

From de-regulation to re-regulation of the Airline Industry. An effective new approach towards the promotion of a competitive market?

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Pronunciation: 'che-l&m, is Latin for airspace or sky. The Romans began questioning the rights they had in the space above the land they owned and to how high above did that right extended to. Ad coelum et ad inferos, they discussed, meaning that their right of property would extend as high up to the heavens and down to hell.

From de-regulation to re-regulation of the Airline Industry. An effective new approach towards the promotion of a competitive market?

by Adriana Hernandez.

Deregulation and market liberalization – USA as a pioneer

The legal framework of the international air transport industry has suffered quite a dramatic and interesting evolution in the past fifty years. The United States of America (USA) can be considered as a pioneer in such area, particularly due to the approval of the Air Cargo Deregulation Act, the Airline Deregulation Act and the International Air Transportation Competition Act back then in 1977, 1978 and 1979 respectively. These liberalization measures designed to culminate in 1984 with the dissolution of the Civil Aviation Board (that fully controlled the domestic market in the country), removed the government's authority to set fares, routes and barriers to market entry, especially for new airline companies. This new approach towards the promotion of domestic competition and a policy of open skies, can be considered as the beginning of the deregulation model of the airline industry; such model has been eventually replicated first in Europe and then in several countries around the world.

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It is actually during the post-deregulation period that the low cost carrier (LCC) business model, originated in USA, started to flourish successfully. The LCC model in contrast to the full service carrier (FSC) model, looks to drive down the costs for the airline in order to offer reduced fares to the public, having in mind the stimulation of passenger traffic. Most of the common practices of this model includes: to rely on direct sales, to operate at secondary airports, to use a single aircraft type, to offer a single-class product by removing all non-essential features, to have high aircraft utilization rates and to keep labor costs low. As it happened with the de-regulation model, the LCC model became to be gradually adopted by different operators in the USA and abroad.

Both, the growth and spread of LCCs through time around the globe, had been promoted and encouraged by the market liberalization. It seems that the progressive deregulation in domestic markets along with several market-oriented air services agreements (ASAs), had become the new norm in the commercial aviation industry. This new scenario had provided a perfect opportunity for LCCs to replicate the so called Southwest Effect¹, which means the decrease in fares and the increase in the market volume due to the entrance of a new LCC. According to the International Civil Aviation Organization the total number of passengers carried on scheduled services increased a 6.4% from 2014 to 2015, reaching a total of 3.5 billion approximately. It is estimated that 28% of the total scheduled passengers last year, were transported by LCCs².

As it has been mentioned, deregulation and market liberalization have had a positive impact regarding competition scenarios by the entry of new firms and consequently a broader catalogue of service providers for the consumers. Nevertheless, they had also significantly altered what it can be considered as the traditional market structure, giving birth to different sorts of collaborations or alliances which may include: code-sharing, marketing and pricing cooperation, schedules coordination, as well as facilities sharing, among others. However, it has to be

1.- The 'Southwest Effect' works on international flights, too. May 8, 2016. Available at: http://www.nytimes.com/2010/11/21/business/21south.html?_r=0
2.- Continuing Traffic Growth and Record Airline Profits Highlight 2015 Air Transport Results. December 22, 2015. Available at: <http://www.icao.int/Newsroom/Pages/Continuing-Traffic-Growth-and-Record-Airline-Profits-Highlight-2015-Air-Transport-Results.aspx>

acknowledged, that these collaborations or alliances may actually turn anticompetitive, harming the industry as a whole and in detriment of the final consumer.

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Competitive vs. Anticompetitive industry?

Despite the benefits generated as a consequence of the de-regulation and the market liberalization, their effects shall not be overstated. According to the Competition Committee of the Organization for Economic Co-operation and Development (OECD), the airline sector still faces structural and behavioural barriers regarding the entrance and expansion of its players³. It is under this new scenario, plagued with concerns about potential anticompetitive behavior, that competition law enforcement became a key tool to assure that the final consumer actually enjoys the benefits of a real efficient air industry.

In the past few years, the application of competition laws and regulations in the commercial aviation, has been more frequent and comprehends a greater number of current issues such as: antitrust immunity, mergers and alliances, abuse of dominant positions, dumping and predatory pricing practices. In the same way, there has been a wave of industry consolidation resulting mainly from mergers and acquisitions, which has reduced competition in some regions. As it happened with the de-regulation and liberalization market practices, the consolidation trend has had a greater embodiment in the USA. Starting with eleven key players in 2005, there has been a reduction up to six by 2014, via mergers⁴.

Taking into consideration the geographical proximity and the historic political/commercial relationship between the USA and the United Mexican States (Mexico), the previously described phenomena and tendencies, naturally have a profound impact for our country. Just on August 21, a new chapter in commercial aviation between the USA and Mexico started with the entry into force of the new Air Transport Agreement, which is intended to allow the airlines of both countries to set their own prices and to provide their services in any routes with unlimited frequency, between the two nations.

Mexico was one of the largest countries that lack a modern and updated ASA with the USA. As Thomas Engle, USA Deputy Assistant Secretary of State for Transportation Affairs stated, the agreement eliminates the restriction to grant the cross-border transportation service to just two airlines. This liberalization is supposed to promote competition and therefore to keep the relevant fares affordable⁵. This perspective is shared by Alejandra

3.- Executive Summary of the discussion on Airline Competition. November 28, 2014. Available at: [http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP/M\(2014\)2/ANN4/FINAL&doclanguage=en](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP/M(2014)2/ANN4/FINAL&doclanguage=en)

4.- Era of airline merger mania comes to a close with last US Airways flight. October 16, 2015. Available at: <http://www.usatoday.com/story/travel/flights/todayinthesky/2015/10/15/airline-mergers-american-delta-united-southwest/73972928/>

5.- U.S. and Mexico Agree to Liberal Air-Service Treaty. December 18, 2015. Available at: <http://www.wsj.com/articles/u-s-and-mexico-agree-to-liberal-air-service-treaty-1450461412>

Palacios Prieto, Chairwoman of the Mexican Federal Economic Competition Commission (COFECE by its acronym in Spanish); for her the new ASA will boost competition and free market access on the cross-border flights market, which will be reflected in an increased availability of flights, greater connectivity and better prices for the benefit of consumers⁶

Main FSC and LCC conduct patterns in terms of competition. Forecast after ASA's execution.

There is one particular current event that concerns the competition authorities from the USA and Mexico: the new joint venture of two major players (Aeromexico and Delta). The request was filed independently before both governments, in order to coordinate prices, capacity and schedules; subject to the applicable legislation in each country. On one hand, on May of this year COFECE approved the \$1.5 billion joint venture subject to certain conditions, which include the assignment of eight pair of slots (schedules for landing and takeoff) in the International Airport of Mexico City⁷ (AICM for its acronym in Spanish). On the other hand, the USA Department of Transportation (DOT) required additional information about how flight slots are awarded at AICM, based actually on COFECE's report, before the DOT can decide whether to grant or not the antitrust immunity⁸. According to the Mexican aviation authority, both carriers will become in fact the bigger cross-border operator, reaching a 24% of market participation⁹. Up to this date, both carriers are still waiting for the USA government reply.

Regarding the strategy post-ASA for the "smaller" players, it should not be a surprise, that the main LCC in the USA, was the first airline to request three new routes for the market USA-Mexico. Even though its request was presented before the entry into force of the ASA, the relevant authorities will have to analyze it under the scope of the new ASA¹⁰. Surprisingly, the previously mentioned major players, expressed their rejection to this request arguing that it is illogic, it will affect other players and will provide several advantages to the petitioner.¹¹ Regarding the Mexican LCCs, they have externalized the interest in increasing their operations and flying new routes, taking advantage of the new ASA.

Even though the simple existence of ASAs is a formal recognition of a restrictive industry, it is crucial for both governments to assure that former regulatory barriers are not replaced by anticompetitive mergers, alliances or any other sort of agreements and practices. Analyzing the new scenario, this new and apparently natural consolidation trend obliges us to formulate the following questions: is it possible to conciliate a long term relationship between FSCs and LCCs? How long before the airline market can be considered as a mature one in terms of efficiency? What other forms of public intervention will be required to prevent a damage to the industry and the final consumer? The allegedly de-regulation it was just a legal fiction that is now being replaced by competition policies, laws and regulations? What is next for this global industry? What is next?

6.- *New Air Transport Agreement between the United States and Mexico, an example of a pro-competitive policy tool.* April 6, 2016. Available at: https://www.cofece.mx/cofece/ingles/images/Comunicados/Comunicados_ingles/COFECE-018-2016.pdf

7.- *Cofece autoriza con condiciones alianza entre Aeroméxico y Delta.* May 2, 2016. Available at: <http://www.elfinanciero.com.mx/empresas/alianza-entre-aeromexico-y-delta-air-lines-sujeta-a-condiciones-cofece.html>

8.- *DOT Wants More Answers On \$1.5B Delta, Aeromexico JV.* May 16, 2016. Available at: <http://www.law360.com/articles/796639/dot-wants-more-answers-on-1-5b-delta-aeromexico-jv>

9.- *Quieren dominar Aeromexico y Delta.* Available at: <http://www.bancomext.com/notas-de-interes/11649>

10.- *Línea de EU busca tres mercados.* June 26, 2016. Available at: <http://eleconomista.com.mx/industrias/2016/06/26/aeromexico-delta-se-abren-mas-rutas-southwest>

11.- *Aeroméxico y Delta se abren a más rutas de Southwest en México.* June 27, 2016. Available at: <http://www.americaeconomia.com/negocios-industrias/aeromexico-y-delta-se-abren-mas-rutas-de-southwest-en-mexico>

What next for the A380?

Last July, it was announced a production cut of the Airbus A380. Does this announce the death of the “Sky’s Giant”? After a quite successful introduction into the commercial sector in 2007, the demand for this Aircraft has gradually reduced over the years. There are two important factors to be taken into account. First, most of the airlines currently operating this aircraft come from Middle East and Asia – Pacific regions, where high volumes of mobility are needed; and second, the airlines are possibly changing their preferences in response to the current economic scenario. This means, they’re opting for smaller, more fuel efficient equipments. This same effect has affected the so-called “Queen of the Skies”, Boeing’s iconic 747. www.aviationweek.com August 24, 2016.

Third generation “Flying Eye Hospital”.

Orbis International, leading the Flying Eye hospital, is a non – profit organization striving to prevent and treat blindness worldwide. The new Boeing MD – 10 corresponds to the third generation of this project, and was donated by one of the most important shipment companies and a host of other companies provided financial help to execute the modifications and outfitting. This organization is based on the idea that form the 280 million visually impaired people in the world, 80 % just need glasses and 20 % can be cured if access to eye care can be granted. Finally, an important technical aspect of the aircraft modification is that the Flying hospital is based in a modular design and has it’s own supplies. So there are no electrical or other connections between the modular containers and the aircraft itself. This fact, makes it possible to remove, when necessary, the containers with no damage to the aircraft. www.aviationweek.com August 24, 2016.

AA’s new drone rules now in effect.

The FAA’s new regulations went into effect Aug. 29 for routine commercial use of small unmanned aircraft systems (UAS), more popularly known as drones or remotely piloted aircraft. You can fly your drone in Class G (uncontrolled) airspace without air traffic control authorization, but operations in any other airspace need air traffic approval. You must request access to controlled airspace via the electronic portal at FAA.gov/UAS, not from individual air traffic facilities. The provisions of the new rule – formally known as Part 107 – are designed to minimize risks to other aircraft and people and property on the ground, according to FAA officials. www.generalaviationnews.com August 29, 2016.

First flight to Cuba.

The flight on JetBlue, the first regularly schedules flight from the United States to Cuba in more than 50 years, was another important step toward normalized relations between two former Cold War foes. The scheduled air service was the latest in a string of important changes between the nations since president Obama decided in 2014 to restore diplomatic relations with Cuba. Cuba and the United States agreed to allow up to 90 daily round-trip flights between the two nations, the Department of Transportation said. Six Airlines have been approved for flights to nine Cuban cities other than Havana, but not all of them have announced their schedules. www.nytimes.com August 29, 2016.

Legendary 747 designer Sutter dies age 95.

Joe Sutter, who was dubbed “Father of the 747” by the Smithsonian National Air and Space Museum, has died at age 95. As the former chief engineer of Boeing’s 747, Sutter is credited with leading the birth of the first widebody airliner, which ushered in the globe-shrinking age of mass air travel. In later years with Boeing, first as vice president of operations and product development, and later as executive vice president for engineering and product development, Sutter was closely involved in development of both the successful and pivotal 757 and 767 models. In 1985 Sutter received the US National Medal of Technology from President Ronald Reagan and in 1986 he retired from full-time work at Boeing after a career spanning four decades. www.atwonline.com August 30, 2016.

DOT awards Havana routes to eight US airlines.

Eight US airlines have been granted permission by the US Department of Transportation (DOT) to begin scheduled flights between the US and Havana, Cuba, this autumn. The Aug. 31 announcement comes nearly two months after six US airlines were granted permission to fly to nine Cuban cities other than Havana, and six months after the US and the Cuban government signed an agreement to open up scheduled air service between the two countries. DOT said its principal objective was “to maximize public benefits, including choosing airlines that offered and could maintain the best service between the US and Havana.” www.atwonline.com August 31, 2016.

Mexico is Latin America’s biggest Private Jet Market despite economic odds.

Fabrice Roger, Jetcraft’s sales director for Latin America, has stated in a recent interview that Mexico is by far the main market in his territory—close to the booming U.S. market. “Mexico has a growing economy, even if its currency is as weak as Brazil’s real.” Speaking at LABACE before Dilma Rousseff’s presidential impeachment was announced, Roger—who is currently based in Mexico—said Brazil has the “double effect of weak currency and low confidence” whereas Mexico is “the key market for us; the fleet is growing and it has lots of buyers and sellers.” He said, “The Brazil market is quiet. But it’s temporary.” His view on Brazil is “there is a true need for private aviation here; Brazil has a higher number of billionaires than Mexico.” He reflected that there were more aircraft in Mexico but they tended to be older, while the Brazilian fleet was fewer in number, but its value is much higher still. www.ainonline.com August 31, 2016.

China, Europe & US in historic accord on aviation emissions.

China, Europe and the US have pledged to join the initial voluntary phases of the carbon-offsetting scheme designed to help international aviation achieve its goal of carbon-neutral growth after 2020. On Sept. 3, the 44 member states of the European Civil Aviation Conference (ECAC) committed to being part of ICAO’s global market-based measure (MBM) scheme “from the start”. On the same day, in a joint declaration ahead of the G20 economic summit in Hangzhou, the US and China said they “expect to be early participants” in the global MBM, also called the Carbon Offset and Reduction Scheme for International Aviation, or CORSIA. ICAO on Sept. 2 released a revised text of the resolution on the global MBM that will be presented for adoption by the ICAO Assembly in early October. This makes participation voluntary in the pilot and first phases of the scheme, covering 2021-26. The MBM will become mandatory only in the second phase, covering 2027-35, with exemptions for countries with only a small share of international aviation activity. www.atwonline.com September 01, 2016.

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CONTRIBUTORS

ADRIANA HERNÁNDEZ

Ms. Adriana Hernández, of Mexican nationality obtained her law degree at Instituto Tecnológico y de Estudios Superiores de Monterrey, Monterrey. She has postgraduate studies in International Law by Escuela de Graduados en Administración Pública y Política Pública, Monterrey. She also holds an MSc in Law and Finance with specialty in Law and Financial Regulation by Queen Mary University of London, London. She is authorized to act as an official translator for English-Spanish languages since 2011.

LANGUAGES: Spanish and English.

PRACTICE AREAS: Aviation Law, Aircraft Contract Law and Corporate Law.

mail: ahernandez@asyv.com


sierra

Prol. Reforma No. 1190 25th Floor,

Santa Fe México D.F. 05349

t. (52.55) 52.92.78.14

f. (52.55) 52.92.78.06

www.asyv.com / www.asyv.aero

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