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LatAm Aviation Defies Protectionism

Latin American aviation defies protectionist winds.

BY LARRY B. PASCAL

Although President Trump has criticized free trade policies such as the NAFTA, in Latin America in general and in the aviation sector in particular, we continue to see a variety of important market opening and cross-border developments. In Chile (**Sebastian Pinera**), Argentina (**Mauricio Macri**), Peru (**Pedro Pablo Kuczynski**), Brazil (**Michel Temer**), we have seen the rise of right-of-center leaders who more openly embrace free trade policies that the US has historically promoted.

Open Skies Agreement Developments in Brazil

Brazil has historically been protective of its local airlines and has been reluctant to embrace the open market approach to international civil aviation known as “Open Skies.” However, the country, Latin America’s largest with a population of approximately 210 million people, has recently been badly hurt by the Lavo Jato scandal and economic crisis, and is looking for ways to encourage travel to and

investment in Brazil. In 2011, Brazil had signed an Open Skies Agreement with the United States, but the agreement remained subject to Brazilian congressional ratification. In late December 2017, the lower house of Brazil’s Congress approved an Open Skies Agreement with the United States. The Open Skies Agreement still requires approval of the Brazilian Senate. The agreement has the support of local airlines LATAM, Gol, and Avianca Brazil, which have announced or have potential alliances with their US partner airlines – American Airlines, Delta, and United, respectively. In particular, American Airlines and LATAM are pursuing a regional joint



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business agreement, which would entail antitrust immunity. Notably, the US Department of Transportation's policy is to not approve applications for antitrust immunity in the absence of an Open Skies Agreement. The Brazilian Competition Authority CADE approved the American Airlines – LATAM application for a Joint Business Agreement and Antitrust Immunity in October 2017, although other regulatory approvals remain including for the US and Chile.

In addition, Brazil's center-right government is supporting separate legislation to remove limits on foreign investment in Brazilian airlines, currently restricted to 20 percent of common voting shares. Such a development would be a startling change, as many countries that embrace Open Skies Agreements such as the US and the European Union, still maintain nationality limitations on ownership of local airlines.

New Airlines Approved in Argentina

In Argentina, President Mauricio Macri has espoused a more open aviation policy for his country, but any efforts at liberalization will have to be balanced with support to state-owned Aerolineas Argentinas. In particular, it remains to be seen whether the Macri Administration will change the country's historic reluctance to a more liberal Open Skies policy. However, President Macri has carried out some liberalization of market access and other modernization measures for the sector.

For example, in May 2017, Argentina ratified the Cape Town Convention, which is designed to facilitate aircraft financing. President Macri, of course, had previously settled the sovereign debt crisis with holdout bondholders, which approved the country's standing in international debt markets.

Also, the Macri Administration has granted new route authority to local airlines. In December 2016, it announced the granting of route authority to five new carriers (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, in which six new carriers (Buenos Aires International Airlines, Grupo Lasa, Just Flight, Norwegian Air Argentina, Servicios Aéreos Patagónicos, and Polar Lineas Aéreas plus Avian Líneas Aéreas which had participated in the prior route case) were subsequently granted a total of 503 new routes.

In particular, Norwegian Air Argentina was granted 72 domestic and 80 international routes. The airline also announced (i) a five-year investment plan totaling US\$4.3 billion



Norwegian Air Argentina was granted 72 domestic and 80 international routes, the author points out. (Photo: Norwegian Air)

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 departures from Buenos Aires in February 2018.

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

Mexico Open Skies Developments

Some observers may be surprised that until recently the U.S. 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 (e.g. 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 U.S. carriers to fly to Mexican markets. The new U.S.-Mexico Air Transport Agreement was signed in November 2014, and entered into effect in August 2016. The new U.S.-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 characterized 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 authorized to operate flights to and from Mexico, and beyond to third-party countries (i.e., fifth freedom rights). Subsequently, 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 obtain US DOT approval.

The Mexican market has recently seen strong growth in domestic and international aviation traffic in part caused by the rise of new low cost Mexican carriers which are

actively looking to take market share from bus companies within Mexico and expanding into the US as well.

Boeing – Embraer Developments

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.

U.S.–Cuba Aviation Developments

The Trump Administration had previously criticized the Obama Administration's historic opening to Cuba. President Trump followed up on this policy criticism by implementing in November 2017 new restrictions which complicate but do not eliminate travel from the US to Cuba. The restrictive measures include (a) creating a new "Cuba Restricted List" in which the U.S. State Department names 180 Cuban entities with which new commercial relations (after June 16, 2017) are to be prohibited, (b) eliminating the individual "people-to-people" travel category, and (c) requiring other travel for educational and religious purposes to be under the auspices of a group licensed by OFAC for that purpose. Several U.S. airlines have eliminated or reduced service to Cuba, primarily but not exclusively to the provincial markets in Cuba or by substituting small regional aircraft from larger narrow body aircrafts. At this time, the U.S. DOT is currently considering how to allocate the newly returned route frequencies to Havana, which continues to be an attractive or at least alluring market for US carriers.

Conclusion

The aviation sector is an area where US companies are strong, and combined with the shifting political winds in several large Latin American markets, may result in further liberalization and increasing cross-border transactions in 2018. In particular, Latin American countries are showing greater signs of recognizing that a vibrant civil aviation sector is an important piece of an economic development strategy for their countries.

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