

# Maciel, Norman & Asociados

## Attorneys at Law

### AVIATION NEWSLETTER

A NEWSLETTER PREPARED BY MN&A'S AVIATION GROUP

SAN MARTIN 323, 19 TH FLOOR (C1004AAG) BUENOS AIRES, ARGENTINA

TEL: (+54 11) 4394-4535

FAX: (+54 11) 4394-8433

e-mail: aviationnews@mna.com.ar

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#### An economic outlook

The Argentine economy recovered strongly from its slump in 2001-2002. Though starved of credit and operating largely on cash, the economy is still benefiting from the devaluation of 2002. Helped by growth, taxes on commodity exports and debt default, the government feels like rolling in money as it can show a surplus (before interest payments) of 6% of GDP in 2004. However, such growth rate is expected to slow this year and some problems still exist.

Firstly, the long awaited solution for the country's default: Following 3 years of harsh negotiations, Argentina was able to make an offer in January which was accepted by 76% of the bond holders, and on April 1<sup>st</sup> it was due to issue US\$ 35.3 billion in bonds in exchange for US\$ 62.3 billion in old defaulted bonds in a swap aiming at enabling the country to return to debt capital markets. But on March 21<sup>st</sup> a New York court froze US\$ 7 bn in defaulted bonds at the request of a group of creditors and this decision was repealed only on May 12. So, it is expected that the government will now be able to complete the swap process of debt restructuring and to be in a position to resume its talks with the IMF on rolling over the 14.4 billion it still owes the Fund.

Secondly, the troubled Argentina's privatized utilities which saw their dollar fees converted to devalued (or "pesified") pesos, a situation that still exists, notwithstanding the government's initial promise of renegotiation within four months. Since that crisis rates have not budged, despite a rise in prices of over 50% and a 70% currency devaluation, a reason why some utilities have lodged claims with the ICSID, the World Bank's arbitration body. Up to date the position of the government and concessionaires remain apart, even though it is expected that the government's attitude will be more flexible after the medium term elections scheduled for October this year.

And lastly, a surge in inflation that brings headaches to both government and people, who have painful memories of it. In fact, consumer prices leapt some 4% in the first quarter of 2005. In a successful effort to resuscitate the economy after the collapse of 2002, the Central Bank pumped in money, printing pesos to buy dollars, thus also boosting exports by keeping the exchange rate undervalued. Conveniently, this allowed the government to impose export taxes to boost its revenues. But in the last three months of 2004 the monetary base rose considerably, real wages dipped and some labour unions started to demand further rises. So the Central Bank has begun to tighten the reins, buying back pesos, buying fewer dollars and raising interest rates. Many economists reckon these measures will curb inflation this year but at the cost of a slowing growth.

#### Bilateral Negotiations

Two important bilateral negotiations took place in 2004. On June 29, on the occasion of the official visit of the Argentine President to China, delegations representing the aeronautical authorities of the two countries met in Beijing with the aim to establish air services between the two countries. A Memorandum of Understanding was signed and a draft Bilateral Treaty was initiated, these instruments being possibly the legal framework in which **Aerolíneas Argentinas** has recently announced its flights to China (see last para. of **Domestic Airlines** below).

On 14 June 2004 delegations representing the aeronautical authorities of the United Arab Emirates and the Republic of Argentina also met in Buenos Aires, an occasion when a Memorandum of Understanding was signed and a draft International Air Services Agreement was initialed. The MOU included agreements on capacity and traffic rights, cooperative marketing arrangements and non-scheduled all cargo services.

#### The 2001 Cape Town Convention and Protocol

In April 2004 the Cape Town Convention on International Interests in Mobile Equipment entered into force and it is expected that the same happens with its Protocol on Matters Specific to Aircraft Equipment not later than 2006. Argentina was among the 58 States represented at the Conference where the two instruments were approved but has not yet ratified them. This, due to inconsistencies existing between principles and procedures of the Convention and Protocol and some principles of public policy of the Argentine legal system, which will only make such ratification possible under a number of declarations as permitted by the two international instruments.(\*)

#### Domestic airlines

In our June 2003 Newsletter we reported the critical condition in which the domestic airlines were, with four small shuttle airlines ceasing to operate and two major carriers, namely **LAPA** and **DINAR** together with **CATA**, another small airline, having to seek protection from creditors under bankruptcy legislation and stopping their flights. We also reported on the setting up of a new state-owned airline, namely **Líneas Aéreas Federales S.A. (LAFSA)**, which had to

(\* ) For further reference see **The 2001 Cape Town Convention and Protocol: An Argentine Perspective** by Rogelio N. Maciel (Air & Space Law, Kluwer, Volume XXIX, Number 3, July 2004).

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absorb **LAPA** and **DINAR**'s 900 staff. So a picture of the last two years would show **Aerolíneas Argentinas (AA)** carrying 80% of the domestic market and **Southern Winds**, **American Falcon** and **Aerovip**, a small carrier, carrying the remaining 20%. As for **LAFSA**, it never took off, as the government instead of acquiring planes to operate the many domestic and international routes granted to this airline- decided to enter into an agreement with **Southern Winds**. It consisted of **SW** painting the name of **LAFSA** on its own planes, incorporating much of the unemployed staff of the bankrupt airlines and receiving from the government a subsidy of some us\$ 3 million per month to pay operational costs, mainly fuel. The airline's finances were never sound, but this aid helped to improve its situation considerably from the operational point of view, as the consensus was that the company would never be able to reduce its past debts. But **Southern Winds** was then involved in a drug smuggling when it was made public that 4 suitcases with some 60 kg of cocaine flew unaccompanied on a **SW** flight which departed from Buenos Aires and arrived in Madrid in September 2004. The incident only broke in the media in February this year and one of the consequences of it was that the government decided to stop the abovementioned aid to the airline, which was thus deprived of that important source of funds and had also to apply for protection from creditors under bankruptcy proceedings by the end of March. As for **Aerovip** and **American Falcon**, the former had also to file similar bankruptcy proceedings and the latter did the same in May 2005.

These facts would have left **Aerolíneas Argentinas** as the only significant player in the domestic market, but at that point the Argentine government decided to usher **LAN**, the Chilean airline, into the domestic market. To fly domestic in Argentina was a long time aim for **LAN**, a dream which now comes true with the acquisition by the latter of **Aero 2000**, an airline which had no planes but was the holder of a concession to fly a few domestic routes. Having found some Argentine shareholders in order to formally comply with the requirement of the majority of capital in the hands of nationals, set forth by the Argentine Aeronautical Code, and further, having overcome the harsh opposition of the unions, **LAN Argentina** is due to start its operations in June with three domestic routes originally granted to **Aero 2000**. Authorization has been requested for 6 additional domestic routes plus expansion of the existing concession to operate international routes to Madrid, Miami, Montevideo, Santiago de Chile and Sao Paulo. **LAN Argentina** also announced plans to expand its international destinations to New York, Los Angeles, Milano, Rome, Mexico, Rio, Auckland and Sydney. Disagreement arose at a point between the Argentine government and the Chileans over the routes to be flown, as the former said it expected the new airline to cover some non-profitable flights to otherwise isolated destinations, and the latter argued that they are a private company that cannot be forced to subsidize certain routes without receiving, in exchange, incentives from the government. Anyway, **LAN Argentina** has announced its June 8 startup with three daily flights to Cordoba and two to Mendoza, operating two B737-200s which will be six by the end of July.

Another acquisition of a local bankrupt airline by local and foreign investors might also be in progress as this Newsletter was being sent to print.

On the same day **LAN** announced the acquisition of its Argentine

subsidiary, **Aerolíneas Argentinas** made public the details of the renewal and enlargement of its fleet with the acquisition of two B737-500s and two B747-400s, and also announced that it plans to start flights to Beijing and Shanghai via Madrid. **Aerolíneas** also said that it plans to build hotels and tourism facilities in the interior of Argentina and to quote its shares at the Buenos Aires Stock Exchange in order to capture local investors for its expansion plans. To complete the picture, it should also be mentioned that its Chilean subsidiary, **Aerolíneas del Sur**, started domestic flights in that country in 2004.

### International airlines

During the last year or so, it has become evident that international airlines have turned their focus again on Argentina as a tourist destination. The Argentine crisis that followed the debacle experienced by the air transport industry after September 11, 2001, seemed to start reverting. In the last 18 months, **Air Canada**, **Delta** and **Mexicana**, resumed their flights to Argentina after having stopped flying here as a consequence of the crisis. Other airlines, such as **Air Comet**, **Air Madrid**, **Lan Peru**, **Lan Ecuador**, the Brazilian **Gol**, the Chilean **Sky** and the Uruguayan **Uair**, started their flights to this country. And 11 other companies which had never interrupted their operations to and in Argentina significantly increased their flights, such as **Aerolíneas Argentinas**, **Air France**, **Alitalia**, **American Airlines**, **Copa**, **British Airways**, **Iberia**, **Lan**, **TAM** and **United Airlines**. The increase in international flights has doubled that of domestic flights, as local air transport fares are not affordable to middle and low income population. Finally, mention should be made of **Continental Airlines**, which at the end of April announced that it had submitted an application to the US Department of Transportation for approval of daily non stop flights from Houston to Buenos Aires. If approved, flights could commence in November this year.

### Airports

Argentina lost the Category 1 status granted by the USA's Federal Aviation Administration in 2002 having to stay since then in Category 2 which restricts the number of flights that the country's airlines can operate to the United States. Argentina then entered into a cooperation agreement with the FAA in order to reinstate the international standards and recommended practices for aircraft operations and maintenance established by the ICAO. As this agreement ended in May 2005, the country would now theoretically be in a position to be upgraded to the much priced Category 1.

As for **Aeroparque**, the Buenos Aires's metropolitan airport, these facilities are currently awaiting an environmental impact study to be completed, to then go ahead with a mega project which includes a 400 mts extension of the runway, widening it as well as taxiways and a complete rearrangement of the surrounding road and rail network. This project could be concluded in a 24 to 30 month time and, once completed, **Aeroparque** could be recategorized as an international regional airport and will work in tandem with **Ezeiza** on flight distribution.

The company concessionaire of the 33 main Argentine airports also announced that it would be investing 140 million pesos in its airports system this year.

If interested on further information, contact us at the following address: [aviationnews@mna.com.ar](mailto:aviationnews@mna.com.ar)