



Open Skies: A View From the Ground
How the Airline Industry is Changing, and What it Means

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The Aircraft Mechanics Fraternal Association (AMFA) represents nearly 5,000 mechanics and related at Southwest Airlines (SWA), Northwest Airlines (NWA), Alaska Airlines (ASA), Horizon Air, and Mesaba Airlines. Given the history of large-scale mergers in the airline industry – American/TWA, USAir/America West, for example – AMFA is of the view that the recently enacted Stage I Open Skies Agreement (OSA) between the United States (U.S.) and European Union (EU) will – and, perhaps already has – lead to the eradication of the traditional airline employee, in this case, the in-house aviation maintenance technician (AMT). This paper seeks to address the concerns of the rank and file AMT, and what the coming years could look like under an US-EU Open Aviation area regime as envisioned by many within the aviation community – from airline executives and Wall Street analysts to numerous elected and appointed government officials.

Economic Effects

Rank and file airline employees have been front and center for one of the most tumultuous economic periods for any industry in recorded history. Since airline deregulation in 1978, there have been over 100 bankruptcies, multiple liquidations, and a fundamental shift in business structure and culture. More aircraft maintenance is outsourced than at any other point in history. According to the United States Department of Transportation's Inspector General (DOT - IG), in the period from 1996 to 2005, airlines increased outsourcing from 37% to 62% of all maintenance performed translating into \$3.4 billion of the \$5.5 billion spent on total maintenance costs being spent on outsourced work¹.

To be fair, several US legacy carriers, notably United, Delta, and American, have Maintenance, Repair, and Overhaul (MRO) facilities at which they perform service work for many other carriers. With that said, workers at American and United were subject to sharp wage cuts, and, in the case of United, the pension obligations were shifted to the Pension Benefit Guarantee Corp. (PBGC) and substantial layoffs and wrought under Chapter 11 bankruptcy protection. Furthermore, in the case of Delta, it is hard to imagine a scenario whereby thousands of at-will employees (Delta's AMTs are not unionized at present) will be shielded from corporate decisions made under the auspices of \$120 per barrel of oil.

In recent years United, Delta, Northwest, and US Airways – four of the largest airlines by revenue and passenger volume in the world, let alone the US – entered bankruptcy in order to cut costs. It should be noted that when United entered what would become one of the longest and most expensive bankruptcies in history, oil was trading between \$25 and \$30 per barrel, or one fourth of the current price. The effect of all of this is that the in-house AMT has become more of a novelty than the norm. The Open Skies Agreement (OSA) will potentially have an equally damning effect.

There are four different ways (direct, indirect, induced, and catalytic)² the OSA would impact the job market; the most relevant to AMFA is the direct impact as it is related to the increase/decrease of jobs directly related to the provision of aviation maintenance services. There is definite potential for an increase in aviation jobs due to the increase in passenger traffic, which is estimated to increase by 26 million passengers over five years under an OSA between the US and the EU.³ The downside is that there will undoubtedly be a shift to more "efficient" carriers resulting in a reduction of labor. In this vane, "more efficient" carries with it perhaps many meanings like merged airlines, downsized legacy carriers, and/or low cost carriers (LCC's) relying on minimal in-house labor for operations.

It is predicted that over five years with an OSA between the two parties, there is the potential for upwards of 80,000 new jobs to be created through increased passenger traffic, as well as pricing

¹ Testimony of DOT-IG Honorable Calvin Scovel III, 29 March 2007, before U.S. House of Representatives Aviation Subcommittee

² Booz Allen Hamilton report 161

³ Ibid 162

synergies and better efficiency. However, this sum would be split between the US and EU; the US is expected to gain 35,000 jobs, and of those, only 10,000 would be directly related to the airline industry (e.g. mechanics).⁴

While the OSA is not necessarily related to an individual airline's respective corporate culture or behavior, it is safe to assume that such a dramatic change in international route and regulatory structure will have an equally dramatic effect on the various air carriers involved, from the largest legacy carrier to the smallest regional operation. Code-sharing alliances have been the most prominent tool by which airlines have increased corporate cooperation without truly merging.

Alliances, Antitrust, Mergers and Open Skies

With few exceptions, every major airline in the world is a member of a code-sharing alliance, most of which have some sort of antitrust immunity among some member airlines. Although the phrase "code-sharing" is relatively benign on its face, the practice is akin to a merger. As now-former Deputy Assistant Attorney General John Nannes testified before the U.S. House Aviation Subcommittee in 1998, "To antitrust law enforcement officials, code-sharing agreements are simply forms of corporate integration that fall somewhere between outright merger and traditional arm's length agreements."⁵ This statement suggests that immune code-sharing airlines are well on their way towards outright merger, and implies further that in the event of a proposed merger – a process that must be reviewed by both DOT and the Department of Justice (DOJ) – the airlines can use the antitrust immunity granted by the U.S. Government to make the case for complete integration...to the U.S. Government.

The major alliances and their members at present are:

- Star Alliance: United, Lufthansa, Air Canada, bmi, US Airways, SAS, ANA
- SkyTeam Alliance: NWA, Air France/KLM, Delta, Continental
- One World Alliance: American, British Airways, Cathay Pacific, JAL

In the case of Northwest and Delta, the two have since settled on merger language and have submitted their request to the Department of Justice (DOJ). They were also granted antitrust immunity in April 2008 with their alliance partners Air France-KLM, CSA Czech Airlines, and Alitalia. In the event of a Northwest/Delta merger, the SkyTeam Alliance would contain the world's largest airline in Delta, and the EU's largest carrier by volume in KLM-Air France. The April 2008 antitrust decision simply expands existing immunity among Northwest and KLM, and the immunized group of Delta, Air France, CSA, and Alitalia (antitrust immunity granted December 2001). The granting of antitrust protection to Delta and Northwest almost ensures the two will merge.

There is significant momentum towards major mergers in the industry as a whole, although, at present, consolidation (real and potential) is limited to intra-continental carriers, e.g. Northwest/Delta (potential) and KLM/Air France (merged in 2004 to create EU's largest carrier). Currently, the only means of cross-border consolidation available to airlines is through alliances and code-sharing agreements and antitrust (anti-competition) immunity typically sought in tandem with such agreements. This is due explicitly to ownership and "fitness" controls codified in U.S. law as follows:

- Ownership by all foreign nationals of more than 25% of a corporation's voting equity is prohibited.
- Actual control of a U.S. airline by foreign nationals is also prohibited – limiting investment to 49.9% of total equity in a U.S. carrier⁶

⁴ Ibid 229

⁵ Testimony of Deputy Assistant Attorney General Mr. John M. Nannes, 30 April 1998, before U.S. House of Representatives Aviation Subcommittee

⁶ US - EU Air Transport Agreement. Annex 4, Article 1, Section 1

The OSA contains a provision addressing this matter as a topic crucial to Stage II negotiations, set forth by the agreement. During the run up to the Stage I agreement, scores of interested parties, AMFA included, addressed concerns with the potential liberalization of U.S. ownership rules, and the negotiators eventually tabled the idea of changing the code. With that being said, European negotiators were adamant about the U.S. easing these provisions (as were the principal U.S. negotiators), and placed a provision in the agreement addressing that fact. Article 21, Section 1, states:

“The parties share the goal of continuing to open access to markets to maximize benefits for consumers, airlines, labor, and communities on both sides of the Atlantic, including the facilitation of investment so as to better reflect the realities of a global aviation industry...The parties shall begin negotiations not later than 60 days after the provisional application of this agreement...”⁷

As the provisions of the Stage I OSA grow more entrenched with on-the-ground airline practices, it is logical to conclude that cross border mergers, most likely among alliance partners, will be realized. And, although the agreement contains language voiding the Stage I agreement in the event of a stalemate in Stage II negotiations (Article 21, Section 3), it is hard to imagine a scenario whereby any profitable airline operations between the U.S. and EU are suspended due to a failure at the regulatory level. In fact, given the extremely cyclical nature of the industry and its notoriously razor-thin operating margins, if there is a hint of profitability stemming from the Stage I OSA, there is little doubt that negotiators would trudge through criticism and doubt to enact a Stage II agreement.

The very premise of Open Skies suggests an end-around of current regulatory and competitive structures. American legacy carriers claim high fuel prices and tough competition from low cost carriers (LCCs) are the primary causes for their weakening financial position up to present. Now, with unlimited rights from continental Europe, the U.S. carriers will face stiff international competition where they never had before. In fact, the driving philosophy of code sharing is based on foreign carriers having limited access to the U.S. market and vice versa.

The increase in competition has resulted in U.S. carriers cutting capacity. For example, Delta will park 45 aircraft in 2008 to cut domestic capacity by 10%; United will cut domestic capacity by 9% in 2008, on top of a 5% reduction in 2007. These cuts in domestic capacity naturally facilitate increased capacity for domestic LCCs, and increased market share. Ironically, most major airlines have argued in favor of the OSA, a system that is bound to increase pressure on them to continue to downsize and streamline. The only logical conclusion to draw from this is that legacy carriers will look to merge with each other in order to cut domestic capacity to the point where they will be international carriers first, and domestic airlines second. LCCs are naturally in favor of this as it gives them more say in pricing; Southwest Airlines, the prototype LCC, was the largest U.S. domestic carrier in terms of passengers boarded in 2006.

As LCCs move in, U.S. legacies will turn to their antitrust-protected alliances and the many fortress hubs they control for profits. The only thing left will be to merge with their large international partners, i.e. Delta/Northwest - Air France/KLM, to form global mega carriers. If current trends continue, the management teams of these large airlines will tout competition and fuel prices as the reasons for cross border mergers to be approved. More importantly, they will be able to use government-sanctioned code sharing agreements as evidence of their already very cozy relationship with the merger partner. It will be either this or bankruptcy, as historically, these have the two options facing struggling carriers.

⁷ U.S. - EU Air Transport Agreement, Article 21, Section 1

Employment rates at the legacy carriers will be further reduced, with many skilled mechanics leaving the field and many more having to take lower paying and sometimes nomadic-in-nature jobs with repair stations; or, they will go to the small regional subsidiaries of their previous employer at the bottom of the pay scale. Chambers of Commerce will testify as to the value of the “hometown airline” and what hub airports do for local business, but there will also be no one working at these “hometown airlines” making enough to own a home in the area. Unencumbered consolidation will necessarily lead to decreased competition and higher prices for consumers. If prices are rising and wages are stagnant, business will suffer.

Regulatory Issues

Increased competition will lower the power of existing airlines and possibly allow for the merger of airlines that might not have been permissible before the OSA, such as within the US Legacy carriers. The U.S. Federal Aviation Authority (FAA), and the European Aviation Safety Authority (EASA) have started a program of homogenization, a further indication of the potential for US-EU carrier mergers. Although we see the need for standardization in aviation, the EU still has 27 different National Aviation Authority’s (NAAs). If a country’s authority does not agree with EASA, they do not have to follow EASA’s decision. Simply put, they do not have the same authority as the FAA. With that in mind, how could they possibly be successful at homogenization?

Creating an OSA presents opportunities and challenges for employees as well as shareholders, management, and governments. The biggest challenge the OSA faces is in streamlining two different systems of labor and immigration legislation. The principle difference is that the US Federal laws are primarily used to govern airline labor relations, whereas in the EU only a small amount of labor related issues are set as the minimum standard for each individual country to either meet or exceed. It will be differences in individual companies’ performances rather than the divergence in social protection of governments for workers that that will shape the welfare issues of employees of both US and EU airlines.

Full implementation of the OSA would require changes or standardization of a number of immigration and regulation laws to provide the necessary underpinning to permit cabotage and wet leasing as traffic rights. As an exchange between sovereign partners in the specific area of air transport services, the OSA does not need to include any legislation on the following:

- Any general liberalization of the labor market. The basic expatriate labor requirements for cabotage-type services apply only to air crews.
- Liberalization of outsourcing beyond wet-leasing freedom. That is, nothing in the OSA would affect one way or another questions such as the use of foreign repair stations, sub contracting catering services, ground handling, etc. It will simply make it more convenient for carriers to outsource their operation to negate the potentially damning effects of intra-organizational labor strife.
- Any modifications of current employee social and labor protections as a consequence of investment liberalization. Both community laws and US recognize rights of employees to seek protections under the laws where they live and work.
- Any change of the rights of labor organizations to represent employees.

Of course, all of this is moot if contractors do most of the work performed for the airline in question, as is increasingly the case, especially in the maintenance field.

Unions in the European Airline Sector

Unions in the EU are organized on the class and crafts principle as in the US, fundamentally organized at the national or local regional levels. However, this situation is likely to evolve and the key unions representing mobile workers have established headquarters in the heart of EU diplomacy, Brussels.

Conclusion

The U.S. airline industry has been economically volatile since deregulation in 1978. The ranks of in-house aircraft mechanics have been decimated. Our wages have been cut, our pensions terminated, our company co-ownership Employee Stock Option Program (ESOP) has in many cases turned out to be worthless, and our jobs are being outsourced at never before seen levels. Small groups of executives are reaping millions of dollars in bonuses as employee lists are cut and pension obligations are shifted to the federal government, all under the auspices of bankruptcy “protection.” Ultimately, the American taxpayer will foot the bill for the many broken promises of a few executives.

AMFA’s main concern is that as OSA begins to develop, fewer and fewer AMTs will be needed. As the carriers begin to downsize to fit the merger model, (outsourcing) fewer of our in-house mechanics will be used. There is also the added concern of the quality of maintenance and of course, security. These are two paramount concerns of the Association.

As proven in AMFA’s filing of a friend of the court letter (*amicus curiae*), the U.S. Court of Appeals for the District of Columbia, upheld the FAA’s regulation requiring all airline workers who perform safety related functions including employees of outsourced aircraft repair stations to undergo periodic drug and alcohol testing. This helped to thwart the Aeronautical Repair Station Association (ARSA) argument that this testing was not needed. AMFA believes that this regulation is proper.

Legislative fixes have been, and continue to be tried. Many elected officials have come out publicly to voice concerns with regards to the ever-increasing amounts of heavy maintenance being performed by unknown individuals with unknown records in unknown places. The FAA is short on manpower, and the U.S. Transportation Security Administration (TSA) lacks the jurisdiction to conduct legislatively mandated audits of foreign repair stations. If the events described in this paper come to fruition, it safe to assume that the nearly 2/3 of heavy maintenance performed by vendors will increase further.

As the global airline industry begins these very serious changes, it must be the focal point of our government to ensure that the American airline worker is not forgotten, and that the flying public is safer than ever.

APPENDIX

Pertinent Articles of the Stage Open Skies Agreement

Article 3 - Cabotage

"Community airlines right to take on board, in the territory of the US, passengers, baggage, cargo, or mail carried for compensation and destined for another point in the territory of the United States" and vice versa.

It is essential to realize that investment and cabotage are different. "The foreign investors brings money and ideas to a new market- the cabotage operator brings outside equipment and people to the new market whose licensing and performance standards are governed by its national rules. The cabotage operation, therefore, raises different questions under the law and policy and its acceptance arguably depends substantially on progress towards regulatory convergence." Stakeholders in the EU perceive an unfair advantage of access in favor of the US because most of the significant routes within the EU can be accessed by US carriers with 5th freedom rights but EU carriers are denied the ability to establish similar networks in the US because they are denied cabotage and investment rights.

Article 4 - Authorization

Airline must have vested within the United States, U.S. national, or both, substantial ownership and effective control - this is a point of contention within the agreement, part of the reason the talks failed in 2005 and will be discussed again during the second round in hopes of lowering or doing away with the controls on foreign ownership

Article 5 - Revocation of Authorization

Either Party can revoke, suspend, or limit the operation authorization or an airline of the other party for reasons of security, safety, if ownership is not vested within the country, and if the airline failed to comply with the laws from Article 7. Unless immediate action is essential, both Parties must meet to discuss the revocation of authorization before it can go into effect.

Article 8 – Safety

The aviation authorities within each party will recognize as valid certificates of airworthiness, competency, and licenses issued or validated by each other and still in force, provided that the requirements for such certificates or licenses at least equal the minimum standards that may be established. The authorities may refuse to recognize as valid for flight above thier own territory, certificates of competency and licenses granted to or validated for thier own nationals by such other authorities.

Authorities can request, and receive within 45 days, consultations with other responsible authorities concerning the safety standards maintained by those authorities relating to aeronautical facilities, aircrews, aircraft, and operation of the airlines overseen by those authorities. If it is determined that the authorities in question do not effectively maintain and administer safety standards and requirements that at least equal the minimum standards, the requesting responsible authority will notify the authorities in question and supply the steps considered necessary to conform to the minimum standards.

The requesting authorities can withhold revoke or limit the operating authorization or technical permission of an airline or airlines for which those authorities provide safety oversight in the event the authorities in question do not take corrective action within a reasonable time period, and may act immediately against such airlines if essential to prevent further noncompliance with the repair standards and requirements which would result in an immediate threat to flight safety.

Article 18 - The Joint Committee

A committee of representatives from both the EU and US meet at least once every year. Either Party can request a meeting to resolve any questions relating to the interpretation of the Agreement. It will review the implementation of the Agreement and its effects on the aviation infrastructure, security measure, condition of competition, and any effects on the labor force.

Article 20 - Competition

The parties recognize that competition is best promoted with standardized regulations between all carriers, and announces its commitment to promote compatible regulatory laws and to minimize differences in thier application.