

AviationAdvocacy

Regulatory Insight and Intelligence

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Aviation Advocacy Sàrl Ch de la Croisette 61C 1260 Nyon Switzerland
Phone: +41 22 361 23 63 Fax: +41 22 361 23 64 info@aviationadvocacy.aero www.aviationadvocacy.aero

Introduction

The US-EC 'open skies' agreement has been signed in Washington, and remarkably, whilst this might seem to mean that regional issues would become increasingly relevant, leaving broad international consensus behind, suddenly, all eyes are turning to ICAO. It seems that there is a need for international consensus between regional blocks, just as there was a need for consensus between States. ICAO has its next tri-annual General Assembly in September and all sorts of items are on the agenda – including environmental issues, air traffic control and possibly spectrum allocation. At the same time, there is corridor talk of a small group of interested parties, including IATA and CANSO forming a 'ginger group' to agitate for widespread reform of ICAO or even a replacement to the Chicago Convention.

In the meantime, even at a regional level, there are a number of issues that have come to the fore in the last weeks that will dominate the agenda this month.

Is Emissions Trading for Aviation in the EU built on sand?

- Airlines in Europe are actively discussing emissions trading schemes with the European Council and the European Parliament
- The proposals being put forward are focused entirely on European issues– with no consideration of the interests of others
- At the same time, a number of non-EU States have written formally to oppose the introduction of such a system
- The impact of that non-EU States letter, and the scheme in general, is open to considerable doubt
- Other airlines need to start putting together a strategy to position itself in this on-going debate. It will be discussed at the ICAO General Assembly later this year

The European Union has embarked on the first attempt worldwide to use market forces to reduce the environmental impact of aviation.

The first shot was fired by the European Parliament in June 2006 when Member Caroline Lucas (from the Greens) tabled a report on reducing the climate change impact of aviation. Its main recommendations (e.g. broad geographical scope, rigorous cap and full auctioning of initial allocation) were extreme and met with unanimous condemnation from industry.

But the Lucas Report prepared the ground for the European Commission to propose a directive to include aviation activities in the existing scheme for greenhouse gas emission allowance trading with the Community. **The EC is now working on that Directive. Within Europe, there is considerable lobbying and positioning in play to prepare for the introduction of such a scheme.**

To date, the position of the European airlines and other players such as business aviation, has been to concede to the inevitability of the introduction of the scheme, and to position themselves accordingly. **They are doing that with no consideration of the**

interest of non-European airlines. IATA for example has been excluded from the negotiations. AEA is looking to the interests of the scheduled carriers.

This is curious, as there can be little doubt that the issue will move outside Europe. The majority of EU aviation emissions come from international flights, which are not subject to emission control targets under the Kyoto Protocol. Once that point is understood, and carriers within Europe call for a 'level playing field' with their competitors, confrontation with third countries is inevitable. The European Commission study for example calls for all flights arriving and departing to and from European airports to be included.

The recitals of the proposal to include aviation in the emissions trading scheme acknowledge that the European Community is not a contracting Party to the 1944 Chicago Convention but that all Member States of the EU are. The recitals also claim that it was agreed at the sixth meeting of the ICAO Committee on Aviation Environmental Protection (CAEP) in 2004 that "an aviation-specific emissions trading system based on a new legal instrument under ICAO auspices seemed sufficiently unattractive that it should not be pursued further. Consequently, Resolution 35-5 of the ICAO Assembly does not propose a new legal instrument but instead endorses open emissions trading and the possibility for States to incorporate emissions from international aviation into their emissions trading schemes." This is not the most widely held interpretation of that Resolution.

This view is indeed disputed by Australia, Canada, the People's Republic of China, Japan, the Republic of Korea and the United States who jointly wrote in April 2007 to the European Union to express their concern about the initiative taken by the EU. They reminded the EU that the ICAO Assembly in 2004 urged "States to refrain from unilateral environmental measures." This letter apparently received very little attention, and generally has not been leaked to the press nor given the distribution that it might have expected. This is curious, and implies that the various Governments are perhaps 'keeping their powder dry' for a more suitable moment to show their concern. We have a copy of the letter, if you are interested in seeing it.

This ad hoc group of States recognised the right of the EU to include emissions from European aircraft in its trading system but not the right to include third-country carriers unilaterally. The signatories signalled their intention to take appropriate measures under international law should the EU insist on moving forward unilaterally.

There are a number of points to note here: first, the European carriers believe that they are being discriminated against by their own governments. Either only they will be affected or if flights into and out of the EU are covered, this will affect only a small percentage of their competitors' flights. Secondly, there is a real risk that to counter that perception, the EU will consider imposing a fuel tax. That should be unacceptable to any non-European airline.

From their perspective, they will need to take a view on a number of factors. First, whether entry into such a scheme is likely to harm it disproportionately compared to its competitors. That will depend on the timing of its introduction, the fleet mix and age at the time and the cost; secondly, whether it wishes to be seen to be taking a proactive step on the environmental debate. It is Aviation Advocacy's view that the environmental

debate will not go away, and that by taking a forward looking position, non-European airlines can position them self better for the future. Finally, other airlines should be discussing this issue with its national delegates to the ICAO General Assembly to be sure that it optimises the outcome. There is considerable scope for this. The current proposal can be opposed on the basis that it is unilateral. This is a matter that is properly decided by ICAO. If that is to happen, frankly, there is will be a considerable time delay in its introduction, which depending on your airline's comparative position may be a good thing. In any event, being proactive at ICAO shows considerable good faith.

The EU proposal is also facing stiff opposition from closer quarters. Some EU Member States have expressed reservations on the ambiguities and vagueness of the proposal. **It might be possible to exploit these differences to be sure that aviation is excluded from the proposed emissions trading scheme.**

The Commission's draft legislation proposes that carbon allowances will be allocated to airlines through a methodology which will be a mix of benchmarking and auctioning. In the initial trading period starting in 2011 the bulk of allowances would come from free allocations. To obtain these allocations, EU airlines will be required to provide data on their activities which will be benchmarked to determine how many free carbon allowances they will receive for the first trading period.

The problem with benchmarking is that it makes no provision for future industry growth or new entrants. In addition the different business models currently used by passenger and cargo airlines also present a challenge to the legislator if the scheme is to avoid market distortions. These challenges are yet to be met.

The mandatory impact assessment conducted by the European Commission has been criticised by industry as being far too optimistic. The assessment claims for example that airlines would be expected to pass on, to a large extent or even in full, the cost of participating in the scheme to their customers; that the scheme would have only a small effect on forecast demand growth; that aviation is in general not very price sensitive; that competition between airlines would not be expected to be significantly affected and that the choice of geographical scope was not likely to change this conclusion; and finally that the choice of geographical scope is not likely to change this conclusion for specific airports (for example airports used by low cost carriers that might be seen to be very cost sensitive) and that in any event, any risk to tourism would likely be decreased if the scope covered all departing and arriving flights.

These issues have been discussed in the aviation industry for many years. As early as 1972 GE introduced engines designed to reduce noise and emissions. If nothing else, what this shows is that in the aviation industry, things can take time.

Aviation Advocacy continues to monitor this situation and will report as developments occur. In the meantime, airlines should prepare their best position so that it can be involved in this debate as appropriate.

Mobile phones, internet surfing and Blackberries on-board: The story so far.

- The final regulatory hurdles are being cleared to allow mobile phones in flight
- Regulation will continue on a national/regional basis
- Airlines interested in using these services will need to ensure that their national telecommunications regulators press regional bodies to introduce a regional framework to allow for its introduction
- Issues around 'social factors' remain unclear
- Currently, it is possible to have phone services (voice, SMS, Blackberry), or internet access (and live TV streams), but not both
- Mobile phones may be a revenue stream for the airline, or a service item

Last week, the US Federal Communications Commission (FCC) halted an investigation that would have lifted the ban on the use of mobile telephones in flight, citing the risk of interference with ground networks. On the other side of the Atlantic, in December of last year the European Electronic Communications Committee (ECC) approved the use of mobile phones inside aircraft, provided that there was an on-board base station (called a pico-cell), a 'network control unit' filtering out any signal from base stations on the ground, and a means of ensuring that the system did not commence operations until the aircraft was 3,000 metres above the ground.

The FCC decision needs to be understood in the context of an auction of spectrum dedicated to the carriage of air to ground traffic that they conducted in 2006 which cost AirCell \$36M and JetBlue \$20M. AirCell is offering a wireless LAN in-cabin solution that then beams directly to transmitters on the ground. JetBlue is looking to offer live TV with its spectrum, again directly from the ground to the aircraft. The FCC decision offers the concessionaires a window to exploit their existing offerings without competition from satellite linked mobile services (that would use different, internationally allocated, spectrum).

At the same time, last week, Qantas started a trial service. One of the big issues that the trials will address are the social issues; the concern of fellow travellers of having passengers talking on the phone in flight. That will not be an issue in the US, but might be in Europe. RyanAir has dismissed the concern, arguing that their flights are 'cheap and cheerful' anyway. Qantas is prohibiting voice calls. Voice calls continue to be a major part of a mobile telephone operator's revenue, so whether the service can economically survive without voice generated revenue is an interesting question.

Aeromobile and OnAir (as well as their customer airlines) are also banking that for short haul flights, telephone service is more attractive than wireless computer access. That passengers on short haul flights feel that surfing the internet is too time consuming, complex and difficult in the limited personal area than making a quick call, or sending an SMS. In the US, AirCell is punting that surfing will sustain their investment. JetBlue is banking on airline passengers wanting to watch TV. JetBlue is also understood to be looking for other customers for its in-flight TV system.

The European approach, of a GSM based service, the capacity requirements of which can be delivered by the existing satellite infrastructure – both the new suppliers of these services are using the Inmarsat satellite constellations – create a new country in the sky,

with roaming relationships with all the existing mobile operators, so that the cost of a call is like any other international call made from a mobile phone, and is billed that way too. All calls made will be billed as part of a subscriber's regular phone bill, not via a separate credit card or other transaction. Aeromobile and OnAir are banking that this convenience will make the service attractive.

For the first airlines, the service providers are providing the equipment. Later airlines will need to pay for the equipment from its revenue stream share. This presents a dilemma to full service carriers which might take a view that only business like applications such as blackberries (as well as SMS services) should be allowed; however, voice calls (with bigger margins) can generate greater revenues.

The issue of interference with the on-board systems, the official reason that mobile phone use is banned is not on the agenda. The systems installed on the aircraft are certified; extensive testing has shown that these systems, by allowing phones to operate at very low power, are in fact less problematic than phones attempting to connect with ground base stations at full power.

Unlike the TV and wireless data systems in the US, the European systems have to be installed in a complex licensing framework. Mobile telephones require access to licensed spectrum. The solution developed and delivered required a Europe wide agreement for mutual recognition of the licences issued for the use of the mobile spectrum by the state of registration of the aircraft, irrespective of where within Europe that aircraft was currently located. This was a major breakthrough, albeit that it was consistent with the terms of the Chicago Convention. Aviation Advocacy did the lobbying on that assignment.

For airlines outside Europe, a similar regulatory structure will be needed. That will require countries to act via their already established regional bodies to act regionally. In Asia and the GCC, there has been considerable movement down this path to agree to the mutual recognition of licences issued by the mobile phone regulator of the State of registration of the aircraft, and the acceptance of the non-interference principle.

Spectrum for Sale?

- User pays comes to resources traditionally given for free to aviation
- The UK is considering auctioning the spectrum necessary for air to ground communications, and this is likely to spread across Europe
- Airlines in other countries need to ensure that it does not spread to their region

Radars, air traffic control, ACARS all depend on spectrum. The particular spectrum band is agreed at the World Radio Conference (organised by the International Telecommunications Union) so that each national government has a coordinated set of frequency bands, and then it is allocated, at no cost, to the relevant aviation agency or authority. It was inevitable that in a world of user pays, this could not last. This week, Ofcom, the UK telecommunications regulator announced that it was going to auction this spectrum.

The aviation industry, having been pushing user pays and fair and open access to resources is now hoist on its own petard on this matter. So is ICAO. It has been an article of faith that this spectrum is available exclusively at no cost. ICAO's charging policy is the Air Navigation Services Economics Panel, which would be required to uphold the ICAO Policy on Charges, meaning that the costs must be based on transparent costs, meaningful consultation and reasonable allocation. Given that almost all other spectrum is now charged on a user by user basis, there is little that ICAO can do to argue against this.

Nevertheless, again this gives some airlines an opportunity to create a commercial differentiation with its competitors. By allowing Europe to go forward with this proposal, (Ofcom is regarded as a thought leader in European telecommunications) there is a cost for European carriers that non European carriers need not face.

Airlines need to consider their view on the upcoming ICAO General Assembly.