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The USA and the EU – Aviation Relations: An Impasse or an Opportunity?

The historic multilateral aviation negotiations between the United States and the European Union (EU) – which began in October 2003 with bright though restrained hopes and expectations on all sides – came to an impasse in June 2004. When it appeared some weeks earlier that the negotiations might not turn out successfully, I was asked to provide written answers to several detailed questions – in the hopes that, given my experience chairing the US Delegation that successfully concluded the APEC open skies multilateral agreement, my answers might be helpful in the negotiation process.

Originally drafted when the negotiations were drawing to a close, my answers have since been modestly revised and updated to reflect the stalemate that finally occurred and that resulted in the rupture of the negotiations without a date set for resumption. It is a certainty that the negotiations will not be restarted before the US elections are over and, depending on the results, at least a few new faces appear on the scene on the US side. It is likewise a certainty that when the negotiations do resume, a new cast of EU officials will have taken over the reigns of leadership within the European Commission (EC), the executive arm of the EU, responsible for guiding future EU aviation and other policies.

But whether these changes will hold out greater hopes for a more successful conclusion in the future remain to be seen. In any case, an analytical appraisal of the issues, and perhaps some practical suggested approaches to their resolution, can do no great harm and, indeed, if read by some of the participants, might even do some good.

HISTORY IN A NUTSHELL

Before launching into the questions and answers, a little past history, especially dealing with the arcane policies and politics of the EU and the EC, may be helpful to the reader.

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For more years than one can recall, the European Commission (EC) has longed to take over what may well have appeared to be the romantic process of negotiating or renegotiating the bilateral aviation agreements for and on behalf of the Member States of the EU – once only 15, and since 1 May 2004, 25 States.² For almost as many years, the then-15 Member States consistently and successfully resisted and positively thwarted the EC's efforts – to the point where the EC decided in 1998 to file a case with the European Court of Justice (ECJ).

THE DECISION OF THE EUROPEAN COURT OF JUSTICE (ECJ)

The object of that case, brought against eight of the Member States, was multi-fold but mainly to obtain for the EC a mandate under which it would enjoy authority to renegotiate the bilateral aviation agreements that EU Member States have negotiated not only with the United States, but with many other countries throughout the world.

When the ECJ's decision was finally issued in November, 2002, some four years after the case was originally brought, it is fair to say that the EC was by no means the victorious party. While the decision has been depicted as a victory for the Commission, the reality suggests otherwise. Not only was the Commission not given the broad mandate it had so long pursued, but the decision, in relevant part, did nothing more than to hold unlawful a certain clause that exists in most, if not all, bilateral aviation agreements throughout the world. This clause is known colloquially as the 'O & C' or 'ownership and control' clause.³ The ECJ's decision held that these clauses in all EU Member State bilaterals (with the US and all others) were illegal because, even though traditional and ubiquitous in such international aviation agreements, they secured rights only for those airlines owned and controlled by nationals of the signatory State.⁴ Thus, for example, if Dutch nationals were to create, or purchase a controlling interest in, a Luxembourg air carrier, neither the USA bilateral with the Netherlands or with Luxembourg would require the US to accept a designation of that carrier by Luxembourg.

2. Poland, the Czech Republic, the Slovak Republic, Hungary, Malta, Cyprus, Slovenia and the three Baltic States became EU members as of 1 May 2004.
3. For a detailed analysis of these clauses, their history, and their impact on international aviation, see Allan I. Mendelsohn, *The United States, the European Union, and the Ownership and Control of Airlines*, CCH Issues in Aviation Law and Policy 13171 (Gerald L. Baliles ed.) (2003).
4. For a detailed and penetrating analysis of the full decision and its holdings with respect to other aspects of international aviation, not relevant here, see René Fennes, *The European Court of Justice Decision on Bilateral Agreements – the Future of Relations*, 17 *Air & Space Lawyer* No. 3 (Winter, 2003).

However, as the European Union had become, or was becoming, a unified market at least in certain aspects of aviation, and as this unification required that citizens of any EU Member State should be able to own an airline or airlines in any other EU Member State, a clause in a bilateral aviation agreement that required the traditional – and more nationally-oriented – approach became illegal. Presumably, therefore, the EC's obligation stemming from the ECJ's decision was limited to revising or updating these illegal O & C clauses plus some few other even less important facets of the once bilateral, but now increasingly multilateral, process.

THE US PROPOSAL TO MULTINATIONALIZE THE O & C CLAUSES

It is a little-known fact of recent history that within only weeks after the ECJ's decision appeared, the US government presented an unusual draft proposal to those EU Member States with which the USA had open skies agreements. This proposal, had it been accepted, would have largely met the Court's requirement that the O & C clauses be multinationalized and that any EU citizens, no matter member state nationality, be allowed to own and control airlines in any EU member state.⁵ But instead of accepting the proposal as a useful first step in the process, Mr. François Lamoureux, the Commission's Director General of Transportation, issued a letter that became the subject of an intriguing article in the International Herald Tribune of 30 January, 2003. The letter characterized the US proposal as 'minimalist', repeated the Commission's oft-stated call upon the Member States to denounce their bilateral air agreements with the United States, and threatened the Member States with ECJ court action should they engage in any 'unilateral' negotiations with the USA.⁶

THE COMMISSION'S CALLS FOR DENUNCIATION

While it is no small wonder why the US proposal died a sudden death, the fact that the Commission used the occasion then to repeat its call for denunciation – and, indeed, has used the occasion of the recent breakdown in the negotiations

5. Even before the USA presented this proposal, the EC should clearly have known that well-established USA policy on ownership and control issues would have been very favorable to a multinationalization clause for all EU Member State carriers. See Allan I. Mendelsohn, *The European Court of Justice Decision on Bilateral Agreements – Ownership and Control*, 17 Air & Space Lawyer No. 3 (Winter, 2003). See especially the discussion in that article about the USDOT's 1998 decision granting Cargo Lion (a Luxembourg-designated all-cargo carrier with EU owners but no owners from Luxembourg) a license to operate services to and from the USA *Id.*, at pp. 20–21.
6. A copy of the full USA proposal and most of the text of Mr. Lamoureux's letter appear at Mendelsohn, *supra*, n. 3 at pp. 13181, 13187–89.

to still again call on the Member States to denounce their bilateral aviation agreements with the US – raises serious questions in the minds of all interested observers. To be sure, one can appreciate a certain Commission disappointment that even the most expansive US proposals did not meet the loosely-formulated wish list that was outlined in Europe's Transatlantic Common Aviation Area (TCAA) policy published some years ago.

But denunciation, let alone repeated calls for it, seemed to be a remedy far more pernicious than creative. After all, why denounce when everyone knows that most of the content of the current bilaterals, perhaps as much as 90 per cent, will inevitably appear in one form or another in any multilateral that is ultimately negotiated?

Similarly, when the USA had already signalled its willingness to accept in some form an O & C clause that would allow the multinationalization of EU Member State airlines (as the US did in its proposal following the ECJ decision), why is there any need, let alone a pressing need, to denounce? More importantly, what would happen if the Member States denounced? Why would it be any more in their interests to denounce than simply to retain the status quo, which seems to have done no airline or any nation, on either side of the ocean, any great harm over the past ten or more years, since open skies agreements became the norm?⁷

Perhaps these demands for denunciation reflect some internal EC political dynamic – not yet generally known or understood outside the Commission. Or perhaps they represent the Commission's game plan to pressure the EU Member States back to the negotiating table. But the fact that the demands go unheeded just as regularly as they are voiced cannot help but raise the question why they are voiced at all. In any event, and if nothing else, that the demands continue to be regularly voiced by the Commission (and as regularly ignored by the Member States) must reflect some continuing tensions between the Commission and the Member States. How deep seated those tensions are we may never know.

THE MANDATE AND 'SEVENTH FREEDOM'

Back to the ECJ's November 2002 decision, however, what the Commission did not gain from that decision was something they had long sought, namely, a broad mandate to negotiate with the USA and other countries over the all-

7. Indeed, it is no secret that most EU carriers fear denunciation simply because an extant open skies agreement is a necessary condition for obtaining DOT approval of an anti-trust immunized code-share relationship. Denouncing the open skies agreements that exist between the USA and EU Member States might well lead to the loss of the all-important anti-trust immunity enjoyed by the major airline code-share alliances.

important issues of traffic rights and routes. Even more interestingly, the ECJ decision was, perhaps purposely, not at all clear about the critical issue of whether the EU had become such a unified entity that, for example, Air France or Lufthansa could – simply because they maintain a ticket office in Madrid – open a turn-around service Madrid-JFK (or any other US point).

Colloquially known as ‘seventh freedom’ services,⁸ such flights, especially those carrying passengers, have seldom if ever been allowed anywhere in international aviation.⁹ This is simply because passengers originating, for example, in Madrid and flying to New York have traditionally been viewed as the province of – or the largely protected market for – the national carriers.

But if the EU had become or was slowly becoming supra-national, then there would, indeed, be no restraints on Lufthansa operating a turn-around service to JFK out of Madrid or Athens, or Olympic operating a turn-around service Paris-JFK. To be sure, no EU Member State had ever allowed such a service in the past – which is perhaps the best reason why the ECJ largely avoided a decision on the issue and left it unclear, for example, what Spain might be able to require of Lufthansa in order for Lufthansa to operate such a turn-around service out of Madrid.

Most informed observers at the time (and many still today) held the view that Spain could, in fact, require Lufthansa to incorporate itself as a separate entity in Spain and, though owned and controlled largely by German (or other) nationals, operate more or less as a Spanish carrier and under Spanish law and the Spanish government’s safety oversight – in order to be able to provide such a turn-around service. Such a more pervasive approach, after all, is what the USA and, for that matter, Europe too, require of all foreign (but not airline) corporations, like Nissan or Honda, seeking to open factories and do business anywhere in the USA or Europe.

It is no wonder that the ECJ opted to avoid this issue, as it is extremely hard, some say impossible, to imagine the government of France (not to mention Air France) welcoming, let alone facilitating, a Paris-JFK turn-around service by the carriers of any (or all) other EU Member States – all, of course, in the interests of European unity!

8. ‘Seventh freedom’ services are generally defined as flights by an airline of State X that commence and terminate in State Y but have no contact on the particular flight with State X. Because the EU is progressively unifying, a turn-around Madrid-JFK service by Air France or Lufthansa has become colloquially known as a ‘virtual’ seventh freedom service.
9. Seventh freedom services have recently been allowed by the United States in limited circumstances but only for all-cargo services.

THE EC RECEIVES A BROAD MANDATE AND THE NEGOTIATIONS BEGIN

Sometime in June 2003, well before the negotiations were scheduled with the United States, the EC, through its own political efforts, managed to obtain from the EU and from the Member States a broad mandate to negotiate with the USA over virtually all aviation issues.¹⁰ It has to be assumed, given the long and consistent prior history of opposition, that the consents of the Member States to such a broad mandate were not readily forthcoming.

But how reluctantly the consents may have been given, or for what political price they were given, or, indeed whether they were given with the intention of later frustrating or undermining whatever progress the EC might make in the negotiations with the USA may never be known. Suffice it to say, however, that the ECJ's decision, with its far more limited and restrained objectives, remained unchanged.

Armed with its broad mandate, the EU-US negotiations opened in October 2003. And the questions and answers follow:

Question (1): What do you think were the most important issues on the table for the negotiators to deal with?

The impetus, indeed the *raison d'être*, for the negotiations, and perhaps also for the broad negotiating mandate that the EC was ultimately able to obtain, was to achieve compliance with the ECJ decision. There were two essential issues that had to be resolved to achieve this goal:

- (1) Requiring the US to accept designations of EU Member State air carriers that are owned by EU citizens but not necessarily by citizens of the EU Member State that designated the carrier – in other words, allowing the development of an institutional multinationalized EU carrier owned at least 50 per cent and 'effectively controlled' by citizens of any EU Member State; and
- (2) Requiring the United States, under certain conditions, to allow some form of 'seventh freedom' services by all EU carriers. In other words, the United States would need to recognize the right of an EU Member State carrier, like Lufthansa, to 'establish' itself in any other EU Member State(s) and to operate turn-around services to JFK (or any other US point) from any city in any such Member State(s) – not just, as in the past, only from a city in the individual EU Member State (viz., Germany) that designated the carrier.

10. For reasons that have never been clarified, the terms of this broad mandate have never been made public. But it did become known that the mandate did not include authority for the EC to negotiate any fifth freedom rights for US carriers beyond any EU Member State. In retrospect, it should have been fairly clear that, in the face of such a significant limitation on the EC's negotiating authority, it would be difficult, if not impossible, for the parties to reach any final comprehensive agreement.

As the EU is clearly on its way towards increasing degrees of unification, the right of an EU carrier designated by one Member State to establish itself in, and to operate turn-around services from, another Member State could not technically be called a 'seventh freedom' service. It therefore became known colloquially as 'virtual' seventh freedom services.¹¹ But even more important than whether the USA would allow such virtual sevenths for all EU Member State carriers was the question of what assurances the USA would need – concerning such critical matters as safety, oversight, State of incorporation, state of taxation, and others – in order to allow such flexibility. In short, how does Lufthansa really 'establish' itself in another EU Member State before opening its virtual seventh freedom services from that State?

US Cabotage

No one questions the critical importance of these issues to the EU and its continuing efforts at unification, especially now with 25, rather than only 15 Member States. Nor does anyone doubt that achieving a positive resolution to these issues was, and remains, a *sine qua non* for any real progress toward unification of aviation relations within the EU and *vis-à-vis* all third countries including, of course, the USA.

While the USA had signalled its willingness to agree to some form of multinationalization of EU airlines (with, of course, protections against 'free riding' by carrier of countries without open skies agreements), there was no agreement on any specific language. Nor was there any agreement on any aspect of the virtual seventh freedom service issue.

It was all the more surprising, therefore, that almost from the moment the negotiations opened, the EC and its then-principal transport commissioner, Ms. Loyola de Palacio, decided, in effect, to largely ignore the importance of both of these issues. Instead, the EC seemed to adopt what became a huge and highly publicized attempt to channel the negotiation into an effort that seemed to almost all American, and most knowledgeable foreign, observers to be doomed from the very start.

The EC's declared objective seemed to become that of forcing the USA into allowing EC Member State carriers to enjoy access both to US cabotage rights (i.e., the right to carry passengers between two domestic US points) and to the US government's Fly America Program (reserving US government-paid travel for US flag carriers).

Whether there are any EU carriers that even want to plunge into the maelstrom of US domestic aviation, let alone whether that market today is anywhere near the profitable market it was even a few years ago, are questions that the EC negotiators seem to have totally ignored. Similarly ignored was the unprec-

11. See n. 8 *supra*.

edented incongruity of demanding that foreign carriers should be able to operate in a huge domestic market like the United States under terms and conditions of tax, employment, safety oversight and other standards totally different from those applicable to all USA carriers operating and competing in that same domestic marketplace.

Nor was there any logical basis for the EU's oft-repeated argument that cabotage rights for foreign carriers in the US had to be equated to fifth freedom rights for USA carriers in Europe – an argument this author seemingly put to rest, finally and conclusively, in an article published over one year ago.¹²

It may have been easy and convenient for the EC negotiators, as they so often did, to suggest that the USA was unwilling to open its cabotage market only because of its desire to protect organized labour. But how about all the other domestic laws and standards? Did the EC negotiators really believe that in a country like the USA one set of carriers (US flag) could operate under domestic standards, while competing with another set (foreign flag) that would operate under diverse other – possibly far more relaxed – foreign standards? It is so truly hard for most American observers to accept that the EC negotiators could have sincerely believed this that many of us came to the view that the argument, no matter how often repeated, was intended for purposes other than its acceptance.

To be sure, everyone in the USA understood that the EC was trying as best it could to expand the negotiations far beyond anything the ECJ decision ever contemplated. Conventional wisdom in the USA has it that the EC's reason for this approach was simply to enable the EC, if successful, to claim credit for negotiating a package deal with the USA that could not have been negotiated bilaterally by individual EU Member States. Once enjoying such 'credit', the EC would then presumably be in a better position to demand that its mandate be broadened to include all other aviation issues (e.g., fifth freedom rights beyond EU Member States) and all other countries.

After all, it was more than likely only because the EC promised it could deliver such a package deal that it was able to obtain a mandate sufficiently broad to even conduct these talks. But if the EC negotiators ever sincerely thought that this internal EU dynamic might move the USA government to allow EU carriers to join the Fly America program (beyond the code-sharing rights EU carriers enjoy today), much less to give up US cabotage rights, they were woefully misguided.

12. See Allan I. Mendelsohn, 'Myths of International Aviation', 68 *J. Air Law & Com.* 519, 520–523 (2003).

Question (2): Do you expect the negotiations to lead to one agreement that creates a common aviation area? Or do you think that several agreements dealing with various issues will be reached over a period of several years?

While a great deal can be achieved in one agreement, especially to enable the EU to comply fully with the ECJ's decision, more than one agreement will almost certainly be required over the years to achieve the broader objectives that both the EC and the USA have in mind and that both would like to achieve at some proximate future date.

Right of Establishment

For example, however unclear when, I believe it is inevitable that at some future time the USA will adopt a right of establishment (R of E) approach in international aviation. Such an approach would permit nationals of friendly foreign nations, on a reciprocal basis, to 'establish' themselves as corporate entities in the United States. Under the traditional 'right of establishment' approach, this means that foreign carriers would be able to set up and wholly own corporations in the USA, obtain air carrier operating authority from the USDOT, and (unlike the cabotage approach) operate US flag carriers under the same labour, tax, immigration and other laws as are applicable to American, United and all other US flag carriers.

Such an approach would also permit these foreign owned but US flagged and regulated carriers to carry traffic between US points, i.e., cabotage. It would also permit them to join the Civil Reserve Air Fleet (CRAF) and thus become directly eligible for the benefits of the City Pairs and Fly America programs.

Instead of relentlessly pursuing their press campaign for cabotage rights in the USA, the EC negotiators should have altered their strategy and sought progress along two lines: (1) the important issues addressed by the ECJ's decision (and other comparable outstanding issues like wet leasing, competition, etc.) that could be immediately obtained; and (2) what might be obtainable only in the future, e.g., the R of E. Moreover, what the EC negotiators seemed not at all to grasp was that the R of E, once exchanged between the USA and the EU, would provide most if not all the benefits in the USA that the EC seeks (by demanding cabotage rights) for its carriers and its citizens.

To be sure, even obtaining the R of E in the USA will be a longer process than the EU wants, as it will require educating the US Congress to think of R of E as not inconsistent with US security and national defence needs.¹³

13. See *id.*, at pp. 531-534 for an explanation why it could be difficult for US interests, especially the US Department of Defense, to oppose the adoption of an R of E approach in US international aviation law.

Then again, however, it may be an equally long process for individual EU Member States even to allow turn-around – i.e., virtual seventh freedom – services at their gateways by other EU Member State carriers, let alone by carriers that are owned by US citizens. But once the EU and the USA move in this direction, no matter that it may require some years, the real process of denationalizing international aviation will have begun.¹⁴

The 49 Per Cent 'Compromise'

I would be remiss in my analysis if I did not briefly mention my personal views about the effectiveness of both the current EU regulation (Article 4 of EU Council Regulation 2407/92) allowing 49 per cent ownership by non-EU nationals and the pending USDOT legislative proposal to raise the US statutory limit on foreign ownership from its current 25 per cent to match the EU's 49 per cent. It is significant that in the more than ten years since the EU has had its 49 per cent limit in effect, there has been only one major attempt even to use that so-called liberalizing approach; and that attempt ended in the ultimate bankruptcy of both companies (Sabena and Swissair).

Perhaps some day the situation may change, but today's reality in Europe suggests that European aviation is not straying very far from the nationally oriented doctrine of 'effective control' by nationals of the designating State. Lufthansa is German, Air France is French, and so on. They remain so not because the USA has set up any roadblocks to European aviation consolidation (as some European commentators have been wont to suggest), but because aviation in Europe remains, and I suspect will for some time continue to remain, very nationally oriented and committed.

Even the much-ballyhooed recent 'merger' between Air France and KLM seems to contemplate a seven year process – at the end of which both carriers will still retain their individual national identities and independent route structures. This is hardly a 'merger' in the minds of most American viewers.¹⁵ To be frank, however, progress in bringing about these historical changes must necessarily be measured. Indeed, it will not be at all different when the US Congress confronts the changes that will ensue from adopting R of E in aviation – which is precisely why it will take a number of years before it becomes possible to adopt a 100 per cent R of E approach in the USA.

I have stated in other forums that, given current realities on both sides of the ocean, there is hardly any point retaining or adopting a 'compromise' 49 per

14. While it is true that the EC finally began to focus on the R of E at a late stage in the negotiation, little progress was, or could have been, made at the time.
15. It may well be, however, that the 'merger' will permit AF to list itself on the N.Y. Stock Exchange, thus assuring itself more liquidity and a platform on which to build a US investor base.

