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- **Emission Trading – passed by Parliament, but not welcomed by airlines**
- **The European Court of Justice: denied boarding, and perhaps denied ETS**
- **Regulatory Reform – all roads lead to Istanbul**
- **Competition at the base of the Tower**
- **Composites and MROs: Competitive Forces?**

Emission Trading – passed by Parliament, but not welcomed by airlines

It is almost like a Delphic quiz: what was the end of the world as we know it, a brave and bold step forward, and an opportunity missed all, at the same time? Emission trading for airlines, obviously. Depending on whom you talked to, the airlines, the parliament and the environment activists were actually talking about the same twenty pages of densely written text, almost fiendishly designed to be impenetrable to the uninitiated. Where you stand depends on where you sit, apparently.

The ETS legislation passed through the European Parliament, in the form reported in our last Aviation Intelligence Reporter, with a series of speeches and a compelling majority. Importantly, the rapporteur Dr Liese paid tribute to certain groups that had worked on the draft of the legislation. And then, in a most unusual step, he singled out the airline associations for their attempts to foil the passage of the draft. Such an ‘ad hominem’ attack on an industry is almost unheard of in Brussels. It seems that calls for non-European airlines to commence litigation against the Directive particularly upset Dr Liese. Spoil sport.

Perhaps stung into action, the associations seemed to find their voice. Finally IATA produced a catchy one-liner: ‘taxes do not reduce emissions’ they thundered. Good, but wrong, of course. Punitive taxes would reduce emissions, but IATA did not use the “p” word, perhaps afraid of putting ideas into Dr Liese’s head. They also produced full page ads in a number of international publications, promoting their four point plan. But, this is not the famous four point plan agreed at the subterranean ‘Summit’ – it is a different four point plan.

Truth be told, it is a better four point plan, to the extent that it does not attempt to do things that only governments can do, but instead puts forward suggestions that governments might like to consider. But it is different nevertheless. The original declaration was poorly drafted, in the way of most committee outputs. The new version is clearly better. But perhaps it is too little, too late. And it makes a mockery of the ‘Summit’ and the much boasted-of coalition.

It is clear that the call to airlines in other jurisdictions to consider action is being watched with great interest. Airlines, and their governments, are threatening litigation. Indeed a number of governments wrote a State letter to the European Commission over a year ago reminding the Commission that in their view, ICAO was the suitable jurisdiction to develop any such scheme. The US, Japan, China, Australia and Canada are amongst the signatories to that letter.

But the truth, as all accept, is that there is nothing that can be done at the moment. The ETS has to be approved, transposed, implemented and brought into effect before any airline or country can claim it is damaging or illegal. In the meantime, airlines will need to take a number of steps to get ready, in case litigation does not eventuate, or the Commission wins (against all predictions). For non-European airlines, this includes registering with a European regulator. For all airlines, it means establishing a base-line of emissions.

The European Court of Justice: denied boarding, and perhaps denied ETS

It may be that all the threatening of international litigation need come to nothing. The European Court of Justice may do the work for those opposed to the ETS. On 7 July, with no fanfare and no notice, the European Court of Justice handed down a very interesting decision.

The Commission certainly wasn't about to tell the world of the outcome. It presented the Commission with a huge dilemma. The best case spinning of the result they might have attempted was 'this result is limited to the particular details of an extremely poorly drafted piece of legislation'. Given that they drafted the legislation, this tack was never likely. But even less likely was the alternative spinning: 'this is a very bad precedent for the decision to apply Europe's emission trading scheme to non-European airlines'.

It has got to be one or the other. The way that the decision was gently added to the official journal without telling anyone, at least shows clearly the Commission is concerned about the outcome and understands the sensitivities.

The case, as we reported some months ago, concerns Emirates and the Denied Boarding Compensation Regulation. Mr. Schenkel purchased a return ticket on Emirates from Germany to Manila, via Dubai. On his return from Manila, the aircraft was delayed for technical reasons. Consequently, he missed his connection in Dubai. Herr Schenkel argued that he was entitled to denied boarding compensation as a result of this missed connection in Dubai.

The decision turns on two big issues: first, the German translation of the Directive has a discrepancy between 'flights' and 'journey'. As we reported at the time, Advocate General Sharpston was not slow to point out the poor quality of the drafting. Secondly, Emirates argued that given the drafting, which appeared to break journeys into a series of flights, each of which was to be considered separately, the Directive cannot then apply to non-European airlines in non-European airports.

The European Court of Justice was asked to consider this problem, as well as that of whether the Directive in fact applies to non-European airlines, for a denial of boarding outside Europe. The Court decided that the Directive did not apply. In doing so, they followed the reasoning of Advocate General Sharpston.

It came to this conclusion first from a detailed analysis of the text. But importantly, it also found that the Directive did not explicitly include non-European airlines when not operating within Europe. To be fair to the Commission, there is no doubt that the ETS draft does explicitly say that it is intended to apply to non-European airlines operating to and from Europe, so the particular point of extra-territoriality is yet to be resolved definitively.

The bad drafting is a pity, because it allowed the ECJ to avoid having to decide on the extra-territoriality point. As a precedent, nevertheless, it would be hard to call it unmitigated in its support for the concept of extra-territoriality.

Regulatory Reform – all roads lead to Istanbul

As we reported in our June Intelligence Reporter, the recent IATA AGM in Istanbul heard of the launch of an IATA push to reform air transport regulation. The call for a meeting, in Istanbul before the end of the year, of 'like minded States' to consider ways to reform aviation without starting again on the Chicago Convention got drowned by the concerns of the airlines over the price of oil. That is a pity, as it is a call worth considering for a minute or two.

The alternative reason for why this idea does not seem to have been picked up as much as it might have may have something to do with the name: The Agenda for Freedom. Please.

IATA appears not to have been too dispirited by the muted response. A number of the airlines from these like minded States seem to have been sent a short briefing paper recently, in which the issues are canvassed in more detail. A number of them have shared the document with us. The airlines, it is assumed, will then be ready to support their government representatives in any consultations that might take place prior to the Istanbul meeting.

There can be few causes more appropriate for IATA to take up than attempting to break through on the barriers to aviation regulation liberalisation. And the Holy Grail in that pursuit must be to break down the limitations on ownership and control. An honourable next best would be to allow airlines a right of establishment in other countries.

This goal is a stated aim of the European side in the recently commenced second round of open skies negotiations with the US. As we have previously noted, the US response – a vast multi-lateral open skies type agreement for any that wishes to participate – is interesting, but does not address the right of establishment point. The US proposes unrestricted traffic rights to all members. In effect, they are proposing the International Transport Agreement of 1944 be resuscitated.

The IATA proposal picks up on the US idea, but then explicitly includes right of establishment as one of the things exchanged between members of the group. Each member of the group would signal their membership by way of reciprocal, conditional declarations. And, the IATA proposal includes an exit strategy too: if not completely satisfied, simply return the new declaration to the shop for a complete refund. More accurately, give 12 month's notice and revoke the new clause.

At the same time, the European Commission is certainly keen on pushing forward with the negotiations for the second round of EU-US liberalisation. The Commission has made it known that it is only interested in this being a two stage process, not a three (or even more) stage process. Consequently, right of establishment must be agreed in this round, they say.

The trouble with that stance is that Europe has given away many of the bargaining chips, including access to Heathrow. With an election late this year in the US, and the time that it will take to then get a new administration in place and up to speed, this is not a short term prospect. And that assumes that the new administration can take on and defeat

the entrenched political forces opposed to the proposal – that unholy alliance of labour and defence. Added to that, the chairman of the Transport Committee in the House, Representative Obestar, is on record for suggesting that ‘over his dead body’ will such a thing happen. Rep. Obestar appears to be in good health. The Commission negotiating team must be in no doubt that this will be a tough road.

A right of establishment need not be the issue that Rep. Obestar and the unions want to make it. If an airline is established in a particular country it will need an AOC issued by that country. In other words, it will be subject to the same safety review and inspection regime as any other carrier in that country. Local staff will be needed to comply with the terms of the AOC. There will need to be post holders and so on, after all. This is no more than can now happen in Europe.

As the IATA proposal notes, the issue is not to tear down the Chicago Convention: it continues to perform a number of necessary functions, including safety oversight and in instilling a safety culture. Nor does the IATA proposal attempt to undermine the role each State plays, or responsibility for, air traffic management service delivery, and safety in its territory. The issue is whether there should be such artificial regulation of commercial operations. And, it attempts to find a way to resolve the issue without need of huge, time consuming, politically dominated multinational negotiations. IATA, being based in Geneva, would no doubt have noted the irony of the failure of yet another attempt to find multinational, all embracing solutions to world trade.

As the IATA paper says, what is needed for this sort of ‘normal’ regulation to work is for there to be clear guidelines to ensure competition. The most obvious, and least intrusive, is to rely on national competition bodies. China’s first anti-trust regime commences on 1 August. India has introduced a new competition regime, too.

A second solution might be for there to be a right of immediate withdrawal (or withdrawal on one year’s notice) if there are genuine concerns. Given that the concerns are held (most usually) by the airlines, and it is the government that would orchestrate the withdrawal (this being an international treaty document) that automatically creates a sort of review procedure whereby the government would need to be convinced before acting.

The third solution suggested is a new supranational competition authority. It can only be assumed that this is the old proposing-something-too-ridiculous-for-words-as-a-stalking-horse negotiating ploy at work.

Competition at the base of the Tower

Competition is a vexing concept for air navigation service providers (ANSPs) and for air traffic management services. The traditional response to calls for competition in ANSP services is to laugh. The louder the better.

It is hard to see how there can be competition in en-route services, if one is to take the definition of ‘competition’ in a very narrow sense. It would call for parallel routes being offered by differing ANSP service providers, thus allowing carriers a choice, or for a

particular territory or country to be divided into areas, with different ANSPs delivering the service in each area. Neither is perhaps ideal in today's world.

Over time, an alternative might be to require the provider of ANSP services to be measured against particular key performance indicators (KPIs) with the State that is using such ANSP service provider as a means to discharge its Article 28 obligations able to switch ANSP service suppliers if the KPIs are not met. That model clearly calls for a mature understanding of Article 28 and the sovereignty obligations, as we discussed last month.

Apart from en-route services there are in fact a number of ANSP services that are actually open to competition – training, software design and implementation and the provision of aeronautical information and mapping services perhaps being examples. The issue that the ANSPs must bear in mind when looking at offering these services is that it is a big bad world out there and competition law applies. ANSPs are not immune from such things – much as they would want to be. It is not impossible (of course it is not impossible), but caution is called for. For a start, the ANSPs need to acknowledge that they cannot use their market power in the en-route service provision market to distort, hinder, lessen or prevent competition in those other markets.

Another approach to introducing competition was launched this month by the UK CAA. It is looking at making the provision of tower services competitive. It is doing no more than required under the Single European Skies (Mark I).

Regulation 1794/06 is a subsidiary and little observed underlying regulation in the Single European Sky package. It lays down measures for the development of a common charging scheme for the provision of air navigation services (ANS) across the Single European Sky. Member States are required to establish charging zones for en-route ANS and ANS provided at airports by 2010.

The Regulation, by providing for the transparent reporting of ANS costs allocated to each charging zone, effectively requires that there be disclosure of cost information for the provision of air navigation services at airports. The Regulation also gives Member States a discretion to reduce its regulatory oversight on smaller airports (that is airports with between 50,000 and 149,999 commercial air movements) if it can be shown that the air navigation services are supplied in a contestable market.

Clearly, that begs a big question. What exactly would be a contestable market for the provision of air navigation services? Yet again the European Commission is forging new territory in the aviation area. There has never been a contestable market for air navigation services before. IATA's preferred poster boy ANSPs (this year's Eagle Award Airways New Zealand, and the costing benchmark for all discussions with the European Commission, the FAA) are not providing services in a contestable environment. Indeed no ANSP in the world currently is.

But introducing competition to ANSPs needs to start somewhere, and UK towers would appear to be the place. For that alone, as a monument to history, an ability to tell your grandchildren that you were there, this public enquiry is very worthy of considered attention. The link is: <http://www.dft.gov.uk/consultations/open/ecregulation17942006>

The paper sets out a range of charging options: a single charge for all airports with more than 50,000 CATMs; a charging regime that discriminates between airports with between 50,000 CATMs and 149,999 CATMs and then those bigger than 149,999 CATMs; a complex arrangement of regional charging zones, that somehow miraculously carves out any large airport from an otherwise low CATM region (Manchester by way of example); and, an airport specific charging zone. This final option provides the least place to hide for each airport (or as the consultation document puts it 'maximum transparency') in relation to its costs.

The deadline for responses to the consultation is 13 October this year.

Composites and MROs: Competitive Forces?

Airlines increasingly outsource maintenance and other work to Maintenance and Repair Organisations (MROs). Around the world more and more MROs have been established and they are a vital part of the smooth running of the industry. Largely, airlines and others put all things to do with maintenance (including MROs) in the same category as children – better seen than heard. Nevertheless, there has been relentless, obsessive focus on cost reduction in this area as airlines focus on their cost base.

The one part of the industry that is concerned by the arrival and the increasing role of the MROs have been the original equipment manufacturers (OEMs). MROs are an important counterpoint to the market power of the OEMs.

A number of innovative solutions have come out of this competition. Engine suppliers, as well as OEMs, are now happy to supply 'power by the hour', rather than sell an engine and spare parts. This has been a huge breakthrough for airlines, allowing them effectively to lease engines and maintenance, rather than outlay a huge amount in one up-front payment.

It has been harder for the airframe manufacturers to get into the equivalent of the power by the hour game. Certainly, the airframe manufacturers help with the leasing of airframes, but the on-going revenue opportunities that the supply of spare and replacement parts, as well as the value added services of providing skilled labour to maintain and overhaul airframes, has proved to be harder to break into.

Unwittingly, composites might prove to be the way they do so. The push for the share of composites in the airframe has been breathtaking. The new generation airframe, including the A380 and even more so, the B787 and the A350 have in the order of half of the airframe made from composites.

Repairing composite components is still a skill in its infancy. But the first results are not all that encouraging for the MROs. Composites are not unsafe – they have been tested repeatedly and if they save weight and fuel there will be a role for them for many years to come. But composites are just as liable to be hit by catering trucks and birds and lightning as non-composite parts.

The issue is not safety, it is competition. Once a part has had something happen, the question is whether it can be repaired, or does it need complete replacement? At a recent seminar, a representative of Lufthansa Technik – perhaps the world's largest MRO – noted that they are now starting to build up considerable experience and data regarding the behaviour of composites. And their findings are that it is difficult to survey what, if any, other damage might have been caused to a composite part in the event of a seemingly unrelated incident.

The prudent solution therefore is to replace the entire component, or part, or panel, as the case may be. But as the percentage of components made from composites grows, and the size of each of those components grows, this becomes an increasingly major task. In the new B787, almost the entire fuselage is one single composite piece. Any minor incident and it might be that one needs an entire new airframe.

And that is where the competition point comes in. MROs cannot compete with that sort of situation. If a repair job is increasingly to supply new aircraft, the OEMs are in the (moulded) box seat. Airframe by the hour, to go along with power by the hour is looking more and more likely.

And at the end of the day, this might be a competition law issue. If the OEMs use their market power to hinder competition in the MRO market, the entire industry will feel the effect of that. As noted above, with competition law issues there are solutions, but first, one has to acknowledge that there is an issue. MROs presently are not well served with an industry association or other representative body. Maybe they need one.

It should also be an issue for the airlines. In the short term, composites save fuel and costs. If every time they need overhaul that actually means replacement, however, the savings may prove ephemeral.

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