

# Aviation Law **Introduction**

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Reference

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### General economic overview

According to the World Bank, market analysts forecast GDP growth of 1.2 per cent for 2017 and 2.3 per cent for 2018 for Latin America and the Caribbean, with the recovery being led by improvements in Argentina and Brazil. In Argentina, where President Macri's party gained seats in a mid-term election, the country is expected to grow by approximately 3 per cent in 2018. Brazil is expected to grow 2.3 per cent in 2018, after contracting for several years and weathering corruption scandals from the Lava Jato investigation. Mexico is forecast to grow above 2 per cent in 2018, although historically the final year in a President's term leads to more modest growth as investors assess the economic direction of the country under a new president. In Chile, former President Sebastian Pinera was re-elected to the highest office and the Chilean Central Bank has estimated economic growth for 2018 at between 2.5 and 3.5 per cent. Growth in the smaller countries representing Central America and the Caribbean is expected to remain at just below 4 per cent in 2018. Few analysts expect big improvements in Venezuela, the oil-blessed Andean country suffering from economic and political crisis. However, the price of oil is gradually creeping upwards (trading of West Texas Intermediate in late December 2017 was approximately US\$60 per barrel), and any increase will likely help the oil and gas producing countries of the region, albeit at the expense of the airlines in the region).

### Open skies agreements developments

Historically, the region has had a mixed approach to the liberalisation of international airline services, sometimes referred to as "open skies". Some countries (such as Chile) have embraced it, while others (such as Argentina and Venezuela) have historically maintained restricted markets (perhaps in order to protect a national flag carrier). In contrast, the EU and the US have embraced open skies, with the EU having open skies within its 28-country territory and the US having signed more than 110 such open skies agreements.

Some observers may be surprised that until recently the US and Mexico had a restrictive bilateral air services agreement, given the fact that cross-border trade and services has grown tremendously since the entering into effect of the North American Free Trade Agreement in 1994. The prior air services agreement was designed to protect the incumbent Mexican airlines, and

particularly the second largest carrier, Mexicana de Aviacion, which has since filed for bankruptcy and ceased operation. The prior bilateral agreement restricted cross-border air service to the "2+2" formula for city pairs involving the largest markets (eg, NYC–Mexico City) and a slightly more relaxed variation of "3+3", allowing three carriers from each country to serve smaller city pairs and tourist markets between countries. With Mexicana's bankruptcy, the basis for a more open treaty emerged with a key trade-off being the potential granting of Aeromexico, the largest Mexican carrier, a closer alliance with its Sky Team partner, Delta, which would give them antitrust immunity in exchange for the removal of the restrictions of US carriers to fly to Mexican markets. The new US–Mexico Air Transport Agreement was signed in November 2014, and entered into effect in August 2016. The new US–Mexico bilateral agreement is an important development in terms of the lifting of many of the restrictions found in the old agreement and hence is being characterised as an "open skies" agreement, although strictly speaking it does not allow for unrestricted fifth freedom passenger rights. As mentioned above, under the new agreement, regularly scheduled flights for passenger services are granted without restrictions for any number of airlines and in any city pairs (compared to the "2+2" or "3+3" formula under the old agreement). Moreover, cargo operators will have even more expanded rights and are authorised to operate flights to and from Mexico, and beyond to third-party countries (ie, fifth freedom rights).

Finally, the Delta–Aeromexico joint business agreement entered into effect, with the two airlines giving up highly coveted slots at Mexico City International Airport in order to get US DOT approval. The new alliance is likely to compete more vigorously and challenge American Airlines and United Airlines which both have a strong presence in the country.

In Argentina, President Mauricio Macri has espoused a more open aviation policy for Argentina, but any efforts at liberalisation will have to be weighed with support to state-owned Aerolíneas Argentinas. It remains to be seen whether the Macri administration will change the country's historic reluctance to adopting a more liberal open skies policy. However, as touched upon below, President Macri has carried out some liberalisation and modernisation measures in the sector.

The Brazilian government also continues to grapple with both ratification of an open skies agreement with the United

States and raising the foreign ownership limits for national airlines. However, in late December 2017, the lower house of Brazil's Congress approved the open skies agreement with the United States. The agreement, which was signed in 2011, still requires approval of the Brazilian Senate. The agreement has the support of local airlines LATAM, Gol and Avianca Brazil, which have announced, or otherwise are working on, alliances with their US partner airlines – American Airlines, Delta and United, respectively.

In particular, although the Brazilian Competition Authority CADE approved the American Airlines – LATAM application for a joint business agreement and antitrust immunity in October 2017, the US Department of Transportation's policy is to not approve such applications in the absence of an open skies agreement.

#### Argentina developments

In July 2017, an International Centre for Settlement of Investment Disputes (ICSID) tribunal ordered Argentina to pay more than US\$320 million to a Spanish travel group after finding the country failed to pay proper compensation when it expropriated two Argentine airlines. Specifically, the tribunal ruled against Argentina for “illegally” seizing the investments of Grupo Marsans affiliates Teinver SA, Transportes de Cercanías SA and Autobuses Urbanos del Sur SA. In particular, the tribunal found that Argentina was unjustified when it unilaterally imposed a particular way of determining the fair market value of the airlines' shares as it was being expropriated. Although the parties had agreed to allow an independent party to settle any differences, the ICSID tribunal found that Argentina failed to complete that valuation and instead began to formally expropriate the companies when the country's then-President Cristina Fernandez ordered the state to take control of the flagship airline Aerolíneas Argentinas SA and its subsidiary Austral-Cielos del Sur SA in 2008.

In May 2017, Argentina enacted the adoption of the Cape Town Convention under Law No. 27,375. The adoption of the convention represents an important milestone in the efforts of President Mauricio Macri to modernise the Argentine aviation sector and promote tourism and travel to the country. His administration had previously announced the granting of route authority to five low-cost carriers in December 2016 (Andes Líneas Aéreas, American Jet, Alas del Sur, Avian Líneas Aéreas and FB Líneas Aéreas).

Then, in September 2017, the government held another public hearing with the participation of six new carriers – Buenos Aires International Airlines, Grupo Lasa, Just Flight, Norwegian Air Argentina, Servicios Aéreos Patagónicos and Polar Líneas Aéreas plus Avian Líneas Aéreas, which had participated in the prior one. The seven airlines were subsequently granted a total of 503 new routes.

In particular, Norwegian Air Argentina was recently granted 72 domestic and 80 international routes. The airline also announced (i) a five-year investment plan totaling US\$4.3 billion over the next five to eight years and (ii) that its first flight will take place in February 2018 (Buenos Aires–London). Furthermore, Avian Líneas Aéreas (Avianca) started its regularly scheduled flights in November 2017 from Buenos Aires, Rosario and Mar del Plata, while FB Líneas Aéreas (known as Flybondi) announced it will start its flights in January 2018 from Cordoba and shortly thereafter adding flights from Buenos Aires in February 2018.

Meanwhile, state-owned Aerolíneas Argentinas is in the middle of a transformation to be more competitive and less dependent on government subsidies. Since President Macri has taken office, Aerolíneas Argentinas has significantly reduced government subsidies with the objective of complete elimination of government subsidies by the end of the Macri term.

#### Brazil developments

Brazil's Supreme Court ruled in May 2017 that international aviation treaties have priority over conflicting provisions in the country's consumer code in a decision that will cap lost baggage compensation and tighten statutory limitations governing when passengers can bring delay claims. In its ruling, the Brazilian Supreme Court confirmed the supremacy of international aviation treaties over domestic law where there is a conflict between the two on consumer disputes. Tension had existed between the country's Consumer Defence Code and the Warsaw and Montreal Conventions since the latter was ratified in Brazil in 2006, and Brazil had earned a reputation for being one of the most permissive countries in terms of allowing passenger claims for passenger delay and lost baggage.

In April 2017, Azul Linhas Aéreas Brasileiras SA (Azul), Brazil's third-largest airline by passengers, went public and raised over US\$570 million in an initial public offering in Brazil and in the US. Azul was founded in 2008 by JetBlue founder David Neeleman, and he is Azul's majority shareholder. Azul has approximately 750 daily flights serving approximately 100 destinations.

In July 2017, Odebrecht SA announced the sale of an important interest in the Rio de Janeiro international airport to China's HNA Infrastructure Co Ltd for US\$19 million. Odebrecht has admitted to being involved in Lavo Jato, the large Brazilian corruption scandal, and the company's financial difficulties are believed to have played a role in the sale. Moreover, the Odebrecht corruption scandal has since spread to other countries in the region.

From an aviation regulatory perspective, Brazil aviation authority ANAC issued Resolution 400/2016, which entered into force in March 2017. The resolution updated and consolidated a variety of passenger rights resolutions into a single act. One of the more significant rule changes was to formally allow airlines to charge for checked baggage, although the allowable weight for carry-on bags was increased from 5kg to 10kg.

President Temer's government is also supporting raising or eliminating the foreign investment limit in Brazilian airlines, which is currently set at 20 per cent of common voting shares. In contrast, many countries set this threshold at 49 per cent foreign ownership and employ some type of corporate control requirement by the national shareholder(s).

In the aircraft manufacturing sector, the Brazilian government has brought a WTO action against Canada in connection the dispute over alleged impermissible subsidies granted by the Canadian government to regional aircraft manufacturer Bombardier.

In December 2017, Boeing and Embraer announced that they are in discussion about a possible acquisition by Boeing of Brazilian regional aircraft manufacturer Embraer. The potential transaction is viewed as a response by Boeing to the joint venture on the C Series Program recently announced by Airbus and Bombardier of Canada. However, the Brazilian government holds a golden share in Embraer that enables it to block extraordinary transactions. An additional obstacle is that President

Temer has announced that although he supports additional investment in Embraer, he does not support a complete takeover. A joint venture between Boeing and Embraer is another alternative, which may give Boeing the additional product offering in the smaller aircraft that Embraer offers without triggering the more sensitive implications of a complete takeover.

#### Colombia developments

Colombia-based Avianca Holdings and a shareholder agreed in November 2017 to withdraw their lawsuits that were filed following disagreements over a planned partnership with US carrier United Airlines. Kingsland Holdings Ltd, Avianca's minority shareholder, sued the company and its controlling shareholder Synergy Group Corp earlier this year, seeking to stop the deal with United. In March 2017, Avianca countersued Kingsland, seeking dismissal of the lawsuit, which was filed in New York State Supreme Court in late February. Avianca, a member of the Star Alliance, has indicated that it continues to negotiate a strategic alliance with United Airlines.

#### Mexico developments

In December 2017, Mexico's Supreme Court announced it will rule on whether the country's competition authority (COFECE) can unilaterally regulate essential airport facilities, after the government's executive branch ignored measures the antitrust enforcer recommended to deal with allegedly anticompetitive airport slot allocation. COFECE claims regulations and guidelines adopted by Mexican president Enrique Peña Nieto in September 2017 addressing concerns about airport slot access violate its authority to regulate essential facilities and services. The new regulations address concerns COFECE first raised in 2015 about potentially anticompetitive barriers to market entry at Mexico City International Airport because of access to existing take-off and landing slots. COFECE believes the regulations do not match its recommendations, and has asked the Supreme Court to clarify the extent of its regulatory powers.

COFECE recommended legislative amendments followed a 2016 finding that Mexico City International Airport gave preferential treatment to incumbent airline Aeroméxico due to its historical monopoly, by holding slots for the airline it did not necessarily need, causing regular delays and organisational difficulties for both domestic and international rival airlines.

But the previously issued presidential decree, which was drafted by Mexico's transport ministry (SCT), did not include all 13 recommendations COFECE had proposed. The competition agency said it had previously rejected the transport ministry's proposed measures as they failed to address the anticompetitive effects of the airport's slot allocation procedures.

In contrast, SCT asserts that it has jurisdiction to address this issue and not COFECE. Interestingly, the new SCT rules are more aligned with international slot norms such as the IATA World Slot Guidelines (albeit not identical) than both the prior existing version and those rules proposed by COFECE.

Notwithstanding the inter-governmental dispute on jurisdiction, reforms as to the administration of slots at the Mexico City International Airport were critical in getting the US to grant Antitrust Immunity to Delta and Aeroméxico to operate under a joint business agreement under the new bilateral air services agreement between the two countries.

Venezuela currency developments and other challenges

The airline industry regularly has had to move adeptly to mitigate the region's periodic currency crises, and 2018 will

be no different, particularly in Venezuela. Currently, there is an estimated US\$4 billion of airline money trapped in Venezuela, subject to unheeded Central Bank requests for repatriation. In early 2017, Air Canada filed an ICSID claim against the government of Venezuela related to the inability to repatriate funds from Venezuela. Air Canada ceased flying to Venezuela in 2014 stemming from a dispute with the government over its inability to repatriate local ticket sales. Other major international airlines have either significantly reduced or eliminated flying to Venezuela for similar reasons.

#### US–Cuba aviation developments

The Trump administration has followed up on the President's 16 June 2017 speech in Miami regarding US policy toward Cuba by implementing new restrictions on trade with Cuba that became effective 9 November. The restrictive measures include (i) creating a new "Cuba Restricted List" in which the US State Department names 180 Cuban entities with which new commercial relations (after 16 June 2017) are to be prohibited, (ii) eliminating the individual "people-to-people" travel category, and (iii) requiring other travel for educational and religious purposes to be under the auspices of a group licensed by OFAC for that purpose. The rules are fairly in line with expectations and did not surprise Cuba watchers. Analysts had largely surmised that the May announcement would harm relations and trade between the two countries, but not roll back 100 per cent the policies of the Obama Administration.

The changes may most impact the travel and tourism industry between the two countries, in part because this is one of the sectors most opened by the Obama Administration reforms. US commercial airline and ferry service is still permitted, but lodging and tour costs are likely to increase due to the additional restrictions. Moreover, some people may be confused or put off by the new restrictions, and therefore select other destinations in the region. Finally, given the direction of these new rules, it is unclear that OFAC will issue new special licences to US hotel groups for the development of Cuban hotels, an area in which Cuba hopes to see more activity.

Similarly, several US airlines have eliminated or reduced service to Cuba, primarily but not exclusively to the provincial markets in Cuba. At this time, the US Department of Transport is currently considering how to allocate the newly returned route frequencies to Havana.

#### NAFTA developments

Although NAFTA does not regulate civil air service, its demise could affect cross-border trade between the US and Mexico in the long run. Both President Trump and USTR Trade Representative Robert Lighthizer have been critical of the NAFTA and the Mexican and Canadian negotiating positions in these rounds of talks. The culmination of the fifth round of the NAFTA renegotiation talks and the announcement of the extension of the talks through 2018 highlight several realities. The parties agree that modernisation of the agreement is necessary, particularly in areas either not addressed or only lightly touched upon in the current version (eg, electronic commerce and energy). Moreover, there appears to be progress in several technical areas. However, the Trump administration has adopted strong negotiating positions in a variety of areas that call into question whether a successfully amended NAFTA can occur. A reduction in cross-border commerce between the US and Mexico could negatively impact the demand for air services

between the two countries in the long run. Some analysts have predicted that President Trump is likely to announce withdrawal of the trade pact, which could generate court challenges in light of the congressional legislation enacted to implement the NAFTA.

#### Conclusion

The aviation sector has always played a key role in bringing nations and people together, while at the same time being at the crossroads of commerce and politics. 2018 appears to be no different, as Latin America with its young population and great potential for growth for the airline sector collides with various economic, social, and political forces from around the world. In particular, the entering into force of a new Open Skies inspired bilateral aviation between the US and Mexico, the congressional advancement of a similar agreement between Brazil and the US, and some preliminary but important steps by Argentina to modernise its aviation sector are all hopeful signs.



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Mr Pascal is the chair of the Americas practice group at Haynes and Boone, LLP and has extensive experience advising multinational companies, private equity groups, and individuals with their investments throughout Latin America and the Caribbean (over 35 jurisdictions), including but not limited to advising Latin American and Spanish companies in these types of matters. He has broad experience in corporate, financial, real estate, energy and aviation projects. Some representative projects include representing US real estate developers in all aspects of their Costa Rican real estate projects, including concession projects at the Papagayo Resort in Guanacaste, Costa Rica. He is the editor of the chapter on South American energy appearing in Matthew Bender's Energy Law and Transactions, and writes and speaks extensively on the energy sector in the region. He also has served as adjunct professor at SMU Dedman School of Law and University of Dallas' Graduate School of Business. Mr Pascal is also a leader in the international bar community, having served as chair of the international law section of the State Bar of Texas, where he headed a campaign to adopt the ABA Model Rule for Foreign Legal Consultants. He serves as the Chair Elect and Director for the World Services Group, one of the largest independent international law firm networks in the world with members in over 120 countries.

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