



6 March 2007

## INFORMATION NOTE

### **Air Transport Agreement between the EU and US**

#### **Introduction**

On 2 March 2007, the Commission initialled the text of a comprehensive first-stage air transport agreement with the United States of America. This agreement will replace the existing bilateral agreements concluded by Member States.

The Commission has been negotiating on the basis of a mandate<sup>1</sup> agreed at the Transport Council of 5 June 2003. The negotiations were launched at the EU-US summit in June 2003 and in total eleven rounds of negotiations took place.

A draft agreement had originally been negotiated in November 2005. On 5<sup>th</sup> December 2005, the Transport Council expressed its unanimous satisfaction that the text represented significant improvement on the proposals considered by the Council in particular on the enhancement of co-operation on a range of regulatory issues. It also welcomed the new opportunities created in the field of market access but observed that improvements in the field of ownership and control of airlines would be an essential element for a Stage One deal to be concluded. It followed with close interest the rule-making process under way in the US through which the Administration was seeking to relax the rules governing control of US airlines by foreign nationals.

Following the withdrawal of the US Administration proposal in December 2006, in response to strong opposition in the US, the December 2006 Transport Council expressed its deep disappointment and regret at this decision, reaffirmed its commitment to a goal of securing a first-stage comprehensive air transport agreement and requested the Commission to enter into urgent consultations with the United States as soon as possible to seek elements that could be used to restore a proper balance of interests.

Following three rounds of negotiations early 2007, the Commission has obtained a number of important elements on 2<sup>nd</sup> March, and has strengthened the commitment by both sides to a second stage agreement, on which negotiations must begin within a defined timescale. The agreement would meet the legal requirements of the Community and deliver substantial immediate economic benefits for transatlantic air travellers and shippers.

A study undertaken on behalf of the Commission concluded that an EU-US Open Aviation Area would, over the first 5 years, stimulate more than 25 million additional EU-US passengers, generate more than €15 billion benefits for consumers and create 80,000 new jobs in the EU and the US combined.

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<sup>1</sup> 11322/03 AVIATION 137 RELEX 202 USA 55 Council decision on authorizing the Commission to open negotiations with the United States in the field of air transport, 9 July 2003.

## **Background**

The mandate for negotiations with the US was granted by the Council after the European Court of Justice ruled in cases brought by the Commission against eight Member States that had concluded bilateral agreements with the United States<sup>2</sup>. The Court of Justice found that the Member States infringed Community law by concluding agreements that:

- touched on certain matters of Community competence; and
- undermined the right of establishment set out in the Treaty by reserving traffic rights for airlines controlled by their own nationals.

Since the Court judgements, the Community acquis affecting air transport has expanded considerably, for example in the fields of security, safety, Single Sky, aircraft noise and unfair pricing. This enlarges the areas of the negotiations with the US that are now subject to exclusive Community competence.

The negotiating mandate set the objective of establishing an Open Aviation Area (OAA) between the EU and US. This would:

- (1) remedy the elements of the existing bilateral agreements that were found to be illegal by bringing all aspects of relations under the legal umbrella of a Community-level agreement and by ensuring that there is no discrimination between Community airlines on the basis of nationality;
- (2) create a single market for air transport between the EU and US in which investment can flow freely and in which European and US airlines can provide air services without any restriction, including in the domestic markets of both parties.

The mandate explicitly recognises the possibility of implementing an agreement in a staged approach, although it requires there to be mechanisms to ensure progression to subsequent stages.

## **Key elements of the November 2005 agreement**

The contents of the draft agreement are summarised in the Annex to this Note. The key benefits of the agreement of November 2005 are that it would:

- (1) bring the EU-US relationship into full conformity with Community law, as it would respect the right of establishment and Community competencies in this area;
- (2) remove all discrimination between EU airlines allowing them new opportunities to fly on any transatlantic route between the EU and US and allowing consolidation of the European airline industry, an objective long sought by both the Commission and Member States;
- (3) remove remaining market access restrictions on flights between the EU and US, thus creating a level playing field between Community carriers;

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<sup>2</sup> Court cases C-466-469/98, C-467/98, C-468/98, C-469/98, C-472/98, C-475/98, C-476/98 of 5 November 2002

- (4) commit both sides to work towards compatible practices and standards and to minimise regulatory divergence in the field of aviation security. In addition the US has accepted the key EU demand that, where possible, it shall take account of the security measures already applied in the EU when adopting measures for entry into its territory, and has also agreed to cooperate in allowing the EU to assess whether security measures at US airports meet EU requirements.
- (5) create new co-operation arrangements between competition authorities. This will facilitate the joint assessment of alliances between EU and US carriers and allow for the development of compatible approaches;
- (6) improve co-operation and consultation between the EU and the US in the areas of safety, government subsidies and environment, which have occasionally given rise to considerable difficulties between the two sides in recent years;
- (7) establish a Joint Committee which will be responsible for resolving questions relating to the interpretation or application of this Agreement;
- (8) recognise the possibility that US airlines may be subject to taxation of aviation fuel on routes between Member States should two Member States exercise their rights under Community law to withdraw the existing tax exemption;
- (9) create new opportunities for EU airlines to wet-lease aircraft to US airlines on international routes, which has been prohibited thus far by the US.

### **Post-November 2005 Developments**

On 2 November 2005, the US Department of Transportation (DOT) made a formal proposal to change the way in which it interprets US legislation governing the ownership and control of US air carriers.

At its 5 December 2005 meeting, the Council welcomed the significant progress made in the negotiations for an EU-US aviation agreement, which it regards as a matter of the highest importance for the future development of aviation worldwide. The Council unanimously expressed its satisfaction that the text represents significant improvement on the proposals considered by the Council in June 2004, in particular on the enhancement of co-operation on a range of regulatory issues, including in the areas of security, competition and state aids. The Council also welcomed the new opportunities created in the field of market access, such as the results achieved on code share approvals and wet leasing, but observed that improvements in the field of ownership and control of airlines would be an essential element for a Stage One deal to be concluded. In this regard the Council stressed that it followed with close interest the rule-making process under way in the US through which the administration was seeking to relax the rules governing control of US airlines by foreign nationals. The Council noted that clear, meaningful and robust changes to US policy in this area would be critical in the evaluation of the overall situation, which will be a priority once the US rule-making process is complete.

The proposal of the US Administration provoked a strong reaction in the US, in response to which DOT issued a modified proposal in May 2006 and allowed further time for consultation. At its 9 June and 12 October 2006, the Council was informed by Vice-President

Barrot of the latest state of play, emphasised the importance it attaches to concluding a historic first-stage EU-US air transport agreement but regretted the further delay in the US reform on control of US air carriers.

In the United States, opposition continued and DOT decided formally to withdraw its proposal in December 2006.

At the Council on 12 December 2006, the Transport Ministers requested the Commission to enter into urgent consultations with the United States as soon as possible to seek elements that could be used to restore a proper balance of interests.

### **March 2007 Negotiations**

Three rounds of negotiations have been held since the beginning of the year, and the text of a revised agreement was initialled by the two sides in Brussels on 2 March 2007. The principal new elements that have been added to the November 2005 agreement are as follows:

- A new Annex on ownership, investment and control, which contains commitments from the US that will create new opportunities for EU airlines and investors:
  - concerning the percentage of US airlines' equity that EU nationals may hold, including the possibility to exceed 50% of total equity;
  - guaranteeing fair and expeditious consideration of a transaction involving investment by EU nationals in US airlines;
  - giving EU airlines operating to the US greater access to non-EU capital;
  - allowing airlines of several third countries operating to the US to be owned and controlled by EU nationals;
  - a role for the Joint Committee in matters concerning ownership and control.
- The EU has reserved the right to limit US investment in EU airlines in line with the more restrictive US rules.
- Detailed provisions on franchising and branding, which will facilitate EU airlines or undertakings to extend their network presence in the US market.
- Commitment from the US that this agreement will qualify EU airlines to apply for antitrust immunity for alliances with US airlines, and that applications will be treated expeditiously.
- The US has granted, unilaterally and for the first time ever, seventh freedom traffic rights for passenger services, that will enable EU airlines to operate services between all members of the European Common Aviation Area and the US.
- The US has granted access to certain types of US Government-financed traffic under the Fly America programme, which was initially foreseen for the 2<sup>nd</sup> stage negotiations, with a commitment to pursue further access in the future.

- A list of priority items for second stage negotiations, and a strong mechanism to ensure progress to a second stage agreement within a strictly defined timescale.

## **Conclusions**

At the Transport Council on 12 December 2006, the Transport Ministers expressed their deep disappointment at the withdrawal by the US of its proposed reform of its policy towards control of US airlines by foreign nationals. In the absence of this key element, the Commission was requested by the Council to resume negotiations.

The Commission has now succeeded in securing new elements in the agreement that ensure a proper balance of interests. The Annex on ownership and control now provides greater legal security in this area than would have been the case under a policy reform by the US that would have been outside the scope of the agreement and subject to possible changes. Further improvements to the November 2005 draft agreement provide for greater market access both in the United States and in the world.

Vice President Barrot will report accordingly to the Transport Council on 22 March 2007. If the Transport Council gives its approval, signature of the Agreement can be foreseen for the EU-US Summit on 30 April 2007. The Agreement would be applied as of 28 October 2007.

## Summary of the agreement

The main elements of the EU-US air transport agreement are as follows:

### Market Access: Traffic rights and commercial –operational matters

- **“Community carrier” concept** permitting EU airlines to operate to the US from any point in the EU (thereby remedying the legal problems identified in the “open skies” rulings of the European Court of Justice in November 2002).
- Removal of all restrictions on international routes between the EU and US (**3rd/4th freedom rights**), and routes beyond the EU and US (**5<sup>th</sup> 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 **7<sup>th</sup> freedom flights for all-cargo services operated by EU airlines** but no additional 7<sup>th</sup> freedom all-cargo rights for US airlines<sup>3</sup>.
- **7<sup>th</sup> freedom rights for passenger services for EU airlines only**, between the US and any point in the European Common Aviation Area (ECAA)<sup>4</sup>.
- 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 antitrust immunity 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** aircraft to US airlines for use on international routes between the US and any third country, which was previously prohibited by the FAA.

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<sup>3</sup> These rights have already been granted by Czech Republic, France, Germany, Luxembourg, Malta, Poland, Portugal and the Slovak Republic

<sup>4</sup> The European Common Aviation Area comprises, in addition to the Member States of the European Community, Albania, Bosnia and Herzegovina, Croatia, Iceland, the former Yugoslav Republic of Macedonia, Montenegro, Norway, Serbia and the United Nations Interim Administration Mission in Kosovo.

## Market access: Ownership and Control

- 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<sup>5</sup>:
  - 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;
  - 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.
  - 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 national 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<sup>6</sup>: 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.
- 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.

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<sup>5</sup> Ownership by all foreign nationals of more than 25% of a corporation's voting equity is prohibited by US law. Actual control of foreign nationals is also limited by US Statute.

<sup>6</sup> European countries: Liechtenstein, Swiss Confederation, Albania, Bosnia and Herzegovina, Croatia, Iceland, the former Yugoslav Republic of Macedonia, Montenegro, Norway Serbia and the United Nations Interim Administration Mission in Kosovo.

African countries: Burkina Faso, the Republic of Cape Verde, the Republic of Cameroon, the Republic of Chad, the Gabonese Republic, the Republic of The Gambia, the Republic of Ghana, the Federal Democratic Republic of Ethiopia, the Republic of Liberia, the Republic of Madagascar, the Republic of Mali, the Kingdom of Morocco, the Republic of Namibia, the Federal Republic of Nigeria, the Republic of Senegal, the United Republic of Tanzania, the Republic of Uganda and Kenya.

## Regulatory Co-operation

- **Security** - the US has agreed on the importance of working towards compatible practices and standards and to minimise regulatory divergence in the security field. In adopting security measures for entry into its territory the US has accepted the EU demand that, where possible, it shall take account of the security measures already applied in the EU. It has also agreed to cooperate in allowing the EU to assess whether security measures at US airports meet EU requirements, with a view to facilitating the development of an approach based on “one-stop security” in the EU. The US has also accepted an obligation to inform the responsible authorities in the EU immediately whenever it takes emergency measures.
- **Safety** - procedures for consultation in the event of safety concerns on either side, and recognition of the development of safety responsibilities at EU level.
- **Competition** - new co-operation arrangements between competition authorities (DG COMP and US DOT) with a commitment to promote compatible regulatory approaches to alliance agreements and other cooperative arrangements between airlines, and to reduce the potential for conflicts in the application of each side’s competition laws.
- **Government subsidies and support** – recognition that government subsidies can distort competition, and establishment of procedures under which either side may raise concerns about measures taken by the other side. The agreement also includes an indication of the type of issues that can be raised, and requires the Joint Committee to maintain an inventory of issues raised by the two sides.
- **Environment** – recognition of the possibility that US airlines may be subject to taxation of aviation fuel on routes between Member States should two Member States exercise their rights under Community law to withdraw the existing tax exemption. It has also been noted explicitly by both sides that nothing in the Agreement affects in any way their respective legal and policy positions on various aviation-related environmental issues, thus keeping open the EU’s options in respect of future environmental measures.
- **Technical cooperation and climate change:** Mutual commitment to enhance cooperation, including in the areas of climate science research and technology development, that will enhance safety, improve fuel efficiency and reduce emissions in air transport. On Emission trading, EU-US intention to work within the framework of the International Civil Aviation Organization.
- **Joint Committee** – establishment of a Joint Committee which will be responsible for resolving questions relating to the interpretation or application of this Agreement, to review implementation of the Agreement and to facilitate greater co-operation. Matters not resolved in the Joint Committee may be referred by either side to formal arbitration, the procedures for which are set out in the Agreement.

## Other issues

- Creation of new rights for EU airlines to carry certain categories of US Government-financed traffic under the **Fly America** programme, with a commitment to pursue further access in the future.

- **International cooperation**, whereby the EU-US Joint Committee can develop a joint approach in international organisations and in relations with third countries.
- **Groundhandling** - traditional provisions guaranteeing access to groundhandling services.
- **Intermodal provisions** - provisions facilitating the combination of air services with surface transportation providers in both cargo and passenger fields.
- **Doing business issues** - inclusion of traditional doing business provisions relating, for example, to the right to establish offices, to maintain staff, and to engage sales agents in the territory of the other Party.
- **Computer reservation systems** - the US has accepted provisions guaranteeing European CRS providers the right to operate in the US, on which the US has yet to make any commitments in the context of the GATS/WTO.

### Entry into force

- **Provisional application:** The Agreement would be provisionally applied from 28 October 2007.
- **Second stage:**
  - The Provision on a second stage agreement foresees that negotiations would start within 60 days of the date of provisional application.
  - A list of **priority items** for second stage negotiations contains 5 key areas: 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.
  - A **strong mechanism to ensure progress** to a second stage agreement within a defined timescale, with the right for each Party to suspend rights if the second-stage agreement has not been reached in a strictly defined calendar.