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UPDATE ON U.S.-LATIN AMERICA BILATERAL RELATIONS

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Much of this conference has dealt with infrastructure and airports. I will go in a different direction and discuss bilateral relations, which form the international superstructure for air transportation. This superstructure has a direct impact on traffic levels and growth and, therefore, has an impact on airport and infrastructure needs and planning. In addition, U.S. bilateral agreements contain provisions relating to safety and security, which impact directly on infrastructure needs.

Any update on bilateral relations, whether it deals with Latin America, Europe or Asia, must begin with a broader analysis of U.S. international aviation policy, because it is critical to understand how, where and if Latin American countries fit into broader U.S. policy.

1. Two years ago the USDOT issued a formal Statement of U.S. International Aviation Policy. This document was the result of a lengthy project by the staff of the Department of Transportation and was the first formal statement of U.S. policy in almost 20 years.

The key objectives of the policy are:

- the airline industry must rely on the marketplace and unrestricted competition, and not on governments, to determine the variety, quality and price of air service
- the U.S. should promote marketing alliances such as code-sharing because they are good for consumers and for competition
- the U.S. should pursue liberalized and open bilateral agreements with countries and groups of countries around the world

2. Of course, as the entire aviation world knows, an important element of the U.S. strategy has also been to pursue so-called open skies agreements wherever it can. In fact, the U.S. has been pursuing open skies agreements and liberalized agreements during the entire decade of the

1990's, well before it issued its formal policy statement. In this hemisphere, for example, the U.S. and Chile signed a very liberal agreement in September of 1989. This agreement proved to be ahead of its time, however, and the two sides agreed on frequency restrictions beginning in 1993.

Regarding open skies, in 1992, the U.S. signed its first open skies agreement with the Netherlands and formally announced a European "open skies initiative." The U.S. stated that it would explore open skies bilateral agreements with "all European countries willing to allow U.S. airlines free access to their markets." This effort has led to the signing of agreements with 12 European countries, most recently Germany in 1996.

In 1992, the U.S. also publicly issued a "Proposal for Open Skies with Central America and Panama," in which the U.S. proposed to negotiate an agreement that would create an open aviation market between the U.S. and six Central American countries and Panama. Unlike Europe, where the U.S. envisioned a series of open bilateral agreements, this proposal for Central America envisioned a single multilateral agreement under which all markets between the U.S. and the seven countries would be opened to airlines from all of those countries. The U.S. proposal even contemplated the additional of Mexico and countries in South America to this multilateral structure. This effort was too far ahead of its time and possibly anyone else's time and went nowhere.

More recently, in 1996, the U.S. began an open skies initiative in Asia addressed to six countries in the region, not including Japan. That effort has led to the signing of open skies agreements with five of those countries (Singapore, Brunei, Malaysia, Taiwan and New Zealand).

Most recently, and of greatest relevance to this gathering, late last year the U.S. began a new open skies initiative in Central America and proposed separate bilateral open skies agreements with seven countries in the region. That effort led to the signing of an open skies agreement with Panama and, in a ceremony here in San Jose, the signing of agreements with Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua. Belize was the only country covered by the U.S. initiative that did not sign a new agreement. Finally, the U.S. and Aruba recently initialled an open skies agreement.

In total, the U.S. now has open skies agreements with 24 countries and one open transborder agreement with Canada. All but one of these agreements was signed since early 1995.

3. What exactly is an open skies agreement? The U.S. lists 11 different elements that collectively form an open skies agreement. The most important of these elements are:

- open entry on all routes, which means an unlimited number of airlines from each side can enter every route covered by the agreement
- unrestricted capacity and frequency on all routes, which means exactly that

- unrestricted route and traffic rights, including via intermediate and beyond points, which means unlimited Third Fourth Fifth and Sixth Freedom rights (this of course does not include cabotage rights, which the U.S. is unlikely to give up at any time during our lifetimes

- double disapproval pricing, which means that a carrier's fares and rates automatically go into effect and can be disapproved after the fact only by joint action on the part of both governments

- a code-sharing provision

With regard to route rights, several recent open skies agreements, including three of the countries in Central America, have so-called Seventh Freedom rights for all-cargo operations. This means that carriers of one country can establish cargo hubs at points in the other country and operate stand-alone flights between there and third countries. For example, a Guatemalan carrier could create a hub in Miami and serve any country it wants and its flights would never have to touch Guatemala. The U.S. is not yet willing to do this for passenger flights, however.

Many of these elements can be found in agreements that are not open-skies agreements. The existing U.S. bilaterals with Brazil and Chile, for example, contain code-sharing provisions, and many U.S. agreements have double-disapproval pricing.

4. The benefits of opening bilateral markets have been quantified by the USDOT. For example, in early 1995 the U.S. and Canada signed an "open transborder" agreement, which is not as open as an open skies agreement. According to the DOT, in the two years since the agreement was signed, total US-Canada passenger traffic has increased 28 percent. Traffic of Canadian carriers has increased 35 percent and that of US carriers 23 percent. During the same period, 17 markets gained nonstop service for the first time. With regard to fares, the DOT determined that, since the transborder agreement was signed, passenger fares have declined by an average of 22 percent in the 50 largest nonstop markets and by 32 percent in the 17 new nonstop markets I mentioned before.

5. So much for background. Looking forward, what does this U.S. policy hold for the countries of Latin America? We know that six countries in Central America have signed open skies agreements with the U.S. They may be wondering when they will see the benefits, however, since the U.S. Government has thus far failed to authorize code-sharing operations between American Airlines and the six airlines of the TACA Group, even though the new bilateral agreements specifically allow code-share operations. We shall see what happens there.

Viewed as a region, South America poses a unique challenge to the U.S. In both Asia and Europe, the U.S. has a single bilateral partner -- and I'm referring to Japan and the U.K. -- that is uniquely critical in terms of its market size and its geographic proximity to other beyond markets. In both the Asia and Europe, the U.S. has a single bilateral partner - and again I'm referring to Japan and the U.K. -- with which the U.S. has an extraordinary history of friction and charges and counter-charges of bilateral violations. In those regions, U.S. strategies are necessarily profoundly influenced by U.S. objectives vis-a-vis those two countries.

By contrast, there is no "U.K." or "Japan" in South America, at least in terms of market size, geographic importance or even in terms of bilateral hostility. Thus, the U.S. strategy is somewhat less likely to be influenced by its objectives in a single country. What the U.S. confronts in South America is (1) a region with one of the fastest-growing aviation markets in the world and (2) a region in which virtually every U.S. bilateral agreement contains capacity restrictions. The U.S. agreements with Argentina, Brazil, Chile, Colombia, Ecuador and Peru all contain capacity restrictions of one sort or another.

The U.S. believes that those restrictions inhibit market growth and that whatever considerations may have justified those restrictions when they were originally adopted cannot be valid for much longer, if they are still valid at all.

Thus, the U.S. strategy will be to pry open one of the markets in the hopes that the new opportunities in that market will put economic pressure on the carriers in other markets, who will in turn urge their governments to re-think their positions and agree to open those other markets.

For some time, it has appeared that Chile will be the first South American country to agree to an open regime with the U.S. Open skies talks were held in April of this year in Santiago and went well. Another round of talks will be held in October. Recent information suggests, however, that Peru could become the first country in South America to reach an open skies agreement with the U.S. if there is substantial delay in achieving an agreement with Chile.

6. What benefit is there in this for the United States? If you listened to the official U.S. position, you might get the impression that there is really very little in this for the U.S. and that the U.S. is simply trying to foster free competition without regard to how it might affect U.S. carriers. I participated in recent bilateral talks between the U.S. and a South American government. The opening U.S. argument was that the U.S. really had everything it wants under the existing bilateral agreement and that the other country would gain far more from an open skies agreement than the U.S. ever could. In fact, the U.S. negotiator said he thought foreign governments should be coming to the U.S. and asking the U.S. for open skies, instead of the U.S. making proposals to foreign governments.

The real story, of course, is somewhat different. U.S. carriers have a great deal to gain from unrestricted competition. They dwarf most of their foreign competitors in terms of financial resources and fleet size. Their costs are substantially lower. They have highly efficient hub and spoke systems. Most importantly, they have huge domestic feed systems that no foreign carrier can duplicate and they enjoy a protected domestic market that no foreign carrier may enter.

This is an enormous natural advantage that the U.S. shows no signs of giving up. It is no surprise, therefore, that critics have charged the U.S. with being hypocritical in advocating open skies while refusing to open the U.S. domestic market.

7. What are foreign governments supposed to do in response to this U.S. open skies initiative? That depends on the country, of course. As a general matter, governments should sue the process to promote the interests of their carriers, just as the U.S. does. If there is no domestic

economic pressure for open skies or pressure from the flag carriers, one alternative is to do nothing. In the long run, however, it seems to me that it is in most carriers' interests for their governments to establish liberalized agreements -- not necessarily open skies agreements -- with the U.S.

The chief reason for this is that, particularly for airlines in this region, the establishment of a code-share relationship with a strong U.S. carrier is vital. The only way they have of gaining access to all those interior U.S. points is through code-sharing. Almost without exception, the U.S. is not going to allow code-sharing operations unless it has a liberal agreement and a code-sharing provision with the country in question.

This does not mean that foreign governments should immediately accept U.S. offers of open skies. To the contrary, since cooperative arrangements with U.S. carriers may be the only way that foreign carriers can attempt to exploit the opportunities created by an open skies agreement and since the U.S. insists on maintaining tight regulatory control over those arrangements, the foreign government must do everything it can to gain U.S. assurance that the U.S. will grant regulatory approvals to those arrangements, including antitrust immunity if that is relevant, if the foreign government enters into an open skies agreement.

The U.S. is very reluctant to acknowledge that there should be any linkage between U.S. regulatory approvals and the signing of an open skies agreement, but the fact of the matter is that in certain cases, most prominently Germany, the U.S. at the very least appears to have traded assurances of regulatory approval and antitrust immunity for an open skies agreement.

Such assurances may, in fact, be the only way of ensuring that an open skies agreement will be truly open. If, for example, the U.S. refuses to grant code-sharing authorizations or antitrust immunity to a particular alliance because the U.S. does not happen to approve of the particular combination of airlines involved in that alliance, then clearly the open skies agreement ceases to be truly open.

This is not a hypothetical. Some U.S. carriers have been urging DOT to adopt a policy that would effectively prevent airlines of Latin America from entering into code-share arrangements with American Airlines. They want the U.S. Government to say to all of the foreign carriers in Latin America: you may do business with Delta, or United or Continental, but you may not do business with American. Such action would, of course, have a direct effect on the U.S. gateways that foreign carriers might use for connecting code-share operations.

Some would say that this would represent extreme government intervention into the marketplace and that this is the very sort of government conduct that U.S. aviation policy and liberal and open skies agreements promise to eliminate. Others would say that government action is necessary to protect competition. This is an argument that the USDOT must address soon.

8. I promised at the beginning that I would give an update on U.S.-Latin America bilateral relations. I will now do that. I recently had a long meeting with U.S. policy officials about

many of the countries in the region, and what I will do is share with you my understanding of current U.S. Government attitudes toward each country.

Of course, any discussion of the region must refer to the FAA's International Aviation Safety Assessment Program (IASA), under which 12 countries of the region are in Category 1, 9 are in Category 2 and 7 are in Category 3. Although the U.S. takes the position that the IASA is a safety matter and must not be tied to route rights, in fact some countries consider there to be a direct linkage between IASA and route rights for U.S. carriers when those countries' carriers are prevented from expanding U.S. operations because of IASA.

Central America. I have already mentioned that six countries signed open skies agreements earlier this year. It is worth noting that these agreements were signed although Guatemala is in Category 2 under IASA and Honduras and Nicaragua are in Category 3.

Mexico. Mexico is the U.S.'s 2d or 3d largest aviation partner. There are 10 million passengers a year in the market. This compares, for example, with the U.S.-Argentina market with over 1 million passengers and the U.S.-Brazil market with over 2 million. The existing bilateral agreement formally allows only one carrier per side to serve a given city-pair market -- so-called single-designation. The relationship is very positive, however, and in practice both governments have been flexible and have allowed 2 or even 3 carriers per side in some markets. The U.S. expects very soon -- possibly this week -- to agree with Mexico to formally allow double-designation in all city pairs. Also, the U.S. expects to agree on a full code-sharing provision, including third-country code-sharing, very soon.

Peru. The U.S.-Peru aviation relationship is improving significantly. Peru recently was upgraded from Category 2 to Category 1 under the FAA's International Aviation Safety Assessment Program, a program that has caused a great deal of anger in many countries in this region.

The existing U.S.-Peru bilateral agreement limits the number of weekly combination and cargo frequencies that may be operated. The agreement is set to expire in 1998. In anticipation of this, the two sides are in the process of scheduling talks, and the U.S. has reason to feel that an open skies agreement may result from those talks.

Ecuador. The situation with Ecuador is not as positive. The relationship is strained by the fact that the FAA put Ecuador in Category 2 under the IASA Program. The existing bilateral agreement places limits on frequencies, and the U.S. does not expect that this will change in the near future. I do not sense that the Ecuador relationship is a matter of the highest priority in Washington.

Colombia. Last year a dispute arose over Colombia's alleged refusal to allow American Airlines to enter the New York-Bogota market. American complained to DOT and asked for sanctions to be imposed on AVIANCA and ACES. After several rounds of talks, the matter was resolved. The two sides signed an agreement that allowed American into the New York-Bogota market

and also established overall frequency limitations in the US-Colombia market through March 1999.

Nevertheless, the situation here is also not very positive. Colombia is also in IASA Category 2. Although the Colombian Government appears to have devoted resources and efforts to change things, the FAA has not upgraded Colombia.

American and AVIANCA have applied to DOT for authority to engage in code-share operations. Absent a significant liberalizing of the bilateral agreement, however, it seems unlikely that DOT will act favorably on the American-AVIANCA arrangement.

Venezuela. The U.S. relationship with Venezuela is not good. Venezuela is in Category 2 under IASA. Late last year the FAA came close to placing it in Category 3, which would have caused a suspension of all Venezuelan carrier flights and, no doubt, a strong retaliation by Venezuela against US carriers.

As things currently stand, Venezuela has taken the position that it will not grant any new rights to U.S. carriers to serve Venezuela until such time as flights between the two countries have been normalized. This means until Venezuela has been upgraded to Category 1. In the meantime, U.S. carriers are upset and are considering filing formal complaints in which they would ask DOT to impose sanctions on Venezuelan carriers.

Chile. Four years ago the U.S. and Chile were at war. The Chilean carriers complained to the Chilean antitrust authorities that American and United were dumping capacity in the market. The U.S. carriers were ordered by Chile's Antimonopolies Commission not to increase their capacity. They immediately complained to DOT. DOT decided that Chile was in violation of the bilateral agreement, and threatened to impose sanctions on U.S. carriers. A peace was negotiated which included restrictions on passenger frequencies in the U.S.-Chile market. The number of permissible frequencies has been gradually increased, and the existing frequency restrictions are set to expire at the end of 1998.

On a more positive note, the two sides agreed on a full code-sharing provision earlier this year. As I mentioned before, the two sides are scheduled to hold a second round of talks on an open skies agreement in October, and Chile may be the first country in South America with an open skies agreement with the U.S.

Brazil. The U.S. aviation relationship with Brazil is also positive. Although there are limitations on frequencies and carrier designations, the two sides agreed last October on increases that opened up the market considerably, much to the satisfaction of the U.S. In fact, four combination carriers and four cargo carriers per side may serve the market, which is quite a lot.

The two sides have also agreed on a limited code-sharing provision, and code-sharing relationships have been announced between United and VARIG, American and TAM and Delta and TransBrasil.

Bilateral talks are scheduled for October of this year, although it is possible that personnel changes within the Brazilian aviation authorities may result in a postponement of the talks.

Argentina. The U.S. agreement with Argentina imposes severe restrictions on passenger and cargo frequencies. Only 26 weekly passenger flights are allowed per side. These restrictions effectively limit the number of carriers that can enter the market. Absent some unusual event, there is no sign that the situation will change in the near future.

Such an unusual event may have arrived in the form of American's announced equity and cooperative arrangement with Aerolineas Argentinas and Austral. It seems highly likely that the U.S. Government will demand a high price for approving that arrangement, and an open skies agreement, or at least a significantly liberalized agreement, will be the price. A reported recent statement from a senior member of the Argentine Government suggests that Argentina is favorably disposed toward a new agreement with the U.S.

This completes my report on U.S.-Latin American bilateral matters. I hope that it has been useful. Thank you very much for your attention.

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