

LEGAL CHALLENGES IN MERGING MEXICAN AIRLINES

By: Ricardo Ortiz Gil Lamadrid, Delegación Benito Juárez, Mexico 03810 Office

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Debate in the Mexican press regarding the proposed merger between two of the largest Mexican airlines, Aeromexico and Mexicana may be heating up, but the fact is, something needs to be done for both airlines and air travelers. While the airlines are faced with high fuel and operating costs, impacting sustainability and profitability, domestic travelers are unhappy with the subsequent higher airfares. Increased prices are prompting them to seek alternative, more cost effective means of transportation. Adding more urgency to the situation, in early June, the secretary of Tourism (Sectur), Gloria Guevara Manzo, addressed the issue of high domestic airfares adversely affecting tourism in Mexico.

For the airlines, the benefits of increased profitability and financial sustainability must be weighed against operational costs and challenges. The principal benefits for the airlines could include cost reductions by combining complementary assets, eliminating duplicate activities, and reducing capacity. Balanced against these potential benefits will be operational costs of integrating workforces, aircraft fleets, and systems. For travelers, although they may see higher airfares in existing markets, a merger of the two airlines could address their increasing demand for more seamless travel to more destinations.

Tough antitrust enforcement could pose another stumbling block to a merger

The possibility of a merger or alliance to reduce operating and financial costs for the two airlines, as with any proposed merger of this magnitude, will undoubtedly under go careful examination by federal authorities to determine if its potential benefits for consumers outweigh the potential negative effects.

The Mexican Antitrust Laws (Ley Federal de Competencia Economica) will have to be taken into consideration when merging the two airlines. The Mexican Antitrust law pursues the protection of competition and free market participation. This law provides an affirmative remedy with federal legislative support against monopolistic practices. It particularly sets out rules for the creation of mergers, which may constitute an effort against free market participation and competition, by granting these companies the power to impose prices unilaterally and control the market.

The Mexican Federal Antitrust Commission ([Comisión Federal de Competencia Económica](#)) oversees corporate consolidations to ensure that the combined size of the new corporation does not have such monopolistic power as to be unlawful under the Mexican laws. The Federal Antitrust Commission is entitled to challenge and penalize companies; the purpose of which is to diminish, impair or impede competition and free market participation. If a transaction exceeds certain thresholds, the parties involved in the transaction must notify the Mexican Federal

Antitrust Commission. Mexicana and Aeromexico have been talking of a tie-up for years. Both airlines had previously been controlled by the Mexican government but operated separately. The original attempt to merge the two airlines was turned down by the Mexican Federal Antitrust Commission but signs are it could happen in the near future.

Airline Industry Indications

This possible merger is seen by some as desirable in order to strengthen the industry. However, others believe that a merger between the two airlines could put this competition in serious risk and mean higher prices and unfavorable conditions on consumers. Additionally, the current market changes and tightening of credit markets have not only further slowed down merger transactions, but have significantly increased the number of deals that fall apart, and in some cases wind up in court

In an airline merger, the biggest challenge is to integrate unionized employees. Labor unions are recognized under the Mexican Federal labor Law as a means of employees uniting to protect their common employment rights. There are large labor unions existing in Mexico. As a result of the labor unions, collective labor contracts are signed between the employer's representative and the representative of the labor union. Labor union collective contracts are reviewed every two years. Airline labor groups - especially pilots - are often hard to merge because pay and work rules are closely tied to seniority. A pilot could easily lose seniority in a merger and end up flying less desirable routes and planes. The two airlines have a total of about 2800 airhostess and 1600 pilots, represented by a union in Mexico. The union contracts of the two airlines contain different labour terms making it further difficult to finalize merger negotiations. For example, the retirement provisions contained in the union contract of Mexicana have more benefits for their employees as compared to that of Aeromexico.

Financial and Legal Considerations

There are also financial considerations that have to be addressed. In May 2009, the National Bank of Foreign trade (Bancomext) rejected Mexicana's request to endorse a guarantee of 60 million dollars that was a prerequisite for Mexicana to issue bonds in order for them to raise funds of 250 million dollars. The financial position of Aeromexico is not strong either. Currently, Aeromexico is in debt to several operators such as Gap, Asur and OMA. As per one of the noise mitigation monitoring reports, there have been several complaints pending against Aeromexico relating to excessive noise production by its aircrafts. The legal costs can become a major concern for the two airlines. On a positive side, Aeromexico recently entered into a successful alliance with American Express. Mexicana followed the example and it also formalized an alliance with American Express which will now allow the two airlines to offer traveler friendly services.

If the Mexican Federal Antitrust Commission approves the merger deal, having the deal properly documented by an experienced aviation attorney will be critical for the two merger parties. The current economic environment calls for special attention to the timing of transactions, relationships with third parties, financing concerns and optimum structures. The merger between

the airlines will also be required to be structured to minimize the tax liability exposure. This can be done through structuring, adherence to corporate formalities and insurance coverage.