain in place until an agreement is sorted out by the Commission".

12. Mr Smethers, Head of Multi-lateral Division Aviation Group, Department for Transport, added "under the agreement arrived at in Council, we are free to continue to negotiating with the States but before we could come to any agreement we would have to go through a Community procedure and get consent. It is fairly clear that we could make minor modifications to Bermuda to update it, we could add the odd provision here and there and that would be acceptable. If we try to do a major bilateral agreement with the US, the Commission would almost certainly hold that it undermined the Community–level negotiations and that we accept as a general position."

CHAPTER 3: THE MANDATE FOR NEGOTIATIONS WITH THE USA

The Committee's Concerns

13. The Committee wished to ensure that the objective of this negotiation was an internal market in aviation incorporating the US on one hand, and the European Union (EU) on the other.

14. In our Report, we listed a number of issues that would have to be met in order to constitute an Open Aviation Area: mutual reduction of restraints on ownership and control of airlines; cabotage; the abandonment of specific policies by the US government such as the "Fly America" policy and the Civil Reserve Air Fleet (CRAF) which limited access for both passenger and all-cargo services. Answers given by officials in the course of this evidence session confirm that the mandate to negotiate an Open Aviation Agreement with the US is designed to cover these points (QQ7, 10, 13, 14, 15, 16 and 17).

"Open Skies"

15. We feared that because eleven EU Member States[5] had concluded "Open Skies" bilateral agreements with the United States, pressure would be put on the remaining Member States, particularly the United Kingdom, to conclude an "Open Skies" agreement as a first stage towards full liberalisation.

16. Were the UK to agree to adopt this particular course of action, negotiations might never proceed to subsequent stages designed to bring about a truly liberalised market in aviation. We had good reasons for this concern (see para 25). In our Report we had considered the position of the United States (Chapter 4) and had noted that the US Administration's response to the ECJ judgments had been to offer to negotiate a revision of the restrictive nationality clause with EU Member States that had "Open Skies" air service agreements (ASAs) with the US. They had not approached the other EU Member States, including the UK. In addition, we knew that an EU/US negotiation would be a difficult and lengthy process. In our conclusions, we stated

> "that while the United States Government would not object to entering full negotiations for an open aviation area, the difficulties in the way of a successful negotiation within the next two or three years will be considerable and should not be under estimated" (para 91).

17. Full liberalisation would require legislative change in both the US and the EU in addition to overcoming political or economic reservations on both sides of the Atlantic.

Linkage between phases

18. In the questions put to the Minister therefore, we sought reassurance that the objective was a fully liberalised market and not a partly liberalised market under the US "Open Skies" model. We acknowledged that the course of such a negotiation would be difficult and probably phased.[6] It would be important that a failsafe mechanism existed to link the phases in such a way as to make sure that the Commission achieved its mandated objective. This linkage is developed in Chapter 4.

Can Member States continue to support existing bilateral ASAs during an EU/US negotiation?

19. If negotiations with the US break down, it will still be important for EU Member States to continue to support existing bilateral air service agreements. The Department for Transport's supplementary evidence[7] sets this out clearly.

> "The safeguard, should talks fail, comes in Article 4 of the draft Regulation[8]. So long as the Commission is actively negotiating with the US, Article 4(4) applies if a Member conducts bilateral talks with the US. The Member State may not apply provisionally, or conclude, a bilateral agreement (with the US) without going through the Community procedure set out in Article 4(3). If on the other hand, the talks have failed, so by definition, the Commission is <u>not</u> actively negotiating with the US, a Member State which concluded a deal with the US would be subject to either Article 4(1) or Article 4(2). If the new deal included the so-called Community

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5 All EU Member States except Greece, Ireland, Spain and the UK

6 Mr John Byerly, who will lead the US negotiating team, stated in a press conference in Brussels on 20 June 2003 that a first agreement on the least controversial points might be concluded before looking to pursue talks in other areas—European Voice 2786 – 21 June, 2003

7 See Appendix 3.

8 Printed at Appendix 4.

clauses, the Member State would be free to conclude the agreement without reference to Brussels, under Article 4(1). If it did not include the so-called Community clauses, the Member State would be free under Article 4(2) to apply the agreement provisionally, though it would have to go through the Community procedure under Article 4(3) before formally concluding the agreement".

CHAPTER 4: UK NEGOTIATING OBJECTIVES

20. The Committee was given access to the Government's negotiating objectives. We therefore asked the witnesses to confirm whether or not they believed that these objectives had been met. Appendix 3 contains a supplementary evidence note from the Department for Transport which sets out how the Department believes these objectives have been met.

Phased negotiations and safeguards

21. The Committee is grateful to the Department for this explanation but we felt that there was still some uncertainty relating to phased negotiation. In his evidence, Mr Smethers said

> "I think there are two safeguards. One is… that we are free to negotiate with the United States but if we come to any sort of agreement, we have to go through the Commission procedure before we could finalise it. That applies so long as the Community and the Commission on behalf of the Community is actively negotiating with the United States. If the Community were no longer actively negotiating with the United States because the talks had run into deadlock or an impasse, then the Community procedure would be lighter and we would have more freedom to make our own arrangements. That is the first safeguard. The second safeguard is that we have written into the mandate that if the Commission comes back to the Council and says "we want to do a phased agreement with the United States", there must be mechanisms to ensure that you do in fact move from phase 1 to phase 2 and to phase 3. Those are the safeguards" (Q34).

22. We asked what safeguards could be written into an agreement to ensure that, for example, if one phase was successful we could guarantee that successive phases would be negotiated and brought to successful conclusions. In his response, Mr Smethers said

> "I think that is a difficulty. One could envisage phase 1 coming into operation and then ceasing to operate if phase 2 did not come into operation or something along those lines. That is not impossible. I'm not disputing that that would be a difficult point of negotiation to find the right mechanism to ensure you did move on. There might be other commitments between the two sides that would effectively be safeguards".

23. To which the Minister, Mr McNulty added

> "……at least the general mechanism is there for saying that if there is phasing there should be necessary progression to subsequent phases".

24. The Committee, nevertheless, felt that, given the time that it would take to negotiate a fully liberalised open aviation agreement with the United States, the danger to UK interest would continue throughout the negotiating period. The threat to UK interests could, paradoxically, come from progress in negotiation of the overall mandate (see para 27). The current bilateral UK/US ASA is sufficiently robust to protect UK interests in other circumstances. We put this again to the witnesses (Q41). In reply, Mr Baker, Divisional Head of International Aviation Negotiations, Department for Transport, said

> "When we have been negotiating bilaterally with the United States, we have thought about the phased agreements. The difficulty there is that some of the things we are asking the Americans to do require legislation so they cannot happen instantaneously. What I have been urging on European colleagues is not to rush into phases, and the dangers of that, because in some ways it is very difficult to get a balanced agreement. If you are going to have three phases because you might not move from phase one to phase two or might not move from phase two to phase three, you have to ensure that each phase is balanced and that trebles the difficulties if you have three phases".

25. We asked the Minister how the Government thought that balance could be achieved. Mr McNulty said

> "We would be fully behind the comprehensive, not the so-called "Open Skies" view, but the open aviation area in view of all those elements, not least as implied earlier, that full and proper access to the American hinterland would seem to be the international aim".

The UK position vis à vis other EU Member States

26. We asked if this position was shared by other Member States or would differences in interests lead to different approaches to a phased negotiation. Mr Smethers said

> "Many of the States already have so-called open skies agreements, so that that would be the first phase for us, would it not? It would not actually be anything for them one way or the other in moving to that because they are there already. By the same token, there might be less worry about moving there for us because if the Commission came back and said, "We are going to open skies for all countries", rather than 11 or 12 as it is at the moment, for them it is a matter of some indifference, is it not? From that point of view, we would probably develop a more intense interest in some of those countries."

27. The Committee did not find this a reassuring answer. If anything, it emphasised the danger we saw inherent in this negotiation. Clearly, it must be attractive to the Commission to bring all Member States into a similar starting position because this would make negotiation easier. An obvious first step might be to require all Member States which did not currently operate "Open Skies" agreements with the USA, to do so. The Committee's fear is that whereas "Open Skies" ASAs with all individual Member States would secure US objectives, it would not secure the EU's objectives of a fully liberalised agreement. The US might simply lose interest in continuing the negotiation at this point. Were this to happen, and were the UK to agree to a Commission proposal to surrender Bermuda 2 for an "Open Skies" ASA with the US, then UK interests will have suffered a reverse: currently, through Bermuda 2, we are able to control US airline access to Heathrow; with an "Open Skies" agreement, we could not continue to do so and our bargaining hand with the US in re–negotiating changes in Bermuda 2 would be weakened. **We therefore recommend that the Government consider carefully before moving to a form of "Open Skies" regime as part of a phased negotiation with the USA.**

OTHER ISSUES RAISED IN THE DEPARTMENT'S EVIDENCE

A "mini-deal" over access to Heathrow?

28. In our earlier Report (para 95), we flagged up rumours of a "mini deal" between the United Kingdom and the United States which would have permitted the American freight carrier, FedEx, access to Heathrow, and BMI British Midland, access to an Atlantic route. On the Department's interpretation of the Council mandates, it seemed to us, that the present mandate made this unlikely. In response, Mr Smethers said "any such agreement would have to be subject to a Community proceeding and so I think you can draw your own conclusions" (Q30).

Slots

29. In our Report, we noted the important role played by the shortage of take–off and landing slots at certain airports, notably Heathrow and Gatwick[9]. During the examination of the witnesses on 23 June we re–iterated our concern about the possible weakening of the negotiating leverage represented by the demand for slots at Heathrow (QQ45-60). The UK dilemma, that we recognised in our Report, remains: the leverage represented by the current excess demand over supply of slots at Heathrow and Gatwick will probably weaken as the Commission negotiates traffic rights on the one hand, and attempts to regulate the allocation of slots at Community airports on the other. We note that the Minister intends to return to this issue.(Q59) **We welcome this**.

[9] See Box 5 on page 25 of the original Report and a more detailed account in the additional supplementary memorandum by the Civil Aviation Authority, pages 34 and 35

CHAPTER 5: CONCLUSIONS

30. The Committee welcomes the Council's granting of these two mandates to the Commission. So far as we can see from the explanation given by the Department, the "horizontal" mandate clarifies the position of Member States, and the mandate to negotiate an Open Aviation Area with the US offers the opportunity for radical change in the aviation industry of the US and EU. We believe that such change is essential in economic terms both for airlines in the US and EU and also for the general economic advantage that properly used assets bring.

31. We remain wary about the attractions of the US model "Open Skies" ASAs and **we therefore recommend that the Government consider carefully before moving to a form of "Open Skies" regime as part of a phased negotiation with the USA.**