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Micawber meets Icarus

Hard Brexit and the aviation sector

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The European Union's efforts to liberalise the European aviation market have borne fruit – and many passengers. Since 1993 the number of routes has increased, monopolies have been broken up, new airlines emerged and fares have dropped significantly. The EU pulled down the last barrier in 1997 since when any EU airline can fly between two points anywhere in the EU. The UK has been a major player in the liberalised market, not least with the prominence of low-cost carriers and the international standing of Heathrow. How much of this could survive a hard Brexit?

Or to put the question more fully: if the UK ceases to be a member of the EU without agreement being reached on replacement rules, how would the air transport industry be affected? The prospects are less of gridlock than of deserted skies. For the problems will face not only UK carriers that were previously at home in an EU-wide market, but equally airlines of the EU27 who will find themselves without legal basis for operating into the UK. To say nothing of third country carriers whose operations into the UK are today governed by EU-level arrangements. Or the operations of UK carriers to those same third countries.

Indeed the problem goes beyond the future EU27, and extends to the broader ECAA – European Common Aviation Area – today comprising 36 states.

Just as in other parts of the Brexit debate people talk of falling back on WTO rules, the aviation sector has its own history that bears recapping in case the fixed Micawberism of the Brexit-at-any-cost camp is put to the test and found wanting.

EU liberalisation

Before liberalisation the nickname "flag carriers" reflected a world comprising essentially State-owned airlines. This reality was codified in the 1944 Chicago Convention which still lays down the ground rules for international civil aviation. The Chicago Convention noted that each contracting State has "*complete and exclusive sovereignty over the airspace above its territory*" (Article 1). As a result "*no scheduled international air service may be operated over or into the territory of a contracting State, except with special permission or authorisation ...*" (Article 6). States therefore created a worldwide network of bilateral agreements under which they granted each other the right for their airlines to operate between their territories.

Most of these bilateral agreements permit States to withhold or withdraw traffic rights from an airline of another State if that airline is not substantially owned and effectively controlled by that other State and/or its nationals.

Air transport in Europe continued to operate along these strict national demarcation lines for some 30 years after the original six signed the Treaty of Rome in 1957. The Treaty left it to the Council to decide if, when and how to deal with the aviation market. The Council's gridlock was only broken after the Court of Justice clarified that competition rules applied to air transport; and Treaty change simplified the Council's legislative process. The European Court of Justice ruled in *Nouvelles Frontières* that the absence of a common transport policy did not exempt the air transport sector from the general competition rules in the Treaty. A year later, in 1987, the Single European Act simplified the adoption of air transport legislation, replacing the unanimity requirement in the Council by qualified majority voting.

These events in the late 1980s led the Commission to table successive liberalisation initiatives, with the 1992 third package allowing any EU licensed carrier to operate air services between two points within the EU, even two points outside its home State – the seventh freedom services – and between two points in a single country other than its home State – cabotage services.

The ECAA

The EU's common market for air transport extends not only to Norway, Iceland and Liechtenstein as part of the European Economic Area, but further still. The EU has negotiated market-opening agreements with further states, based on regulatory convergence and gradual implementation of the EU aviation rules. The single aviation market was extended to the Western Balkans in 2006: Albania, Bosnia and Herzegovina, Croatia, the former Yugoslav Republic of Macedonia, Montenegro, Serbia and Kosovo. This created the so-called European Common Aviation Area ("**ECAA**"). Less far-reaching agreements (e.g. without provision for cabotage services) have been reached with Morocco (2006), Georgia and Jordan (2010), Moldova (2012) and Israel (2013). An agreement with the Ukraine awaits signature, while negotiations are ongoing with Lebanon, Tunisia and Azerbaijan.

The EU's common aviation market was a catalyst to the emergence of Low Cost Carriers ("**LCCs**") in the 1990s, radically changing the airline industry in Europe. The extensive pan-European networks of LCCs Ryanair, easyJet, Vueling, and also Norwegian are built upon the ECAA. A large proportion of the routes operated by UK airline easyJet, for example, do not touch the UK. Based on data from the Centre for Aviation ("**CAPA**") 43% of easyJet's flights in the week after the Brexit vote did not depart or arrive at a UK airport. And easyJet's operations include wholly domestic routes in three non-UK countries: France, Italy and Portugal.

Brexit: effects on UK owned airlines

A strict condition of an EU Operating Licence, and rights to fly on the basis of that single licence, is that carriers must be majority-owned and effectively controlled by EU nationals. Following Brexit UK shareholders would no longer count as EU nationals, with well-publicised consequences for e.g. easyJet and Ryanair, which both have significant UK investors. These carriers may have to consider corporate restructuring or at least need to

reshape their shareholder bases by recourse to provisions in their statutes allowing for forced sales, so as to enable them to stay above the 50% EU threshold.

Brexit: effects on the ECAA

A hard Brexit, without any transitional arrangements, would end the UK's membership of the ECAA, removing the UK carriers' right to fly from the UK to another member country. UK airlines would similarly no longer be able to fly between EU countries and would lose the right to fly within an EU country. The runway would similarly disappear for EU27 airlines operating to/from and within the UK.

As a result, airlines of course want the UK government to negotiate continued access to the liberalised market. The UK government also recognised the importance of the airline industry for the UK. A joint statement by the Secretary of State for Exiting the EU, the Secretary of State for Transport and the Chief Executive of Airlines UK (the industry association of airlines) emphasised the importance of aviation for the UK economy, stating that "*Market access remains a top priority, and we want to make sure we have liberal access to European aviation markets. We will also work closely to explore new opportunities for further liberalisation*" (Joint Statement of the UK Government and Airlines UK, 14 November 2016). The simplest way to maintain the *status quo* would be for the UK to join the ECAA, which would also ensure that all bilateral agreements between the EU and third countries continue to apply. Other options could be the Swiss model where the UK negotiates a bilateral air transport agreement with the EU, or the Norwegian model where the UK would become a member of the European Economic Area.

However simple the ECAA route could be, and despite airline support for accession to the ECAA (see e.g. easyJet's press release of 24 June 2016), it seems unlikely that the UK will adopt this approach. Membership of the ECAA would require the UK to accept the entire EU aviation *acquis* and this includes areas of law that the UK no longer wants to apply such as, for example, rules on state aid. It may also be that some of the signatory states would object (in the broader context of Brexit negotiations) to the UK's continued participation after Brexit.

The Swiss model might then be considered, but a new bilateral agreement may take longer to negotiate; and the Swiss/EU air transport agreement also effectively binds Switzerland to much of the EU's aviation legislation. The UK could hypothetically opt to negotiate individual agreements with the different EU Member States and some or all of the ECAA countries. This would be both time-consuming and complex, and seems unlikely to replicate full access to the ECAA, e.g. for a UK airline to operate cabotage services. The EEA/Norwegian model presents similar challenges about accepting the entire EU aviation *acquis*.

This recitation of the difficulties associated with any of the existing forms of relationship is drearily familiar to followers of the Brexit debate. Yet what is at stake in the air transport sector is perhaps more profound and immediate compared, say, to manufacturing industries concerned whether their goods will still comply with Single Market requirements: plainly they still will, on the day after UK exit, and for a continuing period beyond. But air traffic rights lapsing *de jure* on that day risks depriving carriers of all colours of the legal basis to operate their businesses.

Brexit: effects on international bilateral agreements

The EU has negotiated a number of bilateral aviation agreements on behalf of the EU Member States. The most well-known is the EU-US Open Skies agreement but there are many others. These EU-negotiated bilateral agreements superseded any pre-existing bilateral agreements between the UK and those third countries. When the UK leaves the EU, the EU-negotiated bilateral agreements will cease to apply if no transitional provisions are agreed.

The UK could return to bilateral agreements that were in place prior to the EU-negotiated ones. For example, the UK and the US could revert to their Bermuda II bilateral agreement first signed in 1946 and last amended in 1991. But these agreements were of course adopted in another era; aviation markets have undergone significant changes since then, and these old agreements may no longer be apt. John Byerly, the US negotiator for the Open Skies Agreement, confirmed to CAPA that this may be an unlikely outcome: "*it is impossible for me to believe that [revisions to bilaterals] is really what would happen in the real world*" (CAPA, 27 June 2016). The UK government and airlines have bravely identified the negotiation of new agreements with third countries as an opportunity. In their 14 November Joint Statement they said that "*We are clear that Brexit provides greater freedom to seek new agreements between the UK and some third countries. This includes looking at possible bilateral agreements to strengthen economic and cultural ties even further with countries such as the US and Canada.*" While that may be a pot of gold at the end of the rainbow, there is a more mundane challenge in simply maintaining continuity of bilateral relations with scores of third states with whom the EU has negotiated air transport agreements – including not only the USA but also e.g. Brazil, Canada and Malaysia.

Brexit: questions beyond route rights

Brexit poses many further questions. For example, the UK would no longer be a member of the European Safety Agency overseeing the EU's safety rules. And passengers departing from the UK will no longer be able to call on the EU's rules dealing with e.g. compensation in case of flight delays. This is no doubt an existing asymmetry, the same holding true already for routes to non-EU destinations. But the UK travelling public will find themselves for the first time on the wrong end of this asymmetry.

Conclusion

Icarus famously flew to close to the sun and suffered the consequences: his wax wings melted, and he drowned at sea. And he had been warned! Brexit threatens a similar air transport meltdown unless common ground can be found, amid the heat of a likely ill-tempered debate, to ensure that UK airspace will not be sealed off from Europe and its aviation partners.