Airneth

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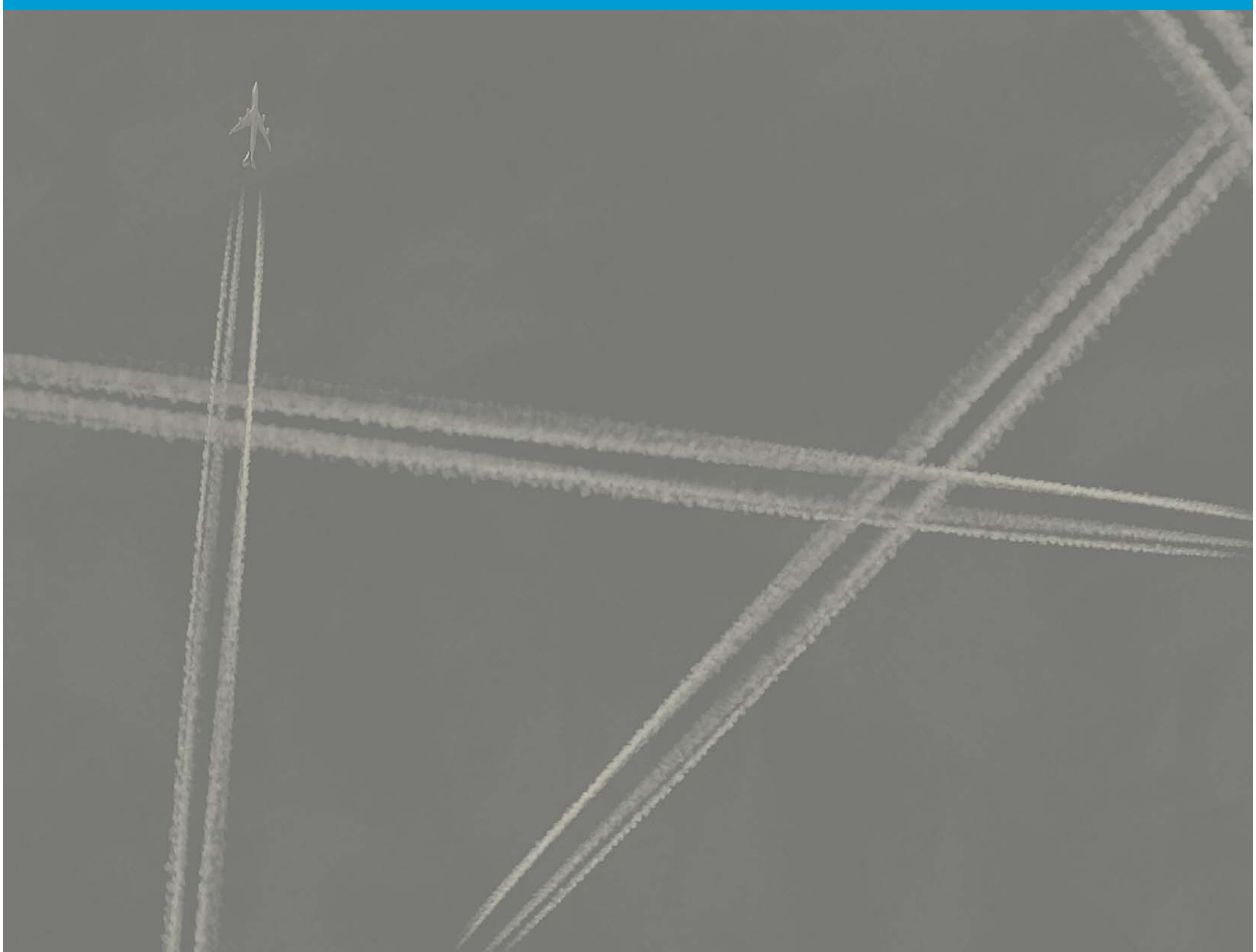
The main findings of the Second Annual Conference 'EU-US Open Skies: competition and change in the worldwide aviation market'.

17 April 2008

Crowne Plaza Hotel – The Hague



Introduction

On 17 April 2008, Airneth organized the Second Annual Conference 'EU-US Open Skies: competition and change in the worldwide aviation market'. During this conference, many experts in the field of air transport addressed the potential consequences of the Open Sky Agreement, which came into effect on 30 March 2008.

In this Airneth report, you will find the main conclusions of the speakers and referees. The full presentations are available at www.airneth.com.

Plenary session I: Setting the scene

The entry into force of the EU-US Open Skies Agreement – Pablo Mendes de Leon, Leiden University

Mendes de Leon points out that the major decision taken in 2002 concerning 'Open Skies' is: *national ownership and effective control* clauses accompanied by designation exclusively by the airline's state infringes the *Freedom of establishment* – requiring 'national treatment' for all EC undertakings, including EC air carriers.

Main problems:

- International law (Chicago Convention; bilaterals) checked against Community law rather than the other way around – questionable approach from an international law point of view (ICAO would probably not agree upon Open Skies)
- Introduction of Freedom of establishment into international air law amounts to recognition of 7 Freedoms of the Air – not agreed upon in Open Skies agreements (US-EC states)

The initial objective of the 2003 mandate is designed to realise an Open Aviation Area, *"where air carriers of both sides can freely establish themselves and freely provide their services on the basis of commercial principles and be able to compete on a fair and equal basis and subject to equivalent or harmonised regulatory conditions."* This has not been completely fulfilled at the moment.

Mendes de Leon concludes that:

- Mandate of 2003 not quite fulfilled, but:
- A few steps have been taken
- Two common markets with some openings
- More freedom for carriers to enter the market with no restrictions on capacity, pricing, frequencies
- An Open Transatlantic Market has yet to be established!

And addresses some points to tackle in the future:

- Further relaxation of ownership and control rules
- Application of environmental standards, including introduction of Emission Trade System
- Agreement to be reached on security and human rights

- Convergence of competition law regimes
- Recognition of the Freedom of establishment
- Institutional arrangements

The impacts of the EU-US Open Sky Agreement: what will happen at Heathrow in spring 2008 - Barry Humphreys, Virgin Atlantic & Peter Morrell, Cranfield University

In April, stage 1 of the Open Sky Agreement will be executed, implicating the following:

- Any licensed EU carrier granted right to fly between any EU airport and any US airport
- 7th freedom EU-US
- No change to ownership and control rules
- No cabotage
- Fly America remains
- No US domestic wet leasing
- For UK-US: removal of Bermuda II constraints.

Substantial expansion is expected to come from Heathrow, since this airport is the only large airport that was 'closed' for new entrants. Most other EU-countries have an agreement with the US already. Heathrow's perceived advantages contain the catchment area, the high yields, the connecting possibilities and the location (close to central London).

The airline responses are not huge due to the unavailability of slots. Secondary slot trading is allowed, but very expensive and the offered slots are available mostly at unwanted times.

Main conclusions are:

- EU/US Open Skies Stage 1 agreement really all about opening up Heathrow
- Significant increase in theoretical market access, but major slot constraints continue to exist
- Short-term reactions of airlines have confirmed the relative attractiveness of Heathrow. Increased demand has increased price of Heathrow slots
- But initial responses well short of studies' predictions
- Net 9 additional frequencies from London
- Early days, but slot situation will only get worse in medium term
- And what happens if no progress in Stage 2 (Further liberalisation of traffic rights, additional foreign investment opportunities, the effect of environmental measures and infrastructure constraints on the exercise of traffic rights, further access to government-financed air transport, wet Leasing)?

Q&A

The original aim of the Open Aviation Area is not mentioned in the first two presentations, which is the success of leaving behind bilateral agreements. Mendes de Leon states that European lawyers still see the Open Skies agreement as a bilateral agreement between the EU and the US, whereas international lawyers see the agreement as an international multilateral agreement between the EU member states and the US. Morrell looks even further into the future and states that this bilateral agreement may be the trend in future developments throughout the world and can lead to an 'Open World Area'.

The UK is putting political pressure to the agreement by stating that if the second phase does not go into force, they will suspend the agreement and will go back to the old system prior to the Open Skies Agreement. This instrument is used by the UK because it will be very hard in the coming months to reach the next stage of the agreement. The US however has a more positive attitude in the sense that they are not threatening with the turning back of the agreement.

Another interesting remark is made about the new role of low cost carriers like Ryan air, who wishes to fly from the continent to the US. This is an exciting and new boost regarding competition and currently is examined and in theory a possibility if low cost carriers will operate on secondary hubs.

Several American and European airlines fly now from London Heathrow airport to hubs in the US. It is suggested that maybe a route with double hubs in Europe can operate to a hub in the US, for example from AMS to LHR and than to JFK. But it is not a guarantee that flying from any point before LHR will be profitable.
Barry Humphreys of Virgin Atlantic once stated that VA does not benefit from the Open Skies agreement before airlines, and did not plan a route to the US because it is afraid that the second phase will not be operational and that everything will go back as it was before the end of March. Morrell states that VA could be having some US points in mind to operate on, but at this point their slots on LHR are more suitable to operate to the East instead of transatlantic.

Plenary session II: Capacity

Market pricing of airport access and the EU-US liberalization – Frank Berardino, GRA Incorporated

Berardino discusses whether several potential changes in the DOT/FAA airport policy adversely affect the EU-US Open Sky agreement. His conclusion: probably not.

The first potential change is new rates and charges, allowing higher fees at more congested times at all American airports. Three sub-measures are discussed.

- A two-part fee, where a part of the fee is based on weight and the other on activity. The expectation is that the effect on international operations will be a net reduction in landing fees, since the aircraft size of this market is higher than the domestic
- The inclusion of projects under construction in rate base. The effect will be an earlier increase in landing fees, but a reduction of total costs passed on to the carrier due to avoided financing costs during the construction

- The inclusion of secondary, under-utilized airport airfield costs in primary airport rate base. This could encourage traffic to move from the congested airports. The fees are likely to increase for international users, but may reduce congestion

The second potential change is the introduction of caps & auctions.

Only four airports have slots and there have been some changes in the last years. Slot controls were eliminated at ORD (2002), JFK and LGA (both 2007). Only DCA still has slot controls. At JFK, there has been a shift towards a cap of 81 flights per hour. Newark (EWR), US' most delayed airport will introduce a cap this summer of 83 flights per hour.

Evidence shows that the deletion of slot controls ends up in new entrants. On the other hand, the slot control system did not work as well. It was possible to trade slots, this never happened however. Suggestion to make a secondary slot market work could be to finite slot lifetimes and introduce initial costs for holding slots.

An auction could be a measure to further control the congestion at airports. The quantity is known (the maximum throughout of the congested airports), but we don't know the prices. Berardino suggests two types of auctions. First the package clock, which shows a lot of price discovery and little buyer remorse. He is in little favor, however, for the sealed bid auction, where the second price is to be paid. This offsets strategic behavior (important!) and there is little buyer remorse of price discovery.

The effect of the auctions depends on the percent of slots that will be auctioned, what part will be grandfathered and what the auction rules will be. The international operations will be advantaged however. It is a precedent for grandfathering, larger aircrafts are advantaged (thus international) and there is a potential to get slots at times that they are needed.

The referee posted several questions:

- Will the financing charges be lowered? Is there a penalty clause in pre-financing?
  → Pre-finance is simply not a good idea and should be penalized. The auction will price out certain carriers, due to the willingness-of-pay
- Is the Delta strategy at JFK a combined strategy with LHR?
  → No clear idea, but in the end, LHR will end up like JFK, Emirates will buy all slots!

Implementing EU-US Open Skies at Heathrow – James Cole, Airport Coordination Ltd

Cole discusses the measures to be taken at Heathrow as a consequence of Open Skies. How to manage the new entrants and forthcoming competition?

- LHR is almost full, 97 percent of the capacity is allocated on grandfather rights
- There are no new morning arrival slots created since 1998 (important for the Asian market)
- There is a government cap on annual air transport movements
- No prospect of additional capacity before 2010-2012

- Gatwick US carriers qualify for new entrant priority, but of no practical value without pool slot availability

→ Therefore, only prospect of entry is via the secondary slot market

The ground rules of slot trading are:
- Willing buyers / willing sellers
- Only air carriers can hold and trade slots
- The Coordinator must confirm feasibility
- Slots are permissions to use a bundle of airport infrastructure
- Slots are subject to use-it-or-lose-it rules
- Only grandfathered slots can be traded (new entrant slots only after 2 years)
- Transactions are transparent but price disclosure is not required
- Difference with American trading system: at LHR trade between international carriers, in US only trade between domestic carriers

Since the introduction of slot trading, the average seats per flight have almost doubled, and the average distance per flights has multiplied by 12.

The introduction of Open Skies has led to some marginal changes at LHR. Carriers have given up flights to secondary airports or daily services for international services from LHR in exchange. The issue of Air France is that they reduced CDG-LHR to 7 per day to use the slots for flights to LAX (Los Angeles). There seems to be a trade-off between aircraft utilization and new international flights.

The expectation for the coming years is that the European carriers will break through the monopoly of BA at LHR and that more US carriers will operate to LHR as well. The resulting problem, however, is the potential negative impact on the operational performance. So there are new challenges to come.

The referee posted some questions, which are answered by Cole:
- Short-haul at LHR is 66 percent, is it going to be more long-haul?
  → Yes, it will probably be set lower due to the long-haul competition; it is unknown, however, at which percentage this will end
- Are the prices of slots going to be higher and higher? Or was 2008 just a good year? Is it prestige or do they earn it back?
  → Prices also depend on future extra runways. Prices are very high, but not fully irrational. There are also network benefits and there are the high consumer demands
- Some short-haul pairs cannot be changed into long-haul due to the shorter turnaround time, what is the strategy of ACL?
  → ACL is trying to swap some slots to make more intercontinental traffic possible
- Will Gatwick perform long-haul in the near future?
  → Probably more long-haul on leisure flights. Stansted will be interesting too, since American Airlines is planning long-haul there

Parallel Session A: EU-US: “the world outside Heathrow”

The impact of Open Skies for Iberia - Sergio López Varela, Vice-Director Strategy and Corporate Development Iberia

The process of deregulation will inevitably bring new players into the market, new low cost carriers and consolidation processes may occur if the restriction on foreign ownership and control are released. The EU-US Open Skies Agreement will produce an increase of traffic and competition and will have a cascade effect in other regions of the world.

Numerous new flights between the EU and US have taken off to new destinations since the agreement got into force. The number of flights has increased this in April-June this year in comparison to last year. In states where there were restrictions to fly transatlantic routes, the number of services will increase. Airlines are making use of the opportunity to operate transatlantic flights from outside their home country; and codesharing and alliance opportunities are also made use of by airlines.

Iberia has to play a major role in the process of the European consolidation model. The treaty will open new opportunities in the field of Joint Venture, alliances and codesharing like mentioned before and thus will allow for a deeper relation with strategic partners, like with American Airlines through ATI, and a stronger cooperation with British Airways on transatlantic routes.

In the long term the cascade effect on other regions such as Mid-Atlantic and South-Atlantic will benefit Iberia, which has a strong presence in this market. The liberalization in this area will however force Iberia to cope with new players, and therefore be more efficient in costs.

In the end no player will be able survive the new liberalized markets in the long term, unless it will be able to improve its efficiency and reduce the level of basic costs of production.

Brussels Airport: the growth perspectives for a secondary gateway - Leon Verhallen, Head of Airline Business Development, Brussels Airport

It was in the aftermath of ‘9/11’ that Sabena collapsed. The airline was relaunched as a much smaller but stronger airline for intra European traffic, whereas low cost Virgin Express took the opportunity to expand its operations.

For Brussels Airport the immediate result was a fall from being the 10th largest airport in Europe to a position around number 20 in 2006, mainly because the majority of the former Sabena transfer passengers moved to other European hubs. When also some well-known long haul airlines such as Singapore Airlines withdrew from Brussels, and the European low cost revolution bypassed the airport, the recovery of passenger traffic growth became a major priority.

The acquisition by Macquarie Airports of the majority of the shares of Brussels

Airport resulted in a change of the company's direction. A change in management, the launch of a new airport identity, and a focus on airport quality, all contributed to a turnaround of the airport's growth during 2007.

An important contribution to this turnaround was an in-depth analysis of some of the major trends in today's aviation industry.

1. Alliance development
A growing number of airlines are member of one of the world's three alliances: Star Alliance, SkyTeam and oneworld. The alliances will increasingly dominate the worldwide airline networks. The world share in revenue passenger kilometres of all three alliances is already above 60% and will grow further with more airlines joining. All larger European airports today are the home base of one of the alliance members. This is not yet the case for Brussels Airport.

2. Low fare airline development
The share of low fare airlines in European airline traffic is growing very fast. According to recent analysis, already 28% of all scheduled intra-European seats are offered through low fare airlines. This will grow to over 40% in 2011. Low fare airlines also have been able to stimulate market growth and to create new markets. Among the 30 largest European airlines in seat capacity in 2006, 8 are low fare airlines.

3. New generation long haul aircraft
The current generation of wide body aircraft such as the Boeing 747 and 777, and Airbus A330 and A340, will be extended by two new aircraft types with less seats but with the same range capacity. The Boeing 787 Dreamliner and the Airbus A50XWB will offer 200-300 seats and will create new opportunities to open up thin long non-stop routes. An example is Tokyo to Brussels. The current market potential on this route would not allow ANA or Japan Airlines to fill a daily large B777 on this route. When the smaller B787 joins their fleets, both airlines will be able to open up more European destinations than London, Paris or Frankfurt.
The opposite trend is concentration. The Airbus A380 and Boeing 747-8I are expected to grow operations between the big hub airports where slot capacity is becoming scarce.

4. Catchment area competition
While airports were often seen as monopolies in the past, this is no longer true in today's aviation industry. Brussels Airport has to attract passengers for its long haul destinations in competition with Amsterdam, Paris and increasingly also Dusseldorf. Car and (high speed) train connections offer the European passenger a wider choice of airports to depart from.
Also low fare passengers are prepared to travel longer distances, to fly for the best fare available to destinations in Europe.

5. Local market strengths
The tourism and business activity of a region or country is another factor to grow passenger demand. The future position of Brussels Airport is directly connected with the tourism development of Brussels and e.g. Antwerp, Ghent, Bruges. It is also related to the regular organisation of large scale events that through intensive promotion attract more foreign visitors.

Also the position of Brussels as the Capital of Europe, Belgium's Fortune 500 companies, European headquarters of large internationals, the harbours, and e.g. the diamond industry in Antwerp contribute to growing numbers of business travellers.
It must be said however that the number of foreign visitors to Belgium definitely can be improved further. A comparison of visitors to The Netherlands versus Belgium shows some striking differences that can not be explained just by the larger size of the country.

Brussels Airport has developed a clear and concise strategic approach to the airline industry. The following target segments have been defined.

1. Brussels Airlines
The home carrier for Brussels Airport is and remains the most important strategic partner. Brussels Airlines operates a dense network of some 50 European destinations, and a unique Africa network with 14 destinations. It also co-operates closely with long haul airline partners such as American, Etihad, Hainan Airlines and recently, Jet Airways.
Brussels Airport will support the upcoming alliance choice that Brussels Airlines is expected to make in 2008, because this will connect Belgium to one of the three worldwide alliances.

2. Long haul network
An analysis of the most important overseas gateways to Europe has resulted in 30 key worldwide destination cities. Airports such as Heathrow or Frankfurt are well connected, but many of the smaller European airports only serve a few cities.
In 2005, Brussels had connections with only six of these 30 cities, mainly in North America. In 2006 three new cities were added, Abu Dhabi, Beijing and Toronto. In 2007 another three cities came on line, being Delhi, Mumbai and Philadelphia. The successful development of Jet Airways at Brussels for their European hub between India and North America, and the start-up of US Airways to Philadelphia are the latest successes.
Brussels Airport has set a target to realize 20 connections to the 30 world gateways in 2011.

3. Low fare and leisure
Until recently, most low fare airlines saw Brussels as a white spot. Airport charges were perceived as high, the Belgian market was not attractive for tourism visits, Virgin Express was a strong local low fare carrier, and Ryanair competed out of Charleroi, with strong local support.
All this has changed during the past year. After a careful entry into the market of Vueling and Skyeurope, these carriers have significantly expanded. New carriers are easyJet, Sterling, Flybe, BlueAir, Myair and Clickair. All this will definitely attract more visitors to Belgium.
But also Brussels Airlines launched its own 'b-light' fares, and both Belgian leisure carriers Jetairfly and Thomas Cook Airlines offer more and more routes with low fare seat only tickets.

A concentrated focus on Brussels Airlines and its partners, the long haul market, and the low fare and leisure market, does not mean that other airlines are less important. Brussels Airport not only values its wide range of current airline clients, it also continues to grow its dense European network to capital cities, economic centres and leisure destinations in close co-operation with all airlines.

It goes without saying that a good network also requires a well organized product on the ground. Recent and upcoming developments include more car parking facilities, better transport modes (such as the new direct train link to Antwerp), and passenger processes (self service and internet check-in, FastLane for business travel, new retail and food & drinks concepts). Passenger growth also requires more product differentiation. This is the reason for future projects such as an extension of Pier A for travel with alliance airlines, or the development of a new terminal and pier for low cost travel.

At the end of 2007 we dare to say that the new strategic approach is bringing strong results. Not only for Brussels Airport in growing passenger numbers, but also for everyone in Belgium involved in tourism, business travel and MICE. Where passenger growth for Brussels Airport in 2006 only just reached 3%, growth in the second half of 2007 went up to 10%. This trend is expected to continue in 2008.

Implications for the Irish aviation market – Sean Barrett, Trinity College Dublin

Ireland is optimistic about its aviation market. The flights between Ireland and the US in 2008 have increased by 23% from 119 to 146 flights up to this moment in comparison to 2007. New routes became operational to San Francisco, Washington and Orlando, next to the existing routes. In 2007 Ireland had 2.3 m Atlantic trips, which is 56 per 100 on the population. The EU average is 10.

The optimism comes from the large FDI flows in both directions; the creation of work of 95,000 jobs in US companies in Ireland and 80,000 jobs in Irish companies in the US; the estimated 40 million Irish descents living in the US; 500,000 Irish passport holders visit the US each year; Irish exports 50.000 US Dollars per head in 2008; GDP per head in Ireland is second in the world.

There are also some other elements that started the end of regulatory capture, which enables the Irish aviation market to flourish. In 2008, 63 years of obstructing direct flights from US to Dublin ends. Both Aer Lingus and US airlines had to stop over at Shannon, this is no longer the case. US airlines were kept out of Dublin for 28 years.
The Downtown Office Syndrome is no longer prevailing, in which the competitors were kept out. The Irish Department of Public Enterprise was not making efficient decisions regarding aviation. That problem has been dealt with either.

Irish aviation in 2008 cannot certainly be ignored with the operations of Ryanair, as Europe's leading LCC; Aer Lingus, as Europes's most profitable legacy airline; CityJet, the Irish profitable subsidiary of Air France; and Aer Arann, a profitable regional airline.

The Atlantic outlook for Ireland is can thus be concluded as a highly developed aviation sector (and still developing), with the creation of new Atlantic routes this year including direct routes to replace back-track.

Q&A

After this session the referee had some relevant and interesting questions regarding the presentations. The referee wondered for example what the effect of the EU-US Open Skies Agreement will be on other airports than London Heathrow. At this current stage there is not much happening at LHR, albeit it has been described as being the most turbulent situation. The speakers react on this remark by saying that it is still too early to see what will happen at other airports and that we will have to give it more time.

Another point of discussion is the question what will become the strategy of the European aviation industry of the large airlines. A few remarks on this point suggest that airlines may compromise new airplanes or that the bigger hubs will focus more on frequency, so that they can compete with big point-to-point markets. The fear for cabotage and the parallel going fear for the trade unions and other internal regulations are rising at this moment, which is influencing the strategy of the large airlines.

Each speaker had some interesting points on ongoing operations, Iberia wants to play a major role in Atlantic services; airport capacity problems play at big airports but not in Brussels airport; and Ireland sees new challenges in the agreement. It everyone is so optimistic about the development, why is it then that we see so little result yet? Iberia is making plans to expand the cooperation with American airlines and British Airways, thus this cooperation needs time to show the benefits of it. Brussels airport is hoping for the death of other secondary hubs, consequently leading to the growth of smaller airports like Brussels. And Ireland is forecasting on the declining hubs, due to rising security costs. This leads to a better point-to-point market in which Dublin is an active actor.

Madrid airport has the 4th position of passenger movements in the EU, which makes the number of competitors for Madrid bigger. Does this mean that Madrid airport can become a serious threat to Schiphol airport and the same of course goes for Brussels airport? Varela states that Madrid airport is definitely a threat for Schiphol. The number of terminals in Madrid is growing and will keep the same trend for the coming future. Brussels airport is also a threat for Schiphol according to Verhallen, due to Jet Airways who will pinch more passengers from Schiphol to Brussels.

Parallel Session B: Sustainability issues and network development

The environmental impacts of the EU-US Open Sky Agreement – Richard Tol, ESRI

Tol (and Mayor) research the implications of Open Skies for carbon dioxide emissions and passenger numbers. They make the following assumptions in the model:

- Travel time and cost assumed to be linear in the distance between airports
- Does not take account of changes in quality of travel, intra-EU travel, business travel
- CO2 emissions of 6.5kg C per passenger for take-off and landing and 0.02kg per passenger-km
- Total international aviation: 3% of global emissions
- The main difference with former research on this topic is that the price elasticities used are lower than other studies and fall with income per capita
- Former research on this topic done by Brattle Group and Booz Allen Hamilton were initiated by the European Commission. The results were good, but that was expected since the outcomes should support a potential EU-US agreement

Three scenarios are tested: a price fall of 5, 20 and 50 percent. Three groups of EU countries are taken as a sample. The effect on arrivals from the US is that when flights become cheaper, US tourists substitute away from other European countries towards cheaper destinations. The effect on emissions shows an increase between 0.2 and 3.4 percent from all EU-countries. The increase of world emissions ranges between 0.04 and 0.7 percent. The reasoning is that travel to Europe is offset by fall in passenger arrivals for other countries. US tourists substitute away from relatively more expensive destinations.

Tol and Mayor execute an extra sensitivity analysis with different elasticities. They conclude that the higher the elasticity, the higher the increase in emissions. Tourists become more sensitive to price, they travel more as the prices fall.

Main conclusions are:

- Competition and lower fares will increase passenger numbers
- Model is built as such that an increase in fares will lead to lower passenger numbers but he emissions will remain high
- As expected this will result in an increase in carbon dioxide emissions
- However, increase in global emissions is smaller than increase in transatlantic travel (because of substitution)
- Effect on emissions sensitive to assumptions of the model
- Increase in traffic has thus implications for climate policy
- Further research is needed on this topic

The referee points out that the model only considers point-to-point services. Tol answers that it is hard to implement networks and there is a lack of data.

The implication of more transatlantic point-to-point routes for European hubs – Jan Veldhuis, SEO Economic Research

Veldhuis researches the consequences of more long-haul point-to-point routes. The EU-US Open Sky Agreement could mean that more connections will be set up, but there will be an increase in EU-Asia connections too. He sees threats in hub-bypassing and opportunities in the new 'single transfer' markets.

There is a potential for 200 new long-haul routes from Europe up to 2030. Today, there are 900 routes. The short-haul connections are around 11000, and most small airports will never be a candidate for long-haul.

Veldhuis assumes that Bristol is a potential candidate for long-haul. If Emirates would introduce a direct flight to Dubai, KLM (Bristol – Amsterdam – Dubai) could be bypassed. This extra flight leads to a 27 percent extra market generation. Veldhuis also shows that most connections operated by KLM are insensitive for this type of bypassing, because they have many destinations which are uniquely served. Potentially 4 percent of the connecting market could be affected at Schiphol, corresponding the percentage of destinations that will potentially be served directly by another carrier. These percentages are much higher on CDG, FRA and especially LHR. Concluding, the potential threat for European hubs is P-to-P between non-Europan hubs and European spoke points (e.g. DXB-BRS by EK).

The potential opportunity for European hubs is P-to-P between European hubs and non-European spoke points (e.g. AMS-DFW by KL). This direct connection increases the market with only 1 percent, but this connection paves the way for new indirect connections, which where initially served by one carrier. This leads to higher percentages and breakthroughs of monopolies. The strategy of KLM seems to be to have a high market share in high yield markets, but these markets are often quite small in pax volume.

Veldhuis concludes:

- Threat of hub-bypassing minimal, at least for AMS
- Number of new routes is small in comparison with total number of connecting markets (Schiphol 4.500 +)
- Hubs may have opportunities if home-carrier opens new routes to secondary destinations overseas
- Market generation expected, as more city-pairs will have upgraded service from “dual transfer” to “single transfer” transfer connection (i.e. BGO-AMS-(DTW)-DFW)

The referee states that there are two measures that can lead to a change of network use: changing the volumes and the emission trading system. He states that the EU puts too much tension on this last measure.

- What is the hubbing effect on sustainability?
  → No clear answer, should be researched in the near future. Veldhuis and Dennis state that the usage of a smaller aircraft on new long-haul routes is less fuel-efficient than a large aircraft.
- KLM lives on 6th freedom rights to be efficient. Is the strategy of Emirates not to bypass AMS, but to replace AMS?
  → More or less, one of the reasons for KLM to be competitive and released from the uncertainty, was the merger with Air-France

The regional airline industry in the US and Europe: Current trends and future outlook – Nigel Dennis (University of Westminster) and Ken Stevens (Horizon Air)

Stevens and Dennis research the different development issues and strategies that are apparent in the regional airline industries of Europe and North America. Some emerging trends can be identified along with examples of 'best practice' in both markets. In addition, more focus on long-haul is expected due to Open Skies.

The EU market is relatively small in terms of surface (compared to US), but has a much higher density and in addition much more competition from trains. This results in a lower load factor between 60 and 70 percent, in Europe. In the US, the load factor lies between 70 and 80 percent. Due to the point-to-point connections in Europe of high dense cities, the aircraft are larger in general, 51 percent consists of 50-100 seaters (in US: 17 percent). There is a tendency of going more and more to these 50-100 seaters in both regions. The business models are also different. In the US, most regional airlines are independent native networks. In Europe, the largest regional airlines operate under a major carrier's brand, but the costs, pricing and risk remains with the regional carrier.

In Europe, regional airlines are trying to reduce their costs through

- Fleet reorganization
- Adoption of parts of the LCC model (e.g. direct sales, unbundled fares, faster turnarounds, use of less congested airports)
- Consolidation (e.g. BA Connect sold to Flybe)
- Investment in new markets (e.g. Flybe specializes in markets too thin or difficult for Ryanair and easyJet)
- Profitability is not that good, but seems to improve

Also more focus on long-haul operations:

- Few of these services are by the national carrier, most are operated by a foreign airline based at the opposite end of the route
- New York is the key destination supporting a daily service from e.g. Edinburgh, Geneva and Venice (mostly Continental or Delta)
- Dubai emerging as the eastbound destination with daily service from e.g. Newcastle, Glasgow, Hamburg (Emirates)
- Ethnic routes feature strongly: VFR traffic based on past migratory patterns e.g. Shannon-Boston, Belfast-Toronto, Lyon-Montreal, Birmingham-Islamabad
- From German airports quasi-charter services operate to holiday destinations (e.g. Leipzig-Puerto Plata, Dusseldorf-Orlando)

Problems here however are that the propensity to travel is much lower in these less densely populated regions. In addition, business travel is small. Solutions are smaller aircrafts (all economy class or executive jets).

Dennis en Stevens conclude that:

- Growth in demand largely in leisure sector which favours lower cost aircraft rather than frequency
- European regional carriers must cut costs to survive; may be better to let major carriers take-over yield management
- US regionals need to reduce dependence on 50 seat jets and may be exposed to 'Ryanair' type low frequency competition
- As cost levels of major/legacy carriers become more competitive they may take flying back in-house leaving regionals to go it alone

- Long-haul services difficult from regional airports unless in a low frequency niche or operating from a major hub at the other end

Plenary Session III: Panel Discussion

Chair: Hendrik Jan de Ru
Panel members: Sean Barrett, Frank Berardino, Leon Verhallen, James Cole, Pablo Mendes de Leon

Statement 1
Consolidation
We see transborder mergers taking place in Europe. Mergers on a national scale are taking place in the US.

a. To what extent is EU-US phase I/II a further trigger for continental consolidation
b. To what extent will EU-US phase II be a trigger for intercontinental/transatlantic consolidation

Verhallen: Continental consolidation will carry on and the positive financial position of airlines in combination with the EU-US Open Skies Agreement will speed up this process. Intercontinental consolidation is still far away though. This is the main challenge for the time being.
Barrett: Intercontinental consolidation may be possible, we can see that by the talks between Southwest and Ryanair for a possible consolidation. In the end not the US, but the EU will dominate the consolidation process.
Cole: European airlines like British Airways and Virgin Atlantic are more Atlantic facing and pioneer in transatlantic consolidation instead of European consolidation.
Berardino: US carriers are owned by hedgefunds, thus they make the decisions on (intercontinental) investments. Ownership issues are political and they can be overcome in time.
Mendes de Leon: There is a need for convergence in competition regimes, so intercontinental consolidation becomes easier. Shareholding issues are still difficult to agree on, thus the community air carrier concept will not hold long. Foreign carriers already have substantial shares in most of the community air carrier.

Statement 2
Networks: Delta-Northwest and the impact on Amsterdam

- Merger between Delta Airlines and Northwest has been announced. Both airlines have, however, different network strategies. Northwest follows the ‘dogbone’ strategy, connecting hubs on both sides of the Atlantic (Detroit/Minneapolis/Memphis and Amsterdam) and feeding this hubs with continental traffic on both sides. Delta follows a hub-bypassing strategies, flying from its

bases in the US to primary AND secondary destinations in Europe.
- Will Delta copy the NW strategy?
- How might this affect the competitive position of Amsterdam?

Verhallen: The strategies will possibly be combined of NW and Delta. It seems to be a Salomon's judgement. NW shows good results in terms in profit, so their strategy should not be changed, and the tendency is more direct traffic, so Delta should (partially) keep their strategy too.
Barrett: Direct routes are more pleasant, the success of SouthWest airlines, now intercontinental.
Berardino: The future of long-haul point-to-point traffic depends on technology (environmental issues). The merger will not change that much, it will probably differ per destination. AMS does not have a hinterland, so will have to focus on transfer passengers.

Q: Is there a possibility of CDG changing into a long-haul airport and AMS into a short-haul?

Barrett: At this point, there are too many hubs, so less intercontinental hubs in Europe could be desirable. The future for AMS therefore also depends on the domestic market of the US.
Mendes de Leon: This will not happen, due to the profit that is made at AMS and the still strong force of bilateral agreements.

Statement 3

Primary slot trading
If primary trading/auctioning would be introduced on both sides of the Atlantic, how should airlines organize this? This involves a lot of uncertainty for airlines. You may have bought an expensive slot at Newark but end up with no slots at Heathrow for your transatlantic service.

Cole: Large carriers can obtain slots on both sides of the Atlantic; the small carriers are the ones who face problems in obtaining slots. Primary slot allocation system must change into a secondary slot trading system to tackle these problems.
Berardino: Both sides of the Atlantic need to have the same sort of auction system, but this is hard to achieve.

Q: DOT slots are not owned by airlines, are the carriers not angry about this?
Berardino: DOT slots are not private property, they allow the carriers to trade them as if the slots are carrier property. But when DOT takes away the slots, then the carriers will get angry.

Statement 4

Ownership issue of slots
Various speakers touched upon the ownership issue of slots and the lack of clarity on this issue.
a. Who is the owner of a slot?
b. How may the ownership issue affect slot trading or auctioning?

Cole: In the EU there is the principle of grandfather slots, which comes to the use it or lose it rule. That will have effect on the value of slots. If it becomes the same way in the US, then the EU will also adapt to this change.
Barrett: The slots are paid by the passengers per ticket at an airline. Competing airports or extra capacity will create extra slots. Grandfather slots is a funny form of property, there are other forms of distributing slots.

Statement 5
In the EU-US agreement, the level playing field is high on the list

- How will ETS introduction by the EU affect this level playing field?
- How will security measures in the US affect the level playing field?

Mendes de Leon: The Emission Trading System (ETS) is intra-European. The parameters of this system are still highly unsure, since the European Commission is still working on it. Fact is that European carriers will suffer, since they are disadvantaged by ETS in comparison to the US.
Verhallen: If the security within the EU would be consolidated, this could be stretched out between the EU and US. This is a quite sensitive subject, but would increase the strength of the Open Sky Agreement.
Rene Fennes (public): Should we care about a level playing field? Governments continuously compete with each other with different taxations and subsidies, in order to get efficient.

Closing Speech

EU-US aviation agreement: promoting a competitive industry – Daniel Calleja Crespo, Director of Aviation DG TREN, European Commission

Europe's aim is to 'normalize' aviation, to 'free the sector' from barriers which are hampering normal development of the industry. The past abnormal industry was not fulfilling its potential. There were higher costs for operators and limited product for consumers. Alliances were the best attempt at overcoming these issues, but they are still only a second-best solution.

Europe has benefited from the creation of the single aviation market in the mid-1990s, however benefits of normalisation is only felt on intra-EU routes. Vital barriers beyond Europe's borders lifted to gain maximum benefit. This external dimension needs willing partners.

With the first stage of the agreement we are only half way there. The EU-US second stage is essential for competition. The choice is clear: either we have a deal on:

- Freedom to decide granted to airlines
- Scope for trans-border consolidation
- Potential for global airline brands and seamless travel experience

- Prospect of financially sustainable future
- Consolidates first stage competitive benefits
- In the interests of the industry, Government, consumers and passengers

Or we have no deal:

- Impoverished and unstable industry staggering from one crisis to the next
- Temptation for more explicit of implicit Government intervention
- Possible 'unwinding' of first stage rights and associated competitive benefits

From the above mentioned points we can conclude that the EU-US agreement is a big boost to competition in the transatlantic market, evidence from Europe is there are further competitive benefits from an OAA, and second phase aims to achieve these benefits.

The programme, presentations and photos concerning the Annual Conference 2008 can be found on our website www.airneth.com