

Aviation Law 2017

Introduction

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General economic overview

Simply put, the airlines in the region may continue to face turbulence in 2017. The International Monetary Fund (IMF) has recently revised downward its economic forecast for Latin American GDP growth to just 1.2 per cent in 2017. The major cause for the regional downgrade was a cut in the growth prospects for both Brazil and Mexico, the region's two largest economies. A bright spot for airlines in the picture remains the relative low price of oil, one of the airline sector's largest costs. However, this development (West Texas Intermediate was trading at approximately US\$55 per barrel at time of writing), if sustained, may still be offset to some degree by the moderation of economic growth in many of the largest markets in the region (if not outright contraction), brought on by declining sales of commodities to China, the continued slowdown of economic growth in Brazil, a slowing Mexican economy brought on by deteriorating trade relations with the United States, and overall stagnating economic growth in many industrial markets such as the EU and Japan.

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 touristic 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 that would give them antitrust immunity in exchange for the removal of the restrictions of US carriers to fly to Mexican markets.² 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 it strictly speaking does not allow for unrestricted fifth freedom passenger rights. As mentioned above, regularly scheduled flights for passengers combinations services are to be provided without restrictions for any number of airlines and in any city pairs (compared with 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).

Delta-Aeromexico alliance approved

In light of the new bilateral agreement between the US and Mexico, Delta and Aeromexico applied for and were granted antitrust immunity for service between these two markets. In a final order issued on 14 December 2016, the US Department of Transportation (DOT) granted conditional antitrust immunity to a proposed alliance agreement between Delta Air Lines, Inc (Delta) and Aerovias de Mexico, SA de CV (Aeromexico) with the two carriers agreeing to meet stringent conditions for DOT approval, thus removing the final barrier to the alliance.

The antitrust immunity from DOT allows Delta and Aeromexico to essentially operate as one company on cross-border flights by jointly setting fares, sharing revenues, and aligning flight schedules to ensure more travellers can make flight connections. In addition, Aeromexico and Delta will co-locate at airport terminals where possible. DOT approved the alliance because it concluded that the expected consumer

benefits – broader US–Mexico connectivity, improved network coordination, reduced travel times and improved efficiencies – outweighed the potential anticompetitive effects of eliminating competition between the two airlines.

Under the DOT’s final order, Delta and Aeromexico must give up 24 slot pairs at Mexico City’s Benito Juárez International Airport (MEX) and four slot pairs at New York City’s John F Kennedy International Airport (JFK), with the surrendered take-off and landing rights going to low-cost carrier (LCC) airline competitors.

Brazil Developments

Brazil has undergone a tumultuous period culminating with the impeachment of former President Dilma Rousseff. Brazil’s new President Michel Temer is perceived as more committed to free market reforms than his predecessor and has announced several privatisation initiatives, including Brazilian airports. At this time, Brazil is also considering raising (or possibly eliminating entirely) the maximum foreign investment in a Brazilian airline, a measure supported by President Temer and the local airlines, which are in need of additional equity capital (Brazil suffers from high interest rates).³

Although the Brazilian Congress has not ratified the proposed and more open Air Services Agreement, the US and Brazil have signed an agreement that would remove restrictions to flying between the two countries. Brazil may now be reluctant to expose its local airlines to additional competition from US carriers, but by comparison Mexico made the politically difficult (but arguably economically sound) decision to permit greater additional competition in exchange for the broader benefits that accrue to the economy of greater transportation ties. The challenging economic times in Brazil are putting pressure on privatised airport concessionaires (who are asking for economic relief in their contracts with the government) and local airlines (that are asking the government to reduce sales tax on aviation fuel). Finally, in December 2016, the Brazilian Civil Aviation Authority (ANAC) approved Resolution No. 400/2016, updating the General Conditions of Air Transportation and moving these rules a little closer to international standards. The new rules are scheduled to take effect in March 2017.

Currency developments and challenges in the region

The industry regularly has had to move adeptly to mitigate the region’s periodic currency crises, and 2017 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 January 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 airlines such as Lufthansa, GOL and LATAM have also ceased flying to Venezuela for similar reasons.

Moreover, local airlines that receive an important portion of their ticket sales in local currencies but have significant US denominated costs such as fuel and interest expense may be hurt by the projected rise in US interest rates projected in 2017. To this effect, the US Federal Reserve has suggested that future increases in US interest rates are on the horizon, and that an

ever stronger dollar may be on the horizon, which would put downward pressure on major regional currencies, such as the Mexican peso which was trading at almost 21 pesos to the US dollar at the time of this article.

Argentina developments

Argentina’s President Mauricio Macri has been working to strengthen the local economy since taking office, and the government suggested in December 2016 that it would like to see approximately US\$1.7 billion in investment by five low cost carriers (Andes Líneas Aéreas, American Jet, Alas del Sur, Avian Líneas Aéreas and FB Líneas Aéreas) over the next four years. In addition, Air Norwegian has announced in January 2017 its plan to form an Argentine unit to serve the Argentine market. Meanwhile, the CEO of Aerolíneas Argentinas, Isela Costantini, a former executive of General Motors Argentina, resigned her position at the state owned Aerolíneas Argentinas, purportedly over disagreements with the government as to the direction of the company. Ms Costantini had succeeded in reducing annual losses by half for 2016 during her tenure. Meanwhile, Avianca Group, a member of the Star Alliance, announced the acquisition of small commuter airline MacAir, a company owned by the father of President Mauricio Macri, foreshadowing the entry of a strong regional competitor for local actors LAN Argentina and Aerolíneas Argentinas.

Colombia developments

Avianca Holdings SA, based in Colombia and controlled by brothers Jose and German Efromovich, is looking to sell an equity interest to improve its balance sheet. Reported interested bidders include Delta, United and Copa. Interestingly, Elliot Management Group has reportedly extended credit to the Efromovich Group and granted collateral in the form of Avianca SA shares or assets as part of the transaction. Avianca SA holding is listed on both the Bogota and NYSE exchanges. Avianca offers access through Latin America, and in particular Colombia, Peru, Costa Rica and Ecuador through local units.

Mexico City International Airport Bond Offering

The Mexico City International Airport raised US\$ 2 billion in a bond offering to support the construction of a new Mexico City International Airport which is scheduled to open by 2019 and double the capacity in a first phase to 50 million passengers per year. Subsequent construction phases would increase capacity even further. A new Mexico City International Airport would address the slot constraints currently facing the airport.

US–Cuba aviation developments

2016 saw the commencement of widespread scheduled air service between the US and Cuba, a historically significant development for open relations between the countries, with the new bilateral aviation agreement authorising 20 daily round trip frequencies for scheduled service to Havana and 10 daily round trip scheduled frequencies for each non-Havana airport offering international service (Camaguey, Santiago de Cuba, Varadero, Santa Clara, Holguin, etc) and unlimited charter service frequencies. Many US carriers commenced or have announced service to Cuba (eg, American, United, Delta, Southwest, Jet

Blue, Virgin America, and Spirit) and analysts are watching how the Trump Administration will manage US-Cuba relations, and its impact on the aviation sector.

The bilateral negotiations had an additional element, as the Cubans fought for some form of parity in terms of market access for the state controlled airline Cubana (certainly a common feature in these bilateral negotiations), but still face the prospect of past legal judgments in the United States against its state owned airline Cubana or the State itself. Code sharing by Cubana with one or more US airlines (or third parties) may at the outset be a more viable approach. One can clearly understand how the negotiations can have broader political ramifications as the updated air services agreement is critical to Cuba seeing more US tourism (which incidentally still remains restricted to the 12 visa categories announced by the Obama Administration in December 2014). An ancillary question is how well Cuba enhances its aviation infrastructure and lodging capacity to cope with the expected increase in passenger travel to Cuba.

Conclusion

The aviation sector has always played a key role in bringing nations and peoples together, while at the same time being at the crossroads of commerce and politics. This year appears to be no different as this growing region 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.

Footnotes

2015 total trade in goods and services between the US and Mexico was over US\$580 billion and Mexico is the US's third largest trading partner according to USTR. See <https://ustr.gov/countries-regions/americas/mexico>.

Mexico City International Airport remains subject to slot controls until a new expanded airport can be built by a projected 2020.

Delta and KLM–Air France holds a minority interest in Brazilian carrier Gol (9.5 per cent and 1.5 per cent, respectively).

Brazilian carrier TAM forms part of the Chilean–Brazil Group LATAM. United and the HNA Group hold a minority interest in Brazilian carrier Azul.



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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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