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STATEMENT OF AMBASSADOR ALAN S. BOYD, SPECIAL REPRESENTATIVE OF THE PRESIDENT FOR THE CIVIL AIR SERVICES NEGOTIATIONS WITH THE UNITED KINGDOM, BEFORE THE SUBCOMMITTEE ON AVIATION OF THE HOUSE COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION, CONCERNING THE NEW U.S.-U.K. CIVIL AIR SERVICES AGREEMENT (BERMUDA 2), SEPTEMBER 29, 1977.

.....

Mr. Chairman:

I appreciate the opportunity to meet with you and your committee this morning regarding the major civil air services agreement recently concluded with the United Kingdom.

This statement is addressed to the development and content of the Agreement between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland concerning Air Services, signed at Bermuda, July 23, 1977. This agreement is now commonly known as Bermuda 2.

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DEVELOPMENT: JUNE-DECEMBER 1976

Termination of the 1946 Bermuda Agreement

Her Majesty's Government believe that the time has come to renegotiate the Bermuda Agreement^{1/} as a whole. Accordingly, they . . . serve notice of termination of the Bermuda Agreement, as amended. . . .

These words in a June 22, 1976, Diplomatic Note from Her Majesty's Ambassador in Washington to the Secretary of State marked the beginning of a 12-month period for negotiation of a new civil air services agreement.

By its own terms regarding termination, the Bermuda Agreement, originally reached in February 1946 with subsequent amendments, the most recent being dated May 27, 1966, would continue in force until midnight, Washington time, on June 21, 1977.

The reasons for the British termination, as set forth in their Diplomatic Note, were:

- The Bermuda Agreement had become out of date "in a number of respects" and did not correspond satisfactorily with the conditions of the 1970s.
- The United States enjoyed greater benefits under the Agreement than did the United Kingdom. U.K. airline revenues were said to be \$227.5 million compared with \$512.8 million for U.S. airline revenues--a 69-31 split in favor of the United States.^{2/}

^{1/} Formally, the Final Act of the Civil Aviation Conference held at Bermuda, 15 January-11 February 1946 and the annexed Agreement between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland relating to Air Services between their Respective Territories, TIAS 1507, 60 Stat. 1499.

^{2/} More specifically, the United Kingdom cited the balance of revenues (for the 12-month period ending March 31, 1976) as:

	<u>U.K. Airlines</u>	<u>U.S. Airlines</u>
North Atlantic U.S.-U.K. Services	\$222.3 million	\$320.3 million
U.S.-Bermuda Services	5.2	35.0
U.S.-Hong Kong Services	---	89.2
Other Country-Third Country Services	---	68.3
	<u>\$227.5 million</u>	<u>\$512.8 million</u>

- Despite recent relative improvement in U.K. benefits over the North Atlantic, "substantial revision of the rights conferred" was needed "to achieve a more equitable balance of benefits overall."
- The capacity provisions needed specific definition. "The understandings reached in 1974 and 1975 for establishing a close relationship between the capacity and the demand need to be consolidated into a new agreement and systematic procedures established for implementing them."^{3/}
- The tariff provisions had proved unworkable--with the practical effect that either party could act unilaterally on tariffs, without consultation, causing great uncertainty as to what tariffs were applicable.^{4/} With no schedule for tariff filings and government reactions to tariff filings, last minute and/or hurried actions often could not be avoided.^{5/}

^{3/} The U.K. Note refers to certain short-term capacity agreements permitted by the U.S. CAB during the Middle East oil embargo, the recession of 1974, the 1974-75 financial crisis of major North Atlantic air carriers, and the 1975 U.S.-U.K. "understanding" on capacity to the effect that both countries wanted to avoid excess capacity harmful to the airlines and the public. (See page 6 below.)

^{4/} Specifically, the Note said: "The practical consequence has been, as recent events have demonstrated, that one of the parties may act unilaterally, without consultation, and without any basis in the Bermuda Agreement for such action, only a few hours before new fares are due to come into effect. This has repercussions on the whole fares structure on the very important North Atlantic routes." While the United States believes that each of its actions on U.S.-U.K. tariffs has been in accordance with the provisions of the Bermuda Agreement, one should note that on March 11, 1976, the New York office of the International Air Transport Association (IATA) filed, on behalf of the U.S. member carriers of IATA, a schedule of summer North Atlantic tariffs for effect May 1, 1976. The Board disapproved this filing on the afternoon of April 30. (In Europe, it was already evening.)

^{5/} In response to the IATA agreement filed March 11, 1976, the Board approved on March 15 Order 76-3-94, served March 18, granting parties and interested persons fifteen days in which to file supporting material and/or comments, and another ten days for replies. This left less than three weeks from the end of the reply period to the date of effectiveness of the tariff.

Thus the issues raised by the British were from the outset economic. They said that the concept of an agreement's providing "fair and equal opportunity" to compete was no longer applicable. They wanted a new agreement to assure a better balance of benefits and more profitable operations for U.S. airlines. In their view:

- routes were to be realigned to give greater benefits for U.K. carriers;
- capacity was to be more tightly regulated to provide greater efficiency of operations and greater opportunity for U.K. carriers;^{6/} and
- the tariff mechanism was to be improved, so that the Civil Aeronautics Board (CAB) could no longer issue eleventh hour vetoes of rate increases.

The U.S. Response

On July 14 the United States responded to the Diplomatic Note of termination to the effect that the United States (1) remained basically satisfied with the then existing Bermuda Agreement and (2) would join with the United Kingdom to negotiate a new agreement. The United States proposed that negotiations begin in London in September.

Immediate Issues

For several years prior to June 22, 1976, the United Kingdom had shown increasing inclination to make unilateral interpretations of the existing 1946 Bermuda Agreement and an increasing willingness to take unilateral actions to enforce their interpretations of its provisions.

Just a few weeks after the note of termination, a delegation from London was in Washington to "clear the decks" of some small problems--immediate issues they were called--so that the negotiation of a new agreement could be conducted without the distraction of "side" issues. But this was not to be. As I shall document shortly, throughout the twelve months of negotiations of Bermuda 2, there were issues of immediate nature the United Kingdom sought to have solved.

^{6/} It was to become clear in subsequent months that the United Kingdom felt that capacity increases by any airline should be restrained until all airlines had reasonably high load factors in the market in question. That is, capacity regulation or predetermination was seen by the British to be a valid means for determining market share and balance of benefits.

An indication of the difficulties the United States would face in the renegotiation is given by the list of problems of immediate concern to the United Kingdom in July 1976. These were:

- U.S. capacity offered on the North Atlantic. The United Kingdom had wanted an intergovernmental agreement on summer 1976 capacity in each market. (Consultations in April had produced agreement only for the London-Miami market.) The British set a July 31 deadline for agreement on winter capacity, arguing that in 1974 both governments had recognized that action was necessary to rationalize the capacity offered on the North Atlantic routes, particularly in view of the severe financial difficulties affecting certain international airlines. The United Kingdom based its position on what it described as an agreement incorporated in a joint statement following a bilateral consultation in 1975. That statement said, in part:

Both countries desired to avoid the operation of excess capacity harmful to both the airlines and the traveling public, as well as wasteful of fuel.

The question, therefore, in the U.K. mind was not whether a means should be found for ensuring the "close relationship" between supply and demand; but rather how this could best be achieved. The British suggested that a 70 percent load factor, while not sacrosanct, represented a reasonable interpretation of the 1975 agreement.^{7/}

- U.S. operations at Hong Kong. The United Kingdom was concerned about Pan American's layover time at Tokyo, change of gauge at Tokyo, and capacity between Hong Kong and Tokyo. The British objected to Pan Am's Hong Kong-Sydney and round-the-world capacity; both of these depended, in the U.K. mind, too heavily on third country traffic.
- CAB action on excess baggage charges.

^{7/} The United States rejected such a load factor standard, saying that the load factor appropriate for a given market depends upon circumstances such as the type of aircraft used and market characteristics such as fare structure and length of haul.

- A recent normal economy fare filing by British Airways which the United Kingdom felt was legal and in effect, while the CAB thought it was not legal and therefore not in effect.

More specifically, on capacity levels to be offered and desirable load factor standards, the British expressed concern that their estimated load factors to and from London (see table) were too low.

July 1976 U.K. Estimate
for Winter 1976-77

<u>Market</u>	<u>Load Factor</u>	<u>Flights per Week</u>	
		<u>U.K.</u>	<u>U.S.</u>
Boston	51.6%	7-707s	7-707s, 4-747s
Chicago	39.1%	5-747s	5-747s
Los Angeles	60.5%	7-DC-10s	7-474s
Miami	43%	7-747s	7-DC-10s
New York	58.7%	7-747s, 7-707s	21-747s, 7-707s
Washington	56.3%	4-747s, 2 or 3 SSTs	5-747s

Actual Capacity
for Winter 1976-77

<u>Market</u>	<u>Actual U.S. Load Factor</u>	<u>Flights per Week</u>	
		<u>U.K.</u>	<u>U.S.</u>
Boston	62.4%	7-707s	7-707s, 4-747s
Chicago	49.9%	5-747s	5-747s
Los Angeles	60.3%	7-DC-10s	7-747s
Miami	58.7%	6-747s	6-DC-10s
New York	56.0%	7-747s, 7-707s	21-747s, 7-707s
Washington	42.7%	4-747s, 2 or 3 SSTs	5-747s

Preparation for Negotiations

Since the United Kingdom had initiated the renegotiation, it was appropriate for the British to make the first set of proposals as to the content of the new agreement. It was, after all, the United States that had had no problem with the operation of the existing agreement. The United Kingdom furnished an outline of its starting proposals in August, together with a proposed negotiation schedule.

The United States formed an interagency policy group, chaired by the Under Secretary of State for Economic Affairs, and supported by a working group. The Departments of State, Transportation, and Commerce, the Council on International Economic Policy (CIEP), and the Civil Aeronautics Board were represented on these groups. These groups reviewed the U.K. outline of objectives for the renegotiations and the general schedule.

The United Kingdom wanted to pursue the central issues of routes and capacity immediately, proposing

- a two-day September meeting to discuss the U.K.'s proposals
- a 7-10 day October meeting to discuss capacity provisions, North Atlantic route rights, and designation
- a 7-10 day December meeting to discuss Hong Kong-related issues
- a 7-10 day January meeting to discuss Bermuda and Caribbean issues and tariffs
- a 7-10 day March meeting for further discussion of tariffs, the link between tariffs and capacity, administrative articles, and any other not-yet-resolved issues
- an April meeting going as long as necessary to reach final agreement.

The United States refused to be drawn into a schedule of meetings that would put our major philosophic concern (adequate service for the public, achieved by responsible carrier response to market demand, and competitive stimulus for development of airline services) and our major economic leverage (access to the densest intercontinental routes in

the world and the extent of U.K. air carrier access to new developing market areas within the United States) in a potential trade-off situation at the beginning of the talks. To have settled routes first would have left the United States with little leverage to protect competitive opportunity in the capacity area--and the British were clearly not going to yield early on capacity.^{8/} Rather the United States suggested that each side should prepare economic analyses of the markets at issue--which would compel the United Kingdom to review the very substantial benefits it enjoyed under the existing regime.

The U.S. proposal was agreed to in the opening round of the negotiations, September 9-10 in London. Economic analysis would be the major topic through the remainder of 1976. This allowed the analytic staffs at the CAB and DOT, as well as those of our airlines, more time to develop data, options, and positions for the crucial negotiating on capacity, routes, and rates, scheduled for late winter and early spring 1977.

United States Policy

On the eve of the September 9 opening of the Bermuda renegotiation, a Presidential policy statement on international air transportation was issued--the result of an 18-month intensive interagency review, led by the Departments of State and Transportation, with the assistance of the Council of Economic Advisers, the Council on International Economic Policy, the National Security Council, the Office of Management and Budget, the Departments of Commerce, Defense, Justice and the Treasury, and the CAB.

That statement was the basic philosophic guidance for the delegation. It set forth as principal U.S. objectives:

- reliance on competitive market forces to the greatest extent feasible, recognizing that the views of other nations may differ and that our policies must be modified in some instances in order to reach bilateral and multilateral accommodations,

^{8/} Indeed the capacity provision proved to be the most difficult part of the negotiation. As discussed later, weeks were devoted to this issue, which was not finally resolved until June 21; there was not even an outline of agreement on capacity until June 3.

- provision for the transportation of people, mail and goods, wherever a substantial need exists, at as low a price as is economically justified,
- support of a private U.S. international air transportation industry that is economically viable and efficient, and that will generate sufficient earnings to attract private capital and provide job opportunities,
- consistency with and contribution toward U.S. national objectives in defense and security, foreign policy, and international commerce.

That Policy Statement reflected awareness of the substantial differences that exist between the international and domestic air transportation operating environments.

We recognize that international transportation presents special challenges--the most obvious being the need to cooperate with other sovereign nations. While the governments of other nations may share our objective of efficient transportation service, many differ sharply in their views as to how such transportation should be organized, financed, regulated, and promoted. Thus, the means by which we pursue our international policy goals often cannot be the same as those by which we conduct our domestic transportation system.^{9/}

That Policy Statement also gave explicit guidance on the central issues that would arise in the negotiation of the new bilateral with the United Kingdom as follows:

General

"Air transport interests are best assured for Americans by the presence of a strong, viable, privately owned U.S. flag international air fleet. . . . There are three major considerations in the development of international air service: route patterns, . . . capacity, and the fares charged. . . . All three are integrally related economic issues."

^{9/} International Air Transportation Policy of the United States, page 2.

Routes

"The U.S. Government should encourage a system of routes as extensive as can be economically justified. . . . Major trunk routes and markets should be identified. . . and given priority negotiating attention. . . . Closer integration of international route systems is in the public interest. . . . In negotiating international route patterns for U.S. carriers, the U.S. Government should structure routes in a way that enables our carriers to draw upon natural traffic flows and, thereby, compete effectively with foreign carriers. . . . In granting authority for all-cargo operations, recognition should be given to the need for routing and scheduling flexibility, which may differ considerably from passenger routing and scheduling patterns."

Competition/Designation

"A basic tenet of U.S. economic philosophy is that marketplace competition produces improved service and lower total costs for the consumer. This is as true in aviation as it is in other areas of commercial activity. However, it does not follow that there must be multiple U.S. flag carriers on all international routes. . . . The United States should authorize more than one U.S. flag airline in scheduled international markets only if they operate profitably, taking into consideration the presence of competition from foreign scheduled airlines and from domestic and foreign charter airlines."

Capacity

"Even under circumstances of extreme financial distress, the preferred approach to excess capacity is unilateral reduction by the carrier. . . . The preservation of the competitive concept underlying the Bermuda system is vital, because systems under which carriers or governments predetermine capacity for market share reasons can introduce artificial restraints unrelated to carrier efficiency or traffic demand. . . . When other countries advocate less flexibility in capacity competition, we may insist, as a quid pro quo, on greater flexibility in pricing competition, so long as forecast load factors are well below full utilization load factors."

Tariffs

"International fares and rates should, to the maximum degree feasible, be cost-related, responsive to consumer demand, and established on the basis of competitive market forces. . . . The United States at present intends to continue to accept the International Air Transport Association as the principal vehicle for international negotiation of scheduled tariffs. . . . IATA and its member carriers should revise their tariff-setting structure, so that it can be more responsive to market forces and innovative fare programs including greater flexibility for rate setting by individual carriers."

Charter Services

"There is a substantial public need for charter-type passenger operations in international markets. . . . We also recognize the growing demand for low-cost services and the inherent efficiencies of full plane operations generally characterized by charter-type services. Most importantly, we recognize the need to have governmental policies that will accommodate the competitive interrelationships between these two types (scheduled and charter) of services."

October 1976 Round

The second round of Bermuda 2 negotiations was held in Washington, October 18-22, 1976. Discussion centered on common assumptions for the economic analyses (to facilitate comparisons in December of the completed papers), on the progress to date in the analyses, and on a number of "non-controversial" articles. (Since an entire air services bilateral agreement was to be negotiated, articles had to be adapted from the Bermuda Agreement, revised from that Agreement, or drafted anew to cover all aspects of air services--for example, definition of terms, grant of operating rights, application of laws, airworthiness, aviation security, commercial operations, customs duties, user charges, consultations, and settlement of disputes. Throughout the negotiations such articles were generally regarded as "non-controversial," although occasionally in light of the differences of view, sometimes quite sharp differences, this was a misnomer. In any case it provided a convenient means to distinguish them from the articles of central economic importance: routes, designation, capacity, charter linkage, and tariffs.

Side Issues. The United Kingdom continued to press for solution of "immediate problems" in the sessions in October. Principal among these was restraint on the winter 1976-77 capacity plans of U.S. carriers--as the sharp difference of opinion continued as to whether the 1975 statement^{10/} regarding avoidance of excess capacity meant that capacity should be agreed a priori. In actuality the "immediate" winter capacity problem was not a side issue, but rather a manifestation of the basic U.K. policy position in the Bermuda 2 negotiations. The United States insisted that the capacity provisions of the 1946 Bermuda Agreement were governing and that there was no agreement or commitment for a a priori government consultation or agreement. This was a particularly significant matter in light of the renegotiations, for to agree to government negotiation of capacity for the winter season would be tantamount to accepting a capacity article in the new agreement calling routinely for predetermination of capacity.

Other "side issues" addressed in October were (1) transatlantic fares for the 1976-77 winter season (the CAB had rejected portions of an IATA agreement and the United Kingdom sought trilateral government negotiations to include Canada); (2) the conversion of IATA tariffs into local selling prices in the United Kingdom, which was being done in a manner that imputed a value of \$2.20-\$2.30 to the pound sterling at a time when the bank exchange value was \$1.68 (U.S. carriers objected to the resulting 20-30 percent yield dilution); and (3) Hong Kong-Sydney capacity.

Charter Issues

In March 1976 the United States and the United Kingdom had reached a Memorandum of Understanding (MOU) regarding charter-worthiness standards. The MOU, due to expire December 31, 1976, defined the types of charter programs that could be operated between our two countries and the applicable conditions. The basic U.S. position in the fall of 1976 was that the MOU should be renewed for a period of one year with the addition of Advance Booking Charter (ABC) programs to the list of acceptable charter types.^{11/} Negotiations to renew the charter MOU were conducted separately

^{10/} See page 6, above.

^{11/} This position on ABCs derived from a September 1976 CAB decision on desirable charter types, and appropriate conditions therefor, and from the September 8 Statement of the International Air Transportation Policy of the United States (cf. pp. 12-13). The MOU appears in TIAS 8303.

from, but in conjunction with, the negotiation of Bermuda 2. Neither delegation expressed a position in 1976 as to whether and how charter and scheduled services should be related in Bermuda 2. Both sides reserved on this "linkage" question for further study, and agreed in principle that renewal of the charter MOU through December 31, 1977, would be desirable as a temporary measure, regardless of the ultimate relationship of charter and scheduled services in Bermuda 2. However, agreement on appropriate conditions for ABCs could not be reached in the December round. The United States delegation felt at that time, with the concurrence of the representative of the National Air Carrier Association, that it would be better to operate charters on an ad hoc "comity and reciprocity" basis, than under any MOU the British were then willing to sign.

December 1976 Round

The third round of negotiations was held in London, December 7-14, 1976. After preliminary discussion of the approaches to the renegotiation, each side presented its economic analysis of market growth, costs, potential revenues, and projected capacity, for both passenger and cargo operations. These analyses included the London, Hong Kong, and Bermuda markets to/from the United States.^{12/}

A central issue in the December discussions was the U.K.'s insistence upon capacity management by governments and the contrary U.S. position that the principles of the 1946 Bermuda Agreement must be preserved. The United States stressed the point that the public interest requires that the managements of privately owned companies must have the freedom and flexibility to make prudent decisions in a free market. On the economic side, the United Kingdom sought a 50-50 split of capacity in each market, equal market share, and control of all elements which in any way might provide a competitive advantage to U.S. airlines. Consideration of the public interest appeared to be strictly secondary.

At the end of the December round the United Kingdom set forth a comprehensive proposal representing "the minimum that will be needed to achieve an orderly transition to

^{12/} An overview of the U.S. analysis appears at Appendix 1.

future air services on an equitable basis." The key points of that paper speak volumes as to the U.K. design for the U.S. international route system:

- no fifth freedom rights into or beyond Great Britain
- no fifth freedom rights beyond Hong Kong
- reduced fifth freedom rights intermediate to Hong Kong
- only one U.S. (and one U.K.) air carrier on each North Atlantic route (between gateway cities)
- only one U.S. airline operating all-cargo services in North Atlantic markets
- a suitable mechanism to regulate North Atlantic capacity
- no through-plane, single-flight number service from behind-gateway points
- no change of gauge.

Transition to this regime was to begin January 31, 1977 and to be completed by October 31, 1977.

My predecessor as head of the U.S. delegation rightly responded that this transition proposal--before any discussion, much less agreement on the nature of the new route structure--was "wholly inappropriate" at that stage of the negotiations.

Side Issues. Both old and new "immediate" issues were raised in December, in addition to the discussion of the economic analyses and certain of the "non-controversial" articles. The United States continued to press on the inequitable conversion of IATA tariffs into pound sterling selling prices. The United Kingdom sought governmental agreement on the winter season North Atlantic regular economy and 22/45 day excursion fares; objected to CAB action regarding most London-Miami fares and British Airways' contract and specific commodity cargo rates; sought agreement on regulation of travel agent commissions and delay in any change in excess baggage charges; objected to the

proposed summer 1977 West Coast-London schedules of U.S. carriers (these were termed "grotesque"); and sought to negotiate appropriate summer 1977 capacity levels in all U.S.-London markets.

On none of these issues was agreement reached.

NEGOTIATIONS: JANUARY-JULY 1977

January 1977

The conclusion of the December round of negotiations, marked by British transmission of their proposal for transition to a new era in our air transport relationship, provided so little prospect for successful negotiation that the State Department presented an aide memoire to the British Embassy on December 23. It read in part:

The USG has most seriously considered the future course of the renegotiation of the U.S.-U.K. air services agreement and has come to the conclusion that the next meeting should be postponed from January 17 to February 28. . . . There is a highly substantive reason for postponement. Several of the proposals which the U.K. delegation submitted in London. . . advance either explicitly or implicitly such extreme positions that they cannot form the basis of a negotiation. . . . The U.S. wants to make clear immediately and unequivocally that it cannot accept as a basis for negotiation either the transitional concepts that document proposes or the implications it leaves with regard to a new agreement.

On January 27 the State Department in a second aide memoire to the British Embassy, lest there be doubt that U.S. resolve might have been weakened with a change in Administration, said:

The United States Government foresees no possibility of reaching agreement based on that United Kingdom position. (i.e., the one presented in July and December). While it assumes that the United Kingdom is prepared to make concessions from that position in the normal negotiating manner, the position as presented is so extreme that, as previously stated, it cannot be an acceptable basis for negotiation.

That aide memoire also addressed the U.S. concern for the larger economic interest of consumer benefit and public service:

While the United States does not assert that unlimited competition is essential in international air transport, it does believe that system efficiency is important to larger economic interests and that it is possible only in an adequately competitive environment.

January and February were a time of reassessment. We were halfway through the one-year notice period. The new Administration was taking office in Washington. The agencies had had time to do the needed analyses of U.S. objectives. We would soon be entering the final rounds--up against a deadline of midnight June 21--and the British had shown no willingness to consider positions on capacity or routes that offered a reasonable context in which to continue negotiations.

The United States delegation had, to that point, done a good job of stating basic U.S. interests and had held firm in the face of extreme demands advanced by the other side. It had rejected certain U.K. proposals as being so extreme as to not even merit continuance of negotiations. At the same time, however, there was no consensus as to how a final agreement might be reached. The several responsible U.S. agencies were each advancing what they felt to be the primary objectives, while the British evidenced no interest in serious negotiations. It became apparent that the negotiations would be difficult so long as the U.K. intransigence persisted.

As I understand the situation, the Secretaries of State and Transportation decided that, in order to force the British to undertake serious negotiation and to focus on broader interests, it would be desirable to "escalate" the level of the talks by the appointment of a special negotiator to head the delegation as the special representative of the President. As is well known, President Carter accepted that recommendation, and on February 16, 1977 asked me to undertake such an assignment. I did. At the same time, Her Majesty's Government named Deputy Secretary of Trade Patrick Shovelton to assume leadership of the U.K. delegation, thus elevating the level on that side.

Development of Positions. Concurrent with reassessment of (1) how to force the British to serious negotiation and (2) the organization of the U.S. delegation, the State Department in late December initiated comprehensive reviews of specific issues. Throughout January and February, working papers and draft agreement articles were developed, reviewed, and revised. With my appointment, I oversaw the end of this effort assuring that, when we began the fourth round of talks in London on February 28, the United States would be prepared to advance specific proposals relating to capacity, routes, designation, tariffs, and linkage of charter and scheduled services.

The review of specific issues was not left to Government agencies alone. On January 28, by notice in the Federal Register,^{13/} the Assistant Secretary of State for Economic and Business Affairs welcomed "any relevant submission or presentation." The public was "particularly invited to address the following issues raised by the United Kingdom or of interest to the United States Government." Six issues were enumerated: capacity, routes, designation of carriers, fares, charter services, and user charges. Each was accompanied by a short discussion. The responses from airlines, industry associations, airport and governmental bodies, and the general public were studied in February and March as the delegation developed its own analyses of the issues.

Three Rounds in the Spring

The central economic issues were negotiated in the course of a 2-week round of talks in London that began February 28, a 4-week round of talks in Washington that began March 28, and a 5 1/2-week round of talks in London that began May 16.

On February 28 the British put forward a proposal on capacity calling for:

- equal division of capacity between U.S. and U.K. airlines on each route;
- carrier agreement on frequency and capacity for North Atlantic passenger routes, and failing that, government negotiation of capacity with a minimum schedule of capacity to operate in the event of no agreement, and
- government determination of frequency and capacity for North Atlantic all-cargo routes, for all routes in the Bermuda, Caribbean, and Hong Kong markets, and for all route segments involving local traffic rights.

The United States had in two aide memoires made clear that certain positions advanced earlier by the United Kingdom were so unacceptable that no purpose would be served by discussing them. Now the United Kingdom persisted in the market determination line, persisted in total disregard of public service factors, of U.S. economic philosophy and commitment.

^{13/} Department of State, Public Notice 514, "US-UK Air Services Agreement (The Bermuda Agreement)," Vol. 42, No. 19, January 28, 1977.

The United Kingdom proposed service to London from twelve U.S. cities--the existing eleven, less Baltimore, plus Atlanta and Houston^{14/}--and sought to have the U.S. route proposal on the table. I refused. I saw no need to discuss routes--or anything else--until we had made some progress in the capacity area. If the United Kingdom would not put forward reasonable proposals on capacity, there could be no agreement. We explained the possible consequences of no agreement. Each day for two weeks I was asked for our North Atlantic route proposal. (The principal agenda items for that round were North Atlantic capacity and route issues.) Each day I said no--not until we make progress on capacity--and that requires some reasonable proposals from the British side.

At the same time that I report that the U.S. position on predetermination of capacity was a nonnegotiable rejection, I should make clear that we appreciated the U.K.'s concern for efficient use of resources and avoidance of excess capacity. President Carter had recently spoken out against waste of fuel and other resources, and I took pains to explain to my British counterpart that we, too, did not wish to see the profligate waste of resources--and that such could be avoided without anticompetitive, anti-consumer interest, rigid predetermination of capacity.

Just as I reiterated that we could never accept the extreme British position, it was evident that neither could they ever accept having no restraint at all on the competitive ability of U.S. carriers to mount capacity--in their phraseology, to dump excess capacity. Accordingly, we advanced proposals that dealt in a pragmatic manner with avoidance of excess capacity, yet avoided predetermination. In fact in March, and again in April, May, and June we found ourselves putting forward a series of proposals just as the British eventually did--we trying to maximize carrier opportunity to develop traffic and serve the public, they trying to assure that U.S. carriers would not outperform British.

In a moment I should like to discuss each of the principal issues as it was finally resolved. But it may be of interest to have a brief listing of the topics covered in each of the three major rounds of negotiations in 1977.

^{14/} I.e., from Atlanta, Boston, Chicago, Detroit, Houston, Los Angeles, Miami, New York, Philadelphia, San Francisco, Seattle, and Washington.

February 28-March 11. In addition to the central discussion on capacity, the sessions addressed the tariff article, certain "non-controversial" articles, and the ever-present side issues--this time the British were troubled by summer capacity to be mounted by Pan American and TWA between San Francisco and London (a route not served by any British airline) because ostensibly this would reduce British Airways' (BA) projected Los Angeles-London load factor from 82% to 77%, and lessen demand (from traffic forced to divert from Los Angeles) for BA's Chicago-London service.^{15/} In concurrent negotiations, as discussed below, we agreed on extension of the charter MOU through March 31, 1978.

The United States Delegation tabled position papers on capacity, tariffs, and designation in this round.

March 28-April 25. Discussion continued in Washington on North Atlantic capacity. We put forward our North Atlantic route proposal which called for nonstop routes in the bilateral to London, Manchester, and/or Prestwick/Glasgow from all eleven existing gateway points^{16/} and the eleven new cities^{17/} that the CAB had recommended in its July 1976 opinion in the Transatlantic Route Proceeding be designated as North Atlantic gateway cities. Agreement was reached on U.S.-Bermuda routes. Caribbean and Hong Kong services were discussed intensely, although no agreement was reached.

^{15/} Additional "side issues" involved criminal action by the Justice Department against British Airways over cargo rates, Pan American's London-Stockholm service proposed to resume in April, and what can only be described as harangues regarding the USG's position vis-a-vis Concorde operations to the United States--in particular, to New York.

^{16/} These eleven cities are Baltimore, Boston, Chicago, Detroit, Los Angeles, Miami, New York, Philadelphia, San Francisco, Seattle, and Washington.

^{17/} These eleven cities are Atlanta, Cleveland, Dallas/Fort Worth, Denver, Houston, Kansas City, Minneapolis/St. Paul, New Orleans, Pittsburgh, St. Louis, and Tampa.

The United States Delegation tabled position papers on tariffs, capacity article, capacity mechanism for the North Atlantic, routes in all market areas, designation, commission rates, "non-controversial" articles, the CAB's policy on ownership and control especially as it relates to carriers in the Caribbean area, antitrust problems in the field of tariffs, the need for local traffic rights at Hong Kong for all-cargo services, and DOT's comments before the CAB on the then pending Laker Airways permit application.

May 16-June 22. The climax of the decisive round in London in May and June was the signing at 5 a.m., June 22, of an agreed minute that said that the United States and the United Kingdom (1) had agreed upon terms for a new air services agreement, (2) would review the draft agreement by July 31, 1977, (3) would resolve any remaining issues which might arise in the course of the review, and (4) would make such drafting modifications as might be required to produce a final text. Essentially all issues, except the already-settled U.S.-Bermuda routes, were on the table in this round. And there were side issues--in particular, the British court suit against Seaboard for an alleged permit violation, and the U.K. insistence on prompt U.S. action on the pending application of Laker Airways.

Two Concluding Rounds

The Agreed Minute on June 22 marked the agreement in substance to the provisions of a new bilateral. Each of these draft provisions was initialed by Mr. Shovelton and me, although on a few points we reserved, meaning that there was not agreement and the points would have to be settled in July. The most significant of these non-agreed issues was the U.K. reservation on North Atlantic all-cargo routes pending consideration of local traffic beyond rights to Mexico.^{18/}

The joint legal and drafting session held in Washington, July 12-15, identified 18 or 20 substantive points of difference. These, together with the non-agreed items left from the June London round, constituted the agenda for the final round of Bermuda 2 negotiations. At the urging of the Bermudian Government, this final round was

^{18/} Other reservations involved language in the "application of laws" article, provisions for ground handling, dispute settlement, and customs duties for ground equipment.

held July 18-23, in Southampton, Bermuda, to commemorate the signing of the first U.S.-U.K. civil air services bilateral some 31 years earlier.

The Charter MOU

Whereas no acceptable extension of the charter MOU had been possible in December, the British were willing to be more liberal in March in the conditions for ABCs. The agreement reached in March covered all types of charters then approved in both countries, and included for the first time U.S.-originating Advance Booking Charters.^{19/} These separate, but concurrent negotiations were led by Deputy Assistant Secretary of State Joel Biller. I was pleased that an appropriate extension of the charter MOU could be agreed, for this offered the prospect of being a first important step toward an ongoing commitment to expansive charter programs. It was evident by March that there would not be time to have a formal agreement on charters prior to the June 22 deadline, whether a part of or separate from Bermuda 2. But with the charter MOU agreed, I foresaw an opportunity to negotiate a firm linkage between charter and scheduled services, perhaps with the charter MOU becoming a temporary annex to Bermuda 2 until further agreement on charter types could be agreed.

^{19/} Public announcement of the agreement was in a joint U.S.-U.K. press release, Department of State release 168, April 7, 1977.

PRINCIPAL PROVISIONS OF BERMUDA 2

The full text of the Bermuda 2 Agreement and the agreed, joint interpretative side letters have been published, and are readily available.^{20/} A copy is attached for the record. Thus, I think it sufficient to focus on the principal economic provisions of the Agreement: routes, designation, capacity, tariffs, and charters.

North Atlantic Routes: Combination Services

The 1946 Bermuda Agreement, as amended in 1966, provided for U.S. air carrier access to London and Prestwick from eleven U.S. gateway cities^{21/} with extensive rights for the aircraft to operate beyond London and with rights to London-third country traffic available on services from Baltimore, Boston, Chicago, Detroit, New York, Philadelphia, and Washington.^{22/} On the routes added in the 1966 amendment, beyond rights were severely restricted: from Miami, none; from Los Angeles, San Francisco, and Seattle, only to Denmark, Norway, Sweden, and Paris.^{23/} The same routes were available for both all-cargo and combination (i.e., passenger/cargo) services.

On routes negotiated in 1946 the United Kingdom had accepted the right of U.S. carriers to operate "behind-gateway" segments, i.e., to operate a through aircraft from some U.S.

^{20/} Copies are available from the Office of Public Affairs at the Department of Transportation. The Agreement is also published by the Department of State in its international agreement series.

^{21/} See footnote 16.

^{22/} Gander, Greenland, Iceland, and Shannon were listed as points that might be served enroute to Great Britain. U.S. airlines could operate beyond London and/or Prestwick on Route 1 to Amsterdam, Helsinki, Copenhagen, Norway, Sweden, Hamburg, Bremen, Berlin, Cologne, Dusseldorf, Frankfurt, Stuttgart, Munich, Warsaw, Moscow, Leningrad, Tallinn, Riga, Kaunas, and Vilnius, and on Route 2 to Brussels, Cologne, Dusseldorf, Frankfurt, Nuremburg, Stuttgart, Munich, Paris, Switzerland, Italy, Vienna, Prague, Budapest, Belgrade, Bucharest, Istanbul, Ankara, a point to Iran, Beirut, a point in Syria, a point in Iraq, a point in Afghanistan, Karachi, Delhi, Calcutta, and points on the transpacific route to and beyond Hong Kong. Only cargo and mail flights could operate between London and Prestwick, on the one hand, and Paris, Switzerland, or Italy, on the other; no local traffic was permitted.

^{23/} No local traffic could be carried on the London-Paris segment.

point to London via a designated gateway without a change of flight number. U.S. airlines, in particular TWA, have done just that. By 1966 the United Kingdom was objecting to this routing flexibility, arguing that it gave competitive advantages to U.S. airlines. As a result, in addition to the sharply reduced beyond-London routings available on the routes added in 1966 (Miami and West Coast), it was agreed that U.S. carriers would not operate behind-gateway segments on these routes.

U.K. carriers, under the amended 1946 Bermuda Agreement, had access from London, Prestwick, and Manchester to Baltimore, Boston, Chicago, Detroit, Los Angeles, Miami, New York, Philadelphia, San Francisco, and Washington.^{24/} U.K. carriers also had considerable U.S.-third country rights involving Montreal, the Caribbean, and South America.^{25/} Generally behind-gateway services could not be operated by U.K. carriers, as there are no major traffic points in the U.K. other than the designated gateways. Customary international practice prevented U.K. operation of flights from Europe through London to the United States under a single flight number.

U.S. Basic Position. On March 28, as soon as we began discussion of routes, I advised the U.K. delegation that, while the size and scope of a route exchange are certainly topics for negotiation, certain fundamental points should be made and clearly understood:

- The United States did not accept the concept of "mirror" or parallel route structures as had been suggested in the U.K. presentation. Route structures must reflect geographic and demographic factors, which differ for each country. The exchange of routes should be balanced in terms of opportunities.
- The United States Government was firmly of the view that the airlines of the United States should be free to arrange domestic services behind U.S. gateways and to connect U.S. gateway points as they deem best.

^{24/} Service to San Francisco had to be via New York. U.S. carriers had authority to all these cities (with no restriction as regards San Francisco) and, in addition, Seattle.

^{25/} Shannon, Iceland, Azores, Bermuda, Gander, and Montreal were listed as points that might be served to the United States. U.K. airlines had the right to operate beyond New York to the Bahamas, Cuba, Jamaica, Panama, a point in Columbia, a point in Ecuador, Lima, Santiago, St. Kitts, Antigua, Dominica, St. Lucia, St. Vincent, Barbados, Grenada, Trinidad and Tobago, and Guyana.

- The United States would not accept a route structure that omits significant rights beyond London.
- The basis for any analysis of a route structure is its economic viability, the question of whether a route can be operated economically.

Bermuda 2. The new Agreement (Annex 1-Route Schedules) with the United Kingdom provides for combination passenger/cargo services of U.S. airlines

1. unlimited rights beyond London (and Prestwick/Glasgow) for the operation of through flights (with transit traffic rights);
2. unlimited rights for on-line transfer of traffic at U.K. points for onward carriage;^{26/}
3. the addition of Anchorage, Atlanta, Dallas/Ft. Worth, and Houston as gateways for nonstop services to London;^{27/}
4. unlimited rights for "change of gauge" at U.K. or third-country points;^{28/}
5. unlimited rights to operate behind-gateway segments with or without change of aircraft or flight number;^{29/}

^{26/} See the Agreement, Note 1 in Section 5 of Annex 1.

^{27/} As the economic data indicated there was not sufficient traffic at Atlanta, Dallas/Ft. Worth, and Houston to support nonstop services at reasonable frequencies by two airlines (one U.S., one U.K.) competitive services will be phased in. Atlanta and Dallas/Ft. Worth may be served nonstop only by U.S. airlines until July 23, 1980; Houston may be served nonstop only by U.K. airlines until July 23, 1980. The United States may designate an additional city as a gateway for nonstop services after July 23, 1980.

^{28/} The Agreement, Note 6. By switching to smaller capacity aircraft as the flights get further from the United States, U.S. airlines may increase their operating efficiency. The British had earlier objected strenuously to this practice, although it has long been recognized in international aviation law.

^{29/} Ibid., Note 5.

6. continuation of a round-the-world routing through London and Hong Kong;^{30/} and
7. rights to carry local traffic between London and Prestwick/Glasgow on the one hand, and on the other Frankfurt, Hamburg, Munich, and Berlin, for an indefinite period; and Austria and Belgium until July 23, 1980; and the Netherlands, Norway, and Sweden until July 23, 1982.^{31/}

The routing flexibility provisions in the above list (i.e., points 1, 2, 4, and 5) apply not only to North Atlantic passenger services, but to all routes and services covered by Bermuda 2--for both Parties. Their potential value, however, is especially great for North Atlantic passenger services.

Much attention has been focused on what the United States gave up. We did give up fifth-freedom or local traffic rights from London. In 1946 our airlines could carry local traffic between London and 40 points as far away as India. Now our airlines can carry local traffic between London and 16 points--only 11 points after 1982. The fact is

^{30/} The round-the-world routing permits both east and westbound services from New York and/or Washington/Baltimore to London, Frankfurt, Turkey, Lebanon, Syria, Iran, Pakistan, New Delhi, Calcutta, Thailand, Hong Kong, Japan, and Honolulu, Los Angeles and/or San Francisco. Local traffic rights are unlimited. There is a restriction that not more than seven flights in each direction shall operate per week; the U.S. airline involved advised that this is not an effective constraint, because curfew, distance, and time zone considerations essentially preclude more than a once-daily frequency.

Many of the beyond-London points listed from the 1946 Agreement were to provide alternative stops for the round-the-world service. With longer range, higher capacity aircraft many of these are not needed. Further, paragraph 5 of Article 2 of Bermuda 2 provides that each Contracting Party shall use its best efforts to facilitate route rearrangements necessitated by armed conflict, political disturbances or developments, or special and unusual circumstances. This language has the effect of permitting one or more of the points served on the round-the-world service to be changed, should future circumstances so require.

^{31/} Two U.S. airlines may serve Frankfurt from London; only one U.S. airline may serve the other points cited from London.

that the local traffic rights are truly essential on the round-the-world service. We maintained these rights.^{32/} U.S. airlines have never operated to Leningrad, Tallinn, Riga, Kaunas, Vilnius, and numerous other points from London. They do not plan to do so in the foreseeable future. There is no point in paying a negotiating price to retain paper rights. At present the only U.S. flights operated beyond London are to Amsterdam, Berlin, Brussels, Bremen, Frankfurt, Oslo, Stockholm, and the round-the-world points. These are maintained, at least in the short term. With continued traffic growth, in a few years' time, local traffic rights will not be necessary for maintenance of direct services to these points.

In exchange for giving up traffic rights that we did not use and traffic rights that our airlines were willing to phase out, we gained the right to operate with transit and on-line connecting (but not local traffic) rights beyond London to the world. This allows U.S. flights to continue to the Continent, thereby extending the direct European services available from U.S. cities.^{33/} Furthermore, U.S. domestic segments can now be combined, however the airlines and the CAB deem appropriate, with U.S.-London segments to provide more direct services to more points in Europe from more U.S. cities.

As we reviewed the economic data, to include the sharp seasonality in traffic,^{34/} the major demand to London, but with a multiplicity of beyond-London destinations, the relative scarcity of direct services to the Continent from

^{32/} The 1946 Agreement contained some rather vague language that U.S. capacity on this route was to be related to U.S. true destination traffic requirements--a vagueness that has led the British in the past to challenge our operation of a daily B-747 between Hong Kong and Delhi. We have eliminated any possible British capacity challenge on the new round-the-world route, substituting instead a frequency limitation of seven flights per week in each direction.

^{33/} Recall that new routes agreed to in 1966 provided for very limited beyond-London operating rights. In Bermuda 2 we eliminated this restriction for Los Angeles, Miami, San Francisco, and Seattle traffic. Following the 1966 pattern and the July 1976 CAB opinion in the Transatlantic Route Proceeding, the new gateways of Atlanta, Dallas/Ft. Worth, and Houston would have had service only to London. Under Bermuda 2 they may have service to London and beyond to whatever European, Asian, and/or African points are granted by the CAB and the President.

^{34/} Daily traffic demand in the summer is more than twice as great as in the winter.

many major U.S. cities, and the relative economics of high capacity, wide-body aircraft,^{35/} it seemed best to maximize the opportunities for U.S. airlines to combine city-pair traffic flows. Profitable airline operations, reasonable fares for the public, and efficient use of fuel and other resources argue for reasonably high load factors on the long intercontinental segments. A means of achieving this, without forcing all traffic through one U.S. gateway, is to design a route structure that permits, for example, an airline to serve (1) U.S. cities A and B to London, continuing on to European city A, and (2) U.S. city C to London, continuing on to European cities B and C, with the right to transfer traffic between these flights at London. Thus, these two intercontinental flights provide

U.S. city A with

one-stop service to London,
two-stop service to European city A, and
connecting service to European cities B and C.

U.S. city B with

nonstop service to London,
one-stop service to European city A, and
connecting service to European cities B and C.

U.S. city C with

nonstop service to London,
one-stop service to European city B,
two-stop service to European city C, and
connecting service to European city A.

Of course, as the number of intercontinental flights increases, so does the number of possible connecting services to European or Asian points.

Bermuda 2 provides the potential for a significant increase in the quality of services available from major U.S. cities. The airlines, with the appropriate authority from the CAB, now have the flexibility to design expanded European route structures that offer more direct services to the public and more route segments to be flown by their flight crews. In

^{35/} Seat-mile costs are about 40 percent lower for wide-body aircraft compared with four-engine narrow-body aircraft.

this sense, I see Bermuda 2 as an expansive agreement-- benefiting the traveling public and the U.S. airline labor force, as well as U.S. airlines.

I am well aware that some cities that desired to be designated as gateways were not. We sought, as I said earlier, to have 22 U.S. cities designated as gateways. The British would not accept so many. Indeed, there is not sufficient traffic to support nonstop services from most, if not all, of these points which were not designated as gateways. Much as I regret not being able to include these cities in the list of nonstop gateways, two points should be made. First, with the unlimited right for U.S. airlines to operate behind-gateway segments, Bermuda 2 permits each of these cities to be served on a one-stop basis to London. Save for Baltimore, this is as much or more service potential as they have now. Second, the Civil Aeronautics Board is free to determine, if the public convenience and necessity so requires, an additional gateway for nonstop services to be operated any time after July 23, 1980.^{36/} Beyond this, additional cities may be added by an exchange of Notes between the United States and the United Kingdom, amending the Agreement.

The British Benefit. It was not possible to obtain the significant flexibility for U.S. route operations that we did without giving important benefits to British air carriers. Indeed, we sought to provide expanded services for the benefit of the public--largely an American public--and fair and equal competitive opportunities for the airlines of both sides.

^{36/} Consultation with the United Kingdom is required in the selection of this new U.S. gateway. The U.S. delegation could have selected this point. However, as it was not to be served nonstop at least until July 23, 1980, we felt the better course would be for the Board to make such a selection after a full evidentiary, public hearing, if it so chose.

The Baltimore situation was particularly difficult, for the Baltimore-Washington Airport has been replaced for transatlantic services by an airport that is not convenient to residents of Baltimore. In the British mind, there is not sufficient traffic to warrant service from two airports in so close proximity. The airlines serving Washington/Baltimore, however, remain free to divide their services between the two airports (BWI and Dulles) as they choose.

In my mind, the major benefits gained by the United Kingdom are

1. equal access to San Francisco and Seattle,^{37/}
2. new U.S. gateways of Atlanta, Dallas/Ft. Worth, and Houston,^{38/}
3. the flexibility to combine U.S. gateways as they choose,^{39/}
4. the right to operate from Continental cities through London to the United States without a change of flight number,
5. the right to serve Canada enroute to or beyond certain U.S. cities,^{40/}
6. the right to serve Mexico City beyond certain U.S. cities,^{41/} and
7. the right to serve Venezuela, Colombia, Manaus, and Peru beyond Atlanta and Houston.^{42/}

North Atlantic Routes: All-Cargo Services

Just as the September 1976 Policy Statement had broken new ground in stating that all-cargo operations should be provided for on their own merits, not simply as an adjunct of passenger operations, Bermuda 2 provides for the first

^{37/} If exercised, this access provides competitive services, Seattle-London, for the first time, and assures the continuation of two airlines, San Francisco-London.

^{38/} See footnote 27 above.

^{39/} U.K. airlines may not carry local traffic between U.S. cities.

^{40/} Specifically, Boston, Chicago, Dallas/Ft. Worth, Detroit, New York, Philadelphia, and Washington/Baltimore. Local traffic rights are included but will require Canadian approval.

^{41/} Specifically, Boston, Detroit, New York, Philadelphia, and Washington/Baltimore. Local traffic rights are included, but will require Mexican approval.

^{42/} Includes local traffic rights between Houston and Peru.

time in a major U.S. bilateral agreement separate route schedules for combination passenger/freight services and for all-cargo services. As noted earlier, the 1946 Bermuda Agreement had provided the same transatlantic routes and, for the most part, the same beyond routes and traffic rights for all-cargo services as for passenger services. Relatively little of this potential authority was ever utilized. And some of the authority was a source of conflict in recent years--a U.S. airline arguing that certain routings were consistent with the 1946 bilateral; the British arguing to the contrary.

Whereas for passenger operations, we sought to provide for the improved services for the public through the development of more direct routings, for all-cargo operations we sought to provide the airlines the flexibility to operate their routes in a manner maximizing their operational efficiency. Thus, an important aspect of the route annex is the provision that points on a route may be served in any order.^{43/}

U.S. all-cargo services may operate to London, Manchester, and/or Prestwick/Glasgow from any point through one of seven designated gateways (Boston, Chicago, Detroit, Houston, Los Angeles, New York, and Philadelphia)^{44/} and beyond to any point in Europe, Africa, or Asia, with or without a change of gauge at London or elsewhere. This ability to combine traffic flows, which is of great importance for the viability of freighter operations, provides greatly expanded routing flexibility for U.S. all-cargo operations. In addition, U.S. all-cargo operators may carry local traffic on their flights through London to Belgium, the Netherlands, Federal Republic of Germany, Turkey, Lebanon, Syria, Jordan,^{45/} Iran, and India. In particular, the all-cargo operators of the United States have greatly improved access to the major air freight markets of Frankfurt and the Middle East.

^{43/} In particular, this explicit provision for circuitous routings resolves an outstanding dispute a U.S. all-cargo airline had with the United Kingdom as to whether Paris might be served enroute from London to New York.

^{44/} Houston may not be served nonstop until July 23, 1980. These gateways provide for all presently operating or planned services.

^{45/} This is a new point, not provided for in the 1966 Amendment to Bermuda.

The British Benefit. Bermuda 2 provides valuable all-cargo route rights to the airlines of the United Kingdom. The British will now have routes from London, Manchester, and Prestwick/Glasgow (1) to Boston, Chicago, Detroit, Los Angeles, New York, and Washington/Baltimore with intermediate and/or beyond rights to Canada and beyond rights to Panama;^{46/} (2) to Atlanta and Houston, with beyond rights to Venezuela, Columbia, Manaus, and Peru;^{47/} and (3) to Miami with local traffic rights beyond to Mexico City.

Bermuda Routes

The 1946 Bermuda Agreement provided for U.S. flag services from New York, Washington, and Baltimore to Bermuda. U.K. airlines had the same route rights with Montreal being a permitted beyond point. In addition, for airlines of both countries, Bermuda was designated as an intermediate point between London and the U.S. gateways of New York, Chicago, Detroit, Washington, Philadelphia, Boston, and Baltimore. In 1966, Boston was added to the list of U.S. gateways authorized for U.K. carriers on turn-around service to Bermuda,^{48/} and Boston, Chicago, and Detroit were added to the list of U.S. gateways authorized for U.S. carriers on turn-around services to Bermuda.^{49/}

The U.S. objective was a route structure that was likely to be viable over time, would satisfy the requirements for air services to Bermuda, and would be a reasonable foundation for U.S.-Bermuda civil aviation relations when Bermuda achieves its independence. In particular, on April 18, 1977, we suggested that the route read: "The United States may designate a U.S. airline or airlines to serve the following route: (1) any U.S. point or points of departure; (2) Bermuda."

^{46/} Local traffic rights are included except between Los Angeles and either Canada or Panama.

^{47/} Local traffic rights are included except between Houston and Peru. Atlanta may not be served nonstop until July 23, 1980.

^{48/} Again, Montreal was an authorized beyond.

^{49/} The 1966 amendment continued the U.S.-Europe routing via Bermuda only for U.K. airlines.

We did not achieve quite that degree of flexibility, but we were able to write a route description that includes all points sought by U.S. airlines. Thus, Bermuda 2 continues the expansion of U.S. gateways to Bermuda with the addition of Atlanta, Miami, and Philadelphia, bringing to nine the number of U.S. gateways designated for nonstop services to Bermuda. In addition, provision is made for a route from Atlanta, Baltimore, Miami, and/or Washington via Bermuda to the Azores and two points in Continental Europe to be determined later.^{50/}

At present, no U.K. airline operates between Bermuda and the United States. Accordingly, we left open the U.S. gateways, should such a service be reinstated at some future time. Bermuda 2 provides simply for three U.S. gateways of the U.K.'s choice. Bermuda is no longer an intermediate point for any U.K. transatlantic route.

Bermuda 2 provides all-cargo routes parallel to those for combination services.

Caribbean Routes

Political changes in the Caribbean area, notably the independence of former U.K. territories and colonies, the economic development of the area, and the increasing demand by American vacationers were important factors in our analysis of a route structure appropriate for the many developing air markets in the Caribbean area. While many of the U.K. territories are developing their own air services--principally air taxi operations--most of the long-haul services are provided by U.S. carriers. The local economies depend heavily on U.S.-origin tourism. As a result, the islands do not wish to be beholden to U.S. airlines to bring in the tourists; they would like to see the development of their own services protected.

In the April 12, 1977 negotiating session, I set forth U.S. objectives with regard to Caribbean routes as follows:

The objective of the United States in this regard is to seek, firstly, maintenance of the existing pattern of air services. Shifts in service patterns could undermine certain major investments in tourism facilities. The second U.S. objective is an enlargement of the air service pattern in order to encourage the economic development of

^{50/} This was provided at the U.K.'s request. No U.S. carrier has expressed an interest in such a routing.

these island nations and territories. We should like to see the new bilateral agreement provide a means for developing an air route network in the Caribbean as extensive as can be economically sustained.

The balance we struck was for U.S. airlines to retain all of their presently operated authority, with some expansion, and certainly greater flexibility, and for U.K. airlines in the area to have greater access to the United States. For both combination and all-cargo services the U.S. routes read from any point or points in United States territory to all twelve of the U.K. points in the Caribbean area^{51/} with 17 possible intermediate or beyond points.^{52/} For both combination and all-cargo services the U.K. routes read from any of the twelve U.K. points in the Caribbean area with intermediate (or beyond) traffic rights^{53/} to/from Puerto Rico, the U.S. Virgin Islands, and any two of the following U.S. mainland points of each airline's choosing: Baltimore, Houston, Miami, New Orleans, Tampa, and Washington.

Pacific Routes: Combination Services

The 1946 Bermuda Agreement, as amended, included North, Central, and South Pacific routes between the U.S. West Coast and Hong Kong for U.S. airlines; North and Central Pacific routes between San Francisco and Hong Kong for U.K. airlines; and a London-New York-San Francisco route to Honolulu and the South Pacific for U.K. airlines.

In particular, U.S. airlines were permitted to operate from Los Angeles, San Francisco, Portland, Seattle and Alaska to/from Hong Kong via Honolulu, Midway, Wake, Guam, Manila, Tokyo, Osaka, Seoul, Okinawa, Taipei, and the Mainland of China, with operating and local traffic rights to any one or more of the following, if desired:

^{51/} These points are Antigua, Dominica, St. Christopher (St. Kitts)-Nevis-Anguilla, St. Lucia, St. Vincent, Belize, British Virgin Islands, Cayman Islands, Montserrat, and Turks and Caicos Islands.

^{52/} The intermediate/beyond points are Aruba, Bahamas, Barbados, Bonaire, Cuba, Curacao, Dominican Republic, Grenada, Guadeloupe, Guyana, Haiti, Jamaica, Martinique, St. Maarten, St. Martin, Trinidad and Tobago, and Venezuela.

^{53/} The intermediate/beyond points are Bahamas, Barbados, Cuba, Dominican Republic, Grenada, Guadeloupe, Guyana, Haiti, Jamaica, Martinique, St. Maarten, St. Martin, and Trinidad and Tobago.

Macao, the Mainland of China, the territories formerly comprised in IndoChina, Thailand, Burma, and Calcutta, connecting with the round-the-world routing from New York and London.^{54/}

The U.S. South Pacific route read from the four major West Coast cities^{55/} and Hawaii to Fiji via the Society Islands and American Samoa with beyond rights to Noumea, New Zealand, and Australia, at which point the route was split into two branches. The first branch came north to Indonesia, Singapore, Malaysia, Thailand, the territories formerly comprised in IndoChina, to Hong Kong, and all the points on the Central and North Pacific routes east of Hong Kong. The second branch permitted an around-the-world route via Indonesia, Singapore, Malaysia, Hong Kong, Thailand, Burma, Calcutta, and points on U.S. Route 2 other than London and Prestwick.^{56/} The effect was to provide, in addition to the London-Hong Kong-Tokyo round-the-world route operated by Pan American, a second U.S. round-the-world route across the Central Pacific (by omitting the Fiji stop) to Hong Kong, India, and Europe (but not Great Britain).

The United Kingdom had two routes: one from Hong Kong to San Francisco, via Tokyo, Manila, Guam, Wake, Midway, and Honolulu, with full local traffic rights to/from U.S. points; the other from London to New York (mandatory stop), San Francisco, Honolulu, American Samoa, Fiji, Australia, and New Zealand.

Long range, large capacity aircraft, development of local airline services, and changes in traffic demand patterns necessitated changes in the transpacific route structures. Our negotiating position was based on the potential for continuing significant growth in the Pacific ocean area in tourism and air trade. This market area has perhaps more growth potential than any other in the world. All of the littoral States can and should expect to benefit from this growth.

^{54/} Full local traffic rights were included, except that no local or stopover traffic was permitted between Hong Kong, on the one hand, and Osaka or Taipei, on the other. The Mainland of China could not be served on a single flight both before and after Hong Kong.

^{55/} Los Angeles, San Francisco, Portland, and Seattle.

^{56/} See footnote 22, above, for a list of the European and Asian points on U.S. Route 2.

Our route proposals in the Pacific area sought to promote this development and to expand the operational flexibility of U.S. carriers for serving this important market area. Such flexibility is required to provide even more beneficial trade and tourism opportunities. We felt that this approach would serve the legitimate interests of both parties.

The United States had a long list of objectives for route authority to Hong Kong, perhaps in part because four U.S. airlines are currently authorized to serve the West Coast-Hong Kong market. These objectives were:

- renewal of the principal round-the-world route through London and Hong Kong with unlimited local traffic rights;
- renewal of the principal route to Hong Kong via Japan (North Pacific route);
- renewal of the Central Pacific route to Hong Kong, even though this had not been operated for some years;
- expanded local traffic rights to/from Hong Kong, in particular the lifting of the local traffic ban as regards Taipei and Osaka, and unlimited all-cargo local traffic rights to Hong Kong;
- renewal of the South Pacific route to Hong Kong, although in the past this route had been heavily dependent upon local traffic for its viability, and had been dropped by the U.S. operator;
- maximum flexibility in U.S. gateways by having the route description read "from the United States;" and
- renewal of the transatlantic route to Hong Kong, although this had been voluntarily suspended some years ago by the U.S. operator.

The U.K. objectives were as straightforward in the Pacific market area, and as restrictive, as they were for North Atlantic markets. The basic U.K. proposals were associated with four routes for combination services and one route for all-cargo services:

For Combination Services

- Hong Kong-Tokyo - points in U.S. territory-Vancouver
- Hong Kong - Okinawa - points in U.S. territory
- London - Anchorage - points in Japan
- Tarawa - Christmas Island - Honolulu

For All-Cargo Services

- Hong Kong - Manila - Kaohsiung - Taipei - Tokyo-Osaka - points in U.S. territory

Each party would be entitled to designate one airline for each of these routes. Neither side should have any local traffic rights, and flight numbers used for services between any points on the routes listed above should be clearly differentiated from flight numbers used for connecting flights on other routes whether domestic or international.

Bermuda 2. We rather quickly accepted the continuation of the present Japan-London routing via Anchorage, obtaining for the first time an Anchorage-London route for a U.S. carrier with open behind-gateway authority. There was no reluctance to grant the Tarawa-Christmas Island-Honolulu routing for a U.K. carrier; no U.S. carrier sought parallel authority, and none is included in the Agreement. The routes to Hong Kong however proved to be very controversial.

The final resolution of these conflicting route objectives was, in my view, substantially to the benefit of the United States. We obtained the authority that was essential for maintenance of a strong schedule of U.S. services to, from, and beyond Hong Kong. At the same time we unfortunately could not obtain certain route rights we wanted very much to have.

As I said earlier, we did renew the round-the-world route through London and Hong Kong, with a frequency limitation of seven flights per week in each direction, but with no limit on capacity or local traffic between Hong Kong and any of the points on the route. We were not successful in arguing for retention of the second round-the-world route through Hong Kong. As this route had not been

operated since early 1975 and had very questionable economics, when fuel prices and aircraft size are taken into account. I did not feel that we could insist on having this route.

The principal U.S. route to Hong Kong has as U.S. gateways: Anchorage, Guam, Honolulu, Los Angeles, New York, San Francisco, and Seattle. Any other U.S. city may be served behind one or more of these designated gateways, as we have the same behind-the-gateway routing flexibility for Pacific and Atlantic routes. To increase the flexibility of U.S. carrier operations via Japan, we have changed the listed intermediate points from "Osaka and Tokyo" to "Japan." The previous ban on local Osaka-Hong Kong traffic and the open Tokyo-Hong Kong rights are now replaced by a limitation (not more than 14) on the number of weekly roundtrips with full traffic rights permitted between Japan and Hong Kong.^{57/} In addition, U.S. flights may operate via any point (e.g., Seoul, Taipei, Guam) en route to Hong Kong, without local traffic rights into/out of Hong Kong--the same open operational routing flexibility obtained for the London markets.

Similar to the beyond rights in transatlantic markets, Bermuda 2 provides operating rights for U.S. carriers to serve any point in Australia, Asia, or Europe beyond Hong Kong. Singapore has been added as a beyond point with local traffic rights, and Macao, North and South Vietnam, Cambodia, the Peoples Republic of China, Burma, and Calcutta have been deleted as points for which U.S. carriers have local traffic rights to/from Hong Kong. Thus under Bermuda 2, U.S. combination carriers may serve local traffic in the Hong Kong-Singapore and Hong Kong-Thailand markets, but with the restriction that not more than seven flights per week in these markets together may carry local traffic.

U.K. Benefit. Consistent with our objective of minimizing economic restrictions and maximizing routing flexibility and expansiveness of services available to the public, we agreed to a U.K. route from Hong Kong via Japan to Guam,

^{57/} This is one per day for each of the two U.S. combination carriers presently serving the market, i.e. the present level of operations.

Honolulu, and the U.S. West Coast,^{58/} with Vancouver being either an intermediate or beyond point.^{59/} As long as there is a frequency limitation on combination services of U.S. airlines between Japan and Hong Kong, U.K. airlines may not serve Japan with more than seven round-trip combination flights per week with full local traffic right to/from the United States.

Pacific Routes: All-Cargo Services

In the Pacific, there are slight differences under Bermuda 2 between all-cargo and combination service routes. In terms of gateways, U.S. all-cargo operators may serve Chicago and any of the combination gateways.^{60/} U.S. gateways for U.K. all-cargo services are the same as for U.K. combination services, except that any or all of the three West Coast points--Los Angeles, San Francisco, and Seattle--may be served each season. The same behind gateway and beyond or intermediate point flexibility in operating rights exists. There are, much to my regret, no local traffic rights for U.S. all-cargo services between Hong Kong and beyond or intermediate points. At the same time, although not offsetting this ban on local traffic, there are no all-cargo local traffic rights for U.K. carriers between the United States and beyond or intermediate points. We argued, very forcefully, I believe for unrestricted and then limited all-cargo traffic rights. We pointed out that Hong Kong merchants depend heavily on U.S. air services to move their products to the United States, and that the directional imbalance (6 tons eastbound for each ton westbound) means that local traffic rights are very important to the U.S. carriers' ability to maintain high levels of service to Hong Kong. The Hong Kong Government would not yield, however, in its desire to protect the developing regional services of Hong Kong's airline, Cathay Pacific.

^{58/} Only two of the three specified points--Los Angeles, San Francisco, Seattle--may be served during a traffic season. A designated airline, at its discretion, may change from one of these points to another each season, with not less than 90 days' notice.

^{59/} The Honolulu-Vancouver segment may not be served until July 23, 1982.

^{60/} I.e., Anchorage, Guam, Honolulu, Los Angeles, New York, San Francisco, and Seattle.

Designation

The 1946 Bermuda Agreement, and most U.S. bilaterals written since then, provide that each party may designate "an airline or airlines" to operate the agreed routes. There was no provision for consultation or delay; it took only one party to designate. This pattern changed when we accepted a side note to the 1966 amendment calling for consultation in the event that either party might wish to designate a second or subsequent airline over any route in the amended 1946 Agreement.^{61/}

As North Atlantic traffic volume has grown, the airlines have increased the size of their aircraft (lowering available seat-mile unit costs), increased frequencies up to one-per-day (with the obvious exception of New York)^{62/} and developed new gateways. The current Transatlantic Route Proceeding at the CAB is focused on the addition of new gateways (particularly in the South). There were no applications for additional carriers to be added to existing gateways.

For one airline to operate a daily B-747 round trip at a sixty percent load factor requires 175,000 passengers annually in a market. Only New York has more than 350,000 passengers annually to/from London.^{63/} The United Kingdom.

^{61/} The United States has taken the position that even if the consultations reached no agreement, we could make additional designations. The United Kingdom never accepted that view. Thus had the issue ever been forced, it is likely that an additional designation could have been made only in exchange for some concession. This is quite different from the unmodified right to make multiple designations.

^{62/} New York-London is the only transatlantic market in which an airline's frequency is more than daily. There each of the U.S. and U.K. airlines operate twice daily in the winter and three times daily in the summer.

^{63/} CAB traffic flow data for 1976 are:

<u>Between London and</u>	<u>Passengers in 1976</u>
New York	1,078,811
Los Angeles	337,300
Miami	256,434
Boston	252,736
Washington/Baltimore	252,282
Chicago	250,857
Seattle	100,869
San Francisco	95,000
Philadelphia	78,851

has argued forcefully over the past several years that multiple U.S. widebody frequencies per day (e.g., one each for each of two U.S. airlines) destroyed the viability of markets. In view of this and of the desire to provide reasonable competitive opportunities to furnish viable services, we agreed to review the traditional U.S. position that multiple airlines should always be permitted.

Our first proposal, put forth February 28, was that, as a matter of right, each side should be allowed two combination airlines on four transatlantic city-pair segments. In addition, to assure the availability of strong competition in large markets, a second carrier could be added, as a matter of right, in any market in which there were more than 600,000 on-board passengers in each of two consecutive years. Otherwise, designations of more than one airline for combination services on a nonstop transatlantic city-pair segment would be subject to bilateral agreement. For transatlantic all-cargo services and for all services in Bermuda, Caribbean, and Pacific markets our position was the traditional multiple designation--"an airline or airlines"--language.

The U.K. position for transatlantic services was straightforward--one airline of each side on each combination and all-cargo service route--including New York.

In principle, the United States had multiple designation in all markets to London, except for Miami and Seattle. In practice, however, at the urging of the Department of Transportation and the President, in response to the economic realities of traffic demand and fuel costs, the Civil Aeronautics Board approved a temporary agreement on January 30, 1975, providing, in part, that Pan American and TWA re-align their U.S.-London services so that

- they competed only from Boston and New York;^{64/}
- Pan American served Detroit and Washington exclusively; and
- TWA served Chicago, Los Angeles, and Philadelphia exclusively.

When the agreement was to expire, the airlines sought a five-year renewal, but gained its renewal until March 4, 1978.

^{64/} Both retained San Francisco-London authority, although neither operated it until April 1977.

Our initial position of four cities for dual designation provided the opportunity for competitive U.S. services at any city likely to support it.

The designation issue is inextricably connected to the capacity issues, which I shall discuss in a moment. If a market will only support two flights a day, it is very difficult for the market to be operated by three airlines at economic load factors. If the United States were to insist upon two carriers in such a market, questions could logically be raised as to how we would provide for fair and equal competitive opportunity for U.K. airlines:

- By having two U.K. carriers, in a market capable of supporting two, but not four airlines?
- By restricting each U.S. airline to three or four flights per week?

Airlines are under considerable pressure to operate daily service and to match the frequency of their competition, be it four, five, six or seven times a week. Dual U.S. designation thus seemed to compound potential excess capacity problems in many markets and certainly restricted the flexibility of carriers to restrain capacity in the off-season.

Another aspect of the designation problem that concerned me was its impact on service quality to cities such as Philadelphia and Detroit. For example, if both Pan American and TWA serve Boston-London, and Boston does not have traffic sufficient to provide reasonable load factors, for these flights and for British Airways, then the airlines must serve a point behind Boston to support the flight--a point such as Philadelphia or Detroit. This in turn means that Philadelphia and Detroit have one-stop services, which restrains the quality of service available to them and their development in turn as nonstop gateways.

Bermuda 2. The new Agreement provides substantially what we sought for a designation article. Certainly, it is closer to our initial position than to the U.K.'s. The designation article of Bermuda 2 maintains the basic principle of multiple designation, "each Contracting Party

shall have the right to designate an airline or airlines for the purpose of operating the agreed services on each of the routes specified, "65/ with certain limitations to apply to North Atlantic routes.

Transatlantic Designation for Combination Services. For North Atlantic combination services, each Party may designate two airlines on each of two nonstop gateway route segments of its own choosing and one airline on other nonstop gateway route segments, with certain exceptions, providing for the enhancement of competitive services. First, additional carriers may be designated if both sides agree. Second, if the on-board traffic volume exceeds 600,000 one way revenue passengers in each of two consecutive twelve month periods, in a market in which one party is permitted one designation, and if that party wishes to designate a second airline, then it may do so as matter of right.66/ Third, in a market with fewer than 600,000 passengers, if the airline of one party has a disproportionately large share (specifically, 450,000 one-way passengers annually), then that party may designate a second airline as a matter of right.67/ Fourth, if an airline of one party provides no service or only minimal service,68/ then the other party may designate a second airline so that competition might be preserved.

The immediate impact of the designation article is that after October 31, both Pan American and TWA will be permitted to operate from only two U.S. cities. At present,

65/ Bermuda 2, Article 3, paragraph 1(a).

66/ Statements to the effect that 600,000 passengers are required before a second carrier may be added are not strictly accurate. The volume of 600,000 is not set as a minimum value before a second carrier is added. Second carriers may be added to any market for which both sides agree; one side cannot block a second carrier of the other side in a market with more than 600,000 passengers.

67/ The thought here is that the airline of the other party must not be providing effective competition if its market share is such that the other airline has 450,000 passengers or more in a market no larger than 600,000.

68/ Minimal service in this context is defined to be fewer than 100 round trip frequencies in a twelve-month period.

both are serving three cities: Boston, New York, and San Francisco. Also, Pan American has announced its intention to resume competition with TWA from Los Angeles next March. Presumably, both airlines will be designated from New York. The second city to have dual U.S. airline designation can be changed from time to time. The Department of State has the responsibility for making the designations, with advice from the Civil Aeronautics Board.

Transatlantic Designation for All-Cargo Services. For all-cargo services, the status quo was preserved for all North Atlantic markets--three U.S. airlines (i.e., Pan American, Seaboard, and TWA). In addition, if the United Kingdom were to designate an airline to operate all-cargo services to Houston, then the United States could, if it so chose, designate an airline other than Pan American, Seaboard, and TWA to operate all-cargo services between Houston and London.

Capacity

As I have already indicated, provisions for determination of capacity proved to be the most difficult part of the Bermuda 2 negotiations. Differences over fundamental philosophy regarding capacity and carrier initiative led to a virtual stalemate for several weeks in March and again at the end of May. Early on, the United States had indicated its willingness to continue the basic language of the 1946 Bermuda Agreement as regards capacity:

- the air transport facilities available to the traveling public should bear a close relationship to the requirements of the public for such transport.
- there shall be a fair and equal opportunity for the carriers of the two nations to operate on any route between their respective territories. . . .
- in the operation by the air carriers of either Government of the trunk services described in the Annex to the Agreement, the interest of the air carriers of the other Government shall be taken into consideration so as not to affect unduly the services which the latter provides on all or part of the same routes.
- it is the understanding of both Governments that services provided by a designated air carrier under the Agreement and its Annex shall retain as their primary objective the provision of capacity adequate to the traffic demands between the country of which such air carrier is a national and the country of ultimate destination of the traffic. The right to embark or disembark on such services international traffic destined for and coming from third countries at a point or points on the routes specified. . . shall be applied in accordance with the general principles of orderly development to which both Governments subscribe and shall be subject to the general principle that capacity should be related:
 - (a) to traffic requirements between the country of origin and the countries of destination;
 - (b) to the requirements of through airline operations; and

- (c) to the traffic requirements of the area through which the airline passes after taking account of local and regional services.^{69/}

Subsequent to signing the Bermuda Agreement on February 11, 1946, the Department of State developed a so-called "standard" or model agreement, which expresses basic U.S. desired language for an agreement on civil air services. As regards capacity, the "standard" article is virtually the same as the Bermuda language above. On March 28, we formally proposed that the "standard article" language be the capacity article in Bermuda 2, with a special addendum, originally put forward on February 28, to assure that the principles set forth in the basic article were implemented in a reasonable manner and to take account of the special circumstances of North Atlantic air transport.

In general the U.S. proposal was that, if an airline desired to increase the number of regularly scheduled seats by more than 15 percent in a season, then the amount of that increase in excess of 15 percent should be reviewed by the airline's own government. Such a review was to have taken account of the public requirement for adequate capacity, the need to avoid uneconomic excess capacity, the development of routes and services, and viable airline operations. If the reviewing government agreed with its airline, then the proposal for the increase would be transmitted to the other government, which would either concur or request consultations. If the consultations produced no agreement, then the full capacity increase could take effect, but the airline would be subject to an ex post facto evaluation of its capacity performance. As long as an airline met its objective load factor, it could continue to propose increases in subsequent seasons. However, if its load factors were lower than forecast it could be restrained in proposing any capacity increase.

It should be borne in mind that this admittedly cumbersome mechanism would be applied, route by route, only in instances where an airline proposed to increase capacity by more than fifteen percent. It was advanced in an effort to meet British concerns over the potential of unrestrained, uneconomic excess capacity--"dumping" of capacity by U.S. airlines.

^{69/} Final Act of the 1946 Bermuda Conference, paragraphs 3-6.

The U.K. delegation however favored a more straightforward approach involving agreements among the airlines. Prior to each season, the airlines of each side would meet to agree on a common estimate of traffic in the season ahead (or, failing agreement, take the average of each side's forecast), determine the capacity appropriate to serve that traffic, and then divide by two--each side to provide one-half of the capacity agreed to be appropriate for the agreed forecast of traffic.

As indicated earlier, the British proposal as we opened the major economic negotiations on February 28 was totally unacceptable. It represented a direct reassertion of the earlier extreme U.K. position. We had already replied in two U.S. aide memoires rejecting the extreme U.K. position as an unacceptable basis for bargaining. I insisted we devote the two weeks of that negotiating session to North Atlantic capacity issues. We did, but little progress was made. At least a third of the discussion in the next round of talks was similarly devoted to capacity--alternative formulations were developed but little real progress was made.

The search for a suitable capacity mechanism consumed much of the decisive 5½ week session in London, that began May 16. On June 19, we tabled the seventh formal revision of our February 28 capacity mechanism, after finding nearly as many U.K. drafts unacceptable. Whether persuaded by the reasonableness of that ^{70/}proposal or by the immediacy of the negotiating deadline, ^{70/}the United Kingdom accepted the June 19 revision as the basis for the special provisions for determination of North Atlantic capacity that appear as Annex 2 of Bermuda 2.

Bermuda 2. The mutual commitment to fair competition is set forth ^{71/}clearly in the main article on capacity determination, ^{71/}which begins

The designated airline or airlines of one Contracting Party shall have a fair and equal opportunity to compete with the designated airline or airlines of the other Contracting Party.

^{70/} The 1946 Bermuda Agreement was to expire at midnight (Washington time) on June 21.

^{71/} Article 11 of Bermuda 2, which is entitled "Fair Competition."

Much of this article is a direct carryover of the U.S. standard article modernization of the 1946 Bermuda language.

There are, however, three important additions designed to enhance fair and equal competitive opportunity. First, there is a restraint on the capacity of an incumbent airline, when a new airline enters a market,^{72/} for a period of time not to exceed two years nor to extend beyond the time when the frequency of the inaugurating airline matches that of the incumbent. Second, recognizing that airline actions leading to excess capacity or to the under provision of capacity can both run counter to the interests of the traveling public, we agreed on a special mechanism for capacity review in North Atlantic markets. Third, in an effort to avoid future confrontations over capacity, such as those increasingly experienced with the United Kingdom in recent years, we proposed, and the United Kingdom accepted, explicit language to the effect that neither of us would unilaterally restrict the operations of the designated airlines of the other except by the terms of Bermuda 2 or by such uniform conditions as may be contemplated by the Convention on International Civil Aviation.^{73/}

In markets other than for North Atlantic combination services, the ex post facto concept of capacity of the 1946 Bermuda agreement is retained, "except that, where frequency or capacity limitations are already provided for a route specified," no additional limitations on capacity are permitted.^{74/}

^{72/} ". . .when a designated airline of one Contracting Party proposes to inaugurate services on a gateway route segment already served by a designated airline or airlines of the other Contracting Party, the incumbent airline or airlines shall each refrain from increasing the frequency of their services to the extent and for the time necessary to ensure that the airline inaugurating service may fairly exercise its rights. . ." (Article 11, paragraph 2)

^{73/} The United States is a signatory of this treaty, opened for signature at Chicago on December 7, 1944, 61 Stat. 1180, TIAS 1591.

^{74/} In particular, U.S. capacity on the round-the-world service (limited to seven frequencies per week in each direction) or on the Hong Kong-Tokyo segment (limited to 14 frequencies per week in each direction) are exempt from review.

Capacity on the North Atlantic. The resolution of long hours of negotiating regarding restraint on the capacity operated in North Atlantic combination services was that all discussion of capacity was to be in terms of frequency, not seats. (Thus, airlines are free to determine the type and size of aircraft they deem are most appropriate.) Only increases in frequencies are to be subjected to review, but an airline can always operate the number of frequencies it was entitled to operate the previous corresponding season plus an allowance for market growth,^{75/} which is, at a minimum, 20 frequencies in a summer season and 15 frequencies in a winter season. Furthermore, no airline may be compelled to operate an average of fewer than four flights per week in any season.

As in other aspects of the Agreement, we sought to regularize procedures in an attempt to lessen the potential for future disputes. Thus the capacity mechanism is to operate according to a time schedule based on the number of days prior to the start of a summer (winter) traffic season. This schedule is:

<u>Days Before Season Begins</u>	<u>Action</u>
180	Each airline files with both Parties its proposed schedules.
165	Deadline for amendment of airline filings.
150	If one Party (the Receiving Party) believes a proposed frequency increase by an airline of the other (the Requesting Party) is inconsistent with the "Fair Competition" article, it may object. ^{76/}

^{75/} Each airline on a nonstop gateway route segment is to make a forecast of market growth, expressed as a percentage. The average of these forecasts is the percentage by which each airline is entitled to increase its frequencies--without challenge--except that each airline is entitled to a minimum increase of 20 frequencies in a summer season, 15 in a winter season. These entitlements are cumulative. The uncontestable entitlement for each successive year depends on the entitlement for the present year, not upon the frequencies actually operated.

^{76/} No objection is permitted if the schedule involves an average of not more than four frequencies per week.

<u>Days Before Season Begins</u>	<u>Action</u>
120	Requesting Party reviews the increase proposed by its airline, and notifies Receiving Party of extent to which it considers the increase warranted.
105	If Receiving Party is not satisfied with Requesting Party's justification, it shall so state.
90	Both Parties shall consult, if necessary.
75	If there is no agreement in the consultations, then the proposing airline shall be entitled to operate the total frequencies to which it was entitled in the preceding corresponding season, plus an allowance for growth, as described a few moments ago.

While we could accept a mechanism for oversight of North Atlantic combination services capacity to be applied in the exceptional case of excess provision of capacity, we could not, and did not, accept a mechanism to be applied routinely. This is clearly stated in the Agreement.^{77/} Also, we view this entire mechanism as an experimental concept. We and the British are obligated to consult in the third quarter of 1981 regarding operation of this mechanism and to decide as to its extension or revision. In the event of no agreement, the capacity mechanism will continue in force until July 23, 1984, at which time it shall lapse.

^{77/} Paragraph 2 of Annex 2, "Capacity on the North Atlantic" reads: "The purpose of this Annex is to provide a consultative process to deal with cases of excess provision of capacity, while ensuring that designated airlines retain adequate scope for managerial initiative in establishing schedules and that the overall market share achieved by each designated airline will depend upon passenger choice rather than the operation of any formula or limitation mechanism. In keeping with these objectives, the Contracting Parties desire to avoid unduly frequent invocation of the consultative mechanism or limitation provision in order to avoid undue burden of detailed supervision of airline scheduling for the Contracting Parties."

I confess that the mechanism may appear cumbersome. At the same time I must say that I do not believe that it will operate in a way adverse to the public's interest in having ready access to transatlantic air services, nor in a way to restrain healthy competition. However, I believe it will cause the airlines to be a little more thoughtful in their capacity planning, and so increase the efficiency of their operations, which means, with independent initiative on the price side, relatively lower fares for the public.

Charter Linkage

The desirability of having Bermuda 2 cover both scheduled and charter services was agreed from the beginning of the negotiating process. I think both sides wanted to see Bermuda 2 developed as a comprehensive agreement and recognized that it could not be comprehensive if one-fourth of North Atlantic passenger traffic and services were not covered by the Agreement.

Earlier I indicated some of the difficulties encountered in our obtaining British acceptance of a renewal of the 1976 Memorandum of Understanding on charter services. That renewal itself consumed a lot of negotiating time, and did not represent quite as liberal a charter program as the United States would have wanted in a permanent agreement.

During the Fall and Winter, and indeed well into the Spring, it did not seem opportune to push for inclusion of charters in the basic scheduled agreement, for the British were talking constantly about a restrictive, tightly regulated regime for scheduled services. Thus it seemed more in the long range U.S. interest to keep the competitive stimulus of a relatively liberal charter regime free from the restraints sought on scheduled services. It was a tactical choice--and I believe we made the correct decision.

The capacity and route issues consumed so much of the available negotiating time that I believe the United States has a more liberal charter regime in U.S.-U.K. markets than we would have had if both types of services had been included at the outset.

Initial Proposals. On March 28, we submitted a draft article on charter services that (1) recognized the importance of readily available, low-cost air transportation to the traveling public and the tourism industries of each side, (2) contained a commitment to continue in force a Memorandum of Understanding (MOU) on charters,^{78/} and (3) underscored that commitment by stating explicitly that

Failure to reach agreement on a Memorandum of Understanding governing charters or on a renewal of such a Memorandum shall be regarded as sufficient cause for either Contracting Party to seek. . .renegotiation of this the basic agreement governing air service relations. . . .

The early British proposals for a linkage between charter and scheduled services placed more emphasis on the need to further the maintenance and development of a viable network of scheduled services, while also recognizing "the substantial and growing demand, from that section of the traveling public which is price rather than time sensitive, for air transport services at the lowest possible level of fares." The British sought to further the maintenance and development of efficient charter services, "but in such a manner as. . .(would) not impair the viability of the scheduled services."

With this rather sharp difference as to how the relationship between charter and scheduled services should be expressed in the text, we both more or less set the issue aside until May. Capacity and routes continued to occupy our attention.

The U.S. Delegation did not want to conclude in April or May a liberal agreement on charters--and we felt that we could if we pushed hard--with the likely prospect that the British might then argue for an off-setting, restrictive agreement on scheduled services. Our tactic was to push for as liberal an agreement on scheduled routes, capacity, designation, and fares as we could obtain. Then we would argue that this was far more restrictive than the United States really wanted, but that we could accept such scheduled provisions, if we had a compensating, liberal agreement on charters.

^{78/} This language had the prospect of assuring in the future at least as liberal a regime for charters as we had agreed to earlier that month for a one-year period. Cf. pages 22-23 above.

We were successful in avoiding British efforts to follow the same tactic in reverse order. Even though we did not obtain as firm a linkage between charter and scheduled provisions as we sought, I believe our tactic proved beneficial in obtaining some important modifications in the U.K. position on charters at the end of the negotiations.

U.S. Analysis. Because of the attention that has been focused on the charter aspects of Bermuda 2, I should like to share with you the statement we made to the British on May 30--when we were putting forward a comprehensive review of our position before making a determination whether that round of talks should end June 3, or whether the U.S. Delegation should remain in London to pursue final agreement against the June 21 deadline.

The United States believes it essential to link the new scheduled services agreement with an agreement on charter services. We believe that the United Kingdom has a corresponding interest.

We recognize that it will not be possible to complete an agreement on charter services before June 22. We suggest, therefore, that such an agreement be negotiated after we finish the negotiations on a scheduled services agreement.

The scheduled services agreement would be brought into effect provisionally, and when an agreement on charters is reached, the scheduled services agreement would be brought into effect definitively. There would have to be a cut off date, however, perhaps April 1, 1978.

Linkage of the Agreements

There are a number of ways for providing a link between agreements on scheduled and charter services. The United States is of the view that the preferable approach is to have a single agreement incorporating air services with specific provisions relating exclusively to charter services contained in an annex. Under this approach, the basic "non-controversial" articles would apply to both scheduled and non-scheduled services.

Alternative mechanisms for providing linkage would be (1) incorporating the charter service provisions among the main articles of the agreement, or (2) drafting a

totally separate (i.e., parallel) agreement to cover charter services with provisions in both the scheduled services and the charter services agreements that the termination of one would necessarily result in the termination of the other.

Policy Statement

In view of the concern that both of us have for the public interest and benefit associated with charter services, we suggest that the following language be added to the preamble of the air services agreement:

Believing that charter air transportation is essential to the consumer interest and provides desirable and healthy competition for scheduled air services;

Outline of a Charter Services Agreement

This paper sets forth the basic issues that should be covered in an agreement (annex) on charter services. The U.S. view of the desired general approach under each topic is indicated.

Charterworthiness. The agreement should provide that each Party establish charterworthiness standards for its own originating traffic.

Recognizing that differences exist between the citizens of each country with respect to work, vacation, and travel customs, the Parties should continue to work toward simplified and common charterworthiness criteria.

Each Government should retain the right to examine the charterworthiness of traffic originating in its territory.

Tariffs. Each Party should preserve the right to require the filing of tariffs for passenger or cargo traffic originating in its own territory.

The agreement should prohibit the establishment of rates for traffic originating outside of the destination country.

A disputes clause should be included to allow for consultations should either party believe that a specific charter rate is uneconomical, unreasonable, or unjustly discriminatory. If, after consultations, an agreement were not reached, the country of origin of the specific charter should control the tariff. The country of origin of the charter should also control specific aspects of the retail price charged the public (cancellation penalties, minimum tour prices, etc.).

Designation and Licensing. Each Party should designate, as it deems appropriate, carriers for charter service. The other Party should, consistent with its law, promptly grant the necessary licenses or permits. Individual flight approvals should not be required except in specified special circumstances (customs, slotting, etc.).

Capacity. Neither Party should regulate the charter capacity of the airlines of the other.

Markets. Designated carriers should be able to originate traffic at any point in the territories of the Parties, subject to country of origin rules, and to the maintenance of a reasonable balance of true originating traffic.

Other. The charter agreement (annex) should contain provisions addressing territorial coverage, cargo, and the relationship of scheduled and non-scheduled services.

Bermuda 2. In the ensuing negotiations we were for the most part successful. Charter air transportation was added to the preamble,

Believing that both scheduled and charter air transportation are important to the consumer interest and are essential elements of a healthy international air transport system,

the first time that it had been so included in a major U.S. air services agreement. Most of the "non-controversial" articles were drafted to cover both charter and scheduled services. Annex 4--"Charter Air Service" extends the coverage of these articles to airlines authorized to operate charter international air services.^{79/}

^{79/} Specifically, paragraph 2 of Annex 4 provides that Articles 1, 4, 6, 9, 10, 14, 16, 17, 18, 19, 20, and 21 of Bermuda 2 apply in their entirety to both scheduled and charter services, as do paragraphs 1, 3, and 4 of Article 2; and paragraphs 1, 2, 4, and 5 of Article 8.

Article 14 contains important policy language expressing, again for the first time in a major air services bilateral agreement, the facts that charter air services are part of the total air service system, and that their further development is required.

The Contracting Parties recognize the need to further the maintenance and development, where a substantial demand exists or may be expected, of a viable network of scheduled air services, consistently and readily available, which caters for all segments of demand and particularly for those needing a wide and flexible range of air services.

The Contracting Parties also recognize the substantial and growing demand from that section of the traveling public which is price rather than time sensitive, for air services at the lowest possible level of fares. The Contracting Parties, therefore, taking into account the relationship of scheduled and charter air services and the need for a total air service system, shall further the maintenance and development of efficient and economic charter air services so as to meet that demand.

Furthermore, Bermuda 2 contains explicit provisions on types of charter programs, as the Memorandum of Understanding on Passenger Charter Air Services, agreed to in March, is regarded as being incorporated in the charter air service annex for as long as that MOU remains in force.

A long-term agreement on charters should include, among other matters, progressive charterworthiness conditions, freedom of market access, arrangements for the designation and authorization of charter airlines which lead to the issuance of permits rather than individual flight licenses, minimization of administrative burdens, arrangements for all-cargo charter services, and capacity and price arrangements consistent with those contained in the present Memorandum of Understanding. While we did not have the time to negotiate these issues in the Spring, we did agree with the British that "the Contracting Parties shall enter into negotiations as soon as possible and, in any event, not later than 31^{80/} December 1977, to work towards the foregoing objectives." Should such negotiations not be

^{30/} Paragraph 3 of Annex 4 to Bermuda 2. The bilateral charter negotiations called for here are scheduled to begin in Washington, October 5-6, 1977.

completed by the March 31, 1978, expiration of the MOU, both sides have agreed to consult further "with a view to a continuation of liberal arrangements for charter air services."

Thus, Bermuda 2 provides for charters in the future on at least as liberal a basis as presently exists. Charters are included for the first time in the basic agreement on air services. The British are committed to negotiation of a comprehensive agreement on charter services, which likely will supplement or supercede the present Annex 4 of Bermuda 2.

At the same time the United States has agreed to work toward a multilateral arrangement for charter air services in the North Atlantic market. A liberal multilateral charter arrangement could provide an important expansion of charter services available to the American public. Commonality of rules could be an asset in the development and marketing of charter programs, thereby enlarging charter opportunities and increasing the competitive stimulus of effective, expansive charter programs.

Tariffs

The final major economic issue I should like to cover this morning is that of tariffs, the mechanism by which the governments accept the conditions for and the level of fares and rates charged on services between our two countries.

The tariff article proved not to be a major stumbling block--or, as we came to refer to difficult issues, reflecting my Florida upbringing, a stump. Both sides recognized that fares and rates should be cost-based and as low as feasible. We agreed further that the mechanism for determining fares and rates should provide a reasonable amount of time for governmental review of proposed tariff levels and timely notice to the public and retail sales industry. Both sides sought to remove differences of views on tariffs--particularly disagreement as to which tariff levels were legally in effect--as sources for future disputes.

The important philosophical difference in the tariff article of Bermuda 2 from the 1946 Bermuda Agreement is in the policy declaration:

The Tariffs charged by the designated airlines of one Contracting Party for public transport to or from the territory of the other Contracting Party shall be established at the lowest level consistent with a high standard of safety and an adequate return to efficient airlines operating on the agreed routes. Each tariff shall, to the extent feasible, be based on the costs of providing such service assuming reasonable load factors. Additional relevant factors shall include among others the need of the airline to meet competition from scheduled or charter air services, taking into account differences in cost and quality of service, and the prevention of unjust discrimination and undue preferences or advantages. To further the reasonable interests of users of air transport services, and to encourage the further development of civil aviation, individual airlines should be encouraged to initiate innovative, cost-based tariffs.^{81/}

For the first time in a major U.S. bilateral agreement, the tariff policy declaration focuses on the lowest level of fares and rates consistent with high safety standards and an adequate return for efficient operations, whereas the existing U.S. "standard article" language was:

All rates to be charged by an airline of one Contracting Party for carriage to or from the territory of the other Contracting Party shall be established at reasonable levels, due regard being paid to all relevant factors, such as costs of operation, reasonable profit, and all rates charged by any other airlines, as well as the characteristics of each service.

The agreement to encourage individual airlines to initiate innovative, cost-based tariffs is also new language.

These policy declarations, in and of themselves, do not change the fares charged the public. But they are important in setting the tone. The September 1976 International Policy Statement articulated U.S. policy on tariff levels. Now in

^{81/} Paragraph 2 of Article 12, Tariffs, of Bermuda 2.

Bermuda 2 the United Kingdom has joined with the United States in a joint declaration of tariff policy, which we believe to be in the best interests of consumers and of the air transport and tourism industries.

The significant procedural change in the tariff article from the 1946 Bermuda Agreement is specification of a timetable for tariff actions. In an effort to avoid eleventh-hour tariff disapprovals, which cause hardships for consumers and airlines alike, the following timetable was agreed to:

<u>Days Before Tariff Effectiveness</u>	<u>Action</u>
a. 105	Tariff agreements (e.g., IATA agreements) to be filed with each Party.
b. 75	Individual airline tariffs, if required, to be filed with each Party.
c. 60 days following step a, but not less than 45 days before effectiveness.	Each Party to have approved or disapproved tariff agreements, in whole or in part.
d. 30 days following step b, but not less than 15 days before effectiveness.	A Party may express dissatisfaction with a tariff filed by an airline of the other Party. Consultations may be requested.

In the event of an expression of dissatisfaction with a tariff, if no consultations are requested, or in the event of consultations which produce no agreement, the Party expressing dissatisfaction with a tariff may "take action to continue in force the existing tariffs beyond the date on which they would otherwise have expired at the levels and under the condition (including seasonal variations) set forth therein."^{82/}

^{82/} Paragraph 7 of Article 12 of Bermuda 2.

As a further step toward harmonization of tariff policies and avoidance of confrontations over effective tariff levels between governments and uncertainty for the airlines and the public, we have jointly agreed to establish a tariff working group, consisting of experts from each side in areas such as accounting, statistics, financial analysis, economics, pricing, and marketing. This group is to make recommendations by July 23, 1978, for review by the appropriate authorities in the United States and the United Kingdom, on load factor standards and evaluation and review criteria for North Atlantic tariffs. This working group provides the opportunity to develop low-priced, innovative fare structures with the United Kingdom, and an opportunity to push for their international acceptance.

This concludes my prepared testimony. I should be glad to answer any questions that you might have on these or other aspects of the recent civil air services negotiations with the United Kingdom.

APPENDIX 1: AN OVERVIEW OF THE U.S. ANALYSIS

British-American air transport relations have worldwide impact, because of the geographic dispersion of the territory of the United Kingdom and the magnitude of the traffic flow. In the five-year forecast period, 1977-1981, the total direct value of the U.S.-U.K. air transport and tourism market, measured in monetary terms, is estimated to be on the order of \$10.2 billion to \$11 billion.

Specifically, tourism spending, directly tied to the exchange of scheduled air services (but not including expenditures for transport) is estimated for the 1977-1981 period to be:

	<u>U.K. Benefit</u>		<u>U.S. Benefit</u>		<u>\$ Million</u>
	<u>\$ Millions</u>	<u>%</u>	<u>\$ Millions</u>	<u>%</u>	<u>Total</u>
U.S.-U.K. Atlantic	2432	72	868	86	3300
U.S.-U.K. Pacific	310	9	90	9	400
U.K.-U.K. Western Hemisphere	<u>650</u>	<u>19</u>	<u>50</u>	<u>5</u>	<u>700</u>
Total	3392	100	1008	100	4400

Air transport revenues for scheduled U.S. and U.K. carrier services are projected for this five-year period to be between \$5.8 billion and \$6.6 billion, divided as follows:

	<u>U.K. Revenue</u>		<u>U.S. Revenue</u>		<u>Total</u>
	<u>\$ Millions</u>	<u>%</u>	<u>\$ Millions</u>	<u>%</u>	
U.S.-U.K. Atlantic	2247-2847	97	2669-2847	76	4916-5694
U.S.-U.K. Pacific	25	1	602	16	627
U.S.-U.K. Western Hemisphere	<u>51</u>	<u>2</u>	<u>285</u>	<u>8</u>	<u>336</u>
Total	2323-2923	100	3556-3734	100	5879-6657

Total air transport revenues and tourism receipts are significant factors in the trade accounts of each nation each year. The net balance of earnings in these accounts favors the United Kingdom each year, and increasingly. From a benefit balance of \$160 million in 1976, the balance is expected to increase to \$250 million to \$400 million in 1981.

In terms of GNP, air transport revenues and tourism are more significant to the United Kingdom than to the United States:

	As Percent of 1975 GNP	
	<u>United Kingdom</u>	<u>United States</u>
Air transport revenues	1.0 - 1.3	0.3
Tourism receipts	1.5	0.1

From: Section I of "An Economic Projection: 1977-1981; Scheduled Air Services Between the United States and the United Kingdom," presented to the U.K. Delegation, December 1976.