

MONDAY 10 MARCH 2008

Present

Bradshaw, L
Dykes, L
Freeman, L (Chairman)
Mitchell, L
Powell of Bayswater, L
Rowe-Beddoe, L
Walpole, L
Whitty, L

Witnesses: **Mr Tim Figures**, Divisional Manager, and **Mr Phil Dykins**, Team Leader, International Aviation and Safety, Department for Transport, examined.

Q1 Chairman: Good afternoon, gentlemen. For the record, would you start by very kindly giving your name and title?

Mr Figures: Certainly, my Lord Chairman. My name is Tim Figures; I am the Head of International Aviation and Safety Division at the Department for Transport.

Mr Dykins: I am Phil Dykins, and I work in the same division.

Q2 Chairman: Mr Figures, I think, came last year---

Mr Figures: I did.

Q3 Chairman: ---when we took evidence, and you have, I am sure, looked at our press release dated 21 March 2007. Time has gone very quickly. It would be helpful, although you may well have planned a statement to help the Committee, if you would include, at the very least, a commentary on our concerns of last year and then how Phase 1 has gone so far. I appreciate that you might wish to be in private session for certain of our questions, and we will go into private session whenever you wish. At some stage on Phase 2, which is

obviously what we are interested in, you might wish to share confidences unrecorded with the Committee.

Mr Figures: Certainly. Thank you very much. Perhaps what I might do first of all is update the Committee on what has happened since we met just under a year go and look forward to the start of the Phase 2 negotiations, and then, perhaps, we could take specific questions and deal with your particular points. As the previous Secretary of State for Transport explained to you in his letter of 11 April 2007, shortly after we met on 19 March last year, the Government did, indeed, agree to a first stage EU-US agreement. That will come into force on 30 March this year, in just a few weeks time, and it will allow, for the first time, any EU airline to fly from any point in the European Union to any point in the United States and vice versa. We have already seen intense market activity as airlines move to take advantage of the new opportunities afforded by this deal. In all, there will be around a 20 per cent increase in flights from Heathrow to the US, starting from next month. Specifically, British Airways will consolidate its US long haul services at Heathrow. That ends the outdated arrangement that required flights to certain destinations to fly only from Gatwick. As you may have read, BA will also plan to launch a direct US service from certain Continental European destinations later this year and has got ambitious plans to expand further in that market. The four main US carriers currently excluded from Heathrow have all made plans to start services from that airport, as has Air France, which will launch a route to Los Angeles in the spring. All of this means more choice and more connections for customers and more market opportunities for UK airlines. In the year since I met the Committee the EU and US sides have also met twice to discuss practical issues relating to the implementation of Phase 1. We have settled the terms of reference of the joint committee, whose job it is to oversee the agreement, and started work in a number of technical areas, such as competition assessment, licensing and social impacts, but we are now looking forward to the commencement of the Phase 2 negotiations.

The Phase 1 agreement set out a clear timetable and process for these. Firstly, they must begin within 60 days of the agreement coming into force - so that means by the end of May this year. Both sides will commence a review of progress no later than the end of November 2009 and, if no satisfactory second stage agreement has been reached by November 2010, then both parties have the ability to suspend rights granted under the agreement and any suspension would come into effect in March 2012. The Government continues to believe that the best outcome for consumers and the airline industry is one which removes restrictions on the ownership and control of airlines. This would allow the aviation sector to behave like any other global capital intensive industry and to determine its structure according to market, rather than political, considerations. Achieving progress on ownership and control reform will be a key aim during the Phase 2 negotiations and we are already actively engaging with the European Commission, our European partners and US stakeholders to prepare the ground for this approach. I hope that was helpful by means of an update of what has happened over the last 12 months and what we are going to be doing over the next few months.

Q4 Chairman: That is extremely helpful, but just for clarification, once Phase 2 negotiations start, I think you said by the end of May, if there is no agreement by November 2010 on Phase 2, then Phase 1 will be suspended by 2012.

Mr Figures: What would have to happen in November 2010 is a political decision about whether where negotiations had got to was sufficient enough to allow the Phase 1 deal to remain in place or, alternatively, whether rights granted under the agreement should be suspended; and that would be a political decision for each of the Member States of the European Union to make individually and so for the Secretary of State for Transport actually here to take at that time.

Q5 Chairman: It will obviously go to the Transport Council, but individual nations will have that opportunity to withdraw?

Mr Figures: Yes.

Q6 Chairman: Could you help the Committee by indicating, or repeating at least, the items that are likely to be on the agenda from the end of May for Phase 2?

Mr Figures: I think there will be two main things. There will be a discussion of whether further traffic rights might be made available to both sides, as there are some traffic rights which the current agreement does not make available, but I think the main issue for discussion, certainly from the European side, will be the on-going issue of access by EU carriers to the US market and, in particular, the current restrictions which, effectively, mean that foreign investors may not own more than 25 per cent of a US airline.

Q7 Chairman: What about the other two issues that the Committee raised? You have covered slot allocations, but the Fly America policy, which, as I recall from our discussion and from evidence, required legislation in the United States at a federal level.

Mr Figures: Indeed. The Phase 1 agreement made some minor liberalisations of the Fly America regime but they were very minor, and, certainly from the point of view of the Government and, as I understand it, from other European Member States and European airlines, further concessions in the right of EU airlines to provide government-financed air transportation to US government employees and contractors is something that we would look to see.

Q8 Chairman: Can the Committee assume that will be on the agenda?

Mr Figures: It certainly will.

Mr Dykins: Perhaps I could add, my Lord Chairman, that there are five items actually listed in the Phase 1 agreement which are priorities for Phase 2, and that is among them, along with the other two that Mr Figures mentioned.

Q9 Chairman: The fifth one?

Mr Dykins: The five are liberalisation of traffic rights, investment opportunities, environmental measures, further access to government financed air transportation, which is Fly America by another name, and something called provision of aircraft with crew.

Q10 Chairman: Could you clarify the additional slot allocations or extra flights? Does that apply just to Heathrow in terms of the UK?

Mr Figures: Do you mean in relation to the Phase 1 agreement?

Q11 Chairman: No, for discussion in Phase 2 but picking up what was presumably not fully allocated or agreed in Phase 1?

Mr Figures: Certainly. Phil, what are the remaining traffic rights?

Mr Dykins: The traffic rights not granted in Phase 1 were really about domestic transport within a country - so flights within the United States or within one of the Member States. On the EU side, we also have certain rights, which the American carriers do not have, to take traffic from the United States to other countries, so-called seventh freedom traffic rights. There are some more of those that could be exchanged and for the American side I think there are some other seventh freedom traffic rights that they would want.

Q12 Chairman: Has the US Federal Government made any statement, formal or informal, in relation to these forthcoming negotiations?

Mr Figures: It has made no formal statement. However, we have informal contact with it on an on-going basis. My understanding is that it is as keen as it always was to see further

progress, particularly on ownership and control reform, but that there remain political challenges, particularly in relation to Congress in the United States, in delivering that outcome because legal change would be needed to do that.

Q13 Chairman: Other than November 2010, is there any indication how long these negotiations are targeted to continue?

Mr Figures: We do not know that at this stage, but it is my expectation that they will continue over the two and a half year period between May this year and November 2010. There are, as you will be aware, some politically significant events that will take place in the United States by the end of this year, and I think that a new administration coming into office early next year may wish to either endorse or take a different approach from the current administration in terms of negotiating with the European Union; so I do not think that it is something that can be wrapped up before a change of administration in Washington.

Q14 Chairman: Before turning to my colleagues, could you tell the Committee what representations you have received since we last met a year ago from the airline industry, from the consumers of airline services to and from the United States and the European Union?

Mr Figures: We have continued to receive representations from the airlines, both individually and collectively through groups such as the Association of European Airlines. We might be able to go into detail perhaps a little bit later in terms of what they have said, because I am not aware that those were public statements, but we have certainly kept an on-going discussion with airlines, both to understand how they wish to take advantage of the new opportunities that open up to them from the end of this month, but also as to how they would wish us to play the Phase 2 negotiations. I am not aware of us having had any direct representation from consumer interests on this particular point, though we do remain in

regular contact with the Air Transport Users Council across a whole range of consumer issues.

Chairman: Perhaps we might come back to this in private session. I will ask my colleagues if they wish to intervene. Lord Whitty.

Q15 Lord Whitty: I have got two questions really. On the question of slots, and I had better put to one side that I am personally strongly opposed to the expansion of Heathrow, but, whatever capacity Heathrow has, there will be some constraints on that capacity over the period we are talking about and the agreements to allow those airlines, British and American, which were previously directed to another airport, back into Heathrow simply puts more pressure on Heathrow. Is it anticipated that there will be some new form of rationing and allocation? In other words, because we have allowed all the major British and American airlines to be at Heathrow, those who are squeezed out are presumably other European airlines and non European, non American airlines?

Mr Figures: There is no plan to change the system of slot allocation at Heathrow in the short or medium term. What has happened to allow these new US carriers into Heathrow is that they have purchased slots on the secondary market, largely from other airlines who were willing to sell them, and those slots have become available either, in one case, because an airline was taken over---

Q16 Lord Whitty: You are replacing rationing by allocation with rationing by price, basically. There was always a bit of that but---

Mr Figures: What they have been able to do is to go into the market and acquire the slots on the secondary market to operate the services, thereby indicating that, although Heathrow is full, they have been able to take advantage of that market opening, and that has come mainly through slots that have been transferred from short haul services to Continental Europe or, in

one case, from an airline that was taken over and whose new owners decided that it no longer wished to operate at Heathrow so they became freely available onto the open market.

Lord Whitty: The net effect is that a larger proportion of the slots at Heathrow, and, going forward, if there is some increased capacity, will be American and British.

Lord Bradshaw: And French.

Q17 Lord Whitty: Big airlines, because they have paid for it. I am not necessarily against it.

Mr Figures: A larger proportion will be used for long haul services and long haul services to the United States, yes; approximately 20 per cent more than is currently the case.

Q18 Lord Whitty: My other point is really related to Phase 2, and you may wish to postpone your answer to this. As you know, Europe has a proposition for all airlines to join in the Emissions Trading Scheme - I noticed Mr Dykins said the environmental considerations were one part of Phase 2 - and the European Commission is looking to all airlines who take off and land from European airports to participate in that scheme. Is that, and the American aviation system's participation in that, part of these negotiations?

Mr Figures: No, it is not, and the reason why it is not is that we do not believe that including all flights arriving and departing from EU airports is something that requires the agreement of third countries through air services agreements. The European Union, with the Government's full support, is taking forward its own legislative process that would apply to all such flights from the time it comes into force.

Q19 Lord Whitty: If I were the Americans, I would say, "You are insisting that we allow cabotage within America, which is American law. Why should we do that when there is effectively a premium being put on American flights in Europe by European law?" It would

seem to me that there was a trade-off here and that if you do not include the requirement to enter the Emissions Trading Scheme (and I know there are all sorts of arguments still going on as to how that will be calculated), then the agreement is incomplete, is it not?

Mr Figures: This will be a multilateral agreement that will require the consent of all parties for it to come into force. It is the Government's view, as I said, that emissions trading for flights arriving and departing from EU airports is something that is within the competence of the European Union, subject to due legal process, to establish and to require and not something that it is appropriate to enter into agreements with third parties or is necessary to obtain the consent of third parties to.

Lord Whitty: All I am saying is that it is, obviously, well within the competence of the American authorities to insist on a Fly America Act, but we may try to get them to alter it. Are the Americans likely to come back at us and say, "What about the Emissions Trading Scheme? That is a unilateral imposition limiting or, at least, increasing the cost of flying."

Lord Bradshaw: But not in favour of any one party.

Mr Figures: Yes, I suppose that is true. You would need a change in the terms.

Q20 Lord Powell of Bayswater: On Phase 1, one of the terms was the application of provisions on aviation security. Do you see any sign that these will be applied by the Americans in an anti-competitive way?

Mr Dykins: I would hesitate to say that it is applied in an anti-competitive way. Certainly the Americans have a great appetite for introducing new and ever more inventive ideas for increasing airline security. There is close co-operation between the security regimes, both in the UK and America, and at Community level with the US, and I think the new agreement has actually helped to oil the wheels and make those contacts better, certainly at Community level. One of the less concrete benefits of the new agreement is that fora have been set up for regular dialogue between the parties so that, not just in security but in a number of regulatory

areas, we do not end up imposing dual burdens on airlines crossing the Atlantic so that they have to meet two separate regimes. We are working towards a system of regulatory convergence in the jargon, or at least mutual compatibility, as far as we can, and that goes for security, as with other areas.

Q21 Lord Powell of Bayswater: The American request, for instance, for federal US marshals to travel on flights, which has been accepted by one or two European countries, I understand: do you regard that as anti-competitive, if they insist on it further?

Mr Dykins: I think there is an issue of principle about their ability to insist and require sovereign countries to do that sort of thing. I am not a security expert, we defer to our colleagues who are, but it is an area of on-going discussion.

Q22 Lord Powell of Bayswater: My second point was going back to the Chairman's point. With what you delicately call significant political developments later this year and then a new US administration, which would take characteristically at least six months to have a position on anything let alone this, these negotiations for Phase 2 are going to be very back-loaded, are they not? They are not really going to start until probably the second half of 2009, which is not going to leave a lot of time for making decisions on whether they are really going anywhere.

Mr Figures: I think what we will do is try and make as much progress as we can with representatives of the current US administration, starting by the end of May, but, yes, I do agree with you that there will be a relatively limited period of time between the new administration getting up to speed, say, in the middle of next year and essentially the start of the election campaign for the congressional mid-term elections at the end of 2010, in which it will be necessary for us to make significant progress.

Q23 Lord Bradshaw: Two things: a number of American airlines are still under Chapter 8 protection. That is not a facility, I believe, that is available anywhere in Europe. Has any progress been made about this, or can we take it that these people are competing really on quite unfair terms?

Mr Dykins: I think most American airlines are now out of bankruptcy protection at the moment and doing relatively well compared to where they were a couple of years ago. Nonetheless, the provision still remains within American law that companies can seek that protection. We do not at the moment have the same level of protection under European law, so we can argue, and have argued, that that is an unfair provision. It is, of course, something that goes much wider than aviation. It would be to some extent the tail wagging the dog if we were to try and solve it through aviation negotiations, but it will certainly be registered by the European side as an element of subsidy and brought forward for discussion in the context of the joint arrangements for reviewing these things, which are part of the agreement.

Q24 Lord Bradshaw: I accept that Chapter 8 protection applies elsewhere, but this is an agreement the Americans want and, therefore, you are in a stronger position to negotiate with them than you are in an area which they do not care about. Has any attempt been made to raise the issue?

Mr Dykins: We did not in Phase 1 seek to actively, as far as I am aware - the Commission, rather, did not actively seek to get the, I think, Chapter 11 provisions changed, but they certainly raised it as an issue where, going forward, we would want to challenge the ability of the Americans to continue to protect their airlines, and it also, of course, works into the discussion about ownership and control, where one of our arguments is that the Americans are propping up weaker airlines where an alternative solution to doing that at public expense, at the American Government's public expense, is actually to allow greater consolidation and

freedom of investment, which will be another way of achieving modernisation of the US industry.

Q25 Lord Bradshaw: Because what they are doing would be classed as state aid, if it were a European airline, and would, therefore, not be allowed. One other thing. You mentioned the landing slots when you were responding to questions by Lord Whitty. Can you tell me whether an American airline which is coming to Heathrow from another place instead of Heathrow, or which has bought out the landing rights of somebody else, actually ends up paying the airport operator less money at Heathrow because the landing charges are lower there than they are elsewhere?

Mr Figures: I am not in a position to answer that question, I am afraid. I do not know, Phil, whether you can.

Mr Dykins: I am not an expert, but I think Heathrow landing charges are higher than other airports in the UK, so I would have thought they would be paying more. They are certainly paying a large premium for acquiring the slots.

Q26 Lord Bradshaw: Yes, but that premium does not go to the airport operator or to the passenger, it goes into somebody else's pocket. I would question whether the landing charges at Heathrow are higher than other airports, but they are certainly lower than they are at Frankfurt and Paris.

Mr Dykins: I thought you meant compared to other UK airports.

Lord Bradshaw: What I am really saying is that money is going out of the system to whoever sells the landing slots, but the customers are going to pay for this. I am very unhappy that we seem to have got ourselves in a position where our landing fees are low but we expect airlines to make a lot of profit out of commercial activity, which is generally to the detriment of passenger facilities.

Q27 Chairman: Perhaps you could send us a note on that.

Mr Figures: I can certainly do that. Perhaps I could just amplify the point, just to recall that what we are seeing is a very significant increase in competition at Heathrow, and I think the protection for consumers will come from that. While there are some US airlines who are currently excluded from Heathrow who have had to pay large sums of money for slots, there are two US carriers currently at Heathrow that have slots already, as well as three UK carriers who would be in a position to launch services in their own right. Those airlines will continue, I am sure, to compete aggressively in the market, and so the fact that they exist and will be operating services in competition with the new entrants, I think, will to some extent help to ensure that prices for consumers remain competitive.

Q28 Lord Walpole: Could I ask two slightly frivolous questions. Do you think as you go on and on and on year after year something major is going to change, like a new aircraft or a different type of aircraft, or what happens when the new Airbus gets into circulation? Do you think that is going to get rid of a few smaller aircraft and, therefore, different slots? The other frivolous question I wanted to ask you is: how do you stop a large aircraft flying across the Atlantic with five seats occupied, as one did other day? That is scandalous, I think, unless there is a good explanation.

Mr Figures: Shall I take those in order. The first question is I cannot predict what changes will happen technologically or operationally in the airline industry in the future, although we do see a trend towards larger aircraft, such as the Airbus A380, and certainly those airlines that have ordered those aircraft, such as British Airways, will be able to increase the number of seats they offer on transatlantic services without having to increase the number of landing slots that they have, which are a very scarce commodity. In terms of the second point, while there is not very much that the UK Government can do about a flight from the US to the UK with only five passengers on board. The idea of moving from a per person air passenger duty

to a per plane air passenger duty is meant to provide a significant disincentive for aircraft operators to do that in the reverse direction, because the same amount of duty would be paid whether the plane had 350 people or one person on it rather than the current arrangement where, if there was one person on it, there would only be one lot of air passenger duty paid.

Q29 Lord Rowe-Beedoe: I share the concern already expressed this afternoon about Heathrow, which is not what we are discussing but it does concern me that you are only talking about Heathrow and the 20 per cent increase in slots. As I was not a member of the Committee last year, I have, therefore, a little catching up to do, but can you tell me whether this is an agreement that actually covers all UK airports and, therefore, what is the allocation and how is that done in Birmingham or Prestwick?

Mr Figures: The agreement applies to all airports in the European Union, not just in the United Kingdom.

Q30 Lord Rowe-Beedoe: Therefore, all of the United Kingdom?

Mr Figures: Yes; indeed. The reason why we focused on Heathrow is because the current arrangement, which runs out at the end of the month, placed significant restrictions on the destinations that could be served from Heathrow and on the numbers of airlines that were able to operate from Heathrow. Those restrictions are removed when the agreement comes into force, and so the changes that I outlined earlier are as a result of the market and airlines responding to provide services that they believe customers want, which up until now they have been prevented from providing by the old arrangements that we are terminating.

Chairman: Are there any more questions in public session? If not, may we thank you very much indeed for putting those answers on the record and thank our shorthand writer. We will now go into private session.