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The aviation market in Latin America is growing fast, and with the gradual relaxation of the regulatory framework in the region there has been a clear trend towards airline mergers and consolidation. In this HFW Aerospace Bulletin, Jeremy Shebson and Giselle Deiro look at the varying approaches adopted by competition authorities in Latin America.

In Europe, Sue Barham and Charles Cockrell examine the temporary suspension last November of the extension of the EU Emissions Trading Scheme to aviation. We also round up recent judicial decisions within Europe concerning delayed and cancelled flights under EC Regulation 261/2004, including the approach taken to 'extraordinary circumstances', the time period for bringing claims, and the remedies available. Sue Barham also looks at the approval by the European Parliament in December 2012 of the draft EU Airports Slot Regulation, which, once approved by the European Council, will see trading in airport slots formally recognised at all EU airports.

More generally, Gordon Gardiner notes IATA's recent consultation on insuring the costs of defending corporate manslaughter claims, and Zohar Zik summarises the Consumer Rights (Payment Surcharges) Regulations 2012, which will restrict the ability of airlines and tour operators to impose debit and credit card surcharges from April this year. He also rounds up two recent cases of general interest.

In addition, the Bulletin contains information on forthcoming conferences and events. For further information about any of the articles, for aviation and aerospace issues in general, please contact one of the team, or your usual contact at HFW.

Giles Kavanagh, Partner and Head of Aerospace.

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Airline consolidation and competition law in Latin America

Introduction

Latin America has recently been labelled as “a bright spot for aviation”. Studies reveal that the aviation market in the region is growing faster than the world average, and that this trend is expected to continue.

Ten years ago, this was unthinkable. For many years, airlines in the region struggled to find competitive business models as a result of a rigid and fragmented regulatory environment. But with the gradual relaxation of the regulatory framework, there has been a clear trend towards consolidation.

This trend has exposed the challenges involved in cross-jurisdictional mergers in the region. Unlike the two major aviation markets (the United States and Europe), competition in Latin America is not regulated by a uniform legal framework whose application is entrusted to a single enforcement agency. This is a burden for airlines, which can be forced to obtain regulatory approval in each country in which they operate. It also creates the risk that the same transaction will be subject to different, and even conflicting, rules of interpretation.

We explore below some of the concepts applied by the competition authorities of some of the more important aviation markets in Latin America in order to illustrate the different approaches which are adopted.

Market definition

When looking at the geographical scope of a market, competition authorities in Latin America have normally followed a city-pair approach, restricting the analysis to overlapping routes. This has been the approach adopted by the competition authorities in both Argentina and Brazil. By contrast, Chile has taken a slightly different approach. In the context of the LAN-TAM merger, Chile’s competition authority considered that connecting services were ‘markets in themselves’. Accordingly, the potential impact of the merger was analyzed not by reference to routes to or from Chile, but rather by the routes which provided feeder traffic for the networks of LAN and TAM. In addition, for long-haul flights, the Chilean authority decided to follow a city-continent and city-country approach, considering Santiago-Europe and Santiago-United States as relevant markets.

When examining the market by type of product, relevant markets are typically defined as passenger or air cargo services (thereby excluding other means of transport from the analysis). Both the Brazilian and Chilean competition authorities have viewed distance from the city centre as the determining factor when assessing whether airports are substitutable. Those competition authorities do however differ with regard to the substitutability of direct and indirect flights. In Brazil, only direct flights have been considered interchangeable, whereas in Chile, a slightly broader approach has been adopted.

The LAN-TAM merger is perhaps a good example of the different outcomes which may arise from different interpretations of the same transaction. The different approaches of the competition authorities in Chile and Brazil were reflected in the remedies which each authority imposed: a significant number of conditions were attached to the approval of the merger in Chile, whilst there were only a few such conditions in Brazil.

Market power

When the Mexican Competition Commission analysed the proposed merger between Aeromexico and Mexicana, it concluded that the merged company would be able to set prices unilaterally or restrict output. In addition, the scarcity of slots was a high barrier for new entrants to the market. As a result of those two factors, the merger was rejected.

The degree of concentration in hub-to-hub routes and entry barriers as result of infrastructure constraints were also important concerns for the Chilean and Brazilian competition authorities in the LAN-TAM merger, which led them to impose remedies to mitigate the effects of the transaction.

However, concentration can actually be seen as stimulating competition. In the recently approved merger between Azul and Trip, the Brazilian competition authority believed that the transaction would improve competition, as the merger would allow the merged airline to compete with the market leaders, GOL and TAM.

Remedies

The array of remedies used by competition authorities in airline

merger cases in the Latin America region are similar to those adopted in other parts of the world. Typical measures include obligations to interline, to allow competitors to participate in loyalty programmes, and to surrender slots.

A slightly different approach was recently adopted by Brazil when assessing the Webjet-GOL merger. The airlines were not required to surrender slots to competitors, but instead the merged company is required to operate at 85% efficiency at Santos Dumont Airport in Rio de Janeiro. If these standards are not met, the company will then be forced to surrender slots.

Restrictions on cooperation agreements are also common. To fulfil the conditions imposed by the Brazilian competition authority, Azul-Trip will have to withdraw gradually from the code-share agreement Trip had signed with TAM. Meanwhile, following the LAN-TAM merger, the merged entity LATAM must choose between LAN's OneWorld and TAM's Star Alliance in order to comply with the conditions imposed by the Chilean competition authority.

Conclusions

Analysis of airline mergers by Latin American competition authorities increasingly draws on the thinking of the European and American competition authorities. Although this is a positive step, it does not eliminate the risk of competition authorities in Latin America interpreting the same concept in different ways. In summary, differences in the existing regulatory framework, disparities in the development of competition regimes, and little coordination between competition authorities are just some of the challenges faced by airlines in relation to mergers in Latin America.

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EU emissions trading scheme update - "stopping the clock"

Ever since the US-airline driven legal challenge to the extension of the EU emissions trading scheme (ETS) to aviation was rejected in December 2011, pressure on the EU from airlines, industry and governments mounted increasingly. By autumn 2012, the countries expressly opposed to the scheme numbered 23. Both China and the US had passed legislation prohibiting their carriers from complying with the scheme and the government of Saudi Arabia was widely reported to be in the process of doing likewise. The impasse intensified as the planned April 2013 deadline for the first submission of allowances under the scheme approached.

Perhaps bowing to the inevitable, on 12 November 2012 the European Commission announced it was recommending a 12 month "stopping of the clock" for ETS insofar as flights to and from non-European countries are concerned, in order to give time for the recent progress within ICAO to be built upon throughout 2013, culminating in the ICAO Assembly in September this year. Operators must return any free allowances they received in 2012 for such flights (and must buy replacement allowances in order to do so if they have already sold those allowances). Subject to that, no enforcement action will be taken before January 2014 against operators which do not comply with the ETS reporting and compliance obligations in respect of flights to or from airports outside the EU (which for this purpose includes the EEA states, Switzerland and Croatia). The proposal still needs to be approved by the European Council and European Parliament before it is legally binding, but that is not expected to be an issue.

Whilst temporary suspension is a sensible step in the face of express and threatened non-compliance by some major international aviation players, it raises many uncertainties. What will happen if ICAO does not achieve the progress towards a global solution for aviation emissions that is anticipated and required? Will enforcement follow immediately on reinstatement of ETS in January 2014 or will the EU consider an extension of the suspension at that stage to allow more time for ICAO? What of US and Chinese legislation prohibiting compliance with EU ETS by their airlines? That remains very much in place. What, also, of those carriers who do not favour the suspension on the terms proposed?

The suspension has not pleased all airlines and industry associations. Concerns are being expressed about the economic disadvantage to European carriers, especially low cost airlines who operate predominantly within Europe and find the whole of their operations still covered by EU ETS. The ECJ's Advocate General, in her opinion which preceded the Court's rejection of the US airlines'

legal challenge, had stated in terms that excluding non-EU airlines from ETS would give them an "unjustified competitive advantage over their European competitors", yet that is precisely the current position. In the meantime, questions are being raised by environmental groups about surcharges collected by airlines to cover their ETS compliance costs: whether those charges remain justifiable and whether they have provided airlines with a windfall profit.

The questions will continue and the pressure for a global solution now transfers to ICAO. One cannot escape the feeling that this particular can has simply been kicked down the road for a while. For further detail on this significant development, please see our briefing (http://www.hfw.com/publications/client-briefings/eu-ets-update-stopping-the-clock-where-do-we-go-from-here).

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EC Regulation 261/2004 update

We examine below recent judicial decisions on various different aspects of EC Regulation 261/2004 (Regulation 261).

Extraordinary circumstances

In its *Wallentin-Hermann v Alitalia* decision (dated 22 December 2008), the European Court of Justice ruled that a technical problem is not covered by the concept of "extraordinary circumstances", unless that problem stems from events which, by their nature or origin, are not inherent in the normal exercise of the activity of the air carrier and are beyond its actual control.

In a decision of 24 October 2012, a Dutch court in Haarlem did not award compensation to passengers as it considered that technical problems in relation to one of the engines on an aircraft, which caused the cancellation of the flight, had to be qualified as "extraordinary circumstances". Due to bad weather conditions, ice which had accumulated in one of the engines caused the tips of the blades within that engine to curl. The engine was examined, and had to be replaced. The Dutch court accepted the air carrier's arguments, and qualified the technical problem as an extraordinary circumstance under Regulation 261. The court decided that the air carrier had provided sufficient evidence to demonstrate that the technical problem had not arisen due to inadequate maintenance of the aircraft. The replacement of the engine and the substitution of another aircraft to operate the flight concerned did not fall under the scope of "reasonable measures" to be taken by the air carrier. The court also referred to the fact that flight safety would be endangered by the technical problem.

In another Dutch case, the Utrecht court held, in a decision given on 24 August 2011, that the air carrier had sufficiently proved that the cancellation of a flight was caused by extraordinary circumstances which could not have been avoided even if all reasonable measures had been taken. On landing, a foreign object damaged the blades in one of the engines, with the result that the aircraft could no longer be operated. Since no spare parts were available, replacement blades had to be flown in. As the repairs to the engine would take time, the carrier therefore decided to cancel the flight. The Utrecht Court based its decision on the following grounds: the carrier had sufficiently demonstrated that (i) the foreign object damage could not have been avoided by covering the engines, since an engine requires free airflow to function; (ii) repairing the engine was impossible since no spare blades were available; and (iii) no substitute aircraft was available.

The Amsterdam court reached a similar conclusion in its decision of 23 June 2011, when it concluded that FOD incidents have to be qualified as extraordinary and beyond the air carrier's control. This case concerned a flight that was cancelled due to a foreign object puncturing the inner lining of the tyre, eventually leading to tread separation and damage to the body and wing. The Amsterdam court was persuaded that this was an extraordinary circumstance, based on a report of the resulting damage and a report from Goodyear.

Obligation to provide care to passengers

In *McDonagh v Ryanair*, the Claimant's Ryanair flight from Faro to Dublin on 17 April 2010 was cancelled as a result of the closure of airspace due to volcanic ash. Flights between continental Europe and Ireland did not resume until 22 April 2010 and Ms McDonagh was unable to return to Dublin until 24 April 2010. During the seven days in which the claimant remained in Faro, Ryanair did not provide her with any care.

The claimant made a claim under Regulation 261 for the costs of meals, refreshments, accommodation and transport incurred whilst she waited in Faro. Ryanair sought to argue that, whilst care and welfare had to be provided when a flight was cancelled due to "extraordinary circumstances", the airspace closure went beyond that and instead constituted "super extraordinary circumstances" which relieved it of its care obligations under the Regulation.

On referral from the Dublin Metropolitan District Court, in a ruling given on 31 January 2013, the European Court of Justice held that there is no separate category of 'particularly extraordinary circumstances' which would exempt carriers from their care obligations under Regulation 261. Whilst the closure of airspace due to the volcanic eruption constituted 'extraordinary circumstances' which relieved Ryanair of any obligation to pay standard compensation under Regulation 261 for the cancelled flight itself, it did not relieve Ryanair from the obligation to provide care and assistance in terms of refreshments, accommodation and the like. The Court also confirmed that there is no temporal or monetary limitation on the care obligation (which was recognised to be particularly important when extraordinary circumstances persist over a long time). However, where a carrier does not provide the care required, affected passengers may only obtain reimbursement of costs that are proved to be necessary, appropriate and reasonable.

The European Court also held as a threshold issue (and in line with previous case law) that, in addition to the powers of National Enforcement Bodies to enforce Regulation 261, passengers are entitled to seek reimbursement through the courts of expenses they incur due to a carrier's non-compliance with its welfare obligations.

Limitation period for claims

In *Moré v Koninklijke* (22 November 2012), the European Court of Justice confirmed the applicable limitation period for bringing claims under Regulation 261. The claimant had reserved a seat with the defendant airline on a flight from Shanghai to Barcelona, scheduled for 20 December 2005. The flight was subsequently cancelled, forcing the claimant to travel the following day. On 27 February 2009, the claimant brought an action under Regulation 261.

The European Court of Justice rejected the defendant's argument that the 2 year limitation period under the Montreal Convention applied. It held that the measures laid out in Articles 5 and 7 of Regulation 261 fall outside the scope of the Warsaw and Montreal Conventions. Since the Regulation did not contain any limitation period of its own, the Court concluded that the limitation period should be determined in accordance with the domestic limitation periods of the relevant Member State.

Whilst not establishing new principles, this case is an important reminder to carriers of the need to be aware that different limitation periods will apply to claims under Regulation 261 depending on the Member State in which the claim is brought.

Limitation of remedies

In *Graham v Thomas Cook Group UK Ltd* (23 July 2012), the English Court of Appeal considered a claim made by a claimant who had booked a flight with Thomas Cook, which was subsequently cancelled due to the volcanic ash airspace closure in 2010. Although the claimant was given a refund, he also requested an alternative flight under Regulation 261. This was refused, and the claimant issued proceedings. Subsequently, Thomas Cook offered an alternative ticket as a goodwill gesture, which was accepted. However, the claimant continued proceedings claiming general damages for distress caused by the cancellation, a sum for wasted expenditure incurred by a third party and punitive or exemplary damages.

The Court of Appeal held that there was no right to the compensation which was being sought for a breach of Regulation 261. It concluded that, this being a simple contract of carriage, there could not be any claim for damages at common law for distress resulting from the cancellation of the flight. The Court of Appeal said that damages for disappointment and distress are allowed in contract law only in rare instances, such as there is a breach of contract to provide a holiday.

The judgment in *Graham* confirms that it is not possible to claim for an additional loss caused by a breach of Article 8 of Regulation 261 over and above the remedies which are provided under Article 8.

Revision of Regulation 261

Work within the European Commission and governments of Member States on long-awaited proposals to amend Regulation 261 is continuing, with draft amendments shortly expected to be published formally. Proposed amendments are likely to be significant and are expected to include: express drafting for delay compensation; an attempt to define "extraordinary circumstances" in more detail; and some limitation on the care and welfare obligations in certain circumstances. Once the draft revisions are in the public domain, we will issue further briefings on them but, in the meantime, carriers are urged to liaise closely with their industry associations to ensure that their input is made known to government and the Commission as the revisions are being finalised.

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Slot trading to be recognised throughout the EU

In December 2012, the European Parliament approved certain amendments to the EU airports slot regulation – the latest legislative step which will see trading in slots formally recognised at all EU airports.

Secondary trading and leasing of slots (involving the exchange of valuable slots for "junk" slots and payment of monetary consideration) has been prevalent in the UK for some years since a landmark court ruling in 1999. However such transactions are not widely practised elsewhere in Europe and, in some countries, are expressly prohibited. That is set to change when amendments to the EU slot regulation come into effect. Slots will be permitted to be freely traded in exchange for monetary consideration at all EU airports. The aim of the changes is to increase utilisation of slots at congested airports by enabling them to be transferred to airlines in the position to make best use of them. The changes to the law may also make it easier for new entrant airlines to gain more of a foothold at capacity constrained airports. The benefit, it is said, will be seen in increased passenger numbers at such airports. The European Parliament has however stepped back from some other elements of the proposed changes to the law which would have raised the slot utilisation criteria which must be met in order for an airline to gain "grandfather rights" to the slots; the requirement remains that slots must be used 80% of the time to qualify for grandfather rights.

Slot trades must be approved by the relevant airport slot co-ordinator, who will need to be satisfied that operations at the airport and connectivity between regional and hub airports will not be prejudiced. There is also a new provision in the regulation which enables EU Member States to provide for a portion of the proceeds of slot trades to be allocated to the airport. It is uncertain at this early stage what effect any such measures might have on the enthusiasm of airlines to engage in secondary trading of slots and on the valuation of these transactions.

The draft amendments still need approval from the European Council before being confirmed and coming into force. Once that happens, secondary trading in slots across EU airports is set to increase and, in exercising their new rights, carriers and their legal advisers will be mindful of the need to document these often valuable transactions carefully.

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Insuring the cost of defending corporate manslaughter claims

Airlines and product manufacturers across the world face potential exposure to corporate manslaughter claims, both internationally and domestically (for example, in the UK under the Corporate Manslaughter Act 2007 and the Health and Safety at Work Act 1974). Indeed, the increasing trend towards the criminalisation of air accidents puts at risk the "just culture" of the aviation industry, and

discourages the open reporting and communication of safety-related information.

Measures can however be put in place to reduce that potential exposure, such as by implementing effective policies and procedures. Airlines and product manufacturers may also seek to insure against the costs of defending corporate manslaughter prosecutions. The standard policy wording (in the form of AVN 108) currently extends coverage to include the reasonable costs and expenses which are incurred by the insured in defending corporate manslaughter claims, as well as the costs of any appeal against conviction (provided that there is a reasonable probability of success). However, for public policy reasons, the cover does not apply to any fines or other penalties which may be imposed as a result of conviction. It also does not apply to the defence costs and expenses of individual directors or employees.

In order to ensure the best available insurance cover IATA, on behalf of insurers, has recently consulted member airlines with a view to identifying relevant corporate manslaughter legislation in member airlines' countries, as well as the approach taken by the judicial authorities in those countries towards corporate manslaughter prosecutions. The results of that consultation will, in due course, be relayed to the insurance market, in an effort to ensure that the international insurance cover for the costs of defending criminal prosecutions is as suitable as possible.

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Consumer Rights Directive: Consumer Rights (Payment Surcharges) Regulations 2012

The Consumer Rights (Payment Surcharges) Regulations 2012 (SI 2012/3110) (the Regulations) have been published and will apply to all consumer contracts for the supply of goods and services entered into on or after 6 April 2013. The Regulations implement Article 19 of the Consumer Rights Directive (2011/83/EU), but are wider in scope because they also extend to cover package holidays, which are expressly excluded from that Directive.

In essence, the Regulations prohibit traders, such as airlines and tour operators, from imposing payment surcharges (such as for the use of credit or debit cards when booking) on consumers when the surcharge exceeds the cost to the trader of using the relevant payment method.

Traders will not be able to enforce a surcharge imposed in breach of the Regulations, and must refund any surcharges which have been paid. The OFT and other enforcement authorities must investigate complaints of non-compliance, and can apply for injunctions against non-compliant traders.

Crucially, the Regulations do not define what kinds of costs businesses may lawfully pass on to consumers. The Government recognises this and, to assist traders, it intends to publish guidance on the kinds of costs they can lawfully surcharge (although it has not indicated when this guidance will be published).

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Case law update

Two recent cases once again demonstrate the (often overlooked) need for parties not only to discuss in detail during contract negotiations the scope of each other's liability, but also the need to document that liability as clearly as possible.

In *ICDL GCC Foundation FZ-LLC v European Computer Driving Licence Foundation Ltd*, the Supreme Court of Ireland (applying principles of contract interpretation common to English and Irish law), considered the meaning of "gross negligence" in a limitation of liability clause. Although this phrase is commonly used by contracting parties, it is not a distinct category of negligence under English law (put simply, a negligent act or omission is negligence, however 'gross' it may be). The Irish Court held that gross negligence meant "a degree of

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negligence where whatever duty of care may be involved has not been met by a significant margin". Whilst of some assistance to draftsmen, there is clearly considerable scope for argument as to what is meant by a "significant margin". This lack of clarity should be borne in mind by parties when drafting a contract.

In *Mir Steel UK Ltd v Morris*, it was argued that the wording of an exclusion clause was insufficiently clear to exclude liability for negligence or intentional wrongdoing. At First Instance, the court held that the clause did exclude liability for negligence and intentional wrongdoing. On appeal, however, it was argued that the judge had given the exclusion clause a wider scope than the parties had intended. The Court of Appeal dismissed the appeal, despite the absence of clear words excluding negligence and intentional wrongdoing.

The Court of Appeal said that the approach to be adopted when construing contracts required the court to ascertain the meaning the contract would convey to a reasonable person, having all the background knowledge which would reasonably have been available to the parties in the particular commercial context in which the contract was made. The Court of Appeal therefore rejected the mechanistic application of any rules of contractual interpretation. Although the court concluded that liability for negligence and intentional wrongdoing was in fact excluded on the facts of this case, the judgment is a reminder that, in order to avoid potential future disputes, parties who wish to exclude liability for negligence should use clear, unambiguous wording to do so.

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News

On 23 January 2012, HFW was pleased to host BATA's Night Flights Summit at our offices in London, which attracted a wide attendance of over 60 delegates. Taking place just the day after the DfT published its consultation of future night flights policy for Heathrow, Gatwick and Stansted, this summit provided a timely opportunity for many different stakeholders, including government, mail and express delivery companies, airports, charter airlines, freight and logistics companies and tourism associations, to discuss the significance of night flights and the consequences of any increased restrictions.

Conferences & Events

International Corporate Jet & Helicopter Finance London 2013
London
(11-13 February 2013)
HFW Sponsoring
Edward Spencer and Zohar Zik presenting
Attending: Adam Shire, Jonathan Russell, Anthea Agathou and Daniella Cavendish

IATA Legal Symposium
Berlin
(17-19 February 2013)
Giles Kavanagh and Richard Gimblett presenting
Attending: Mert Hifzi, Pierre Fruhling and Sue Barham

Willis IATA AAPA Asia Pacific Aviation Insurance Conference
Jakarta
(6-7 March 2013)
Attending: Mert Hifzi, Keith Richardson, Peter Coles, Ashleigh Williamson and Kate Seaton

CHC Safety Summit
Vancouver
(18-20 March 2013)
HFW Sponsoring
Nick Hughes and Peter Coles presenting

Institute of Space Policy and Law
London
(22 and 29 April 2013)
Nick Hughes presenting

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