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"Washington Trends"

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I am delighted to address the second AITAL Leaders Forum. Thank you, Alex de Gunten, Mike Miller and Celestino Pena.

I am here to talk about "Washington trends" that may affect the airlines in Latin America. Actually, it can be a challenge to talk about Washington trends because that involves actually identifying some trends. A trend is a series of events or actions that are consistent in some way, that show a particular progression and that tend to reflect a strategy or design or a long-term vision. That, however, is not always how things work in Washington. With some notable exceptions, what we often see in Washington is a series of short-term reactions; if these reactions are consistent enough to be called a trend, it is often by accident, and not the result of a design or a plan.

Furthermore, even when we do have trends, they are often inconsistent with other developments. For instance, we have long-term trend toward domestic and international airline deregulation. The deregulation of GDS's last year is a recent element of that trend. On the other hand, since 2001 we have seen numerous instances of direct US government financial support for US airlines. This is

directly contrary to the free market that deregulation is intended to create. In fact, one senior member of Congress recently suggested that Congress should simply re-regulate US airlines instead of periodically supporting them through special measures, such as pension relief.

- The most recent development in the trend toward deregulation is, of course, DOT's well-publicized proposal regarding "actual control" of US carriers for the purpose of determining their citizenship. DOT considers this proposal to be a major development on the road to international liberalization. I will explain this in detail.

  By way of background, under US aviation law, it has always been required that – in order for a carrier to be a "citizen of the United States" – 75% of the voting stock of a US carrier must be owned or controlled by US citizens, and the president and 2/3 of the directors and senior management must be US citizens. Over the years, in various cases, DOT has gone beyond these specific objective requirements and added a further, less objective requirement that a US carrier must be under the "actual control" of US citizens. What this actually means has depended on the facts of a given case. However, this added requirement has generally made it more difficult for a carrier to satisfy the citizenship test. Two years ago, in 2003, our Congress amended the law and formally added DOT's "actual control" requirement to the citizenship test – to make the test more difficult.

DOT's recent proposal represents a clear change in direction: instead of interpreting the statute to make it more difficult to satisfy the citizenship test, DOT proposes to make it easier to satisfy the test. Under the proposal, as a matter of general policy, DOT would allow foreign citizens to be responsible for significant economic matters, such as a U.S. carrier's day-to-day operations, its marketing plans and its decisions regarding aircraft acquisitions. U.S. citizens would still be required to have control over (a) the carrier's safety policies and compliance, (b) its security policies and compliance and (c) its participation in the Department of Defense CRAF program. In addition, the carrier's organizational documents, such as articles of incorporation, by-laws and shareholder agreements, would still have to provide for actual control by U.S. citizens.

DOT stated that its proposal was made in recognition of the increased globalization of investment capital and was intended to increase the possibility of foreign investment in US carriers, by allowing foreign investors to have more control. As a strategic matter, the proposal also is an effort to satisfy the demands of the European Commission and the European Union for a more liberal ownership regime as part of a US-EU air services agreement. Also, as a practical matter, the proposal does not involve amending the 25% voting interest limitation, which would require action by Congress and is something that our negotiators are unable to deliver.

DOT added a major condition to its proposal: in order for its new, more liberal interpretation of "actual control" to apply to a specific carrier, the foreign investment in the carrier must be from countries that have open skies agreements with the U.S. and that are willing to give U.S. investors reciprocal investment opportunities in their carriers.

Personally, I don't like this condition. If DOT's purpose truly is to facilitate foreign investment in US carriers, why have a policy that excludes investors from some of our major trading partners? Why exclude investment from countries such as the UK, Japan, China and Brazil, which do not have open skies agreements with the US, while permitting investment from countries such as Iceland, Nigeria, Thailand and Malta, which do have open skies agreements? The answer can be found in the US-EU negotiations and US-UK relations. Very briefly, the US does not want to make a concession regarding citizenship requirements without achieving an agreement to remove the restrictions on the rights of US carriers to serve London Heathrow.

It is clear that DOT's proposal will face substantial opposition. Carriers on both sides of the Atlantic have already attacked it. More importantly, last month a group of 85 congressmen sent a letter to the Secretary of Transportation asking him to withdraw the proposal. These members of Congress say that DOT's new liberal interpretation of "actual control" would be unauthorized and contrary to Congress' purpose in 2003, when it added

the actual control requirement in order to make the citizenship test more difficult to satisfy. Furthermore, legislation is being introduced in the House to effectively block the proposal. The larger question is whether this proposal is important to anyone outside of Washington, Brussels and London.

- On the subject of liberalization, beyond this "actual control" proposal, the US will continue to push for more international liberalization, including new open skies agreements in Latin America and elsewhere. In June 1992, I addressed the AITAL General Assembly in Montevideo. At that time -- 13 years ago -- the US was developing open skies initiatives for Europe and Latin America but did not yet have a single open skies agreement in place; not one. In the intervening 13 years, the US has reached 73 open skies agreements.
  Ten of those agreements are with nations in Latin America and were signed between 1997 and 2005. The US clearly wants to continue this trend, and as it looks at South America it sees significant open skies gaps in major markets including Argentina, Bolivia, Brazil, Colombia, Ecuador and Venezuela. The speed with which the US may pursue these countries is hard to predict, given the fact that the US also wants to reach open skies, or at least increased liberalization, in large markets such as the EU, China and Japan.

  The ongoing talks between the US and the EU indicate a trend away from the traditional bilateral framework and toward a multilateral structure. It is interesting to note that this trend has a Latin American flavor: in1992, the US

made a proposal to various Central American governments to enter into a single, multilateral open skies agreement with liberalized citizenship requirements. Although this effort did not produce a multilateral agreement, it did produce several bilateral open skies agreements, and a few years later, the US and Chile and later Peru became parties to the Multilateral Agreement on the Liberalization of International Air Transportation, commonly known as the APEC agreement.

- On a subject related to open skies, it is likely that the USDOT will continue, in the future, to grant antitrust immunity to alliances between US carriers and carriers from countries that have open skies agreements with the US. The first grant of antitrust immunity involving a Latin American carrier was for the Lan Chile-American Airlines alliance in 1999, followed by COPA-Continental Airlines in 2001 and the addition of Lan Peru to the Lan-American alliance in October of this year.

As this suggests, there is a direct linkage between antitrust immunity and open skies. Although DOT will not openly agree to exchange antitrust immunity for an open skies agreement, in fact such a bargain has been reached more than once. Therefore, foreign carriers can benefit if their governments will delay agreeing to open skies until a time when the carriers have agreements with US carriers for which they want antitrust immunity from the US.

- I should add that another possible change that could come from the US-EU talks and could benefit foreign carriers generally is an end to the FAA's prohibition against US carriers wet leasing aircraft from foreign carriers. The draft agreement reached last month specifically allows EU carriers to wet lease to US carriers.

- On a different subject, DOT will continue to take action and propose regulations to protect consumers. The most prominent current example of this is DOT's complex system of proposed rules regarding discrimination by foreign airline against disabled passengers. I suppose most people here are familiar with this proposal which, in the view of many, is an example of territorial overreaching that threatens to conflict with other countries' laws and could put airlines in a compliance nightmare. According to DOT, we should not expect to see further action on this proposal until mid-2006, and what we see then may be a new proposal, as opposed to a final rule.

- In another area, the Department of Homeland Security and the Transportation Security Administration will continue to take steps intended to tighten airline security, and Congress will continue to closely watch what they are doing. In recent years there has been more new regulatory activity involving security than in any other area. Some of these changes were dramatically broad and were undertaken within extremely short and often unrealistic time frames

mandated by the Congress. This helps to explain why things have not always gone smoothly.

For example, the TSA's new APIS reporting requirements, which became fully effective in October, have created numerous compliance questions and confusion. The so-called Secure Flight Program for US carriers has been beset with many problems and criticisms and is still only in a test phase. The suspension of Transit Without Visa privileges has directly impacted traffic in numerous markets. Legal questions still remain regarding the obligation of carriers to provide their passengers' PNR data to DHS.

Looking forward, the TSA's comprehensive air cargo security regulations – which were proposed over 12 months ago and which require foreign cargo carriers to adopt security programs – have been delayed. It is still not clear when they might be issued in final form.

- The DOT and FAA will also continue a trend toward improved operational efficiency, which is a natural cousin to deregulation. In this regard, DOT's Next Generation Air Transportation System is intended to create a new and more efficient national airspace system , and the FAA is implementing a Required Navigation Performance program that is intended to allow more efficient airline operations and use of airspace.

- One trend that seems to be losing strength is US Government financial support for US carriers. After 9-11 there was an outpouring of support for US carriers: $5 billion in direct grants; a $10 billion loan guarantee program; subsidization of the cost of installing reinforced cockpit doors; a moratorium – for US carriers only – from the TSA's September 11 Security Fee; and subsidized war risk insurance. More recently, however, Congress has not granted a request from US carriers for relief from taxes on jet fuel (4.4 ¢/gal). Congress also has moved slowly on changes to our pension laws in order that would help airlines with seriously under-funded defined benefit pension plans. Northwest and Delta have pushed hard to get this legislation, but it did not come fast enough to save them from Chapter 11. Speaking of Chapter 11, I will leave for another day the issue of whether Chapter 11 protection itself is another form of government subsidization for US carriers.

- Finally, one area that will deserve close attention in the future – to see if it becomes a trend – is the consolidation of US airlines. In the past five years we have had two significant merger attempts: one by US Airways and United, which the US Department of Justice said it would oppose in 2001, and the recent one by US Airways and America West, which the Government allowed to proceed. It obviously is too early to say if this marks the beginning of a trend; we need to wait for the next transaction. Recently the CEO of United Air Lines – our second largest carrier – gave a speech in which he argued that US policy under deregulation has been to encourage the creation of

domestic new entrants (in order to maximize price competition) while discouraging the creation of strong national carriers through consolidation. Mr. Tilton argued that, in order for US carriers to be able to compete internationally with large foreign carriers, the Government must adopt a policy in favor of consolidation.

Unlike some officials in the EU, the US Government has given no public indication that it favors airline consolidation. However, with 3 of the 4 largest US carriers currently in Chapter 11, you have to wonder what long-term policy goal would be achieved if the Government were to oppose a merger involving one or more of those airlines. Under these circumstances, some consolidation seems possible, and we should watch closely the US Government response to any future merger proposals.

That concludes my remarks. Thank you very much for your time.

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Mr. Simpson is the past president of the International Aviation Club and is a member of the Board of Directors of the Chilean-American Chamber of Commerce of Washington. He was a member of the official delegations of the Government of Chile and the Government of Turkey in those countries' bilateral negotiations with the United States that produced open skies agreements.

Mr. Simpson received his bachelor's degree *magna cum laude* from Tufts University and his law degree from Georgetown University.

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