LATIN LAWYER REFERENCE AVIATION LAW 2019

Introduction

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JANUARY 2019

LATIN LAWYER INSIGHT

General economic and political overview

In 2018, the Latin American and Caribbean region has experienced a modest downturn in economic activity owing to a variety of factors, particularly the circumstances faced by some larger markets in South America. According to the World Bank, the region is now expected to grow 0.6 per cent in 2018 and 1.6 per cent in 2019 (excluding Venezuela, the growth rates would be 1.6 per cent in 2018 and 2.1 per cent in 2019). Some of the main reasons cited by the World Bank for the weaker regional growth include the market turbulence and related currency issues that started in Argentina in April 2018, the growth slowdown in Brazil (which coincided with a presidential election campaign this year), and the continued economic troubles in Venezuela. Finally, the end of 2018 saw downward pressures on the price of oil, which negatively impacts many of the petroleum-dependent countries of the region.

2018 has also seen important political changes with right of centre candidate Jair Bolsonaro being elected President in Brazil and left of centre Manuel Lopez Obrador being elected in Mexico. Both leaders are expected to take their countries in different directions.

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 to protect a national flag carrier) (although Argentina has recently taken steps to permit more market entrants to obtain their operating certificate, thereby increasing local competition). 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.

However, the region took an important step forward when the US and Mexico adopted an Open Skies Agreement in August 2016. The adoption of the Open Skies Agreement was closely linked to the approval of the Delta-Aeromexico Joint Business Agreement, which was made possible by the willingness of the two airlines to give up highly coveted slots at the current Mexico City International Airport in exchange for regulatory approval of their joint business. 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 the cross-border market between the countries. Delta also took an increased non-controlling equity piece in the Aeromexico Group as part of the transaction.

In 2018, the cause of market liberalisation spread to Brazil where it finally obtained congressional approval for a long pending Open Skies Agreement with the United States. 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.

United - Avianca – Copa transaction

At the end of November 2018, United Airlines announced a three-way Joint Business Agreement with Avianca (Colombia) and Copa (Panama). The alliance will result in the three airlines sharing revenues, integrating service, and coordinating pricing and scheduling on their respective networks, excluding Brazil. As part of the transaction, United has agreed to loan US$456 million to a company controlled by Avianca's main shareholder, German Efromovich. The funds will be used to repay a loan from Elliot Management Corp, according to a report by the Wall Street Journal. The Joint Business Agreement is subject to regulatory approval in the countries. Avianca is one of the largest airlines in the region with a fleet of over 180 aircraft, but the airline is also heavily indebted. The agreement also addresses the somewhat contentious relationship with Avianca's second largest shareholder Kingsland Holdings Ltd by offering Kingsland a put option with United. The alliance agreement pointedly excludes Latin America's largest country Brazil, where Avianca has a separately operated Brazilian affiliate, and United also holds an 8 per cent interest in Azul. The announced alliance agreement is likely to sharpen the competition between the two other largest US airlines, American and Delta, which, as alluded to above, both have taken steps to get stronger in the region either via their own joint business agreements or acquisitions of minority interests in Latin American airlines (or both).

European – Latin American Developments

In August 2018, the European Union announced the formation of a new initiative called the EU–Latin America Cooperation on Civil Aviation. The four-year project, administered by the European Aviation Safety Agency contemplates US$8.2 million in support to encourage greater utilisation of EU standards in the region, increase European market access to the region and enhance the EU's reputation as a leader in the harmonisation of regulatory standards. The initiative is intended to address the challenges of inadequate infrastructure in the region, which if not resolved, could harm the overall benefit of civil air transportation to the region. To this effect, IATA has reported that in the region civil aviation supports 5.2 million jobs and US$167 billion in GDP. The initial meeting of this EU initiative was attended by representatives of Argentina, Brazil, Chile, Costa Rica, Antigua, Colombia, Mexico and Peru, as well as other oversight organisations.

Brazil developments

As mentioned above, the US and Brazil have approved their Open Skies Agreement. This means that the US now has Open Skies Agreements with three of the largest aviation markets in the region – Brazil, Mexico and Colombia. Moreover, this development could generate more impetus in Brazil for raising the limits on foreign investment, which at this time is 20 per cent. To this effect, there has been some discussion that Brazil might raise the limit to 49 per cent, which would make it very competitive with most major markets in the world. An increase in foreign investment limits for Brazilian airlines would help them with their capitalisation levels, particularly given the declining value of the Brazilian real, high local interest rates and a weakened economic environment.

Boeing – Embraer Transaction

In late 2017, Boeing and Embraer announced that they were in discussions 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 previously announced by Airbus and Bombardier of Canada. However, the Brazilian government holds a golden share in Embraer that enables it to block extraordinary transactions.

In July 2018, further news of the proposed Boeing – Embraer transaction was released. Some of those details of the proposed transaction included: (i) Boeing acquiring an 80 per cent interest in the commercial aircraft unit of Embraer (ie, ERJs, E-Jets and E-Jets E2, (ii) the commercial aircraft unit of Embraer being valued at US$ 4.75 billion, (iii) Embraer retaining its executive jet business and its defense business, and (iv) Boeing and Embraer separately exploring the establishment of a joint venture related to Embraer's KC-390 heavy lifter.

Chile

In 2017, Chilean ultra-low-cost carrier JetSMART, backed by US investment fund Indigo Partners, which also has investments in Frontier Airlines in the US, Volaris in Mexico, and Wizz Air in Eastern Europe, entered the Chilean market with a fleet of three Airbus 320 aircraft. Chile is one of the few markets in the region that permits 100 per cent foreign ownership of a local airline. In June 2018, JetSMART announced its plan to have a fleet of 18 aircraft by the end of 2019, resulting in an investment of US$490 million. It currently has a fleet of six aircraft. JetSMART joins LATAM Chile, Sky Airline and LAW in the local Chilean market. JetSMART also has local affiliates in Peru and Argentina.

Mexico developments

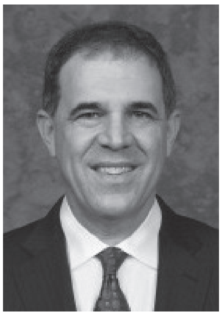
In Mexico, 2018 ushered in new uncertainty as candidate Manuel Lopez Obrador campaigned against the completion of the new Mexico City International Airport, which had been announced by President Enrique Pena Nieto in September 2014 at an estimated cost of US$13 billion. The new airport was to be built in the Texcoco area of the state of Mexico about 10km northeast of the current airport and contemplated an integrated operation, with the closing of the current international airport Benito Juarez. However, a public referendum was held in October 2018 at the insistence of then incoming President Lopez Obrador in which voters were asked to select between the two options – the Texcoco site and the Santa Maria Military Air Force Base (used in conjunction with the existing airport). The Santa Maria site is located 40km north of the existing Benito Juarez Airport. Analysts have asserted that the Santa Maria site is too close to the Benito Juarez airport and suggested it would result in reduced traffic for the Mexico City area. Nevertheless, voters selected the Santa Lucia site in the referendum and as a consequence President Lopez Obrador has vowed to suspend ongoing construction at the Texcoco cite.

NAFTA developments

After a prolonged period of uncertainty over NAFTA prompted by President Trump's criticism of the trade pact, in October 2018, the US, Mexico and Canada announced that they had reached an agreement on an updated trade agreement called the United States Mexico Canada Agreement (USMCA). The signing of the USMCA, which is still subject to ratification by each country's legislative branch, is likely to remove an important investment cloud that had emerged after President Trump took office.

Conclusion

It is ironic that while the world passes through a period of tension as to trade liberalisation and market access, the historically restricted Latin American aviation market has seen in recent years important advances in market liberalisation. These include Mexico in 2016 with the Open Skies Agreement with the US, 2018 with the US-Brazil Open Skies Agreement coupled with the potential for an increase in 2019 in the foreign investment limit, and the approval of the Macri administration of new start-up airlines in Argentina. (Ironically, although the United States is an industry leader as to Open Skies Agreements with foreign countries, it has a relatively low foreign investment limit which constrains new entrants with access to foreign capital.) These liberalisation measures should lead to greater investment, increased supply in the market and overall greater economic activity, particularly for markets in the region dependent on tourism.



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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.

He speaks English and Spanish fluently and regularly negotiates transactions in Spanish.

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Haynes and Boone, LLP is a 550+ lawyer, international law firm with offices across the US, London, Mexico City and Shanghai. The London office was established in September 2016, when the firm merged with Curtis Davis Garrard, LLP, the well-known boutique firm whose focus was in marine construction projects. As a result of the merger, the firm possesses enhanced global capabilities in the corporate, energy, international dispute resolution, financial services, and shipping sectors, with the London office providing English law advice and representation to clients in global business transactions and dispute resolution matters on a worldwide basis. Our London energy and shipping teams boast extensive experience, and an exceptional reputation, serving the offshore oil and gas and shipbuilding sectors. The firm has English law qualified dispute lawyers with a long and distinguished record of representing clients in court and arbitral proceedings, and in other forms of dispute resolution (for example, adjudication, expert determination and mediation). Our energy clients include major and independent oil and gas producers, offshore oilfield service contractors and equipment companies, large commercial lenders, and hedge funds and private equity firms operating in the energy sector. Our maritime clients include shipowners, charterers, engineering consultants, private equity and other financial services companies, shipyards, and insurers, covering the full spectrum of commercial shipping. For LNG projects, the office brings together project development, construction, transportation, and gas supply experience on behalf of developers.

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